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ARTICLE

Common Law Recognition of Limit on Foreign Trustee Liability

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Synopsis

On 23 April 2018, the Privy Council handed down judgment in *Investec Trust (Guernsey) Limited et al. v Glenalla Properties Limited et al.* [2018] UKPC 7 on appeal from the Court of Appeal of Guernsey ('Guernsey CA'). The case relates to the family trusts of Robert and Vincent Tchenguiz and the events which occurred during the onset of the financial crisis in 2007 and following the collapse of Kaupthing Bank hf ('Kaupthing') in October 2008. It raises an important issue under the common law regarding the recognition of limitations of liability for foreign directors, managers, partners and trustees, and further addresses the scope of trustee indemnification and the rejection of a restitutionary claim arising from a complex group restructuring.

Background

The appeals concern disputes about the administration of a family trust, the Tchenguiz Discretionary Trust ('TDT'), in the period between March 2007 and October 2008. The TDT was set up as a discretionary trust under Jersey law and the beneficiaries of the TDT were the family members of Robert Tchenguiz. The assets held within the TDT were originally held within the Tchenguiz Family Trust ('TFT'), the beneficiaries of which included Robert and Vincent Tchenguiz. The TFT included assets which were notionally held for Robert and Vincent Tchenguiz respectively. These assets comprised companies that held investments in public equity, private equity and real estate. Many of the investments in public equity were held through contracts for differences and other margin contracts. These activities were not typical for a private discretionary trust.

It was determined that the brothers' interests should be separated and thus the TDT came into being. The separation took place in August 2007. At that time, Investec Trust (Guernsey) Limited ('Investec') was the sole trustee of the TFT. The trustees of the TDT were Investec and Bayeux Trustees Limited ('I&B'). At all material times, a company called R20 Limited (of which Robert Tchenguiz was chairman) was the investment adviser to the TDT and prior to that advised the TFT in relation to Robert Tchenguiz's notional interests.

Three key events were: (i) a loan agreement dated 20 August 2007 under which Investec as the TFT trustee and three subsidiaries in the TFT borrowed £100 million from Kaupthing secured by share pledges and a personal guarantee from Robert Tchenguiz (the 'TFT Loan Agreement'); (ii) the transfer of assets and related liabilities from the TFT to the TDT on 24 August 2007; and (iii) the subsequent refinancing of the TDT through a restructuring of the TDT's corporate assets in a framework agreement (the 'Framework Agreement') and an overdraft loan agreement (the 'Overdraft Loan Agreement') both dated 19 December 2007.

When the banking market deteriorated in the second half of 2007, the TFT and later the TDT were exposed to margin calls, which, if not met, would have caused the trusts to lose the investments they retained. In order to meet the margin calls, the TFT trustee (and three subsidiaries) entered into the TFT Loan Agreement. I&B assumed liability for the TFT Loan Agreement by a deed of novation dated 24 August 2007. Among the liabilities of the TFT that were transferred to the TDT trustees by deeds of novation were sums of €79 million owed to Glenalla Properties Ltd ('Glenalla') and £81 million owed to Thorson Investments Ltd ('Thorson').

Following the transfer, the financial position of various companies within the TDT worsened considerably. The solution proposed was to agree new and more extensive financing with Kaupthing and to transfer certain TDT companies to be held by a new TDT company called Oscatello Investments Ltd ('Oscatello') supported by share charges over the transferred companies. This was achieved through the Framework Agreement and the Overdraft Loan Agreement. The transaction documents contemplated Oscatello using £39 million of the new lending to discharge I&B's liability under the TFT Loan Agreement and the release of the related security including the personal guarantee of Robert Tchenguiz. This payment was recorded in the TDT's books as a loan by Oscatello to I&B. However, the Framework Agreement was silent as to the basis on which the payment by Oscatello was to be made. This payment was the basis for the claim in restitution.

As the financial crisis worsened, in December 2008 Kaupthing exercised its security over the entities in the Oscatello structure. In April 2010, the liquidators of Glenalla, Thorson and Oscatello demanded repayment

from I&B. Proceedings were issued by I&B in Guernsey. I&B were replaced as trustees of the TDT by Rawlinson & Hunter SA ('R&H') who in turn were later replaced by Balchan Management Limited (the 'Current Trustees').

