INSOL International™

INSOLVENCY AND TRUSTS

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Price £100.00

ISBN 978-1-907764-22-6

Published September 2018

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President's Introduction

On behalf of INSOL International I am very proud to introduce this publication – Insolvency and Trusts.

There is a range of interesting issues that practitioners working with trusts have to deal with when the trustees are unable to pay their debts out of trust assets as they fall due, or where the trust liabilities exceed the trust assets. This is primarily attributable to the fact that trusts do not of themselves have legal capacity and are in reality a structure arising from a relationship between a settlor who passes the property to the trustee who becomes accountable in terms of the trust to third party beneficiaries.

This publication explores the issues thoroughly. It covers a comprehensive list of 23 critical issues, including the legal capacity of a trust according to domestic law; whether a trust can be treated as insolvent; prohibitions against trusts, how trusts are regulated; and whether insolvency can extend to trust assets located in local as well as foreign jurisdictions. The insolvency-related implications are extensive.

This book covers 14 country chapters. The jurisdictions are Australia, Bermuda, British Virgin Islands, Canada, Cayman Islands, England & Wales, Guernsey, Hong Kong, Jersey, Mauritius, Singapore, Switzerland, The Bahamas and USA.

Many INSOL members have generously given their time and expertise in writing the country chapters for this book. The project was led by Anthony Dessain formerly of Bedell Cristin, Jersey and Robert Gardner of Bedell Cristin, Jersey and we would like to sincerely thank Anthony and Robert for their continued interest and assistance in finalising this publication.

We have no doubt that our members will find this publication to be a valuable source of information in this very specialised area of law.

Adam Harris
President, INSOL International
Bowmans

Foreword

Insolvency and trusts are like oil and water. They do not mix. There are common misconceptions arising from general talk of companies and trusts owning assets and entering transactions.

A company is an entity, often with limited liability for itself and its directors and shareholders, whereas a trust is a relationship involving the settlor, trustee, beneficiaries and others. A trust cannot transact as it is not a legal person.

In this work we aim to illuminate this developing area. There are many professionals who are experts in banking and insolvency and not in trusts and, similarly, many trusts practitioners, and indeed trustees, who are experts in trusts and companies and their administration but who are not familiar with insolvency principles. We hope this will inform both groups. We are also aware that many jurisdictions do, and many more do not, know the concept of a trust and we hope this publication will help to enlighten those involved.

In addition, within various trust jurisdictions based on common law concepts, there are differences and nuances often created by statute or by differences in the development of the law. To these jurisdictions we hope the comparatives will interest and provide creative guidance.

Generally a trustee has a right of indemnity to meet or be reimbursed for liabilities for properly payable remuneration and reasonably incurred expenses from the trust assets. Where the assets of the trust are insufficient or unavailable, the personal private assets of the trustees are at risk. This can create a so - called insolvent trust. However, it is technically an impossibility to have an insolvent trust as it is a relationship not an entity. It is only by analysing the nature of a trusteeship and a trust, various scenarios and the effect on those involved, that a clear picture emerges as to what is then best for the competing parties arguing over a shortfall of assets.

The difficulty may arise by a fall in value of the assets, having illiquid assets, assets subject to charges or injunctions or other forms of embargo, disputes over ownership, loss of assets or a liability arises that is unexpected or greater than anticipated. This may involve loans, guarantees indemnities, options, calls, breach of warranties and liabilities generally.

Subject to the laws of a particular jurisdiction, we list a summary of 20 generally accepted key principles relevant to understand a so-called insolvent trust:

1. A trust is not a legal person.

2. Trust assets are vested in trustees, who are the only entities capable of assuming legal rights and liabilities in relation to the trust.

3. Trustees are not agents for the beneficiaries, since their duty is to act independently.

4. English law does not look further than the legal persons (natural or corporate) having the relevant rights and liabilities.

5. The legal personality of a trustee is unitary. A trustee assumes liabilities personally and without limit, thus engaging not only the trust assets but his personal estate.

6. This liability may be limited by contract, but the mere fact of contracting expressly as trustee is not enough to limit it.

7. There must be words negativing the personal liability which is an ordinary incident of trusteeship.

8. A trustee is entitled to procure debts properly incurred as trustee to be paid out of the trust estate or, if he pays it in the first instance from his own pocket, to be indemnified out of the trust estate.

9. To secure his right of indemnity, the trustee has an equitable lien on the trust assets.

10. The equitable lien normally survives after a trustee has ceased to be a trustee.

11. A creditor has no direct access to the trust assets to enforce his debt. His action is against the trustee, who is the only person whose liability is engaged and the only one capable of being sued.

12. A judgment against the trustee, even for a liability incurred for the benefit of the trust, cannot be enforced directly against trust assets, which the trustee does not beneficially own.

13. The creditor's recourse against the trust assets is only by way of subrogation to the trustee's rights of indemnity.

14. Because the creditor's recourse to the assets is derived from the trustee's right of indemnity, it is vulnerable. It is exercisable only to the extent that that right exists. It may be defeated if there are insufficient trust assets to satisfy his debt, or if the trustee's right of indemnity is defeated, for example because the debt was unreasonably or improperly incurred and the indemnity does not extend to such debts, or because the trust deed excludes it on account of the trustee's wilful default or gross negligence, or there is a breach of trust by the trustee, even in relation to a matter unconnected with the incurring of the relevant liability, which will, to the extent that it creates a liability to account on the part of the trustee, stand in the way of the enforcement of the indemnity.

15. Trustees are jointly and severally liable.

16. A trust cannot be made bankrupt or subject to an insolvency procedure as it is not a legal person.

17. A trust cannot in reality be insolvent but it is a convenient shorthand expression.

18. Insolvency is judged on the cash flow test.

19. Bankruptcy does not generally affect trust assets.

20. A trustee who becomes bankrupt does not automatically cease to be a trustee, but will probably resign or be replaced. It may be appropriate to seek directions from the Court.

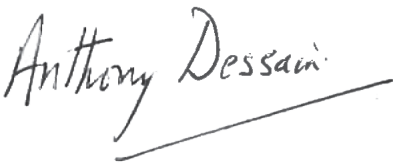
The scenarios need to be examined as to whether one is approaching the matter from the viewpoint of a settlor, a trustee, a beneficiary, a protector or appointor, a third party creditor or debtor, or an insolvency office holder or any of those persons. Whilst the principles will remain constant and the factual positions unlimited, the tensions applying to obtain or to defend the assets and to minimise the losses, will create many arguments.

These arguments can involve discussion on where the economic benefit and burden should fairly fall. The laws of many countries that provide for trusts use a mixture of statutory and case law authorities, and jurisdictions will often look to other jurisdictions for guidance. Further difficulties arise where a person is involved in a trust or the trust is subject to a specific law and that law does not recognise a trust, or does so in a different way or to a limited extent.

Some apply domestic law, their own private international law and foreign recognition principles, and others apply only domestic law. Therefore, a review of a number of countries' laws is appropriate. They throw up many similarities but also some differences and developments. We have asked a set number of questions to illuminate the subject.

Finally, this publication follows the Privy Council case of *Investec Trust (Guernsey) Limited and others v Glenalla Properties Limited and others* (2018 UKPC 7) concerning the personal liability of trustees for loans made to them by underlying companies affecting the scope of trustee indemnification.

We hope you find this helpful.



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Contents

AUSTRALIA

1. Are trusts legal and valid under domestic law? What are they principally used for?

Trusts are recognised under Australian statute and general law. They are a fundamental tool used in all aspects of commerce, superannuation and personal financial structuring and management. Their primary purposes are to facilitate pooled investment, asset protection and taxation structuring.

The most common types of trusts are unit trusts, discretionary trusts, testamentary trusts, fixed trusts and charitable trusts. Commercial trusts fall into two broad categories. The first is a public unit trust regulated under the Corporations Act 2001 (Cth)* as a managed investment scheme. The second is a trading trust, which may be unit or discretionary trust, but is used for private investment purposes rather than raising public funds.

2. Are foreign trusts recognised under your private international laws?

Australia has adopted The Hague Convention on the Law Applicable to Trusts and on their Recognition of 1984 (Convention) under the Trusts (Hague Convention) Act 1991 (Cth). Although the Convention has only been ratified by a relatively small number of countries, the Convention is applied to foreign trusts regardless of where they were created. The Convention deals with the applicable law and recognition. Where the applicable foreign law does not recognise the institution of trusts, they will be incapable of being recognised in Australia under the Convention.[1]

The Convention only applies to trusts created voluntarily and evidenced in writing. Implied, resulting and constructive trusts are incapable of recognition under the Convention.

At a minimum, recognition of a foreign trust under the Convention has the effect that the trust property constitutes a separate fund and that the trustee may sue and be sued in their capacity as a trustee. Insofar as the law applicable to the trust requires or provides, recognition shall also imply that the personal creditors of the trustee shall have no recourse against the trust assets and that the trust assets shall not form part of the trustee's estate upon his insolvency or bankruptcy.[2]

3. Are there any prohibitions against trusts?

There are no general prohibitions against trusts.

4. Are trusts and service providers regulated?

Trustees are subject to statutory duties and obligations pursuant to general trustee legislation in each State and Territory and are subject to fiduciary duties in equity.

In addition to the general trustee legislation, there is specific statutory regulation applicable to certain types of financial investment trusts including managed investment schemes (pooled investment funds) and superannuation trusts. Responsible entities (trustees of managed investment schemes) and superannuation fund trustees are subject to the regulatory supervision of the Australian Securities and Investments Commission and the Australian Prudential Regulation Authority respectively.

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* (Cth) is the standard term used to designate Commonwealth (as distinct from State) legislation in Australia.

1 *Nygh's Conflict of Laws in Australia*, 9th ed, 2014, 770-1.

2 Trusts (Hague Convention) Act 1991 (Cth) Schedule, Article 11.

5. Can the following become insolvent and subject to insolvency procedures?

5.1 A trust itself

Trusts have no separate legal personality. It is the trustee personally who owns the assets and incurs liabilities, albeit in its capacity as trustee. An insolvent trust is therefore a reference to a trust which has insufficient trust property to meet the liabilities incurred by the trustees in relation to the trust. It will only be subject to formal insolvency procedures through the trustee.

5.2 A settlor

Both individual and corporate settlors are capable of being insolvent and subject to Australian insolvency procedures both before or after creation of the trust.

5.3 A trustee

Both individual and corporate trustees are capable of being insolvent and subject to Australian insolvency procedures both whilst they are a trustee or after ceasing to be a trustee.

5.4 A beneficiary

As noted above, both individuals and corporates are capable of being insolvent and subject to Australian insolvency procedures whilst as a beneficiary or after ceasing to be a beneficiary.

5.5 A protector

In Australia, it will often be an appointor who has the power to appoint and remove a trustee under the terms of a trust deed. In their capacity as an individual, an appointor may be subject to the personal insolvency regime. However, this will not affect their capacity to act as appointor absent an express provision to that effect in the trust deed.

6. Do you distinguish between claims made against each of the parties stated in section 5 in respect of their obligations in acting for or in relation to the trust and, on the other hand, obligations incurred privately and personally?

In Australia, a settlor's role is limited to establishing a trust. Although they are the settlor of the trust, establishing the trust is an act done in their personal capacity.

Trustees are personally liable for obligations incurred whilst acting in their capacity as trustee, unless those liabilities are expressly limited contractually between the trustee and the relevant counterparty. Trustees have a right to indemnity from the assets of the trust in respect of obligations properly and reasonably incurred in relation to the trust. This right does not exist in respect of obligations incurred by trustees which are unrelated to the trust.

Beneficiaries and protectors have rights conferred on them under a trust, they do not generally incur obligations in relation to a trust.

7. What are your main insolvency procedures that could be relevant?

The main Australian insolvency procedures are liquidation, voluntary administration, receivership and schemes of arrangement for corporations and personal bankruptcy for individuals.

7.1 Liquidation

Liquidation, or 'winding up', involves the appointment of a liquidator who is required to collect and realise the company's assets (including any assets which can be recovered under the statutory antecedent transaction provisions) and return the proceeds to the company's creditors, and any surplus to its members. The objective is to achieve the orderly end of the company's existence in a matter that maximises the return to creditors and members. Liquidation can be both solvent or insolvent and voluntary or involuntary. Voluntary liquidation generally commences when creditors vote for liquidation at the end of an administration or when a solvent company's shareholders resolve to liquidate the company. Involuntary liquidation is where a court orders the company be wound up on the application of a creditor, director or shareholder.

The liquidator is required to collect, protect and realise the company's assets, investigate the company's affairs and report to creditors (and the regulator in relation to any possible offences), distribute the proceeds of realisation to creditors in accordance with the statutory priority regime (after payment of the costs of liquidation) and to apply for deregistration of the company once the liquidation process is complete.

7.2 Voluntary Administration

A company that is insolvent or is likely to become insolvent may appoint a voluntary administrator. The administrator takes control of the company to undertake a review of the company's affairs and financial position and to prepare a report to creditors within 20 business days (25 business days if the administration commenced in December or less than 25 business days before Good Friday), or longer if an extension from the Court is obtained. A statutory moratorium subsists whilst the company is in administration.

The administrator is required to make a recommendation to creditors that, at the end of the administration period, the company be wound up, enter into a deed of company arrangement or return to the control of its directors. Creditors then vote to determine the company's future.

A deed of company arrangement is a statutory restructuring mechanism designed to maximise the chances of the company, or a part thereof, continuing in existence and to give creditors the opportunity to receive a better return than they would achieve in a liquidation of the company. A deed can be structured to impose a moratorium, compromise creditors' claims, reschedule debts and / or exchange debt for equity.

Secured creditors are only bound by the deed if they vote in favour of it. Creditors vote as a single class and only a bare majority is required to carry the vote. If a poll is demanded, a majority in number and value is required and the administrator will have a casting vote in the event of a deadlock.

A primary benefit of restructuring under a deed of company arrangement is that it can be done without court approval or application.

7.3 Schemes of Arrangement

Schemes of arrangement are a statutory restructuring mechanism. They enable a corporation to enter into a compromise or arrangement with its members or creditors. Schemes can be effected whilst a company is solvent or insolvent and can also be implemented in respect of unit trusts and managed investment schemes. Schemes of arrangement require court approval and are generally only used for large scale insolvencies.

7.4 Receivership

A receiver or receiver and manager can be appointed by a court or privately pursuant to a general or specific security agreement. Receivers are empowered to realise the company's assets for the purpose of paying the costs of the receivership and the amount owing to the appointing secured creditor. Their primary duties are to their appointor, however, they are also subject to statutory duties if acting as an officer of the company. In exercising the power of sale, a receiver has a statutory obligation to take all reasonable care to sell the property for not less than market value (if it has a market value) or, otherwise, the best price that is reasonably obtainable in the circumstances.

Where receivers are incurring expenses in maintaining and preserving trust property, they will have an equitable lien over the property of the trust referrable to that expenditure, as well as for their reasonable remuneration.

7.5 Personal bankruptcy

Individuals who are unable to pay their debts as and when they fall due can voluntarily declare bankruptcy or be made bankrupt at the suit of a creditor. A bankruptcy trustee is appointed to manage the affairs of the bankrupt for a period of three years and to realise the assets of the bankrupt for the benefit of creditors. During the bankruptcy period, bankrupts are subject to a number of restrictions. They may not act as directors or be employed in a number of professional roles. There is legislation currently before the Australian Senate which will reduce the bankruptcy period to one year if passed.

8. What is the effect of bankruptcy on the following?

8.1 A trust

As noted above, a trust has no separate legal personality and cannot technically be bankrupt. Where a trust has insufficient assets to meet its liabilities, the trustees will generally be personally liable for debts incurred on behalf of the trust, unless they have expressly limited their liability with the counterparty under the terms of the contract.

8.2 A settlor

Where a settlor becomes bankrupt or, in the case of a corporation, goes into liquidation, the bankruptcy trustee or liquidator will review all transactions entered into by the settlor, including the establishment of any trusts. Where the establishment of the trust violates the antecedent transaction provisions, a liquidator is able to seek a wide range of remedies including orders for the return of the property or payment of compensation.

Where the settlor is an individual, the trustee in bankruptcy will review any transfers of property made by the bankrupt, including any transfers made to a trust. If the transfer was made within the last five years and the bankrupt was insolvent at the time of the transfer or became insolvent as a result of the transfer it will be susceptible to challenge under section 120 of the Bankruptcy Act 1996 (Cth). If the bankrupt was solvent at the time of the transfer and did not become insolvent as a result of the transfer, it may be attacked if it was a transfer for undervalue made in the last two years. Where the bankruptcy trustee can establish that the transfer was made for the purpose of avoiding property being distributed to creditors, the bankruptcy trustee can challenge the transfer regardless of when it was made.[3]

8.3 A trustee

Trust deeds will often provide that the office of trustee will be *ipso facto* vacated in the event the trustee is subject to an external insolvency procedure. Insolvent trustees can also be removed by the court on an application of a co-trustee or beneficiary.

Where a trustee is no longer a trustee due to an insolvency-related *ipso facto* clause, but no new trustee has been appointed, the trustee will continue to hold the trust assets as a bare trustee without a power of sale. In the case of a corporate trustee, the liquidator will generally apply for orders appointing himself as receiver of the trust property or an order for judicial sale.[4]

Absent an *ipso facto* clause or application to remove a corporate trustee, the company will remain trustee of the trust under the control of the liquidator rather than the directors. The trust assets remain vested in the corporation but will not be available to the company's general creditors, save to the extent of any right for the company as trustee to exercise its right of indemnity from trust assets.

Where the corporate trustee is unable to satisfy liabilities incurred on behalf of the trust and is not entitled to be indemnified from trust assets due to either a breach of trust, the trustee acting *ultra vires* or a limitation of liability under the trust deed, the directors will be personally liable under statute.[5]

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3 Section 121 Bankruptcy Act 1996 (Cth). An example of a successful challenge under this provision was *Windoval Pty Ltd (as trustee of the Bonnell Family Trust) & Ors v Donnelly* (2014) 314 ALR 622. In that case the bankruptcy trustee challenged a transfer made by the bankrupt to a family trust some 14 years earlier. The trustee alleged that the bankrupt knew at the time of the transfer that there was a real possibility that the Commissioner of Taxation would disallow certain contributions made by him to a non-complying superannuation fund. By winding up the superannuation fund and transferring the proceeds to the family trust, he knew he was depriving himself of the ability to meet any future assessment for taxation.

4 There are conflicting authorities as to whether a liquidator has power under section 477(2)(c), Corporations Act 2001 (Cth) to sell assets held in a capacity as bare trustee. *See, Apostolou v VA Corp Aust Pty Ltd* (2010) 77 ACSR 84, *Re Stansfield DIY Wealth Pty Ltd* (2014) 103 ACSR 104.

5 Section 197, Corporations Act 2001 (Cth).

If the trustee is an individual, any property of the bankrupt which is divisible amongst his or her creditors will vest in the bankruptcy trustee upon appointment.[6] Property held by the bankrupt on trust for another person is excluded and does not vest in the bankruptcy trustee.[7]

8.4 A beneficiary

The impact of bankruptcy on a beneficiary's trust entitlements will depend on the nature of the trust. If the bankrupt is a beneficiary of a discretionary trust, the trust assets will generally not be available to creditors. All the beneficiary has is a right to be considered. A trustee in bankruptcy has no power to compel the trustee to exercise its discretion in favour of the bankrupt. However, to the extent there are unpaid trust distributions owing to the bankrupt or the bankrupt has entitlements to default income, these rights may vest in the bankruptcy trustee.

8.5 A protector

The insolvency of a protector (referred to in Australia as an appointor) will only affect the trust if the trust deed provides that the protector's office is vacated *ipso facto* upon their insolvency.

9. Can an insolvency procedure extend to trust assets located in local and foreign jurisdictions?

9.1 Local jurisdiction

Yes.

9.2 Foreign jurisdiction

If the relevant insolvency procedure is under the Bankruptcy Act 1996 (Cth), it will extend to assets in another jurisdiction by virtue of the definition of property under section 5, which refers to property in Australia or elsewhere.

Where the insolvency procedure is under the Corporations Act 2001 (Cth), although the antecedent transaction provisions are not expressed to have extraterritorial application, the court may make orders regarding the transaction itself. To the extent those orders relate to trust property situated in another jurisdiction, the enforceability of those orders will depend on the applicable laws in that jurisdiction.

Australian courts will appoint receivers, make freezing orders and Anton Pillar orders over assets situated in a foreign jurisdiction. However, in order for such orders to be effective, or for a receiver to exercise power over assets situated outside of Australia, assistance from a foreign court will be required.

10. Can trusts be challenged to obtain assets, information, examine witnesses or for any other purpose?

As already noted, a trust itself is not capable of challenge as it has no separate legal personality. There are no specific statutory or common law rules for obtaining information or examining witnesses through a trust structure. However, trustees and

6 See sections 5 and 58(1), Bankruptcy Act 1996 (Cth).

beneficiaries must, in their ordinary capacity as an individual or corporation, provide information or be examined as a witness if required by court order or statute.

11. On what grounds can a trust arrangement be challenged?

11.1 The settlor was insolvent when the trust was created or became insolvent as a result of creating it

The trust arrangement itself will not usually be affected by virtue of the settlor being insolvent or becoming insolvent as a result of the trust being created. However, as set out in response to question 8.2 above, payments made by the settlor to establish the trust may be the subject of antecedent transaction claims by a liquidator or bankruptcy trustee.

11.2 The settlor becomes insolvent

See section 11.1 above.

11.3 The settlor lacked capacity or authority to create the trust

Generally upon attaining the age of 18, most individuals will be deemed to have the requisite capacity to create a trust.[8] Minors are taken to lack capacity but may be able to create a trust once they reach the 'age of discretion', which is typically defined as the age at which the minor can understand what is involved and exercise judgment.[9] A trust created by a minor, however, is voidable, but is not void in itself.[10] Capacity may also be affected by mental disability, alcohol or where due to mental incapacity the individual otherwise lacks an understanding of the transaction.

A corporation also has authority to create trusts, and this is so even if the corporation's constitution specifically prohibits or restricts such an exercise of power.[11] This restriction alone will not render the trust invalid. Similarly, a bankrupt individual lacks authority to create or declare a trust over their property if the property has been vested in the trustee in bankruptcy for distribution.[12]

11.4 The settlor lacked the capacity or authority to transfer the assets to the trustees

Where a settlor lacks capacity or authority to transfer assets to the trustee, those transfers may be considered void. However, the fact that assets may not be validly transferred does not necessarily result in the trust itself being considered invalid. Not all trusts are created by the transfer of assets.

11.5 The assets were not validly transferred or the transfer was not fully completed

Not all trusts are created by the transfer of assets. Although many trusts are created by a transfer of property to another to be held on the terms of the trust, it is also possible for a person to declare himself trustee of property legally and beneficially

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7 Section 116(2), Bankruptcy Act 1996 (Cth).
8 Age of Majority Act 1977 (Vic), s 3.
9 J.D. Heydon & M.J. Leeming, *Jacob's Law of Trusts in Australia* (LexisNexis, 8th ed. 2016).
10 LexisNexis Butterworths, *Halsbury's Laws of Australia* (as at 29 July 2014), 110 Contract, 'Introduction to Capacity of Parties' [110-2575].
11 Corporations Act 2001 (Cth) s 125.
12 J. D. Heydon & M. J. Leeming, *Jacob's Law of Trusts in Australia* (LexisNexis, 8th ed. 2016).

owned by him. Alternatively, a trust can be established by the beneficial owner of property in the possession of a third party if they direct that third party to hold the property on trust for another.

If a settlor is creating a voluntary trust by transfer of assets, it will only be enforced by a court if the trust is completely constituted.[13] A trust will not be completely constituted if it is still executory, such that an order for specific performance for the transfer of assets was required in order for the trust to be formed.

11.6 The trust was not validly created

Where a trust created inter vivos (i.e. voluntarily for no consideration) involves an interest in real property, statute requires trusts to be evidenced in writing in order to be properly created and enforceable.[14] Similarly, testamentary trusts are required to comply with the relevant state-based legislation governing the execution of wills.

11.7 The transfer could be subsequently set aside as void or voidable

The reasons for making a transfer void or voidable are set out below.

11.7.1 Mistake

Where the creation of a trust which involves a transfer of assets is induced by mistake, it may be revoked by the settlor at general law.[15] If the settlor is bankrupt, the power to revoke a trust on this basis vests in the trustee in bankruptcy.[16]

11.7.2 If there was an undervalue

Under property law legislation in each State, dispositions of property which are made with an intent to defraud creditors are voidable at the suit of a prejudiced party regardless of whether the transferor is in external administration.[17] These provisions will not apply where the disposition was made to a bona fide purchaser for value without notice.

If the transferor was a corporation, a liquidator will be able to seek to have a transfer for undervalue set aside as either an uncommercial transaction or as an unreasonable director-related transaction.

A corporate transaction will be an uncommercial transaction if a reasonable person in the company's circumstances would not have entered into the transaction.[18] In order to be voidable, the transaction must also be an insolvent transaction. That is, the transaction was entered into at a time when the company was insolvent or the transaction caused the company to become insolvent. The transaction must have

13 *Ellison v Ellison* (1802) 31 ER 1243.
14 Section 23C Conveyancing Act 1919 (NSW); s 60(2) Property Law Act 1974 (Qld); s 29 Law of Property Act 1936 (SA); s 60(2) Conveyancing and Law of Property Act 1884 (TAS); s 53 Property Law Act 1958 (Vic).
15 *Valoutin Pty Ltd v Furst* (1998) 154 ALR 119.
16 See Bankruptcy Act 1966 (Cth) s 116(1)(b).
17 Section 239(1) Civil Law (Property) Act 2006 (ACT); s 208(1) Law of Property Act 2000 (NT); s 37A(1) Conveyancing Act 1919 (NSW); s 228(1) Property Law Act 1974 (Qld); s 86(1) Law of Property Act 1936 (SA); s 40(1) Conveyancing and Law of Property Act 1884 (TAS); s 172(1) Property Law Act 1958 (Vic); s 89(1) Property Law Act 1969 (WA).
18 Section 588FB(1), Corporations Act 2001 (Cth).

occurred within two years prior to the relation-back day, which is the date of winding up (or in the case of a court ordered winding up, the date the application for orders winding up the company was filed).[19]

In order for a liquidator to set aside an unreasonable director-related transaction, they need to demonstrate that a payment, disposition or issue is to be made to a director or close associate of the director of the company (or to another person for their benefit) and that a reasonable person in the company's circumstances would not have entered into the transaction having regards to any benefit or detriment to the company.[20] The transaction is voidable if it was entered into within four years of the relation-back day.[21]

11.7.3 If there was a preference

Under Australian law, a voidable preference may arise where one creditor has been paid in preference to other creditors.[22] A preference will not arise in the case of gratuitous transfers to establish a trust in circumstances where there was no pre-existing debtor creditor relationship prior to the insolvency.[23]

11.7.4 If there was a sham

Trusts are a creature of equity and will not be enforced for illegal or immoral purposes.[24]

Where a trust confers a vested interest to a beneficiary for life or in fee simple, any clause which purports to determine the trust upon the bankruptcy of the beneficiary with a gift of the property or interest to a third party will be void and the beneficiary's interest in the relevant property will remain unqualified.[25]

11.7.5 Any other grounds

Where a trust constitutes a managed investment scheme under section 9 of the Corporations Act 2001 (Cth)[26], it may be wound up by the Court if it is not registered in accordance with section 601ED of that Act or on just and equitable grounds.

12. What protections and defences exist to protect those listed in section 5 and are they statutory or common law or otherwise?

There are no defences to insolvency in Australia which would prevent an insolvent settlor, trustee, beneficiary or protector becoming subject to an insolvency procedure.

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19 Sections 9 and 588FE(3), Corporations Act 2001 (Cth).
20 Section 588FDA, Corporations Act 2001 (Cth).
21 Section 588FE(6A), Corporations Act 2001 (Cth).
22 Section 588FA, Corporations Act 2001 (Cth); s 122 Bankruptcy Act 1966 (Cth).
23 *V R Dye & Co v Peninsula Hotels Pty Ltd* (in liq) [1999] 2 VR 201.
24 See, Maurice v Lyons [1969] 1 NSWR 307.
25 *Caboche v Ramsay* (1993) 119 ALR 215.
26 A managed investment scheme includes a scheme in which people contribute money or money's worth as consideration to acquire rights or interests to benefits produced by the scheme, those contributions are pooled and the members do not have any day to day control over the operation of the scheme. A number of specific schemes such as time share arrangements also fall within the definition of managed investment scheme.

Those parties can, however, attempt to utilise relevant statutory restructuring regimes to effect a compromise or arrangement with creditors in order to avoid bankruptcy or liquidation.[27]

13. Can claims be made in a bankruptcy where the insolvency office holder stands in the shoes of a bankrupt to exercise the rights given by the trust in favour of the following parties

13.1 The settlor

It is unlikely that a settlor has any residual rights post establishment of the trust which would be capable of being exercised by an insolvency office holder.

13.2 A trustee

As already noted, trust assets may be used to discharge liabilities properly and reasonably incurred in relation to the administration of the trust. A trustee has a right of indemnity in relation to such liabilities, which is secured by an equitable lien over the trust assets. The right of indemnity and the lien vest in the liquidator on a winding up (or in the bankruptcy trustee in a bankruptcy).

The trustee's right of indemnity can be effected in two ways. Where the trustee has met a liability out of its own funds, it has a right of reimbursement or recoupment from trust assets. Where the trustee is using trust assets directly to satisfy a creditor, this is referred to as a right of exoneration.

13.3 A beneficiary

Where a bankrupt is a beneficiary of a discretionary trust, all they have is a right or entitlement to the assets of the trust where the trustee exercises its discretion to make a distribution from the trust to their benefit.[28] There is no right or entitlement to the assets of the trust, and accordingly, there is no property to vest in the trustee.

13.4 A protector

A trustee in bankruptcy would not have the right to stand in the shoes of the bankrupt to exercise his or her rights as a protector (appointor). However, where the protector is a corporation, its rights under the trust will be exercisable by a liquidator.

14. Are rights of subrogation established by law?

The right of creditors to be subrogated to an insolvent trustee's right of indemnity is well-established.[29] It is an equitable remedy, entirely derivative in nature.

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27 Individuals can make arrangements with their creditors under Parts IX and X of the Bankruptcy Act 1966 (Cth). Companies under administration may enter into a deed of company arrangement if its creditors vote in favour of the arrangement at the second creditors' meeting. Alternatively, they can effect a creditors' scheme of arrangement under section 411 of the Corporations Act 2001 (Cth).

28 *Gartside v IRC* [1968] AC 553.

29 *Octavo Investments Pty Limited v Knight* (1979) 144 CLR 360.

The right of subrogation does not necessarily give trust creditors priority over the trustee's general creditors. It is accepted that an insolvent trustee's right of indemnity is property of the company.[30] However, there are conflicting authorities regarding the operation of the right of indemnity in two critical respects, both of which impact the right of subrogation. The first issue is whether proceeds from the trustee's right of indemnity are subject to the statutory priority regime. The second is whether distribution of the proceeds is confined to trust creditors general creditors of the trustee are entitled to share in the proceeds.

Recent decisions of the Victorian Court of Appeal and the Full Federal Court have resolved the first issue and determined that the statutory priority regime applies to proceeds from the right of indemnity. However, the question as to whether general creditors are entitled to share in the proceeds from the right of indemnity remains unclear as there is yet to be any case law involving both general and trust creditors.[31]

15. Can the veil of a company owned by a trust be pierced or lifted and, if so, in what circumstances?

Where a company owned by a corporate trustee incurs debts whilst insolvent, the parent corporate trustee may be liable under section 588V of the Corporations Act 2001 (Cth). In order to be liable, there must have been reasonable grounds for suspecting that the subsidiary was or would become insolvent and the corporate trustee, or at least one of its directors:

(a) had been aware of the grounds for suspecting insolvency; or

(b) having regard to the nature and extent of the parent corporate trustee's control over the subsidiary's affairs and to any other relevant circumstances, it was reasonable to expect a holding company in the corporate trustee's circumstances to be so aware of such grounds.

16. Can the veil of a trust be pierced or lifted and, if so, in what circumstances?

As a trust is not a legal personality, it does not have a veil which can be pierced or lifted. As noted elsewhere in this chapter, there are circumstances where a trust will be found to be invalidly created or where its assets become subject to antecedent transaction provisions under Australian insolvency law.

17. If a trust can be treated as insolvent, is this on the basis of the cash flow test, the balance sheet test or another test and, if so, what test?

As already stated, a trust itself cannot be treated as insolvent. In determining whether a corporate trustee is insolvent, the relevant test in Australia is whether the company is able to pay its debts as and when they become due.[32] This is assessed based on matters such as the company's general financial condition, its business activities, assets, liabilities and money which can be procured by sale or on the security of assets.[33]

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30 *Re Amerind Pty Ltd (receivers and managers appointed) (in liquidation)* [2018] VSCA 41; *Re Enhill Pty Ltd* [1983] 1 VR 56.

31 *Re Amerind Pty Ltd (receivers and managers appointed) (in liquidation)* [2018] VSCA 41 and *Jones (liquidator) v Matrix Partners Pty Ltd*, *re Killarnee Civil & Concrete Contractors Pty Ltd (in liq)* [2018] FCAFC 40.

32 Section 95A, Corporations Act 2001 (Cth).

33 *Standard Chartered Bank of Australia Ltd v Antico* (1995) 18 ACSR 1.

18. Can or have receivers been appointed to act as a trustee or with powers over trust assets? If so, in what circumstances?

Trustees may grant security over trust assets provided they have power to do so pursuant to the terms of the trust.

Where the trustee is a responsible entity of a managed investment scheme, a receiver and manager appointed to the corporation will have power to act as responsible entity of that scheme as role and remuneration forms part of the assets and undertakings of the corporation.

The court also has an inherent power to appoint a receiver and manager over assets of private trusts. A receiver may be appointed on the application of a trustee or a beneficiary where the appointment is necessary to protect the trust property.[34]

19. Are claims against trustees limited or unlimited? If limited, are they limited as to amount and by time?

Claims against trustees for debts incurred in the course of performance of the trust are prima facie unlimited,[35] save for generally applicable limitations such as statutory limitation periods. When contracting with third parties, trustees may expressly limit their liability to the extent of their indemnity from the assets of the trust.

Where there are co-trustees of a trust, they will be jointly and severally liable for breach of trust. Each trustee will generally have a right of contribution from the co-trustee.[36]

20. Are there provisions or cases where trusts, or those connected to them, are based in a foreign jurisdiction?

Australian courts will have jurisdiction over the administration of a trust and its assets where it has jurisdiction *in personam* over the trustee by personal service within the forum or by service outside the jurisdiction in accordance with the rules governing service out. If a foreign trustee is served within Australia, an Australian court can exercise jurisdiction over the trustee in respect of the trust even if the governing law of the trust is foreign and / or its assets are situated outside of Australia.[37]

Any person can be a trustee of a trust, regardless of where they are based. Where a trust is subject to the State of Victoria's Trustee Act 1958, an appointor has a statutory entitlement to appoint a new trustee if the trustee remains out of Victoria for more than one year without having properly delegated the execution of the trust (section 41).

It is also worth recognising that the taxation of foreign trusts is heavily regulated in Australia.

34 *Middleton v Dodswell* (1806) 33 ER 294.
35 *Elders Trustee & Executor Co Ltd v E G Reeves Pty Ltd* (1987) 78 ALR 193.
36 *Cockburn v GIO Finance Ltd (No 2)* (2001) 51 NSWLR 624.
37 In the Estate of Webb; *Webb v Rogers* (1992) 57 SASR 193.

21. What are the main means to seek assistance from another jurisdiction?

The means by which assistance may be sought from another jurisdiction will largely depend upon the laws of the jurisdiction in question. As discussed above, it may be possible to obtain assistance in relation to the operation of a trust under the Convention. Where the assistance relates to the insolvency of the trustee, there are a number of ways in which foreign assistance could potentially be obtained. These include seeking assistance under the UNCITRAL Model Law on Cross-Border Insolvency, reciprocal foreign judgment enforcement legislation, at common law under principles of comity or specific foreign statutory provisions (such as those akin to the aid and auxiliary provisions contained in section 581 of the Corporations Act 2001 (Cth)).

22. What is the position as to whether the foreign jurisdiction does or does not recognise trusts?

If an Australian court is asked to enforce a foreign judgment which does not recognise the existence of a trust which would be recognised under Australian law, it is unlikely that recognition will be denied on that basis alone. As a general proposition, the fact that an Australian court would have determined a matter differently will not be sufficient to deny recognition.[38]

Under the Convention, a trust is generally governed by the law chosen by the settlor. But where the law chosen does not provide for or recognise trusts, article 7 of the Convention provides that the trust is to be governed by the law "with which it is most closely connected". Article 11 of the Convention provides that a trust, even if created in accordance with the law specified under article 7, would be recognised as a trust in that jurisdiction where it would not otherwise be recognised. The Convention provides that in that jurisdiction (where trusts are not recognised but for the operation of the Convention), as a minimum, that the trust property constitutes a separate fund, that the trustee may sue and be sued in his capacity as trustee, and that he may appear or act in this capacity before a notary or any person acting in an official capacity.

23. What particular issues, difficulties and solutions have arisen or may arise relating to trust arrangements or those involved with them?

The lack of a specific statutory regime for dealing with insolvent trusts, particularly insolvent commercial trusts, gives rise to real complexity in Australia. Some of those issues include:

(a) the extent to which a liquidator or voluntary administrator is entitled to be indemnified from trust assets;
(b) how trust property is to be distributed to creditors in the absence of a statutory priority regime;
(c) the extent to which antecedent transaction provisions relate to commercial trusts;
(d) the position where a corporate trustee is removed as trustee ipso facto upon its insolvency; and
(e) the rights and interests of stakeholders where a corporate trustee is trustee of multiple trusts and the segregation of the relevant assets and liabilities has not been maintained.

38 *Nygh's Conflict of Laws in Australia*, 9th ed, 2014, 928.

The Australian courts deal with these issues and other issues relating to insolvent trusts on a case by case basis, applying relevant statutory provisions and the doctrine of precedent as required by the common law applicable in this jurisdiction.

BERMUDA

1. Are trusts legal and valid under domestic law? If so, what are they principally used for in Bermuda?

Under Bermuda law, a trust is not, in and of itself, a legal entity, but a legal relationship that arises, either by design or by operation of law, and usually in circumstances where one person (a settlor) gives, or settles, property (the trust fund or trust assets), to a trustee (or trustees), to hold the legal title to such assets for the benefit of certain other persons (the beneficiaries) or for a specified purpose.

A wide variety of trusts, and trust-related structures, are legal and valid under domestic Bermuda law, including bare trusts, discretionary trusts, fixed interest trusts, unit trusts, charitable purpose trusts, non-charitable purpose trusts, *'Quistclose'* trusts, testamentary trusts, statutory trusts, resulting trusts, and constructive trusts.

Bermuda is a self-governing British Overseas Territory. As such, the legal principles governing the establishment, recognition, and operation of trusts in Bermuda are derived from a variety of sources, including Bermudian statute law, Bermudian common law, English common law, UK legislation extended to Bermuda, and principles of equity.

Bermuda has its own Court system, including a designated Commercial Court which is part of the Supreme Court of Bermuda, with rights of appeal to the Court of Appeal for Bermuda, and then the Privy Council in London.

Some of the more important statutes, as a matter of Bermuda trusts law, include the following pieces of legislation (including amendments to such legislation, and regulations made thereunder) -

- Trustee Act 1975
- Trusts (Special Provisions) Act 1989
- Trusts (Regulation of Trust Business) Act 2001
- Supreme Court Act 1905,[1] and the Rules of the Supreme Court of Bermuda 1985[2]
- Perpetuities and Accumulations Act 2009[3]
- Evidence Act 1905
- Foreign Judgments (Reciprocal Enforcement) Act 1958
- Limitation Act 1984
- Conveyancing Act 1983
- Matrimonial Causes Act 1974

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1 The Supreme Court Act 1905 provides, by section 15, that *"subject to the provisions of any Acts which have been passed in any way altering, amending or modifying the same, and of this Act, the common law, the doctrines of equity, and the Acts of the Parliament of England of general application which were in force in England at the date when these Islands were settled, that is to say, on the eleventh day of July one thousand six hundred and twelve, shall be, and are hereby declared to be, in force within Bermuda".* Section 18 further provides that *"In every civil cause or matter which is pending in the Supreme Court law and equity shall be administered concurrently … and in all matters in which there is any conflict or variance between the rules of equity and the rules of common law with reference to the same matter the rules of equity shall prevail".*

2 RSC Order 85 provides a set of procedural rules for administration actions and applications for Court directions relating to a trust.

3 The Perpetuities and Accumulations Act 2009 was the subject of consideration in *Re C Trust* [2016] SC (Bda) 53 Civ, *Re G Trusts* [2017] SC (Bda) 98 Civ, and *Re XYZ Trusts* (No. 2) [2018] SC (Bda) 2 Civ.

- Charities Act 2014
- Succession Act 1974
- Administration of Estates Act 1974
- Wills Act 1988
- Life Insurance Act 1978
- Pension Trust Funds Act 1966
- National Pension Scheme (Occupational Pensions) Act 1998, and
- Proceeds of Crime Act 1997.

Also, by an Order in Council (the Recognition of Trusts Act 1987 (Overseas Territories) Order 1989, SI 1989 No. 673), the UK's Recognition of Trusts Act 1987, ratifying The Hague Convention on the Law Applicable to Trusts and on Their Recognition 1985 (The Hague Convention) was extended and applied to Bermuda as of 1 June 1989.

Although there is an increasing amount of local Bermudian and Privy Council case law relating to trust-related and insolvency-related legal issues, the Bermuda Courts are also often assisted by case law from England and Wales, and other common law jurisdictions with similar trusts and insolvency legislation to that which is in force in Bermuda, and also by the views expressed by the editors of the leading textbooks on English law.[4]

Bermuda trusts are used to achieve a wide range of commercial and legal objectives, both locally and internationally.

Principal uses of trusts, under Bermuda law, include the following (in summary):

- Estate and tax planning, including provision for spouses and dependents
- Charitable purposes
- Non-charitable purposes
- Employee benefits
- Pension trusts
- Asset protection
- Asset holding,
- Asset trading, and
- Business and investment, including secured lending

2. Are foreign trusts recognised under the private international laws?

Yes. There are two overlapping pieces of legislation that address the recognition of foreign trusts under Bermuda's private international law. As set out above, the UK's Recognition of Trusts Act 1987 incorporates certain provisions of The Hague

4 It is also customary practice, in the case of trustee's applications for directions or Beddoes relief from the Bermuda Court, to exhibit the opinions of leading members of the English or Bermuda Bar.

Convention on the Law Applicable to Trusts and on Their Recognition, and this was extended to and made applicable to Bermuda by Order in Council effective 1 June 1989. In addition, sections 5 to 7 of Bermuda's local Trusts (Special Provisions) Act 1989 effectively adopted sections 6 to 8 of The Hague Convention into local Bermuda law, as of January 1990.

3. Are there any prohibitions against trusts?

There are no prohibitions against legally valid trusts under Bermuda law. However, there are various statutory provisions, as well as common law and equitable principles, which prohibit the use of illegal or invalid trusts, including, for example, trusts established for criminal or fraudulent purposes, sham trusts, or trusts that are contrary to public policy, or trusts that are void for lack of certainty.

4. Are trusts and service providers regulated?

Yes, trusts and service providers carrying on trusts-related businesses in or from Bermuda are regulated to a considerable extent. Bermuda's Trusts (Regulation of Trust Business) Act 2001 provides that any person who carries on "trust business" in or from Bermuda (which is defined to be "*the provision of the services of a trustee as a business, trade, profession or vocation*" must be licensed by the Bermuda Monetary Authority, unless such person is covered by one of the exemptions under the Trusts (Regulation of Trust Business) Exemption Order 2002).

There are two types of licence available:

- an 'unlimited licence', which is only available to trust companies
- a 'limited licence', which is available to individuals, partnerships, and companies holding trust assets not exceeding $30 million.

Relevant regulations made under the Trusts (Regulation of Trust Business) Act 2001 include the Trusts (Regulation of Trust Business) Exemption Order 2002, the Trusts (Regulation of Trust Business) Order 2003, the Trust Business Appeal Tribunal Regulations 2004, and the Trusts (Regulation of Trust Business) (Reporting Accountants) (Facts and Matters of Material Significance) Regulations 2006.

Professional trustees are also regulated for anti-money laundering and anti-terrorist financing purposes under the Proceeds of the Crimes Act 1997, and for international sanctions purposes under the International Sanctions Regulations 2013 (and relevant UK sanctions legislation extended to Bermuda).

Banks, asset managers, and funds (including unit trusts) are also regulated by the Bermuda Monetary Authority, pursuant to various pieces of sector-specific legislation. Various professional service providers (such as lawyers and accountants) and corporate service providers are also regulated pursuant to sector-specific legislation.

Finally, it is important to note that the Bermuda Court has an inherent jurisdiction to supervise the administration of a Bermuda trust, and thereby regulate the affairs of a trust, following the Privy Council's decision in *Schmidt v Rosewood Trust Ltd* [2003] 2 AC 709.[5]

[5] This has been followed and applied in Bermuda on a number of occasions, including in the case of *Wingate v Butterfield Trust* [2007] Bda LR 76.

5. Can the following become insolvent and subject to insolvency procedures?

5.1 A trust itself

As discussed above, a trust is not, in and of itself, a legal entity, but a legal relationship. As a result, it is not legally possible for a trust, itself, to become insolvent, or to be subjected, itself, to formal insolvency procedures.

Colloquially, however, it might be argued (depending on the context and the circumstances) that a trust is insolvent (in a practical or commercial sense rather than a legal sense) when the trust assets are inadequate to satisfy the liabilities incurred by the trustee acting in its capacity as such (although the trustee's own state of solvency or insolvency, the nature and extent of the trustee's personal liability to creditors, and the trustee's potential rights of indemnity against the trust assets and / or the trust beneficiaries, will involve separate questions and analysis).

Since the Commercial Court of the Supreme Court of Bermuda is often willing to adopt a pragmatic and flexible approach to its resolution of insolvency-related legal issues and trusts-related legal issues, it is possible that the Court might be persuaded, in an appropriate case, to exercise its inherent jurisdiction over the administration of a Bermuda trust, and its case management rules and powers, to devise a novel insolvency procedure appropriate to the circumstances of any particular case, taking into account the interests of all relevant creditors, the beneficiaries, and the trustee (and, if relevant and appropriate, the protector or the settlor).

Absent a clear legislative framework for the Court's liquidation of an insolvent trust, however, it may be difficult for the Court to devise a stable and effective insolvency procedure, absent the consent of all relevant stakeholders and their express submission to the jurisdiction of the Bermuda Court.

5.2 A settlor, trustee, beneficiary, protector

All these parties can become insolvent and subject to insolvency before and / or after they become a settlor, trustee, or a protector.[6]

In each of these cases (assuming that the relevant settlor, trustee, beneficiary, or protector are subject to the jurisdiction of the Supreme Court of Bermuda, they will be subject to insolvency procedures appropriate to their legal status.

6. Do you distinguish between claims made against each of the parties in section 5 in respect of their obligations in acting for or in relation to the trust and, on the other hand, obligations incurred privately and personally?

Depending on the circumstances (and, in particular, any agreed limitations of liability or rights of recourse), Bermuda law does recognize potential distinctions between trust-related liabilities and non-trust related liabilities, although there is no statutory provision under Bermuda law that necessarily limits the personal liability of a settlor, trustee, beneficiary, or protector to the trust assets. As a matter of Bermuda law, if a trustee wishes to limit its personal liability to the trust assets, the trustee will need to specifically enter into an agreement with any creditor, beneficiary, or claimant in this respect.

6 It may be of interest to note that in *Von Knierem v BTC* [1994] Bda LR 50, the Bermuda court held that a protector's power of removal of a trustee was a fiduciary power.

It is to be noted that personal creditors of a trustee will not generally be entitled to have recourse to assets held on trust, or ring-fenced, for third parties.

7. What are the main insolvency procedures that could be relevant?

The formal insolvency procedures available for Bermuda companies in financial difficulties are principally contained in the Companies Act 1981 (the winding up provisions of which are substantially modelled on the UK's Companies Act 1948).

Some provisions of the Bankruptcy Act 1989, which principally addresses the personal bankruptcy of individuals, are also applied to companies, by virtue of section 235 of the Companies Act 1981, and there is some scope for debate as to the applicability of certain provisions of the Bankruptcy Act 1989 to corporate partnerships.

There are also specific provisions relating to insurance companies in the Insurance Act 1978 and relating to segregated accounts companies and their general and segregated accounts in the Segregated Accounts Companies Act 2000.

There are also specific provisions relating to banks in the Banking (Special Resolution Regime) Act 2016, although only sections 1 and 10 of that Act are currently in force.

The rules relating to compulsory winding up of companies are contained in the Companies (Winding Up) Rules 1982 and the rules relating to personal bankruptcy are contained in the Bankruptcy Rules 1990. The Rules of the Supreme Court 1985 can also be relevant to the Bermuda Court's handling of insolvency and trust-related legal proceedings.

8. What is the effect of bankruptcy on a trust, settlor, trustee, beneficiary and protector?

Local Bermuda case law is not yet fully developed in this respect, therefore the Bermuda Courts are likely to have regard to the case law from English and common law jurisdictions, as well as the leading textbooks, for solutions to any particular problems that arise in the event of bankruptcy or insolvency.

Bermuda law is likely to follow English law to the effect that neither an individual trustee being adjudged bankrupt, nor a corporate trustee being put into liquidation, is thereby deprived of its trusteeship unless the trust instrument so provides, pending retirement, removal or dissolution, or intervention by the Court or by the Bermuda Monetary Authority. Section 31(1) of the Trustee Act 1975 gives the Court discretion to appoint a new trustee where the current trustee is bankrupt or is a corporation which is in liquidation or has been dissolved.

9. Can an insolvency procedure extend to trust assets located in local and foreign jurisdictions?

Yes, this is possible. The position will be determined by a combination of both common law principles and the various statutory provisions referred to above.

10. Can trusts be challenged?

10.1 To obtain assets

In certain limited circumstances, trusts can be the subject of a legal challenge (whether by a creditor, a beneficiary, a settlor, an estate representative, or a third party) for the purposes of obtaining assets, including, for example, cases involving proprietary tracing claims, sham trusts, illegal trusts, *ultra vires* trusts, uncertain trusts, fraudulent conveyances, and fraudulent preferences.

10.2 To obtain information

There are various circumstances in which a Bermuda Court might order the disclosure or production of information relating to a trust to appropriate parties, subject to such safeguards as may be appropriate or necessary with respect to issues of confidentiality and privilege.[7]

10.3 To examine witnesses

There are various circumstances in which a Bermuda Court might order the examination of a witness in matters relating to a trust, subject to such safeguards as may be appropriate or necessary with respect to issues of confidentiality and privilege.

10.4 For any other purpose

It is impossible to describe all potential circumstances under Bermuda law in which a Bermuda-trust might be challenged for purposes other than (a) obtaining assets, (b) obtaining information, or (c) examining witnesses. However, one such purpose may be where the establishment of the trust was invalid, and it is in the interests of all interested parties in having the trust set aside, for the purpose of establishing a more efficient trust structure.[8]

11. On what grounds can a trust arrangement be challenged?

There are a variety of statutory provisions under Bermuda law which might enable various trust arrangements to be challenged, depending on the precise facts of any particular case, but including circumstances where the settlor lacks capacity, the trust lacks certainty, and also circumstances where assets have been conveyed fraudulently or dishonestly in fraud of certain creditors.

These statutory provisions include certain sections of the Conveyancing Act 1983, the Companies Act 1981, the Life Insurance Act 1978, the Bankruptcy Act 1989, the Matrimonial Causes Act 1974, and the Succession Act 1974.

12. What protections and defences exist to protect those listed at section 5 and are they statutory or common law or otherwise?

There are a range of potential protections and defences that might be relied upon, both as a matter of statute and as a matter of common law. These include, for example, the right to an indemnity in certain circumstances; the ability to apply to the Court for relief from liability; the ability to secure an indemnity or limitation of liability by deed or by contract; and time limits under the Limitation Act 1984.

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7 *Jennings v Jennings* [2009] Bda LR 73 and *Wingate v Butterfield Trust* [2007] Bda LR 76.
8 *BQ v DQ* [2010] Bda LR 26.

13. Can claims be made in a bankruptcy where the insolvency office holder stands in the shoes of a bankrupt to exercise the rights given by the trust in favour of the following?

The parties referred to are a settlor, trustee, beneficiary and a protector. Yes, in general terms, subject to the circumstances of any particular case this is possible.

14. Are rights of subrogation established by law?

Yes, following English common law and equity in this respect.

A trust creditor of a trustee (i.e. a creditor to whom a trustee has incurred contractual or non-contractual liability in the exercise of its trust powers) is likely to have the right to look to the trustee's right of indemnity and associated lien over trust assets, and to be subrogated to those rights.

15. Can the veil of a company owned by a trust be pierced or lifted and, if so, in what circumstances?

Yes, Bermuda law is likely to follow and apply the decision of the United Kingdom's Supreme Court in *Petrodel Resources Ltd v Prest.*[9] It is not possible however, to describe every circumstance in which the corporate 'veil' might be 'pierced' or 'lifted' under Bermuda law.

16. Can the veil of a trust be pierced or lifted and, if so, in what circumstances?

Since a trust is not, in and of itself, a legal entity (unlike a company, which has corporate legal personality), it is unlikely that a Bermuda court would need to resort to a legal concept of piercing the corporate veil in the context of a Bermuda-law trust. However, there may be limited circumstances (alluded to above) where a Bermuda court can be persuaded to set aside a trust, for example in cases of fraud or dishonesty.

17. If a trust can be treated as insolvent, is this on the basis of the cash flow test, the balance sheet test or another test and, if so, what test?

As discussed above, a trust is not, in and of itself, a legal entity, but a legal relationship. As a result, it is not legally possible for a trust, itself, to become insolvent, or to be subjected to insolvency procedures. However, to the extent that a trustee of a Bermuda law trust might be concerned with insolvency-related issues, it would be prudent to have regard both to the cash flow test and to the balance sheet test, at least by way of analogy. This is because a Bermuda company is deemed to be insolvent and unable to pay its debts, pursuant to sections 161(e) and 162 of the Companies Act 1981, in the following circumstances:

17.1 Cash flow insolvency and balance sheet insolvency

A Bermuda company is deemed to be insolvent if it is proved to the satisfaction of the Bermuda court that it is unable to pay its debts. In determining whether a company is unable to pay its debts, the court shall take into account the contingent and prospective liabilities of the company. In essence, the court can take into account both cash flow insolvency (also known as commercial insolvency) and balance sheet insolvency (also known as absolute insolvency).

9 [2013] UKSC 34.

17.2 Failure to pay a statutory demand

A Bermuda company is also deemed to be insolvent if a creditor to whom the company is indebted in a sum exceeding $500 has served a statutory demand on the company requiring payment that remains neglected for a period of three weeks.

17.3 Unsatisfied execution of judgment

Further, a Bermuda company is deemed to be insolvent if the execution or other process issued on a judgment of any court in favour of a creditor of the company is returned unsatisfied.

18. Can or have receivers been appointed to act as a trustee or with powers over trust assets? If so, in what circumstances?

Although the Privy Council decision in the case of *TMSF v Merrill Lynch Bank*[10] was decided on appeal from the Cayman Islands, its *ratio decidendi* is likely to be treated as binding by a Bermuda Court, to the effect that the Court has the power to appoint a receiver pursuant to the Court's power of equitable execution in aid of enforcement of a judgment debt, including over certain trust-related powers analogous to property interests.

There have also been many cases in Bermuda in which secured creditors have appointed security trustees or receivers over secured assets, outside of Court, pursuant to the terms of the relevant charge or mortgage. There are various statutory provisions relevant to the taking of security in Bermuda, including, for example, section 19(d) of the Supreme Court Act 1905, section 1 of the Bonds and Promissory Notes Act 1874, and section 2 of the Charge and Security (Special Provisions) Act 1990.

19. Are claims against trustees limited or unlimited? If limited, are they limited as to amount and by time? Do underlying companies have a role?

As a matter of Bermuda law, a trustee's personal liability to a contracting counterparty is unlimited unless the relevant contract includes an express limitation of liability.

Section 23(1) of Bermuda's Limitation Act 1984 provides that no period of limitation or time limit shall apply to an action by a beneficiary under a trust in respect of any fraud or fraudulent breach of trust to which the trustee was a party or privy or to recover from the trustee any trust property or the proceeds of trust property in the possession of the trustee, or previously received by the trustee and converted to his use.

Otherwise, section 23(3) of Bermuda's Limitation Act 1984 provides that an action by a beneficiary to recover trust property or in respect of any breach of trust, not being an action for which a period of limitation is prescribed by any other provision of the Act, shall not be brought after the expiration of 6 years from the date on which the right of action accrued. For these purposes, the right of action is not treated as having accrued to any beneficiary entitled to a future interest in the trust property until the interest fell into possession.

