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Chancery Bar Association Isle of Man Conference

Conference Chair
Penelope Reed QC, 5 Stone Buildings

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Directors on the brink and in the shadows

Lesley Anderson QC
&
Matthew Morrison

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At the brink, on the verge or in the zone?

When and how are directors required to take account of creditors' interests?

Matthew Morrison

Serle Court

Order of Play

- The (limited) statutory guidance in the UK and the IoM
- The interests of creditors in an insolvent company
- When will / should duties to creditors arise in circumstances short of insolvency?
- What do / should such duties entail?
- The position of secured creditors

UK: The Statutory Duty CA 2006, s.172

- To act in ways in which directors consider, in good faith, would be most likely to promote the success of the company
- Must have regard to long term consequences, employees, suppliers, customers, environment, community, acting fairly between members etc.
- No specific guidance as to when, and to what extent, they must have regard to interests of creditors: existing enactments/rules of law are preserved *(s.172(3))*

IoM: Non-codified directors' duties

- Fiduciary duties said to *"largely mirror"* English CA 2006, ss.170-177

  FSA v Irving CHP 2013/130, 24.i.2018 at [108] (Christie QC) – not disturbed on appeal (2018/7, 11.xi.2018)

- Include duty to act and exercise powers in good faith in what directors subjectively consider to be the best interests of the company as a whole

  Templeton Insurance v Corlett Ord 11/23, 18.vi.2013 at [72]-[94] (Corlett)

- When company is insolvent, interests of the company equated with the interests of creditors

  Irving at [109]

Creditors' interests in insolvent companies

"In a solvent company the proprietary interests of the shareholders entitle them as the general body to be regarded as the company when questions of the duty of directors arise. If, as a general body, they authorise or ratify a particular action of the directors, there can be no challenge to the validity of what the directors have done. But ***where a company is insolvent the interests of the creditors intrude.*** *They become prospectively entitled, through the mechanism of liquidation, to displace the power of the shareholders and directors to deal with the company's assets.* ***It is in a practical sense their assets and not the shareholders' assets that, through the medium of the company, are under the management of the directors*** *…"*

(*Per* Street CJ in *Kinsela v Russell Kinsela Pty Ltd* (1986) 4 NSWLR 722 at 730 quoted with approval by Lord Neuberger in *Bilta (UK) Ltd v Nazir* [2016] AC 1 at [123])

Determining Insolvency: UK

- Statutory test under IA1986, s.123:
  - Company unable to pay debts on balance of probabilities without incurring further debt
  - Cash flow test includes debts falling due in reasonably near future *Re Cheyne Finance plc* [2008] 1 BCLC 741
  - Balance sheet test:
    - Whether present, future, contingent and prospective liabilities exceed assets
    - To be used where cannot foresee with any reasonable degree of certainty what lies in the reasonably near future *Re Eurosail* [2013] 1 WLR 1408

Determining Insolvency: IoM

- IoM CA1931, ss.162-164 apply to 1931 and 2006 Act companies (IoM CA2006, s.182)
- Company deemed to be unable to pay its debts if £50 demand not met, if execution of judgment unsatisfied or:
  "if it is proved to the satisfaction of the court that the company is unable to pay its debts, and, 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."
- Compared with IA1986 position in *Irvine* (1st instance) at [113]-[118]

What suffices short of insolvency?

- Company in a *"dangerous"* or *"precarious financial position"*

  Facia Footwear v Hinchcliffe [1998] 1 BCLC 218 at 228b; *Re MDA Investment Management Ltd* [2004] 1 BCLC 217 at [75]

- *"…doubtfully solvent"*

  Nourse LJ in *Brady v Brady* [1987] 3 BCC 535 at 552

- *"…bordering on insolvency"*

  Lord Toulson in *Bilta* (*supra*)

- *"…real and not remote risk of insolvency"*

  Kalis Enterprises Pty Ltd v Baloglow [2007] NSWCA 191 at [162]; *Re HLC Environmental Projects Ltd* [2014] BCC 337 at [89]

What suffices short of insolvency?