The principal issues at trial were: (a) whether I&B was liable to Oscatello as a result of Oscatello's discharge of the TFT Loan Agreement; (b) whether I&B had any personal liability in respect of any sums due to Glenalla, Thorson or Oscatello or whether such claims extended only to the trust property of the TDT; (c) at R&H's behest, whether I&B had a right of indemnity on the basis that the liabilities had not been 'reasonably incurred' in August 2007 for the purposes of article 26(2) of the Trusts (Jersey) Law 1984 (the 'TJL'); or (d) whether I&B were liable for breach of trust because of their alleged gross negligence. This allegation was essentially that I&B – either as part of the Framework Agreement or shortly thereafter – should have procured that any liabilities relating to the Oscatello structure were ring-fenced so that in the events that followed Kaupthing would only have been able to have recourse to the assets in that part of the TDT beneath Oscatello, and not to other assets held elsewhere within the TDT.

The procedural history was convoluted and resulted in eight judgments being handed down by the Guernsey CA. For reasons of brevity, the first instance judgment and the reasoning of the Guernsey CA are not addressed in detail and the focus is on the most significant aspects of the appeal to the Privy Council.[1]

The meaning of article 32 of the TJL

The Board first considered the meaning of article 32 of the TJL, which provides that 'where a trustee is a party to a transaction [...] 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.'

The Board considered that the effect of this article was to abrogate the rule of English law that the law looks no further than the legal entity against whom the claim is made and introduces a distinction between a trustee's personal and fiduciary capacities. Where the article applies, a trustee is treated as incurring liabilities only 'as trustee' and there is therefore no recourse available to his personal assets. The Board went on to hold that article 32 did not alter the nature of the trustee's right to have recourse to trust assets. Consequently, a creditor of the trust could be subrogated to the trustee's right to be indemnified from trust property. However, where the trustee was guilty of a breach of trust, the trustee may have no right to be indemnified unless and until he has made good the breach of trust. Third parties should therefore note that, where article 32 and similar provisions under other foreign laws apply, the ability to recover what is owed to them absent security may depend on factors wholly outside their control and which may be unrelated to the dealings in question.

The next question the Board had to consider was whether this limitation of Jersey trusts law should apply despite the fact that the relevant obligations were not governed by Jersey law and fell to be adjudicated outside Jersey. By a majority decision (Lord Mance dissenting), the Board upheld the decision of the Guernsey CA that article 32 should apply.

It was common ground that Guernsey principles of private international law were the same as the principles under English law, except where modified by a Guernsey statute. Section 65(1) of the Trusts (Guernsey) Law 2007 ('TGL') provides: 'Subject to subsection (2) [which was not relevant], a foreign trust is governed by, and shall be interpreted in accordance with, its proper law.'

The starting point for determining this issue was the three-stage test set out in *Raiffeisen Zentralbank Österreich AG v Five Star Trading LLC and others* [2001] QB 825, namely (i) characterisation of the relevant issue; (ii) selection of the rule of conflict of laws which lays down a connecting factor for that issue; and, (iii) identification of the system of law which is tied by that connecting factor to that issue.

The process must not be carried out mechanistically, but rather with the objective of identifying the most appropriate law to govern the issue, in a spirit of comity. The particular notions of the domestic law, either of the lex fori, or of any other system of domestic law available for choice, should not be allowed to dominate the analysis.

The Board concluded that the time had come to recognise as a general rule that the common law will recognise and give effect to limitations of liability which arise under an entity's constitutive documents by reason of the particular status of capacity in which its members or officers assume an obligation. This rule would not be confined to entities which have separate legal personality but would also apply to partnerships and foreign trusts. The Board agreed with the proposition expressed in *Dicey, Morris and Collins on the Conflict of Laws* (15th ed [2012], para. 30-010) that

Notes

1 The judgments below comprise: *Investec et al. v Glenalla et al.* (Guernsey Royal Court Judgment 38/2013); *Investec Trust (Guernsey) Limited et al. v Glenalla Properties Limited et al.* (Guernsey CA Judgment 28/2014); *Investec Trust (Guernsey) Limited et al. v Glenalla Properties Limited et al.* (Guernsey CA Judgment 41/2014); *Investec Trust (Guernsey) Limited et al. v Glenalla Properties Limited et al.* (Guernsey CA Judgment 08/2015); *Investec Trust (Guernsey) Limited et al. v Glenalla Properties Limited et al.* (Guernsey CA Judgment 35/2015); *Investec Trust (Guernsey) Limited et al. v Glenalla Properties Limited et al.* (Guernsey CA Judgment 55/2015); *Investec Trust (Guernsey) Limited et al. v Glenalla Properties Limited et al.* (Guernsey CA Judgment 7/2016); *Investec Trust (Guernsey) Limited et al. v Glenalla Properties Limited et al.* (Guernsey CA Judgment 15/2016); *Investec Trust (Guernsey) Limited et al. v Glenalla Properties Limited et al.* (Guernsey CA Judgment 31/2016).