[10] [2011] UKPC 17.

20. Are there provisions or cases where trusts, or those connected to them, are based in a foreign jurisdiction?

Yes. Bermuda's Trusts (Special Provisions) Act 1989 contains various statutory provisions dealing with issues of jurisdiction and governing law in trust cases with both a Bermudian and a foreign element.

There are also various reported Bermuda cases that consider conflicts of law issues as between Bermuda law and foreign law. For example, in *Garner v Schindler,*[11] the Bermuda Court refused to recognize a challenge to the validity of a Bermuda trust that allegedly breached certain forced heirship provisions under Mexican law. More recently, in the *Matter of a Trust,*[12] the Bermuda Court has considered the potential impact of Bermuda's Children Act 1998 on a trust whose governing law was being changed from Cayman Islands to Bermuda law.[13]

21. What are the main means to seek assistance from another jurisdiction?

Ordinarily, an officeholder appointed by the Bermuda Court to conduct an insolvency or bankruptcy procedure would either make an application to the Bermuda Court for an Order that it issues a Letter of Request for assistance to the relevant foreign Court, or (with the sanction of the Bermuda Court), the officeholder would make an application for recognition and assistance directly to such foreign Court (in accordance with applicable foreign law), if and to the extent that the officeholder needs to gather in assets or information located in a foreign jurisdiction, with the assistance of the foreign Court.

The position is potentially more complicated in the case of a Bermuda trust, if the trust's assets are located in Bermuda, but the trust's (or the trustee's) potential liabilities are located in a foreign jurisdiction. In those circumstances, Bermuda-based trustees often make an application to the Bermuda Court for the Court's directions on the difficult issue of whether or not to submit to the jurisdiction of the foreign Court (given the obvious risk that this presents in terms of exposing the trust and its assets to potential enforcement proceedings). Whether or not the trust itself, or the trustee's legal status, will be recognised by the foreign Court will depend on the foreign law in question.

Locally, Bermuda has no statutory equivalent of Chapter 15 of the US's Bankruptcy Code, section 426 of the UK's Insolvency Act 1986, or the UK's Cross-Border Insolvency Regulations 2006, by which the UK implemented the United Nations Commission on International Trade Law's Model Law on Cross-Border Insolvency. The Supreme Court of Bermuda has nonetheless confirmed, following the Privy Council decision in *Cambridge Gas Transportation Corp v Navigator Holdings plc*[14] that, as a matter of common law and in the corporate context, the Supreme Court of Bermuda may (and usually does) recognise liquidators appointed by the Court of the company's domicile and the effects of a winding up order made by that Court, and has a discretion pursuant to such recognition to assist the primary liquidation Court by doing whatever it could have done in the case of a domestic insolvency. However, the precise scope of Bermudian Courts' common law power to assist foreign liquidations, and, in particular, to "*provide assistance by doing whatever it could have done in the case of a domestic insolvency*" has been the subject of considerable

11 [1992] Bda LR 34.
12 [2017] SC (Bda) 38 Civ.
13 *Re G Trusts* [2017] SC (Bda) 98 Civ.
14 [2007] 1 AC 508.

debate in a number of recent judgments, including in two recent judgments by the Privy Council, on appeals from the Court of Appeal for Bermuda, in *Singularis Holdings Limited v PricewaterhouseCoopers*[15] and *PricewaterhouseCoopers v Saad Investments Company Limited.*[16]

Separately, section 144 of Bermuda's Bankruptcy Act 1989 provides that the Bermuda Court and its Court officers shall assist the Courts having bankruptcy jurisdiction in any part of the United Kingdom, when requested to do so, with respect to comparable matters falling within the Bermuda Court's own jurisdiction, having regard to the rules of private international law.

22. What is the position as to whether the foreign jurisdiction does or does not recognise trusts?

This issue has not previously been considered by the Bermuda courts.

23. What particular issues, difficulties and solutions have arisen or may arise relating to trust arrangements or those involved with them?

In practice, there have been a number of insolvency-related complications involving Bermuda trusts in recent years, although only some have been the subject of reported Court judgments.

In the local context, many buildings and properties in Bermuda are held on trust by professional trustees, and often occupied or managed by the trust's principal beneficiaries. This has given rise to various legal complications when there is a default in repayment of mortgage loans, with associated negative equity or funding shortfalls, with lenders taking action against both trustees and beneficiaries (often under the terms of a personal guarantee). Separately, there have been a number of cases in which trustees of poorly-performing trusts have been removed or replaced for one reason or another, in circumstances where they have then sought to negotiate a secured indemnity against their contingent liabilities, either out of the trust assets remaining in their hands (over which they may have the right to a lien),[17] or out of the beneficiaries' personal assets.

The Trustee Act 1975 was also amended in 2014 to include a new section 47A, which was intended to place the old common law rule in 'Hastings-Bass' on a statutory footing in Bermuda (enabling the Bermuda Court to correct certain mistakes in the administration of a Bermuda trust).[18] The new section 47A was applied by the Bermuda Court in the case of *Re F Trust*[19] in setting aside certain trustee appointments that had mistakenly exposed the trust assets to unintended UK tax liabilities. There may well be future cases in which either section 47A or section 47 of the Trustee Act 1975[20] can be deployed to rescue or restructure or vary a Bermuda trust facing insolvency-related issues.

In the international context, the Bermuda Court of Appeal has accepted that certain investors in a mutual fund were to be treated as beneficiaries under a '*Quistclose*'

15 [2014] UKPC 36.
16 [2014] UKPC 35.
17 *Orconsult v Bickle* [2008] Bda LR 41.
18 The new section 47A is without prejudice to the Court's equitable powers of rectification in the case of mistake: see *Church Bay Trust Co Ltd v Attorney General* [2017] SC Bda 34 Civ.
19 [2015] SC (Bda) 77 Civ.
20 For an example of section 47 being applied, see *GH v KL* [2011] Bda LR 86.

trust, rather than shareholders or unsecured creditors, in circumstances where they had submitted share subscription monies shortly before the fund's insolvency but had not yet been issued shares.[21]

There have also been various cases in which the Privy Council and the local Bermuda Courts have had to consider the true meaning and effect of an exclusive jurisdiction or 'forum for administration' clause in a trust deed (which might also be relevant in the event of an insolvency scenario).[22]

Finally, it is not uncommon in Bermuda for liquidators to be appointed over a company and its affairs, only to discover that certain assets held in the name of the company are actually held on trust for certain beneficiaries (with the effect that such assets are not available for distribution to the company's creditors). This has resulted in a number of cases in which careful consideration has had to be given to the proper method by which to administer such trust assets, and the extent to which the liquidator is then entitled to be remunerated out of such trust assets, pursuant to the English case *Berkeley Applegate (Investment Consultants) Ltd.*[23]

21 *Kingate Global Fund Ltd v Knightsbridge Fund Ltd* [2009] Bda LR 59.
22 *Crociani v Crociani* [2014] UKPC 40, and *Re A Trust* [2012] Bda LR 79.
23 [1989] Ch 32.

BRITISH VIRGIN ISLANDS

1. Are trusts legal and valid under domestic law? What are they principally used for?

Trusts are an integral part of the laws of the British Virgin Islands (the BVI).

The general principles of BVI trusts law are derived from English law and they are supplemented by the following key statutes:

- Trustee Ordinance (as amended) (the Trustee Act);
- Virgin Islands Special Trusts Act, 2003; and
- Banks and Trust Companies Act, 1990 (as amended).

The Trustee Act defines a "*trust*" as "*the legal relationship created, either inter vivos or on death, by a settlor when assets have been placed under the control of a trustee for the benefit of a beneficiary or for a special purpose."* (s.2(2))

Trusts are flexible vehicles and are used for a wide range of reasons, including: family and business succession planning, asset protection, probate avoidance, and in a variety of commercial situations.

2. Are foreign trusts recognised under private international laws?

Foreign trusts are recognised in the BVI under The Hague Convention on the Law Applicable to Trusts and on their Recognition (the Convention).

Pursuant to article 11 of the Convention, such recognition implies, "*as a minimum, that the trust property constitutes a separate fund, that the trustee may sue and be sued in his capacity as trustee, and that he may appear or act in this capacity before a notary or any person acting in an official capacity.*"

3. Are there any prohibitions against trusts?

There are no prohibitions on the use of trusts under BVI law.

4. Are trusts and service providers regulated?

The BVI is a well-regulated financial jurisdiction and the Banks and Trust Companies Act, 1990 requires companies carrying on "trust business" in or from within the BVI to hold a licence. The definition of "trust business" includes the business of acting as a professional trustee, protector or administrator of a trust or settlement.

There are a number of exclusions from the definition of "trust business" and the following services do not require the provider of such services to hold a licence:

- nominee services;
- director services; and
- acting solely as bare trustee.

Further, the requirement to hold a licence does not apply to individuals who carry on a trust business or to private trust companies (PTC). Pursuant to the Financial Services (Exemptions) Regulations, 2007 a PTC must be a BVI company and it can carry out either unremunerated trust business, or "related" trust business (generally where the beneficiaries are all charities or is the settlor) without any licencing obligations.

5. Can the following become insolvent and subject to insolvency procedures?

5.1 A trust itself

A trust itself is not a legal entity (and does not have a separate legal personality under BVI law). However, it can become insolvent on a balance sheet or cash flow basis. A trust itself cannot be subject to insolvency procedures. Such action must be taken against the trustee who may or may not have recourse to the trust assets.

5.2 A settlor

Settlors, whether individuals or corporate entities, can become insolvent and subject to insolvency procedures. They can become insolvent both before or after the creation of a trust, although the implications of becoming insolvent differ depending on when the insolvency occurs.

An individual is insolvent if:

(a) he fails to comply with the requirements of a statutory demand; or

(b) execution of a judgment, decree or order of a BVI court is not satisfied.

A corporate entity is insolvent if:

(a) it fails to comply with the requirements of a statutory demand;

(b) execution of a judgment, decree or order of a BVI court is not satisfied; or

(c) either:

(i) the value of its liabilities exceeds its assets; or

(ii) it is unable to pay its debts as they fall due.

The impact that a settlor's insolvency has on a trust depends upon the facts and circumstances applicable to particular cases.

For example, a transaction is voidable if it is entered into at a time when the debtor is insolvent or if it causes the debtor to become insolvent.[1] If a settlor, therefore, settles assets in a trust at a time when he is insolvent, the settlement may be challenged. Further, an individual settlor who is bankrupt and has settled assets in a trust in the five years prior to the date of the bankruptcy order commits an offence.

1 Section 400 Insolvency Act, 2003.

5.3 A trustee

A trustee, whether an individual or a corporate entity, can be insolvent and subject to insolvency procedures both whilst a trustee or after ceasing to be trustee.

A trustee does not automatically cease to be trustee simply because of the trustee's insolvency unless the trust instrument provides otherwise.

However, pursuant to section 42(1) of the Trustee Act, the Court may make an order appointing a new trustee in substitution for a trustee who *is a bankrupt, or is a corporation which is in liquidation or has been dissolved*.

5.4 A beneficiary

A beneficiary can be insolvent under BVI law while a beneficiary or after ceasing to be a beneficiary.

The general rule is that upon the bankruptcy of a beneficiary, his interest in the trust is available for realisation by his trustee in bankruptcy and for disposal of the proceeds among his creditors.

However, where a beneficiary does not have a fixed interest in a trust but merely a right to be considered for the distribution of income or capital at the discretion of a trustee or other person, the bankruptcy of the discretionary beneficiary does not destroy the trustees' discretion[2] and so the beneficiary's prospective entitlement is not necessarily available to his or her creditors.

5.5 A protector

A protector can become insolvent in his, her or its own right. The protector's insolvency however, should not affect the trust's assets or result in the protector automatically ceasing to be the protector unless the trust instrument provides otherwise.

6. Do you distinguish between claims made against each of the parties stated in section 5 in respect of their obligations in acting for or in relation to the trust and, on the other hand, obligations incurred privately and personally?

6.1 A trust

A trust does not have a separate legal personality under BVI law. Accordingly, it cannot assume obligations in its own name or be subject to insolvency proceedings in its own right.

6.2 A settlor

A settlement may be set aside if the settlor subsequently becomes insolvent. Further, if they have reserved powers to themselves under section 86 of the Trustee Act, then the right to exercise that power may be vulnerable to claims by their personal creditors.

2 *Chambers v Smith* (1878) 3 App Cas 795, HL Sc.

6.3 A trustee

Section 98 of the Trustee Act limits trustee's personal contractual liability.

Pursuant to section 98(2), "*where in a contract properly entered into by a trustee, the trustee discloses his fiduciary capacity, the trustee is personally liable for any sum payable under the contract only to the extent of the value of the trust fund when the payment falls due*".

Further, pursuant to section 99 of the Trustee Act, a trustee is personally liable for torts and other non-contractual obligations in relation to a trust "*only if the trustee is personally at fault*".

Moreover, pursuant to section 207(4) of the Insolvency Act, 2003 "*assets held by a company in liquidation on trust for another person are not assets of the company*". The position is the same with respect to assets held on trust by bankrupt individuals by virtue of section 313(2)(a).

6.4 A beneficiary

A beneficiary in his capacity as such cannot incur obligations in relation to a trust. However, in the event of the beneficiary's insolvency (bankruptcy) his interest in the trust will form part of the assets available for realisation and distribution among his creditors.

6.5 A protector

A protector in his capacity as such cannot incur obligations in relation to a trust.

7. What are the main insolvency procedures that could be relevant?

The main insolvency procedures that could be relevant are:

- Individual bankruptcy;
- Liquidation: insolvent voluntary or compulsory;
- Creditors' Arrangement; and
- Scheme of Arrangement.

7.1 Compulsory Liquidation

Pursuant to s. 162 of the IA, an application for the appointment of a liquidator over a company can be made by:

- the company;
- a creditor;
- a member;
- the supervisor of a creditors' arrangement in respect of the company;

- the Financial Services Commission; or
- the Attorney General.

The potential grounds for an application are set out in s. 161(1) of the IA. They are:

- the company is insolvent;
- the court considers it just and equitable; or
- that it is in the public interest.

Under s. 8(1) of the IA, a company is insolvent where:

- it fails to comply with, or set aside, a statutory demand;
- execution or process of a judgment, decree or order is returned unsatisfied;
- the company is unable to pay its debts as they fall due; or
- the value of its liabilities exceeds that of its assets.

In order to apply for an order to appoint a liquidator, a creditor must have an unsecured debt of at least US$2,000.

7.2 Insolvent Voluntary Liquidation

The requirements for the appointment of a liquidator by the members of a company under s. 159(2) of the IA are:

- Resolution of 75% of the members of the company (unless the memorandum & articles require a higher percentage) (s. 159(3) of the IA);
- the prior written consent of a BVI licenced IP (s. 161(1)(c) of the IA); and
- no pending application before the Court to appoint a liquidator (s. 161(1)(b) of the IA).

7.3 Creditors Arrangement

Part II of the IA provides for a relatively straightforward procedure for a company in financial difficulties to bind all its creditors with an arrangement compromising its debts (including dissenting creditors and creditors abstaining from voting on the approval of the arrangement).

Under Regulation 83 of the Insolvency Rules 2005, the company must be insolvent and a 75% majority by value of creditors must approve the arrangement.

7.4 Scheme of Arrangement

Pursuant to s.179A(1) of the BVI Business Companies Act 2004 (BCA), where a compromise or arrangement is proposed between a company and its creditors, or any class of them the court may order a meeting of the creditors (or class of creditors) to be summoned in such manner as the court directs.

An application for the above order can be made by the company, any creditor, any member or the company's administrator or liquidator.[3]

A scheme has to be approved by a majority in number and 75% in value of the creditors.[4]

8. What is the effect of bankruptcy on the following?

8.1 A trust

As stated above, a trust cannot be insolvent as it does not have a legal personality.

8.2 A settlor

As explained above, a settlement may be set aside if the settlor subsequently becomes insolvent.

8.3 A trustee

As explained above, unless the trust instrument provides otherwise, a bankrupt does not automatically cease to be a trustee.

However, bankruptcy is one of the grounds for a replacement of a trustee by the court under section 42(1) of the Trustee Act.

8.4 A beneficiary

As explained above, in the event of the beneficiary's insolvency (bankruptcy) his interest in the trust will form part of the assets available for realisation and distribution among his creditors.

8.5 A protector

As explained above, the protector's insolvency / bankruptcy neither affects the trust's assets nor results in him automatically ceasing to be a protector (unless the trust instrument provides otherwise).

9. Can an insolvency procedure extend to trust assets located in local and / or foreign jurisdictions?

9.1 Local jurisdiction

All domestic BVI insolvency proceedings are overseen by the BVI court, which has jurisdiction over any assets located within the BVI. Accordingly, a BVI insolvency procedure can, in principle, extend to any assets (including, among others, trust assets) located in the BVI.

In certain circumstances, a foreign insolvency procedure may extend to assets (including, but not limited to, trust assets) located in the BVI. There are a number of potential routes to achieve this:

3 Section 179A(2), BCA.
4 Section 179A(3), BCA.

- procuring the liquidation of a foreign company by the BVI court;
- where available, seeking an order under Part XIX (Orders in the Aid of Foreign Proceedings) of the IA; or
- potentially, obtaining recognition and the limited assistance available at common law.

9.1.1 Liquidation of a foreign company in the BVI

In some circumstances it may be possible to apply for the winding up of the foreign company in the BVI under section 163 of the IA. Although the foreign office holders themselves would not have standing to bring such an application, not being persons mentioned in section 162(2) of the IA, a creditor could bring an application in the BVI with a view to a BVI liquidator being appointed who would then have the full powers available to court-appointed liquidators.

9.1.2 Orders in aid of foreign insolvency proceedings under Part XIX of the IA

S. 467 of the IA enables a foreign representative to apply to the BVI court for an order in aid of foreign proceedings. However, under the IA the BVI Court can only provide assistance to foreign representatives from designated "*relevant*" foreign jurisdictions, being: Australia, Canada, Finland, Hong Kong, Japan, Jersey, New Zealand, the UK and the USA.

Pursuant to s. 468 of the IA, the BVI court is required to take into account:

- the just treatment of all persons claiming in the foreign proceedings;
- the protection of persons in the BVI who may have claims in the foreign proceedings;
- the prevention of preferences and fraud;
- the need for ranking for foreign claimants to be in order with BVI claimants; and
- comity.

The orders that may be made by the BVI Court in aid of foreign proceedings are very wide and include (pursuant to s. 467(3) of the IA) orders:

- to restrain proceedings;
- for delivery of property of the company to a foreign representative;
- co-ordinating BVI insolvency with foreign insolvency; and
- authorising the foreign representative of any person who could be examined in BVI insolvency proceedings.

9.1.3 Common law recognition

As a matter of BVI common law, assistance can be given to overseas appointees regardless of whether or not assistance is available under the IA.

In the case of *Re C (A bankrupt) (BVIHC(Com) 0080 of 2013)*, the trustees in bankruptcy of a Hong Kong bankrupt applied to the BVI court for: (a) recognition at common law and assistance in the form of a grant of powers that they would have had if they had been appointed under the IA; alternatively (b) assistance under section 467, Part XIX of the IA.

Although Hong Kong is one of the "*relevant*" foreign jurisdictions (and, therefore assistance is available under the IA) Bannister J held that there was also a power at common law to recognise the Hong Kong representatives and to grant assistance.

As noted by Bannister J in Re C, whilst s.470 enables common law powers of assistance to continue to be available to foreign representatives from "*relevant countries*", it does not mean that common law assistance is not available to foreign representatives from other countries: the reason s.470 deals only with the relevant countries is simply that it reflects the ambit of Part XIX

9.2 Foreign jurisdictions

BVI law does not prohibit a BVI insolvency procedure to extend to trust assets located in another jurisdiction. However, the extent to which this can be done in practice is a matter of the law of the *situs* of the trust assets.

10. Can trusts be challenged?

10.1 To obtain assets

Trusts can be challenged to obtain assets if the creation of a trust with respect to such assets constituted a "*voidable transaction*" under Part VIII of the IA. Potentially "*voidable transactions*" comprise of:

- unfair preferences (s. 245 of the IA);
- transactions at an undervalue (s. 246);
- voidable floating charges (s. 247); and
- extortionate credit transactions (s. 248).

Other than in the case of extortionate credit transactions, the transaction must be an "*insolvency transaction*", as defined in s. 244(2) of the IA being one that is entered into when the company is insolvent or which causes the company to become insolvent.

10.1.1 Vulnerability period

A transaction cannot be challenged unless it was entered into within the "*vulnerability period*". Pursuant to s. 244(1) of the IA, the vulnerability period is:

- years prior to the onset of insolvency for a "*connected person*";
- 6 months prior to the onset of insolvency for any other person; or
- 5 years in the case of extortionate credit transactions.

The "*onset of insolvency*" is defined in s. 244(1) as being:

- the date the application to appoint a liquidator was issued; or,
- in a voluntary liquidation, the date of the appointment of the liquidator by the members.

10.1.2 Connected person

A "*connected person*"[5] includes related companies and directors, as well as members of the company and related companies.

10.1.3 Unfair preference[6]

An unfair preference may be voided where an insolvency transaction in the vulnerability period has the effect of putting a creditor into a position which will be better than the position he would have been in had the transaction not been entered into.

10.1.4 Transaction at an undervalue[7]

An undervalue transaction may be voided where it is an insolvency transaction in the vulnerability period where the company:

- made a gift to a person or entered into a transaction on terms that provide for the company to receive no consideration or
- entered into a transaction with a person for consideration which is significantly less than the value of the consideration provided by the company.

No order will be made, in either case, where the transaction is entered into in good faith for the purposes of the business and there were reasonable grounds for believing it would benefit the company (s. 246(2)).

10.1.5 Floating charges[8]

Floating charges are voidable if they are created within the vulnerability period and constitute an insolvent transaction, unless one of the exceptions specified in s. 247(2) applies.

10.1.6 Extortionate credit transactions[9]

Extortionate credit transactions are those credit transactions that:

- require grossly exorbitant sums to be paid; or
- which otherwise grossly contravene ordinary principles of fair trading.

5 As defined in s. 5, IA.
6 Section 245, IA.
7 Section 246, IA.
8 Section 247, IA.
9 Section 248, IA.

10.1.7 Orders in respect of voidable transactions

The orders which may be made by the Court where it is satisfied that a transaction entered into by the company is a voidable one are described in detail s. 249 of the IA.

In summary, the orders include:

- setting aside the transaction in whole or in part;
- restoring the position to what it would have been if the company had not entered into the transaction; and
- varying the transaction.

10.1.8 Freezing injunctions

It may also be possible to obtain a freezing injunction over the assets of a trust. The requirements for a freezing injunction under BVI law are broadly the same as in England and a number of other common law jurisdictions, and to succeed the applicant will need to establish:[10]

i. a good arguable case against the respondent;

ii. risk of dissipation of the assets if the injunction is not granted; and

iii. that it is just and convenient for the injunction to be granted.

10.2 To obtain information

As far as disclosure of information to beneficiaries by trustees and protectors is concerned, the general principles are contained in the Privy Council decision of *Schmidt v Rosewood Trust Ltd.*[11] In summary, these principles are:

- a beneficiary has a right to seek disclosure of trust documents;
- that right is an aspect of the court's inherent jurisdiction to supervise, and, where appropriate, to intervene in, the administration of trusts;
- A proprietary right is neither sufficient nor necessary to entitle a beneficiary to disclosure of trust documents;
- the guidance as to how the court should exercise its discretion in cases where disclosure is sought is contained in the decided cases;
- there are three areas in which the court may have to form a discretionary judgment:

  (i) whether a discretionary object (or some beneficiary with only a remote or wholly defeasible interest) should be granted any relief at all;

  (ii) what classes of documents should be disclosed, either completely or in redacted form; and

10 See, *Rybolovleva v Rybolovleva* BVIHCV 2008 / 0403; *Irish Response Ltd v Direct Beauty Products Limited* [2011] EWHC 37.

11 *Schmidt v Rosewood Trust Ltd* [2003] UKPC 26; [2003] 2 AC 709.

(iii) what safeguards should be imposed (whether by undertakings to the court, arrangements for professional inspection, or otherwise) to limit the use which may be made of documents or information disclosed under the order of the court.

In the context of general commercial litigation (as opposed to trusts litigation between beneficiaries and trustees or protectors), disclosure of information could be sought under the Norwich Pharmacal principles.[12] To succeed, the applicant must show the following:

- a wrong has been carried out, or arguably carried out, by an ultimate wrongdoer;
- an order is needed to enable an action to be brought against the ultimate wrongdoer, usually to identify them;
- it is just and convenient to make the order and there is no other practical way of obtaining the information; and
- the person against whom the order is sought:
  - has been mixed up in so as to have facilitated the wrongdoing;
  - is likely to be able to provide the information necessary for the wrongdoer to be sued.

Once the above threshold requirements have been satisfied, it still remains a matter for the court's discretion as to whether or not to grant the relief, and the disclosure order will not be granted unless, in the view of the court, it is necessary and proportionate in all the circumstances.

10.3 To examine witnesses

Pursuant to ECSC CPR Part 33 (Court Attendance by Witness and Depositions):

- the court may issue a witness summons – a document requiring witness to attend court to give evidence or to produce documents to the Court (CPR 33.2); and
- the court may make an order on an application by a party for a person to be examined before the trial or the hearing of any application in the proceedings (CPR 33.7 Evidence by deposition before examiner).

These procedural remedies are, in principle, available in any litigation in the BVI courts, including litigation related to trusts.

10.4 Any other purpose

A trust may be challenged in the context of enforcement of a domestic or foreign judgment against the assets of a judgment debtor who is a beneficiary or alleged beneficiary of such trust.

12 *Norwich Pharmacal Co v Customs and Excise Commissioners* [1974] AC 133.

11. On what grounds can a trust arrangement be challenged?

11.1 The settlor was insolvent when the trust was created or became insolvent as a result of creating it

A trust arrangement may be challenged in such circumstances as a voidable transaction (as described above in the answer to question 10(10.1)).

11.2 The settlor becomes insolvent

A trust arrangement may be challenged in such circumstances as a voidable transaction (as described above in the answer to question 10.1).

11.3 The settlor lacked capacity or authority to create the trust

11.3.1 Individual settlors

A trust may be set aside if it was created by an individual who was under-age (younger than 18 years old) or of unsound mind.

11.3.2 Corporate settlors

With regards to capacity, s. 28(1) of the BCA provides that, subject to the BCA and the memorandum and articles of the company, "*a company has, irrespective of corporate benefit*":

- full capacity to carry on or undertake any business or activity, do any act or enter into any transaction; and
- or these purposes, full rights, powers and privileges.

Moreover, pursuant to section 28 of the BCA:

- the powers of a company include the power to protect the assets of the company for the benefit of the company, its creditors and its members and, at the discretion of the directors, for any person having a direct or indirect interest in the company;[13] and
- for this purpose the directors may cause the company to transfer any of its assets in trust to one or more trustees, each of which may be an individual, company, association, partnership, foundation or similar entity and, with respect to the transfer, the directors may provide that the company, its creditors, its members or any person having a direct or indirect interest in the company, or any of them, may be the beneficiaries of the trust.[14]

Further, pursuant to s. 29(1) of the BCA, "*no act of a company and no transfer of an asset by or to a company is invalid by reason only of the fact that the company did not have the capacity, right or power to perform the act or to transfer or receive the asset*".

13 Section 28(2)(d), BCA.
14 Section. 28(3) of the BCA.

As far as authority is concerned, s. 31 of the BCA provides, in effect, that a transaction cannot be challenged on the ground of lack of authority, unless the other party to the transaction has, or ought to have, by virtue of his or her relationship to the company, knowledge of the relevant matters causing the lack of authority;[15] or has actual knowledge of the fraud or forgery.[16]

11.4 The settlor lacked the capacity or authority to transfer the assets to the trustees

The same rules as set out in the answer to question 11(11.3) above will apply.

11.5 The assets were not validly transferred or the transfer was not fully completed

Where the assets were not validly transferred to the trustee, the basic rule is that no trust will be constituted as the court will not "*perfect an imperfect gift*".[17]

Where the transfer was not fully completed but the settlor has made "*every effort*" to perfect the gift, the settlor may be deemed to hold the assets on trust for the trustee until the transfer is fully completed, for example, by registration.[18]

11.6 The trust was not validly created

Under the BVI law (similarly to the trusts law of other major common law jurisdictions), in order to create a valid trust the settlor must comply with the requirement of the "*three certainties*", namely: (1) certainty of intention to create a trust; (2) certainty of subject matter; and (3) certainty of beneficiaries (or objects).

A trust arrangement may be declared by the court to be invalid if it does not comply with the requirement of the "*three certainties*".

11.7 Grounds for avoiding transactions

There are several instances where transfers are set aside as void or voidable. The circumstances are as follows:

11.7.1 Mistake

A transfer may be rescinded (set aside) on the ground of mistake.

Following the decision of the UK Supreme Court in the leading case of *Pitt v Holt*[19] the test may be summarised as follows:[20]

- where a settlement or other voluntary disposition is made with the settlor or disponor acting under a mistake, as opposed to ignorance, inadvertence or misprediction, the court may set aside the disposition in equity;
- the mistake may be of fact or of law;

15 Section 31(1), BCA.
16 Section 31(2), BCA.
17 *Milroy v Lord [1862] 4 De GF* & J 264.
18 *Re Rose [1952] Ch 499 CA*.
19 *Pitt v Holt [2013] UKSC 26*.
20 Lewin on Trusts 19th Ed., paras 4-064- 4-066.

- the operative mistake must be of so serious a character as to render it unjust or unconscionable on the part of the donee to retain the property given to him, or to trustees for his benefit; the assessment of what is or would be unconscionable is an objective one; and
- the gravity or seriousness of the mistake must be assessed by a close examination of the facts, whether or not tested by cross-examination, including the circumstances of the mistake and its consequences for the disponor.

11.7.2 There was an undervalue or preference or preference

As explained above in the answer to question 10(10.1), a transaction may be set aside in the context of insolvency if it was an undervalue, or a preference.

11.7.3 There was a sham

It is a settled principle, that where a settlor makes a declaration of trust but in reality, has no intention to create one, such a declaration may be disregarded as a sham.[21]

The effect of a trust being found to be a sham is that the trust is deemed absolutely void and the trust assets are regarded as beneficially owned by the settlor.

11.7.4 Other grounds

Pursuant to s. 84(2) subsections (a) and (b) of the Trustee Act, a non-charitable purpose trust will be invalid if the purpose is not "*specific, reasonable and possible*" or is "immoral, contrary to public policy or unlawful".

12. What protections and defences exist to protect those listed in question 5 and are they statutory or common law or otherwise?

12.1 A trust

A trust cannot sue or be sued as it is not a legal entity.

12.2 A settlor

A settlor has no special protections.

12.3 A trustee

A trustee, acting as a trustee, has a number of protections.

Sections 6-8 of the Trustee Act exempt the trustee from or limit his liability for breach of trust in relation to investments which cease to be authorised, certain loans and other investments as well as losses caused by improper investments (subject to the satisfaction of the conditions specified therein).

[21] See, for example, *Midland Bank v Wyatt* [1997] BCLC 242.

Sections 27-29 of the Trustee Act contain further exemptions from and limitations of liability of trustees in relation to certain rents and covenants, conveyances and distributions of real and personal property as well as transactions entered into by trustees acting for the purposes of more than one trust. Section 30 of the Trustee Act also exempts trustees from liability for act or payments made by them under certain powers of attorney.

Section 31 of the Trustee Act contains a general exemption of liability and implied indemnity as follows:

- trustees are exempted from liability for certain receipts of money and securities;
- a trustee is answerable and accountable for his own acts and omissions only and not of any other trustee nor any person with whom any trust money or security may be deposited;
- a trustee is not liable for any loss to the trust fund unless the same happens through his own wilful default; and
- a trustee may reimburse himself or pay out of the trust premises all expenses incurred in or about the execution of the trusts or powers.

The Trustees' Relief Act 1877 allows a trustee to apply to the Court for "the opinion, advice or direction […] on any questions respecting the management or administration of trust property". The trustee will then be deemed to have discharged his duty in the subject matter of the application unless he has been "guilty of any fraud or wilful concealment or misrepresentation in obtaining such opinion, advice or direction".

Pursuant to section 59 of the Trustee Act, the Court may confer the required powers on trustees to enter into transactions with respect to trust property which would otherwise be beyond the scope of the trustees' powers under the trust instrument or the law, if, in the opinion of the Court, the transaction is "*expedient*".

Section 63 of the Trustee Act gives the Court power to relieve a trustee from personal liability for any breach of trust where the Court is satisfied that the trustee "*acted honestly and reasonably and ought fairly to be excused for the breach of trust and for omitting to obtain the directions of the Court in the matter in which he committed such breach*". Section 64 gives the Court a further power to make the beneficiary indemnify the trustee for a breach of trust committed by him "*at the instigation or request or with the consent in writing of a beneficiary*".

As described in more detail above in 6.3, sections 98 and 99 of the Trustee Act limit trustee's personal contractual and tortuous / non-contractual liability. Further, if the trust instrument provides for the application of section 97 of the Trustee Act, the trustee will not be personally liable under any contract into which he enters with a third party if he has disclosed (or the other party is aware) that he was contracting as trustee (unless the contract provides otherwise). A claim based on such a contract may be satisfied out of the trust fund.

12.4 A beneficiary

There are no special protections and defences.

12.5 A protector

Pursuant to section 86(3) of the Trustee Act, a protector shall not be deemed to be a trustee by virtue only of the exercise of his statutory powers (set out in section 86(2)(a)-(d) and (g)) and, unless the trust instrument provides otherwise, is not liable to the beneficiaries for the bona fide exercise of such powers.

13. Can claims be made in a bankruptcy where the insolvency office holder stands in the shoes of a bankrupt to exercise the rights given by the trust in favour of the following?

13.1 A settlor

Claims may be made in favour of the settler, a trustee, a beneficiary and a protector or in the circumstances mentioned above.

By virtue of s. 175 of the IA which provides that with effect from the commencement of the liquidation of a company the liquidator has custody and control of the assets of the company (including any choses in action). The position is the same with respect to bankrupt individuals pursuant to s. 292 of the IA.

13.2 A trustee

Yes, see the answer to question (13.1) above.

13.3 A beneficiary

Yes, see the answer to question (13.1) above.

13.4 A protector

Yes, see the answer to question (13.1) above.

14. Are rights of subrogation established by law?

The right of subrogation is established under s. 100 of the Trustee Act. S. 100(1)(a) provides that "*where a trustee of a trust has incurred a liability in favour of another party ("the third party") under or by virtue of a contract properly entered into by the trustee, the trustee shall have a right of indemnity in relation to that liability against the trust fund and against distributed property or its traceable product, to which right the third party shall be subrogated*".

S. 100(1)(b) provides that in computing the amount of the indemnity any indebtedness of the trustee shall be disregarded.

Pursuant to s. 100(2), where a contract was entered into without the requisite power or without compliance with any requirements for its exercise or otherwise in breach of duty, the trustee shall be liable to compensate the trust fund for any amount to which the right of subrogation applies by virtue of s. 100(1).

Further, pursuant to s. 100(5) rights of indemnity conferred by s. 100 are:

- without prejudice to any other rights of indemnity or reimbursement to which a trustee may be entitled; and
- shall subsist notwithstanding any purported waiver or exclusion, in whole or in part, by the trustee.

15. Can the veil of a company owned by a trust be pierced or lifted and, if so, in what circumstances?

A trust cannot own shares in a company as a trust does not have a separate legal personality under the BVI law.

The general rules for "*piercing the corporate veil*" are contained in the two leading UK Supreme Court judgments: *VTB Capital Plc v Nutritek and Prest v Petrodel Resources Limited*.[22]

In *Prest v Petrodel* the Supreme Court confirmed the principle that "*the court may be justified in piercing the corporate veil if a company's separate legal personality is being abused for the purpose of some relevant wrongdoing is well established in the authorities*".

Lord Sumption reviewed the authorities and identified two principles under which the corporate veil may be pierced: namely the "*concealment principle*" and the "*evasion principle*".

The concealment principle does not involve piercing the corporate veil at all. It simply describes cases where a company is used to hide the identity of the real actors. The courts would look behind the company to discover the matters that the corporate structure conceals.

On the other hand, in cases where the evasion principle applies "*the court may disregard the corporate veil if there is a legal right against the person in control of it which exists independently of the company's involvement, and a company is interposed so that the separate legal personality of the company will defeat the right or frustrate its enforcement*."

Lord Sumption further stated that the corporate veil can only be pierced to prevent the abuse of the company's legal personality. It is not an abuse to cause the company to incur a legal liability in the first place, but the real question is whether the person is under an existing legal obligation or liability, or subject to an existing legal restriction, that he deliberately evades or whose enforcement he deliberately frustrates, by interposing a company under his control. If so, the corporate veil may be pierced for the sole purpose of depriving the controller of the company of the improper advantage that they would otherwise obtain by the company's separate personality.

16. Can the veil of a trust be pierced or lifted and, if so, in what circumstances?

A trust does not have a separate legal personality under the law. Accordingly, the doctrine of "*piercing the corporate veil*" does not apply.

22 *VTB Capital Plc v Nutritek* [2013] UKSC 5 and *Prest v Petrodel Resources Limited* [2013] UKSC 34.

17. If a trust can be treated as insolvent, is this on the basis of the cash flow test, the balance sheet test or another test and, if so, what test?

A trust does not have a separate legal personality under the law. Accordingly, it cannot become "*insolvent*".

The test for insolvency as applicable to a corporate is set out in s. 8 of the IA but is not applicable with respect to trust.

18. Can or have receivers been appointed to act as a trustee or with powers over trust assets? If so, in what circumstances?

The BVI court has statutory power to appoint a receiver if, on the evidence, it appears to the court to be "*just or convenient*" to do so. With respect to trust assets, a receiver may in some cases be an appointed pending an application for the appointment of a new trustee, for example, where claims of breach of trust are made against the trustees and the court is unwilling to remove them pending the determination of those claims, but where the evidence is sufficiently strong to warrant the protection afforded by a receivership.[23]

Section 24 of the Eastern Caribbean Supreme Court (Virgin Islands) Act 1969 provides:

> "*A mandamus or an injunction may be granted or a receiver appointed by an interlocutory order of the High Court or of a judge thereof in all cases in which it appears to the Court or the Judge to be just or convenient that the order should be made and any such order may be made either unconditionally or upon such terms and conditions as the court or the judge thinks just.*"

The purpose of the appointment the receiver in this case must be the preservation of trust assets.[24] In essence, a Court will not make an order for the appointment of a receiver where there is some lesser injunctive order that will achieve what is needed,[25] and the Court will also not make an order where it is going to have no practical effect.

The relief must be just or convenient. The Court also needs to be satisfied that:

- the applicant's claim gives rise to a serious issue to be tried on the merits of the main claim;
- damages are not an adequate remedy for the applicant if the receivership is not granted and the threatened wrong occurs;
- but that the respondent could be adequately compensated on the applicant's cross-undertaking in damages; and
- if there is doubt in relation to this that the balance of convenience is in favour of granting the relief.[26]

23 *Lewin on Trusts* 19th Ed., para 38-031.
24 *Norgulf Holdings Limited v Michael Wilson & Partners Limited HVAP* 2007 / 8).
25 *JSC BTA Bank v Ablyazov* [2011] Bus LR D119.
26 *The Siskina* [1979] AC 210.

The court will usually require an applicant to give a cross-undertaking in damages to compensate the respondent if the receivership is wrongly granted and causes loss, and it may require the applicant to lodge security against that cross-undertaking.

19. Are claims against trustees limited or unlimited? If limited, are they limited as to amount and by time?

As stated above, S. 98 of the Trustee Act limits trustee's personal contractual liability. Pursuant to section 98(2), "*where in a contract properly entered into by a trustee, the trustee discloses his fiduciary capacity, the trustee is personally liable for any sum payable under the contract only to the extent of the value of the trust fund when the payment falls due*". Further, pursuant to section 99 of the Trustee Act, a trustee is personally liable for torts and other non-contractual obligations in relation to a trust "*only if the trustee is personally at fault*".

Moreover, a trust instrument may provide for the application of section 97 of the Trustee Act (which is a non-mandatory provision of the act). If this is the case, the trustee will not be personally liable under any contract into which he enters with a third party if he has disclosed (or the other party is aware) that he was contracting as trustee (unless the contract provides otherwise). A claim based on such a contract may be satisfied out of the trust fund.

20 Are there provisions or cases where trusts, or those connected to them, are based in a foreign jurisdiction?

Conflict of laws rules applicable to trusts (including determination of proper law and jurisdiction of the court) are contained in sections 80-83A of the Trustee Act.

21. What are the main means to seek assistance from another jurisdiction?

The BVI is not a party to the Convention of 18 March 1970 on the Taking of Evidence Abroad in Civil or Commercial Matters (the Evidence Convention) or any other analogous international instrument.

However, the Evidence Convention has been incorporated into domestic law under the Evidence (Proceedings in Foreign Jurisdictions) Ordinance (Cap 24). Therefore, it is open to the BVI court to issue a letter of request for assistance to a foreign court but whether such a request will be acceded to is a matter of domestic law of the "*receiving*" foreign jurisdiction as there is no reciprocity under the Evidence Convention.

22. What is the position as to whether the foreign jurisdiction does or does not recognise trusts?

Whether any assistance is available in a foreign jurisdiction is a question of domestic law of the relevant foreign jurisdiction.

23. What particular issues, difficulties and solutions have arisen or may arise relating to trust arrangements or those involved with them?

BVI remains a trust jurisdiction of choice. The jurisdiction has a modern and sophisticated legislative framework which gives effective protection to the trustees and beneficiaries as well as third parties dealing with the trust.

In particular, a trust governed by BVI law allows the trustee allows the trustee to limit or exclude his personal liability (provided he exercises his powers in the proper manner). At the same time, a third party dealing with the trust (provided it carries out appropriate due diligence and verifies the trustees' powers and the requirements for their exercise) can have direct recourse to the assets of the trust, without having to concern itself with any breach of trust by the trustee. This ensures commercial certainty and makes BVI trusts a useful tool for use in international asset-holding and structuring of complex cross-border commercial transactions.

BVI non-charitable purpose trusts are also becoming increasingly popular and are used by international clients in commercial, inheritance and tax planning purposes.

CANADA

1. Are trusts legal and valid under domestic law? What are they principally used for?

Trusts are well established in Canadian law. A trust can be used for a wide variety of personal and commercial purposes. Personal trusts, are, generally created by individuals through *inter vivos* or testamentary disposition. In turn commercial trusts, may be used among other things as an unincorporated alternative to setting up a corporation, as a security or holding entity or an instrument for investments. Trusts more broadly, can be established both by operation of the common law (including resulting and constructive trusts) or explicitly by federal or provincial statute (including what is colloquially known as a deemed trust). A trust in and of itself, generally speaking, is not a legal entity.

2. Are foreign trusts recognized under private international laws?

All Canadian jurisdictions generally speaking recognize foreign trusts at common law. Canada is additionally a signatory to *The Hague Convention of the Law Applicable to Trusts and on Their Recognition*, which among other things provides for the recognition of foreign trusts. It has been in turn ratified in the provinces of British Columbia, Alberta, Saskatchewan, Manitoba, Ontario, New Brunswick, Nova Scotia, Newfoundland and PEI.

3. Are there any prohibitions against trusts?

There are no general prohibitions against trusts in Canada.

4. Are trusts and service providers regulated?

Trusts themselves are not broadly regulated in Canada, with the exception of "trust companies" that operate under either provincial or federal legislation and conduct activities similar to those of a bank. Such entities are regulated by the Office of the Superintendent of Financial Institutions and are subject to the Trust and Loan Companies Act.

Trustees more generally are governed in each province, by provincial legislation, for instance in Ontario the Trustee Act (Ontario).

5. Can the following become insolvent and subject to insolvency procedures?

5.1 A trust itself

Generally speaking, no – as described further below, there are three main insolvency statutes in Canada, being the Bankruptcy and Insolvency Act (the BIA), the Companies' Creditors Arrangement Act (the CCAA) and the Winding-Up and Restructuring Act (the WURA).

With respect to the BIA, a trust (with the exception of an income trust, which is a trust that has assets in Canada if its units are listed on a prescribed stock exchange or if its units are in turn held by a trust listed on a prescribed stock exchange) is not a "person", "debtor" or "insolvent person" within the meaning of the BIA and therefore cannot be the subject of insolvency proceedings under this statute.

Similarly, a trust (with the exception of an income trust) is not a "company" or a "body corporate" and thus cannot be a "debtor company" within the meaning of the CCAA. It is worth noting though that in the context of the CCAA, courts have on occasion been willing to extend the stay of proceedings obtained pursuant to the CCAA to an entity that does not the meet the definition of a "debtor company", where the business and affairs of the "debtor company" and the non "debtor company" are so intertwined that it would further the purpose of the CCAA proceedings of the "debtor company".[1] In this respect, a trust may obtain ancillary protection under the CCAA.

Finally, a trust (with the exception of a trust company incorporated under the Trust and Loan Companies Act (i.e. a regulated financial institution)), is not an eligible entity to which the WURA applies.

5.2 A settlor

Yes, there is no prohibition under any of the applicable statutes or by common law that would prevent a settlor from becoming the subject of insolvency proceedings, either before or after the creation of a trust.

5.3 A trustee

Yes, there is no prohibition under any of the applicable statutes or by common law that would prevent a trustee becoming the subject of insolvency proceedings, either whilst a trustee or after ceasing to be a trustee.

5.4 A beneficiary

Yes, there is no prohibition under any of the applicable statutes or by common law that would prevent a beneficiary becoming the subject of insolvency proceedings, either whilst a trustee or after ceasing to be a trustee.

5.5 A protector

Yes, there is no prohibition under any of the applicable statutes or by common law that would prevent a protector from becoming the subject of insolvency proceedings, either before or after the creation of a trust.

6. Do you distinguish between claims made against each of the parties mentioned in section 5 in respect of their obligations in acting for or in relation to the trust and, on the other hand, obligations incurred privately and personally?

No, generally speaking there is no distinction at law, in respect of a claim made in the bankruptcy proceedings against a settlor, trustee, beneficiary or protector, in relation to a trust (other than a beneficiary of a trust making a claim that it is entitled to trust assets), and on the other hand, obligations incurred privately and personally.

1 *Re Lehndorff General Partner Ltd.*, 1993 *CarswellOnt* 183.

7. What are your main insolvency procedures that could be relevant?

The principal insolvency statutes in Canada are the BIA, the CCAA and to a lesser extent the WURA. The BIA includes both personal and corporate bankruptcy proceedings, consumer and corporate proposals and corporate receivership proceedings. The CCAA, is strictly a corporate statute and is reserved for corporations with debts in excess of $5,000,000. The CCAA is utilized for both restructuring proceedings and liquidation proceedings. Finally, the WURA, is a winding-up regime for financial institutions (i.e. banks, insurance companies, and trust companies as described above).

8. What is the effect of bankruptcy on the following parties?

81. A trust

As stated above, a trust, with the exception of an income trust cannot be a bankrupt or otherwise commence insolvency proceedings. There are no reported decisions, where an income trust has filed for or been adjudicated bankrupt or otherwise commenced insolvency proceedings, so it is difficult to determine the effect such proceedings would have on an income trust.

8.2 A settlor

In Canada, when a settlor is bankrupt or otherwise has commenced insolvency proceedings, the settlor's establishment of a trust prior to such proceedings being commenced may give rise to a reviewable transaction under the applicable insolvency legislation (as further described below), where a preference has occurred and / or where a transfer at undervalue has occurred. This may have the effect of defeating the trust, for the benefit of the settlor's creditors. In addition to being a reviewable transaction under insolvency legislation, the trust can additionally be challenged under provincial fraudulent conveyance / preference legislation. Provincial fraudulent conveyance / preference legislation may be used in concert with the reviewable transaction provisions in the applicable insolvency legislation or in the alternative where certain prerequisites under insolvency legislation cannot otherwise be met (most commonly, where the statutory limitation periods in such legislation has passed).

8.3 A trustee

There is case law in Canada to the effect that the bankruptcy of a trustee, specifically, is grounds for removing him from such a position, at least in the context of an estate trustee. That being said, at common law there is no automatic bar to a bankrupt acting as a trustee without evidence establishing that the trustee, by his bankruptcy has been rendered unfit to act as a trustee.[2] Over and above this case law, in certain provinces, provincial legislation governing trustees, specifically vests in the court the power to make an order appointing a new trustee, where *inter alia* the existing trustee is a bankrupt. A trustee in bankruptcy may itself apply to replace the bankrupt as rustee and from acting in the administration of a trust.[3]

2 *Bartel v. Bartel*, 2006 *CarswellMan* 408 (Man. CA).
3 *Re MacNaughton*, 1972 *CarswellOnt* 80.

Importantly and generally speaking, neither the bankruptcy of a trustee nor the commencement of receivership proceedings will result in the applicable trust assets vesting in the trustee in bankruptcy of the bankrupt, or the receiver, as the case may be, for the satisfaction of the estate's creditors (i.e. the trust assets would be excluded from the estate). In this respect, section 67(1) of the BIA, specifically provides that the property of a bankrupt divisible among his creditors does not include "property held by the bankrupt in trust for any other person".

The exception to section 67(1), would be deemed trusts (i.e. trusts created by federal or provincial legislation), the underlying assets of which, in a bankruptcy (but not a receivership), will lose the priority normally accorded to trusts if they cannot meet the test for a trust at common law.

8.4 A beneficiary

In Canada, when a beneficiary is bankrupt or receivership proceedings have been commenced, any assets held in trust for the beneficiary by a third party will vest in the trustee in bankruptcy of the beneficiary, or the receiver, as the case may be, for satisfaction of the beneficiary's creditors. Where insolvency proceedings have been commenced under the CCAA or the proposal provisions of the BIA, the beneficiary will continue to have a right of possession over such assets.

8.5 A protector

There are no reported decisions, where a protector has filed for or been adjudicated bankrupt or otherwise commenced insolvency proceedings, so it is difficult to determine the effect such proceedings would have on a protector.

9. Can an insolvency procedure extend to trust assets located in local and / or foreign jurisdictions?

9.1 Local jurisdiction

No, in accordance with the above, if the trust assets, are the product of a true trust at common law, insolvency proceedings will not extend to such assets, subject to the creation of the trust or the transfer of assets to the trust being a reviewable transaction under provincial fraudulent conveyance / preference legislation or the transfer at undervalue / preference provisions of the insolvency legislation applicable in the circumstances.

9.2 Foreign jurisdictions

No, in accordance with the above, if the trust assets, are the product of a true trust at common law, insolvency proceedings will not extend to such assets, subject to the creation of the trust or the transfer of assets to the trust being a reviewable transaction under provincial fraudulent conveyance / preference legislation or the transfer at undervalue / preference provisions of the insolvency legislation applicable in the circumstances.

10. Can trusts be challenged?

10.1 To obtain assets

A trust can be challenged as a preference, fraudulent conveyance or transfer for undervalue under applicable bankruptcy or provincial law.

10.2 To obtain information

It's not clear a trust could be challenged solely to obtain information.

10.3 To examine witnesses

Local rules applying to examination and discovery of witnesses would apply to the examination of any trustee or other person involved in a trust.

11. On what grounds can a trust arrangement be challenged?

11.1 The settlor was insolvent when the trust was created or became insolvent as a result of creating it

Such circumstances may give rise to a reviewable transaction under provincial fraudulent conveyance / preference legislation. This legislation is liberally interpreted by courts in Canada, in order to protect creditors from transactions that were undertaken to defeat their legitimate claims. Should a settlor commence formal insolvency proceedings, in addition to being reviewable under provincial fraudulent conveyance / preference legislation, the trust can be challenged under the transfer at undervalue / preference provisions of the insolvency legislation applicable in the circumstances.

11.2 The settlor becomes insolvent

This may also give rise to a reviewable transaction under provincial fraudulent conveyance / preference legislation and the transfer at undervalue / preference provisions of the insolvency legislation applicable in the circumstances. Whether the trust is reviewable in the circumstances may depend on among other things whether the settlor was on the eve of insolvency at the time the trust was established (or rendered insolvent the trust) and should insolvency proceedings be commenced the date of commencement relative to the date the trust was created.

11.3 The settlor lacked capacity or authority to create the trust

A lack of capacity to create a trust, in terms of both age and mental capacity are grounds for challenging a trust in Canada.

11.4 The settlor lacked the capacity or authority to transfer the assets to the trustees

A lack of capacity to transfer assets to a trustee, in terms of both age and mental capacity are grounds for challenging a trust in Canada.

11.5 The assets were not validly transferred or the transfer was not fully completed

Where assets were not validly transferred, in accordance with the test elucidated above, this is grounds for challenging a trust.

11.6 The trust was not validly created

A trust arrangement may be challenged, where a trust was not validly created, i.e. the three certainties of a trust are not present, being: (i.) certainty of intention; (ii.) certainty of subject-matter; and (iii.) certainty of objects.

11.7 The transfer could be subsequently set aside as void or voidable

The reasons that would make a transfer void or voidable are as follows:

11.7.1 Mistake

A high burden of proof is necessary, but where the settlor's true intent is established, and the mistake is fundamental, it is possible (albeit rare), that a trust may be set aside on the grounds of a mistake.

11.7.2 If there was an undervalue

Yes, as mentioned above with respect to questions 11.1 and 11.2, a trust that is the product of a transfer at undervalue may be challenged under both federal insolvency legislation and certain provincial fraudulent conveyance legislation. Under insolvency legislation, a different threshold exists in challenging a transfer at undervalue where the recipient is arm's length vs. non-arm's length. In arm's length transactions, the following elements are required to establish a transfer at undervalue:

- a disposition of property occurred in which no consideration is received by the debtor or for which the consideration is conspicuously less than the fair market value;
- the transfer occurred within one year of the initial bankruptcy event;
- the debtor was insolvent at the time of the transfer; and
- the debtor intended to defeat, defraud or delay its creditors.

In turn, in non-arm's length transactions, the following elements must be proven:

- a disposition of property occurred in which no consideration is received by the debtor or for which the consideration is conspicuously less than fair market value; and
- the transfer occurred within one year prior to the date of the initial bankruptcy event; or
- the transfer occurred within five years prior to the date of the initial bankruptcy event; and
    - the debtor was either insolvent at the time of the transfer (or was rendered insolvent by it); or
    - intended to defraud, defeat or delay a creditor.

11.7.3 If there was a preference

Yes, as mentioned above with respect to questions 11.1 and 11.2, a trust that results in a preference may be challenged under both insolvency legislation and certain provincial preference legislation. Similar to a transfer at undervalue, under insolvency legislation, a different test exists to making out a fraudulent preference, where the recipient is arm's length vs. non-arm's length. For an arm's length transaction, a preference may be voidable where:

- it was made with a view to giving a preference; and
- it occurred within three months of the initial bankruptcy event.

In contrast for a non-arm's length transaction, a preference may be voidable where:

- it has the effect of preferring one creditor over another; and
- it occurred within one year of the initial bankruptcy event.

11.7.4 If there was a sham

Yes, although not a precise term, the term "sham", has been used by courts in Canada to set aside trusts where the settlor's true intent is to defeat his creditors. In such circumstances the settlor's true intent is to retain control of the assets purportedly held in trust, notwithstanding the terms of the trust deed. Setting aside a trust on the grounds that it is a "sham" although conceptually similar to a preference or transfer at undervalue, is separate and apart from these legal concepts.

12. What protections and defences exist to protect those listed at 5 and are they statutory or common law or otherwise?

Generally speaking, the challenge of a trust on the grounds set out in question 1, will be adjudicated based on a factual determination made by the court, in respect of the various tests outlined and referenced above. In all such instances, it is likely that any defense will be grounded in among other things, the notion that the establishment and / or transfer of assets was *bona fide*.

13. Can claims be made in a bankruptcy where the insolvency office holder stands in the shoes of a bankrupt to exercise the rights given by the trust in favour of the following parties?

13.1 The settlor

In bankruptcy or receivership proceedings, the trustee in bankruptcy, or receiver, as the case may be, will stand in the shoes of the settlor. In CCAA proceedings or proposal proceedings under the BIA, the applicable insolvency professional being, the monitor and proposal trustee, respectively, will not stand in the shoes of the settlor.

13.2 A trustee

Where insolvency proceedings are commenced, the applicable insolvency professional will not, as described above, automatically stand in the shoes of a trustee, to exercise its right and obligations *vis-à-vis* the trust.

13.3 A beneficiary

In bankruptcy or receivership proceedings, the trustee in bankruptcy, or receiver, as the case may be, will stand in the shoes of the beneficiary. In CCAA proceedings or proposal proceedings under the BIA, the applicable insolvency professional being, the monitor and proposal trustee, respectively, will not stand in the shoes of the beneficiary.

13.4 A protector

As discussed above, as there are no reported decisions, where a protector has filed for or been adjudicated bankrupt or otherwise commenced insolvency proceedings, it is difficult to know whether in a bankruptcy or receivership proceeding, the trustee in bankruptcy, or receiver, as the case may be, will stand in the shoes of the protector. As CCAA proceeds and proposal proceedings are debtor in possession proceedings, the applicable insolvency professional being, the monitor and proposal trustee, respectively, will not stand in the shoes of the protector.