- ***"…on the verge of insolvency"*** (*BTI 2014 LLC v Sequana SC* [2016] EWHC 1686 (Ch); *Dickinson v NAL Realisations* [2017] EWHC 28 at [113]-[121]; *Singularis Holdings Ltd v Daiwa Capital Markets Europe Ltd* [2017] EWHC 257 (Ch) at [137]; *Burnden Holdings (UK) Limited v Fielding* [2017] EWHC 2118 (Ch)*; SoS v Akbar* [2017] EWHC 2856 (Ch) at [92]-[94])
- *"To say that my house is on the verge of burning down seems to me to describe a much more worrying situation compared to one in which there is a risk which is something more than a remote risk of my house burning down"* (*BTI at [477]*)
- *"The essence of the test is that the directors ought in their conduct of the company's business to be anticipating the insolvency of the company because, when it occurs, the creditors have a greater claim to the assets of the company than the shareholders"* (*BTI* at [478])

Recent Guidance from Guernsey

- The *"verge of insolvency"* test conveys an *"appropriate sense of imminence"*
- It is a flexible and fact dependent test which requires regard to be had *"…to the particular nature of the business, the state of the company's balance sheet and all the overall circumstances."*

(*per* Marshall LB in *Carlyle Capital Corporation Limited v Conway & Ors* (Royal Court of Guernsey) (Judgment 38/2017; 4/9/17 at [440]-[443])

Relationship with IA1986, ss.214/246ZB

- Requirement that defendant director *"knew or ought to have known that there was no reasonable prospect that the company would avoid entering insolvent liquidation/administration"* (ss.214(2) and 246ZB(2))
- Cf. company being factually on verge of insolvency
- Under ss.214/246ZB director with requisite knowledge is obliged to show every step was taken with a view to minimizing potential loss to creditors (ss.214(3)/246ZB(3))
- Cf. subjective fiduciary duty / *Charterbridge* test

Elision of the Tests

- CLR Final Report: Actual or constructive knowledge of a substantial probability of an insolvent liquidation (para. 3.17)
- Cf. CLR Model Clause: *"knows or would know but for a failure of his duty to exercise due care and skill, that it is more likely than not that the company will at some point be unable to pay its debts as they fall due"*
- Alternative: adopt focus on insolvent liquidation but abandon requirement to show actual or constructive knowledge

What does the duty entail?

- The duty remains subjective

HOWEVER

- *"…the subjective test only applies where there is evidence of actual consideration of the best interests of the company. Where there is no such evidence, the proper test is objective, namely whether an intelligent and honest man in the position of a director of the company concerned could, in the circumstances, have reasonably believed that the transaction was for the benefit of the company"*

  (*per* John Randall QC in *HLC Environmental Projects Ltd* applying the principles first established in the context of solvent companies in *Charterbridge Corpn Ltd v Lloyds Bank* [1970] Ch 62 at 74E-F)

What does the duty entail?

- Creditors interests must always be considered even in solvent companies (*Winkworth v Baron Developments Ltd* [1986] 1 WLR 1512; *Brady* (*supra*) at 40G-H; *LRH Services Ltd v Trew* [2018] EWHC 600 (Ch))
- Divergence of approaches in verge of insolvency context:
  - Creditors' interests become paramount (Colin Gwyer & Associates Ltd v London Wharf (Limehouse) Ltd [2003] 2 BCLC 153 at [74] drawing upon *Brady* and *Kinsela*)
  - Creditors' interests are the most important consideration but shareholders' interests may still be taken into account (*Ultraframe (UK Limited v Fielding* [2005] EWHC 1638 at [1304])
  - Sliding scale depending on degree of financial difficulty (*The Bell Group v Westpac Banking Corp* [2008] WASC 239 at 4419; *Carlyle* at [452])

Further Guidance from Guernsey

- *"…the English line of authority which proposes that the interests of creditors become "paramount" over-states the true position. Even in English law, on closer review, there is a more fluid and fact-dependent approach than is implied by the absolutist connotations of the word 'paramount'"* (*Carlyle* at [452])
- *"The directors' duty to act in the best interests of the company extends to embrace the interests of its creditors, and requires giving precedence to those interests where that is necessary, in the particular circumstances of the case, to give proper recognition to the fact that the creditors will have priority of interest in the assets of the company over its shareholders if a subsequent winding up takes place"* (*Carlyle* at [455])

When will the duty be breached?