the substantive law of the country under which an entity was formed 'will determine the legal nature of the entity so created, e.g. whether the entity is a corporation or partnership and, if the latter, the legal incidents which attach to it.' The Board further held that section 65(1) TGL also meant that the personal liability of a Jersey law trustee should be determined by its proper law.

A further question the Board considered was the meaning and effect of article 26(2) TJL i.e. whether the former trustees were entitled to discharge their liabilities through recovery of trust property from the subsequent trustee. Article 26(2) TJL states that 'a trustee may reimburse himself or herself out of the trust for or pay out of the trust all expenses and liabilities reasonably incurred in connection with the trust.' The Board agreed with the Guernsey CA which had previously held that certain BVI loans were liabilities reasonably incurred by the former trustees of the TDT, sufficient to engage the indemnity in article 26(2) TJL. That the BVI loans may have been unreasonably allowed to continue rather than discharged as part of the restructuring of the TDT did not undermine the finding that the liabilities were reasonably incurred by the former trustees in the first place, thereby securing the protection of article 26(2) TJL.

However, where a liability is originally reasonably incurred, unreasonable conduct by the trustees which leaves it in place rather than discharged will always be a breach of trust. But the measure of the loss thereby caused to the beneficiaries will by no means usually be equivalent to the amount of the liability, since discharging a liability generally comes at a cost. The Board also rejected the Current Trustees' appeal against the decisions below that I&B had not been guilty of gross negligence. This meant that I&B were entitled to be indemnified out of the trust's assets since the terms of the TDT provided that the trustees would not be liable for conduct less than gross negligence.

Oscatello's claim in restitution

Oscatello had drawn £39 million under the Overdraft Loan Agreement to discharge I&B's liability under the TFT Loan Agreement. While this event was identified as a step under the Framework Agreement, there was no mention of the basis on which such payment was to be made. Oscatello argued that I&B were liable in restitution to repay this sum.

The Board reviewed the steps that were to be taken under the Framework Agreement. These included the transfer of various companies to be held by Oscatello which in turn was indirectly held by I&B as trustees. The Board considered that in economic terms I&B would be no better or worse off whether the discharge of their indebtedness was effected by Oscatello with or without recourse to I&B. If with recourse, I&B would bear the loss directly. If without recourse, they would bear it through the diminution of the value of their subsidiary, Oscatello. It is submitted that this analysis is correct only so long as Oscatello is solvent. In the event of Oscatello's insolvency, I&B's shares would be worthless but they would have no liability with respect to the loan.

The Board concluded, in agreement with the Guernsey CA, that there was not scope for the operation of a principle of restitution in circumstances where the Framework Agreement and Overdraft Loan Agreement provided comprehensive arrangements. They operated coherently and understandably without any basis for regarding them as involving a tacit understanding that I&B would repay Oscatello. This meant that to the extent that there had been any enrichment of I&B, it was not unjust.

Conclusion

The Board's decision is noteworthy principally for two reasons. First, it represents a development of the common law in the context of recognising the liability of relevant individuals by reference to the foreign law governing separate legal entities and non-separate legal entities alike. In the trust context, this could operate harshly against third parties who have claims against the trustee with no direct recourse against trust assets (or a trustee's personal assets) and whose indirect recourse may be delayed or prevented by claims of breach of trust that may even have nothing to do with the relevant transaction. Furthermore, the dissenting judgment of Lord Mance and the reservations expressed by Lord Briggs may lead to further consideration of the issue in due course, particularly in the context of litigation in England where (unlike in Guernsey) there is no similar limitation on a trustee's liability under domestic law.

The second point is perhaps less controversial. It will be extremely difficult to make a successful claim for restitution arising out of contractual arrangements to which the litigants are parties.

International Corporate Rescue

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