14. Are rights of subrogation established by law?

Third party creditors of a trustee in certain circumstances can be subrogated to a trustee's right of indemnification from an estate. Subrogation only exists with respect to assets which remain in the estate, and to which the trustee has a right of indemnity. Subrogation cannot occur with respect to assets that have already been transferred by a trustee to a beneficiary.

15. Can the veil of a company owned by a trust be pierced or lifted and, if so, in what circumstances?

In only exceptional cases that result in a flagrant injustice, will a Court pierce the corporate veil of an incorporated company. Typically, the corporate veil will only be pierced when a company is incorporated for an illegal, fraudulent or improper purpose, or those in control expressly direct a wrongful thing to be done and the company is being used as shield for fraudulent or improper conduct.

16. Can the veil of a trust be pierced or lifted and, if so, in what circumstances?

A trustee, acting in his capacity as trustee deals or contracts with third parties as a principal and not as an agent of the trust or its beneficiaries. In this respect, there is no veil per se, as trustees are personally liable in such situations. A trustee may also be found liable to the beneficiaries of trust, where he fails to carry out his obligations under the terms of the trust, the rules of equity or certain provincial or federal statutes.

17. If a trust can be treated as insolvent, is this on the basis of the cash flow test, the balance sheet test or another test and, if so, what test?

As noted above, trusts are generally speaking not capable of being treated as insolvent. More broadly speaking, whether or not for the purposes of insolvency legislation an entity or person is insolvent can be determined both on a cash flow and balance sheet basis.

18. Can or have receivers been appointed to act as a trustee or with powers over trust assets? If so, in what circumstances?

A receiver when appointed will not as of right be appointed to act as a trustee or with powers over trust assets. Even if this power is sought, the trust assets, will not be assets available to satisfy the estate in receivership.

19. Are claims against trustees limited or unlimited? If limited, are they limited as to amount and by time? Do underlying companies have a role?

Claims against a trustee in terms of quantum, generally speaking are unlimited. Liability may be limited to a degree by the terms of a trust deed. It is standard practice for trustees to seek and obtain liability insurance, given their broad personal liability at law. In terms of applicable statutory limitations periods, limitation periods vary by province across Canada, but generally for most causes of actions range from 2-6 years. Certain provinces, notably in their legislation governing limitation periods, have specific limitations period that are just applicable to actions against trustees.

20. Are there provisions or cases where trusts, or those connected to them, are based in a foreign jurisdiction?

Under Canadian Insolvency law, the Court has broad jurisdiction to make various orders – if it was determined that a Canadian Court had jurisdiction to affect a foreign trust then it would be open to the court to grant relief as it deemed fit.

21. What are the main means to seek assistance from another jurisdiction?

The ability to seek assistance from another jurisdiction is typically dependent on the laws of that other jurisdiction. Such request could be dependent upon the UNCITRAL Model Law or common law principles of comity.

22. What is the position as to whether the foreign jurisdiction does or does not recognise trusts?

The applicability of foreign law would depend on an analysis of conflicts of law and the appropriate applicable law in the circumstances.

23. What particular issues, difficulties and solutions have arisen or may arise relating to trust arrangements or those involved with them?

The issues arising from trust arrangements depend on which entity is the focus of attention – whether the trustee or the beneficiary, etc. It would also depend on the issues at hand and the assets subject to the trust. Each trust case in the context of an insolvency has to be addressed on a case by case basis.

CAYMAN ISLANDS

1. Are trusts legal and valid under domestic law? What are they principally used for?

Trusts are legal and valid under Cayman Islands law. The principal legislation governing Cayman trusts is the Trusts Law (2018 Revision) (the Trusts Law), the Fraudulent Dispositions Law (1996 Revision) (the FD Law) and the Perpetuities Law (1999 Revision) (the Perpetuities Law). The Trusts Law grants the Grand Court of the Cayman Islands (the Grand Court) a "supervisory" jurisdiction to deal with trust matters concerning Cayman law governed trusts. English case law is considered of highly persuasive authority in Cayman.

In the Cayman Islands, trusts are principally used for the purposes explained below.

1.1 Preservation of wealth

Trusts can preserve the continuity of ownership of particular assets, such as a business, within a family. By vesting legal ownership of the assets in the trustee, the relevant individuals can continue to benefit from the assets, while avoiding division of ownership amongst a large number of second and third generation beneficiaries.

1.2 Forced heirship

Where a settlor disposes of assets during his or her lifetime by settling them on a Cayman Islands trust, the trust assets will not form part of the settlor's estate upon his or her death. As discussed below, this may enable a settlor to avoid forced heirship rules which may be mandatory under the laws of his or her domicile, residence or nationality and which would otherwise determine to whom and in proportions in which a settlor's estate will devolve. The choice of Cayman Islands law as the governing law is conclusive and any questions arising in connection with the trust will be determined according to Cayman Islands law. The application of foreign law is excluded.

1.3 Succession planning

A Cayman Islands trust provides an efficient vehicle for the transfer of beneficial ownership interests on the death of a settlor and can also be used to hold shares in a company owning immovable property situated outside of the Cayman Islands rather than directly in the real property itself. This has the effect of characterising an interest as movable rather than immovable, which can itself present attractive opportunities for tax and financial planning.

1.4 Asset protection

Cayman Islands trusts can be established for the principal purpose of protecting assets from risk. The use of a Cayman Islands trust in conjunction with an underlying company can be used to convert an onshore asset into an offshore one, can interpose an additional layer of confidentiality in a chain of ownership, and may also enable trust assets to be held in a jurisdiction which does not recognise the trust concept.

1.5 Commercial trusts

Cayman Islands trusts are also used for the following commercial purposes:

- As a unit trust or mutual fund for the collective investment of capital.
- In off-balance sheet transactions, to hold the share capital of an "orphan" special purpose vehicle (typically under the terms of a STAR or charitable trust).[1]
- As part of an asset securitisation scheme, to provide for mortgages and receivables to be held pursuant to the terms of a trust.
- To provide for employee share option and executive incentive schemes.

2. Are foreign trusts recognised under private international laws?

The Hague Convention on the Law Applicable to Trusts and on their Recognition 1985 (The Hague Trusts Convention) has not been extended to the Cayman Islands. However, there is nothing in local legislation that would prevent most types of internationally accepted trusts as being recognised in the Cayman Islands. All the types of foreign trusts possible under English law can be recognised under Cayman Islands law, including:

- Discretionary trusts
- Interest in possession trusts
- Reserved powers trusts
- Charitable trusts

Reserved powers trusts are particularly common in the Cayman Islands, in part as a result of the enactment of the Trusts (Amendment) (Immediate Effect and Reserved Powers) Law 1998, which is now contained in Part III of the Trusts Law.

3. Are there any prohibitions against trusts?

There are no prohibitions against trusts in the Cayman Islands.

4. Are trusts and service providers regulated?

While individual trustees of Cayman Islands trusts are not regulated, certain other trustee and other service providers are subject to regulations pursuant to the laws of the Cayman Islands.

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1 "STAR" refers to the Special Trusts Alternative Regime Law (now to be found in part VII of the Trusts Law (2018 Revision), commonly known as STAR, which is unique to the Cayman Islands. STAR establishes an entirely separate regime from ordinary trusts, so only applies where the trust instrument contains a declaration to that effect. The objects of a STAR can be persons, or purposes, or both, and the purposes can be of any number or kind, charitable or non-charitable, provided they are legal and not contrary to public policy.

The Banks and Trust Companies Law (2018 Revision) and the Private Trust Companies Regulations (2013 Revision) (the PTCR) give the Cayman Islands Monetary Authority (CIMA) the responsibility of regulating the trust industry in the Cayman Islands. This includes licensing, registration and ongoing supervision. Generally, there are two types of licenses granted to trustees carrying on a trust business in Cayman.

- A full trust license, which entitles the holder to provide trustee services to the public generally; and
- A restricted trust license, which is issued subject to the condition that the trust business is limited to certain named clients.

Private Trust Companies (PTCs) can hold a restricted trust licence. Under such licences, CIMA permits a maximum of 20 trusteeships provided that the trusts are all related. Each licensee is required to have at least two directors, at least one of whom is required to have sound professional knowledge of and experience in trust business. All directors must be approved by CIMA. Further, a licensed PTC is required to have a place of business in Cayman which must have resources (including staff and facilities) and hold such books and records as CIMA considers appropriate. Each licensee is also required to have two individuals or a body corporate, approved by CIMA, resident or incorporated in Cayman to be its agent.

In some circumstances, a PTC may obtain an exemption from licensing. In order to qualify for the licensing exemption under the PTCR, a company must be a trust company which is incorporated in Cayman; and conducts no trust business other than "connected trust business". Connected trust business is defined as "trust business in respect of trusts the contributors to the funds of which are all, in relation to each other, connected persons". For these purposes, a person is connected to another person if:

- they are in a relationship listed in the schedule to the PTCR (a wide class of family relationships);
- one is contributing funds into a trust as trustee of a trust of which the other is a contributor;
- each is in a group of companies; or
- one is a company and the other is a beneficial owner of shares or other ownership interests of that company or of any other company in the same group of companies.

5. Can the following become insolvent and subject to insolvency procedures?

5.1 A trust

Pursuant to Cayman Islands law, a trust is not a legal entity with separate legal personality, so it cannot itself become insolvent. While a trust is sometimes described as being "insolvent", in reality this means no more than that the trustee has incurred liabilities in its capacity as such which exceed the amount or value of the trust fund, or the trustee has incurred liabilities which they are unable to meet out of liquid trust assets as they arise. In that case, it is the trustee's responsibility to meet the liabilities concerned out of his or her own assets, for generally there is no limit on his or her personal liability. If the trustee is unable to do so, then it is the trustee, not the trust that will become insolvent.

5.2 A settlor

A settlor may become insolvent and subject to insolvency procedures. If the settlor is an individual, then he or she may enter into bankruptcy pursuant to the Bankruptcy Law (1997 Revision) (the Bankruptcy Law). A settlor that is a corporation may become insolvent and subject to the winding up procedures under the Companies Law (2018 Revision) (the Companies Law) discussed further in relation to question 7 below.

5.3 A trustee

A trustee may become insolvent and subject to insolvency procedures in the same way as a settlor. Bankruptcy proceedings may be taken against the trustee if an individual or winding up or liquidation proceedings against the trustee if it is a corporation. It should be noted that, during its trusteeship, an individual trustee who is adjudged bankrupt or a corporate trustee which goes into liquidation is only deprived of the trusteeship if the trust instrument so provides. Most Cayman Islands trust deeds will include a provision to this effect. Similarly, bankruptcy is not in itself a disqualification from becoming a trustee. Assets which are clearly identified as trust assets will not form part of the trustee's insolvent estate.

5.4 A beneficiary

A beneficiary of a trust can become insolvent in the same way as a settlor and trustee.

5.5 A protector

A protector may become insolvent in the same way as a beneficiary, settlor, and trustee and in accordance with the procedures referred to above.

6. Do you distinguish between claims made against each of the parties stated in section 5 in respect of their obligations in acting for or in relation to the trust and, on the other hand, obligations incurred privately and personally?

As noted at section 5.1 above, a trustee can become liable in its personal capacity for obligations or other liabilities it has incurred as trustee, if those liabilities exceed the level of the indemnity provided to it out of the assets of the trust pursuant to the provisions of the relevant trust deed. However, conversely, if it is clear that any obligation or liability has been incurred by a trustee while acting in its personal capacity rather than *vis-à-vis* the trust, that obligation or liability cannot then be extended to and encroach on the trust assets.

No distinction is made in respect of settlors and beneficiaries, as they do not ordinarily have obligations to act for or in relation to a Cayman Islands trust.

7. What are the main insolvency procedures that could be relevant?

7.1 Corporate entities

For corporate entities which are acting as trustees or protectors, or where the shares in Cayman Islands companies are settled onto trusts, the main and most relevant procedure is winding up pursuant to the Companies Law. This can be done in two ways.

7.1.1 Compulsory winding up

The company, any creditor (including a contingent or prospective creditor) or any shareholder of the company can present a winding-up petition to the court at any time. A company may be wound up by the court if, among other things, the company passes a special resolution requiring it to be wound up by the court, it suspends its business for a whole year, the company is unable to pay its debts, or the court decides that it is just and equitable for the company to be wound up.

A company is deemed unable to pay its debts where it neglects to pay a debt provided for in a statutory demand served in the prescribed way, fails to satisfy a judgment or order of the court, or it is otherwise proved to the satisfaction of the court that the company is unable to pay its debts.

A company is placed into compulsory liquidation by court order, and official liquidators are appointed by the court; the consent of stakeholders is not required. The authority of official liquidators displaces that of the company's directors, and they control the company's affairs subject to the court's supervision.

7.1.2 Voluntary winding up

Voluntary liquidation can be used by companies incorporated and registered under the Companies Law. A company can be wound up voluntarily when an event occurs which the memorandum or articles provide is to trigger the company's winding-up, or if the company resolves that it be wound up voluntarily.

A liquidator appointed to conduct a voluntary liquidation does not require the court's authorisation to exercise his or her powers. However, the liquidator can apply to the court to determine any question that arises during the winding-up process. A voluntary liquidation can be brought under the court's supervision. For the company to resolve by special resolution that it be wound up voluntarily, a majority of at least two-thirds of the company's members is required. For the company to resolve by ordinary resolution that it be wound up voluntarily because it is unable to pay its debts as they fall due, a majority in number of the company's members is required.

On appointing a voluntary liquidator, the directors' powers cease, except to the extent the company (through a general meeting) or the liquidator sanctions the continuance of those powers. The company must cease business activities except so far as necessary for its beneficial winding-up, and no protection from the company's creditors is available during a voluntary liquidation.

7.2 Individuals

For individuals who are insolvent, bankruptcy orders may be made as follows.

The Bankruptcy Law sets out the law and procedures in relation to bankruptcy proceedings. The Grand Court (Bankruptcy) Rules contain the forms that are prescribed for use in bankruptcy proceedings.

Bankruptcy proceedings may be initiated when a person is unable or unwilling to pay his or her debts. All proceedings in bankruptcy must be commenced by petition in the Grand Court. A petition may be presented by a bankrupt debtor or by one or more creditors who are owed at least $40.00.

A Trustee in Bankruptcy is appointed under the Bankruptcy Law to administer the estates of debtors in bankruptcy and with the approval of the Court, may appoint an agent to assist where the estate is large enough to justify it.

In a straightforward bankruptcy case, the Trustee in Bankruptcy collects and distributes the assets of the debtor for the benefit of his or her creditors. In some cases, a deed of arrangement may be entered into between a debtor and his or her creditors with a view to avoiding an adjudication of bankruptcy.

8. What is the effect of bankruptcy on the following?

8.1 A trust

As a trust is not a separate legal entity, and cannot become "bankrupt", this question is not applicable.

8.2 A settlor

In the event of the bankruptcy of an individual settlor, the Trustee in Bankruptcy may investigate the circumstances in which the settlor established his or her trusts. To this end, the Trustee in Bankruptcy will be looking to determine whether any dispositions into a trust were made fraudulently.

The FD Law renders voidable (at the instance of a creditor prejudiced thereby) any disposition made with an intent to defraud and at an undervalue.[2] It should be noted that the test for setting aside such a disposition is twofold: it must be with intent to defraud and also at an undervalue.

This means that a disposition made even at an undervalue (such as a disposition to trustees) is safe from the attack of creditors unless the creditors can show an intent to defraud creditors then existing. Even if such an attack succeeds, the disposition is only set aside to the extent necessary to satisfy the creditors prejudiced by the disposition. The FD Law specifically provides that the burden of proof of the transferor's intent to defraud is on the creditor seeking to set aside the disposition.[3] There is a limitation period of six years after the disposition which prevents any action being taken to set aside the disposition after that time.

In addition, section 107 of the Bankruptcy Law provides that a settlement can be avoided by the settlor's Trustee in Bankruptcy in the following circumstances:

- If a provisional or absolute order in bankruptcy takes effect against the settlor within two years after the date of the settlement; or
- If the settlor becomes bankrupt within ten years after the date of the settlement, unless the parties claiming under the settlement can prove that the settlor was able to pay all of his or her debts without the aid of the property comprised in the settlement at the time of making the settlement.

There are similar, but not identical, avoidance provisions upon the insolvency of a corporate settlor, contained in sections 145 and 146 of the Companies Law.

2 Up until the introduction of the FD Law, the Cayman Islands gave effect to the Fraudulent Conveyances Act 1571 (usually known as the Statute of Elizabeth), which rendered void any disposition intended to defeat, delay or hinder the interests of creditors.

3 Section 4(2), FD Law.

8.3 A trustee

Upon the bankruptcy of an individual trustee, the trustee loses control over its assets because a Trustee in Bankruptcy will be appointed. Upon the insolvency of a corporate trustee, the trustee also loses control of its assets because liquidators are appointed. However, assets held by the trustee that are clearly assets of the trust will not form part of the trustee's bankrupt / insolvent estate.

Whether a bankrupt individual trustee can continue to act as trustee of a Cayman Islands trust will depend on the particular provisions of the relevant trust deed. Most modern deeds will include a clause which provides for the removal of the trustee in the event of him or her being declared bankrupt, but there is nothing expressed in local statute that provides for removal to be mandatory.

8.4 A beneficiary

Upon the insolvency / bankruptcy of a beneficiary, his or her vested and contingent interests under a fixed interest trust will vest in his or her Trustee in Bankruptcy or liquidators and will be available for realisation by the liquidator / bankruptcy trustee and for disposal of the proceeds among the creditors. However, if the trust in question is a true discretionary trust and the beneficiary has no fixed entitlements, the situation will be different. In those circumstances, the trustees are not compelled to pay or apply any of the income to a particular beneficiary and this means that a discretionary beneficiary has no right to any of the income but only a right to require the trustees to consider from time to time whether to make a distribution to him or her and a mere hope that they will do so. Accordingly, the beneficiaries' creditors can take none of the income or other distributions from the trust unless and until the discretion is exercised in his or her favour.

8.5 A protector

In terms of bankruptcy, the position in relation to protectors is similar to that of trustees.

9. Can an insolvency procedure extend to trust assets located in the local and / or foreign jurisdictions?

9.1 Local jurisdiction

Trust assets do not form part of the insolvency / bankruptcy estate of the trustee and remain to be dealt with in accordance with the terms of the trust. However, trust assets located in the Cayman Islands may be able to be "clawed back" from the trust in the event of an insolvency procedure such as a winding-up, or the bankruptcy of the settlor, pursuant to the procedures outlined at questions 7 and 8 above.

9.2 Foreign jurisdictions

Whether assets of a Cayman Islands trust which are located in another jurisdiction can be the subject of insolvency procedures commenced in the Cayman Islands will be a matter for the courts of that jurisdiction.

10. Can trusts be challenged?

10.1 To obtain assets

A Cayman Islands trust can be challenged to obtain assets if there are allegations that the trust is a fraud or "sham" (as to which, see question 11 below). Further a disposition into a trust can be challenged under the FD Law, or under s.107 of the Bankruptcy Law or s.145-146 of the Companies Law, as discussed at paragraph 8.2 above.

10.2 To obtain information

A trust is not usually "challenged" to obtain information, but beneficiaries of a Cayman Islands trust can seek to compel the disclosure of information about the trust from the trustee. Whether or not they will be successful depends entirely on the type of trust in question. For beneficiaries of ordinary discretionary trusts (and other forms of trust excluding non-charitable purpose trusts) the position will be as set out in the leading English and Commonwealth cases. *Schmidt v Rosewood*[4] and *Armitage v Nurse*[5] have been applied by the Cayman Islands courts,[6] and trustees can refuse to disclose information about a trust that is of a commercially sensitive nature or where the documents are not relevant or evidentially essential to a beneficiary's case, or where the probative value of the information is minimal and outweighed by the prejudice it may cause to other beneficiaries or to the proper administration of the trust. With respect to private purpose or STAR trusts, the position regarding access to information by beneficiaries is expressly modified by statute.

Third parties can only seek to obtain information from a trustee in the course of litigation.

It should be noted that requests or applications for the disclosure of confidential information by trustees may bring the terms of the Confidential Information Disclosure Law (2016 Revision) (the CIDL) into operation.[7] The CIDL provides that such information can only be disclosed with the express or implied consent of the owner, in compliance with an applicable law or regulation, at the request of specified authorities including the Cayman Islands Police or otherwise pursuant to a court order obtained in accordance with the CIDL. Accordingly, a court order may be needed before confidential trust information can be disclosed by a trustee.

10.3 To examine witnesses

Beneficiaries and third parties can seek to examine witnesses about the affairs of a trust in the course of litigation.

10.4 For any other purpose

See the grounds discussed further at paragraph 11 below.

11. On what grounds can a trust arrangement be challenged?

A Cayman Islands trust can be challenged on the four grounds.

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4 [2003] UKPC 26.
5 [1997] EWCA Civ 1279.
6 *Lemos v Coutts and Others* 2003 CILR 281.
7 The CIDL defines 'confidential information' as including information, arising in or brought into Cayman, concerning any property of a person to whom a duty of confidence is owed by the person who receives the information.

11.1 The settlor was insolvent when the trust was created or became insolvent as a result of creating it

In these circumstances, the settlor will likely be subject to investigations into the circumstances in which the settlor established his or her trusts and may see some of the assets of the trust clawed back as a matter of statute, pursuant to the FD Law or the avoidance provisions of the Companies Law or Bankruptcy Law discussed in paragraph 8.2 above.

11.2 The settlor lacked capacity or authority to create the trust or to transfer the assets to the trustees

If a person lacks mental capacity, or is underage, they cannot transfer or give good receipt for trust assets. Pursuant to Cayman Islands common law, a settlement of assets onto a Cayman Islands trust can be challenged on this basis and the Court will consider carefully, usually with the assistance of court appointed guardians and medical advisors, what the intentions of the settlor were at the time the trust was settled.[8]

11.3 The assets were not validly transferred, or the transfer was not fully completed

This could either be under the general law governing the transfer of property (e.g. if formalities for the transfer of property have not been complied with) or under FD Law. As noted above, the FD Law provides for an action to be brought where there was an "intent to defraud", defined in the statute as an intention of a transferor wilfully to defeat an obligation or liability owed to a creditor, which existed on or prior to the date of the relevant disposition and of which the transferor had notice. The disposition will only be set aside to the extent necessary to satisfy the obligation. If the court is satisfied that the transferee or beneficiary has not acted in bad faith, then the disposition will only be set aside subject to the transferee's proper fees, costs and pre-existing rights, claims, and interests or subject to the right of the beneficiary to receive distributions.[9]

11.4 The trust was not validly created

A transfer of assets into a Cayman Islands trust could be subsequently set aside as void or voidable because it is a sham. In this regard, the allegation would be that the trust does not in practice create the legal rights and obligations which it gives the appearance of creating. If it can be shown that the parties did not intend to create a trust and instead intended to give a false impression that they had created one, then the trust will be overturned. The concept of a sham trust is recognised in the Cayman Islands.[10] Part III of the Trusts Law (2018 Revision) provides guidelines as to what trust arrangements are acceptable and will not otherwise be considered a sham.

12. What protections and defences exist to protect those listed in question 5 and are they statutory or common law or otherwise?

Defences to any challenges to the validity of a Cayman Islands trust are discussed below.

8 *In the matter of D* [2009] CILR 432.
9 See *Al Sabah and Another v. Grupo Torras SA* [2005] UKPC1, in which the Privy Council ultimately found that the trust assets were in fact the assets of the settlor in his capacity as a debtor in bankruptcy, pursuant to the FD Law.
10 *Walker International Holdings Ltd v Olearius Ltd* [2003] CILR 457.

12.1 The settlor

If the settlor is able to show that any and all transfers of assets into a Cayman Islands trust were made honestly, at fair value, and without any intent to defraud the settlor's creditors, then the provisions of the FD Law and the avoidance provisions of the Companies Law or the Bankruptcy Law are unlikely to bite.

12.2 The trustee

If the court is satisfied that a trustee has not acted in bad faith in receiving property settled on to the Cayman Islands trust, then the trustee will be able to retain sufficient funds to pay its entire costs incurred in defending any proceedings challenging the validity of the trust, and will also be entitled to retain its proper fees and costs incurred in administering the trust, as would any predecessor trustee who had similarly not acted in bad faith. This is consistent with the common law approach to trustee cost protection provided for in *Re Beddoe*[11] as most recently applied by the Grand Court in *X (as Trustee of the A Trust) v Y (as Beneficiary of the A Trust).*[12]

12.3 A beneficiary

Section 5(b) of the FD Law confirms that any beneficiary who has received a distribution properly from the trust fund in terms of the trust will be entitled to retain that distribution provided that he or she has not acted in bad faith.

13. Can claims be made in a bankruptcy where the insolvency office holder stands in the shoes of a bankrupt to exercise the rights given by the trust in favour of the following?

13.1 The settlor

Section 107 of the Bankruptcy Law provides that a settlement can be avoided by the settlor's Trustee in Bankruptcy in the following circumstances:

- If a provisional or absolute order in bankruptcy takes effect against the settlor within two years after the date of the settlement; or
- If the settlor becomes bankrupt within ten years after the date of the settlement, unless the parties claiming under the settlement can prove that the settlor was able to pay all of his or her debts without the aid of the property comprised in the settlement at the time of making the settlement.

13.2 A trustee and protectors

A power vested in an individual trustee as or protector does not pass to his or her Trustee in Bankruptcy.

13.3 A beneficiary

If a beneficiary becomes insolvent, his or her interest in the trust could be terminated and the trust fund applied for his or her benefit in the most appropriate way (including by way of payment out to creditors).

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11 [1893] 1 CH 547.
12 Unreported, 15 March 2017, Smellie CJ.

13.4 A protector

As stated in section 13.2 above.

14. Are rights of subrogation established by law?

Under Cayman Islands law, a trust creditor has the right to look to the trustee's right of indemnity and associated lien over trust assets and is entitled to be subrogated to those rights. Importantly, the trustee's rights take priority over the rights of the beneficiary, and the beneficiary's secured creditors, and their successors.

The right of subrogation:

- prevents the beneficiaries from avoiding liabilities which properly fall on the trust fund;
- entitles the creditors to enforce their liabilities against trust property to the extent that the trustee would be so entitled. However, the creditors have no right of subrogation unless the trustee is entitled to an indemnity from the trust assets;
- in cases where the trustee itself is insolvent, entitles creditors to enforce an unsecured claim against the trust property in cases where it would not be possible to enforce the claim against the trustee personally due to the trustee's insolvency; and
- where a trustee has a right of indemnity in relation to a debt incurred by the trustee which carries interest, the creditor, in proceedings against the trust fund upon default by the trustee, would be entitled to recover that interest along with the initial debt.

15. Can the veil of a company owned by a trust be pierced or lifted and, if so, in what circumstances?

The general legal principles regarding corporate personality under the law of the Cayman Islands are similar to those under English law. While the number of judicial decisions in the Cayman Islands on the doctrine of lifting or piercing the corporate veil is not as extensive as the English case law, the Grand Court has consistently followed the English case rulings on the doctrine.

The view of the Grand Court is that it is only in exceptional circumstances that the principle of the separate legal personality of a company is to be ignored and the court will lift or pierce the corporate veil. These include:

- *Illegal or improper purpose*

  Where a company has been incorporated and used for an illegal or improper purpose, such as to evade pre-existing obligations of the shareholders to creditors or other third parties, or otherwise to mislead those dealing with a company, its proprietor and / or closely affiliated companies.[13]

- *Fraud*

  Where a company or group of companies is used as a means of perpetrating a fraud.[14]

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13 *Bonotto v Boccaletti* [2001] CILR 120.
14 *Algosaibi v Saad Investments* [2010] 1 CILR 553.

16. Can the veil of a trust be pierced or lifted and, if so, in what circumstances?

Unlike companies, Cayman Islands trusts do not have a separate legal personality and, as such, there is no separate "veil" to be pierced or lifted. Pursuant to Cayman Islands law, then, the only way to get at trust assets is by challenge based on allegations of a sham, or to attack the transfer of assets into the trust pursuant to the provisions of the FD Law or the avoidance provisions in the Companies Law or the Bankruptcy Law as described at paragraph 8.2 above.

17. If a trust can be treated as insolvent, is this on the basis of the cash flow test, the balance sheet test or another test and, if so, what test?

As a trust cannot be treated as insolvent, this question is not applicable. A trustee will be insolvent if he cannot pay his debts as they fall due.

18. Can or have receivers been appointed to act as a trustee or with powers over trust assets? If so, in what circumstances?

As confirmed by the Privy Council in *Tasarruf Mevduati Sigorta Fonu v Merrill Lynch Bank and Trust Co (Cayman) Ltd*[15] (TMSF), in certain circumstances a receiver may be appointed with powers over the assets of a Cayman Islands trust. More specifically:

> In that case, a Mr Demirel had settled approximately US$24m in two Cayman-law discretionary trusts. TMSF, the Turkish banking regulator, obtained a judgment in Turkey against Mr Demirel in the sum of circa US$30m for damage caused by allegedly fraudulent loan transactions. Mr Demirel had reserved to himself full power of revocation over the Cayman trusts.
>
> TMSF wanted to enforce its judgment debt against Mr Demirel, but could only enforce the judgment against the trust assets if the assets first came back to Mr Demirel by him exercising his powers of revocation. As a means of achieving this, TMSF issued a claim in the Cayman Islands for assignment of Mr Demirel's power of revocation to a receiver and for authority to allow the receiver to revoke the trusts. In doing so, the Court was asked to consider whether Mr Demirel's power of revocation was a form of property.
>
> The Privy Council ruled that there were no absolute rules as to the distinction between powers and property and, in the circumstances of the case, the power to revoke the trust could be regarded as a right "tantamount to ownership" of the underlying trust assets. The Privy Council decided that a receiver could be appointed over a power of revocation as a means of enabling the plaintiff to enforce its judgment against the settlor.

TMSF therefore suggests that a receiver can be appointed over trustee powers concerning the control or access property, including the power of revocation. In practice, this can mean that the rights of an individual creditor in bankruptcy can sometimes be better than those of the trustee.

15 [2011] UKPC 17.

19. Are claims against trustees limited or unlimited? If limited, are they limited as to amount and by time? Do underlying companies have a role?

As a Cayman Islands trust is a legal arrangement, and not a legal entity, liabilities incurred in connection with the trust will be in the trustee's name, not in the name of the trust. The trustee's liabilities to third parties are unlimited. The trustee has a right of indemnity from the trust fund in respect of most liabilities incurred in respect of the trust, but this is limited to the level of the assets in the trust fund. As a result, if the trustee enters into a contract with a third party relating to trust business (for example, for a loan) that third party will be able to claim against the trustee personally under the contract in unlimited amount.

At common law, it is possible to limit liability to the trust assets if the trustee and the creditor have expressly so agreed. A trustee may be able to persuade a third party to agree that liability should be limited or excluded or that the creditor can only have recourse to the trust assets pursuant to the trustee's right of indemnity. However, if this is not expressly agreed, then any shortfall will have to be met from the trustee's own pocket.

20. Are there provisions or cases where trusts, or those connected to them, are based in a foreign jurisdiction?

If trusts, or those connected to them, are based in a foreign jurisdiction, investigations into those trusts may be undertaken in reliance on the provisions of the various treaties discussed further at question 21 below.

The Grand Court will receive and grant letters of request from the courts of other countries for information or testimony in aid of proceedings before those foreign courts and provided always that the foreign court would reciprocate in similar circumstances. This jurisdiction is exercised either by virtue of the inherent powers of the Grand Court in recognition of its obligation of comity owed to foreign courts or, as the case might be, pursuant to the Convention in the Taking of Evidence abroad in Civil or Commercial Matters 1970 (The Hague Evidence Convention), discussed further below.

21. What are the main means to seek assistance from another jurisdiction?

The Cayman Islands is a signatory to various international treaties providing for international co-operation, including:

- The Vienna Convention; and
- The United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances;
- The United Nations Treaty on Organized Crime;
- The United Nations Convention against Corruption; and
- The Organisation for Economic Co-operation and Development Anti-Bribery Convention;
- Various Tax Information Exchange Agreements.

The Cayman Islands can therefore implement many of the legal tools generally available pursuant to these treaties, including letters rogatory for requests for evidence procurement. The procedural framework for implementing these tools is dependent on the international treaty and can vary substantially.

Application for assistance in relation to the service of documents abroad can be made under The Hague Convention on the Service Abroad of Judicial and Extra-judicial Documents (the Hague Service Convention). The Hague Service Convention has been extended by the United Kingdom (a ratifying State) to the Cayman Islands and given legislative force in the Islands by the extension by Order-in Council of the Evidence (Proceedings in Other Jurisdictions) Act 1975 to the Islands. Evidence may be obtained from persons located in other jurisdictions pursuant to The Hague Evidence Convention.

Mutual legal assistance can be obtained from foreign courts in insolvency / bankruptcy proceedings at common law.[16]

Mutual legal assistance between the Cayman Islands and the United States continues to be effected primarily via pre-existing, equivalent provisions under the Mutual Legal Assistance (United States of America) Law (2015 Revision).

22. What is the position as to whether the foreign jurisdiction does or does not recognise trusts?

Part VII of the Trusts Law sets out comprehensive conflict of laws rules, which are designed to provide certainty and to prevent a challenge to the validity of a Cayman Islands trust on specified grounds. These provisions provide that trusts governed by the laws of the Cayman Islands or dispositions of property held on such trusts cannot be held void, voidable, liable to be set aside or defective, nor can the capacity of any settlor be questioned because:

- The laws of any foreign jurisdiction prohibit or do not recognise the concept of a trust; or
- The trust or disposition avoids, or defeats rights, claims or interests conferred by foreign law on any person because of a personal relationship to the settlor or by way of heirship rights, or contravenes any rule of foreign law, any foreign judicial or administrative order or action that recognises, protects or enforces such rights, claims or interests.

Further, an heirship right, as that term is defined in the Trusts Law, conferred by a foreign law in relation to the property of a living person does not affect the ownership of property nor constitute a liability for the purposes of the FD Law.

Section 93 of the Trusts Law confirms that a foreign judgment will not be recognised enforced or give rise to an estoppel if it is inconsistent with sections 91 or 92 of the Trusts Law.

16 *Singularis Holdings Ltd v PricewaterhouseCoopers* [2015] 1 AC 1675.

23. What particular issues, difficulties and solutions have arisen or may arise relating to trust arrangements or those involved with them?

23.1 Trustee paralysis

While it is a relatively rare occurrence, circumstances can arise in the life of a trust that lead a trustee to the view that its hands are effectively tied and it cannot perform the proper administration of the trust (for example, due to risk of criminal liability). This can leave the interests of its beneficiaries in great peril, particularly if the trust is under attack. However, as confirmed in a recent case before the Grand Court, the beneficiaries of trusts governed by Cayman Islands law can obtain from the court orders substituting a new trustee in the place of the original to prevent trustee paralysis.[17] Section 10 of the Trusts Law provides that the court has power to appoint new trustees, including in substitution for existing trustees, whenever it is expedient to do so, or if it is otherwise found to be inexpedient, difficult or impracticable to do so without the assistance of the court. Section 64 of the Law which provides that an order for the appointment of a new trustee may be made on the application of any person beneficially interested in the property to which the trust relates.

23.2 Issues of mental capacity

From time to time, issues as to the mental capacity of the settlor and his or her true intentions in respect of distributions from Cayman Islands trusts may arise. This was the case in *In the matter of D.*[18] The family matriarch (Mrs D) had lost capacity and, as a consequence, a committee of guardians had been appointed by the Grand Court to look after her financial affairs. Before she lost capacity, Mrs D had entered into a settlement agreement with her family, which had the effect of ending lengthy and contentious litigation in Cayman and other jurisdictions through payments out of trusts settled by Mrs D. Flowing from that settlement agreement were questions raised by some of the parties as to whether they should be granted a tax indemnity as a consequence of the settlement. Two of the guardians applied to the Grand Court seeking directions to enter into an indemnity agreement on behalf of Mrs D despite the fact that the potential liability, under the proposed indemnity, would be met out of Mrs D's estate. The Grand Court found that it had jurisdiction to make such directions, particularly as they concerned the maintenance and benefit of Mrs D's immediate family.

17 *In the Matter of Various Trusts* (unreported, 22 February 2017).
18 [2009] CILR 432.

ENGLAND AND WALES

1. Are trusts legal and valid under domestic law? What are they principally used for?

A 'trust' has been defined as "*an equitable obligation, binding a person (who is called a trustee) to deal with property over which he has control (which is called the trust property) for the benefit of persons (who are called the beneficiaries or cestuis que trusts), of whom he may himself be one, and any one of whom may enforce the obligation*". (*Re Marshall's Will Trusts* [1945] Ch. 217, per Cohen J)

Trusts are legal and valid under English law (subject to the points made at 3. below in relation to illegal trusts and trusts against public policy).

Trusts occur in a wide variety of situations. They can be created by contract, by statute, or by operation of law. They are commonly used by charities, pension funds and private individuals. They are also used in commercial transactions, for instance to hold security for syndicated loans, or to subordinate junior creditors on a winding-up of the borrower, and for financial investments.

2. Are foreign trusts recognised under private international laws?

In general, yes. The UK is a signatory to The Hague Convention on the Law Applicable to Trusts and on their Recognition. This covers trusts created voluntarily and evidenced in writing.[1] Article 11 of the Convention provides that a trust created in accordance with the law specified by Chapter II of the Convention as governing the trust shall be recognised as a trust. The Convention has been enacted into English law by the Recognition of Trusts Act 1987, which also extends recognition to oral trusts of property governed by English law, and to trusts arising by virtue of a judicial decision.[2] Where the Convention does not apply, the foreign trust may still be recognised under the common law.

3. Are there any prohibitions against trusts?

There are no prohibitions against trusts per se. However, if a trust is formed for a purpose which is unlawful or against public policy, it may be void or unenforceable.

4. Are trusts and service providers regulated?

Many of the areas in which trusts are used are regulated, such as charities, pensions and investments. Her Majesty's Revenue and Customs (HMRC) maintains a register of the beneficial owners of taxable relevant trusts.[3]

A relevant trust is a UK express trust or a non-UK express trust which receives income from or has assets in the UK.[4]

HMRC are also the supervisory authority for trust service providers which are not supervised by the FCA or certain other professional bodies. The FCA maintains a register of authorised persons who have given notification that they are acting

1 Article 3.
2 Section 1(2), Recognition of Trusts Act 1987.
3 Regulation 45, Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 / 692.
4 Regulation 42, Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 / 692.
5 Regulation 7(c)(iii), Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 / 692.

as a trust service provider. HMRC maintains a register of professional trust service providers who are not included on the FCA's register.[6] A relevant person who is not included on the register must not act as a trust service provider.[7]

5. Can the following become insolvent and subject to insolvency procedures?

5.1 A trust itself

As defined above, trusts are not legal entities under English law. Consequently, they cannot become 'insolvent' and they are not, per se, subject to insolvency procedures. However:

- a trustee could have rights against the property making up the trust fund (such as under a right of indemnity) which may exceed the value of the trust fund; and
- a 'winding-up procedure' may be set out in the trust deed itself, setting out how trust assets may be distributed.

5.2 A settlor

A settlor can, in principle, become insolvent or subject to insolvency proceedings in England and Wales before or after the creation of the trust. In practice, it would depend on the legal nature of the settlor and its location.

5.3 A trustee

A trustee can, in principle, become insolvent and subject to insolvency procedures in England and Wales whilst a trustee or after ceasing to be a trustee. In practice, it would depend on the legal nature of the trustee and its location.

5.4 A beneficiary

A beneficiary can, in principle, become insolvent and subject to insolvency procedures in England and Wales whilst a beneficiary or after ceasing to be a beneficiary. In practice, it would depend on the legal nature of the beneficiary and its location.

5.5 A protector

A protector can, in principle, become insolvent and subject to insolvency procedures in England and Wales. In practice, it would depend on the legal nature of the protector and its location.

6. Do you distinguish between claims made against each of the parties stated in section 5 in respect of their obligations in acting for or in relation to the trust and, on the other hand, obligations incurred privately and personally?

No (see section 19 below), although creditors of a trustee in relation to debts incurred for the purposes of the trust may have certain subrogation rights not available to other creditors (see section 14 below).

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6 Regulation 54, Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 / 692.

7 Regulation 56(1), Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 / 692.

7. What are the main insolvency procedures that could be relevant?

Liquidation, administration, schemes of arrangement (although these are not solely used in the context of insolvency) and company voluntary arrangements (for companies) and bankruptcy and individual voluntary arrangements (for individuals).

8. What is the effect of bankruptcy on the following?

8.1 A trust

As explained above, trusts are not legal entities. Consequently, they cannot become 'insolvent' and they are not, per se, subject to insolvency procedures.

8.2 A settlor

Following the entry of the settlor into insolvency proceedings, the settlor's assets vest in or fall under the control of the insolvency practitioner appointed as trustee / administrator / liquidator. As such, the settlor would be unable to make a declaration of trust after insolvency proceedings have begun in respect of assets acquired before the insolvency proceedings. If the settlor was insolvent at the time of the declaration of trust (or as a result of the declaration of trust) then the declaration may be set aside as a transaction at an undervalue if the settlor subsequently becomes subject to insolvency proceedings.[8]

8.3 A trustee

The bankruptcy or liquidation of a trustee does not automatically disqualify the trustee from being a trustee per se, unless there is an express provision to that effect in the trust deed. However, insolvency could make the trustee vulnerable to being removed, by a person who has power to do so under the Trust Deed or by the Court.[9] In particular, the Court may remove the trustee if he or she has to receive or deal with trust funds so that they cannot be misappropriated.[10]

Although the trustee is the legal owner of the trust fund, in relation to private individuals the trust fund does not become part of the trustee's bankruptcy estate (section 283(3) of the Insolvency Act 1986). Similarly, the powers of the trustee (if an individual) do not vest in the trustee in bankruptcy.[11] Notwithstanding this, however, the trustee in bankruptcy can disclaim onerous trust property.[12] Also note that when a trustee (who is an individual) is discharged from bankruptcy, this will include a release from any liability for breach of trust (except in relation to a fraudulent breach of trust).[13]

Where the trustee is a company, the powers of the trustee would be exercisable by the administrator or, it would appear, the liquidator of the company.[14] If an administrator or liquidator of a corporate trustee administers the property of the trustee held on trust, the Court has jurisdiction to make an order enabling them to be paid out of the trust property.[15]

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8 Sections 238 / 339, Insolvency Act 1986.
9 Section 36 and 41, Trustee Act 1925; *Re Henderson* [1940] Ch 764.
10 *Re Barker's Trusts* (1875) 1 ChD 43; *Re Adams' Trust* (1879) 12 ChD 634.
11 Section 283(4), Insolvency Act 1986.
12 *The Governors of St. Thomas's Hospital v Richardson* [1910] 1 KB 271.
13 Section 281(1) and (3), Insolvency Act 1986.
14 *Denny v Yeldon* [1995] 3 All ER 624; for liquidators see discussion at 22-018 to 22-019 of Lewin on Trusts.
15 *Re Berkeley Applegate (Investment Consultants) Ltd.* (No. 2) (1988) 4 BCC 279.

8.4 A beneficiary

Following a beneficiary becoming bankrupt, his / her assets vest in the trustee in bankruptcy, including any beneficial interest in a trust.[16]

8.5 A protector

Bankruptcy or liquidation does not automatically disqualify the protector from being a protector per se: this would depend on the terms of the trust deed. Note, however, that the Court has inherent jurisdiction to remove a protector in 'a proper case', such as where the protector is unsuitable to exercise the power in question.[17] The powers of the protector who is an individual would not vest in the trustee in bankruptcy.[18] The powers of a corporate protector, however, would be exercisable by its administrator or liquidator.[19]

9. Can an insolvency procedure extend to trust assets located in the local and foreign jurisdictions?

9.1 Local jurisdiction

As set out above:

(i) trusts are not subject to insolvency proceedings;

(ii) trust assets do not fall within the bankruptcy estate of the trustee; but

(iii) a beneficial interest in a trust would vest in the bankruptcy estate of a beneficiary.

9.2 Foreign jurisdictions

A bankrupt's property located in a foreign jurisdiction will still form part of the bankruptcy estate.[20] It therefore follows that under English law, a beneficiary's interest in trust assets located abroad would form part of the bankruptcy estate.

As set out above, the current position is determined by a combination of statute and common law.

10. Can trusts be challenged?

10.1 To obtain assets

Yes, for instance if the creation of the trust constituted a transaction at an undervalue (see 11 below).[21]

16 Sections 283 and 306, Insolvency Act 1986.
17 *Bridge Trustees Ltd v Noel Penny (Turbines) Ltd* [2008] EWHC 2054 (Ch).
18 Sections 283(4), 314(1), para 12 of Schedule 5, Insolvency Act 1986; *Wily v Burton* [1994] FCA 1146; Lewin on Trusts at 29-045, 29-087 to 29-088.
19 *Denny v Yeldon* [1995] 3 All ER 624; *Lewin on Trusts* at 29-090.
20 *Singh v The Official Receiver* [1997] BPIR 530.
21 Sections 238 / 339, Insolvency Act 1986.

10.2 To obtain information

The trust itself is not a legal entity, and so cannot be compelled to provide information. However, the trustee, beneficiary, settlor or protector could be required to provide information by an insolvency office holder in certain circumstances.[22]

10.3 To examine witnesses

The trust itself is not a legal entity, and so cannot be examined as a witness. However, the trustee, beneficiary, settlor or protector could be required to provide information (see 10.2 above).

11. On what grounds can a trust arrangement be challenged?

11.1 The settlor was insolvent when the trust was created or became insolvent as a result of creating it

Yes - this would be a transaction at an undervalue.[23]
If the settlor is a company, there is a defence to a transaction at an undervalue claim if it entered into the settlement in good faith and for the purposes of carrying on its business, and there were reasonable grounds for believing that the transaction would benefit the settlor.[24]

11.2 The settlor becomes insolvent

Depending on timing,[25] this could be challenged as a transaction at an undervalue.

11.3 The settlor lacked capacity or authority to create the trust

Depending on the circumstances, this may be a ground on which a trust can be challenged.

For instance, if the settlor is of unsound mind (and is not subject to an order under sections 16 and 18 of the Mental Capacity Act 2005 or a receiver under the Mental Health Act 1983) the settlement is void or, perhaps, voidable.[26] The mental capacity required in respect of an instrument varies with the circumstances of the transaction. Thus, at one extreme, if the subject matter and value of a gift are trivial in relation to the donor's other assets a low degree of understanding will suffice. But, at the other extreme, if its effect is to dispose of the donor's only asset of value and thus, for practical purposes, to pre-empt the devolution of his estate under his will or on his intestacy, then the degree of understanding required is as high as that required for a will, and the donor must understand the claims of all potential donees and the extent of the property to be disposed of.[27]

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22 Sections 236 / 366, Insolvency Act 1986.
23 Sections 238 / 339, Insolvency Act 1986.
24 Section 238 (5), Insolvency Act 1986.
25 i.e. up to 2 years before the onset of insolvency if the settlor is a company, or up to 5 years before the making of the bankruptcy application if an individual.
26 *Sutton v Sutton* [2009] EWHC 2576 (Ch).
27 *Re Beaney* [1978] 1 WLR 770.

If the settlement of the trust is for value, fair and *bona fide*, and the person who gave value had no notice of the lack of mental capacity at the time of execution, the settlement may be valid.[28]

If the settlor has been made subject to an order under sections 16 and 18 of the Mental Capacity Act 2005, the trust is probably void.[29]

If the settlor is a company, the validity of an act done by a company shall not be called into question on the ground of lack of capacity by reason of anything in the company's constitution.[30] Furthermore, in favour of a person dealing with a company in good faith, the power of the directors to bind the company, or authorise others to do so, is deemed to be free of any limitation under the company's constitution.[31] It would therefore be difficult to challenge the creation of the trust, unless the directors of the settlor did not have authority and the trustees acted in bad faith in accepting the trust property.[32]

11.4 The settlor lacked the capacity or authority to transfer the assets to the trustees

The position is the same is the same as stated in 11.3.

11.5 The assets were not validly transferred, or the transfer was not fully completed

Under the principle that equity will not perfect an imperfect gift, if the trustee to whom the trust assets were intended to be transferred by the settlor requires the Court to exercise its equitable jurisdiction to complete the transfer, the Court will not and the trust will not have come into effect.[33] However, if the trustees have acted to their detriment in reliance of the imperfect transfer, the settlor may be estopped from denying the transfer.[34]

11.6 The trust was not validly created

For an express trust to be valid, and for the Court to enforce it, there must be (i) an intention to create a trust (ii) certainty of subject matter and (iii) certainty of objects.[35]

11.7 The transfer could be subsequently set aside as void or voidable

The reasons that would make a transfer void or voidable are as follows:

11.7.1 Mistake

A trust created by a voluntary settlement may be rectified or rescinded for mistake. The mistake must be of sufficient gravity to make it unconscionable to leave it uncorrected.[36]

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28 *Price v Berrington* (1851) 3 Macnaghten & Gordon 486, *Elliot v Ince* (1857) 7 De Gex Macnaghten & Gordon 475; *Fehily v Atkinson* [2016] EWHC 3069 (Ch).
29 Re Walker [1905] 1 Ch. 160.
30 Section 39, Companies Act 2006.
31 Section 40, Companies Act 2006.
32 *MBF (1954) Ltd v Nuffield Nursing Homes Trust* [2001] All ER (D) 244 (Jul) in relation to gifts.
33 *Jones v Lock* (1865-66) LR 1 Ch App 25.
34 *Dillwyn v Llewlyn* (1862) 4 De GF&J 517; *Re Vandervell's Trusts* (No.2) [1974] Ch 269.
35 *Knight v Knight* (1840) 3 Beav. 148.
36 *Pitt v Holt* [2013] UKSC 26.

A trust created for value may be rectified if the document executed does not properly express the terms of the agreement.[37] It may also be rendered void by mistake at common law, but this is a difficult test to satisfy.[38]

11.7.2 If there was an undervalue

If the transfer of trust assets by the settlor was a transaction at an undervalue, the Court will make an order restoring the position to what it would have been if the settlor had not entered into the transaction.[39] There is a menu of orders which the Court can make to restore the position, including requiring the property to be transferred back to the settlor.[40]

If the settlor is a company, there is a defence to a transaction at an undervalue claim if it entered into the settlement in good faith and for the purposes of carrying on its business, and there were reasonable grounds for believing that the transaction would benefit the settlor.[41]

Transactions at an undervalue defrauding creditors may be set aside by the Court, irrespective of whether the settlor has entered into an insolvency process.[42] This could occur where a settlor transfers assets to a trust for no consideration (or for consideration which is significantly less than the value of the assets) for the purpose of putting them beyond the reach of creditors. In such circumstances, the transfer is voidable (rather than void). There is protection, however, for innocent third parties acting in good faith for value.[43]

11.7.3 If there was a preference

If the transfer by the settlor was a preference, the Court will make an order restoring the position to what it would have been if the settlor had not given the preference.[44] There are a menu of orders which the Court can make to restore the position, including requiring the property to be transferred back to the settlor.[45]

11.7.4 If there was a sham

If a trust is a sham, the parties will not be able to rely on it as representing the true position as to the rights and obligations they have created, and the Court can ignore it in determining what those rights are.[46] However, parties may be estopped from relying on the trust being a sham if this would prejudice third parties who have relied on the trust being valid. The Court may find that the trustee holds the trust fund on trust for the settlor rather than for the purported beneficiaries.[47]

37 *Hanley v Pearson* (1879) 13 ChD 545.
38 *Great Peace Shipping Ltd v Tsavliris Salvage (International) Ltd* [2002] EWCA Civ 1407.
39 Sections 238(3) and 339(2), Insolvency Act 1986.
40 Sections 241 and 342, Insolvency Act 1986.
41 Section 238(5), Insolvency Act 1986.
42 Section 423, Insolvency Act 1986.
43 Section 425(2), Insolvency Act 1986.
44 Sections 239(3) and 340(2), Insolvency Act 1986.
45 Sections 241 and 342, Insolvency Act 1986.
46 *Re Yates (A Bankrupt)* [2004] EWHC 3448 (Ch).
47 *Minwalla v Minwalla* [2004] EWHC 2823 (Fam).

11.8 Any other grounds

Under section 357 of the Insolvency Act 1986, a bankrupt settlor commits an offence if they make any gift or transfer of property in the period of five years leading up to the bankruptcy. The settlor would have a defence if they had no intent to defraud.[48]

In the context of inheritance, a challenge to a settlement may be made under section 10 or 11 of the Inheritance (Provision for Family and Dependants) Act 1975, and in the context of divorce, under section 37 of the Matrimonial Causes Act 1973.

12. What protections and defences exist to protect those listed in section 5 and are they statutory or common law or otherwise?

See under each relevant heading of section 11 above.

13. Can claims be made in a bankruptcy where the IP stands in the shoes of a bankrupt to exercise the rights given by the trust in favour of the following parties?

The parties referred to are the settlor, a trustee, a beneficiary and a protector.

Where a trustee (who is an individual) has been made bankrupt the beneficiary would not need to make a claim in respect of trust assets, as the trust fund would not form part of the bankruptcy estate. Similarly, the powers of the trustee do not vest in the trustee in bankruptcy, so a claim in relation to the exercise of powers would not be made in the bankruptcy.[49] Where the trustee is a company, by contrast, the powers of the trustee would be exercisable by the administrator or, it would appear, the liquidator of the company.[50]

Co-trustees, or (with leave of the Court) a beneficiary, would be entitled to prove in the estate of the bankrupt trustee in respect of breach of trust claims. It is thought that settlors and protectors would not be able to prove for breach of trust, as the trustee does not have a fiduciary relationship with them.[51] Where the bankrupt trustee is also a beneficiary, his or her interest can be used to satisfy the liability for breach of trust.[52]

14. Are rights of subrogation established by law?

Trustees are entitled to an indemnity against all costs, expenses and liabilities properly incurred in administering a trust and have a lien on the trust assets to secure such indemnity.[53]

48 Section 352 of the Insolvency Act 1986.
49 Section 283(4) of the Insolvency Act 1986.
50 *Denny v Yeldon* [1995] 3 All ER 624; for liquidators see discussion at 22-018 to 22-019 of *Lewin on Trusts*.
51 Lewin at 22-052 and 39-071, although footnote 255 points out that in certain circumstances the protector may be able to sue for breach of trust if the trustee fails to allow the protector to fulfil its duties under the trust.
52 *Chillingworth v Chambers* [1896] 1 Ch 685.
53 *Alsop Wilkinson (A Firm) v Neary* [1996] 1 WLR 1220 at 1224; section 31, Trustee Act 2000.

A creditor of the trustee, who has incurred the debt for the purposes of the trust, has no right against the trust, but does have a right to sue the trustee who has incurred the debt. If the trustee has a right of indemnity against the estate, the creditor is subrogated to that right, and for that purpose the creditor is allowed to intervene. The creditor may sue the trustee and may claim the benefit of the indemnity and lien to which the trustee is entitled out of the estate.[54]

15. Can the veil of a company owned by a trust be pierced or lifted and, if so, in what circumstances?

A trust itself cannot own anything (including a company), as it is not an entity under English law.

16. Can the veil of a trust be pierced or lifted and, if so, in what circumstances?

We are not aware of any cases where a Court has pierced the veil of a trust so as to enable a creditor of the settlor to have recourse against the assets of a valid trust.[55]

17. If a trust can be treated as insolvent, is this on the basis of the cash flow test, the balance sheet test or another test and, if so, what test?

The trust itself cannot be insolvent under the Insolvency Act 1986.

18. Can or have receivers been appointed to act as a trustee or with powers over trust assets? If so, in what circumstances?

An administrative receiver of a corporate trustee cannot exercise the powers of the trustee.[56]

If the terms of the trust permit the trustee to create security over trust assets, then the chargee may be able to appoint a receiver over such assets. However, the receiver would not act as trustee.

19. Are claims against trustees limited or unlimited? If limited, are they limited as to amount and by time? Do underlying companies have a role?

A trustee will be personally liable to the full extent of his or her own wealth unless in the contract with the creditor there was a provision which limited their liability.[57] Such a contractual provision could be, for example, that the trustee will only be liable to the extent that there are trust assets out of which the trustee can be indemnified.

20. Are there provisions or cases where trusts, or those connected to them, are based in a foreign jurisdiction?

The Court has an inherent jurisdiction to remove a trustee, even of a foreign trust where the trust funds are outside of England and Wales and the trustees are not English.[58]

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54 *Re Frith* [1902] 1 Ch 342; *re Raybould* [1900] 1 Ch 199; ex p. *Garland* (1804) 10 Ves.110.
55 *Re Abacus* (CI) Ltd (trustee of the Esteem Settlement) [2003] JRC 092 at [74] and [104]; although see *Dadourian Group International Inc v Azuri Limited* [2005] EWHC 1768 (Ch).
56 *Buckley v Hudson Forge Ltd [1999] Pens*. LR 151.
57 *Muir v City of Glasgow Bank* (1879) 4 App Cas 337.
58 *Chellaram v Chellaram* [1985] Ch 409.