- Clear cut cases: *excessive payments to directors; payments when company unable to pay debts; preferences; unlawful distributions etc.*

  Official Receiver v Stern [2002] 1 BCLC 119 at [51]-[54]; *Vivendi SA v Richards* [2013] BCC 771; *GHLM Trading Ltd v Maroo* [2012] 2 BCLC 369 at [168]-[169]; *HLC Environmental* (*supra*); *FSA v Irving* (1st instance and appeal)

- Decisions to continue to trade are particularly difficult (as in wrongful trading context)

  Re Continental Assurance of London [2001] BPIR 733 at [106]-[108]; *Facia Footwear* (*supra*); *Re Ralls Builders Ltd* [2016] Bus LR 555 at [168]-[179]; *Carlyle* at [458]

Practical Guidance

- Taking advice and holding regular well documented meetings where creditors' interests are discussed and reasons for decisions are stated
- Consideration of working capital requirements in respect of future debts
- Considering steps to improve liquidity (although n.b. risks of fire sales)
- Initiating insolvency proceedings where cannot trade through difficulties and will lead to better result

Duties to Secured Creditors?

Carlyle strongly suggests secured creditors will not be owed the same duties as unsecured creditors:

"…this follows from the very reason for the interests of the "company's creditors" coming to the fore, namely that ***because it is in a parlous state, the company is trading at the risk of its creditors not getting paid****. It is therefore the creditors who are at such risk whose interests are to be protected, and they are the unsecured creditors.* ***Secured creditors - at any rate those with fixed security - are not at the same risk as unsecured creditors. They have first call on their security whatever risks or actions the company takes*** *and they have a degree of control through whatever powers of realisation their security confers on them. This is the benefit as against unsecured creditors for which they have bargained, but it means that their interests are fully protected by their security as long as it is adequate. This security is not being risked whether the company continues trading or does not…"* (*Carlyle* at [463])

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De Jure, de facto and Shadow Directors – catch up

Lesley Anderson QC

Kings Chambers and Hardwicke

De Jure, De Facto and Shadow Directors

Distinction between statutory, *de facto* and shadow directors well established

S.250 CA 2006

The general duties: s.171 to 177 CA 2006

Civil consequences of breach: s.178 CA 2006

Application of more than one duties: s.179 CA 2006

Consent, approval or authorisation by members: s.180 CA 2006

Application of duties to others s.170(5) CA 2006

Relief under s.1157 CA 2006

De Jure, De Facto and Shadow Directors

De Facto directors

Locus classicus still *Holland v Revenue and Customers Commissioners and another* [2010] UKSC 51

Lord Hope at [20] to [39]

Lord Collins at [70] to [93]

Re Mumtaz Properties [2011] EWCA Civ 10

"one of the nerve centres from which the activities of the company radiated"

Smithton Ltd v Naggar [2015] 1 WLR 189, CA

Arden LJ at [33] to [45]

De Jure, De Facto and Shadow Directors

All Relevant factors including:

Is he the sole person directing affairs or with others (whether formally appointed or not)?

Is he acting on an equal footing with others?

Was he held out by the company as director?

Did he hold himself out as a director?

Did he use the title?