21. What are the main means to seek assistance from another jurisdiction?

In terms of obtaining recognition for an English insolvency practitioner as trustee in bankruptcy, liquidator or administrator of the trustee, this very much depends on the other jurisdiction.

If the jurisdiction is in the European Union (other than Denmark), recognition can be sought under the recast Insolvency Regulation.

If the jurisdiction has adopted it, recognition can be sought under the UNCITRAL Model Law on Cross-Border Insolvency.

22. What is the position as to whether the foreign jurisdiction does or does not recognise trusts?

Recognition of an English trust in a foreign jurisdiction would be a matter of local law. The significance of the issue of recognition may depend on the relief sought by the English insolvency practitioner.

23. What particular issues, difficulties and solutions have arisen or may arise relating to trust arrangements or those involved with them?

As trust assets are beneficially held, creditors of the trustee (who has incurred such debts for the purposes of the trust) cannot realise trust assets directly. As discussed above, they may be subrogated to the trustee's right of indemnity, but if this right has not arisen or been lost (e.g. due to the actions of the trustee), the creditors will similarly not have the right.[59]

Issues may arise where a trustee converts trust property into property of another character, or mixes it with other property, and then becomes insolvent. The beneficiaries of the trust will be able to trace into the new or mixed property. This proprietary interest precludes the property being distributed the ordinary unsecured creditors of the trustee.

59 *Re Frith* [1902] 1 Ch 342.

GUERNSEY, CHANNEL ISLANDS

1. Are trusts legal and valid under domestic law? What are they principally used for?

The Bailiwick of Guernsey lies west of the Cotentin peninsula of France and since separation from the old Duchy of Normandy and France in 1204 has maintained and developed a legal and political independence from both the continent and the United Kingdom. The roots of the legal system in the Bailiwick reflect the ancient 'customary' laws of the Duchy of Normandy such that even today Guernsey Advocates have to have regard to medieval Norman legal texts. This is particularly so in areas such as land law and inheritance with concepts that many English or Commonwealth lawyers would find quite alien and, in reverse, the concept of the "trust" was not believed to form part of our customary laws.

Trusts were first placed on a statutory footing in Guernsey in 1989 and the most recent trusts legislation was the Trusts (Guernsey) Law 2007 (the Trusts Law). It has been held that as England is the origin of trust law that the Guernsey courts should look to the decisions of the English courts for help in finding solutions to issues not covered by local statute or customary law.[1] The Guernsey courts will also look for guidance to decisions of the Jersey courts and other Commonwealth jurisdictions.

In common with other international finance centres, Guernsey law trusts are encountered in a wide variety of situations. They are most commonly used in relation to personal wealth planning to hold and enhance family wealth including personal and business assets. In addition to wealth preservation (providing protection against asset loss through forced heirship / succession issues or divorce) they are increasingly used in a commercial context for property and investment holding, security arrangements, voting control arrangements, unit trusts and collective investment schemes. Guernsey has developed over a number of years a strong reputation in the fields of pension and employee benefit schemes where trusts form an integral part of the product provided.

2. Are foreign trusts recognised under the private international laws?

Yes. Foreign trusts are regarded as being governed by and interpreted in accordance with their proper law.[2] A foreign law trust is, though, unenforceable to the extent that;

(a) it purports to do anything contrary to the law of Guernsey,

(b) it confers or imposes any right or function the exercise or discharge of which would be contrary to the law of Guernsey, or

(c) the Royal Court declares that it is immoral or contrary to public policy.

The Royal Court may exercise jurisdiction over foreign trusts albeit that some provisions of the Trusts Law apply only to Guernsey law trusts, some apply only to foreign law trusts and some apply generally to both Guernsey and foreign law trusts.

The provisions of The Hague Convention on the Law Applicable to Trusts and on Their Recognition have been extended to Guernsey.

1 *Spread Trustee Co Ltd v Hutcheson* [2011] UKPC 13, 15 June 2011.
2 Section 65, Trusts Law.

3. Are there any prohibitions against trusts?

No.

4. Are trusts and service providers regulated?

Trusts are not regulated in Guernsey. However, professional trustees or corporate service providers do need to be licensed by the Guernsey Financial Services Commission. Most commonly this requirement arises under the Regulation of Fiduciaries, Administration Businesses and Company Directors, etc (Bailiwick of Guernsey) Law 2000. Regulated persons and entities are subject to the restrictions and requirements under various laws, orders and codes of conduct.

5. Can the following become insolvent and subject to insolvency procedures?

5.1 A trust itself

No. A trust is only a relationship and does not, of itself, have legal personality.

The label of an "insolvent trust" is often used but merely as a useful label as a trust cannot be insolvent. A term gaining increasing popularity to recognise this legal issue is that of the "dry trust". The courts in Guernsey have yet to deal with any such case concerning a Guernsey law trust but it is considered likely that they would follow the course taken by their neighbours in Jersey adopting the approach taken there in *Crill v. Alpha Asset Finance Ltd*[3] and then *the Z Trusts*.[4]

5.2 A settlor

Yes. The determination of insolvency, though, may well be one for the jurisdiction and legal nature of the settlor.

5.3 A trustee, a beneficiary and a protector

All three parties can become insolvent and be subject to insolvency proceedings.

It should be noted however, that the term "Protector" is one arising from the terms of the trust deed and is not a creature of statute as such under Guernsey law.

6. Do you distinguish between claims made against each of the parties below in respect of their obligations in acting for or in relation to the trust and, on the other hand, obligations incurred privately and personally?

A claim cannot be brought against a trust itself as it has no legal personality. However, claims brought against settlors, trustees and so forth may be brought against them in their own name or in their capacity relating to the trust. For example, claims against a trustee may be brought against them in their own name putting at risk their own personal assets and not those of the trust. Conversely a claim may be brought against them in their capacity as trustee in which case enforcement would be against the assets of that particular trust. A trustee, protector or other trust "official" may have a right to an indemnity or recourse to reimburse themselves from the

3 2009 JLR N8, 2009 JRC 040.
4 2015 JRC 214, 2015 JRC 196C and 2015 JRC 031.

assets of a trust in relation to trust-related claims brought against them personally. Such indemnity is often subject to the terms of the trust.

7. What are the main insolvency procedures that could be relevant?

The main Guernsey insolvency procedures with respect to companies and individuals are stated below.

7.1 Companies

- A winding up under the Companies (Guernsey) Law 2008 (as amended) – either voluntary or compulsory by order of the Royal Court; or
- Administration

7.2 Individuals

- A declaration of being "*en etat en désastre*" which allows all the creditors to share the proceeds of sale of a debtor's chattels, as opposed to a single creditor liquidating assets entirely for their benefit. This is not the equivalent of an English bankruptcy order.
- A declaration of insolvency has been made under the *Loi ayant* rapport aux *Débiteurs et à la Renonciation*, 1929.

8. What is the effect of bankruptcy?

8.1 Generally

As noted above there is no equivalent in Guernsey to bankruptcy albeit that the corporate insolvency regime is similar to that of England and Wales.

The effect of a declaration *en désastre* is to deprive an insolvent debtor of the possession of his moveable and immoveable estate. The arresting creditor has responsibility for running the process which will include the appointment of a commissioner to assess each of the claims of the creditors and to rank them in priority. The conclusion of the proceedings does not constitute a discharge of the debtor's liabilities. Creditors may continue to pursue the debtor for the remainder of the debt should assets of the debtor appear after the initial *désastre*.

The effect of a winding up is that a liquidator will be appointed, and the status and capacity of the company continues until it is dissolved. No action can be brought or proceeded against the company without leave of the Court.

The effect of a bankruptcy on the following parties may be explained as follows:

8.2 A trust

A trust is not directly affected as it is not an entity.

8.3 A settlor

This will depend on what, if any, rights the settlor or the settlor's trustee in bankruptcy has against the trustees in respect of trust assets. These rights may be rights reserved to the settlor under the terms of the trust (for example, by way of a reserved power) or rights an insolvency office holder may have to claw back value following transactions at an undervalue, or for preferential payments or claims based on a Pauline action where there was an intention to defeat creditors.

8.4 A trustee

The insolvency of a trustee does not disqualify the trustee from continuing as a trustee unless the trust otherwise provides, although usually the trustee would resign or be removed by the court. There may also be a claim for a claw back into the insolvent estate on the basis of a transaction at an undervalue or for a preference.

The Trusts Law provides specific protection for the trust assets held by a trustee who becomes insolvent. Where a trustee becomes bankrupt, or upon his property becoming liable to arrest, *saisie* or similar process of law, his creditors have no recourse against the trust property except to the extent that the trustee himself has a claim against it or a beneficial interest in it.[5]

Assets can be held by a bankrupt person but found to be held on trust and not available to the creditors. This can apply to a claim against a trustee where the creditors cannot have recourse to the trust assets and where the principles of *Barclays Bank Ltd v. Quistclose Investments Ltd* are engaged.[6] These principles are recognised under Guernsey law.

8.5 A beneficiary

In addition to the effect described above, where a beneficiary is bankrupt, the Court may decide that it is not right for trustees to make a distribution to a beneficiary against his will where it will not benefit the bankrupt, for example, where any distribution would be very small in relation to the total debt owed to a creditor.

8.6 A protector

The same position as described in 8.4 above apply.

9. Can an insolvency procedure extend to trust assets located in local and / or foreign jurisdictions?

9.1 Local jurisdiction

As noted above, trusts are not themselves subject to insolvency procedures.

A foreign procedure may extend to trust assets located in the Bailiwick of Guernsey. The Royal Court may provide assistance to a foreign court or office holder (under a letter or request or applicable statutory means) in respect of certain prescribed

5 Section 74, Trusts Law.
6 [1970] AC 567 (HL).

jurisdictions and it will generally apply established principles of private international law. Under Section 14 of the Trusts Law, foreign laws and orders affecting such matters as the validity of a trust are always subject to Guernsey law without regard to private international law principles.

9.2 Foreign jurisdictions

This may require recognition abroad in order to be of any practical effect.

Established principles of private international law of that jurisdiction would normally apply.

For both 9.1 and 9.2 above this is governed by a mixture of statutory and common law.

10. Can trusts be challenged?

10.1 To obtain assets

Yes, this is possible and how this may be done is explained under sec. 11 below.

10.2 To obtain information

A trust itself cannot be ordered to provide information. However, the trustee, beneficiary, settlor or protector could be required to provide information by an insolvency office holder or by order of the Royal Court in certain circumstances.

10.3 To examine witnesses

The trust is not, itself, a legal person and cannot be examined. However, as noted at 10.2 above, the individuals concerned with the affairs of a trust may be subject to examination. There are various statutory avenues to secure this.

10.4 For any other purpose

Other remedies that may be sought in relation to trusts may concern the giving of accounts by trustees, injunctions, appointment and removal of trustees and the appointment of a receiver.

11. On what grounds can a trust arrangement be challenged?

11.1 The settlor was insolvent when the trust was created or became insolvent as a result of creating it

Where a trust is created in order to defeat existing creditors and possibly impending creditors, the court has power to set aside that arrangement based on a Pauline action.

The Court also has power to restore the position to prevent a wrongful preference under, for example, applicable provisions concerning corporate insolvency of the Companies (Guernsey) Law 2008 (as amended).

11.2 The settlor becomes insolvent

Where the transfer causes the insolvency the same position as explained in 11.1 apply.

11.3 The settlor lacked capacity or authority to create the trust

A settlor must have the legal capacity to act to create a trust and to transfer completely the assets to the trustees. Accordingly, for an individual, being of unsound mind or being a minor or suffering another legal impediment, may well invalidate a trust.

11.4 The settlor lacked capacity or authority to transfer the assets to the trustees

The same positions as stated in 11.3 apply.

11.5 The assets were not validly transferred, or the transfer was not fully completed

The trustees must have the assets fully vested in them or otherwise hold the assets. On the appointment or change of a trustee there is no automatic statutory vesting.

11.6 The trust was not validly created

The trust must be valid and be categorised as a true trust. There must be an intention to create the trust, certainty of subject matter and certainty of objects.

11.7 When can a transfer be subsequently set aside as void or voidable?

11.7.1 Mistake

The Royal Court may declare that a trust was established by mistake and is therefore invalid.[7]

11.7.2 If there was an undervalue

The Court has statutory power as indicated in 11.7.1 above to deal with a transaction at an undervalue where there has been a bankruptcy of the settlor.

11.7.3 If there was a preference

The position is the same as explained in 11.7.2 above.

11.7.4 If there was a sham

A sham requires a common intention on the part of a settlor and a trustee to give an effect to a transaction or arrangement different from the way it is described.

There have been no Guernsey decisions on the point but the view taken in this area by the English courts will be highly persuasive.[8]

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7 Section 11(2)(d)(i), Trusts Law.
8 E.g. as in the recent case of *SC Mezhdunarodniy Promyshlenniy Bank v Pugachev* [2017] EWHC 2426.

11.7.5 Any other grounds?

Under the Trusts Law, trusts are invalid where the Royal Court declares the trust was invalid, not only on the grounds of mistake but also by duress, fraud, undue influence, misrepresentation or breach of fiduciary duty or the trust was immoral or contrary to public policy or its terms are so uncertain as to make its performance impossible.[9]

12. What protections and defences exist to protect those listed at section 5 and are they statutory or common law or otherwise?

12.1 A trust

A trust cannot sue or be sued as it is not a legal entity.

12.2 A settlor

A settlor has no special protections / defences.

12.3 A trustee

A trustee, acting as a trustee, has a number of protections / defences under the Trusts Law.

There are various statutory provisions under the Trusts Law which may provide protections / defences for trustees but also limit potential exposure. A good example is the ability to seek directions from the Royal Court under section 69 of the Trusts Law in relation to proposed acts which will provide protection against a trustee for adverse claims arising from beneficiaries concerning such acts.

By way of further illustration of the protections available, an adult beneficiary in full knowledge of all material facts may relieve and indemnify a trustee from personal liability for breach of trust.[10]

In addition, the Royal Court has power to relieve a trustee for liability for breach of trust where it appears to the court that he has acted honestly and reasonably and ought fairly to be excused for the breach.[11]

Furthermore, where a trustee commits a breach of trust at the instigation or request or with the concurrence of a beneficiary, the Royal Court, whether or not the beneficiary is a minor or a person under legal disability, may impound all or part of his interest by way of indemnity to the trustee or a person claiming through him.[12]

In relation to dealings with third parties, in common with many other offshore jurisdictions, there has been a statutory modification of the general rule under English law. Section 42 of the Trusts Law states as follows.

9 Section 11(2), Trusts Law.
10 Section 40, Trusts Law.
11 Section 55, Trusts Law.
12 Section 56, Trusts Law.

"*42. (1) Subject to subsection (3), where, in a transaction or matter affecting a trust, a trustee informs a third party that he is acting as trustee or the third party is otherwise aware of the fact, the trustee does not incur any personal liability and a claim by the third party in respect of the transaction or matter extends only to the trust property.*

(2) If the trustee fails to inform the third party that he is acting as trustee and the third party is otherwise unaware of the fact –

(a) he incurs personal liability to the third party in respect of the transaction or matter, and

(b) he has a right of indemnity against the trust property in respect of his personal liability, unless he acted in breach of trust.

(3) Nothing in this section prejudices a trustee's liability for breach of trust or any claim for breach of warranty of authority.

(4) This section applies to a transaction notwithstanding the lex causae of the transaction, unless the terms of the transaction expressly provide to the contrary."

The effect of the similarly worded provisions of Jersey's trusts law has been considered by the Guernsey Royal Court, the Guernsey Court of Appeal and then the Privy Council in *Investec Trust (Guernsey) Limited v. Glenalla Properties Limited*.[13] This was not a decision concerning a Guernsey law trust, which is the reason Section 42 did not apply. However, in cases where Section 42 does apply, the case is likely to be highly persuasive as to the outcome where that section does apply.

The majority of the Privy Council, when considering the equivalent Jersey law provision, stated that the statutory limitation on the trustee's liability is achieved by treating the trustee as having two legally distinct capacities. The words limiting the creditor's claim neither cap the trustee's liability nor merely control execution of judgments. Rather, they describe the character of the claim (as being against the trustee in that capacity).

In summary the Privy Council held as follows:

1. The extent of the trustees' liability (as trustee) was governed by the proper law of the trust which includes the protection offered by that law (e.g. including section 42 if a Guernsey Law trust). Where the trustee transacts in a fiduciary capacity and the counterparty is aware of this, the latter's recourse is limited to the trust assets and cannot extend to the trustee's personal assets.

2. Creditors had no form of direct recourse to the trust assets. Rather their rights derive from subrogation to the trustee's rights of indemnity. One effect of this is that if the trustee loses its right of indemnity (perhaps as a result of a breach of trust) then there is no such right to which the creditor can be subrogated.

13 [2018] UKPC 7.

3. If debts are reasonably incurred by the trustees, resulting in indemnity rights being triggered, then the indemnity could not subsequently be lost, for example by an unreasonable failure to discharge those debts.

4. In addition to taking advantage of the provisions of Section 42, in any event a trustee could make use of contractual limited recourse provisions. Alternatively, the trustee can seek to avoid personal liability by entering obligations through an interposed underlying subsidiary with the benefit of limited liability.

A trustee may be protected where a claim is not pursued with reasonable diligence. The general prescription period for breach of trust is 3 years (with an 18 year long stop) and for tort and breach of contract, 6 years.

12.4 A beneficiary

There are no special protections / defences.

12.5 A protector

The position is the same as stated in 12.4 above.

13. Can claims be made in a bankruptcy where the insolvency office holder stands in the shoes of a bankrupt to exercise the rights given by the trust in favour of the following parties?

13.1 The settlor

Generally, an insolvency office holder will step into the shoes of the bankrupt with an ability to control and realise all assets and rights.

Generally, where a settlor has retained certain rights, perhaps in the trust instrument or in the transfer of assets to the trustees, the office holder will be able to exercise such rights in accordance with their terms.

13.2 A trustee

On the insolvency of a trustee, that insolvency will not extend to the assets of the trust and the insolvency office holder will not be able to use trust assets for the benefit of the creditors.

13.3 A beneficiary

Again, in principle, any rights held by a beneficiary can be exercised by the insolvency office holder.

13.4 A protector

On the insolvency of a protector, such powers may be exercisable by the insolvency office holder. However, the person having power to appoint or remove the protector would be likely to exercise those powers of appointment and removal.

In all such cases, directions can be sought from the Court under the Trusts Law.

14. Are rights of subrogation established by law?

A trustee has a right of indemnity from the trust assets to reimburse himself for his personal liability to a counterparty with whom he contracts as trustee.

The trustee will not be able to rely on his right of indemnity if he is in breach of trust (in which case it would not be available to the counterparty by way of subrogation). If the trustee fails to discharge the obligation to the counterparty then the counterparty is subrogated to the trustee's right of indemnity i.e. steps into the trustee's shoes.

It follows that the counterparty has no right of subrogation where the trustee has no right of indemnity. Following the Privy Council decision in *Glenalla*, the English position appears to be preserved, not modified, by Section 42 of the Trusts Law.

15. Can the veil of a company owned by a trust be pierced or lifted and, if so, in what circumstances?

General legal principles about corporate personality under Guernsey law are similar to those under English law. In other words, there is a strict veil drawn between a limited liability company and its shareholders meaning, for example, that shareholders are generally not liable for the debts of the company.

However, the corporate veil can be pierced by the Royal Court under customary law principles in limited and rare circumstances. There has been no decision in Guernsey since the UK Supreme Court judgments in *VTB Capital plc v Nutritek International Corp*,[14] and *Prest v Petrodel Resources Ltd*.[15] Those decisions are likely to be followed in Guernsey as English law principles are highly persuasive in this context.

16. Can the veil of a trust be pierced or lifted and, if so, in what circumstances?

No. A trust does not have separate legal personality.

17. If a trust can be treated as insolvent, is this on the basis of the cash flow test, the balance sheet test or another test and, if so, what test?

There are no decisions concerning Guernsey law relating to trusts that provide any guidance on this topic. It is believed that the Guernsey courts may adopt the approach taken by the Jersey Royal Court in the case of *Z Trust*.[16]

If the author's belief is correct that means the Guernsey courts will, therefore, assess insolvency in this context on a cash-flow basis.

14 2013 UK SC 5.
15 2013 UK SC 34.
16 2015(2) JLR 175.

18. Can or have receivers been appointed to act as a trustee or with powers over trust assets? If so, in what circumstances?

The Royal Court in the *Glenalla* case has appointed receivers over the assets of a trust in order to "hold the ring" pending appeal following judgment to the Court of Appeal. Hitherto it had been received wisdom that such appointments were not possible under customary law and, unfortunately, there is no written reasoned judgment available to provide any background or detailed rationale for the appointment.

19. Are claims against trustees limited or unlimited? If limited, are they limited as to amount and by time? Do underlying companies have a role?

Please see section 12 above in relation to the statutory provisions limiting claims.

In addition to deploying limited recourse provision in contracts, trustees will often seek to ensure that potential liabilities to third parties are limited through use of interposed limited liability companies in order to conduct transactions or hold assets. The use of such companies avoids the need for trustees to directly take on obligations personally. However, as in the *Glenalla* case, such protection may be lost where the underlying company lends to the trustees, the company become bankrupt and the insolvency office holder then claims against the trustees as borrowers from the company.

20. Are there provisions or cases where trusts, or those connected to them, are based in a foreign jurisdiction?

Under Section 4 of the Trusts Law the Royal Court has jurisdiction in relation to a trust where a trustee is resident in Guernsey, any property of the trust is situated or administered in Guernsey, or the terms of the trust provide that the Royal Court is to have jurisdiction. As indicated in section 2 above, certain provisions of the Trusts Law apply to foreign trusts, i.e. non-Guernsey trusts.

21. What are the main means to seek assistance from another jurisdiction?

A Guernsey appointed liquidator can seek to obtain recognition of his appointment and assistance from another jurisdiction. Recognition is sought ordinarily via a letter of request and the procedure will, of course, be subject to the recipient jurisdiction.

Guernsey is not part of the EU and, therefore, does not fall under the recast Insolvency Regulation.

22. What is the position as to whether the foreign jurisdiction does or does not recognise trusts?

The question of recognition of a Guernsey law trust is down to the local law of the foreign jurisdiction.

23. What particular issues, difficulties and solutions have arisen or may arise relating to trust arrangements or those involved with them?

Trusts have proved to be a very flexible and pragmatic means of handling assets especially in the context of private wealth. However, with the increasingly complicated way in which trust assets may have been leveraged to support commercial ventures and their exposure globally, trustees are now faced with having to consider carefully the various jurisdictions in which they may be dealing and not just focus upon the "home" jurisdiction of the trust.

Questions more commonly posed in the arena of corporate insolvency and cross-border recovery now feature prominently in the previously more genteel world of trust litigation with potentially serious problems for trusts and trustees. For example, Guernsey law caters specifically for a broad range of powers to be reserved to settlors or beneficiaries without in any way impacting upon the validity of the trust. This has been perceived to add a commercial advantage in terms of promoting the use of Guernsey law particularly to jurisdictions unfamiliar with the concept of trusts. However, decisions such as that delivered by the Privy Council Cayman in the TMSF case[17] demonstrate how the insolvency practitioner (in this case a trustee in bankruptcy) can assert ownership over such reserved powers (a power to revoke) and use them to bust open a trust.

The issue of "dry trusts" has been of increasing interest since the crash of 2008 which left trustees holding interests in many insolvent properties owning SPVs and holding themselves out of pocket for their fees whilst balancing demands from trust creditors. The topic is likely to see further judicial comment in the coming years particularly in relation to competing creditors' rights. The recent judgment of the Privy Council in the *Glenalla* case may only prove to be start of that jurisprudential journey.

17 *Tasarruf Mevduati Sigorta Fonu v Merrill Lynch Bank and Trust. Company (Cayman) Limited and others* [2011] UKPC.

HONG KONG

1. Are trusts legal and valid under domestic law? What are they principally used for?

Hong Kong was returned to the People's Republic of China in 1997 and by virtue of the Basic Law and the Hong Kong Reunification Ordinance (Cap 2601) adopted by the Hong Kong SAR's Legislature on 1 July 1997, the common law, rules of equity, ordinances, subsidiary legislation and customary law in force immediately before 1 July 1997 were adopted as laws of the Hong Kong Special Administrative Region.

Trusts are legal and valid under Hong Kong law. The law of trust continues to derive from common law, often looking to cases in the UK, which are no longer binding where arising after 1 July 1997, and other commonwealth countries, which in each case may be persuasive. Administration of trusts is also regulated in part by specific statutes.

Trusts are used for a variety of purposes in Hong Kong. The most popular trusts include occupational retirement schemes, corporate trusts (such as REITs and unit trusts), family trusts, as well as charitable trusts. They often feature in commercial transactions, such as to hold the benefit of interests in security or corporate bonds on behalf of multiple lenders.

Trusts may arise by contract, statute or operation of law.

2. Are foreign trusts recognised under private international laws?

Recognition of foreign trusts is governed by the Recognition of Trusts Ordinance (Cap 76), which was enacted on 30 June 1997 to enable certain articles of The Hague Convention on the Law Applicable to Trusts and on their Recognition (the Convention) to apply in Hong Kong.

Article 11 of the Convention (which has the force of law in Hong Kong by virtue of the Recognition of Trusts Ordinance) provides that a trust created in accordance with the law specified by Chapter II (Applicable Law) of the Convention shall be recognised as a trust in Hong Kong. The applicable law of a trust will be the law chosen by the settlor expressly or implied in the terms of the trust and, if necessary, in light of the circumstances of the trust. Where no law has been chosen or is implied at all, the trust will be governed by the law with which it is most closely connected.[1]

The Convention only applies to trusts created voluntarily and evidenced in writing.[2] Furthermore, Hong Kong courts remain free by virtue of Article 14 of the Convention to recognise foreign trusts on a more liberal basis than that required by the Convention.

3. Are there any prohibitions against trusts?

In general, a fully constituted trust with certainty of subject matter and object and intention to create a trust will be a valid trust. A trust that is illegal or contrary to public policy may be void or unenforceable and, generally, will not be assisted by the Hong Kong courts in its administration.[3]

1 Articles 6 and 7, Convention.
2 Article 3, Convention.
3 *Holman v Johnson* [1775-1802] All ER Rep 98.

A trust to defraud creditors, such as an outright sham trust, is likely to be void.

4. Are trusts and service providers regulated?

In addition to common law rules, ordinances have been enacted in Hong Kong to regulate the operation of trusts and their service providers. Ordinances of significance include the Trustee Ordinance (Cap 29), the Variation of Trusts Ordinance (Cap 253) and the Perpetuities and Accumulations Ordinance (Cap 257). Legislation for specific industry areas may also be relevant, such as the Occupational Retirement Schemes Ordinance (Cap 426).

The Trustee Ordinance regulates various aspects of trustees, such as their duties, liabilities and remuneration. In particular, Part 8 of the Trustee Ordinance regulates the registration and operation of trust companies. The Trustee Ordinance imposes a statutory duty in relation to certain trustee functions, for which the trustee must exercise care and skill that is reasonable in the circumstances, having regard to special knowledge / experience or professional capacity of that trustee.

Where the statutory duty applies, it will sit alongside trustee duties at common law (such as the duty to act in the best interests of beneficiaries). Professional trustees who are remunerated for their services cannot exclude or indemnify against liabilities for fraud, wilful misconduct or gross negligence.

The Variation of Trusts Ordinance gives the court the power to modify trust terms and even revoke trusts when necessary.

The rule against perpetuities which requires trusts in Hong Kong to run no more than 80 years no longer applies to any trust created on or after 1 December 2013 – any such trust may last for an unlimited period.

5. Can the following become insolvent and subject to insolvency procedures?

5.1 A trust itself

A trust is not a legal entity, so it cannot itself become insolvent or subject to insolvency procedures. Reference to an “insolvent trust” would be no more than to circumstances where there are insufficient trust assets to meet the liabilities incurred by the trustee in his capacity as such.

5.2 A settlor

A bankrupt individual or an insolvent company cannot become a settlor. By virtue of section 42 of the Bankruptcy Ordinance (Cap 6), where a person is adjudged bankrupt, any disposition of property by that person (which would include the setting up of a trust) after the commencement of the bankruptcy will be void. Similarly, any disposition of a company’s property made after the commencement of its winding up will be voidable pursuant to section 182 of the Companies Winding Up and Miscellaneous Provisions Ordinance (Cap 32) (CWUMPO).

A settlor can be adjudged bankrupt or become insolvent after the creation of a trust. For its effect, please see section 8 below.

5.3 A trustee

A trustee can, in principle, become bankrupt / insolvent and be subject to insolvency procedures whilst acting as a trustee or after ceasing to be a trustee. For its effect, please see section 8 below.

Although undesirable for an undischarged bankrupt to be appointed as trustee,[4] there is no express statutory prohibition of such an appointment in Hong Kong. Similarly, a corporate trust company in liquidation should not be appointed as trustee given that it will be dissolved upon completion of the winding up.

However, under section 101 of the Trustee Ordinance, a trust company cannot be wound up voluntarily without sanction of the court if any part of an estate in relation to which the trust company acts as trustee remains not administered.

5.4 A beneficiary

A beneficiary can be adjudged bankrupt or become insolvent whilst a beneficiary or after ceasing to be a beneficiary. For its effect, please see section 8 below.

5.5 A protector

A protector can be adjudged bankrupt or become insolvent and be subject to bankruptcy / insolvency procedures.

6. Do you distinguish between claims made against each of the parties in section 5 with respect of their obligations in acting for or in relation to the trust and, on the other hand, obligations incurred privately and personally?

In relation to trustees, where there is a breach of trust by the trustee which causes damage or loss to or of trust assets, both proprietary claims and personal claims against the trustee may be available to, for example, a beneficiary.

7. What are your main insolvency procedures that could be relevant?

7.1 Individuals

For individuals, bankruptcy procedures begin by a creditor filing with the court a bankruptcy petition against the individual, or by a debtor who is unable to repay his debts filing a bankruptcy petition against himself with the court. Once the court makes a bankruptcy order, no proceedings may commence or be continued against the debtor / bankrupt or his assets, unless with leave of the court.

Upon the making of the bankruptcy order, the Official Receiver becomes the provisional trustee. All assets belonging to the bankrupt vest automatically in the provisional trustee / trustee until the bankrupt's discharge from bankruptcy. The trustee has the power to take control of the assets of the bankrupt and administer them. Also, creditors of the bankrupt may submit proofs of debt to the provisional trustee / trustee in order to establish their claims.

4 *Re Barker's Trust* (1875) 1 Ch D 43.

7.2 Companies

For companies: members' voluntary liquidation, creditors' voluntary liquidation and compulsory liquidation.

The (provisional) liquidator of the company has a duty to administer the assets of the company, including investigating the company's affairs to identify and collect in the company's assets, as well as adjudicating the proofs of debt by creditors.

8. What is the effect of bankruptcy on the following?

8.1 A trust

A trust is not a legal entity so it cannot itself become insolvent or be subject to insolvency procedures.

8.2 A settlor

Any declaration of a trust by a corporate settlor in respect of its assets after insolvency proceedings have started will be void upon the making of a winding up order by the Hong Kong court (unless the court orders otherwise).

Pursuant to section 49 of the Bankruptcy Ordinance, if a natural person settlor is adjudged bankrupt, a trust may be set aside by the court by virtue of it being a transaction at an undervalue, if it was set up in the five years preceding the presentation of the bankruptcy petition on which the settlor is adjudged bankrupt.

Similarly, where the settlor is a body corporate, a trust may be set aside pursuant to section 265D of the CWUMPO.

Alternatively, pursuant to section 50 of the Bankruptcy Ordinance, a trust may be set aside for being an unfair preference if the beneficiary is a creditor, or a surety or a guarantor of the settlor's debts or other liabilities. The trust must have been set up in the two years preceding the presentation of the bankruptcy petition on which the settlor is adjudged bankrupt if the beneficiary is an associate of the settlor, or six months preceding such date if the beneficiary is not an associate. In addition, one would need to establish that the settlor had a desire to prefer the beneficiary (which will be presumed in the case of an associate); and that the settlor was bankrupt at the time of setting up the trust or became bankrupt in consequence of setting up the trust.

Where the settlor is a body corporate, broadly the same principles apply in setting aside the trust pursuant to section 266 of the CWUMPO.

8.3 A trustee

Bankruptcy or insolvency does not automatically disqualify a trustee from continuing to act as a trustee, unless so specified in the trust deed. However, a bankrupt or insolvent trustee may become unfit to act, and in such cases, section 37 of the Trustee Ordinance allows an out of court appointment of a new trustee in his place.

Further, under section 42 of the Trustee Ordinance, the court has the power to appoint a new trustee in substitution for a natural person trustee that has entered bankruptcy or a corporate trustee which is in liquidation, if it is expedient to do so and it is found inexpedient, difficult or impracticable so to do without the assistance of the court.

A trustee's bankruptcy does not affect trust assets held by him, as section 43(3) of the Bankruptcy Ordinance expressly excludes "property held by the bankrupt on trust for any other person" from the bankrupt's estate. The CWUMPO does not have a similar provision for corporate trustees, but section 264 of the CWUMPO provides that bankruptcy rules shall apply to the winding up of insolvent companies. As such, trust assets should be excluded from an insolvent company's own assets. In any case, at common law assets held by an insolvent company on trust for another person do not form part of the company's assets.

Liquidators will frequently undertake the task of distributing property of a company in liquidation held on trust for others but will be wary of liability for breach of duty in acting in respect of trust property. The Court may exercise its discretion to grant an order entitling the liquidator to be paid out of trust property for his work in administering that trust property.[5]

8.4 A beneficiary

If a natural person beneficiary becomes bankrupt, its assets (including interests held on trust for it) will vest in the trustee in bankruptcy and may be dealt with by the trustee in bankruptcy.[6]

8.5 A protector

The scope of the powers and rights of the protector will be set out in the trust deed. In the event that a protector is declared bankrupt / insolvent, the court would have to ascertain whether the continuance of the protector would be detrimental to the execution of the trust.[7]

9. Can an insolvency procedure extend to trust assets located in local and / or foreign jurisdictions?

9.1 Local jurisdiction

As discussed in section 8.3, trust assets held by the trustee do not form part of the trustee's own assets and are therefore unavailable for distribution to the general creditors of the trustee upon his bankruptcy or its insolvency.

9.2 Foreign jurisdictions

Pursuant to Article 11 of the Convention (which has the force of law in Hong Kong by virtue of the Recognition of Trusts Ordinance), as long as a trust is created in accordance with its applicable law, the trust will be recognised in Hong Kong and, in so far as the law applicable to the trust requires or provides, such recognition will

5 *Re Berkeley Applegate (Investment Consultants) Ltd. (No. 2)* (1988) 4 BCC 279.
6 See sections 58 and 60, Bankruptcy Ordinance.
7 *Letterstedt v Broers* [1884] UKPC 1; (1884) 9 App Cas 371 (PC).

imply (among other things) that (a) personal creditors of the trustee have no recourse against the trust assets; and (b) the trust assets do not form part of the trustee's estate upon its insolvency or his bankruptcy.

A bankrupt's beneficial interest in trust assets located abroad should generally form part of the bankrupt's estate and vest in the trustee in bankruptcy. However, section 55 of the Bankruptcy Ordinance, which requires the bankrupt to join in selling property out of Hong Kong for the benefit of creditors, recognises that the vesting provisions of that Ordinance may not effect a change in the foreign register of title.

10. Can trusts be challenged?

10.1 To obtain assets

Subject to any defences available to the settlor, a trust could be challenged if the creation of the trust involved mistake, was contrary to public policy, constituted an undervalue transaction or an unfair preference, or was formed for an illegal purpose (for example to defraud creditors). Potential defences include, for example, that an undervalue transaction was entered into by a company in good faith and for the purpose of carrying on its business, and there were reasonable grounds for believing that the transaction would benefit the company.

10.2 To obtain information; to examine witnesses; for any other purpose?

As it is not a legal entity, a trust itself cannot be compelled to provide information.

A trustee, beneficiary, settlor or protector could be required by an insolvency office holder to provide information in certain circumstances.

The English High Court found in *JSC Mezhdunarodniy Promyshlenniy Bank v Pugachev* (*JSC Mezhdunarodniy*),[8] that it has the jurisdiction to make a freezing order that also carries with it the power to make whatever ancillary orders are necessary to make the freezing order effective. In that case, the freezing order included a further order that required the defendant to provide further information about the trust, the identity of the trustees and beneficiaries and the details of the trust assets.

The *JSC Mezhdunarodniy* case may be persuasive in Hong Kong should a similar issue arise for determination in the Hong Kong courts.

11. On what grounds can a trust arrangement be challenged?

11.1 The settlor was insolvent when the trust was created or became insolvent as a result of creating it

By virtue of section 42 of the Bankruptcy Ordinance, where a person is adjudged bankrupt, any subsequent disposition of property by that person (which would include the setting up of a trust) would be void. Similarly, any disposition of a company's property made after the commencement of its winding up will be voidable pursuant to section 182 of the CWUMPO. See also comments at section 5.2.

8 [2016] 1WLR 160 (CA); See also [2015] WTLR 1759 (CA) and [2017] EWHC 2426 (CH).

In the case of a corporate settlor, the court may not set aside an undervalue transaction if it is satisfied that the company entered into the transaction in good faith and for the purpose of carrying on its business, and at the time it did so, there were reasonable grounds for believing that the transaction would benefit the company.

11.2 The settlor becomes insolvent

See comments at section 8.2.

11.3 The settlor lacked capacity or authority to create the trust

A settlor must be competent to create a valid trust. A trust arrangement made by a minor may be voidable. A trust arrangement made by a person who is mentally incapable of understanding the arrangement is also generally void or voidable, but it may be valid if the settlement is fair and *bona fide* and the person gave value for the settlement with no notice of such mental incapacity.

11.4 The settlor lacked capacity or authority to transfer the assets to the trustees

A settlor must have ownership of the assets before he can transfer them on trust.

11.5 The assets were not validly transferred, or the transfer was not fully completed

Following the common law rule, an express trust must be completely constituted for it to be valid in Hong Kong. If the assets are not validly transferred or the transfer is not fully completed, the trust is unenforceable.

11.6 The trust was not validly created

If a trust is set up for illegal purposes, it is not validly created and could be challenged. See section 3 for details.

11.7 The transfer could be subsequently set aside as void or voidable

The reasons may be stated as explained below.

11.7.1 Mistake

Where the mistake has impacted the effect of the transaction itself, the trust may be revoked.[9]

11.7.2 If there was an undervalue

Pursuant to section 49 of the Bankruptcy Ordinance, if a natural person settlor is adjudged bankrupt, the trust may be set aside by the court by virtue of it being a transaction at an undervalue, if it was set up in the five years preceding the presentation of the bankruptcy petition on which the settlor is adjudged bankrupt.

Similarly, where the settlor is a body corporate, the trust could be set aside pursuant to section 265D of the CWUMPO (but see potential defence noted in section 10.1).

9 *Allcard v Skinner* (1887) 36 ChD 145.

11.7.3 If there was a preference

Pursuant to section 50 of the Bankruptcy Ordinance, the trust may be set aside for being an unfair preference if it was set up anytime in the two years preceding the presentation of the bankruptcy petition on which the settlor is adjudged bankrupt if the beneficiary is an associate of the settlor, or six months preceding such date if the beneficiary is not an associate.

Similarly, where the settlor is a body corporate, the same principles apply pursuant to section 266 of the CWUMPO.

11.7.4 If there was a sham

The sham "trust" would be treated as never having been created and the assets purportedly the subject of the "trust" may be treated as belonging to the settlor, although if there are third parties who have relied in good faith on the purported trust arrangements a settlor may be estopped from recovering the trust property.

11.7. 5 Any other grounds

A trust may be set aside where there was misrepresentation (*Re Glubb*)[10] or undue influence (*Barclays Bank plc v O'Brien*)[11] involved in the setting up of the trust.

According to section 60 of the Conveyancing and Property Ordinance (Cap 219), a disposition of property made with intent to defraud creditors is voidable at the instance of any person thereby prejudiced. Therefore where a trust is set up by a settlor with the intent to defraud creditors, the trust arrangement can be challenged and set aside.

12. What protections and defences exist to protect those listed at 5 and are they statutory or common law or otherwise?

To protect the validity of the trust, the settlor needs to have the capacity to set up the trust and the "three certainties" of a trust (subject matter, object and intent) have to be present. Also, the establishment of the trust must not involve mistake, an undervalue transaction or unfair preference or be against public policy or for an illegal purpose (as mentioned above).

In relation to the protection of beneficiaries, trustees must comply with their fiduciary duties (e.g. no conflict and no profit) owed to the beneficiaries. Further, section 41W of the Trustee Ordinance prohibits exemptions for professional trustees for liability based on fraud, wilful misconduct and gross negligence.

10 [1900] 1 Ch. 354.
11 [1994] 1 AC 180.

13. Can claims be made in a bankruptcy where the IP stands in the shoes of a bankrupt to exercise the rights given by the trust in favour of the following parties?

13.1 The settlor

Where a settlor is adjudged bankrupt, a trust that prejudices the creditors may be voidable. There are statutory provisions that empower the court to set aside trusts that were designed to facilitate undervalue transactions or to provide unfair preference to particular creditors (sections 49 and 50, Bankruptcy Ordinance). (See also section 8.2)

13.2 A trustee

Trust property held by a trustee adjudged bankrupt or in liquidation would not be part of the trustee's estate and would not be available to repay the general creditors of the trustee.

However, if the trustee is owed monies due to the trustee's management of the trust, the trustee's creditors may be entitled to claim against the trust property to the extent of the trustee's indemnity; and a liability for breach of trust by a trustee is capable of proof in a bankruptcy or winding up.

Where the trustee is a company, the powers of the trustee may be exercisable by the liquidator of the company.[12] A bankrupt trustee may continue to act until removed or replaced.

13.3 A beneficiary

Where a beneficiary is adjudged bankrupt, the beneficiary's interest under the trust would be vested in the bankruptcy trustee. The bankruptcy trustee could then realise the beneficial interest and distribute the proceeds to the creditors of the bankrupt beneficiary. A corporate beneficiary's assets do not automatically vest in its liquidator but would be recoverable for realisation and their proceeds distributable to its creditors.

13.4 A protector

Protectors may not be able to prove for breach of trust, on the basis that the trustee will generally not have a fiduciary relationship with them. A protector may have a right of indemnity in respect of costs incurred in discharging any fiduciary function in connection with the trust and accordingly a bankrupt or insolvent protector's creditors may seek to claim against trust property to the extent of any such right of indemnity.

14. Are rights of subrogation established by law?

The right of subrogation is available as an equitable remedy. If a creditor is entitled to claim directly against a trustee, the creditor may be able to claim the benefit of the trustee's right of indemnity out of the trust assets.

12 *Re Berkeley Applegate (Investment Consultants) Ltd*. (No. 2) (1988) 4 BCC 279.

15. Can the veil of a company owned by a trust be pierced or lifted and, if so, in what circumstances?

A trust is not a legal entity and cannot itself own anything.

The UK Supreme Court held in *Petrodel v Prest*[13] that the corporate veil could be pierced when the purpose of a company is to conceal assets, evade legal obligations or to frustrate enforcement (the principle is a limited one and the court will only use it in exceptional circumstances). The Hong Kong courts have followed *Petrodel*.[14]

16. Can the veil of a trust be pierced or lifted and, if so, in what circumstances?

We are not aware of any Hong Kong precedent on this point.

17. If a trust can be treated as insolvent, is this on the basis of the cash flow test, the balance sheet test or another rest and, if so, what test?

A trust cannot itself be insolvent.

18. Can or have receivers been appointed to act as a trustee or with powers over trust assets? If so, in what circumstances?

Appointment of receivers is specifically provided for under section 21L of the High Court Ordinance (Cap 4) in all cases in which it appears to the Hong Kong court to be just or convenient to do so.

Hong Kong courts have allowed the appointment of receivers of trust property in *Employees for whom Zhang Caikui*[15] *is holding shares in China Shanshui Investment Co Ltd v Zhang Caikui.* In this case, the court applied the Australian case of *Yunghanns v Candoora No 19 Pty Ltd (No2)*[16] and held that when it comes to appointing receivers of trust property, the freedom of settlors to choose their trustees needs to be taken into account. However, a receiver of trust property would be appointed where it is necessary for the proper administration of the trust. Strong grounds are generally required in order to justify such appointment, which include, without limitation, scenarios as stated below:

(i) the security of the trust property is in jeopardy, such as where the affairs of the trust are in disorder and the appointment is necessary to secure continuity of management;

(ii) the trustees deny or dispute the trust;

(iii) where the trustee is guilty of conduct that endangers the property; or

(iv) where the trustee is of such character as is likely to lead to the jeopardy of trust property (which involves a qualitative judgment).

13 [2013] UKSC 34.
14 See for example *SLA v HKL* (FCMC 75000 / 2010).
15 [2017] 5 HKLRD 240.
16 (2000) 35 ACSR 34.

Although the court appointed a receiver over trust assets in that case, it also made a note that it was a "drastic remedy of last resort", and the court would not normally do so "if there was a less invasive form of protection".

19. Are claims against trustees limited or unlimited? If limited, are they limited as to amount and by time? Do underlying companies have a role?

The personal liabilities of trustees are generally unlimited unless the contrary is agreed in the trust instrument.

The liability for breaches of trust by the trustee cannot, in general, be excluded by exemption clauses in trust instruments. However, exemptions from liability for unintentional and honest breaches of trust may be valid and effective.

However, the liability of professional trustees who receive remuneration for providing trust services must not be excluded if the breach of trust arises from the professional trustee's own fraud, wilful misconduct or gross negligence, as expressly set out in section 41W of the Trustee Ordinance.

Section 60 of the Trustee Ordinance provides that where a trustee has acted honestly and reasonably and ought fairly to be excused for his breach of trust, then the court may relieve him wholly or partly from personal liability for such breach.

20. Are there provisions or cases where trusts, or those connected to them, are based in a foreign jurisdiction?

China Shanshui Investment Co Ltd v Zhang Caikui[17] concerned two discretionary trusts governed by the laws of the British Virgin Islands.

Def Foundation Inc & others v Estate of Chang Yin Ching (deceased) & Others[18] is a case where both Canadian and Hong Kong proceedings were commenced in relation to certain trust issues relating to several Canadian residents. By reason of sufficient connection to Hong Kong, the Hong Kong (first instance) court found that it was an appropriate forum.

21. What are the main means to seek assistance from another jurisdiction?

It is common for letters of request to be issued to foreign courts to seek their judicial assistance.

22. What is the position as to whether the foreign jurisdiction does or does not recognise trusts?

This would depend on the private international law of the foreign jurisdiction.

17 Ibid.
18 [2001] HKEC 1371.

23. What particular issues, difficulties and solutions have arisen or may arise relating to trust arrangements or those involved with them?

In insolvency proceedings for substantial corporate groups operating globally and providing brokerage services, a significant factor contributing to the complexity may be that group entities hold segregated assets (principally securities and funds) for their clients, who may be individuals or entities within or outside the debtor group.

Liquidators of certain Lehman Brothers entities in Hong Kong sought permission from the Hong Kong court (and were granted the application) to impose a "bar date" for third parties to claim the client assets held by or to the order of those entities. The application was an important step in the liquidators' plans to distribute the client assets, by defining the universe of claimants.

The learned Judge in that case was satisfied that, to the extent the relevant entities held client assets, they did so on trust. The jurisdictional basis for imposing a "bar date" is to be found in section 29 of the Trustee Ordinance, which broadly allows a trustee to obtain protection when distributing assets held on trust, by means of prior notice inviting potential beneficiaries to make claims by a specified time, after which the trustee may distribute the trust assets to claimants "*having regard only to the claims, whether formal or not, of which [the trustee] then [the time of distribution] had notice*".

Most cases in which section 29 of the Trustee Ordinance (or its equivalent in other common law jurisdictions) had previously been invoked concerned the administration of the estates of deceased persons, many dating back to early in the 20th century or before.

JERSEY, CHANNEL ISLANDS

1. Are trusts legal and valid under your domestic law? What are they principally used for?

The root of Jersey law derives from Norman law which did not have the trust concept, although it did recognise life interests and reversions for immovable property. Trusts have been used in Jersey since the 19th century, based upon English common law principles and are now based on a statutory footing by the Trusts (Jersey) Law 1984 as amended (the Trusts Law). This is a consolidation of principles and not a codification.[1]

It contains provisions preserving the customary law position.[2]

It contains some private international conflicts of law principles (Articles 4 and 48-57). English and commonwealth common law principles (but not those derived by statute) are a guide and may, if appropriate, be adopted or adapted by the Royal Court of Jersey to form part of Jersey law. There is now a considerable body of Jersey case law.

Article 3 of the Trusts Law provides that "subject to this Law, a trust shall be recognized by the law of Jersey as valid and enforceable."

Article 2 of the Trusts Law states:

> "A trust exists where a person (known as a trustee) holds or has vested in the person or is deemed to hold or have vested in the person property (of which the person is not the owner in the person's own right) -
>
> (a) for the benefit of any person (known as a beneficiary) whether or not yet ascertained or in existence;
>
> (b) for any purpose which is not for the benefit only of the trustee; or
>
> (c) for such benefit as is mentioned in sub-paragraph (a) and also for any such purpose as is mentioned in sub-paragraph (b)."
>
> Accordingly:
>
> - a person holds or is vested with property, not in his own right, but for the benefit of another person (who may be neither ascertained nor in existence); and
> - for a purpose which is not solely for the benefit of the trustee.

A trust can come into existence in any manner including by oral declaration, by a written instrument (including a will) and arise by conduct. However, a unit trust must be in writing.[3]

It can also come into existence by operation of law, for example where there is a resulting trust or a constructive trust.[4]

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1 Article1(2), Trusts (Jersey) Law 1984 and *In the matter of the Esteem Settlement* 2002 JLR 53 at paragraph 87.
2 Article 59, Trusts (Jersey) Law 1984.
3 Article 7, Trusts (Jersey) Law 1984.
4 *United Capital Corporation Limited v. Bender and five Others* 2006 JLR 242.

Jersey trusts permeate many areas of personal and business activity. Personal trusts can be created *inter vivos* or by will or codicil.

Inter vivos trusts may or may not extend beyond a person's lifetime and can be used to hold personal as well as business assets. The most common reasons for creating a trust are to protect, enhance and manage family wealth, deal with forced heirship issues and succession planning.

Commercial trusts are used for all kinds of property and investment holding and for many purposes such as security arrangements, escrow accounts, voting control arrangements, pensions, unit trusts and collective investment schemes, share options and executive incentive schemes. The trusts may be discretionary or fixed; they may be for charities or for charitable purposes or for statutory non-charitable philanthropic purpose trusts.

2. Are foreign trusts recognised under private international laws?

Foreign trusts are regarded as being governed by and interpreted in accordance with their proper law.[5] However, such trusts are unenforceable to the extent they do anything contrary to Jersey law or confer any rights, powers or obligations which are contrary to Jersey law or which apply directly to immoveable property situate in Jersey.

The proper law of a trust is the law that is expressed by its terms or, failing that, can be implied by its terms or the law which had the closest connection when it was created.[6]

The Hague Convention on the Law Applicable to Trusts and on Their Recognition is referred to in the Trusts (Amendment No. 2) (Jersey) Law 1991. This law incorporates provisions for recognition of foreign trusts.

In addition the Royal Court has jurisdiction over trusts where:

- the trust is a Jersey Proper Law trust; or
- a trustee of a foreign trust is resident in Jersey; or
- any trust property of a foreign trust is situated in Jersey; or
- administration of any trust property of a foreign trust is carried on in Jersey.[7]

Accordingly, the Royal Court, in addition to recognition of a Jersey trust, may have jurisdiction over certain foreign trusts. Some provisions of the Trusts Law apply only to Jersey law trusts, some apply only to foreign law trusts and some apply generally to both Jersey and foreign law trusts.

3. Are there any prohibitions against trusts?

There are no prohibitions, but clearly the requirements needed to satisfy the existence of a trust must be present.

5 Article 49, Trusts (Jersey) Law 1984.
6 Article 4, Trusts (Jersey) Law 1984.
7 Article 5, Trusts (Jersey) Law 1984.

A trust is valid in accordance with its terms but invalid to the extent:

- it does anything contrary to Jersey law;
- it confers any right, power or obligation which is contrary to Jersey law;
- it applies directly to immoveable property situate in Jersey; or
- it has no beneficiary unless it is a charitable trust or a non-charitable purpose trust that has an enforcer.[8]

4. Are trusts and service providers regulated?

Trusts are not registered in Jersey, although charitable trusts may register with the Charity Commission.[9] Under the Financial Services (Jersey) Law 1998 any company or individual carrying on financial services business in or from within Jersey and a company registered in Jersey carrying on such business must be registered with the Jersey Financial Services Commission. This also applies to any person holding themselves out as doing so. Failure to comply is a criminal offence. Financial services business includes carrying on trust company business and providing trustee or fiduciary services, including fulfilling or arranging for another person to do so. Regulated persons are subject to the restrictions and requirements under various laws, orders and codes of conduct.

5. Can the following become insolvent and subject to insolvency procedures?

5.1 A trust itself

A trust cannot become insolvent or bankrupt. Insolvency occurs where there is an inability to discharge debts or obligations as they fall due (the cash flow test) or there are insufficient assets to meet all debts and liabilities (the balance sheet test). It follows that insolvency can only apply to a legally recognised person capable of having obligations and of holding assets. Jersey insolvency procedures can only apply to a person with a legal personality. These may be individuals, corporations or foundations.

A trust is not a legal entity. It is a relationship between the settlor, the trustee, the beneficiary and any other specified persons in relation to the terms on which assets are held or obligations owed. It relates to rights, duties and powers. There has been an increase in the use of trusts to achieve many purposes and which often include being subject to obligations to third parties. These may be contractual, statutory, proprietary or tortious. They may include loans, warranties and covenants, options, short selling derivatives, capital calls, partnership liabilities and giving guarantees or indemnities. An executor or administrator in an estate is a form of trustee with fiduciary duties. That estate may have assets and liabilities or be insolvent with creditors.[10]

Unlike companies and foundations which are both legal entities, there are no statutory winding up provisions applying to trusts. As such, the rights, duties and remedies that arise in the context of an insolvent trust are principally matters of trust law rather than bankruptcy law.

8 Article 11, Trusts (Jersey) Law 1984.
9 Charities (Jersey) Law 2014.
10 *In the matter of the Z Trusts* [2015] (3) JLR 175, 2015 (2) JLR 108, 2015 (1) JLR N13 and [2015] JRC 031.

The Royal Court has formulated the following principles:[11]

- a trust is not a separate legal entity and cannot as a matter of law be insolvent. To speak of an insolvent trust is a misnomer.
- However, the term "insolvent trust" is indeed a useful form of shorthand or convenient label. When the Court refers to an insolvent trust it does so in that way.
- The test for "insolvency" of a trust is the cash flow test, namely the inability of the trustee to meet its debts as trustees as they fall due out of the trust property.
- Where a trust becomes insolvent it should thereafter be administered for the benefit of the creditors as a body.
- In the case of an insolvency or probable insolvency of a trust, 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 trustees.
- Under the Trusts Law, the Court has a wide jurisdiction over trusts.[12] There is an ability for trustees and others to seek directions of the Court on many trust aspects including Article 51 as to any matter concerning a trust and more specifically under Article 47B-J for "mistake" as defined in the Trusts Law.
- In exercise of the Court's supervisory role, a trustee cannot be directed by the Court to do something outside the powers conferred upon the trustees by the trust deed.
- There may be power in a trust deed for a trustee to engage an insolvency practitioner to assist in winding up a trust, if appropriate, to delegate that function to such insolvency practitioner.
- There is precedent for the Court appointing receivers of a trust but it is a power to be exercised very sparingly.
- The winding up of an insolvent estate of a deceased is administered under the common law. The Bankruptcy (Désastre) (Jersey) Law 1990 (the "Désastre Law") is not applicable (Article 4(2)) and the Probate (Jersey) Law 1998 provides for the appointment of executors but does not give directions as to the administration of a deceased's estate.[13]
- The Court can give directions to an executor of a will where the estate holds valuable assets but has many creditors and is insolvent.
- It would be inappropriate for the position of an executor administering an insolvent estate to be equated directly with a trustee in bankruptcy (or the Viscount in a désastre) where specific procedural steps are specified by statute, as it would be both unwieldy and costly.[14]

5.2 A settlor

A settlor can become insolvent and subject to insolvency procedures before or after the creation of a trust in Jersey or elsewhere.

11 *In the matter of the Z Trusts* [2015] (3) JLR 175, 2015 (2) JLR 108, 2015 (1) JLR N13 and [2015] JRC 031.
12 Article 5, Trusts (Jersey) Law 1984.
13 *Crill v. Alpha Asset Finance Limited (Re Hickman)* 2009 JLR N8, 2009 JRC 40.
14 *Crill v. Alpha Asset Finance (CI) Limited (Re Hickman)* 2009 JLR N8, 2009 JRC 40.

5.3 A trustee

A trustee can become insolvent and subject to insolvency procedures in both situations.

5.4 A beneficiary

A beneficiary can become insolvent and subject to insolvency procedures.

5.4 A protector

A protector can also become insolvent and subject to insolvency procedures.

6. Do you distinguish between claims made against each party stated below in respect of their obligations in acting for or in relation to the trust and, on the other hand, obligations incurred privately and personally?

6.1 A trust itself

Claims cannot be made against the trust as such, but can be made whether in Jersey or elsewhere against a settlor, trustee, beneficiary or a protector. Such claims may be either personal or proprietary.

6.2 A settlor

A claim against a settlor may be against the settlor and enforceable against assets, including rights, which the settlor may have in the settlor's own name, such as rights created under the terms of a trust.

6.3 A trustee

The position in England is that there is no distinction between the capacities in which a trustee may be liable for obligations it has entered into. The trustee is always personally liable, although may be able to seek an indemnity out of the trust assets in respect of liabilities it has incurred as trustee.

As set out in more detail at paragraph 12(c) below, the creditor's position against the trustee of a Jersey law trust is modified by statute (Article 32(1)(a) of the Trusts Law). In particular, where a trustee has entered a transaction or other matter affecting a trust and the other party is aware that the trustee is acting as trustee, then the trustee's liability is limited to the extent of the trust assets. The Privy Council on appeal from the Court of Appeal of Guernsey has ruled on the application and meaning of this Article,[15] the majority stating that the statutory limitation on the trustee's liability is achieved by treating the trustee as having two legally distinct capacities. The words limiting the creditor's claim neither cap the trustee's liability nor merely control execution of judgments. Rather, they describe the character of the claim (as being against the trustee in either a fiduciary or personal capacity).

15 *Investec Trust (Guernsey) Limited and another v. Glenalla Properties Limited and others* 2018 UKPC 7.

According to Article 32(1) (b) of the Trusts Law a trustee may enter transactions or other matters affecting a trust where the counterparty is unaware of the trustee's capacity as trustee, in which case the claim is treated as a personal claim (although the trustee may have a right of indemnity).

A trustee may, alternatively, incur liabilities in which Article 32 is not engaged at all (where the trustee has not entered a transaction or matter affecting a trust) and there is no question of trust assets being affected.

6.4 A beneficiary

Claims against beneficiaries may be enforceable against the beneficiaries' personally held assets or may be enforceable pursuant to and consistent with such rights as a beneficiary may have under the terms of any trust.

6.5 A protector

A claim against protectors (who have been categorised as fiduciaries) may relate to them personally or in relation to a trust. However, such claims will also be personal to them although if they relate to a trust they may have a right of indemnity to claim against the trustees if the terms of the trust so provide. Unlike trustees, they will of course not have trust assets vested in them.

7. What are the main insolvency procedures that could be relevant?

The main Jersey bankruptcy procedures are:

- a Court ordered declaration en désastre which can be applied to the property of individual or corporate debtors under the Désastre Law; and
- a creditors' winding up under the Companies (Jersey) Law 1991 (the "Companies Law") where at least two thirds of the members of a Jersey company so resolve.

There are other procedures available such as:

- where a person surrenders all his property under the control of the Court;
- under the Debt Remission (Individuals) (Jersey) Law 2016
- cession, where all property is surrendered; and
- where the Court declares all property renounced.

Other procedures, that are not defined as bankruptcy procedures that can be applied where there is or there may become an insolvency, are:

- a Court winding up on the basis it is just and equitable to do so;
- various windings up permitted by statute, such as under the Foundations (Winding Up) (Jersey) Regulations 2009 and for various types of partnerships; and
- a company scheme of arrangement.

None of these procedures apply directly to trusts.

8. What is the effect of bankruptcy?

8.1 Generally

The effect of a declaration *en désastre "is to deprive an insolvent debtor of the possession of his moveable estate and to vest that possession in Her Majesty's Viscount whose duty it is to get in and liquidate that estate for the benefit of the creditors who prove their claims"*.[16] Since this judgment, *désastre* has been extended to immoveable property too.

The effect of a creditors' winding up is that the status and capacity of the company continues until it is dissolved. It must cease to carry on business except so far as required for its beneficial winding up. No action can be brought or proceeded against the company without leave of the Court. A liquidator and liquidation committee will be appointed. Accordingly, unlike in a *désastre*, the assets remain vested in the company.

8.2 What is the effect of a bankruptcy on the following parties?

8.2.1 A trust

The trust is not directly affected as it is not an entity.[17]

8.2.2 A settlor

This will depend on what, if any, rights the settlor or the settlor's trustee in bankruptcy has against the trustees in respect of trust assets. These rights may be rights reserved to the settlor under the terms of the trust or rights an insolvency office holder may have to claw back value following transactions at an undervalue, or for preferential payments or claims based on a Pauline action where there was an intention to defeat creditors.

8.2.3 A trustee

The bankruptcy of a trustee does not disqualify the trustee from continuing as a trustee unless the trust otherwise provides, although usually the trustee would resign or be removed by the Court. There may also be a claim for a claw back into the insolvent estate on the basis of a transaction at an undervalue or for a preference.

In a *désastre*, no trust property held by the debtor will vest in the Viscount.[18] This is also reflected in the Trusts Law[19] which states:

> *"Where a trustee becomes insolvent or upon distraint, execution or any similar process of law being made, taken or used against any of the trustee's property, the trustee's creditors shall have no right or claim against the trust property except to the extent that the trustee himself or herself has a claim against the trust or has a beneficial interest in the trust."*

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16 *In the matter of Overseas Insurance Brokers Ltd* 1966 JJ 547. Under Article 5, Bankruptcy (*Désastre*) (Jersey) Law 1990 all property and powers of the debtor vest immediately in the Viscount.
17 *In the matter of the Esteem Settlement* 2002 JLR 53.
18 Article 8, Bankruptcy (*Désastre*) (Jersey) Law 1990.
19 Article 54(4), Trusts (Jersey) Law 1984.

The position is further clarified by part of Article 54 which states:

(1) Subject to paragraph 2:

(a) the interest of a trustee in the property is limited to that which is necessary for the proper performance of the trust; and

(b) such property shall not be deemed to form part of the trustee's assets.

(2) Where a trustee is also a beneficiary of the same trust, paragraph (1) shall not apply to the trustee's interest in the trust property as a beneficiary.

In certain cases where a trustee has become en désastre, the Viscount acts as a caretaker to facilitate the appointment and the transfer of assets to a new trustee, provided in all the circumstances it is right to make the transfer.

The general principle is well illustrated where assets are provided to help a company in distress to avoid bankruptcy.

Assets can be held by a bankrupt person but found to be held on trust and not available to the creditors. This can apply to a claim against a trustee where the creditors cannot have recourse to the trust assets and where the principles of *Barclays Bank Ltd v. Quistclose Investments Ltd* are engaged.[21]

The Royal Court has accepted that the *Quistclose* principle applies under Jersey law and that the correct interpretation is set out in *Bieber v. Teathers Ltd*.[22]

In the *Quistclose* case, Rolls Razor Limited was in need of funding as it was indebted to the Bank. Rolls Razor obtained a loan from *Quistclose* on condition that it should be used for a particular purpose, namely to pay dividends due. The Bank was aware of this. After receiving the loan which was paid into a separate bank account with the Bank, but before paying the dividend, Rolls Razor went into voluntary liquidation. *Quistclose* successfully argued that this arrangement gave rise to a relationship of a fiduciary character or trust in favour, as a primary trust, of the creditors to whom the dividends were due and secondly if the primary trust failed, of the third party (*Quistclose*). It made no difference that this was a loan rather than a gift.

In brief, the legal principles to be drawn from Bieber are:

- did the payer and recipient intend the money to be freely disposable by the recipient?
- merely paying the money for a particular purpose may not create a fiduciary relationship;
- it must be clear that the money was not to form part of the general assets of the recipient but should only be used only for a particular purpose and if not so used, returned;
- it will be unconscionable for a recipient to obtain money and then to disregard the terms on which it was received or equity will impose a fiduciary obligation;

20 *Viscount and PricewaterhouseCoopers v. AG* 2002 JLR 268.
21 *Barclays Bank Ltd v. Quistclose Investments Ltd* [1970] AC 567 (HL).
22 *Bieber v. Teathers Ltd* [2012] EWCA Civ 1466, [2013] 1 BCLC 248. See *Nolan v. Minerva Trust Company Ltd* 2014 [2014] (2) JLR 117 at paragraphs 163-165.

- such a trust is akin to a retention of title clause;
- the subjective intentions of the parties as to the creation of a trust are irrelevant; and
- the particular purpose must be specified for it to be sufficiently clear whether the application of the money does or does not fall within its terms.

The Bank knew the purpose for which the funds were intended to be put and would have otherwise obtained "a windfall".

8.2.4 A beneficiary

In addition to the effect described above, where a beneficiary is bankrupt, the Court may decide that it is not right for trustees to make a distribution to a beneficiary against his will where it will not benefit the bankrupt, for example, where any distribution would be very small in relation to the total debt owed to a creditor.[23]

8.2.5 A protector

The bankruptcy of a protector does not disqualify the protector from continuing as a protector unless the trust otherwise provides, although usually the protector would resign or be removed by the court.

9. Can an insolvency procedure extend to trust assets in the local jurisdiction and / or foreign jurisdiction?

9.1 Local jurisdiction

A foreign, ie non-Jersey, insolvency procedure may or may not under that foreign law be able to affect trust assets located in Jersey. However, as a matter of Jersey law and procedure, in practice this is likely to require recognition by the Royal Court of the foreign insolvency and the powers of the insolvency practitioner. Under Article 49 of the Désastre Law the Royal Court may, in its discretion, give assistance to a foreign court in respect of certain prescribed jurisdictions and may apply the law of Jersey or the law of that foreign jurisdiction to the extent it considers fit. When doing this, it must have regard to principles of private international law and may have regard to the UNCITRAL Model Law on cross border insolvency. Where a requesting foreign court is from a non-prescribed jurisdiction, the Royal Court may also apply Jersey law to the extent it thinks fit and it will generally apply established principles of private international law. Under Article 9 of the Trusts Law, foreign laws and orders affecting such matters as the validity of a trust are always subject to Jersey domestic law without regard to private international law principles.

9.2 Foreign jurisdictions

A Jersey insolvency procedure would not apply to trust assets outside Jersey although the Court may have jurisdiction.

A Jersey insolvency procedure can clearly apply as a matter of Jersey law to non-trust assets outside Jersey. This may require recognition abroad.[24] Established principles of private international law of that jurisdiction would normally apply.

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23 *In the matter of the Esteem Settlement and the No. 52 Trust* 2001 JLR 7.
24 *In the matter of a debtor* (Order in Aid No. 1 of 1979) ex parte the Viscount of the Royal Court of Jersey [1981] Ch 384.

The rules are a mixture of statutory and common law.

10. Can trusts be challenged?

10.1 To obtain assets

Actions may be taken by the claimant in hostile litigation on a number of grounds, the most likely of which are set out at question 11. Alternatively, the Attorney General, a trustee, an enforcer or a beneficiary of a trust have a right to, and others, with leave of the Court can, seek directions of the Court under Article 51 of the Trusts Law. The Court has wide powers to make orders affecting the execution and administration of the trust, how trustees should act, directions concerning a beneficiary, validity and enforceability and the appointment and removal of trustees and others. Litigious actions are normally heard in public and directions hearings in private.

It follows that an insolvency officeholder appointed over a settlor can seek to challenge the validity of a trust which, if successful, may mean the assets result back to the settlor. There may be a challenge to a decision affecting the transfer of assets into or out of a trust with a view to assisting creditors.

10.2 To obtain information

Sometimes, prior to a full challenge, there may be a request for information either made to the trustees or others in writing, or with the aid of a court order. In the latter case there will be an important implied undertaking as to the use to which the information is put and restrictions on disclosure. Any breach of the undertaking is considered serious by the Royal Court and may prevent future applications succeeding.

10.3 To examine witnesses

Usually an application to examine witnesses will only be made after information has been ordered to be disclosed and only if this is necessary or appropriate. Examination will be in Jersey and often before the Viscount, as the Court enforcement officer, who will preside over the proceedings which will be taped.

In addition to orders under the Trusts Law, orders may be made under the Service of Process and Taking of Evidence (Jersey) Law 1960, under the Désastre Law, the Companies Law or other specific statutes. In all cases, sufficient evidence must be placed before the Court which may grant any order on such terms and for such purposes as it sees fit.

10.4 For any other purpose

Other remedies that may be sought in relation to trusts may concern the giving of accounts, injunctions, appointment and removal of trustees and, exceptionally, the appointment of a receiver.[25]

25 *In the matter of the IMK Family Trust, Mubarik v. Mubarak* 2008 JLR 250 and 2008 JLR 430.

11. On what grounds can a trust arrangement be challenged?

11.1 The settlor was insolvent when the trust was created or became insolvent as a result of creating it

Where a trust is created in order to defeat existing creditors and possibly impending creditors, the Court has power to set aside that arrangement based on a Pauline action.[26]

The transaction may also be a transaction at an undervalue if there is no "cause" (French pronunciation) so that the Court has power to set it aside.[27] Cause would include consideration and something less.

The Court also has power to restore the position to prevent a wrongful preference.[28]

11.2 The settlor becomes insolvent

Where the transfer causes the insolvency (a) above could also apply.

11.3 The settlor lacked capacity or authority to create the trust

A settlor normally must have the legal capacity to act to create a trust and to transfer completely the assets to the trustees. Accordingly, for an individual, being of unsound mind or being a minor or suffering another legal impediment, may well invalidate a trust.

11.4 The settlor lacked capacity or authority to transfer the assets to the trustees

As stated in 11.3 above.

11.5 The assets were not validly transferred or the transfer was not fully completed

The trustees must have the assets fully vested in them or otherwise hold the assets. On the appointment or change of a trustee there is no automatic statutory vesting as in some jurisdictions. If, for example, shares are purportedly transferred but without the required consent of directors or without an entry in the company's register of members, questions may arise whether there has been a transfer at all as regards certain of the parties.

11.6 The trust was not validly created

The trust must be valid and be categorised as a true trust. There must be an intention to create the trust, certainty of subject matter and certainty of objects.

11.7 The transfer could be subsequently set aside as void or voidable

The grounds for setting aside are explained below.

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26 *Golder v. Société des Magasins Concorde Limited* 1967 JJ 721 and *In the matter of the Esteem Settlement* 2002 JLR 53.
27 Article 17, Bankruptcy (*Désastre*) (Jersey) Law 1990 and Article 176, Companies (Jersey) Law 1991.
28 Article 17A, Bankruptcy (*Désastre*) (Jersey) Law 1990 and Article 176A , Companies (Jersey) Law 1991.

11.7.1 Mistake

The Trusts Law indicates the trust will be invalid if the Royal Court declares it was established by mistake. In certain limited circumstances, the Court has power to rectify the mistake.[29]

11.7.2 If there was an undervalue[30]

The Court has statutory power as indicated in 11.1 above to deal with a transaction at an undervalue where there has been a bankruptcy of the settlor.

11.7.3 If there was a preference[31]

As stated in 11.7.2 above.

11.7.4 If there was a sham

A sham requires a common intention on the part of a settlor and a trustee to give an effect to a transaction or arrangement different from the way it is described.[32]

The law has developed so that there have been few recent successful claims, particularly where the trustees are professionals and since the maxim "donner et retenir ne vaut" (you cannot give and retain) has been disapplied to trusts. The definition of sham has been clarified by subsequent cases.[33]

11.7.5 Any other grounds

Jersey has strict legitime inheritance rules for Jersey domiciled individuals giving rights to claim fixed shares of moveable property to spouses and children. A trust intended only to defeat such a rule and made in contemplation of death may be questionable.

Under the Trusts Law, trusts are invalid where the Royal Court declares the trust was invalid, not only on the grounds of mistake but also by duress, fraud, undue influence, misrepresentation or breach of fiduciary duty or the trust was immoral or contrary to public policy or its terms are so uncertain as to make its performance impossible.[34]

Generally, under the Trusts Law, no foreign law or court order will be recognised to invalidate a trust or a transfer to a trust or the capacity to create a trust. All such matters are a matter for Jersey domestic law only.

12. What protections and defences exist to protect those listed in question 5 and are they statutory or common law or otherwise?

12.1 A trust

A trust cannot sue or be sued as it is not a legal entity.

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29 Articles 11 and 47B to 47J, Trusts (Jersey) Law 1984.
30 Article 17, Bankruptcy (*Désastre*) (Jersey) Law 1990 and Article 176, Companies (Jersey) Law 1990.
31 Article 17A, Bankruptcy (*Désastre*) (Jersey) Law 1990 and Article 176, Companies (Jersey) Law 1990.
32 *Mackinnon v. Regent Trust Company Limited* 2005 JLR 198.
33 Article 9(1), Trusts (Jersey) Law 1984 and *In the matter of the Esteem Settlement* 2003 JLR 188.
34 Article 11(2), Trusts (Jersey) Law 1984.

12.3 A settlor

A settlor has no special protections.

12.3 A trustee

A trustee, acting as a trustee, has a number of protections.

Whilst a trustee must comply with the terms of a trust and not act in breach of trust, if he does so the Court has power under Article 45 of the Trusts Law to relieve the trustee from personal liability for breach of trust where it appears to the Court that he is or may be personally liable for the breach and he has acted honestly and reasonably and ought fairly to be excused.

Where the trustee commits a breach of trust at the request or with the consent of the beneficiary, the Court has power under Article 46 of the Trusts Law to impound the beneficiary's interest by way of indemnity for the trustee.

Where a third party makes a claim, Article 32 of the Trusts Law has modified the orthodox general rule based on English law. Article 32 can apply whether the trust is or is not "insolvent".

As set out at paragraph 6(c) above, the orthodox position based on English law is that a trustee incurs liabilities which are not limited by reference to the assets in the trust being administered. The trustee incurs unlimited personal liability. The trustee might be able to rely on his indemnity out of the assets under administration. However, if the trustee is prevented from relying on the indemnity, or alternatively if the indemnity is insufficient to cover the liabilities incurred, then as a matter of general English law the trustee is under an obligation to fund any shortfall personally. In Jersey this has been altered by Article 32, which states:

"(1) Where a trustee is a party to any transaction or matter affecting the trust –

(a) if the other party knows that the trustee is acting as trustee, any claim by the other party shall be against the trustee as trustee and shall extend only to the trust property;

(b) if the other party does not know that the trustee is acting as trustee, any claim by the other party may be made against the trustee personally (though, without prejudice to his or her personal liability, the trustee shall have a right of recourse to the trust property by way of indemnity).

(2) Paragraph (1) shall not affect any liability the trustee may have for breach of trust."

In *Investec Trust (Guernsey) Ltd and another v. Glenalla Properties Limited* and others[35] the application and meaning of Article 32(1) was considered.

First, the Privy Council had to consider whether the Guernsey based trustees could rely on Article 32 (a Jersey law provision) in the Guernsey Court. The majority of the Privy Council confirmed that the extent of the trustees' liability (as trustees) was

35 [2018] UKPC 7.

governed by the proper law of the trust (Jersey law), which includes the protection offered by Article 32. Further, it was clear that the counterparties knew that the trustees were acting as such. Lord Mance dissented, regarding the issue of a trustee's liability to a third party as being governed by the law of the obligation in question (which was not Jersey law).

Second, the Privy Council considered how Article 32(1) changed the ''normal'' rules of trustee liability and concluded that where the trustee of a Jersey law trust transacts, the effect of Article 32 is that the trustee can transact either in a personal or in a fiduciary capacity. Where the trustee transacts in a fiduciary capacity and the counterparty is aware of this, the latter's recourse is limited to the trust assets and cannot extend to the trustee's personal assets.

Third, the Privy Council considered whether the creditor counterparty had direct recourse against the trust assets. Overturning the Court of Appeal, the Court concluded that creditors had no form of direct recourse to the trust assets. Rather their rights derive from subrogation to the trustee's rights of indemnity. One effect of this is that if the trustee loses his right of indemnity (perhaps as a result of a breach of trust) then there is no such right to which the creditor can be subrogated. At the same time, Article 32 (1) (a) prevents any recourse against the trustee personally. As a result, if there is no security or third party guarantee, then creditors might find they have no recourse at all.

Fourth, the Privy Council considered whether the trustees' right to reimbursement (out of trust assets) in respect of the liabilities could be engaged but subsequently lost. The Privy Council confirmed that if the loans were reasonably incurred, resulting in indemnity rights being triggered, then the indemnity could not subsequently be lost, for example, by an unreasonable failure to discharge those loans.

Fifth, the Privy Council considered whether the trustees could rely on the statutory limited recourse provisions to protect themselves from adverse costs orders. In the Privy Council's view they could not: Article 32 was not engaged, since this would be inconsistent with another statutory provision (Article 53), which provides the Court with full discretion as to costs.

The Privy Council was not required to rule on the meaning of Article 32(1)(b). However, the Court of Appeal had already done so, holding that where Article 32(1)(b) applies (the third party did not know the trustee was acting as trustee) the general orthodox position under English law will apply. The trustee's personal assets may be at risk if for some reason the indemnity does not apply or the indemnity cannot be fully enforced against the trust property or the trust property is insufficient to satisfy the claim.

Whilst the Investec decision is a Guernsey case, in practice it will be binding in Jersey.

Article 32(1) is plainly of great potential assistance to the trustee of a Jersey law trust. However, a similar effect can be created by the use of contractual limited recourse provisions. Alternatively, the trustee can seek to avoid personal liability by entering obligations through an underlying subsidiary with the benefit of limited liability. (See question 19).

A trustee is not liable for a breach of trust committed prior to the trustee's appointment if the breach was committed by another person.[36]

A trustee is not liable for a breach of trust committed by a co-trustee unless he becomes aware of it and the trustee conceals or fails to prevent it.[37]

Subject to certain safeguards, a beneficiary may relieve a trustee for breach of trust and indemnify the trustee for breach of trust.[38]

The liability of trustees is generally joint and several. This may of course involve some protection or indeed none at all.[39]

The terms of a trust can relieve, release or exonerate a trustee from liability other than for the trustee's own fraud, wilful misconduct or gross negligence. Accordingly, there can be protection for negligent or innocent acts or failures to act.[40]

A trustee has wide powers to seek directions from the Royal Court under Article 51 of the Trusts Law and any order made may protect the trustee from adverse claims or from making inappropriate decisions.

A trustee may be protected where a claim is not pursued with reasonable diligence. The general prescription period for breach of trust and tort is 3 years and for breach of contract, 10 years.[41]

However, a trustee will not be protected and a third party will be protected where he is a bona fide purchaser for value without notice of any breach of contract so that the trustee will be treated as a beneficial owner of the trust property and the third party will not be affected by the trusts holding the property.[42]

A trustee's indemnity may be supported by an equitable lien.

In the matter of *Rawlinson & Hunter Trustees SA*,[43] the Royal Court considered the relative rights of priority for claimants to the assets of an insolvent trust. This case involved the ZIII Trust. The Court found that the trustee's right of indemnity extends to cover payments made by the trustee and to liabilities existing, contingent, future or otherwise. The indemnity involves a right of reimbursement to recover what the trustee had paid personally and a right of exoneration to receive payment direct from the trust fund.

That right of indemnity gives rise to an equitable charge or equitable lien over the equitable interest in the trust property. That indemnity will not, however, run against a bona fide purchaser for value of the legal estate.

Both the indemnity and the equitable lien continue after the retirement or removal of trustees.

36 Article 30(4), Trusts (Jersey) Law 1984.
37 Article 30(5), Trusts (Jersey) Law 1984.
38 Article 30(6), Trusts (Jersey) Law 1984.
39 Article 30(8), Trusts (Jersey) Law 1984.
40 Article 30(10), Trusts (Jersey) Law 1984.
41 See Article 57, Trusts (Jersey) Law 1984 and *Nolan v. Minerva Trust Company Ltd* 2014 (2) JLR 117.
42 See Article 55, Trusts (Jersey) Law 1984.
43 2018 JRC 119.

The trust was described by the Court as insolvent. There were claims by successive trustees and others. Where a trust is insolvent, the beneficiaries have no interest in the trust funds. Only the trustees claiming their indemnity and their equitable lien, or creditors claiming through the trustees to the trust assets, have an interest.

As regards competing claims of successive trustees, these rank *pari passu*.

As regards competing claims of trustees and creditors, if the creditors knew of the trust, Article 32(1)(a) will limit the liability of the trustees in any event. If the creditors were unaware of the trust, their recourse through the trustees will rank after satisfaction of the rights of the trustees to their own indemnity and equitable lien.

12.4 A beneficiary

There are no special protections and defences.

12.5 A protector

The position is as stated in 12.4 above.

13. Can claims be made in a bankruptcy where the insolvency office holder stands in the shoes of a bankrupt to exercise the rights given by the trust in favour of of the following parties?

13.1 The settlor

Generally, an insolvency officer holder will step into the shoes of the bankrupt with an ability to control and realise all assets and rights.

Generally, where a settlor has retained certain rights, perhaps in the trust instrument or in the transfer of assets to the trustees, the office holder will be able to exercise such rights in accordance with their terms. Article 9A of the Trusts Law envisages such powers as including powers to revoke, vary or amend the terms of a trust, advance or pay capital and income, to give directions appointing or removing trustees and changing the proper law. In principle, these may then be exercisable by the insolvency office holder.

A foreign non Jersey bankruptcy will usually require court recognition.

13.2 Trustee

On the bankruptcy of a trustee, as indicated, the bankruptcy will not extend to the assets of the trust and the insolvency office holder will not be able to use trust assets for the benefit of the creditors. The office holder of the trustee should however seek to preserve and safeguard assets and take such steps to seek out a new trustee and administratively to co-operate in passing the assets held in the name of the bankrupt to the new trustee. The insolvency office holder of a company may be able to protect the assets more effectively than an individual trustee.

13.3 Beneficiary

Again, in principle, the rights held by a beneficiary can be exercised by the insolvency office holder.

13.4 Protector

On the insolvency of a protector, such powers may be exercisable by the insolvency office holder. However, the person having power to appoint or remove the protector would be likely to exercise those powers of appointment and removal.

In all such cases, directions can be sought from the Court under the Trusts Law.

14. Are rights of subrogation established by law?

A trustee has a right of indemnity from the trust assets to reimburse himself for his personal liability to a counterparty with whom he contracts as trustee. Generally, the trustee may not be able to rely on his right of indemnity (in which case it would not be available to the counterparty by way of subrogation) if the trustee is in default for some reason, for example by committing a breach of trust or unreasonably incurring the liability at issue. If the trustee fails to discharge the obligation to the counterparty then the counterparty is subrogated to the trustee's right of indemnity i.e. steps into the trustee's shoes.

It follows that the counterparty has no right of subrogation where the trustee has no right of indemnity. This right of subrogation has not been established in relation to fiduciary and equitable principles although there seems no reason why the Royal Court should not expressly adopt the English position and indeed every reason why it would do so.

Following the Privy Council decision in *Investec Trust (Guernsey) Ltd and another v. Glenalla Properties Limited and others*[44] the English position appears to be preserved, not modified, by Article 32 of the Trusts Law. As set out in question 12 above, a creditor's rights against a trustee (even where Article 32(1)(a) applies), derive from subrogation to the trustee's rights of indemnity.

Under English and Jersey law, therefore, the creditor is prevented from satisfaction of its claim out of trust assets and is prevented from having any rights of subrogation to a claim from the trust assets, so long as an alleged breach of trust remains in dispute.

As indicated at the end of 12(c) above, a creditor's right to claim trust assets by way of subrogation through a trustee may be curtailed where there are insufficient assets to satisfy the trustee's own claim to the indemnity and to satisfy the trustee's equitable lien.

44 [2018] UKPC 7.

15. Can the veil of a company owned by a trust be pierced or lifted and, if so, in what circumstances?

General legal principles about corporate personality under Jersey law are similar to those under English law. In other words, there is a strict veil drawn between a limited liability company and its shareholders meaning, for example, that shareholders are generally not liable for the debts of the company.

However, the corporate veil can be pierced by the Royal Court under customary law principles in limited and rare circumstances. The leading case is *Re Esteem Settlement*,[45] which involved a huge fraud on the Kuwait Investment Office by an individual who had established a Jersey trust (the Esteem Settlement). Whilst refusing to pierce the corporate veil in this case, the Court held that the corporate veil could be pierced if two elements are proved: (i) the shareholder is a ''controlling shareholder'' in the company; and (ii) the actions complained of involve illegality or impropriety (which included attempting to defeat existing creditors). These are strictly required; the Royal Court made it clear that the veil could not be pierced simply to achieve justice. The Court noted that the correct terminology is ''piercing'' (not ''lifting'') the veil.

It is plain from the Esteem Settlement case that English principles are likely to be of persuasive value in this area.

16. Can the veil of a trust be pierced or lifted and, if so, in what circumstances?

In the Esteem Settlement case, the plaintiff attempted to pierce the veil of the trust. It was unsuccessful in this, the Royal Court holding that the principle of piercing the corporate veil does not apply to trusts, since a trust does not have a separate legal personality.

As a result, a Jersey trust cannot be attacked or challenged by reference to this principle.

17. If a trust can be treated as insolvent, is this on the basis of the cash flow test, the balance sheet test or another test and, if so, what test?

As indicated above under question 5, in the case of *Z Trust*[46] the Royal Court acknowledged that a trust could not technically be insolvent (as a trust is not a legal entity) but the Court accepted that insolvency was a useful shorthand concept. In particular the Court held that it was useful for determining the duties of the trustee once a trustee realises that the trust has become insolvent, or is probably insolvent.

The Court held that insolvency in this context should be determined on a cash-flow basis (as distinct from the balance sheet basis which applies when a deceased's estate is concerned).

The Court held that on insolvency, as the beneficiaries are effectively "out of the money", the trustee must shift its attention to the interests of creditors and must obtain approval from either the creditors or the Court in relation to the future administration of the trust. The duties are owed to all creditors as a class and not

45 *In the matter of the Esteem Settlement*, 2003 JLR 188.
46 *In the matter of the Z III Trust* 2015 (2) JLR 175.

to individual creditors or to a majority of creditors. The Court also noted, following previous authority in the context of insolvent estates, that the trustee's ability to charge remuneration based on the trust instrument is conditional on solvency. Upon insolvency, the trustee must get creditor agreement or Court protection for the charging of ongoing fees. Failure to do so may mean that fees incurred beyond the point of insolvency might rank equal to, or perhaps even behind, the claims of other creditors.

18. Can or have receivers been appointed to act as a trustee or with powers over trust assets? If so, in what circumstances?

Receivers have been appointed to a trust by the Royal Court. The first time this occurred was in the case of In the matter of *The IMK Family Trust*.[47] The Royal Court said:

> *''It is clear that, as part of its general supervisory jurisdiction in respect of trusts, the Chancery Division of the English High Court has power to appoint receivers of a trust (see Lewin, paras. 38–28 – 38–39, at 1551–1555 and the cases there cited). It is an exceptional remedy to be granted only where there is a clearly identified need to do so. An example of where it may be appropriate is where there is an application for the appointment of a new trustee amidst claims of breach of trust and the court is unwilling to remove the trustee pending the determination of those claims but the evidence is sufficiently strong to warrant the protection afforded by a receivership.*
>
> *In our judgment, this court also has power to appoint a receiver of a trust under its inherent supervisory jurisdiction, although the power is to be exercised very sparingly. We consider this to be an appropriate case in which to exercise that jurisdiction.''*

In the IMK case two accountants were appointed by the Royal Court as receivers of the trust to take the necessary steps to realize liquidity from the underlying assets so that the settlor's wife in English divorce proceedings could be paid the sums owed to her pursuant to English Court orders. The Court held that the appointment was appropriate, as it would have been unreasonable to have expected the trustee to take the required steps itself and the expertise of investigative accountants was required. The accountants were appointed as principals and not as agents of the trustee.

Receivers have also been appointed by the Royal Court to collect trust assets in the case of *Crociani v. Crociani*.[48]

The terms of the trust may also permit the trustee to create security over trust assets. If so, then the chargee may be able to appoint a receiver (including for instance an English LPA receiver) under the law governing the charge.

19. Are claims against trustees limited or unlimited? If limited, are they limited as to amount and by time? Do underlying companies have a role?

A trustee may obtain added protection by importing the provisions of Article 32(1)(a) into a written agreement and supplemented by other protective clauses generally

47 *The IMK Family Trust* 2008 JLR 250.
48 *Crociani v. Crociani* [2017] JRC 146.

to limit liability by amount, by time and by circumstances. To do so may well avoid issues as to whether a non Jersey Court would or would not apply Article 32 to a Jersey proper law trust when it has no equivalent under its own law. The contractual protection may not fully protect against statutory, fiduciary or tortious liability.
A further protection is to ensure third party liabilities are incurred by an underlying limited liability company so avoiding the trustees taking on directly held obligations. However, such protection can be lost where the underlying company lends to the trustees as in the *Glenalla* case where the company become bankrupt and the insolvency office holder claims against the trustees as borrowers from the company.

20. Are there provisions or cases where trusts, or those connected to them, are based in a foreign jurisdiction?

As indicated in question 2 above, under Article 5 of the Trusts Law, the Royal Court has jurisdiction in relation to a trust where:

- the trust is a Jersey trust; or
- a trustee of a foreign trust is resident in Jersey; or
- any trust property of a foreign trust is situated in Jersey; or
- administration of any trust property of a foreign trust is carried on in Jersey.

Accordingly, the Royal Court will have jurisdiction even where the trustee and all of the trust assets are located outside Jersey so long as the proper law of the trust is Jersey law. Subject to the Royal Court having jurisdiction, some provisions of the Trusts Law apply only to Jersey law trusts and some apply to foreign law trusts and some apply generally to Jersey or foreign law trusts. There are many cases involving settlors, trustees and beneficiaries who are based outside Jersey and where the assets are in or outside Jersey. Most trust cases tend to involve trusts where their proper law or place of administration is in Jersey. There are trusts that are subject to Jersey law but have no other connecting factors as regards people or assets. Such an express choice of law or implied law is valid under Article 4 of the Trusts Law.

21. What are the main means to seek assistance from another jurisdiction?

In the insolvency context, a person who has taken an insolvency appointment according to Jersey law can seek recognition of the appointment and assistance from the Courts of an overseas jurisdiction. This could be an appointment in respect of a Jersey based trust company which has been placed into Court winding up.

When this occurs the trusts under administration are generally moved to a new provider expeditiously.

Assets held in trust for others would not fall into the insolvency estate and would not be available for creditors of the trustee.

However, the insolvency officer holder may need recognition and assistance in an overseas jurisdiction. This is done via a court to court letter of request, although the precise procedure depends on the receiving court. For instance, the English Court will receive a letter of request from the Royal Court of Jersey for assistance

through section 426 of the Insolvency Act 1986. Conversely, requests can be made to the Royal Court by overseas courts which are processed pursuant to Article 49 of the Bankruptcy Law (in respect of certain prescribed countries) and pursuant to the customary law (in other cases).

22. What is the position as to whether the foreign jurisdiction does or does not recognise trusts?

As a general point the trustee will be the legal owner of the asset, whether the asset is owned by the trustee personally or on trust for others. The trust arrangement which sits behind the legal ownership of the assets in question may or may not be relevant in the foreign jurisdiction but it would appear to be a question which arises under the foreign law.

23. What particular issues, difficulties and solutions have arisen or may arise relating to trust arrangements or those involved with them?

Trustees have traditionally held low risk assets with little or no borrowing. Insolvency in the administration of trusts was rare. More recently, trustee borrowing and highly commercial leveraged trusts as well as volatile asset values have created instances where trustees have encountered insolvency in the administration of their trusts. As a result, the law is uncertain and is developing quickly. It is important to start with orthodox trust principles when analysing the legal effects of this: trustees are legally responsible for the obligations they incur as trustees with a right of recourse from the trust assets. A trustee's liability may be unlimited (per orthodox principles) which exposes a trustee's personal assets to claims of ''trust'' creditors. The trustee's liability may be limited by contract or (in Jersey, amongst other jurisdictions) by statute if certain conditions are met. Where there are allegations of breach of trust, the right of the trustee to exercise its indemnity may be lost and with it a creditor's right of subrogation.

The Jersey statutory overlay to the orthodox principles therefore materially changes the respective rights of trustees, beneficiaries and creditors as between themselves.

A further developing area is the recognition and interpretation of the effects of property rights and different insolvency rules across various jurisdictional borders over which a trustee's operations span, including in particular into jurisdictions where trusts are not recognised.

The payment of trustee fees is an area of particular interest. The Royal Court has held that where a trust becomes ''insolvent'' (on the cash flow basis), the trustee must seek directions from the Court or from the trust creditors. Failure to do so may disentitle the trustee from taking further fees ahead of other creditors. In a complex winding down, these fees may be significant.

MAURITIUS

1. Are trusts legal and valid under domestic law? What are they principally used for?

A trust can be legally and validly constituted in Mauritius under the Trusts Act 2001 of Mauritius (the Trusts Act). Section 4 of the Act provides that a trust shall be recognised as valid and enforceable under the laws of Mauritius subject to the provisions of the Act.

Generally, trusts are used by domestic and international clients for estate planning, succession planning, asset protection, to provide for a vulnerable member of the family, trading and for charitable purposes among others.

2. Are foreign trusts recognised under private international laws?

The Act provides that a foreign trust shall be enforceable in Mauritius[1] except in the following circumstances:

(i) It purports to do anything which under the law of Mauritius is an offence;

(ii) It confers or imposes any right or function the exercise or discharge of which under the law of Mauritius is an offence;

(iii) It is immoral or contrary to public policy; or

(iv) It purports to apply directly to immovable property situated in Mauritius.

The Act also provides that a foreign trust is governed by and shall be interpreted in accordance with the terms of the trust and its proper law.

3. Are there any prohibitions against trusts?

A trust can only be valid if it is created by an instrument in writing.[2] A trust cannot:[3]

(i) hold property which is inalienable under the laws of Mauritius;

(ii) have a leasehold interest that has an unexpired term of less than 18 years;

(iii) any immovable property in Mauritius where the trust is a non-charitable purpose trust.

4. Are trusts and service providers regulated?

Trusts are not registered with the authorities in Mauritius and at present there is no register of trusts in Mauritius. Generally, trustees are corporate trustees and they must be licensed by the Financial Services Commission of Mauritius (the FSC). A trustee has the obligation to carry out the necessary customer due diligence on the settlor and all the beneficiaries of the trust and has furthermore the on-going obligation to continue such due diligence during its tenure as trustee. The corporate trustee is thus a regulated entity and has to comply with the regulatory requirements of the FSC. The FSC conducts an on-site inspection of its licensees every year and the corporate trustee is under an obligation to keep in its file all the due diligence documents, accounts and other records in their file.

1 Section 60, Trusts Act.
2 Section 6 (1) (b), Trusts Act.
3 Section 7(2), Trusts Act.

5. Can the following become insolvent and subject to insolvency procedures?

5.1 A trust itself

A trust is not a juristic legal person as a company. It is a legal arrangement whereby a settlor appoints a trustee to administer a trust for the benefit of beneficiaries. Thus, a trust does not have a legal personality and is not a legal entity. Therefore, it would be erroneous to say that a trust is solvent or insolvent. This being said, a trustee of a trust has the obligation to meet any liabilities of a trust out of the trust assets. From this perspective, a trust may be deemed insolvent when the trustee is unable to discharge a liability which is due for payment and the trust assets are not sufficient to allow the trustee to discharge the liability. Section 63 (1)(a)(ii) of the Trusts Act provides that any person having an interest in a trust may apply to the Supreme Court for an order in respect of any payment due into court or otherwise. The Insolvency Act 2009 is silent as regards trusts.

5.2 A settlor

Under section 8 of the Trusts Act, any person who has the legal capacity to contract may create a trust. Clearly, an insolvent person whether an individual or a company, will not have the legal capacity to contract and will not be able to settle property and create a trust. The insolvency status of an individual is effective and has a legal bearing when the person is adjudicated bankrupt by the Court in Mauritius

A settlor becoming insolvent after the creation of a trust would not affect a trust. Once the trust is formed and the settlor has gifted property to the trust, the trustee continues to hold the legal ownership of the assets which he administers for the benefit of the appointed beneficiaries. Therefore, the insolvency of the settlor will affect the settlor and should not affect the trust.

5.3 A trustee

A trustee is normally a corporate trustee constituted under the Companies Act 2001. During its tenure as a trustee, it may become insolvent. In such a situation, the board of directors of the trustee company must immediately stop trading and resolve to appoint a provisional liquidator.

A trustee may also become insolvent after it has ceased to be a trustee of a trust. This situation is very specific to the trustee and it is unlikely to affect those trusts.

5.4 A beneficiary

A beneficiary can become insolvent both whilst being a beneficiary of a trust and also after ceasing to be a beneficiary of such a trust. The insolvency status of the beneficiary should not affect the trust, the trustee or the other beneficiaries.

5.5 A protector

A protector can be an individual of sound mind, including the settlor a body corporate firm or partnership.[4] The protector may also be a trustee or a beneficiary of the trust. Both an individual and a settlor (if they are individuals) if insolvent may be subject to bankruptcy proceedings under the Insolvency Act 2009. Otherwise, if the protector is a corporate entity which is subject to insolvency proceedings either by creditors to whom a debt is owed and there is a default as regards repayment by the protector. Alternatively, the board of the corporate entity should appoint a provisional liquidator once they become aware that the entity is insolvent.

6. Do you distinguish between claims made against each of the parties stated in question 5 in respect of their obligations in acting for or in relation to the trust and, on the other hand, obligations incurred privately and personally?

In view of the fact that a trust is an arrangement and not a legal entity, any claim against a trust should be directed against the trustee. It would be relevant to distinguish between a claim against a trustee in relation to the administration of a trust and on the other hand a claim privately on the trustee.

First, a trustee generally is a corporate entity licensed by the Financial Services Commission of Mauritius. If the claim against the trustee is for a debt connected with the trust, the trustee will have to ensure that, if the debt is for a sum of money due and payable and that the trust assets are surplus to the liabilities, he is under an obligation to pay. If the trust assets are not sufficient to meet its liabilities, and the trustee is unable to pay the debt amount, then the trustee if faced with such claim will have to seek an order from the Court pursuant to the Act for the termination of the trust and the distribution of the assets.

On the other hand, if a claim is made against the trustee in its private capacity, and the trustee is unable to meet the claim, the claimant can initiate insolvency proceedings against the trustee pursuant to provisions of the Insolvency Act 2009. Also, the claimant may be able to make a statutory demand and ultimately require the Court to make an order for the winding up of the trustee company. Otherwise for the other claims there should not be a major difference.

7. What are your main insolvency procedures that could be relevant?

Insolvency procedures are set out in the Insolvency Act 2009. This statute consolidates the procedures applicable to corporate entities and individuals who can go bankrupt.

As regards an individual, a debtor is adjudicated bankrupt when –

- a creditor of the debtor petitions the Court for a bankruptcy order; or
- the debtor petitions the Court for a bankruptcy order;

and in either case, the Court makes the bankruptcy order.

The Court will only issue a bankruptcy order on a creditor's petition if one of the following grounds of adjudication is established to the satisfaction of the Court.

4 Section 24, Trusts Act 2001.

- Failure to comply with bankruptcy notice.
- Departure from Mauritius with intent to defeat or delay a creditor;
- Notification in writing by the debtor to a creditor that he has suspended or proposes to suspend, payment of his debts.
- Admission to creditors that the debtor is insolvent.

For a corporate trustee, the board of the trustee company must pursuant to section 162 of the Companies Act 2001, call for a board meeting once it believes that the company is unable to pay its debts and to determine whether a liquidator or an administrator is appointed. Creditors can also sue the company and call for a creditor winding up of the company.

8. What is the effect of bankruptcy on the following?

8.1 A trust

As explained above, and if we could call a trust bankrupt in Mauritius, the direct effect is that the creditors can apply to court for an order for the termination of the trust and the distribution of the assets pursuant to section 58 of the Trusts Act.

8.2 A settlor

The bankruptcy of a settlor would render the person incapacitated to conduct any commercial transaction or role. He will not be able to gift any asset as a bankrupt as he would fall under the supervision of the Official Receiver. However, if his bankruptcy occurs after the trust has been formed, it should not affect the trust.

8.3 A trustee

An insolvent trustee (as mentioned above being a corporate trustee) must be put into administration or liquidation.

8.4 A beneficiary

A bankrupt beneficiary will be subject to the procedure following his adjudication as a bankrupt under section 22 of the Insolvency Act 2009. The Official Receiver will advertise the adjudication and the bankrupt beneficiary is required to file with the Official Receiver a statement of his affairs. All his property will vest with the Official Receiver.

8.5 A protector

A protector has a specific supervisory role in the administration of the trust by a trustee with certain powers in the terms of the trust. His bankruptcy will inevitably bring him under the purview of the Official Receiver and he would be inapt to fulfil this role. As a result, he will have to step down and arrange to have him replaced in line with the terms of the trust instrument.

9. Can an insolvency procedure extend to trust assets located in the local and / or foreign jurisdictions?

9.1 Local jurisdiction

An insolvency proceeding, more specifically an international insolvency proceeding, can be extended to any property in Mauritius inclusive of but not limited to trusts assets.

If a judgment is given in a foreign jurisdiction and such a judgment relates to the assets in a trust in Mauritius, the judgment can be enforced in Mauritius by making it executory by the process of *exequatur* as provided for under Article 546 of the *Code de Procedure Civile*. Also, a creditor can initiate proceedings in Mauritius where the trust assets are situated.[5]

9.2 Foreign jurisdictions

A creditor may choose to initiate proceedings in relation to a trust in Mauritius and may choose to extend such proceedings in another jurisdiction. A judgment given in Mauritius may be enforced in another jurisdiction subject to meeting the requirements and protocols of that jurisdiction. If the Mauritian Authorities are to lay hands on the assets overseas, then there are statutory provisions under the Financial Intelligence and Anti-Money Laundering Act 2002 and the Mutual Assistance in Criminal and Related Matters Act 2003.

10. Can trusts be challenged?

10.1 To obtain assets

The Act provides that the court may declare a trust void, where it is established that the trust was made with the intent to defraud persons who were creditors of the settlor at the time when the trust property was vested in the trustee.[6] The Trusts Act provides that no action shall lie against the trustee of a trust after more than 2 years from the date of the transfer or disposal of the assets of the trust.

10.2 To obtain information

Pursuant to section 33 of the Trusts Act, a trustee is required on receipt of a request to provide accurate information as to the state and amount of the trust property and the conduct of the trust administration:

- to the Court, and to the settlor, the enforcer, or the protector of the trust, unless the trustee has reason to believe that such a person is making the request under duress; and
- where the terms of the trust so authorise to any beneficiary of the trust of full age who has legal capacity and having a vested interest in the trust; and to any charity for the benefit of which the trust was established.

5 *Alison Joan Henwood v Barclays Bank Plc* (*Offshore Banking Unit*) 2003 SCJ 205.
6 Section 11(3), Trusts Act 2001.

In *Vignaud v Temple Corporate Services*, the applicant who was a beneficiary under the trust applied for an order to the Supreme Court for an order for disclosure for information pursuant to section 33. The Supreme Court declined the application on the grounds that the terms of the trust had not authorised this. In this case the terms of the trust were silent on the question of disclosure. The Court held that in the absence of any express provision to this effect, no disclosure order could be made.

10.3 To examine witnesses

This has not taken place in the normal course of matters.

11. On what grounds can a trust arrangement be challenged?

11.1 The settlor was insolvent when the trust was created or became insolvent as a result of creating it

Challenging a trust created by a settlor who was bankrupt will definitely be a ground to successfully challenge a trust.

11.2 The settlor becomes insolvent

A settlor becoming insolvent after a trust has been formed is most unlikely to vitiate a trust. The only situation that the trust could be challenged would be if the trust was formed with the intent to defraud creditors.

11.3 The settlor lacked capacity or authority to create the trust

This can certainly be a ground to challenge a trust. For example, if the settlor was of unsound mind it would be a valid ground.

11.4 The settlor lacked the capacity or authority to transfer the assets to the trustees

The answer would be similar as 11.3 above.

11.5 The assets were not validly transferred, or the transfer was not fully completed

Section 7 of the Trusts Act sets out the provisions relating to transfer of property on trust.

11.6 The trust was not validly created

This could be a ground for challenge.

11.7 Reasons why a transfer could be subsequently set aside as void or voidable

- A mistake.
- If there was an undervalue.
- If there was a preference.
- If there was a sham.

[7] 2011 SCJ 153.

12. What protections and defences exist to protect those listed in section 5 and are they statutory or common law or otherwise?

The only defences available would be for the party to show that he had capacity or that the action required on his part to complete a transfer. The Act does not specifically mention the defences and any such defence would be based on common law or precedents from the UK or other Commonwealth jurisdictions.

13. Can claims be made in a bankruptcy where the insolvency office holder stands in the shoes of a bankrupt to exercise the rights given by the trust in favour of the trustee?

If the bankrupt is an individual, once adjudicated bankrupt by the court, all the assets of that person would be vested with the Official Receiver who is appointed by court.

14. Are rights of subrogation established by law?

The rights of subrogation are provided in the Code Civil Mauricien (The Mauritian Civil Code) which is a code derived from the French Code Napoleon. The relevant articles are 1249 to 1252. Pursuant to the provisions of the Civil code, rights of subrogation in Mauritius can arise by agreement or by operation of the law pursuant to the provisions of the Civil Code.

Rights of subrogation enable a third party to exercise the rights of a creditor where:

(i) the creditor upon receipt of payment from such third party subrogates him to his own rights, powers, privileges and remedies against the debtor and such subrogation is expressly agreed by the parties at the same time as payment of the debt; or

(ii) where the debtor borrows money from such third parties for the purpose of repaying the debt, in which case the loan agreement has to be made before a Notary.

14.1 Operation of law

Subrogation can also arise by operation of the law in the following circumstances for the benefit of:

- a creditor who repays the debt of another preferred creditor; or
- a purchaser of an immovable property paying the creditors to whom the property was mortgaged from the funds used for the acquisition; or
- a debtor who is liable with others or for others for the payment of the debt and had an interest in repaying the debt; or
- a heir who has repaid the debts of the succession out of his proprietary funds.

15. Can the veil of a company owned by a trust be pierced or lifted and, if so, in what circumstances?

The veil of a company can be pierced in circumstances where it can be established that the company was set up as a cloak for fraud or misconduct. It is irrelevant that the company is owned by a trust.

16. Can the veil of a trust be pierced or lifted and, if so, in what circumstances?

Contrary to a company, a trust is not an incorporated entity. It is an arrangement between a settlor and a trustee to administer the assets of the trusts for the benefit of appointed beneficiaries. Therefore, the question of lifting the veil of a trust is not applicable.

17. If a trust can be treated as insolvent, is this on the basis of the cash flow test, the balance sheet test or another test and, if so, what test?

Part of this question has been addressed in question 9 above. The key test to apply in relation to the inability of a trustee to meet a claim is whether the assets in the trust are sufficient to meet the liabilities.

18. Can or have receivers been appointed to act as a trustee or with powers over trust assets? If so, in what circumstances?

There are no reported judgments where a receiver has been appointed to act as trustee or with powers over trust assets in Mauritius. The Act does not stipulate any provision to this effect and it is unclear how a receiver can be appointed.

If the trustee is a company formed under the Companies Act 2001, according to this statute, then the directors of the company must appoint a liquidator as soon as they are aware that the company is insolvent. The company must stop trading otherwise the directors run the risk of being personally liable for the debts of the company.

A receiver under Mauritius law is appointed under an instrument or charge or by a court.

19. Are claims against trustees limited or unlimited? If limited, are they limited as to amount and by time? Do underlying companies have a role?

Claims against trustees may be unlimited and clients would be prudent to choose a trustee which has a track record and have established a reputation and have competent qualified professionals to support its portfolio of clients. Also, such companies would be keen to have an insurance cover to mitigate their liabilities in the event of any claims. Depending on the terms and conditions and of the engagement, some trustees could choose to limit their liability for a claim for a specific period of time and may in defence argue that being a company they have a limited liability.

20. Are there provisions or cases where trusts, or those connected to them, are based in a foreign jurisdiction?

It is fairly common to find that in most trusts which are set up in Mauritius, the settlor and the beneficiaries are located in various jurisdictions.

21. What are the main means to seek assistance from another jurisdiction?

From the perspective of the authorities who need to seek assistance from other jurisdictions, the Financial Intelligence Unit of Mauritius (the FIU) is a body constituted under the Financial Intelligence and Anti-Money Laundering Act 2002. The FIU forms part of the Egmont Group.

22. What is the position as to whether the foreign jurisdiction does or does not recognise trusts?

This would not matter. First, from a regulatory perspective, it is common knowledge that regulators do have a collaboration with their counterparts in various countries. The FSC of Mauritius has signed a Memorandum of Understanding with the non-banking financial services regulators with various countries. Collaboration does also happen on an informal basis.

23. What particular issues, difficulties and solutions have arisen or may arise relating to trust arrangements or those involved with them?

It is clear that Mauritius is a jurisdiction where trusts are recognised by our law. Issues may arise where the trust may have been set up with the objective of defeating creditors' claims or that the trust is a sham.

SINGAPORE

1. Are trusts legal and valid under domestic law? What are they principally used for?

Trusts are legal and valid under Singapore domestic law. Singapore, a former British colony, inherited English trust law. Equitable principles first became part of Singapore law by virtue of the Second Charter of Justice 1826. Under s. 3(1) of the Application of English Law Act,[1] the "common law of England (including the principles and rules of equity), so far as it was part of the law of Singapore immediately before 12 November 1993" continues to be part of the law of Singapore. Under this common law system, the legal and equitable interests in property can be separated.

Where property is held on trust, the trustee holds the legal title of the property, whereas the beneficiary holds the equitable interest in it. Generally, the legal interest is enforceable against the world, at large; the caveat for equitable interests is that it cannot be enforced against a *bona fide* purchaser for value without notice. As will be discussed below, this rule of thumb is not, however, without exceptions.

In terms of their principal use, there is a basic division between private and public trusts in Singapore. Private trusts are predominantly used by and for individuals, and enforced by the beneficiaries themselves; there are, however, also non-charitable purpose trusts.[2] Private trusts can be divided into express, constructive and resulting trusts, and this first category, of express trusts, can be divided further into fixed and discretionary trusts, executed and executory trusts, as well as completely and incompletely constituted trusts. A new, more sophisticated form of alternative vehicle for the channelling of commercial investment by unit holders through a joint enterprise has been introduced into Singapore jurisprudence more recently, by the Business Trusts Act[3] - these are termed "business trusts". They are still a type of trust – the legal and beneficial interests are separate, and the owner of the legal title is subject to obligations owed to the owner of the equitable interest.[4] In Singapore, private trusts are most commonly used for, *inter alia*, estate planning, asset protection and now even as investment vehicles.

Public trusts, on the other hand, are used for purposes beneficial to the community, and enforced by the Attorney General: see s. 9(1) of the Government Proceedings Act.[5]

2. Are foreign trusts recognised under your private international laws?

Foreign trusts are recognised under Singapore private international laws. Singapore, however, is not party to The Hague Convention on the Law Applicable to Trusts and on their Recognition. Whether the equitable obligations that arise from a foreign trust can be enforced in Singapore depends on the extent to which the foreign law that governs the underlying relationship recognises them. The choice of law rules for trusts are drawn by analogy from contracts. In other words, the proper law of the trust is the law chosen by the trustee, or, in the absence of such choice, the system of law to which the trust has the closest connection.[6] The approach is three-fold, namely,

(a) first, to determine if the trust arrangements state expressly what the governing law is,

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1 (Cap. 7A, 1994 Rev Ed).
2 In *Bermuda Trust (Singapore) Ltd v Wee Richard* [1998] SGHC 390, for example, trusts for the purpose of performing Sinchew rites, a form of ancestor-worship ceremonies, were recognized.
3 (Cap. 31A, 2005 Rev Ed).
4 *Re Croesus Retail Asset Management* [2017] SGHC 194, at ¶10.
5 (Cap. 121, 1985 Rev Ed).
6 *Trisuryo Garuda Nusa Pte Ltd v SKP Pradiksi (North) Sdn Bhd and anor and anor appeal* [2017] SGCA 49 at ¶41, citing *Halsbury's Laws of Singapore*, Vol. 6(2) (Singapore: LexisNexis, 2016) at ¶75.330.

(b) in the absence of an express provisions, to see whether the intention of the parties as to the governing law can be inferred from the circumstances, and

(c) if this cannot be done, to determine the system of law to which the trust has the most close and real connection.