Whether part of the “corporate governing structure”

De Jure, De Facto and Shadow Directors

De Facto and shadow directors

Support for fact sensitive approach

Lord Collins in *Holland* at [93]

De Jure, De Facto and Shadow Directors

De Facto directors

David Ingram (Liquidator of MSD Cash & Carry Plc) v Mohinder Singh and others

[2018] EWHC 1235 (Ch)

HHJ Hodge QC sitting as Judge of the High Court at [95] to [117]

2 *de facto* directors held liable to account for preference which arose when setting off amount owing to director on his loan account against the value of assets transferred to associated company

De Jure, De Facto and Shadow Directors

De Facto directors

Brian Johnson (as Liquidator of Strobe 2) v Christian Arden

[2018] EWHC 1624 (Ch)

Dep. Judge Kyriakides

[128] to [135] and [147]

Obiter no real prospect of showing that Company Secretary/Legal Director had acted as *de facto* director in absence of holding out

Instructing and/or receiving advice from other professions not sufficient or that he was director of subsidiaries

De Jure, De Facto and Shadow Directors

De Facto directors

Integral Petroleum SA v Petrogat FZE

[2018] EWHC 2686 (Comm)

Moulder J.

Regulation 1215/2012 Art 24(5)

Civil contempt of court

[67] to [68] and [80] to [82]

De facto director sufficiently involved with company to procure compliance with court order and no real risk of uncertainty or unfairness if held liable

De Jure, De Facto and Shadow Directors

Shadow directors

SSTI v Deverell

[2001] Ch 340

Morritt LJ at [35] and [36]

Ultraframe (UK) Limited v Fielding [2005] EWHC 1638 (Ch)

Lewison J. at [1264] to [1277]

De Jure, De Facto and Shadow Directors

Shadow directors

Instant Access Properties Limited (In Liquidation) v Bradley John Rosser and Ors

[2018] EWHC 756 (Ch)

Morgan J.

Possible to be shadow directors in relation to only some activities[249] although relevant to focus on role at time of activity challenged [230]

Paralle

De Jure, De Facto and Shadow Directors

Shadow directors

Integral Petroleum SA v Petrogat FZE supra

Responsibility for contempt did not rest with shadow director acting under the instructions from the directors

De Jure, De Facto and Shadow Directors

Postscript on burden of proof

GHLM Trading Ltd v Maroo [2012] EWHC 61 (Ch) per Newey J at [149]

Re Idessa (UK) Ltd, Burke v Morrison [2011] EWHC 804 (Ch) at [28]

Ingram supra at [140]

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Capacity & Undue Influence

David Rees QC,
Alexander Learmonth
&
Elis Gomer

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AN INTRODUCTION TO THE ENGLISH COURT OF PROTECTION AND THE MENTAL CAPACITY ACT 2005

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KNOWLEDGE AND APPROVAL
WHAT TO LOOK FOR?

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Knowledge and approval of the contents of the will

1. What does it mean?
2. How can it be proved?

Proving knowledge and approval – two stage approach

1. Burden on person propounding the will.
2. But presumption of knowledge and approval from due execution and capacity
3. But presumption reversed when person instrumental in preparing will is a beneficiary (*Barry v Butlin*)
4. Burden depends on circumstances

Proving knowledge and approval – one stage approach

Gill v Woodall (2010, CA), per Lord Neuberger:

“the court should simply "consider all the relevant evidence available and then, drawing such inferences as it can from the totality of that material, it has to come to a conclusion whether or not those propounding the will have discharged the burden of establishing that the testatrix knew and approved the contents of the document which is put forward as a valid testamentary disposition.”

Proving knowledge and approval – reading over etc.

Gill v Woodall:

> "The proposition that Mrs Gill knew and approved of the contents of the Will appears, at first sight, very hard indeed to resist. As a matter of common sense and authority, the fact that a will has been properly executed, after being prepared by a solicitor and read over to the testatrix, raises a very strong presumption that it represents the testatrix's intentions at the relevant time, namely the moment she executes the will."

What does knowledge and approval mean?

1. "Knowledge and approval is traditional language for saying that the will *represented* the testator's testamentary intentions".
2. "whether the testatrix had understood what was in the will when she had signed it *and what its effect would be*"
3. "It is not enough that he knows what is written in the document which he signs."
4. "whether the testatrix understood what she was doing and its effect *so that* the will concerned represents her testamentary intentions".