See *Overseas Union Insurance Ltd v Turegum Insurance Co,*[7] approved in *Pacific Recreation Pte Ltd v S Y Technology Inc.*[8] where equitable duties arise from a factual matrix where the legal foundation is premised on an independent established category, such as contract or tort, it is appropriate to centre the choice of law analysis on the established category concerned.[9] If the principles of foreign law are in issue, the Singapore courts will require evidence as to how this foreign law should be applied.[10]

3. Are there any prohibitions against trusts?

Aside from any express prohibitions specially drafted into the trust deed by the parties to it,[11] there are certain general prohibitions against the creation of trusts in Singapore. Four particular instances merit further consideration, namely, (1) illegality and public policy, (2) insolvency restrictions, (3) attempts to defraud creditors and (4) the general anti-avoidance provision under s. 33 of the Income Tax Act.[12]

3.1 Illegality and public policy

A trust may not be created for a purpose that is illegal or contrary to public policy. If a trust is found to have been entered into for such purposes, it would be considered void and unenforceable.[13] At the heart of the doctrine of illegality is a dichotomy, between statutory illegality, in breach of a particular statutory provision, and illegality at common law, where the trust would have been prohibited by any head of public policy.[14] There is a diversity of illegal trusts under such heads; a trust may be illegal because it is established for an illegal purpose, as where a trust is established in order to conceal monies from criminal activities, or for an illegal consideration, as where a trust is established in consideration of the commission of an offence, or because it obliges the trustees or the beneficiaries to commit an illegality.[15] In determining whether it would be proportionate to render the trust unenforceable, the Court will likely consider, *inter alia*, the same factors taken into account in *Tan Siew May v Boon Lay Choo and anor,*[16] where an option to purchase a property was ultimately found to be illegal, namely, (i) whether allowing the claim would undermine the purpose of the prohibiting rule, (ii) the nature and gravity of the illegality, (iii) the remoteness or centrality of the illegality to the contract, (iv) the object, intent and conduct of the parties, and (v) the consequences of denying the claim.[17]

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7 [2001] 2 SLR 885 at ¶82.
8 [2008] 2 SLR 491at ¶36.
9 *Trisuryo Garuda Nusa*, n 6, at ¶41, citing *Rickshaw Investments* [2007] 1 SLR(R) 377 at ¶81 and TM Yeo, *Choice of Law for Equitable Doctrines* (Oxford: Oxford University Press, 2004).
10 *Pacific Recreation,* n 8.
11 For example, *British & Malayan Trustees Ltd v Abdul Jalil bin Ahmad and ors* [1990] 2 SLR(R) 449 at ¶¶25 and 26.
12 (Cap. 134, 2001 Rev Ed).
13 The approach adopted towards illegal contracts in *Ting Siew May v Boon Lay Choo and anor* [2014] 3 SLR 609 at, *inter alia*, ¶¶112 and 124 (*cf.* the view of the English Law Commission that an illegal trust is valid but unenforceable: see at ¶¶6.62 and 6.68).
14 *Ting Siew May*, *ibid*, at ¶28.
15 The Report by the Law Commission of England and Wales, *Illegal Transactions: The Effect of Illegality on Contracts and Trusts*, (London, United Kingdom: 1999) LCCP No 154, cited approvingly in *Ting Siew May, ibid*, at ¶¶45, 66 and 69.
16 *Ting Siew May*, *ibid.*
17 *Ting Siew May, ibid*, at ¶70.

3.2 Insolvency restrictions

A trust arrangement under which the settlor is insolvent when creating it, or becomes insolvent as a result of creating it, is also proscribed under Singapore law. Any disposition of a property by a company that has been wound up or an individual adjudged to be bankrupt shall be void, unless the Court orders otherwise.[18] Any disposition of a transfer of assets without consideration can be set aside as a transaction at undervalue if it takes places within the five years before the bankruptcy petition or winding up application was presented before the settlor.[19] However, the settlor must have been insolvent at the material time, or become insolvent in consequence of the transaction.[20]

3.3 Attempts to defraud creditors

Where a settlor is found to have effected a trust with intent to defraud creditors, the creditors may still be able to unwind the trust – even if more than five years have passed since the initial transfer, unlike the abovementioned insolvency restrictions.[21] S.73B of the Conveyancing and Law of Property Act[22] expressly provides that any conveyance of property made with the intent to defraud creditors shall be voidable at the instance of any person thereby prejudiced.

3.4 The general anti-avoidance provision under s. 33 of the Income Tax Act

A trust arrangement cannot contravene s. 33 of the Income Tax Act.[23] Under this provision, where the Comptroller is satisfied that the purpose of any arrangement, including any trust and all steps which it is carried into effect, has been planned to directly or indirectly, *inter alia*, alter the incidence of any tax payable or otherwise payable by a person or reduce or avoid any liability of a person to pay tax or make a return, the Comptroller may disregard or vary the arrangement as he considers fit. He has the power to compute or recompute any gains or profits, or impose liability to tax, to counteract any tax advantage obtained or obtainable under such arrangement. Trusts devised to circumvent this GAAR will be regarded as tax avoidance arrangements,[24] and set aside.

Where a trust is held to be void, as it was created despite the abovementioned prohibitions, the trustees hold the trust property on resulting trust for the settlor.[25] Any distributions out of the trust funds are also void, and may be recovered by the settlor.[26] Where a trust is held to be valid but unenforceable, however, it is arguable that the trustee still notionally holds the property on the illegal trust. As the trust is unenforceable, the beneficiaries will unfortunately be unable to enforce the trustee's fiduciary obligations. In such circumstances, the trustee can treat the legal and beneficial title as his own and pass such title without incurring liability for a breach of trust.

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18 Section 259, Companies Act (Cap. 50, 2006 Rev Ed); s. 77, Bankruptcy Act (Cap. 20, 2009 Rev Ed).
19 Section 87, Trustees Act (Cap. 337, 2005 Rev Ed), which specifically refers to s. 329, Companies Act, *ibid*, read with ss. 98 and 100, Bankruptcy Act.
20 Section 100(2), Bankruptcy Act, *ibid,*
21 Section 86, Trustees Act, n 19,
22 (Cap. 61, 1994 Rev Ed),
23 Income Tax Act, n 12,
24 Inland Revenue Authority of Singapore (IRAS), 'IRAS e-Tax Guide' (11 July 2016), https://www.iras.gov.sg/irashome/uploadedFiles/IRASHome/e-Tax_Guides/etaxguides_CIT_The%20General%20Anti-avoidance%20Provision%20and%20its%20Application.pdf (accessed 16 August 2017); *AQQ v CIT* [2012] SGHC 249, at ¶154 on the relevant factors used to determine whether a tax avoidance arrangement exists.
25 For example, *Illegal Transactions,* n 15, at ¶4.1.
26 *Ibid.*

4. Are trusts and service providers regulated?

The principal statutes governing trust and service providers are the Trustees Act,[27] the new Trustees (Transparency and Effective Control) Regulations 2017 (the TA Regulations),[28] the Trust Companies Act,[29] the Trust Companies Regulations 2005[30] and the Business Trusts Act.[31]

The Trustees Act provides the basic legislative framework for trustees of trusts established under Singapore law. It defines a trustee's duties of care and general powers (including that of investment, and the right to appoint agents, nominees[32] and custodians)[33] and, unless expressly excluded by the trust instrument, is administered by the Ministry of Law. On 31 March 2017, the Trustees Act was amended, and the new TA Regulations were subsequently introduced. The TA Regulations set out the details of the new framework of statutory obligations on trustees of express trusts, in respect of trusts governed by Singapore law, administered in Singapore and which have a Singapore resident as one of its trustees.[34] Under the Act, trustees are now expected to:

(i) Carry out their general power to invest[35] subject to standard investment criteria,[36] as well as an obligation to obtain and consider proper advice and carry out periodic reviews.[37]

(ii) Keep accounting records related to relevant trusts,[38] and render annual returns of accounts, within the statutorily prescribed time limits.[39]

(iii) Obtain, keep and maintain up-to-date information on relevant trust parties (including the settlor, trustee, protector and beneficiary)[40] and their effective controllers,[41] as well as service suppliers,[42] verified by means of reliable and independently sourced data, documents or information. and

(iv) Disclose to any specified person with whom the trustee forms a business relationship or enters into a prescribed transaction after 30 April 2017 that he is acting for the relevant trust, beforehand.[43]

The Trust Companies Act and Trust Companies Regulations 2005, on the other hand, aim to regulate the trust business licensing regime, irrespective of whether the trusts are established under domestic or foreign law. The Monetary Authority of Singapore (the MAS), rather than the Ministry of Law, supervises trust companies by means of

27 Trustees Act, n 19.
28 (No. S 151 of 2017).
29 (Cap. 336, 2006 Rev Ed).
30 (Rg 4, 2006 Rev Ed).
31 Business Trusts Act, n 3.
32 Section 41G, Trustees Act, n 19.
33 Section 41H, *ibid*.
34 Section 84, *ibid*.
35 Section 4, *ibid*.
36 Although diversification is necessary only "in so far as appropriate to the circumstances of the trust": sections 3A(2) and 5(3)(b), *ibid*.
37 Sections 5 and 6, *ibid*.
38 Section 9, *ibid*, as well as s. 9, TA Regulations, n 28.
39 Section 78, Trustees Act, *ibid*.
40 Section 4, TA Regulations, n 28.
41 Section 5, *ibid*.
42 Section 6, *ibid*.
43 Section 8, *ibid*.

off-site reviews, on-site inspections (whether full or thematic) and company visits,[44] and also issues guidelines, which all licensed trust companies must adhere to.[45] This regulatory framework sets out the licensing requirements for persons conducting trust businesses in Singapore, the suitability requirements for managers, directors and significant shareholders of trust services companies,[47] the financial requirements for trust services companies, as well as their obligations to prevent money laundering and counter the financing of terrorism. No person is allowed to carry out trust business in or from Singapore unless that person is a licensed trust company. This ensures that only fit and proper persons are allowed to operate in the trust services industry, to promote confidence in Singapore's robust private banking and wealth management industry, as well as its overall reputation as an international financial centre. The trust business activities regulated under the Trust Companies Act are stated below:[48]

(i) Providing services with respect to the creation of an express trust.

(ii) Acting as a trustee in relation to an express trust.

(iii) Arranging for any person to act as trustee in respect of an express trust. and

(iv) Providing trust administration services in relation to an express trust.

Private trust companies, lawyers and accountants assisting in the creation of trusts or providing non-discretionary services,[49] executors and administrators of the estates of deceased persons, bare trustees, charitable trustees and trustee-managers of business trusts are excluded from the ambit of the Trust Companies Act, as the trusts involved are not actively used for investment and wealth planning purposes.[50] Private trust companies are, nevertheless, still required to engage a licensed trust company to carry out trust administration services necessary to comply with MAS written directions on anti-money laundering and the financing of terrorism.[51]

Business trusts, on the other hand, unlike bare trusts and charitable trusts which are under the sole regulatory ambit of the Trustees Act, are regulated specifically by the Business Trusts Act. The Business Trusts Act provides for the governance and regulation of registered business trusts, and sets out its own comprehensive

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44 MAS, '*Trust Companies Act (Chapter 336): Frequently Asked Questions'* (30 December 2016), http://www.mas.gov.sg/~/media/MAS/Regulations%20and%20Financial%20Stability/Regulations%20Guidance%20and%20Licensing/Trust%20Companies/FAQs_TCA_revised%2030%20December%202016.pdf (accessed 17 August 2017).

45 In particular, MAS Guidelines TCA-G02 and FSG-G01, which set out the criteria for granting a trust business license and the fit and proper criteria applicable to all relevant persons carrying out an activity regulated by the MAS, respectively.

46 All licensed trust companies must, for example, have at least two resident managers, who are fit and proper persons, with some satisfactory tertiary education or professional qualifications. One of them must have a minimum of five years of relevant working experience, and the other at least three.

47 This includes a minimum paid-up capital and / or qualifying assets of S$250,000, as well as adequate professional indemnity insurance to cover all liabilities arising out of the negligent discharge of its duties, for an amount commensurate with the levels of risk of its business, of at least the higher of S$1 million or 2.5 times the turnover (based on the previous year, or estimated, if a new business) of the trust business.

48 The First Schedule, Trust Companies Act, n 29.

49 Lawyers may also act as trustees in relation to express trusts without obtaining a license provided that the MAS notifications are complied with, and the financial assets and number of clients relating to such trusts are below the prescribed amounts.

50 MAS, 'Trust Companies Act (Cap. 336): FAQ', at n 44. For a complete list of persons exempt under the Trust. Companies Act and the scope of exemption, section 15, Trust Companies Act, n 29, and Rule 4 of the Trust Companies (Exemption) Regulations (Rg 1, 2006 Rev Ed).

51 Rule 4(2), Trust Companies (Exemption) Regulations, *ibid.*

framework as to the duties of the trustee-manager, management, audit and winding-up, some of which are similar to the provisions under the Companies Act.[52]

All trust companies (irrespective of whether licensed under the Trust Companies Act or exempt), however, are required to abide by both MAS Notice TCA-N03 and the guidelines issued to it, which were published on 30 November 2015. The Notice and guidelines regulate trust companies' operations and business activities.

5. Can the following become insolvent and subject to insolvency procedures?

5.1 A trust itself

A trust can become insolvent and subject to insolvency procedures. In considering the impact of insolvency on trusts, trust arrangements that create a 'quasi-security' arrangement and trust companies that have become insolvent must be considered separately. This will be discussed further under 8.1 below.

5.2 A settlor

A settlor can become insolvent and subject to insolvency procedures, both before and after the creation of the trust. This will be discussed further under 8.2 below.

5.3 A trustee

A trustee can become insolvent and subject to insolvency procedures, both whilst a trustee and after ceasing to be a trustee. This will be discussed further under 8.3 below.

5.4 A beneficiary

A beneficiary can also become insolvent and subject to insolvency procedures, both whilst a beneficiary and after ceasing to be a beneficiary. This will be discussed further under 8.4 below.

5.5 A protector

Under Singapore law, it is possible for settlors to appoint a protector (whether individual or corporate) to supervise the trustee in his administration of a trust. The protector will usually be granted the authority to replace trustees or make modifications to the trust instrument, to manoeuvre the performance of the trust, in accordance with the settlor's preferences – the settlor therefore retains some form of control over both the trust and the trustee.[53] Where a protector is appointed, the role of the trustee appears to be reduced to that of a mere 'agent' for the settlor. A protector can become insolvent and subject to insolvency procedures. This will be discussed further under 8.5 below.

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52 *Re: Croesus Retail Asset Management Pte. Ltd.* [2017] SGHC 194 at ¶10, where, in considering how a business trust arrangement should be restructured, the Singapore High Court approved the utilisation of the usual requirements under s. 210, Companies Act, n 18, subject to modification if necessary.

53 TH Tey, '*Reservation of Settlor's Powers*' (2009) *21 Singapore Academy of Law Journal 517* and *TH Tey, Trust Protector* (2008) *20 Singapore Academy of Law Journal* 273, for a further discussion on the role of protectors.

6. Do you distinguish between claims made against each of the party stated below in respect of their obligations in acting for or in relation to the trust and, on the other hand, obligations incurred privately and personally?

The obligations incurred with respect to a trust usually remain professional, if incurred in such capacity.

(1) If however, in the course of winding up, a trustee-manager of a registered business trust, is found to have engaged in fraudulent trading, he shall be guilty of an offence and liable on conviction to a fine, a term of imprisonment or both.[54] The court may, on the application of the liquidator or any creditor or unitholder of the trust, declare him personally responsible without any limitation of liability for the payment of the debt so incurred (in whole, or in part).[55]

(2) On first principles, a trustee of a trust fund or vehicle (whether individual or a trust company) who enters a contract with a third party is *prima facie* personally liable to the third party, given that a trust fund has no legal personality. However, where a trustee incurs a liability towards a creditor in the proper discharge of the trust, he is entitled to a trustee's indemnity in two forms, namely -

- a right to be indemnified out of the trust property, which is effected by a lien or charge (thereby taking priority over claims of any beneficiary), and
- a personal indemnity against the beneficiary which extends beyond the trust assets.[56]

In circumstances where there is no direct dealing between the trust creditor and beneficiaries, however, trust creditors can only institute their claims against the trustee personally, and not against the trust assets.[57]

7. What are the main insolvency procedures that could be relevant?

The various corporate insolvency and restructuring regimes applicable to companies in Singapore are set out under the Companies Act and its subsidiary legislation. Aside from liquidation and receiverships, there are also various pre-insolvency proceedings, which afford a debtor in financial difficulties an interim opportunity to avoid the commencement of formal insolvency proceedings – namely, judicial management and schemes of arrangement.

Each of these four different regimes will be discussed briefly, to provide an overview of Singapore's insolvency regime.

7.1 Liquidation

Under the Companies Act, the most common ground to compulsorily wind up a company is on the basis that it is unable to pay its debts.[58] Under s. 254(2) of the Act, a company is deemed unable to pay its debts where:-

54 Section 50(1), Business Trusts Act, n 3. In such circumstances, the fine shall not exceed S$100,000, and the imprisonment shall be for a term not exceeding 2 years.
55 Section 50(2), *ibid.*
56 *EC Investment Holding Pte Ltd v Ridout Residence Pte Ltd and anor* [2013] 4 SLR 123, at ¶13.
57 *Ibid*, at ¶15.
58 Section 254(1)(e), Companies Act, n 18.

(i) a company neglects to pay a debt of at least S$10,000 three weeks after a statutory demand is served on it;

(ii) execution or another process issued on a judgment, decree or order of court in favour of a creditor of the company is returned unsatisfied; or

(iii) it is proved to the court's satisfaction that the company is unable to pay its debts, taking into account contingent and prospective liabilities.

Aside from compulsory liquidation by the court,[59] members or creditors may also apply for voluntary liquidation,[60] In such circumstance, the members or creditors will have the right to choose the liquidator themselves. Once the winding-up order is made or a provisional liquidator is appointed, there is an automatic stay of legal proceedings – unless the court gives leave for these to continue, in the interests of justice.

7.2 Receivership

Private receivership[61] is commonly regarded as a corporate insolvency regime, although, unlike liquidation and judicial management, it is not a collective or court-administered process. Receivership is, in essence, a mode of enforcing security. In the corporate insolvency setting, a receiver is normally appointed by a security holder for the primary purpose of realising the security and applying the proceeds of sale towards the discharge of debts owed to him. Where the security is a floating charge that covers the undertaking of the company, the receiver is also conferred powers of management over the said undertaking and therefore referred to as a receiver and manager.[62]

7.3 Judicial Management

Both Judicial Management and Schemes of Arrangement are methods of formal financial reorganization. Judicial Management is an interim measure designed to allow companies in financial trouble an opportunity to rehabilitate, or preserve their business, as a going concern.[63] Pursuant to the Companies (Amendment) Act 2017,[64] an action can be brought in respect of unregistered or foreign companies,[65] as well as when a company is likely to be unable to pay its debts – even if it has not reached that stage yet.[66] It cannot, however, be ordered for companies that are already in winding up, or for banks, finance companies or insurance companies.[67] A company or its directors (pursuant to a resolution of its members or the board of directors) may make an application for a judicial management order from the Court.[68]

59 Under Part X, Division 2, *ibid*, in particular s. 247.
60 Under Part X, Division 3, *ibid*, *ibid.*
61 Part VIII, *ibid*. The provisions in the Companies Act are largely procedural in nature, and designed to ensure that members and creditors of the company continue to have sufficient information *vis-à-vis* the financial status of the Company after a receiver is appointed.
62 EB Lee et al., *Report of the Insolvency Law Review Committee: Final Report* (Singapore: Ministry of Law, 2013), at p 50.
63 Part VIIIA, Companies Act, n 18, in particular s. 227A.
64 (No. 15 of 2017).
65 Pursuant to the revised definition of "company" under s. 227AA, Companies Act, n 18.
66 Section 227B(a), *ibid.*
67 Section 227B(7), *ibid.*
68 Section 227B, *ibid.*

Certain threshold requirements must be met, before a judicial management order will be granted. First, the Company must be insolvent,[69] and, second, at least one of the three statutory purposes of judicial management must be met, namely that:

(i) the company will survive or the whole or part of its business will remain as a going concern;

(ii) judicial management is a condition to the approval of a court-ordered scheme of arrangement that the company has entered into with its creditors; or

(iii) realisation of a company's assets will be more advantageous in a judicial management situation than a winding up.

Once a judicial management order is made, the business and property of the company will be managed by a judicial manager, instead of the board of directors, for a period of 180 days (subject to an extension by the Court).[70] During this period, the company may not be wound up, a receiver and manager cannot be appointed over its property, and there will be a moratorium on any legal claims against it, unless leave of court or the judicial manager is obtained.[71] The judicial manager has the power to apply for rescue funding to be 'super' prioritised, ahead of all other secured debt.[72]

7.4 Schemes of Arrangement

The scheme of arrangement framework, on the other hand, is intended to provide machinery to overcome the impossibility of obtaining the individual consent of each member of a class to a compromise arrangement, and to prevent a minority from frustrating what would be a beneficial scheme.[73] Any corporation or society liable to be wound up under the Act can apply for a scheme of arrangement.[74] Where a scheme or compromise is proposed between a company and its creditors or any class of them, or between a company and its members or any class of them, the Court may, on the application in a summary way of the company or any member (or the liquidator, in the case of a company being wound up), order a meeting of the creditors, members or class of creditors or members to be summoned in such manner as the Court directs. If the meeting approves the scheme by a majority in number representing three-quarters in value of the creditors, members or class of creditors or members, it can be considered for approval by the Court, subject to such modifications or conditions that the Court thinks fit.[76] As of 2017, there is now also a fast-track negotiation scheme that allows the Court to approve a scheme without holding a meeting of creditors.[77] Once approved by the Court, the scheme is binding on all creditors and members of the company.[78]

Pursuant to the Companies (Amendment) Act 2017, foreign companies with a substantial connection to Singapore can avail themselves under this regime. To enhance creditor protection, debtors must comply with the disclosure requirements

69 Under s. 227B(1)(a), *ibid.*
70 Section 277B(8), *ibid.*
71 Section 227D, *ibid.*
72 Section 227HA, *ibid.*
73 Section 210, *ibid.*
74 Section 210(11), *ibid*; the broad circumstances under which a company may be wound up are set out under s. 254, *ibid.*
75 Section 210(3AB), *ibid.*
76 Section 210(4), *ibid.*
77 Section 211I, *ibid.*
78 Section 210(3AA), *ibid.*

on the company's financial affairs,[79] and cannot dissipate assets[80] during the 30-day moratorium now imposed from the day the application is made.[81] This moratorium extends to subsidiaries with a "necessary and integral role in the compromise or arrangement".[82] The Singapore Courts also now have the power to grant a world-wide moratorium on legal actions and enforcement proceedings,[83] grant 'super' priority to rescue funders by priming them over pre-existing lenders,[84] and cram down on certain dissenting classes of creditors (provided certain conditions are met).[85] These powers mirror those available to the United States Courts under the Chapter 11 regime.

8. What is the effect of bankruptcy on the following?

8.1 A trust

Trust arrangements that create a 'quasi - security' arrangement and trust companies that have become insolvent must be considered separately:

8.1.1 Trust arrangements

Trust arrangements that result in assets being subjected to some form of 'quasi - security' arrangement generally fall outside the insolvency process, thereby depriving the *pari passu* rule of its intended effect to a considerable extent. These 'quasi - security' arrangements, which would include an express trust, *Quistclose* trust,[87] mistaken payment constructive trust[88] or constructive trust arising out of a breach of fiduciary duty,[89] generally cause the trust property to be exempt from distribution, in the face of insolvency. There has, however, been some debate as to whether the grant of a security can be impugned as an undervalue transaction, and the Singapore High Court has indicated that it prefers the view that it can.[90]

A secured creditor, however, must realise his security within six months of the date of the bankruptcy order or insolvency, or lose his entitlement to interest in respect of the debt.[91] The security itself, however, is not jeopardised, and can still be recovered. All unsecured property and those under trust arrangements that do not create a 'quasi-security' (such as resulting trusts), on the other hand, must be applied *pari passu* in satisfaction of the company's liabilities,[92] in accordance with the preferential order of priority set out under the Companies Act.[93]

79 Section 211B(6), *ibid.*
80 Section 211D, *ibid.*
81 Section 211B(8), *ibid.*
82 Section 211C, *ibid.*
83 Section 211C(5)(b), *ibid.*
84 Section 211E, *ibid.*
85 Section 211H, *ibid.*
86 *Re Kayford Ltd* [1975] 1 WLR 279.
87 *Barclays Bank v Quistclose Investments* [1970] AC 567.
88 *Chase Manhattan Bank v Israel-British Bank* [1981] Ch 105.
89 *Attorney General for Hong Kong v Reid* [1994] 1 AC 324.
90 *Encus International Pte Ltd (in compulsory liquidation) v Tenacious Investment Pte Ltd and ors* [2016] 2 SLR 1178, where Prakash J expressed her preference for the approach that the English Court of Appeal had adopted in *Hill v Spread Trustee Co Ltd* [2007] 1 WLR 2404 (rather than that in *Re MC Bacon Ltd* [1990] BCC 78), albeit *obiter dicta.*
91 Section 76(4) of the Bankruptcy Act, n 18, and s 327(2), Companies Act, n 18.
92 Section 300 of the Companies Act, *ibid.*
93 Section 328, *ibid.*

8.1.2 Trust companies and vehicles

The insolvency of trust companies and registered business trusts are governed by the Trust Companies Act and the Business Trusts Act respectively, as has been explained above.

8.1.2.1 Trust companies

Any licensed trust company which is or is likely to become insolvent, is or is likely to become unable to meet its obligations, or has suspended or is about to suspend payments, is statutorily required to immediately inform MAS of this fact. Failure to do so is an offence, punishable by a fine.[94] When MAS is:

- informed of or discovers that a licensed trust company is in such circumstance;
- of the opinion that such a company is carrying on its business in a manner likely to be detrimental to the interests of the public or the protected parties of the company, is likely to be unable to meet its abovementioned obligations; or has contravened the Act or the conditions attached to its licence; or
- simply considers it in the public interest,

it may require the company to immediately take or refrain from any action it considers necessary, appoint one or more statutory advisers (on terms and conditions it deems fit) to advise the company on its proper management, or assume control of and manage such of the business of the company itself.[95] MAS will, as soon as practicable, publish in the Gazette such particulars relating to its control of the company as it deems fit.[96] MAS or the statutory manager in control can apply to the High Court for an order that current (as well as former) officers or members of the company, *inter alia*, pay, deliver, convey, surrender or transfer, such property, books or information that they may have in their possession.[97] MAS may at any time fix the remuneration and expenses that the company is to pay to it or the statutory manager or advisor in control.[98]

8.1.2.2 Registered business trusts

The court may, on application of the trustee-manager or his director, a unitholder or creditor of the registered business trust, order the winding up of a registered business trust if, *inter alia*, within 3 months before the making of the application for the order, execution was issued on a judgment or a decree or order was obtained in court (whether in Singapore or elsewhere), in favour of a creditor, and the execution was returned unsatisfied.[99] Upon such order, the trustee-manager shall wind up the trust.[100] The court may, by order, appoint an approved liquidator to take responsibility for winding up, and give directions as to the procedures for the winding up as well as the powers, duties, obligations and remuneration that the liquidator is to have and

94 Section 21B, Trust Companies Act, n 29. The fine must not exceed S$50,000, and S$5,000 for every day thereafter for which the offence continues.
95 Section 21C, *ibid*. Failure to comply with any requirements imposed by MAS shall be punishable with a fine, under the same limits set out above.
96 Section 21E(4), *ibid.*
97 Section 21F, *ibid.*
98 Section 21G, *ibid.*
99 Section 46, Business Trusts Act, n 3.
100 Sections 46 and 47, *ibid.*

receive.[101] Any unclaimed monies arising from the trust property, or profits, income or other payments or returns to unit holders that have remained unclaimed, for more than 6 months from the date payable, shall be paid by the trustee-manager to the Official Receiver to be placed to the credit of the Business Trusts Liquidation Account, with a certificate of receipt as acknowledgment.[102]

If, in the course of winding up, a trustee-manager is found to have engaged in fraudulent trading, he shall be guilty of an offence and liable on conviction to a fine, a term of imprisonment or both.[103] The court may, on the application of the liquidator or any creditor or unitholder of the trust, declare him personally responsible without any limitation of liability for the payment of the debt so incurred (in whole, or in part).[104]

8.2 A settlor

The consequences when the settlor of a trust becomes insolvent (both before, as well as after the creation of the trust) have been considered in the detailed discussion under question 3 above. A trust arrangement under which the settlor was insolvent when creating it, or became insolvent as a result of creating it, may be voidable as a transaction at an undervalue. It should be expressly noted that trustees are considered associates of the bankrupt settlor, under s. 101(5) of the Companies Act. Therefore, an undervalue transaction entered into in favour of a trustee can be set aside if entered into by the settlor 2 years from the date of the bankruptcy petition or winding up application (rather than 6 months).

8.3 A trustee

Bankrupts cannot be appointed or act as trustees in respect of any trust, unless they obtain leave of court.[105] The impact of insolvency on trustees and beneficiaries was recently considered by the Singapore High Court in *EC Investment Holding Pte Ltd v Ridout Residence Pte Ltd and Another*[106] (*EC Investment Holding*), where creditors sought to enforce their rights against an insolvent trustee and insolvent beneficiary. The case concerned two contested options to purchase a property at 39A Ridout Road (the Property). The first option was granted to Ridout Residence Pte Ltd (Ridout), a corporate trustee created by a Mr. Agus Anwar (who was also its sole director, shareholder and beneficiary), to EC Investment Holding Pte Ltd ("ECIH"). After granting this first option, Ridout granted a second option to a Mr. Thomas Chan. Both ECIH and Mr. Chan sued Ridout for specified performance, when it resisted their attempts to exercise their options to purchase. The Court awarded specific performance and damages to Mr. Chan, whereas ECIH was only held to be entitled to damages. While proceedings were ongoing, a bankruptcy order was made against Mr. Anwar. Mr. Chan completed the sale and purchase of the Property, by discharging the pre-existing mortgage and charge over the property, pursuant to the Court Order. He paid the resulting excess of S$4 million (respective to the purchase price) into Court. The main issue that then arose before the court was the priority of claims, in what appeared to amount to a competition between the following parties.

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101 Section 48, *ibid.*
102 Section 49, *ibid.*
103 Section 50(1), *ibid*. In such circumstances, the fine shall not exceed S$100,000, and the imprisonment shall be for a term not exceeding 2 years.
104 Section 50(2), *ibid.*
105 Section 130(1), Bankruptcy Act, n 18.
106 *EC Investment Holding*, n 56.

(i) ECIH, for its claim of damages of S$19 million.

(ii) Mr. Chan, for a claim of damages of S$3 million as a result of late completion.

(iii) TYF Realty Pte Ltd (TYF), the property agent who had facilitated the sale to Mr. Chan, for its agent's fees of S$230,000.

(iv) The Official Assignee, who sought to enforce the claims Mr. Anwar's creditors had against his personal estate.

On the facts of *EC Investment Holding*, the Singapore High Court held that Ridout was entitled to an indemnity from the trust for its liability, following its contractual breaches, as Mr. Anwar had signed the contracts administering the trust with ECIH, Mr Chan and TYF in his capacity as a director of Ridout. ECIH and Thomas Chan's claims took precedence over the claims of TYF and Mr. Anwar's other creditors, as the Court Orders in their favour (and Ridout's right of indemnity against the trust assets with respect to these claims) pre-dated Mr. Anwar's bankruptcy. This indemnity would take priority over the claim of Mr. Anwar against Ridout, in his capacity as a beneficiary. TYF's claim for damages, however, was only accepted by the District Court after Mr. Anwar's bankruptcy. TYF's claim therefore stood *pari passu* with the debts of Mr. Anwar's other creditors, at best. In any event, however, as there were sufficient assets to meet the parties' claims, they agreed to rank *pari passu* and try to come to a settlement on their respective claims. The Court also briefly referred to the case of *In Re Suco Gold Pty Ltd (in Liquidation)* and *Lewin on Trusts*, which expressed a preference for *pari passu* distribution, in circumstances where there were insufficient assets to do so[107] – although it did not decide on this issue, as it did not arise on the facts.

The claims that had not been raised in earlier proceedings, namely, Mr. Chan's right of equitable set-off (in respect of the contractual interest he was entitled to charge for late completion, against Ridout's right to seek the balance of the purchase price), could not, however, be invoked at this late stage of proceedings. Mr. Chan had lost the right to invoke his right of equitable set off.[108]

8.4 A beneficiary

The impact of insolvency on beneficiaries was also considered by the Singapore High Court in *EC Investment Holding Pte Ltd*, where creditors sought to enforce their rights against an insolvent trustee and insolvent beneficiary, as set out above. Creditors with an interest that pre-dates the beneficiary's bankruptcy will take priority over the bankrupt beneficiary's creditors' interest. Creditors who receive their interest after the said bankruptcy will have their claims stand in *pari passu*, at best.

8.5 A protector

While there is no statutory regulation of the relationship between trust protectors and trustees yet,[109] the general disqualification of a bankrupt from being appointed or acting as a trustee or personal representative in respect of any trust,[110] leaves little

[107] *Ibid*, at ¶34.
[108] *Ibid*, at, *inter alia*, ¶50.
[109] In its report titled *Report of the Sub-Committee on the Reform of Certain Aspects of the Trustees Act* (Singapore: Singapore Academy of Law, 31 March 2003), the Law Reform Committee of the Singapore Academy of Law recommended a wait-and-see approach, for more opportunity to monitor and review the developments of other jurisdictions before considering legislative reform: see ¶42.
[110] Section 130(1), Bankruptcy Act, n 18, as discussed earlier.

doubt that the Official Assignee and the Court will be equally reluctant to allow an insolvent protector to continue to supervise the administration of a trust.[111]

9. Can an insolvency procedure extend to trust assets located in local and / or foreign jurisdictions

9.1 Local jurisdiction

Yes, insolvency procedures do extend to trust assets within the local jurisdiction. Pursuant to the Companies (Amendment) Act 2017, the 'ring-fencing' rule that required that assets of a foreign company (in liquidation) with a Singapore branch that are within Singapore be used to settle all liabilities that the foreign company incurred in Singapore first, before the assets can be transferred to the main liquidation overseas, has now more or less been abolished.[112] In most circumstances, Singapore creditors will therefore no longer have priority over other creditors, and must pay the amount realised from the foreign company's assets in Singapore to the foreign liquidator. The rule does, however, still apply to specific financial institutions, such as banks and insurance companies.[113]

This is consistent with Article 21 of the UNCITRAL Model Law on Cross-Border Insolvency (the Model Law),[114] which stipulates that post-recognition relief is at the Court's discretion. Singapore recently implemented the Model Law, through the Companies (Amendment) Act 2017.[115] The applicable case law indicates that, in deciding whether to exercise its discretion, the Court must be satisfied that the interests of the creditors and other interested persons, including the debtor are adequately protected[116] – the foreign representative, persons affected or the Court itself may also modify or terminate the relief, at any point.[117]

9.2 Foreign jurisdictions

Pursuant to the Companies (Amendment) Act 2017, the Court may also now wind up foreign (and not just local) companies, with trust assets located overseas, if it is of the opinion that the company has "substantial connection" with Singapore, applying the factors set out in the Companies Act.[118] An action for judicial management can also be brought in respect of a foreign companies, with trusts assets located overseas.[119] Chapter IV of the Model Law aims to provide certainty and finality in respect of, *inter alia*, cooperation and coordination among member states in which the debtor's assets

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111 In any event, a trust protector would arguably fall within the definition of 'personal representative', in such context.

112 Section 377(3)(c), Companies Act, n 18. This rule was previously endorsed in *Tohru Motobayashi v Official Receiver and Another* [2000] 4 SLR 529, although it did not apply to unregistered foreign companies, or those that did not carry on business in Singapore: see *Beluga Chartering GmbH (in liquidation) and ors v Beluga Projects (Singapore) Pte Ltd and Another* [2014] 2 SLR 815.

113 Section 377(14), Companies Act, *ibid.*

114 "*Model Law on Cross-Border Insolvency* (1997)", http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency/1997Model.html (accessed 23 August 2017).

115 Sections 354A to 354C, Companies Act, n 18; this was recommended by the Insolvency Law Review Committee in their Final Report in 2013, n 62.

116 *UNCITRAL Model Law on Cross-Border Insolvency: The Judicial Perspective*, at ¶¶144 to 146, citing *Rubin v Eurofinance* [2009] EWHC 2129, on appeal [2010] EWCA Civ 895.

117 Art. 22, Model Law, n 114.

118 Sections 351(1)(d) and 351(2A), Companies Act, n 18. The factors include, *inter alia*, where the foreign company has its centre of main interests in Singapore, is carrying on business in Singapore, has a place or substantial assets in Singapore or is registered under Division 2, Part XI, *ibid.*

119 Pursuant to the revised definition of "company" under s. 227AA, *ibid.*

are located,[120] and this would cover the cooperation of foreign courts and foreign representations with our local courts and representatives in respect of trusts assets located overseas.

10. Can trusts be challenged?

10.1 To obtain assets

Transactions defrauding creditors may be attacked by any person thereby prejudiced, whereas other voidable transactions may only be attacked by a liquidator or judicial manager, and not a mere trustee or beneficiary. Where a trust arrangement is challenged on a tax-related basis, the Comptroller can also conduct raids and take possession of documents and computers at will, to obtain information. This power can be used to investigate trust arrangements in Singapore, at the Comptroller's discretion.

If a trust arrangement is sought to be investigated by a foreign state, Singapore will provide international assistance through Part II of the framework of the Mutual Assistance in Criminal Matters Act[121] (the MACMA), Under s. 3 of the MACMA, the assistance that may be given under the MACMA includes:

(i) the provision and obtaining of evidence and things (which would include trust assets);

(ii) the recovery, forfeiture or confiscation of property (which would include trust assets) in respect of offences;

(iii) the retraining of dealings in property, or the freezing of assets, that may be recovered, forfeited or confiscated in respect of offences; and

(iv) the execution of requests for search and seizure.

10.2 To obtain information

Where a trust arrangement is challenged on a tax-related basis, however, the Comptroller of Income Tax can also compel persons to complete tax returns as well as attend personally and produce any document he may consider necessary, to obtain full information of their income.[122] This power can be used to investigate trust arrangements in Singapore, at the Comptroller's discretion.

Ordinarily, where a trust arrangement is not being attacked as a sham or in breach of the anti-avoidance provision in s.33 of the Income Tax Act, beneficiaries also have a general right to investigate a trust – at least insofar as their rights to inspect the trust accounts that their trustees are legally obliged to maintain (and the information contained therein) amounts to such. The Singapore High Court has, however, held that there are limits to this; this does not mean that any beneficiary can keep on demanding accounts and information without giving the trustee or personal representative some respite.[123]

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[120] Arts. 25, 26, 27, 29 and 30, Model Law, n 114.
[121] (Cap. 190A, 2001 Rev Ed).
[122] Section 65, Income Tax Act, n 12.
[123] *Chiang Shirley v Chiang Dong Pheng* [2015] 3 SLR 770, at ¶89.

In *Re Section 22 of the Mutual Assistance in Criminal Matters Act,*[124] the Singapore Court of Appeal granted the Attorney-General's application for a bank to produce the complete account records of one of its customers to an authorised officer of a foreign state, and for the officer to take the same away for a specified period, pursuant to the MACMA. The assistance given in relation to the provision and obtaining of evidence and things, under s. 3 of the MACMA, would also include information related to a trust arrangement.

Specific mention also ought to be made that, with its ratification of the Convention on Mutual Administrative Assistance in Tax Matters (and subsequent implementation of the Income Tax (Exchange of Information) Order 2016,[125] which gave effect to this), Singapore has endorsed the Organization for Economic Co-operation and Development (OECD) standard for the exchange of information through tax treaties. This will be relevant where a foreign state seeks information on a trust arrangement in Singapore, for tax investigation purposes.

Despite the general restrictions on trust companies' disclosure of information regarding a trust (including the settlor and beneficiaries),[126] the Third Schedule to the Trust Companies Act permits these companies to make disclosure, in many of the circumstances contemplated above, where, for example, disclosure is necessary to comply with an order or request made under any specified law to furnish information, for the purposes of an investigation or prosecution, of an offence alleged or suspected to have been committed.

10.3 To examine witnesses

The assistance given under s. 3 of the MACMA also extends to:

(i) the location and identification of witnesses; and

(ii) the making of arrangements for witnesses to give evidence or assist in criminal investigation.

10.4 For any other purpose

The main circumstances under which trusts can be challenged for investigation purposes have been comprehensively set out above.

11. On what grounds can a trust arrangement be challenged?

11.1 The settlor was insolvent when the trust was created or became insolvent as a result of creating it

This has been discussed in response to question 8.2 above.

11.2 The settlor becomes insolvent

This has also been discussed in response to question 8.2 above.

[124] [2009] 1 SLR(R) 283.
[125] (No. S 34 of 2016).
[126] Section 49(1), Trust Companies Act, n 29.

11.3 The settlor lacked capacity or authority to create the trust

A trust will be set aside if the settlor lacked the capacity or authority to create the trust: see *Re BKR* [2015] 4 SLR 81 (*Re BKR*).

11.4 The settlor lacked the capacity or authority to transfer the assets to the trustees

A trust will also be set aside if the settlor lacked the capacity or authority to transfer the assets to the trustee see *Re BKR* above.

11.5 The assets were not validly transferred or the transfer was not fully completed

The transfer of the trust assets will not be considered to have been valid or complete, where the settlor has not effectively transferred certain property to the trustee and declared the trust on which the trustee is to hold such property. In such circumstances, a trust will not be constituted. If, however, the Court finds that the settlors have done all within their powers to constitute the trust when transferring the property (provided, of course, that they did have capacity and authority to do the same) and were frustrated by formalities beyond their control, it can perfect the constitution of the trust, in equity.[127]

11.6 The trust was not validly created

The three certainties set out in *Knight v Knight*[128] must be complied with, in order for an express trust to be considered valid. These are the certainties as to, first, the intention of the settlor to create a trust, secondly, the subject matter, and, thirdly, the identity of the beneficiaries. The first certainty of intention is satisfied where there is sufficient evidence to show that the settlor clearly intended to create a trust, such as where, for example, trust monies are kept separate and not mixed with other monies.[129] The second certainty of subject matter requires that both the trust property in question is certain as well as the precise extent of the beneficial interests to be had in the same. The trust property must therefore be expressly designated or defined such that it is capable of being ascertained.[130] The third element of certainty as to the identity of beneficiaries requires that these objects or persons must, like the trust property, be either expressly designated or defined in a manner capable of being ascertained.[131]

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[127] *Pennington v Waine* [2002] 1 WLR 2075 and *In re Rose* [1949] Ch 78, cited approvingly by the Singapore Court of Appeal in *Tsu Soo Sin v Oei Tjiong Bin and anor* [2009] 1 SLR(R) 529.

[128] (1840) 3 Beav 138, applied in Singapore in, *inter alia*, *Attorney-General v Aljunied-Hougang-Punggol-East Town Council* [2015] 4 SLR 474, *Chiang Sing Jeong and anor v Treasure Resort Pte Ltd and ors* [2013] SGHC 126 and *Joshua Steven v Joshua Deborah Steven and Ors* [2004] 4 SLR(R) 216.

[129] For example, *Hinckley Singapore Trading Pte Ltd v Sogo Department Stores (S) Pte Ltd (under judicial management)* [2001] 3 SLR(R) 119; see also Joshua Steven, ibid, where there was contradictory evidence as to the settlor's true intent.

[130] For example, *Joshua Steven*, *ibid*, where the subject matter was uncertain because it was alleged that the trust was intended to cover two trust properties, but the terms of the trust excluded one of them.

[131] For example, *Yeap Cheah Neo v Ong Cheng Neo* [1875] LR 6 PC 381, where there was held to be a lack of certainty of beneficiaries as it was unclear whether adopted children were intended to fall within the term "family"; see also *Toh Eng Lan v Foong Fook Yue and anor appeal* [1998] 3 SLR(R) 833, where it was unclear whether a beneficiary was to be granted permanent or temporary rights to "stay in the house".

11.7 Grounds for a transfer to be set aside as void or voidable

11.7.1 Mistake

The court has the equitable jurisdiction to set aside a voluntary disposition on the ground of mistake when there is a causative mistake, as to either the legal character of the transaction or a matter of fact or law that was basic to the transaction, and the mistake is of such gravity that it would be unconscionable to refuse relief: see *BMM v BMN and Another matter*[132] (*BMM v BMN*), citing *Pitt v Holt*[133] approvingly, at [95]. The gravity of the mistake will be assessed objectively, with particular focus on the circumstances of the mistake, its centrality to the transaction in question and the seriousness of its consequences (including tax consequences) for the disponor, in particular: *BMM v BMN* at [95].

11.7.2 If there was an undervalue

Liquidators and judicial managers have the power to attack undervalue transactions, which were entered into when the company was insolvent or became insolvent as a result of which, and any person thereby prejudiced may seek to set aside a transaction defrauding creditors. The circumstances under which this may be done have been discussed in response to questions 3 and 8.2 above.

11.7.3 If there was a preference

Liquidators and judicial managers have the power to attack unfair preferences, which were entered into when the company was insolvent or became insolvent as a result of which, and any person thereby prejudiced may seek to set aside a transaction defrauding creditors. Ordinarily, unfair preferences can be challenged if they took place within 6 months of the presentation of the winding up application. If given to an associate of the company, however, they can be challenged within two years of the application.

11.7.4 If there was a sham

Where the settlor is found to have retained control over the trust assets, the trust arrangement can be set aside as a sham.[134] A trust arrangement devised to defraud creditors will also, broadly speaking, be regarded a sham. These rules can be related back to the first ingredient required to validly create an express trust, *i.e.*, certainty of intention to create a trust. However, there is a statutory defence under s. 90(5) of the Trustees Act. No trust arrangement will be invalidated by a sham by reason only that the settlor reserves to himself any or all powers of investment or asset management functions under the trust.

11.8 Any other grounds

Other examples of circumstances where transfers can be set aside as void or voidable transactions include as stated below.

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[132] [2017] SGHC 131.
[133] [2013] 2 AC 108.
[134] Whether the trust instrument stipulates as much itself (see *Armitage v Nurse* [1998] Ch 241, at 253), or if it is a sham in substance, because of a 'common understanding' (see *Shalson v Russo* [2005] Ch 81).

- Extortionate credit transactions, entered into within a period of three years before the commencement of winding up or judicial management may be set aside;[135]
- Where a person who was a director of the company acquired or sold any property, business or undertaking for cash consideration within two years before the commencement of winding up, the liquidator or judicial manager may recover from the person or company the value for which the cash consideration exceeded or fell short of the value of the same;[136]
- Where there is an unprofitable contract with onerous obligations not yet performed or property that consists of an estate or interest in land burdened with onerous covenants, shares in corporations or any other property unsellable due to onerous conditions, the liquidator or judicial manager may also disclaim the said property within 12 months after winding up (unless extended);[137]
- Floating charges for past value, if created within six months of the commencement of winding up (unless it is proved that the company was solvent immediately after the creation of the charge), are void, save for any cash paid in consideration of the charge;[138] and
- Registrable charges that have not been registered within 30 days from their creation are void.[139]

12. What protections and defences exist to protect those listed at section 5 and are they statutory or common law or otherwise?

As a general rule, transactions carried out at arms' length and involving a *bona fide* purchaser for value without notice, will not be set aside. The Court has broad remedial discretion to make such order "as it thinks fit" to restore the company to the position that it would have been in, had it not entered into the transaction[140] – subject to when third parties raise a good faith defence, as *bona fide* purchasers for value without notice.[141] This is statutorily provided, in respect of undervalue transactions or unfair preferences, to ensure such third parties are not unfairly prejudiced.[142]

Similarly, where a company enters into such a transaction in good faith, for the purpose of carrying out business, with reasonable grounds to believe that the transaction would benefit the company, under, for example, genuine economic pressure to provide security in consideration of a forbearance to sue by the creditor.[143]

Where a trust is alleged to be a sham, specifically, there is also a statutory defence under s. 90(5) of the Trustees Act, which provides that no trust arrangement will be invalidated by a sham by reason only that the settlor reserves to himself any or all powers of investment or asset management functions under the trust.

13. Can claims be made in a bankruptcy where the IP stands in the shoes of a bankrupt to exercise the rights given by the trust in favour of the following?

135 Section 103 of the Bankruptcy Act read with ss. 329 and 227T of the Companies Act, n 18.
136 Sections 331 and 227X(b) of the Companies Act, *ibid.*
137 Sections 332 and 227X(b), *ibid.*
138 Sections 330 and 227X(b), *ibid.*
139 Section 131, *ibid.*
140 Section 99(2) Bankruptcy Act, n 18.

13.1 The settlor

The same restrictions that apply to the settlors, trustees, beneficiaries and protectors, as set out above, will apply to IPs who step into their shoes once they are made bankrupt and seek to exercise any rights they might believe themselves entitled to under a trust arrangement. A trust arrangement that is void or has voidable consequences will not be valid simply because it is a different person seeking to invoke the same rights, in respect of the same transactions. The IP can, however, stand in the shoes of the settlors, trustees, beneficiaries and protectors to exercise existing rights that they would have, which are unaffected by insolvency.

On this issue of claims against IPs, specifically, it should be commented that, after winding up has commenced, proceedings may be brought against any past or present liquidator, officer or person who has taken part in the formation and promotion and formation of the company guilty of, *inter alia*, a breach of trust in relation to the company, under s. 341 of the Companies Act. Unlike s. 212 of the UK Insolvency Act, our local s. 341 omits administrators and administrative receivers. The Court may, on the application of the liquidator (provided, of course, it is not his misconduct being investigated), any creditor or contributory examine the conduct of such person and compel him to repay or restore the money or property with interest or to contribute such sum to the assets by way of compensation. To commence such proceedings, the party initiating the proceedings will apply to the court (by originating summons) for an order in terms, and serve the application on the liquidator, officer or such other person. After parties attend before the Court, it may be ordered that proceedings be treated as if commenced by a writ of summons, in the event of a dispute of fact, which will require pleadings, discovery and a full trial on the merits be ordered before a verdict is arrived at.[144]

There is a distinction in how claims may be brought against liquidators and receivers, in respect of an alleged breach of trust. Where a receiver has been appointed to realise the assets under a charge or security and thereafter pay the creditors, any creditor, contributory or liquidator of the company may apply to the court for an examination of the conduct of a receiver who appears to have been guilty of a breach of trust in relation to the company.[145] The receiver may be found criminally liable for an offence,[146] and can be compelled by the Court to repay or restore the money or property with interest or to contribute such sum to the assets by way of compensation.[147] Privately appointed receivers who are also managers, however, may seek special statutory relief under s. 391 of the Companies Act. This statutory relief may be granted if the Court is of the view that, although liable, they have acted honestly and reasonably in the circumstances of the case, and that they ought fairly to be excused: see s. 391(1). This statutory relief is not available to privately appointed receivers who are not also managers.

13.2 A trustee, beneficiary and protector

The position with respect to all three parties are the same as stated in section 13.1.

141 Section 102(3), *ibid*, read with ss. 329 and 227T of the Companies Act, n 18.
142 *Ibid.*
143 Rule 6 of the Companies (Application of Bankruptcy Act Provisions) Regulations (Rg 3, 1996 Rev Ed).
144 *Kie Hock Shipping* [1983-1984] SLR(R) 796.
145 Section 227(2), Companies Act, n 18.
146 Section 227(3), *ibid.*
147 Section 227(2), *ibid.*

14. Are rights of subrogation established by law?

Rights of subrogation are established under Singapore law, and the creditor may obtain a Court Order to be subrogated to the trustee's right of indemnity. By nature, subrogation is not a "cause of action", but rather "an equitable remedy which is not granted as a right but where it is appropriate to do so".[148] If the creditor obtains such an Order against the trustee, his *in personam* right against the trustee is elevated to a claim *in rem* over the trust assets, and the creditor gains priority over the beneficiaries of the trust assets because equity regards the creditor's claim as having primacy over that of the beneficiary.[149] In short, the creditor is put in the place of the trustee, so that he can enforce the latter's rights.

The Singapore High Court held, in *EC Investment Holding*, that the creditors of a trust do not need to put a trustee into insolvency in order to enforce their rights of subrogation.[150] It is only necessary to liquidate or bankrupt a trustee when seeking to subrogate to a trustee's right of indemnity against a beneficiary personally.[151] As a matter of policy, requiring the creditors to put the trustee into insolvency first, irrespective of circumstance, would result in unnecessary time and costs wasted.[152]

It should also be noted, in passing, that, while a creditor may not bring legal proceedings against, for example, a trustee for the misappropriation of trust assets *on behalf of* the company in liquidation, the right to the fruits of the claim will belong to him, if he is assigned a claim against a trustee by the company[153] - the principles of assignment apply separately from that of subrogation, and ought not to be confused.

15. Can the veil of a company owned by a trust be pierced or lifted and, if so, in what circumstances?

On the issue of whether party can enforce its claim against a parent company, affiliated company or directors and officers, it is material to note that subsidiary and parent companies, members of a corporate group, and their directors and officers, are all considered to be separate legal entities from one another under Singapore law, by virtue of the doctrine of 'separate legal personality'.[154] Insolvency proceedings, or claims with respect to their assets and liabilities, are all dealt with separately. They will not be held responsible for the liabilities of their subsidiaries or affiliates, unless the court is of the view that the corporate veil between the companies should be pierced. The Courts will only pierce the veil of incorporation in exceptional circumstances, where it can be shown that the company is not, by nature, a separate entity. Generally, the Courts will pierce the veil where, upon a factual inquiry, they discover that the corporate form has been abused to further an improper purpose (*i.e.*, a sham company), the corporate veil is a mere façade, or the group is essentially an alter-ego, and the companies within it are trading as one single personality.[155]

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148 *EC Investment Holding*, n 56, at ¶16.
149 *Ibid*, at ¶15.
150 *Ibid.*
151 *Ibid.*
152 *Ibid*, at ¶28.
153 *Re Vanguard Energy Pte Ltd* [2015] 4 SLR 597.
154 Laid down by Lord Macnaghten in *Salomon v Salomon* [1987] AC 22, which is considered trite law in Singapore: see, for example, *Manuchar Steel Hong Kong Ltd v Star Pacific Line Pte Ltd* [2014] 4 SLR 832; *Public Prosecutor v Lew Syn Pau and anor* [2006] 4 SLR(R) 210.
155 *Tjong Very Sumito and ors v Chan Sing En and Ors* [2012] 3 SLR 953, which was upheld by the Court of Appeal in [2013] 4 SLR 308 on this point.

16. Can the veil of a trust be pierced or lifted and, if so, in what circumstances?

The veil of a trust company can be pierced or lifted under the same circumstances as those set out above.

17. If a trust can be treated as insolvent, is this on the basis of the cash flow test, the balance sheet test or another test and, if so, what test?

In Singapore, there are two tests for determining whether a company (which would include a trust company) is insolvent, on the basis that it is unable to pay its debts.[156]

The first is the cash flow test, under which a creditor must show that the company failed to meet a current demand for a debt already due, whereas the second is the balance sheet test, under which the creditor must show that the company's overall liabilities exceed its assets.[157] On this second test, the liabilities owed to present, future and contingent creditors of the company and all assets of the company at the time of the hearing will be taken into consideration.[158]

18. Can or have receivers been appointed to act as a trustee or with powers over trust assets? If so, in what circumstances?

Receivers can be appointed to act as trustee or with powers over trust assets, insofar as is necessary to fulfil their duties to realise the securities over which they are appointed. The role of the receiver has been discussed under question 7 above, and how claims may be brought against receivers, as insolvency professionals, is discussed under question 13.1 above.

19. Are claims against trustees limited or unlimited? Do underlying companies have a role?

In the event that a trustee breaches his duties, three main remedies may be available against him, namely, (1) a proprietary remedy, (2) an account for profits and (3) claims *in personam*, under which he is held personally liable.

If both proprietary and personal remedies are available, the aggrieved party may only elect one. Under Singapore law, a dishonest trustee who has breached the 'no profit' rule can be subject to a proprietary claim.[159] Where a beneficiary is asserting a proprietary claim and the trust property has been mixed with other assets, he is still entitled to a continuing beneficial interest in the trust property and its traceable proceeds. His interest binds everyone who takes the property and proceeds, except a bona fide purchaser for value without notice. In such circumstances, a tracing exercise can be conducted, to discover and establish the form into which the trust assets have been converted.[160]

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156 *Re Great Eastern Hotel* [1988] 2 SLR(R) 276; *Re Sanpete Builders (S) Pte Ltd* [1989] 1 SLR(R) 5.
157 *Ibid.*
158 A prospect of acquiring assets before the company has to meet future liabilities is also relevant to the exercise of discretion: see *In Re Craven Insurance Co Ltd* [1968] 1 WLR 675.
159 *Sumitomo Bank Ltd v Kartika Ratna Thahir and Ors and Anor matter* [1992] 3 SLR(R) 638, which is consistent with the Privy Council's ruling in *Attorney General of Hong Kong v Reid* [1994] 1 AC 324 (*cf. Lister v Stubbs* [1890] All ER 797).
160 *Catalog (Australia) Pty Ltd v Tong Tien See Pte Ltd* [2002] 3 SLR 241.

In general, the remedy of personal claims will only be awarded if the defaulting trustee has not gained from the breach or no longer has the trust property that he had initially gained.[161]

20. Are there provisions or cases where trusts, or those connected to them, are based in a foreign jurisdiction?

Yes, there are cases where trust arrangements, trust assets, and those connected to them, are based in a foreign jurisdiction. This will be discussed further in response to question 22 below.

21. What are the main means to seek assistance from another jurisdiction?

If Singapore requires to investigate a trust arrangement within a foreign state on criminal grounds, it may also seek international assistance through Part III of the framework of the MACMA, which applies to requests by foreign countries to Singapore for assistance, in the alternative. The types of assistance which may be given under the MACMA have been comprehensively set out in response to question 10 above.

22. What is the position as to whether the foreign jurisdiction does or does not recognise trusts?

The Singapore Courts have not yet had to grapple with the legal conundrum of whether they should recognise a trust over trust property that is sited in a foreign jurisdiction whose laws do not recognise (or, perhaps, even proscribe) trusts. The Court of Appeal in *Trisuryo Garuda Nusa Pte Ltd v SKP Pradiksi (North) Sdn Bhd and anor and anor appeal*[162] has, however, expressed the preliminary view (albeit *obiter dicta*) that it would be "untenable" and "invidious" for the Singapore courts "to refuse their aid to parties who have structured their transactions in Singapore on the basis of Singapore law solely because the assets affected by the trust are foreign assets", notwithstanding parties' expert evidence that trust arrangements were illegal in Indonesia, and *contra* the public policy there.[163] The Court did, nevertheless, note that, as this was only a stay application, parties could canvass this issue at the hearing of the merits of the claim, and the matter would be properly decided. The position therefore remains open to argument.

23. What particular issues, difficulties and solutions have arisen or may arise relating to trust arrangements or those involved with them?

This issue recently arose before the UK Supreme Court, in *Akers v Samba Financial Group.*[164] The case concerned an action brought in England by the liquidators of the respondent Cayman company, SICL, to void a disposition of shares in Saudi Arabian banks by one Al-Sanea to the appellant under s. 127 of the UK Insolvency Act 1986. It was argued that Al-Sanea held the shares on trust for SICL. Interestingly, it was considered to be common ground between parties that the law of Saudi Arabia, where the shares were sited, did not recognise the institution of a trust or a division between legal and equitable proprietary interests. It was eventually held

[161] TH Tey, *Trusts, Trustees and Equitable Remedies* (Singapore: LexisNexis, 2010), p 930.
[162] [2017] SGCA 49.
[163] *Ibid*, at ¶95.
[164] [2017] AC 424.

that, in principle, there could be a Cayman (or English) trust of assets situated in a jurisdiction that has no concept of a trust as understood under Cayman (or English) law. The bases for this was that the English court's equitable jurisdiction was founded on its power *in personam* of the alleged trustee, rather than the *situs* of the trust property.

The Court was careful to qualify, however, that these principles are subject to any mandatory rules of the jurisdiction in which the assets are situated that the English court thinks should limit such principles, or even defeat them (including principles of private international law, such as The Hague Convention on the Recognition of Trusts – which Singapore is not party to, in any event). The Court appeared to accept, *obiter dicta*, that assuming, *ex hypothesi*, a mandatory rule of Saudi Arabian law overrides any equitable interest that would subsist under the alleged trust, then even if the appellant had been on notice of the breach, it would take the shares free of the equitable interest.[165] The Court would give the trusts over shares "their intended effect to the greatest extent *possible*, *having regard to the overriding effect of any disposition under their lex situs".*[166] As Professor Richard Nolan has astutely observed, in his case commentary on the decision:

> "*The willingness of an English court to defer to the mandatory property rules of another jurisdiction makes good sense for at least two reasons. First, as a matter of comity, it ill becomes an English court to defy the effect of mandatory rules of another jurisdiction governing property which is, ex hypothesi, located in that other jurisdiction. Secondly, as a matter of equity, it is hard to see why a person who may rely on the mandatory rules of another jurisdiction to give that person ownership of an asset in that jurisdiction, free of third-party interests in that asset, is acting unconscionably in merely seeking to rely on that rule*."

On the whole, while the approach that the Singapore Courts might take, were such an issue to arise before it, remains unclear at this juncture, there is a strong reason to believe that, as a matter of international comity, the Singapore Courts should not assist to enforce a trust if to do so would be against the laws or public policy of the foreign jurisdiction where the trust property is sited.

[165] *Ibid*, at ¶20.
[166] ¶22, as well as ¶51.

SWITZERLAND

1. Are trusts legal and valid under domestic law? If so, what are they principally used for?

Under the Swiss domestic law it is not possible to form a trust. It is however possible to create a trust domiciled in Switzerland under a foreign law.

2. Are foreign trusts recognised under private international laws?

In April 2007 Switzerland ratified the Hague Convention of 1 July, 1985 on the Law Applicable to trusts and on their Recognition and it has implemented this convention into its private international law. Accordingly, Switzerland recognizes foreign trusts based on the convention, even if the trust is subject to the laws of a state, which is not a signatory to the convention. Switzerland does recognize so called «inland trusts» (i.e. trusts whose only international aspect is the foreign law chosen) in accordance with Article 13 of the Convention.

3. Are there any prohibitions against trusts?

No.

4. Are trusts and service providers regulated?

Currently not.

Switzerland intends however to implement new legislation (Swiss Federal Act on Financial Service Providers) which will put trustees and financial service providers under the supervision of a governmental body. According to the new legislation trustees must further provide a certain organisation and must guarantee the correct conduct of their business. The new legislation will however not be enacted before 2019.

5. Can the following become insolvent and subject to insolvency procedures?

5.1 A trust itself

Formally no. Only the assets of a trust in accordance with article 284a of the Swiss Federal Act on Debt Enforcement and Bankruptcy (DEB). The proceeding is conducted against the trustee as representative of the trust at the seat of the trust.

5.2 A settlor

Yes, if the settlor is subject to Swiss Bankruptcy Jurisdiction (i.e. domiciled in Switzerland and registered in the Swiss Commercial Register).

5.3 A trustee

If the trust is domiciled in Switzerland or if the trustee is domiciled in Switzerland and registered in the Swiss Commercial Register it is possible for the trust to be insolvent.

Similarly, if the trustee ceases to be a trustee and is domiciled in Switzerland and registered in the Swiss Commercial Register that person can be subject to insolvency proceedings.

5.4 A beneficiary

Yes, if subject to Swiss bankruptcy jurisdiction.

5.5 A protector

Yes, if subject to Swiss bankruptcy jurisdiction. The same position as stated in section 5.4 above is applicable.

6. Do you distinguish between claims made against each of the parties stated below in respect of their obligations in acting for or in relation to the trust and, on the other hand, obligations incurred privately and personally?

This distinction depends on the foreign law applicable to the trust. This law decides whether a certain claim is directed against such parties personally or against the trust. A trustee, who is not domiciled in Switzerland can only become subject to Swiss Bankruptcy Jurisdiction for claims directed against the trust according to Art. 284a DEB. With respect to a settlor, beneficiary and a protector, Swiss Law does not provide a specific bankruptcy jurisdiction for claims related to the trust.

7. What are the main insolvency procedures that could be relevant?

The applicable proceeding is the Bankruptcy proceeding according to articles 159 et seq. of DEB.

8. What is the effect of bankruptcy on the following?

8.1 A trust

All assets of the trusts are liquidated and distributed amongst the creditors in accordance with the Swiss Act on Debt Enforcement and Bankruptcy.

8.2 A settlor

If a settlor becomes subject to Swiss bankruptcy, only assets owned by the settlor will be subject to bankruptcy and distributed amongst its creditors. The creation of the trust can however be challenged with a voidance action (*actio pauliana*).

8.3 A trustee

In the bankruptcy of a trustee, the assets of the trust will be separated *ex officio* from the assets of the trustee.

8.4 A beneficiary

In the bankruptcy of a beneficiary, claims of the beneficiary against the trust form part of the bankruptcy estate.

8.5 A protector

There is no specific provision in Swiss law regarding the bankruptcy of a protector. If according to the relevant foreign trust law, claims of the protector against the trust are possible, then such claims fall in to the Swiss estate.

9. Can an insolvency procedure extend to trust assets located in the local jurisdiction and / or foreign jurisdictions?

9.1 Local jurisdiction

A foreign bankruptcy proceeding over the assets of a foreign trust can be recognized in Switzerland in accordance with Articles 166 et seq. of the Swiss Code of International Private Law. The effect of the recognition is however, the opening of Swiss Bankruptcy Proceeding restricted to the assets of the foreign trust located in Switzerland. The assets located in Switzerland will be distributed in the Swiss Proceeding to certain privileged creditors and any surplus will be handed over to the foreign bankruptcy administrator.

9.2 Foreign jurisdictions

Yes, this is possible and it is governed by statute law.

10. Can trusts be challenged?

10.1 To obtain assets

A trust can be challenged according to the substantive law applicable to the trust, which is never Swiss law (see section 1.)

10.2 To obtain information, examine witnesses and for any other purpose

The position with respect to the above is the same as stated in section 10.1.

11. On what grounds can a trust arrangement be challenged?

11.1 The settlor was insolvent when the trust was created or became insolvent as a result of creating it

The transfer of assets without consideration from the settlor to the trust can be challenged by an avoidance action based on Swiss debt enforcement and bankruptcy law.

11.2 The settlor becomes insolvent

An avoidance action applies when the transfer took place a year before the seizure of assets of the settlor or the opening of bankruptcy proceedings (Art. 286 DEB). If the settlor intended to disadvantage his creditors or favour certain of his creditors to the disadvantage of others, the transfer is voidable if it took place 5 years prior to the seizure of assets or the opening of bankruptcy proceedings if at that time the settlor was already in a difficult financial situation and if the intention was apparent to the other party (Art. 288 DEBC).

11.3 The settlor lacked capacity or authority to create the trust

This question is governed by the substantive law applicable to the trust.

11.4 The settlor lacked the capacity or authority to transfer the assets to the trustees

This question is governed by the substantive law applicable to the transfer.

11.5 The assets were not validly transferred or the transfer was not fully completed

This question is governed by the substantive law applicable to the transfer.

11.6 The trust was not validly created

This question is governed by the substantive law applicable to the trust.

11.7 The transfer could be subsequently set aside as void or voidable

The grounds for such a transaction to be void or voidable are as stated below.

11.7.1 Mistake

This question whether there was a mistake is governed by the law applicable on the trust. If the mistake was in the creation of the trust or by the law applicable to the transfer of assets.

11.7.2 If there was an undervalue

This question is primarily governed by the substantive law applicable to the trust. An avoidance action based on Swiss debt enforcement and bancruptcy law may be brought in accordance with the requirements described in 11.1 above.

11.7.3 If there was a preference

This question is governed by the substantive law applicable to the trust. An avoidance action based on Swiss debt enforcement and bancruptcy law may be brought in according to the requirements described in 11.1 above.

11.7.4 If there was a sham

This question is governed by the substantive law applicable to the trust.

11.7.5 Any other grounds

This question is governed by the substantive law applicable to the trust.

12. What protections and defences exist to protect those listed in section 5 and are they statutory or common law or otherwise?

Each debtor may appeal against the opening of insolvency proceedings according to Art. 174 DEB.

13. Can claims be made in a bankruptcy where the IP stands in the shoes of a bankrupt to exercise the rights given by the trust in favour of the following parties?

13.1 The settlor

The administration of a bankrupt estate may exercise the rights given by the trust in favour of the bankrupt settlor.

13.2 A trustee

In a bankruptcy of the trustee the assets of the trust will be separated out (Art. 284b DEBC). The administration of a bankrupt estate may therefore not exercise the rights given by the trust in favour of the bankrupt.

13.3 A beneficiary

The administration of a bankrupt estate may exercise the rights given by the trusts in favour of the bankrupt beneficiary so long as these rights have a present value.

13.4 A protector

There is no provision in Swiss law regarding the bankruptcy of a protector. In our view it depends if these rights have any present value for the bankrupt estate.

14. Are rights of subrogation established by law?

Rights of subrogation are established in Art. 110 and 149 of the Swiss Code of Obligation.

15. Can the veil of a company owned by a trust be pierced or lifted and, if so, in what circumstances?

According to Swiss jurisprudence the veil of a company can be pierced if the company and its owner are economically identical and if relying on the separate corporate entity constitutes an abuse of right.

16. Can the veil of a trust be pierced or lifted and, if so, in what circumstances?

The veil of a trust can be pierced if the foreign law applicable to the trust allows this.

17. If a trust can be treated as insolvent, is this on the basis of the cash flow test, the balance sheet test or another test and, if so, what test?

A trust under Swiss Bankruptcy Law cannot be treated as insolvent. Only the trustee can become insolvent.

18. Can or have receivers been appointed to act as a trustee or with powers over trust assets? If so, in what circumstances?

No.

19. Are claims against trustees limited or unlimited? If limited, are they limited as to amount and by time?

Whether such claims against the trustees are limited or unlimited is subject to the foreign law applicable on trusts.

20. Are there provisions or cases where trusts, or those connected to them, are based in a foreign jurisdiction?

The Swiss Code on Private International Law has the following provisions regarding trusts.

20.1 Chapter 9a: Trusts

I. Notions - Art. 149a

The term "trust" refers to trusts that are created by means of legal relationships within the meaning of The Hague Convention of 1 July 1985, on the Law Applicable to Trusts and on their Recognition, regardless of whether they are evidenced by writing within the meaning of Article 3 of the Convention.

II. Jurisdiction - Art. 149b

1 In matters concerning trust law, the choice of jurisdiction under the terms of the trust shall be determinative. The choice, or an authorization for these purposes, in the terms must be observed only if it is in writing or in another form which enables proof by text. Unless otherwise provided, the designated court shall have exclusive jurisdiction. Article 5, paragraph 2, is applicable by analogy.

2 The designated court may not decline its jurisdiction if:

a. A party, the trust or a trustee has their domicile, place of habitual residence or a place of business in the canton of this court, or

b. A major portion of the trust assets is located in Switzerland.

3 If there is no valid choice of jurisdiction or if the court thereby designated does not have exclusive jurisdiction, the Swiss courts shall have jurisdiction:

a. At the domicile or, in the absence of domicile, the place of habitual residence of the defendant;

b. At the registered office of the trust, or

c. For actions based on the activities of a place of business in Switzerland, at the location of this place of business.

4 In the case of disputes concerning responsibility based on the public issuance of equity and debt instruments, the action may also be brought before the Swiss courts at the place of issuance. This jurisdiction cannot be precluded by a choice of jurisdiction.

III. Applicable law - Art. 149c

1 With respect to the law applicable to trusts, The Hague Convention of July 1, 1985, on the Law Applicable to Trusts and on Their Recognition is applicable.

2 The law designated as applicable under the Convention also applies if, under Article 5 of the Convention, such law is not to be applied or if, under Article 13 of the Convention, no obligation to recognize a trust exists.

IV. Special rules concerning publicity - Art. 149d

1 In the case of trust assets that are entered in the name of trustees in the Real Estate Register, the Ships Register or the Aircraft Register, reference may be made to the trust relationship by means of an annotation.

2 Trust relationships that affect intellectual property rights registered in Switzerland shall be entered in the relevant register upon request.

3 A trust relationship that is not noted or entered shall be invalid against bona fide third parties.

V. Foreign decisions - Art. 149e

1 Foreign decisions in matters concerning trust law shall be recognized in Switzerland if:

a. They have been issued by a validly designated court under Article 149b, paragraph 1;

b. They were issued in the State in which the defendant has his domicile, place of habitual residence or place of business;

c. They were issued in the State in which the trust has its registered office;

d. They were issued in the State whose law governs the trust, or

e. They are recognized in the State in which the trust has its registered office, and the defendant did not have his domicile in Switzerland.

2 With respect to foreign decisions concerning claims relating to the public issuance of equity and debt instruments by means of a prospectus, circular or similar publications, Article 165, paragraph 2, is applicable by analogy.

21. What are the main means to seek assistance from another jurisdiction?

The main means to seek assistance from another jurisdiction is by a bankruptcy proceeding in Switzerland where assets of the debtor are situated abroad. To what extent that assistance is given is determined by the law of the state in which the assets are situated.

22. What is the position as to whether the foreign jurisdiction does or does not recognise trusts?

Switzerland is a party to The Hague Convention of 1 July1985 on the Law Applicable to Trusts and on their Recognition. Swiss law is silent as to whether the foreign jurisdiction does or does not recognise trusts.

23. What particular issues, difficulties and solutions have arisen or may arise relating to trust arrangements or those involved with them?

Switzerland does not have any provision regarding trusts other than to recognise trusts under a foreign law. However, it is possible to create a trust in Switzerland which is governed by a foreign jurisdiction even if all the parties involved are based in Switzerland.

THE BAHAMAS

1. Are trusts legal and valid under your domestic law? What are they principally used for?

Trusts are legal and valid under Bahamian law. The Bahamas is a common law country and recognizes trusts and the relationship created by its formation.[1] The legislation in The Bahamas was therefore first derived from the British Trustee Act of 1893.

1.1 Legality

In accordance with the Bahamian Trustee Act 1998 (the Trustee Act) a *"trust instrument"* means '*the instrument, if any, creating the trust, or where the trust was not created by an instrument refers to any oral declaration creating the trust*'. *"Instrument"* is defined as, "*a written law and an instrument made under such law".*

A trust is defined as a unique relationship which allows an individual or a legal entity (the settlor) to transfer assets, which may be of almost any type to a third party (the trustee) to be administered for the benefit of persons chosen by the settlor (the beneficiaries). The concept is based on the separation of legal ownership of the trust assets (which rests with the trustees) from the beneficial ownership (which rests with the beneficiaries).

1.2 The use of trusts

Trusts are principally used for asset protection, estate planning, commercial structures, and to create a charitable fund. Where trusts are used for tax and estate planning, assets may be transferred to a trustee (either an individual or a trust company in The Bahamas) who can mitigate the burden of taxation in the settlor's home country or domicile to the extent that the law of the home jurisdiction imposing the tax permits.

A purpose trust may also be created for a specific purpose and must not have ascertainable beneficiaries.

Under a discretionary trust (as opposed to a fixed trust) beneficiaries do not have a legally enforceable right to any part of the trust property and whether or not they receive a benefit is a matter for the trustees' unfettered discretion; in the case of a fixed trust the interests of the beneficiaries are delineated and quantified within the trust instrument.

2. Are foreign trusts recognised under your private international laws?

Foreign trusts are capable of being recognized under private international laws and subject to the provisions of the Trusts (Choice of Governing Law) Act 1990 and subject to satisfying the test as to their validity in the foreign jurisdiction.[2]

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1 The first trust company established in The Bahamas was The Bahamas General Trust Company Ltd., in 1936 which later became known as the RoyWest Trust Corporation of The Bahamas and became known as Societe Generale Private Banking (Bahamas) Ltd.

2 See section 7(2), Trusts (Choice of Governing Law) Act.

Foreign laws may be recognized in determining whether the settlor is the owner of the settled property or is the holder of a power to dispose of such property; and as it relates to the disposition of property under foreign law. A similar issue arose in the case of *Al Sabah and others v Grupo Torras SA and another* [3] in which a Bahamian trustee in bankruptcy wished to challenge the validity of Cayman trusts. The Privy Council noted that the Cayman court was '*prima facie*' the competent court that could declare the trusts to be invalid – so presumably an order of the Bahamian court that the trusts were invalid would not be recognized and enforced in the Cayman Islands.

3. Are there any prohibitions against trusts?

A trust may not be created for an illegal purpose nor should it be contrary to public policy. A trust cannot be created to defeat creditors.

4. Are trusts and service providers regulated?

Yes, trusts and service providers are regulated in The Bahamas. If a Bahamian company acts as trustee of a trust it must have a trust licence issued by the Governor under the Banks and Trust Companies Regulations Act 2000[4] (the 'Bank and Trust Companies Regulations').[5]

Individual trustees are not however required to hold a licence.

5. Can the following become insolvent and subject to insolvency procedures?

5.1 A trust itself

A trust is not a separate legal entity, and cannot as a matter of law be insolvent.[6] However, it is the assets that are reposed or conferred on a corporation as trustee by a settlor to be held for the benefit of beneficiaries i.e. the trust fund which can be deemed to be insolvent.

5.2 A settlor

A settlor can be deemed to be insolvent before the creation of the trust if it can be shown that the effect of the transfer into the trust was to render, or probably might render, the settlor unable to meet his then existing liabilities.

To determine whether the settlor was insolvent the court would consider whether there has been an intent to defraud. The relevant statute is the Fraudulent Dispositions Act, 1991 which in large part was derived from the Statute of Elizabeth 1571.[7]

A settlor can also be deemed insolvent after the creation of a trust. Under the Fraudulent Dispositions Act, every disposition of property made with an intent to defraud and at an undervalue shall be voidable at the instance of a creditor thereby

3 [2005] 1 All ER 871.
4 The person appointed under paragraph 1 of the Schedule to the Central Bank of The Bahamas Act.
5 Regulation 3 (2), Bank and Trust Companies Regulations provides that no trust company shall carry on trusts business from within The Bahamas whether or not such business is carried on in The Bahamas unless it is in possession of a valid licence granted by the Governor authorising it to carry on such business.
6 See in the *Matter of the Representation of Volaw Trustee Limited in its Capacity as Trustee of the ZII Trust* [2015] JRC 196C.
7 Titled 'An Act Against Fraudulent Deeds, Gifts, Alienations, etc.'

prejudiced. The burden of establishing an intent to defraud shall be upon the creditor seeking to set aside the disposition. Proceedings seeking to set aside the relevant disposition must be commenced within two years of the date of the relevant disposition. In considering the intent to defraud, if the settlor's financial position is precarious, it is objective evidence of an intention to defraud if he acts to put property beyond the reach of creditors.

Furthermore, section 71 of the Bankruptcy Act 1870[8] (the Bankruptcy Act) prevents the use of trusts as a means of avoiding liability to creditors and such disposition may be set aside in the case of bankruptcy and permits certain claims to be clawed back.

In the case of a trader,[9] section 71[10] of the Bankruptcy Act enables dispositions made within two years of the bankruptcy where a trust has been established for his wife or children, to be set aside as void against a trustee in bankruptcy. The section also enables dispositions made after two years but within ten years to be set aside where the bankrupt was solvent at the date of the disposition without the aid of the property comprised in it. The obstacle of falling within a definition of 'Trader' has been an issue that was sought to be avoided in the *Al Sabah* case where insolvency proceedings were pursued in other jurisdictions such as the Cayman Islands where the legislation provided greater clarity.

Additionally, under section 72 of the Bankruptcy Act[11] a settlement may be set aside if there was a preference if the settlor becomes bankrupt within three months of making the payment and it was made with a view to giving a creditor a preference over other creditors. In the event the settlor is a company a fraudulent preference payment may

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8 Section *71 states - Any settlement of property made by a trader not being a settlement made before and in consideration of marriage, or made in favour of a purchaser or incumbrancer in good faith and for valuable consideration, or a settlement made on or for the wife or children of the settlor of property which has accrued to the settlor after marriage in right of his wife, shall, if the settlor become bankrupt within two years after the date of such settlement, be void as against the trustee of the bankrupt appointed under this Act, and shall, if the settlor becomes bankrupt at any subsequent time within ten years after the date of such settlement, unless the parties claiming under such settlement can prove that the settlor was at the time of making the settlement able to pay all his debts without the aid of the property comprised in such settlement, be void against such trustee. Any covenant or contract made by a trader, in consideration of marriage, for the future settlement upon or for his wife or children of any money or property wherein he had not at the date of his marriage any estate or interest, whether vested or contingent in possession or remainder, and not being money or property of or in right of his wife, shall, upon his becoming bankrupt before such property or money has been actually transferred or paid pursuant to such contract or covenant, be void against his trustee appointed under this Act. "Settlement" shall, for the purposes of this section, include any conveyance or transfer of property.*
On bankruptcy, a bankrupt's estate vests in the trustee in bankruptcy immediately on his appointment taking effect, and it so vests without any conveyance, assignment or transfer.

9 Schedule (Section 2), Bankruptcy Act; *"Description of Traders Apothecaries, auctioneers, bankers, brokers, builders, carpenters, carriers, inn keepers, tavern keepers, hotel keepers, coffee house keepers, lime burners, livery stable keepers, printers, shipowners, shipwrights, victuallers, warehousemen, wharfingers, persons insuring ships or their freight or other matters against perils of the sea, persons using the trade of merchandise by way of bargaining, exchange, bartering, commission, consignment, or otherwise, in gross or by retail, and persons who, either for themselves or as agents or factors for others, seek their living by buying and selling or buying and letting for hire goods or commodities, or by the workmanship or the conversion of goods or commodities; but a farmer, grazier, common labourer, or workman for hire, shall not, nor shall, be deemed as such a trader for the purposes of this Act."*

10 Similarly, to s. 42, English Bankruptcy Act of 1914.

11 Section 72 provides *"Every conveyance or transfer of property, or charge thereon made, every payment made, every obligation incurred, and every judicial proceeding taken or suffered by any person unable to pay his debts as they become due from his own moneys in favour of any creditor, or any person in trust for any creditor, with a view of giving such creditor a preference over the other creditors, shall if the person making, taking, paying or suffering the same becomes bankrupt, within three months after the date of making, taking, paying or suffering the same, be deemed fraudulent and void as against the trustee of the bankrupt appointed under this Act; but this section shall not affect the rights of a purchaser, payee, or incumbrancer in good faith and for valuable consideration."*

also be set aside as void pursuant to the Companies (Winding Up Amendment Act) 2011.[12]

In the event of the insolvency of the settlor after the creation of the trust, a trustee in bankruptcy or receiver may be appointed to act on behalf of the general creditors of the settlor. If insolvency takes place shortly after the settlement, courts are likely to infer the necessary intent at the relevant time.

A trust cannot be settled with the intent to defeat creditor claims which, in the event the disposition did not occur the settlor would not be solvent. Section 39 (3) of the Trustee Act provides in relation to protective trusts, that nothing in this section shall operate to validate any trust which would, if contained in the instrument creating the trust, be liable to be set aside. The effect of this section is that it remains impossible for a settlor to settle property on himself for life or until he should become bankrupt and where the principal beneficiary also becomes entitled to the trust capital, the two interests will not merge.[13]

5.3 A trustee

A trustee may be insolvent and subject to insolvency procedures whilst a trustee. The insolvency of a trustee may arise due to trading and investment losses that a trustee may be empowered to exercise. A trustee can be made personally liable for acts as principal.

A trustee may be insolvent and subject to insolvency procedures after ceasing to be a trustee. Where a corporation being a trustee is in liquidation or has been dissolved or has otherwise ceased to have a corporate existence, then the corporation shall be deemed to be and to have been, from the date of the liquidation, dissolution, removal or ceasing to have a corporate existence, incapable of acting in the trusts or powers reposed in or conferred on the corporation.[14] In these circumstances, the court has the power to appoint a new trustee in substitution for a trustee who is in liquidation or has been dissolved or has ceased to have a corporate existence.

Trustees would have the power to engage an insolvency practitioner to assist them in the process of winding up the trusts and, if appropriate, to delegate powers to that insolvency practitioner.

5.4 A beneficiary

Previously, under the common law a beneficiary may be made subject to insolvency proceedings whilst a beneficiary and after ceasing to be a beneficiary. It is not possible to impose a condition or proviso that a beneficiary's interest shall not be subject to the claims of creditors in the event of his insolvency, the interest (whether absolute or limited) will vest in his trustee in bankruptcy.[15]

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12 Section 241 provides: *"Every conveyance or transfer of property, or charge thereon, and every payment obligation and judicial proceeding, made, incurred, taken or suffered by any company in favour of any creditor at a time when the company is unable to pay its debts within the meaning of section 188 with a view to giving such creditor a preference over the other creditors shall be invalid if made, incurred, taken or suffered within six months immediately preceding the commencement of a liquidation."*

13 See *Re Chance's Settlement Trusts* [1918] WN 34.

14 Section 42(3), Trustee Act.

15 The Bahamas follows the common law position as set forth in *Brandon v Robinson* (1811) 18 Ves 429.

In The Bahamas the common law position has been nullified by the statute by virtue of section 40 of the Trustee Act which now provides, notwithstanding any rule of law or equity to the contrary, it shall be lawful for an instrument or disposition to provide that any estate or interest in any property given or to be given to any individual as a beneficiary shall not during the life of the beneficiary, or such lesser period as may be specified in the instrument or disposition, be alienated or pass by bankruptcy, insolvency or liquidation or be liable to be seized, sold, attached, or taken in execution by process of law and where so provided such provision shall take effect accordingly.

A beneficiary may simply be made an object of a discretionary trust, thereby ensuring that he has no interest as such which could vest in a trustee in bankruptcy.[16]

Under section 39 of the Trustee Act,[17] upon the determination of the protected life interest, the statutory discretionary trusts defined in *section 39* come into operation and trustees must apply the income '*for the maintenance or support, or otherwise for the benefit'* of all or any one or more exclusively of the other or others of the persons comprised in the relevant class of objects. The class includes the principal beneficiary himself.[18] Therefore, despite assignment or bankruptcy, payments could still properly be made to a beneficiary for what he needs for his maintenance and support and he would have to account to his assignee or creditors only for any surplus above such amounts.[19] Under section 36 of the Bankruptcy Act, provision i s also made for an allowance to the bankrupt for maintenance of his family.[20]

Discretionary payments of income to a bankrupt object such as a beneficiary are also deemed to be 'property' [21] vesting in the trustee in bankruptcy under section 70 of the Bankruptcy Act. [22]

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16 See Thomas & Hudson *The Law of Trusts* para 9.02 p. 254.

17 39. (1) *"Where any income including an annuity or other periodical income payment is directed to be held on protective trusts for the benefit of any person (in this section called "the principal beneficiary") for the period of his life or for any less period, then during that period (in this section called the "trust period") the said income shall, without prejudice to any prior interest, be held on the following trust, namely — (a) upon trust for the principal beneficiary during the trust period or until he, whether before or after the termination of any prior interest, does or attempts to do or suffers any act or thing or until any event happens other than an advance under any statutory or express power whereby if the said income were payable during the trust period to the principal beneficiary absolutely during that period he would be deprived of the right to receive the same or any part thereof, in any of which cases as well as on the termination of the trust period whichever first happens the trust of the said income shall fail or determine; (b) if the trust aforesaid fails or determines during the subsistence of the trust period, then during the residue of that period the said income shall be held upon trust for the application thereof for the maintenance or support or otherwise for the benefit of all or any one or more exclusively of the other or others of the following persons (that is to say) — (i) the principal beneficiary and his or her wife or husband, if any, and his or her children or more remote issue, if any, or (ii) if there is no wife or husband or issue of the principal beneficiary in existence, the principal beneficiary and the persons who would if he were actually dead be entitled to the trust property or the income thereof or to the annuity fund, if any, or arrears of the annuity, as the case may be, as the trustees in their absolute discretion, without being liable to account for the exercise of such discretion, think fit….(3) Nothing in this section shall operate to validate any trust which if contained in the instrument creating the trust be liable to be set aside."*

18 See Thomas & Hudson, *The Law of Trusts* para 9.13 p. 262.

19 *Re. Ashby* [1892] 1 QB 872.

20 According to S. 36, *"the trustee, with the consent of the creditors testified by a resolution pass in general meeting, may from time to time, during the continuance of the bankruptcy, make such allowance as may be approved by the creditors to the bankrupt out of his property for the support of the bankrupt and his family, or in consideration of his services if he is engaged in winding up his estate."*

21 'Property' is defined in the Bankruptcy Act as - *including money, goods, things in action, land, and every description of property, whether real or personal; also, obligations, easement and every description of estate, interest and profit, present or future, vested or contingent, arising, out of or incident to property as above defined.*

22 Section 70; *"Where a bankrupt is in the receipt of a salary or income, however, derived, the court, upon the application of the trustee, shall from time to time make such order as it thinks just for the payment of such salary or income, or of any part thereof, to the trustee during the bankruptcy, and to the Registrar, if necessary, after the close of the bankruptcy, to be applied by him in such manner as the court may direct."*

However, it should be noted that an assignee, creditor, or trustee in bankruptcy does not become a member of the class of objects and remains a stranger in relation to the trustee's discretion. Therefore, any payment by the trustees directly to such assignee, creditor, or trustee in bankruptcy may be excessive and void, although the terms of the discretion may be sufficiently wide to authorize payment to a third party if and in so far as such payment can be said to be of benefit to the object himself as noted above. The rights of an assignee or creditor cannot be greater than those of the object himself he would have the right to have the trust administered properly but no right to demand that the trustees exercise their discretion in his favour.[23]

A beneficiary once he ceases to be a beneficiary would have no interest under a trust.

5.5 A protector

A protector can be subject to insolvency and insolvency procedures. Where an individual protector is made bankrupt, the capacity of that individual to continue to exercise any or all of the powers of protector will be determined in accordance with the law of the forum of the bankruptcy.[24]

The insolvency of a trustee would render a trustee unfit to continue in office, hence similarly this principle may also apply to protectors and the court may be minded to remove an insolvent protector from office. A protector however, unlike a trustee does not hold trust property and it is only to the extent that a bankrupt protector may be in a position to abuse his fiduciary position does any risk exist and the court may exercise its inherent jurisdiction to remove a bankrupt or insolvent protector.[25]

If a corporate protector has insufficient assets to satisfy an order made against it, it will be deemed unable to pay its debts and may face an insolvency procedure managed by a liquidator or receiver. If the corporate protector is put into liquidation the powers of the directors will cease and the liquidator will wind up the company and distribute its assets to creditors.

6. Do you distinguish between claims made against each of the parties in section 5 with respect of their obligations in acting for or in relation to the trust and, on the other hand, obligations incurred privately and personally?

Claims[26] may be made against a settlor, trustee, beneficiary or protector. A trustee and protector however may be subject to distinct claims in acting for or in relation

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23 See Thomas & Hudson on *Trusts* para 9.15 p. 263.
24 See Holden on *Protectors*, para 4.42.
25 Holden on *Protectors'* para 4.53.
26 Under Section 79A, Trustee Act as amended, *"the Court has jurisdiction to hear and determine any claim concerning a trust where –*
"(1) - (a) the governing law of the trust is the law of The Bahamas;
(b) a trustee of a trust is ordinarily resident, incorporated or registered in The Bahamas;
(c) any of the trust property is situate in The Bahamas (but only in respect of that property);
(d) the administration of the trust is carried on in The Bahamas;
(e) the Court is otherwise the natural forum for the litigation; or
(f) the trust instrument confers jurisdiction on the Court (but only to the extent of the jurisdiction so conferred).
(2) Subsection (1) shall apply.
(a) to claims against persons whether within or outside the territorial jurisdiction of the Court; and
(b) in addition to any other circumstance in which the Court has jurisdiction.
(3) In this section, 'claim' includes any application or other reference that may be made to the Court under this Act, the Purpose Trusts Act and the Perpetuities Act."

to the trust for example for breach of fiduciary duty. A trustee acts as principal in connection with the administration of a trust and is personally liable whether or not he is acting in accordance with the powers and duties conferred on him. A settlor and beneficiary on the other hand may be subject to claims arising from obligations incurred privately and personally.

7. What are your main insolvency procedures that could be relevant?

The main insolvency procedures are the potential liquidation of the trustee if the trustee is a corporation, the appointment of a judicial trustee, the appointment of a receiver over trust assets, and the appointment of a trustee in bankruptcy in the case of a bankrupt settlor or beneficiary.

8. What is the effect of bankruptcy on the following?

8.1 A trust

Where there is an insolvent trust the estate should be administered in the best interests of creditors of the trust. The creditors' recourse would be to the trust assets.

On bankruptcy, a bankrupt's estate vests in the trustee in bankruptcy immediately on his appointment taking effect, and it so vests without any conveyance, assignment or transfer.

8.2 A settlor

The effect of bankruptcy[27] on a settlor is that, on the appointment of a trustee the property shall forthwith pass to and vest in the trustee appointed.[28] Thus, an interest under a trust, such as a life interest or interests in remainder, is included, but not a mere *spes* enjoyed by the bankrupt as an object of a discretionary trust, nor a special power of appointment exercisable by the bankrupt but of which he himself is not an object.

Neither a settlor nor any other person donating property to a trust may benefit from the right to be inalienable and it is impossible for a settlor to settle property on himself for life or until he should become bankrupt.[29]

8.3 A trustee

In the case of insolvency or bankruptcy of a trustee the court may appoint a new trustee because an insolvent trustee would cease to have the requisite corporate existence to maintain such an appointment.[30]

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27 Section 15, Bankruptcy Act.

28 Under section 4 (1), Bankruptcy Act 1870 a person may be adjudicated bankrupt are provided for ie. Where:-
"4. A single creditor, or two or more creditors, if the debt due to such single creditor, or the aggregate amount of debts due to such several creditors from any debtor amount to a sum of not less than two hundred dollars, may present a petition to the court, praying that the debtor be adjudged a bankrupt, and alleging as the ground for such adjudication any one or more of the following acts or defaults, hereinafter deemed to be and included under the expression "acts of bankruptcy" —
(1) that the debtor has, in The Bahamas or elsewhere, made a conveyance or assignment of his property to a trustee or trustees for the benefit of his creditors generally;
(2) that the debtor has, in The Bahamas or elsewhere, made a fraudulent conveyance, gift, delivery or transfer of his property or of any part thereof…"

29 Section 40 (5), Trustee Act.

30 Section 48, Trustee Act.

A receiver may be appointed over the income in the trust fund. A trustee cannot make payments directly to an assignee, creditor or trustee in bankruptcy and such payments if so made may be deemed void as the assignee, creditor or trustee in bankruptcy does not become a member of the class of objects and remains a stranger to the trustees' discretion.[31]

In order to protect trust property from the threat of a desperate bankrupt, the court is empowered to remove a bankrupt trustee from office.[32] Bankruptcy renders a trustee unfit to act because a bankrupt trustee may be tempted to misappropriate trust funds in his possession.

8.4 A beneficiary

A receiver may be appointed over income of the trust fund prior to bankruptcy. A beneficiary that has created an act of bankruptcy or act of assignment does not however disqualify him from being a member of the class of objects, section 39 (1) of the Trustee Act expressly includes him in the class. A beneficiary who is not also a settlor also retains certain rights in the case of bankruptcy pursuant to section 40 of the Trustee Act.[33]

Until removed from office, a trustee's discretion is not terminated or suspended, and a trustee is authorized to apply income for the benefit of a beneficiary although in bankruptcy there is no compelling reason why discretionary payments of income to a bankrupt object should not be 'property' vesting in his trustee in bankruptcy.[34]

8.5 A protector

A settlor is free to include a clause in the trust instrument for the automatic removal of the protector in the event of his bankruptcy. If such a clause is included and the protector is adjudicated bankrupt, he will automatically be removed from office. However, absent such a clause the bankruptcy of the protector will not lead to his automatic removal from office.[35]

The powers of the protector [36] passing to the trustee in bankruptcy will therefore be exercisable by the trustee in bankruptcy. The trustee in bankruptcy shall have the power to exercise any powers vested in the protector under the Bankruptcy Act, and to execute all powers of attorney, deeds, and other instruments expedient or necessary for the purpose of carrying into effect the provisions of the Bankruptcy Act; to sell the property of the bankrupt (including the goodwill of the business, if any, and the book debts due or owing due to the bankrupt) by public auction or private contract with power, if he thinks fit to transfer the whole thereof to any person or company, or to sell the same in parcels, according to section 23 of the Bankruptcy Act.

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31 Thomas & Hudson, *The Law of Trusts*, p. 263.
32 See *Re Adam's Trust* (1879) 12 ChD 634.
33 According to Section 40 (1), Trustee Act,- *notwithstanding any rule of law or equity to the contrary, it shall be lawful for an instrument35 or disposition to provide that any estate or interest in any property given or to be given to any individual as a beneficiary shall not during the life of the beneficiary, or such lesser period as may be specified in the instrument or disposition, be alienated or pass by bankruptcy, insolvency or liquidation or be liable to be seized, sold, attached, or taken in execution by process of law and where so provided such provision shall take effect accordingly.. A settlor nor any person donating property to the trust may benefit from the provisions of this section.*
34 *Re Landau (A Bankrupt)* [1998] Ch 223.
35 Holden on *Protectors* para 4.48 and see *Re Crest Realty Pty Ltd. (No 2)* [1977] 1 NSWLR 664.

9. Can an insolvency procedure extend to trust assets located in the local and / or foreign jurisdictions?

9.1 Local jurisdiction

Foreign bankruptcy proceedings are recognized if they take place in the jurisdiction in which the debtor is domiciled in the eyes of Bahamian law, or if the debtor has submitted to the proceedings. In the case of corporate insolvency involving a Bahamian company for example as trustee, the centre of incorporation governs where the proceedings should be commenced.

Where a foreign adjudication is recognized, Bahamian law will also recognize the person appointed under those proceedings as the equivalent of a Bahamian trustee in bankruptcy. This position is based both on the common law and statute.

However, the scope and powers of a foreign trustee in bankruptcy remains unclear as noted by the Privy Council in the *Al Sabah*[37] case, in which doubt was expressed as to the effect and scope of the application for recognition by a Bahamian trustee which was made by letter of request to the Cayman Court. It was held that if the doubt was well-founded, it shows that the Bahamian trustee in bankruptcy, like the Scottish trustee in bankruptcy in *Galbraith v Grimshaw and Baxter*[38] may still 'find himself…falling between two stools'[39] (in terms of being capable of realising assets).

The Board in *Al Sabah* considered whether the Grand Court was authorised to exercise in favour of the Bahamian trustee in bankruptcy a special statutory power which might not be available to him (because of the 'trader' requirement)[40] if the trusts in question were governed by Bahamian law and the trustees were resident in The Bahamas and facing proceedings in the Bahamian Court. The Board in turn concluded at [46] that the jurisdiction conferred by section 122 of the Bankruptcy Act

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36 Section 81, Trustee Act provides: 81. (1) *"A trust instrument may contain provisions by virtue of which the exercise by the trustees of any of their powers and discretions shall be subject to the previous consent of the settlor or of some other person as protector, and if so provided in the trust instrument the trustees shall not be liable for any loss caused by their actions if the previous consent was given and they acted in good faith. (2) The trust instrument may confer on the settlor or on any protectors any powers including (without limitation) power to do any one or more of the following - (a) determine the law of which jurisdiction shall be the proper law of the trust; (b) change the forum of administration of the trust; (c) remove trustees; (d) appoint new or additional trustees; (e) exclude any beneficiary as a beneficiary of the trust; (f) add any person (including the settlor and any private or charitable trust or foundation) as a beneficiary of the trust in addition to any existing beneficiary of the trust; (g) give or withhold consent to specified actions of the trustee either conditionally or unconditionally; and (h) release any of the protectors' powers. (3) A person exercising any one or more of the powers set forth in paragraphs (a) to (h) of subsection (2) shall not by virtue only of such exercise be deemed to be a trustee and, unless otherwise provided in the trust instrument, is not liable to the beneficiaries for the bona fide exercise of the power".*

37 [2005] 1 All ER 871.

38 [1910] AC 508 at 510 [1908-10] All ER Rep 561 Which was concerned with s.117 of the Bankruptcy Act 1883. The House of Lords decided that where a Scottish sequestration (bankruptcy) occurred about a fortnight after an English garnishee order nisi, the judgment creditor prevailed over the trustee in bankruptcy, although the result would have been different if both the attachment and the bankruptcy had occurred in the same jurisdiction (whether England or Scotland). The attachment in England had not been completed, but the fact that it had started meant that the garnished debt was no longer 'free assets' of the bankrupt.

39 As noted in paragraph [41] of Al Sabah ibid. In the Law of Insolvency (3rd ed., 2002) p.773 (para 29-050) Professor Ian Fletcher has criticised *Galbraith v Grimshaw* as a *'somewhat unsophisticated, if not disingenuous, decision, which purports to disallow any possibility that the rules of law in force in one jurisdiction may enjoy effect elsewhere by virtue of rules of private international law in force in the other countries concerned,'* and he suggests that it is overdue for reconsideration.

40 See Trader definition pursuant to the Bankruptcy Act as defined at footnote 11.

1914[41] of Britain is in the Cayman Islands and the other territories in which it remains in force, essentially as wide as that conferred by s.426. (The Bahamian Bankruptcy Act of 1870 does not contain an equivalent provision to s.122 although Lyons J. gave effect to the section by placing reliance on a Bahamian enactment (after The Bahamas became independent in 1973) entitled 'Acts of the United Kingdom Parliament applying in or affecting The Bahamas otherwise than by virtue of an enactment of the Legislature of The Bahamas').

In coming to that conclusion, the Board noted that there was a requirement under s.426(5) requiring the court to have regard to the rules of private international law and in coming to the conclusion in exercising powers under that section, the court may find it necessary to consider whether the requesting court has properly exercised jurisdiction over a debtor with no obvious connection with its territory, and it might also, have to take account of the general principle against enforcement of the public laws of another country see *Re. Tucker.*[42] It was held at [47] that considerations of private international law may be material in subsequent proceedings which the Bahamian trustee in bankruptcy takes in the Grand Court, but their Lordships had no reason to suspect that there would be any real doubt about the debtor's sufficient connection to The Bahamas where he was permanently resident. The larger of the trusts in question, the Comfort Trust, was governed by Bahamian law and the switch to the Cayman Islands took place when the English proceedings against the debtor were already imminent.

9.2 Foreign jurisdictions

It is a matter for the private international law of the *situs* to determine whether recognition will be accorded to a Bahamian adjudication to the trustee's status, and to his title. The trustee's title to foreign assets is likely to be subject to any real rights in the property arising under the *lex situs* and it is also likely that the courts of the situs will accord priority to certain personal rights in favour of local creditors.[43]

Insolvency proceedings extended to assets in another jurisdiction in the *Al Sabah* case ibid. where the debtor was the settlor in respect of two trusts governed by the law of the Cayman Islands which he established under Bahamian law. The debtor was the principal beneficiary under the trust. Smellie CJ acceded to a letter of request by the Supreme Court of The Bahamas seeking assistance from the Grand Court of the Cayman Islands by (i) recognising in the jurisdiction of the Cayman Islands, the appointment of the trustee in bankruptcy of the property of Mohammed *Al Sabah*, a judgment debtor of Grupo Torras SA; (ii) granting to the trustee all general law powers and the statutory powers accorded to a trustee in bankruptcy in that jurisdiction and in particular the powers under s 107[44] of the Cayman Bankruptcy Law (1997 Revision); and (iii) granting him such other powers of the Grand Court of the Cayman Islands saw fit.

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41 Section 122 provides: *Courts to be auxiliary to each other. The High Court, the county courts, the courts having jurisdiction in bankruptcy in Scotland and Ireland, and every British court elsewhere having jurisdiction in bankruptcy or insolvency, and the officers of those courts respectively, shall severally act in aid of and by auxiliary to each other in all matters of bankruptcy, and an order of the court seeking aid, with a request to another of the said courts, shall be deemed sufficient to enable the latter court to exercise, in regard to the matters directed by the order, such jurisdiction as either the court which made the request, or the court to which the request is made, could exercise in regard to similar matters within their respective jurisdictions.'*

42 [1987-89] MLR 220.

43 Thomas & Hudson *The Law of Trusts* para 9.56.

44 The section provides that any voluntary settlement of property is to be void against the trustee in bankruptcy if the settlor is made bankrupt (i) within two years after the date of the settlement or (ii) within ten years after the date of the settlement unless the beneficiaries can prove that the settlor was, when he made the settlement, able to pay all his debts without the aid of the property comprised in the settlement (and that the settled property passed to the trustee on execution of the settlement).

In that case, on 13 March 2002 Lyons J. of the Supreme Court of The Bahamas made an *ex parte* order for a letter of request to be issued seeking assistance (i) that the appointment of the trustee in bankruptcy of the property of the debtor should be recognised in the jurisdiction of the Cayman Islands; (ii) that the trustee should be granted all general law powers and the statutory powers accorded to a trustee in bankruptcy in [the jurisdiction of the Cayman Islands]… and in particular… the powers under s.107 of the [Cayman] Bankruptcy Law and (iii) that he should be granted such other powers as the Grand Court of the Cayman Islands thought fit. The decision was based on the fact that although the Bankruptcy Act of The Bahamas did not contain any power comparable to s. 74 of the United Kingdom Bankruptcy Act 1869 (the antecedent of s.122) Lyons J. was nonetheless satisfied that s.122 applied in The Bahamas, having been specially mentioned in a Bahamian enactment (after The Bahamas became independent in 1973) entitled 'Acts of the United Kingdom Parliament applying in or affecting The Bahamas otherwise than by virtue of an enactment of the Legislature of The Bahamas'.[45]

The jurisdiction to extend insolvency proceedings in relation to a trust in another jurisdiction can therefore be based on both common law and statute.

10. Can trusts be challenged?

10.1 To obtain assets

Yes, trusts can be challenged on the basis that there is a sham if the creditor contends that the trust assets are held on resulting trust for the settlor and thus available to meet his claims. In such circumstances, the Fraudulent Dispositions Act, and sections 71 and 72 of the Bankruptcy Act (noted at section 5 above) would be relevant.

10.2 To obtain information

A trust can be challenged to obtain information for the purpose of asset tracing, by way of Norwich Pharmacal relief or by virtue of a mareva injunction and / or disclosure orders, however, there are statutory limitations to this right.

Under section 83 of the Trustee Act, no information including information concerning the existence of a trust shall be provided or given to beneficiaries with a contingent interest, objects of discretionary powers or any other persons who are not entitled to vested interests under the trusts if the trustees in their absolute discretion consider that it would not be in the best interest of the beneficiary to give the information unless a person vested by the trust instrument with power to request or approve disclosure requests approves such disclosure.

Trustees have the right in their absolute discretion to determine confidentiality and to secure the right to confidentiality of beneficiaries, including whether financial statements about a trust should be disclosed. There are restrictions as to what may be disclosed.

In the decision of *Ashley Dawson-Damer Grampian Trust Company Limited*[46] the Bahamian Supreme Court had an opportunity to consider a request made by a

45 See para [16] of *Al Sabah* ibid.
46 2015 / CLE / gen 00341.

discretionary beneficiary of a Bahamian Trust for further and better particulars. Section 83 (8) which provides no person shall be bound or compelled by any process of discovery or inspection or under any equitable rule or principle to disclose or produce to any beneficiary other person documents such as a memorandum or letter of wishes issued by the settlor or any documents concerning the exercise of the Trustee's discretion, was relied on by the Trustee as a basis to refuse the disclosure request. Section 83 was construed by the court to apply to the automatic discovery process in ordinary civil litigation. It was held the intention of Parliament under the section was for the removal of the ability for litigants to simply commence an action and compel disclosure as part of the discovery process rather than a complete ouster of the jurisdiction of the court to order disclosure.[47] The Court determined that any argument that section 83(8) could shield all activities of trustees even in the face of wrongdoing is untenable.[48]

Further, in the Bahamian case of *Grupo Torras SA et al v PTC Management Ltd. et al* [49] Brownie J. Construed section 83(8) of the Trustee Act in a tracing claim where directions were sought as to its effect, with respect to disclosure provisions in a mareva injunction. It was held, that whilst it is important to protect the interests of trustees and beneficiaries, it is also important to see that section 83 is not construed in an inappropriate way that would facilitate wrong-doing.

10.3 To examine witnesses

The court has the power on the application of the trustee at any time after an order of adjudication has been made against a bankrupt, to summon before it the bankrupt or his wife, or any person whatever known or suspected to have in his possession any of the estate or effects belonging to the bankrupt, or supposed to be indebted to the bankrupt, or any person whom the court may deem capable of giving information respecting the bankrupt, his trade dealings or property, and the court may require any such person to produce any documents in his custody or power relating to the bankrupt, his dealings or property; and if any person so summoned, after having been tendered a reasonable sum, refuses to come before the court at the time appointed, or refuses to produce such documents, having no lawful impediment made known to the court at the time of its sitting and allowed by it, the court may, by warrant addressed as aforesaid, cause such person to be apprehended and brought up for examination.[50]

Further, according to sections 77 and 78 of the Bankruptcy Act, the court may examine upon oath, either by word of mouth or by written interrogatories, any person so brought before it in manner aforesaid concerning the bankrupt, his dealings or property. Further, If any person on examination before the court admits he is indebted to the bankrupt, the court may, on the application of the trustee, order him to pay to the trustee, at such time, and in such manner as to the court seems expedient, the amount admitted, or any part thereof, either in full discharge of the whole amount in question or not, as the court thinks fit, with or without costs of the examination.[51]

47 Per Winder J. at [34].
48 See also *North Shore Ventures Ltd. v Anstead Holdings Inc.* [2012] EWCA Civ 11.
49 CL / 1262 / 1998.
50 Section 76, Bankruptcy Act.
51 See also *Ex parte Crossley In Re Taylor* [1872] LR 13 Eq. 409 and *In Re Tucker (A Bankrupt)* 1990 Ch. 148 as to the scope of examination.

11. On what grounds can a trust arrangement be challenged?

11.1 The settlor was insolvent when the trust was created or became insolvent as a result of creating it

Yes, such a settlement can be set aside as void in accordance with section 71 of the Bankruptcy Act under the limited definition of Trader as defined in the 1870 Act, and the Fraudulent Dispositions Act.

11.2 The settlor becomes insolvent

Section 71[52] enables dispositions to be set aside where the dispositions were made within two years of the bankruptcy or after two years but within ten years where the bankrupt was solvent at the date of the disposition without the aid of the property comprised in it. Similarly, a trust may be challenged if the settlor becomes insolvent within two years after the disposition where there is an intent to defraud under the Fraudulent Dispositions Act.

The onus of proof is on the applicant to show that the settlement was a transaction entered into for the purpose of putting assets beyond the reach of a person who is making or may make a claim against the settlor or of otherwise prejudicing the interests of such claimant or potential claimant. Once the applicant has established his case the person seeking escape from having an order made against him must discharge the onus of showing that he falls within the protection afforded by providing good faith, value and lack of notice of the relevant circumstances, including the debtor's purpose to prejudice creditors.

11.3 The settlor lacked capacity or authority to create the trust

A settlement, whether voluntary or for value, is voidable at the instance of the settlor (or the settlor's representative) if the settlor can prove that he lacked the requisite mental capacity at the time of making the settlement.[53]

A person will have no right to avoid the settlement, if, after gaining or regaining capacity, he has done anything to adopt or affirm the settlement. The standard of mental capacity relative to a voluntary settlement *inter vivos* is the same as that for the making of a will. The settlor must understand the general nature and effect of the transaction and must also recognise persons who have a moral claim upon her or him and to exercise a balanced judgment in relation to such claims.

11.4 The settlor lacked the capacity or authority to transfer the assets to the trustees

The degree of mental capacity relative to a settlement for value differs from that appropriate to a voluntary settlement. The sole standard required is capacity to understand the general nature of the transaction that is designed to be achieved by the creation of the trust. The standard differs from that for a voluntary settlement because there is a question of depriving another party of the benefits of a fair and proper bargain. Accordingly, it is not to the point that the settlor's judgment to dispose for value may have been affected by a delusion provided he understood the general nature of the transaction.[54]

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52 Similar to s. 42, English Bankruptcy Act 1914.
53 See *Cargo v McIntyre* [1976] 1 NSWLR 729.
54 See Ford and Lee, *Principles of Law and Trusts*, para 211.

11.5 The assets were not validly transferred, or the transfer was not fully completed

If there is doubt as to whether the property has been validly transferred, the potential trustees and beneficiaries are volunteers, and it should be established that a settlor has done all that he could do and that the trustees or beneficiaries have acquired the property in a different way and that there was a proper gift.

11.6 The trust was not validly created

In order for a trust to be validly created the three certainties must exist, (i) certainty of intention, (ii) certainty of subject matter and (iii) certainty of objects. A settlor who retains no beneficial interest and no express power of control over trustees, cannot enforce a trust which he has created.[55] It could be alleged that there was undue influence, duress or fraud in that the trust does not reflect the settlor's wishes; or that the settlor lacked the capacity to form a trust and the trust does not reflect the settlor's wishes. A claim can also be made that a trust does not serve its purpose or that trust language is ambiguous.

A trustee against whom any hostile litigation is brought challenging the validity of the settlement does not have a duty to defend the trust but is obliged to remain neutral and offer to submit to the court's directions where there are rival claimants to the beneficial interest able to fight their own battles.[56] The trustee will however be entitled to an indemnity and a lien for his costs incurred in serving a defence and agreeing to submit to the court's directions and in making discovery.[57]

11.7 What are the grounds for a transfer could be subsequently set aside as void or voidable?

The grounds are stated below.