Fitzgerald v Henerty (CA)

"All that is necessary is knowledge and approval of the contents of the Will, *not* of their effect".

"One begins with intention – here that the shares should go back to Vale — then asks whether the Will carried it through. It did."

Kunicki v Haywards (2016)

"In my view, it is not a requirement of the plea, in all cases, that it must be established that the testator must have appreciated the legal effect of the words used in the document in issue. Suppose that a solicitor drafts a will believing it accords with her client's instructions but, through a drafting error which may be rectified by the court, the legal effect of the words is to divert a gift from its intended recipient to a third party. Suppose too that the solicitor advises or otherwise leads her client to believe that the effect of her drafting is that the intended recipient of the gift will receive it. Suppose too that the client fully and freely considers that advice or information and then approves the words used. I am of the view that it cannot be said, in these circumstances, that, solely because of the drafting error and its legal effect, the testator did not know and approve the contents of his will."

Cases on approximating rectification – not a useful guide

Compare *Beech v Public Trustee* (1923) …
"if knowing the words intended to be used, he approves them and executes the will, then he knows and approves the contents of his will, and all the contents, even though such approval may be due to a mistaken belief of his own, or to honestly mistaken advice from others, as to their true meaning and effect"

… with *Re Morris* (1971)
"That some rule or rules of evidence or law could have been evolved by the court to require the court to hold by some fictitious or artificial reasoning that nevertheless she did know and approve is repugnant, to say the least."

Old House of Lords cases

Fulton v Andrew:

- the reading of the will "had not taken place in such a way as to convey to the mind of the testator a due appreciation of the contents and effect of the residuary clause
- the need to be satisfied "that the effect of the clause with regard to the gift of the residue was made clear to him

Wintle v Nye:

- "the quality of her understanding was relevant"
- "not, of course, the language of art in which it was couched, but the *character of the disposition* that she was making."
- "brought home to her mind the effect of her will"

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UNDUE INFLUENCE AND THIRD PARTY ADVICE

ELIS MEREDYDD GOMER

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- Undue influence arguments continue to be raised in probate and estate claims and appear likely to proliferate further in line with the increase in contentious probate and estates claims generally.

- The recent vogue for allegations of 'fraudulent calumny' and the greater willingness to challenge inter vivos dispositions brings the law of undue influence into sharper focus.

- This talk concentrates on a recent case – *Brindley v Brindley* [2018] EWHC 157 (Ch) and looks at the application of the relevant law in that context.

- The Claimant (Alan Brindley) and the Defendant (Gordon Brindley) are brothers and are the children of Shirley Brindley by her (also deceased) husband, James Leslie Brindley (hereafter 'Mr Brindley'). Gordon is the elder of the two sons by seven years.

- Shirley resided with Alan and his wife Jackie between 2011 and January 2014; in January 2014, Jackie became ill and Gordon suggested that Shirley should stay with him for a few days.

- This period of a few days, which commenced on 21 January, 2014, eventually became much longer and Shirley never in fact moved back in with Alan.

- When Shirley went to stay with Gordon, Shirley owned her property outright. The position under her last will was that Alan and Gordon were joint executors of the estate and joint residuary beneficiaries.

- In late March 2014 (i.e. a very short time after Shirley had moved in with Gordon), Chy-Kerenza was conveyed into the joint names of Shirley and Gordon and Shirley executed a home-made will (drafted by Gordon) which appointed him the sole executor of Shirley's estate.

- The meeting with Mr Freeman, the solicitor advising on the transfer, took place three days after the new will was signed; he was not told about it.

- Alan brought a claim seeking to set aside the property transfer.