11.7.1 Mistake

Section 91C of the Trustee Act (as amended) clarifies the law relating to trustee indemnities and allows settlors and donors of property to a trust to benefit from provisions in a trust relating to restrictions against alienation and inserts a new section giving statutory effect to the rule in *Re Hastings Bass.*[58]

Under the section, the court may, on an application, declare the exercise of the fiduciary power void or voidable and make such determination as it deems fit, if the court is satisfied that *(a)* a person with the fiduciary power – *(i)* has failed to take into account relevant considerations; or *(ii)* has taken into account irrelevant considerations; and *(b)* such person – *(i)* would not have exercised the fiduciary power; or *(ii)* would have exercised the fiduciary power, but on a different occasion, or in a different manner, to that in which it was exercised.

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55 See *Twinsectra Ltd. v Yardley* [2002] AC 164.
56 See Underhill and Hayton, *Law Relating to Trusts and Trustees*, Seventeenth Edition.
57 See the Trustee Act.
58 *Re Hastings-Bass* [1975] Ch 25 determined in the ruling of Buckley LJ, that, *'Where a trustee by the terms of a trust… is given a discretion as to some matter under which he acts in good faith, the court should not interfere with his action, notwithstanding that it does not have the full effect which he intended unless 1) what he has achieved is unauthorized by the power conferred on him or where he has acted outside of the power conferred on him or 2) if it is clear that he would not have acted as he did a) had he not taken in account considerations which he should not have taken into account or b) had he not failed to take into account considerations which he ought to have taken into account.'*

The common law position is that if a person who appears by a settlement to be the settlor proves that he executed it under a fundamental error as to the very nature of the transaction, the settlement will be set aside as being void.[59]

Where a trust instrument has been prepared as part of a bargain between parties and the document fails to express correctly the transaction between the parties because of a mistake, rectification of the document to make it accord with the transaction can be ordered by the court in its discretion.[60]

Where a settlor is induced to create a trust by the fraudulent misrepresentation of another person the trust is voidable. Even an innocent misrepresentation will have this effect.[61]

11.7.2 If there was an undervalue

Section 71 of the Bankruptcy Act and the Fraudulent Dispositions Act are again relevant to such a challenge which may be made.

11.7.3 If there was a preference

Section 72 of the Bankruptcy Act and section 241 of the Companies (Winding Up Amendment) Act as noted above are relevant to set aside such transactions.

11.7.4 If there was a sham

Section 3 of the Trustee Act clarifies the provisions in relation to sham trusts. The section provides that the retention, possession or acquisition by the settlor of any of the matters referred to in relation to the following powers shall not invalidate a trust or the trust instrument or cause a trust created *inter vivos* to be a testamentary trust or disposition or the trust instrument creating it to be a testamentary document:-

(a) power to postpone the sale of real estate comprised in the trust fund which is held upon trust to sell the same;

(b) power to receive additional property into the trust fund;

(c) power to borrow on the security of the trust fund;

(d) power to lend any part of the trust fund to any person

(e) power to vote securities held as part of the trust fund and to deposit such securities
in any voting trust and to give proxies or powers of attorney in respect thereof;

(f) power to incorporate companies to hold the trust fund or any part thereof;

(g) power to apply the trust fund or the income thereof in policies of insurance;

(h) power to apply the trust fund in purchasing or acquiring or making improvements in or repairs to or on any land in the occupation or intended for occupation by any beneficiary;

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59 *Berridge v PublicTrustee* [1914] 33 NZLR 865.
60 See *Re. Butlin's Settlement Trusts* [1976] Ch. 251.
61 See. *Re Glubb* [1900] 1 Ch. 354.

(i) power to lay out part of the trust fund in the purchase of goods and chattels for the use of any beneficiary;

(j) power to grant options;

(k) power to hold bearer securities;

(l) power to pay duties, fees or taxes out of the trust fund notwithstanding that the same shall not be recoverable from the trustees or from any persons interested under the trusts or that the payment shall not be to the advantage of such persons;

(m) power to institute prosecute and defend lawsuits and to compromise any matter of difference or to submit the same to arbitration;[62]

(n) power to make any distribution of the trust fund in specie;

(o) power to obtain the opinion of counsel;

(p) power to engage an investment advisor;

(q) power to employ and pay out of the trust fund fees of any agent or agents in any part of the world;

(r) power to release, extinguish or restrict any power contained in the trust instrument or by law conferred on the trustees;

(s) power to omit to register bonds or securities;

(t) power to act as a director, officer, manager or employee of any company whose shares or debentures may be comprised directly or indirectly in the trust fund and to retain fees paid for acting in such capacity.

The common law position in relation to sham trusts was set out in the following terms in the case of *In Re the Esteem Settlement, Grupo Torras SA v Al-Sabah & Ors*[63] which held, in order to find a sham, the court must find that both the settlor and the trustee intended that the true position should be otherwise than as set out in the trust deed which they both executed. A trust is either a sham so that the trust assets are beneficially owned by the settlor, or it is not and they are not. If the trustees automatically, without exercising their own discretion, do whatever the settlor-beneficiary asks, then the trust is a sham where such was the deal between the trustees and the settlor. However, where the trustees, exercising their own discretion, virtually always do as the settlor-beneficiary asks, then the trust is not a sham, so creditors have no right to have recourse to the assets to satisfy claims against the settlor.[64]

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62 Section 91 A, Trustee Act (as amended) also provides for the Arbitration of trust disputes to enable any dispute or administration question in relation to a trust to be determined by arbitration in accordance with the provisions of the trust instrument, in which circumstances the Arbitration Act shall apply to a trust arbitration.

63 [2004] WTLR 1.

64 *Shalson and other v Russo and other* [2005] Ch. 281 held that where a person was fraudulently induced to lend money to another the money advanced did not become subject to an immediately binding constructive trust in the lender's favour but became the borrower's property both legally and beneficially. A settlement executed by a settlor and a trustee could not be regarded as a sham unless both the settlor and the trustee intended it to be a sham from the outset, or later came to such an intention.

11.7.5 Any other grounds

A person may apply to the court to declare the exercise of a fiduciary power by a trustee voidable. According to section 91 C of the Trustee Act (as amended) the court may, declare the exercise of the fiduciary power void or voidable and make such determination as it deems fit.

An application may be made by (a) a trustee, protector, or any other person exercising the power; (b) a successor in title of the trustee or protector; (c) a power holder under section 81 A[65] (d) a beneficiary; (e) an 'authorised applicant' as defined in the Purpose Trust Act; (f) for a purpose trust, the Attorney-General if there is no authorised applicant; (g) any person with leave of the court.

Whether or not in the exercise of the power the person exercising the power, or any person advising such person, acted in breach of trust, in breach of duty or was otherwise at fault shall be immaterial to the making of a declaration by the court under this section.[66]

Section 87A of the Trustee Act provides for the termination of interest of a beneficiary upon the validity of the trust[67] being challenged, in whole or in part, in any court within or outside The Bahamas, or any action being taken to assist, promote or encourage a challenge. The section applies whether or not the challenge or action is brought or taken by the beneficiary or is brought or taken in good faith or with reasonable cause.

The court will also set aside or rectify a settlement executed under duress or in ignorance or mistake, or procured by fraud, misrepresentation, or undue influence, provided that the settlor has not acquiesced in the settlement after the influence has ceased, or after he has become aware of its legal effect and that the parties can be restored substantially to their original positions.

11.7.5.1 Undue influence

A gift to trustees may be set aside for undue influence. This doctrine is intended to protect the donor by ensuring that the influence of the dominant person over the donor is not abused so as to prevent the donor's conduct from being an expression of his own free will.[68] This may arise where the law irrefutably presumes there to be a relationship of trust and confidence such as between a solicitor and client, and parent and a child who has not reached full age. Similarly it may arise if there was a relationship of trust and confidence such as between husband and wife and the gift calls for explanation as so bountiful to the recipient or so detrimental to the donor as to seem explicable only on the basis that the gift had been procured by undue

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65 Power holder means *"any person holding a power in relation to a trust (including any power of appointment, consent, direction, revocation or variation, and any power to appoint or remove trustees or power holders) and includes a person in the position of a protector."*

66 Fiduciary power means *"a power that, when exercised, must be exercised for the benefit of or taking in account the interests of at least one person other than the person who holds the power and in the case of a purpose or charitable trust, to advance the purposes of such trust."*
No order may be made which would prejudice a bona fide purchaser for value without notice of any trust property without knowledge of the matters which allow the court to set aside the exercise of a fiduciary power

67 Under the section, the *'validity of the trust' includes the validity of any disposition of property to be held upon the trusts of the trust and any question whether any settlor of the trust intended to create a trust on the terms of the trust instrument.*

68 Per Hayton J. *Attacking Offshore Trusts*, at p.11

influence and the defendant cannot discharge the evidential burden of showing that there was no undue influence, for example, because independent legal advice had been given to the claimant.

11.7.5.2 Matrimonial cases

Under section 54 of the Matrimonial Causes Act[69] a reviewable disposition[70] of property may be set aside by the court if it is made with the intention of defeating a person's claim for financial relief.

11.7.5.3 Criminal activity

The Proceeds of Crime Act, 2000[71] also provides for measures that can be imposed to confiscate property subject to a trust fund as settled by criminals and charging orders may be imposed in relation thereto. A Receiver can be appointed to realise assets[72] and orders can be made against Bank and Trust Companies for the purpose

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69 Section 54 (2) *"Where proceedings for financial relief are brought by one person against another, the court may, on the application of the first-mentioned person — (a) if it is satisfied that the other party to the proceedings is, with the intention of defeating the claim for financial relief, about to make any disposition or to transfer out of the jurisdiction or otherwise deal with any property, make such order as it thinks fit for restraining the other party from so doing or otherwise for protecting the claim; (b) if it is satisfied that the other party has, with that intention, made a reviewable disposition and that if the disposition were set aside financial relief or different financial relief would be granted to the applicant, make an order setting aside the disposition; (c) if it is satisfied, in a case where an order has been obtained under any of the provisions mentioned in subsection (1) by the applicant against the other party, that the other party has, with that intention made a reviewable disposition, make an order setting aside the disposition; and an application for the purposes of paragraph (b) shall be made in the proceedings for the financial relief in question. (3) Where the court makes an order under subsection (2)(b) or (c) setting aside a disposition it shall give such consequential directions as it thinks fit for giving effect to the order (including directions requiring the making of any payments or the disposal of any property). (4) Any disposition made by the other party to the proceedings for financial relief in question (whether before or after the commencement of those proceedings) is a reviewable disposition for the purposes of subsection (2)(b) and (c) unless it was made for valuable consideration (other than marriage) to a person, who, at the time of the disposition, acted in relation to it in good faith and without notice of any intention on the part of the other party to defeat the applicant's claim for financial relief. (5) Where an application is made under this section with respect to a disposition which took place less than three years before the date of the application or with respect to a disposition or other dealing with property which is about to take place and the court is satisfied - (a) in a case falling within subsection (2)(a) or (b) that the disposition or other dealing would (apart from this section) have the consequence, or (b) in a case falling within subsection (2)(c) that the disposition has had the consequence, of defeating the applicant's claim for financial relief, it shall be presumed, unless the contrary is shown, that the person who disposed of or is about to dispose of or deal with the property did so or, as the case may be, is about to do so, with the intention of defeating the applicant's claim for financial relief. (6) In this section "disposition" does not include any provision contained in a will or codicil but, with that exception, includes any conveyance, assurance or gift of property of any description, whether made by an instrument or otherwise. (7) This section does not apply to a disposition made more than three years before the coming into operation of this section.*

70 Section 54 (4), Matrimonial Causes Act provides: *"Any disposition made by the other party to the proceedings for financial relief in question (whether before or after the commencement of those proceedings) is a reviewable disposition for the purposes of subsection (2)(b) and (c) unless it was made for valuable consideration (other than marriage) to a person, who, at the time of the disposition, acted in relation to it in good faith and without notice of any intention on the part of the other party to defeat the applicant's claim for financial relief."*

71 Section 27 (4) provides: *a charge may be imposed by a charging order only on - (a) any interest in realisable property, which is an interest held beneficially by the defendant or by a person to whom the defendant has directly or indirectly made a gift caught by this Act- (i) in any chargeable asset; or (ii) under any trust; or (b) any interest in realisable property held by a person as trustee of a trust if the interest is in a chargeable asset or is an interest under another trust and a charge may, by virtue of paragraph (a), be imposed by a charging order on the whole beneficial interest under the first mentioned trust. (6) In any case where a charge is imposed by a charging order on any interest in any relevant security, the court may provide for the charge to extend to any interest or dividend payable in respect of them. (3) Subject to any provision made under section 29, a charge imposed by a charging order shall have the like effect and shall be enforceable in the same manner as an equitable charge created by the person holding the beneficial interest or, as the case may be, the trustees by writing under their hand."*

72 Section 29, Proceeds of Crime Act, 2000.

of gathering information[73] and a monitoring order[74] can be imposed over certain accounts held by bank and trust companies.

In the rare event that a settlor could prove that a trust *inter vivos* was created under actual coercive pressure (such as the threat of prosecution for some alleged offence) the settlor would have grounds in equity to regard the trust as voidable. The right to avoid a trust created under undue influence will come to an end if the settlor so acts after becoming aware of the initial invalidity of the trusts to affirm it, consciously and deliberately.

12. What protections and defences exist to protect those listed at section 5 and are they statutory or common law or otherwise?

The relevant parties are a settlor, trustee, beneficiary and protector. Section 74 of the Bankruptcy Act provides for protection of certain transactions with a bankrupt by providing that the following payments under the Bankruptcy Act shall not be rendered invalid - (1) any payment made in good faith and for value received to any bankrupt before the date of the order of adjudication by a person not having at the time of such payment notice of any act of bankruptcy committed by the bankrupt, and available against him for adjudication; (2) any payment or delivery of money or goods belonging to a bankrupt, made to such bankrupt by a depositary of such money or goods before the date of the order of adjudication, who had not at the time of such payment or delivery notice of any act of bankruptcy committed by the bankrupt, and available against him for adjudication; (3) any contract or dealing with any bankrupt, made in good faith and for valuable consideration, before the date of the order of adjudication, by a person not having, at the time of making such contract or dealing, notice of any act of bankruptcy committed by the bankrupt, and available against him for adjudication.

Section 75 of the Bankruptcy Act[75] allows for protection of certain transactions entered into by or in relation to the property of the bankrupt for good faith and valuable consideration before the date of adjudication such as dispositions or contracts relating to property, execution or attachments against land or execution or attachments against goods of a bankrupt.

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73 Section 35, Proceeds of Crime Act, 2000 provides *"Provided however that where a production order requires information which is restricted under the Banks and Trust Companies Regulations Act and the Central Bank of The Bahamas Act, application shall be made ex parte to a Judge in chambers."*

74 Section 39, Proceeds of Crime Act, 2000.

75 *Subject and without prejudice to the provisions of this Act relating to the proceeds of the sale and seizure of goods of a trader, and to the provisions of this Act avoiding certain settlements, and avoiding, on the ground of their constituting fraudulent preferences, certain conveyances, charges, payments and judicial proceedings, the following transactions by and in relation to the property of a bankrupt shall be valid, notwithstanding any prior act of bankruptcy - (1) any disposition or contract with respect to the disposition of property by conveyance, transfer, charge, delivery of goods, payment of money, or otherwise howsoever made by any bankrupt in good faith and for valuable considerations, before the date of the order of adjudication, with any person not having at the time of the making of such disposition of property notice of any act of bankruptcy committed by the bankrupt, and available against him for adjudication; (2) any execution or attachment against the land of the bankrupt, executed in good faith by seizure before the date of the order of adjudication, if the person on whose account such execution or attachment was issued had not at the time of the same being so executed by seizure, notice of any act of bankruptcy committed by the bankrupt and available against him for adjudication; (3) any execution or attachment against the goods of any bankrupt, executed in good faith by seizure and sale before the date of the order of adjudication, if the person on whose account such execution or attachment was issued had not at the time of the same being executed by seizure and sale notice of any act of bankruptcy committed by the bankrupt and available against him for adjudication.*

13. Can claims be made in a bankruptcy where the IP stands in the shoes of a bankrupt to exercise the rights given by the trust in favour of the following?

13.1 The settlor

Yes, however where a trust is not exclusively for the benefit of the bankrupt, but is for the maintenance of the bankrupt and another person, the creditors will take only so much as was intended for the bankrupt.[76] Section 39 of the Trustee Act referred to above and section 36 of the Bankruptcy Act permits payments to be made to a beneficiary for what he needs for his maintenance and support. He would have to account to his assignee or creditors only for any surplus above such amounts.[77] A settlor can therefore make certain claims if he remains entitled notwithstanding an IP's appointment standing in the shoes of a bankrupt.

Where a settlor has a life interest determinable on the event of bankruptcy an order may be made appointing a judgment creditor of the settlor as receiver of the income. If a power of revocation is reserved to the settlor, it may be possible for the power of revocation to be delegated to receivers to exercise certain powers such as revocation of the trust as was held in the Privy Council case of *Tasarruf Mevduati Sigorta Fonu v Merril Lynch Bank and Trust Company (Cayman) Limited and Others.*[78]

There is an inherent jurisdiction to appoint a receiver in circumstances where it is just and equitable to do so according to the Supreme Court Act 1996.

13.2 A trustee

In the case of insolvency trustees would have the power to engage an insolvency practitioner to assist them in the process of winding up the trusts and, if appropriate, to delegate powers to that insolvency practitioner.

Where trustees have an arbitrary power of applying or not applying a fund for the benefit of the bankrupt, or of applying the fund in the alternative, either for the benefit of the bankrupt or of another person, the bankruptcy will have no effect upon the power.[79]

13.3 A beneficiary

Yes, in circumstances where property is vested in trustees upon trust for a beneficiary for life. If a beneficiary becomes bankrupt or insolvent, the trustees would be entitled during his life to apply trust funds towards the maintenance and support of the beneficiary and his then present or any future wife and children, or any of them as the trustees think proper. The power to apply income towards the wife and family of the insolvent is not destroyed by the insolvency and the life estate does not vest in the assignee but the trustees have a right under the power to appoint in favour of the insolvent, his wife and children or any of them in exclusion of any other of them though any benefit which the insolvent might take would belong to the assignee.

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76 See *Lewin on Trusts* p. 97.

77 According to the section, the trustee, with the consent of the creditors testified by a resolution pass in general meeting, may from time to time, during the continuance of the bankruptcy, make such allowance as may be approved by the creditors to the bankrupt out of his property for the support of the bankrupt and his family, or in consideration of his services if he is engaged in winding up his estate.

78 [2011] UKPC 17.

79 See *Chambers v Smith* [1873] 3 App Cas 795.

Section 39 of the Trustee Act makes provision for protective trusts[80] the effect of which is that, where the protected life interest has been forfeited either by bankruptcy or alienation, the trustees must not, under the discretion vested in them, continue to pay the income to the chief beneficiary; they will be accountable in respect of any such income after they have received notice of bankruptcy or assignment; the trustees may, however, expend the income for the benefit of the principal after his life interest has been forfeited either by bankruptcy or alienation.[81]

13.4 A protector

Yes, where the power of a protector is exercisable partly for his own benefit and partly for the benefit of another, the power will pass to the trustee in bankruptcy of an insolvent protector. A power in the protector to advance a proportion of trust income to each of the beneficiaries in fixed shares where one of the beneficiaries is the protector would therefore vest in the trustee in bankruptcy.[82]

14. Are rights of subrogation established by law?

Yes, at common law, in the case of a trust, all the claims of the creditors are against the trustee (save where security has been taken directly over the trust assets), with their rights being subrogated to the trustee's right of indemnity[83] (under the statute) against the trust fund. A trust creditor[84] has the right to look to the trustee's right of indemnity and associated lien over trust assets and is entitled to be subrogated to those rights. If subrogation applies, the right of indemnity survives the trustee's bankruptcy and the trust creditors do not have to compete with the trustee's other creditors.

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80 See footnote 18.

81 See *Lewin on Trusts* Sixteenth Edition, p.105.

82 Holden on Protectors para 4.45.

83 Section 36 of the Trustee Act (as amended) makes provision for the implied indemnity of a trustee whereby *"a trustee shall be chargeable only for money and securities actually received by him notwithstanding his signing any receipt for the sake of conformity, and shall be answerable and accountable only for his own acts, receipts, neglects or defaults and not for those of any other trustee nor for any banker, broker or other person with whom any trust money or securities may be deposited nor for any other loss, unless such loss happens through his own individual act or omission. Subsection (2) permits that a trustee may reimburse himself or pay or discharge out of the trust property all expenses incurred in or about the execution of the trusts or powers. (3) A trustee may upon resignation, retirement, Removal, transfer or otherwise ceasing to be trustee of a trust, whether created before, on or after the commencement of this Act- (a) require from any continuing or new trustee or continuing and new trustee (in the event of the trustee's resignation, retirement or removal), from the settlor (in the event of the trust's revocation) or from any beneficiary (in the event of a final distribution to such beneficiary) a release and indemnity holding harmless the outgoing trustee, and the servants and agents of the outgoing trustee and (if it is a corporation) its directors and officers from and against any and all claims, demands, actions, proceedings, damages, costs, charges and expenses whatsoever for, or arising out of, or in relation to, any act or omission of the outgoing trustee or of any such directors; officers, servants or agents in respect of the administration of the trust by the outgoing trustee; and (b) withhold such trust property as the outgoing trustee in good faith considers necessary to pay outstanding liabilities, whether present, future contingent or otherwise or to satisfy the aforesaid indemnity. (4) The release and indemnity and right to withhold trust property referred to in subsection (3) shall not extend to any liabilities for breach of trust or in respect of which the outgoing trustee would otherwise not have been entitled to a release and indemnity out of the trust property had the outgoing trustee remained a trustee; and the release and indemnity given by any continuing or new trustees shall be limited to the trust property in their possession or under their control from time to time."*

84 In order to be subrogated the creditor must be a 'trust creditor' and the trustee must have incurred liability to the creditor as a result of exercise of trust powers. A creditor can only be subrogated if he proves that the trustee has a right of indemnity.

15. Can the veil of a company owned by a trust be pierced or lifted and, if so, in what circumstances?

The veil of a company may be pierced in order to impose a liability of a company upon its shareholder, or to impose liability upon a company by reason of the action of its shareholder. The court will use its powers to pierce the corporate veil if the company is involved in some impropriety or where the company was shown to be a façade or sham. The court is entitled to 'pierce the corporate veil' and recognise the receipt of the company as that of the individual(s) in control of it if the company was used as a device or façade to conceal the true facts thereby avoiding concealing any liability of those individuals.[85]

An example of this arose in the case of *Private Trust Corporation v Grupo Torras SA (27 October 1997)* a decision of the Court of Appeal of The Bahamas. Grupo Torras obtained a mareva injunction and accompanying disclosure orders in respect of the Bluebird Trust of which Private Trust Corporation (PTC) was the trustee. PTC appealed. The Court of Appeal upheld the injunction. In the course of his judgment, Gonsalves-Sabola P, having said that a case had been made that the assets of the Bluebird Trust are in fact Sheikh Fahad's assets went on to say:

'If it be established that the Bluebird Trust was a vehicle over which Sheikh Fahad exercised substantial or effective control, the Court would pierce the corporate structure of PTC and regard Sheikh Fahad as beneficial owner of the assets of the trusts applying the principles recognised by Cumming-Bruce LJ in Re A Company and Mummery J in TSB Private Bank International SA v Chabra and Another (1992) 1 WLR 231.'

It is to be noted that both Mance J. and the Bahamian Court of Appeal placed great weight on the comments of Cumming-Bruce LJ in *Re a Company* that the veil may be pierced where it is necessary in order to achieve justice, notwithstanding that this test has been held to be too wide and has not been followed.[86]

16. Can the veil of a trust be pierced or lifted and, if so, in what circumstances?

No, there is no case where a court has pierced the veil of a trust so as to enable a creditor of the settlor to have recourse against the assets in a valid trust, see *Re Esteem*. Ibid. In that case it was held that since there is a separation of economic interest unlike in the case of a company where the ultimate economic interest lies with the controlling shareholder, the assets are not held for the settlor in the case of a trust. They are held upon trust for a class of beneficiaries (which may or may not include the settlor) and the court will enforce the obligations of the trustees towards those beneficiaries. Therefore, it was determined that piercing the veil is not applicable to trusts. Further, because in order for there to be substantial and effective control, the trustees must have abdicated their fiduciary duties and been in breach of trust. It could not be right that the Court should be asked by piercing the veil, notionally to effect a transfer to the settlor in circumstances where, were that made by the trustees without an order of the Court, it would be liable to be set aside.

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85 Per *Morrit VC in Salomon v A Salomon & Co. Ltd.* [1897] AC 22.

86 In *International Credit and Investments Co (Overseas) Ltd. v Adham* [1998] BCC 134 the defendants in a case alleging massive fraud, had set about evading various interim orders of both the English and Bahamian courts, the court agreed as an interim preservative measure to appoint a receiver of certain real property in England which was owned by a Bahamian company which was in turn owned by a Liechtenstein trust. The judge held that the court would not allow its orders to be evaded by the manipulation of shadowy offshore trusts and companies.

17. If a trust can be treated as insolvent, is this on the basis of the cash flow test, the balance sheet test or another test and, if so, what test?

The insolvency of the trust fund arises in circumstances where, under the cash flow test there is an inability for the trustee to pay debts as they fall due and owing. In such circumstances, the trust may be deemed *'insolvent'* and creditors would have recourse to the assets of the Trust.

18. Can or have receivers been appointed to act as a trustee or with powers over trust assets? if so, in what circumstances?

The common law position is that the court may appoint a receiver of a trust see *Re IMK Family Trust*[87] although such a power is exercised sparingly. There is a dearth of legal authority as to whether an insolvency practitioner is appointed to conduct the winding up of an insolvent trust including the realisation of trust assets, and such a proposal may be tantamount to appointing the insolvency practitioner as receiver of the trust assets. Whether the trust assets remain in the legal ownership of the trustee or the insolvency practitioner is appointed receiver, the court would have the power to do so in an appropriate case.[88] See also *In International Credit and Investments Co (Overseas) Ltd. v Adham* at footnote 87.

In considering whether such an application should be made, a trustee may apply without commencing an action upon a written statement for the opinion, advice or direction of the Court or Judge in Chambers on any question respecting the management or administration of the trust property or the assets of any testator or intestate pursuant to section 77 of the Trustee Act.

19. Are claims against trustees limited or unlimited? do underlying companies have a role?

At common law, it is only possible to limit liability to the trust assets if the trustee and the creditor have expressly agreed. A trustee will not have done enough if all that is done is for the trustee to state that he contracts as 'trustee'.[89] A trustee may be able to claim that liability should be limited or excluded or that a creditor can only have recourse to the trust assets in accordance with the trustee's right of indemnity.

The statutory limitation to a trustee's liability relative to the value of the trust fund received by the trustee is described in section 36 of the Trustee Act (see point 14 above) and a trustee may be relieved from personal liability under section 73 of the Trustee Act.[90]

Trustees may exercise powers of investment in accordance with section 5 of the Trustee Act and, according to section 6 (4) of the Trustee Act, trustees shall not be

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87 [2008] JLR 250.

88 See *In the Matter of the Representation of Barclays Private Bank Limited in its capacity as trustee of the ZII Trust* and *In the Matter of Volaw Trustee Limited in its capacity as Trustee of the ZII Trust* [2015] JRC 214.

89 *Muir v City of Glasgow Bank* [1879] 4 AC 337.

90 73. *"If it appears to the Court that a trustee (including a director, officer, employee, servant or agent of a corporate trustee) whether appointed by the Court or otherwise is or may be personally liable for any breach of trust, whether the transaction alleged to be a breach of trust occurred before, on or after the commencement of this Act, but has acted honestly and reasonably and ought fairly to be excused for the breach of trust and for omitting to obtain the directions of the Court in the matter in which he committed such breach, then the Court may relieve him either wholly or partly from personal liability for the same, whether or not he has acted with the requisite degree of prudence, diligence and skill."*

liable for any loss which may result from their having made, changed, retained or disposed of any investment pursuant to proper advice. The powers and immunities conferred by this section are in addition to those conferred by the trust instrument and by law.

Under section 7 of the Trustee Act, trustees shall not be liable for breach of trust by reason only of their continuing to hold investments which have ceased to be authorised investments. Further, section 8 (1) provides, trustees lending money on the security of any property on which they can properly lend shall not be chargeable with breach of trust by reason only of the proportion borne by the amount of the loan to the value of the property at the time when the loan was made.

Pursuant to section 9 of the Trustee Act, where trustees improperly advance trust money on a mortgage security which would at the time of the investment be a proper investment in all respects for a smaller sum than is actually advanced, the security shall be deemed an authorised investment for the smaller sum and the trustees shall only be liable to make good the sum advanced in excess of the smaller sum with interest.

Claims against underlying companies may be brought on the basis that a constructive trust has arisen where assets from a trust have been extracted, in breach of trust, from a fund held on express trusts.[91] Where a recipient of money, which is a product of a breach of trust[92] has not given value for the payment, the recipient becomes a trustee of that money, that is to say a constructive trustee, holding it on trust for the beneficiaries under the trust from which the money has been extracted.[93]

20. Are there provisions or cases where trusts, or those connected to them, are based in a foreign jurisdiction?

Section 31 of the Trustee Act provides for a power to delegate trusts; a trustee may, by power of attorney or any other written instrument, delegate to any person in or outside The Bahamas the execution or exercise of all or any trust, powers and discretions vested in him as such trustee either alone or jointly with any other person. There are various cases where trusts or those connected to them are based in foreign jurisdictions such as *In the Matter of Sheikh Fahad Mohammed Al Sabah, A Bankrupt, and in the Matter of section 122 of the Bankruptcy Act 1914;*[94] *Crociani and others v Crociani and others.*[95]

21. What are the main means to seek assistance from another jurisdiction?

Assistance can be sought by way of an application for recognition, seeking the issuance of a Letter of Request and Letters Rogatory.

91 *Independent Trustee Services Ltd. v GP Noble Trustees Ltd.* [2013] Ch. 91, 80.
92 See also *Armitage v Nurse* [1998] Ch. 241 which held that a clause excluding the liability of a trustee for equitable fraud or unconscionable behaviour was not so repugnant to the trust or contrary to public policy so as to be liable to be set aside at the suit of the beneficiary.
93 *Independent Trustee Services* ibid.
94 [2001] No. 511.
95 [2017] JRC 146.
96 Trusts (Choice of Governing Law) Act 1990.

22. What is the position as to whether the foreign jurisdiction does or does not recognise trusts?

The Bahamas has legislation to the effect that no trust governed by Bahamian law and no disposition of property to be held on such a trust is to be void, voidable, and liable to be set aside or defective in any manner by reference to a foreign law, nor is the capacity of any settlor to be questioned nor is the trustee or any beneficiary or any other person to be subjected to any liability or deprived of any right by reason that - (a) the laws of any foreign jurisdiction prohibit or do not recognise the concept of a trust; or (b) the trust or disposition avoids or defeats rights, claims or interest conferred by foreign law upon any person by reason of a personal relationship to the settlor or by way of heirship rights or contravenes any rule of foreign law or any foreign, judicial or administrative order or action intended to recognise, protect, enforce or give effect to any such rights, claims or interest.[96]

Under the Trusts (Choice of Governing Law) Act, in the creation of trust, a settlor, whether or not he is resident in The Bahamas, may expressly declare in the trust instrument that the laws of The Bahamas shall be the governing law of the trust. All questions arising in regard to a trust which is for the time being governed by the laws of The Bahamas or in regard to any disposition of property upon the trust, including any aspect of the validity of the trust or disposition or the interpretation or effect thereof are to be governed by Bahamian law.

As it relates to civil law jurisdictions, an heirship right conferred by foreign law in relation to the property of a living person shall not be recognised as affecting the ownership of immovable property in The Bahamas or movable property wherever situate for the purposes of determining matters to be determined by the governing law, and constituting an obligation or liability for the purposes of the Fraudulent Dispositions Act, 1991[97] or for any other purpose.

The Bahamas is not a signatory to The Hague Convention on the Law Applicable to Trusts and on their Recognition 1985.

23. What particular issues, difficulties and solutions have arisen or may arise relating to trust arrangements or those involved with them?

It is possible that claims may be pursued against an adviser and not just the debtor-client in the case of asset protection trusts, and the adviser may be liable to a creditor as constructive trustee, as a knowing recipient of trust property or as a dishonest assistant in a breach of trust.

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97 Under section 6 of the Fraudulent Dispositions Act. *"A disposition shall be set aside pursuant to this Act only to the extent necessary to satisfy the obligation to a creditor at whose instance the disposition had been set aside together with such costs as the court may allow. S. 7. Nothing in this Act - (a) shall validate any disposition of property which is neither owned by the transferor nor the subject of a power in that behalf vested in the transferor; (b) shall affect the recognition of a foreign law in determining whether the transferor is the owner of such property or the holder of such power."*

UNITED STATES OF AMERICA – THE STATE OF NEW JERSEY

1. Are trusts legal and valid under your domestic law? What are they principally used for?

In the United States, trusts are controlled by the laws of the individual state and, as such, vary across the different jurisdictions of the US. The following questions have been responded to under the laws of New Jersey and, where applicable, federal bankruptcy law. In New Jersey, trusts are legal and valid. There are, however, certain standards that trusts must comply with. On 19 January 2016, New Jersey enacted the New Jersey Uniform Trust Code, which had an effective date of 17 July 2016. It is codified under NJSA 3B:31 *et seq*. The Code sets out guidelines with regard to the requirements for the creation, modification, and termination of a trust. It also governs the different types of lawful trusts, the duties and liabilities of trustees, remedies for breaches of a trustee's obligations, creditor claims, the use of revocable trusts as alternatives to wills, and various administrative provisions. Trusts in New Jersey are extremely versatile and offer flexibility to meet various objectives. Although the purposes of trusts span a broad spectrum of goals, trusts are principally created by individuals as a money management tool for present and future generations of families, to provide for the requirements and care of specified individuals, or for continued charitable purposes. Federal estate tax savings and probate avoidance also drive the creation of trusts.

2. Are foreign trusts recognised under your private international laws?

Foreign trusts are recognized in New Jersey. Income and assets from foreign trusts may need to be reported to state and federal taxing authorities. The reader is directed to 26 USC § 6048 for information pertaining to certain foreign trusts and the reporting requirements for foreign trusts that have settlors or beneficiaries that are United States citizens.

3. Are there any prohibitions against trusts?

While there are no outright prohibitions against trusts, they must be lawfully created for a valid purpose. The main prohibitions exist to control the actions of trustees and ensure the trustee is always acting in the best interest of the beneficiaries and in accordance with the intent of the settlor of the trust. In this regard, trustees are charged with the utmost duty of loyalty, including a prohibition against self-dealing, as well as a duty of care to act accordingly, including the requirement to act as a prudent investor would to protect the corpus of the trust.

4. Are trusts and service providers regulated?

Indirectly, through regulating the individuals who typically form and administer the trusts. Attorneys and accountants typically form and administer trusts, and these professions are regulated through licensing requirements and continuing education courses. Additionally, for example, New Jersey's trusts are regulated in that they are governed by NJSA 3B:31 *et seq*. and relevant case law that interprets various trust provisions.

5. Can the following become insolvent and subject to insolvency procedures?

5.1 A trust itself

A trust itself can never become insolvent because it does not actually own any assets. Trust property is technically split between legal title and equitable title. The trustee holds legal title to any property placed in trust while the beneficiaries hold equitable title to that same property. Accordingly, a trust cannot sue or be sued, nor can it be subject to insolvency procedures.

If, however, a trust is determined to be a "business trust," it may file for protection under the US Bankruptcy Code. Factors used in determining whether a trust is a "business trust" that is eligible for relief under the Bankruptcy Code include the following:[1]

- whether the trust has the attributes of a corporation;
- whether the trust was created for the purpose of carrying on some kind of business or created to protect and preserve the res;
- whether the trust engages in business-like activities;
- whether the trust transacts business for the benefit of investors; and
- whether there is the presence or absence of a profit motive.

5.2 A settlor

The ability for creditors of a settlor of a trust to reach the trust's assets depends on a variety of factors, but a main one is the classification of the trust as revocable or irrevocable. A grantor or settlor of a revocable trust has complete control over the trust corpus until his or her death. With an irrevocable trust, the grantor has removed his or her rights to the assets of the trust and only the beneficiaries can change or modify the trust. The most significant factor is that of control: what property that forms the corpus of the trust does the settlor maintain control over or have a right to receive in distributions?

During the lifetime of the settlor, the property of a revocable trust is subject to claims of the settlor's creditors. With respect to an irrevocable trust, a creditor or assignee of the settlor may reach the maximum amount that can be distributed to or for the settlor's benefit. If a trust has more than one settlor, the amount the creditor or assignee of a particular settlor may reach may not exceed the settlor's interest in the portion of the trust attributable to that settlor's contribution.

After the death of a settlor, and subject to the settlor's right to direct the source from which liabilities will be paid, the property of a trust that was revocable at the settlor's death is subject to claims of the settlor's creditors, costs of administration of the settlor's estate, the expenses of the settlor's funeral and disposal of remains, and to a surviving spouse or partner in a civil union and children to the extent the settlor's probate estate is inadequate to satisfy those claims, costs, expenses.[2]

1 *In re Blanche Zwerdling Revocable Living Tr.*, 531 BR 537, 542-43 (Bankr. DNJ 2015).
2 NJSA § 3B:31-39.

5.3 A trustee

Trust property is not subject to personal obligations of the trustee, even if the trustee becomes insolvent.[3] However, the trustee must be sure to have no comingled personal funds and funds held in trust, otherwise the funds may be considered part of the bankruptcy estate. The Bankruptcy Code states that "all legal or equitable interests of the debtor in property as of the commencement of the case" are considered property of the estate.[4] But the Bankruptcy Code also provides that "[p]roperty of the estate does not include any power that the debtor may exercise solely for the benefit of an entity other than the debtor",[5] and this exception typically encompasses funds held by the debtor in trust.[6]

5.4 A beneficiary

Except as otherwise provided by law, to the extent a beneficiary's interest is not protected by a spendthrift provision, a creditor or assignee of the beneficiary may reach the beneficiary's interest by attachment of present or future distributions to or for the benefit of the beneficiary.[7] This, too, goes to the aspect of control over the distributions a beneficiary is entitled to receive from the trust. Any amount that a beneficiary has an absolute right to receive is generally reachable by a creditor. A valid "spendthrift" provision restrains both voluntary and involuntary transfer of the beneficiary's interest, including through attachment by creditors or insolvency proceedings.

6. Do you distinguish between claims made against each of the parties stated in section 5 in respect of their obligations in acting for or in relation to the trust and, on the other hand, obligations incurred privately and personally?

Depending on the person against whom the claim is made, the difference between personal obligations and those incurred in relation to the trust will be significant. For instance, a claim made against a beneficiary need not be made against the person in their capacity as a beneficiary. The extent to which the beneficiary's creditors can reach assets of the trust is determined by the existence of a valid spendthrift provision in the trust instrument. Similarly, as noted above, the ability of creditors to reach a settlor's assets held in trust will be determined by whether the trust is revocable or irrevocable, and what amounts can be distributed from the trust to or for the benefit of the settlor. Conversely, a trustee's creditors may be able to reach property of the trust depending on if the trustee mixed trust assets and / or monies with his personal assets and / or monies.

3 NJSA § 3B:31-41.
4 11 USC § 541(a)(1).
5 11 USC § 541(b)(1).
6 *Begier v. IRS*, 496 US 53, 58 (1990) ("*[T]he debtor does not own an equitable interest in property he holds in trust for another, [therefore] that interest is not property of the estate, and, likewise, not property of the debtor.*").
7 NJSA § 3B:31-35.

7. What are your main insolvency procedures that could be relevant?

A main section of the Bankruptcy Code that should be analysed with regard to trusts is section 541, which determines what assets are considered property of the bankruptcy estate. 11 USC § 541(d) states "[p]roperty in which the debtor holds, as of the commencement of the case, only legal title and not an equitable interest . . . becomes property of the estate . . . only to the extent of the debtor's legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold". Additionally, there are Bankruptcy Code and state law provisions that allow creditors to potentially claw back funds of a debtor that have been fraudulently transferred outside the reach of creditors.

8. What is the effect of bankruptcy on the following parties?

The parties conscerned are a trust, settlor, trustee and a beneficiary.

Noted that the ansers with respect to each party is stated in section 5.

9. Can an insolvency procedure extend to trust assets located in a local and / or foreign Jurisdiction?

9.1 Local jurisdiction

Yes, if the debtor's interest in the trust assets meets the requirements set forth above.

9.2 Foreign jurisdictions

Yes, if the debtor's interest in the trust assets meets the requirements set forth above.

This is a statutory provision under section 541 of the Bankruptcy Code. Under paragraph (1), subsection (a), the estate is comprised of all legal or equitable interests of the debtor in property, wherever located, as of the commencement of the estate.

10. Can trusts be challenged?

10.1 To obtain assets

Yes, a challenger would seek to impose a constructive trust on assets of the trust by showing that the he was the rightful recipient of the asset. Furthermore, a revocable trust does not offer asset protection, and creditors can reach trust assets just as they would from the settlor personally during the settlor's lifetime. After the settlor dies, creditors of the deceased settlor have nine months from the date of death within which to present their claims.[8] Additionally, as noted in the answer to section 7 above, creditors may look to the Bankruptcy Code and state law for potentially seeking the return of funds that were fraudulently transferred into a trust.

10.2 To obtain information

A trustee can be subject of a suit challenging the trustee's administration of the trust, and the trustee may be required to produce evidence and information showing the trustee acted responsibly and as a prudent person would.

8 NJSA § 3B: 31-39.

10.3 To examine witnesses

During a proceeding contesting the terms of a trust, extrinsic evidence is admissible to assist the judge in determining the probable intent of the settlor. As such, witness testimony and other documents may be offered into evidence.[9]

11. On what grounds can a trust arrangement be challenged?

Generally, an action to contest the validity of a trust must be commenced by the earlier of three years after the settlor's death or four months, in the case of a resident, or six months, in the case of a nonresident, following receipt of trust instrument and notice of the trust's existence.[10] Furthermore, a trust can always be challenged on the grounds that it was not validly created. The requirements for creating a valid trust are:[11]

(1) the settlor has capacity to create a trust;

(2) the settlor indicates an intention to create a trust;

(3) the trust has a definite beneficiary or is a charitable trust, a trust for the care of an animal, or a trust for a noncharitable purpose as provided in NJSA § 3B:31-25;

(4) the trustee has duties to perform; and

(5) the same person is not the sole trustee and sole beneficiary of all beneficial interests.

11.1 The settlor was insolvent when the trust was created or became insolvent as a result of creating it

A trust can be challenged in such a way. This would be considered a claim that the trust was the result of a fraudulent conveyance. If one makes a transfer with actual intent to hinder, delay, or defraud a creditor, or if one makes a transfer at a time and under circumstances that appear to be a fraudulent transfer, then a creditor can obtain a judgment against the trust regardless of how well the trust is designed and drafted.[12]

11.2 The settlor becomes insolvent

Under the US Bankruptcy Code, a trustee may avoid any transfer of an interest of the debtor in property under a theory of fraudulent transfer if the transfer was made on or within two years prior to the filing of the bankruptcy. Accordingly, a settlor could transfer assets into a trust, later become insolvent, file for bankruptcy protection within two years of transferring said assets into a trust, and those assets might be vulnerable to recovery by a trustee as a fraudulent transfer. Moreover, Bankruptcy Code section 544(b) allows the trustee to stand in the shoes of an existing unsecured creditor and permits the trustee to bring state law fraudulent conveyance and other similar actions that such a creditor could bring. New Jersey's fraudulent conveyance

9 *In re Voorhees' Tr.*, 93 NJ Super. 293, 298-99 (App. Div. 1967) (When trust instrument itself fails to indicate settlor's intent, resort may be had to extrinsic evidence to determine terms of trust.).
10 NJSA § 3B:31-45.
11 NJSA § 3B:31-19.
12 Bankruptcy Code § 548 and NJSA § 25:2–25.

laws are codified under NJSA § 25:2-20 *et seq*., or the New Jersey Uniform Fraudulent Transfer Act (NJUFTA). The NJUFTA allows for recovery of a fraudulent transfer within four years of the transfer. Accordingly, in this jurisdiction, a bankruptcy trustee can use applicable state law to reach back up to four years to recover a fraudulent transfer.

11.3 The settlor lacked capacity or authority to create the trust

Lack of testamentary capacity of the settlor at the time the trust was executed is a valid reason for challenging the trust.

11.4 The settlor lacked the capacity or authority to transfer the assets to the trustees

The position is the same as stated in section 11.3 above.

11.5 The assets were not validly transferred or the transfer was not fully completed

One of the requirements of a valid trust is that the trust has assets. If the circumstances are such that assets were never validly conveyed to the trust, the trust would not exist. However, a court may place the assets in a constructive trust if it believes it to be the intent of the settlor.

11.6 The trust was not validly created

Yes. A prerequisite for assets being placed in trust is that a valid trust exists. A challenger is able to contest the trust under the theory that the trust was never validly formed.

11.7 The transfer could be subsequently set aside as void or voidable

The reasons for making a transfer void or voidable are stated below:-

- mistake;
- if there was an undervalue;
- if there was a preference; and
- if there was a sham.

12. What protections and defences exist to protect those listed at section 5 and are they statutory or common law or otherwise?

Defenses and protections to the grounds to contest a trust listed above is stated in both statutory and common law, as well as proper planning. With regard to fraudulent conveyance actions, the best defense is proper planning in advance, and to not establish a trust at a time when you are insolvent or the transfer of assets would make you insolvent. Furthermore, the form of the trust is an important aspect, i.e., whether a revocable or irrevocable trust is established. In the case of an irrevocable trust that names one's descendants as beneficiaries, a creditor would not be able to attack it as a self-settled trust if the settlor became insolvent, filed for bankruptcy protection, or had other judgments against him. Attacks on a trust under a theory that the trust itself was never validly formed or the settlor lacked the requisite capacity are governed by Articles 3 and 5 of the New Jersey Uniform Trust Code.

13. Can claims be made in a bankruptcy where the IP stands in the shoes of a bankrupt to exercise the rights given by the trust in favour of specific parties?

The parties referred to are a settlor, a trustee, and a beneficiary.

A trustee, under the Bankruptcy Code, can stand in the shoes of a creditor and make a claim for anything that is rightfully considered "property of the estate" under section 541 of the Bankruptcy Code. This means legal or equitable interest, wherever located, that the debtor has. Accordingly, depending on who the debtor is with regard to the trust (settlor / trustee / beneficiary), all of the above would be suitable claims made in a bankruptcy case. For example *In re Remington*,[13] the Spendthrift trust provision was held binding on the bankrupt beneficiary's trustee who stands in the shoes of creditors. *In re Watson*,[14] a trustee's breach of trust, in failing to pay trust assets over to the trustee of Chapter 7 estate of a debtor-beneficiary as required by a demand provision of the trust, entitled the Chapter 7 trustee, standing in the shoes of a debtor-beneficiary, to award reasonable attorney fees which amounted to 40% of the value of the recorded assets.

14. Are rights of subrogation established by law?

Although subrogation is of equitable origin and is enforced on equitable principles, recovery is generally sought at law, but the right of subrogation will not be recognized at law unless the right of action made the subject thereof is legal in its nature, and is cognizable at law.[15] With regard to the rights included in a bankruptcy estate, those rights are determined by state law.[16]

In New Jersey, an equitable right of subrogation exists as stated above.

15. Can the veil of a trust be pierced or lifted and, if so, in what circumstances?

Allegations such as these would require the person making the allegations to prove that the trust itself was utilized as a vehicle for committing equitable or legal fraud.[17] The argument could also be made that a trust is not a separate legal entity from a debtor. This argument will revolve around the theories of dominion and control over the assets of the trust, and whether the trust itself was just the *alter-ego* of the debtor. A reviewing court will examine a variety of factors in making its determination of whether the veil of a trust should be pierced. These factors include failure to adhere to corporate formality and facts that demonstrate some form of misrepresentation, deceit, undercapitalization, or other form of injustice. While piercing a trust's veil, or prevailing on a theory the trust was one's *alter-ego* would be a novel theory in New Jersey, it has been alleged in this jurisdiction and courts have stated it should be the subject of a proof hearing to assess liability.[18]

13 14 BR 496, (Bankr. D NJ 1981).
14 325 BR 380 (Bankr. SD Tx. 2005).
15 *Standard Acc. Ins. Co. v. Pellecchia*, 15 NJ 162 (1954).
16 *Universal Bonding Ins. Co. v. Gittens & Sprinkle Enter., Inc.*, 960 F.2d 366, 369 (3d Cir. 1992) (citing *Butner v. United States*, 440 US 48, 54 (1979).
17 *Marascio v. Campanella*, 298 NJSuper. 491, 502 (App. Div. 1997); See also *PF&J Clinton Realty, LLC v. Willis*, No. A-0512-06T2, 2007 WL 1135594, at *5 (NJ Super. Ct. App. Div. Apr. 18, 2007).
18 PF&J Clinton Realty, LLC at *5 (citing *Siwiec v. Financial Resources, Inc.*, 375 NJSuper. 212, 219 (App. Div. 2005)).

Furthermore, other courts in the United States have recently grappled with similar questions and have concluded that although a trust cannot be liable as an alter ego because it is not a legal entity, the trustee of the trust may be added as a judgment debtor in his representative capacity, thus enabling the judgment creditor to reach the assets of the trust.[19]

16. Can the veil of a company owned by a trust be pierced or lifted and, if so, in what circumstances?

To pierce the veil of a company, New Jersey follows a two-part test. First, one corporation must be organized and operated as to make it a mere instrumentality of another corporation. Second, the dominant corporation must be using the subservient corporation to perpetrate fraud, to accomplish injustice, or to circumvent the law. If both of the elements are satisfied, it is proper to pierce the veil and impose liability on the dominant corporation for the actions of the subservient corporation.[20] Indicia of being a mere instrumentality of another corporation include the comingling of assets, holding out one company to represent the other, and when there is active and direct participation by the representative of one corporation in the activities of another.[21] The tactic of veil-piercing is normally used to reach past the corporation and get to the assets of the parent corporation or owner.

In the case where a company is wholly-owned by a trust, the veil of the company could be pierced, but the plaintiff would then need to pursue the assets of the parent trust. This analysis would proceed much in the same way as the answer to question 15, above. Such an action would proceed on novel legal grounds as noted above and would likely be extremely fact-sensitive, potentially with a proof hearing to assess liability.

17. If a trust can be treated as insolvent, is this on the basis of the cash flow test, the balance sheet test or another test and, if so, what test?

A trust cannot be treated as insolvent in this jurisdiction.

18. Can or have receivers been appointed to act as a trustee or with powers over trust assets? If so, in what circumstances?

A receiver can act as a trustee. Because a trustee is endowed with legal title to the assets in a trust, if the trustee of a trust is, for instance, a corporation that files for bankruptcy protection, then the legal interest it has in the trusts assets would be part of the bankruptcy estate. Furthermore, if a receiver is appointed to the bankruptcy estate, the receiver would hold power as trustee over the aforementioned trust.[22]

19 *Greenspan v. LADT, LLC*, 2010 WL 5395685 (Cal. App. 2d Dist. 2010).
20 *Major League Baseball Promotion v. Colour-Tex*, 729 F.Supp. 1035 (D NJ 1990).
21 *Stochastic Decisions, Inc. v. DiDomenico*, 236 NJ Super. 388 (App. Div. 1989).
22 *Laudan v. ABC Travel Sys., Inc.*, 64 NJ Super. 204 (Ch. Div. 1960) (where receiver of insolvent company acted as trustee).

19. Are claims against trustees limited or unlimited? If limited, are they limited as to amount and by time? Do underlying companies have a role?

A trustee's liability may be expressly limited by an exculpatory clause in the instrument that created the trust itself.[23] Generally, a trustee has a duty of loyalty and a duty of care. While the duty of care to act as a prudent investor may be waived according to the express terms of the trust, the duty of loyalty cannot be waived. This means the trustee cannot engage in self-dealing, usurp an opportunity that could belong to the beneficiaries of the trust, of act in any way that would place himself in a position where it would be for his own benefit to violate his duty of loyalty.[24] The duty of loyalty also does not recognize the good or bad faith of the trustee in his actions; instead, any breach of this duty would impose liability on the trustee. There is no limitation on an amount of a claim against the trustee for breach of duty; rather, it is determined by the amount by which the trustee profited or lost in the trust's name.

20. Are there provisions or cases where trusts, or those connected to them, are based in a foreign jurisdiction?

Yes, as stated above, the bankruptcy estate consists of all the debtor's property, wherever located, including foreign jurisdictions. Furthermore, while a trust may be valid in one jurisdiction, that does not mean the bankruptcy court will recognize the trust as a valid means of asset protection. For example, self-settled trusts (trusts where the settlor is also the beneficiary) are not valid in some United States jurisdictions, while they are valid in some off-shore / foreign jurisdictions. Some bankruptcy courts have refused to recognize the self-settled trust laws of a foreign jurisdiction because it is against the policy of the federal bankruptcy courts.[25]

21. What are the main means to seek assistance from another jurisdiction?

When considering action by another jurisdiction, one must first consider if the trust is being properly administered in the present jurisdiction, or should be transferred to another U.S. jurisdiction, or a foreign jurisdiction. In New Jersey, this analysis is governed by statute.

21.1 Principal place of administration

a. Without precluding other means for establishing a sufficient connection with the designated jurisdiction, terms of a trust designating the principal place of administration are valid and controlling if:

(1) a trustee maintains a place of business located in or a trustee is a resident of the designated jurisdiction; or

(2) all or part of the administration occurs in the designated jurisdiction.

In the absence of terms of a trust designating the principal place of administration, the initial principal place of administration of a nontestamentary trust shall be this State if the trust is governed by the law of this State, and the principal place of administration of a testamentary trust shall be the jurisdiction in which the decedent was domiciled at the time of death.

23 *Tuttle v. Gilmore*, 36 NJ Eq. 617, 618 (1883).
24 *In re Koretzky's Estate*, 8 NJ 506, 528 (1951).
25 *In re Portnoy*, 201 B.R. 685 (Bankr. SDNY 1996).

b. A trustee is under a continuing duty to administer the trust at a place appropriate to its purposes, its administration, and the interests of the beneficiaries.

c. The trustee, in furtherance of the duty prescribed by subsection b. of this section, may transfer the trust's principal place of administration to another State or to a jurisdiction outside of the United States.

d. The trustee shall notify the qualified beneficiaries of a proposed transfer of a trust's principal place of administration not less than 60 days before initiating the transfer. The notice of a proposed transfer shall include:

(1) the name of the jurisdiction to which the principal place of administration is to be transferred;

(2) the address and telephone number at the new location at which the trustee can be contacted;

(3) the date on which the proposed transfer is anticipated to occur; and

(4) the date, not less than 60 days after the giving of the notice, by which the qualified beneficiary is required to notify the trustee of an objection to the proposed transfer.

e. The authority of a trustee under this section to transfer a trust's principal place of administration terminates if a qualified beneficiary notifies the trustee of an objection to the proposed transfer on or before the date specified in the notice, unless the trustee secures judicial approval for the transfer.

f. In connection with a transfer of the trust's principal place of administration, the trustee may transfer some or all of the trust property to a successor trustee designated in the terms of the trust or appointed pursuant to NJS3B:31-49.[26]

22. What is the position as to whether the foreign jurisdiction does or does not recognise trusts?

The meaning and effect of the terms of a trust are determined by:

a. the law of the jurisdiction designated in the terms unless the designation of that jurisdiction's law is contrary to a strong public policy of the jurisdiction having the most significant relationship to the matter at issue; or

b. in the absence of a controlling designation in the terms of the trust, the law of the jurisdiction having the most significant relationship to the matter at issue.[27]

26 NJ Stat. Ann. § 3B:31-8 (West).
27 NJSA 3B:31-7.

23. What particular issues, difficulties and solutions have arisen or may arise relating to trust arrangements or those involved with them?

The most recent development in New Jersey trust law was the adoption of the New Jersey Uniform Trust Code (NJ UTC) just last year. Notably, the adoption of the NJ UTC may bring resolution to areas that were unsettled, including the modification and termination of trusts as well as authorizing the use of non-judicial settlement agreements.

The ability to modify a trust enables the court, a settlor, trustee, or beneficiary to alter an existing trust term or provision to better serve the purpose of the trust. An example of a permissible type of modification under the NJ UTC is found in NJSA § 3B:31-27, which provides that a non-charitable irrevocable trust may be modified or terminated upon consent of the settlor and all beneficiaries, even if the modification or termination is inconsistent with a material purpose of the trust.

Many trust disputes were settled informally through nonjudicial settlement agreements prior to adopting the NJ UTC. However, parties are now expressly authorized to use nonjudicial settlement agreements under NJSA § 3B:31-11. Eliminating the cost and delay of court approval, the NJ UTC authorizes the use of nonjudicial settlement agreements in the following scenarios:

(1) interpreting the terms of a trust;

(2) approving a trustee's account;

(3) approving or restraining a trustee's actions;

(4) approving the resignation or appointment of a trustee;

(5) transferring a trust's principal place of administration; and

(6) establishing a trustee's liability for an action related to a trust.

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ISBN 978-1-907764-22-6