- The Judge (HHJ Klein, sitting as a Judge of the High Court) found:

- *"…in relation to the Transfer, there was a sufficient relationship of trust and confidence in which Gordon was the ascendant party and in which Mrs Brindley was in a position of dependence…whilst the relationship between Gordon and Mrs Brindley was not so unbalanced, as a coercive relationship might have been, that any independent advice given to Mrs Brindley in relation to a particular transaction could not have an emancipated effect, it was a relationship, in my view, in which Mrs Brindley was, without more, prepared to agree a course of action proposed by Gordon."*

- *"…before Mrs Brindley met with Mr Freeman, she did not appreciate the effect of a gift of the Cornish property to Gordon as a beneficial joint tenant…I am satisfied that she was prepared to so instruct Mr Freeman simply because Gordon had proposed such a course of action."*

- *"[a transaction] will not be set aside, for example, if the victim receives a sufficiently full and independent explanation of the proposed transaction before the transaction is effected from someone with full knowledge of the relevant circumstances so that, taking into account the other circumstances which exist at the time, the victim makes an independent and fully informed judgment about the proposed transaction."*

- *"The important question I have to resolve is whether the advice which Mr Freeman gave to Mrs Brindley at the 19 March 2014 meeting had an emancipating effect, so that the proper conclusion is that the Transfer was not caused by any undue influence."*

- So far so good…

- *"…I have come to the conclusion that the advice which Mr Freeman gave to Mrs Brindley at the 19 March 2014 meeting was sufficient to have such an emancipating effect, so that the Transfer was not procured or otherwise caused by Gordon's undue influence but was a transaction carried out by Mrs Brindley of her own free will."*

- *"…I have come to the conclusion that the advice which Mr Freeman gave to Mrs Brindley at the 19 March 2014 meeting was sufficient to have such an emancipating effect, so that the Transfer was not procured or otherwise caused by Gordon's undue influence but was a transaction carried out by Mrs Brindley of her own free will."*

- Some key legal points:

- *"Proof that the complainant received advice from a third party before entering into the impugned transaction is one of the matters that the court takes into account when weighing all the evidence. The weight, or importance, to be attached to such advice depends on all the circumstances. In the normal course, advice from a solicitor or other outside adviser can be expected to bring home to a complainant a proper understanding of what he or she is about to do…"*

- [Lord Nicholls in Etridge at paragraph 20]

- *"…But a person may understand fully the implications of a proposed transaction, for instance, a substantial gift, and yet still be acting under the undue influence of another. Proof of outside advice does not, of itself, necessarily show that the subsequent completion of the transaction was free from the exercise of undue influence. Whether it will be proper to infer that outside advice had an emancipating effect, so that the transaction was not brought about by the exercise of undue influence, is a question of fact to be decided having regard to all the evidence in the case."*

- [Lord Nicholls in *Etridge* at paragraph 20]

- *"How much significance do I attach to the participation of Mr Freeman? The answer is: some, but not a lot. The fact that a solicitor was instructed to act on a transfer does not automatically mean that it is not at risk of being set aside on grounds of undue influence…in this case Mr Freeman was not instructed for the purpose of looking out for undue influence, and if he detected any signs of it, counteracting it…"*

- [Park J in *Glanville v Glanville* at paragraph 62]

- *"It was not his role to say to Mr Glanville that the proposed deed of gift would prevent Mr Glanville (if he died before his wife, as seemed a near certainty) from leaving the house to his own family, and to ask Mr Glanville if he was really sure that he wanted to do that. It is true that, from the conversation which Mr Freeman did have with Mr Glanville, he was satisfied that Mr Glanville did want to enter into the deed of gift, but Mr Blayney is right when he says that, in a case where undue influence is alleged, the question is not whether a donor wanted to make a gift, but why he wanted to make it."*

- [Park J in *Glanville v Glanville* at paragraph 62]

- Points to note:
  - *Brindley* has a fairly unusual set of facts – I know of no other case where a finding that undue influence was present was made, on the one hand, but that the claim nonetheless failed due to the outside involvement of a third party.
  - Mr Freeman, who provided the advice to Shirley, does not appear to have been aware that (as the Judge found) Shirley was acting under the undue influence of Gordon. That in itself is a powerful limitation on the evidence he gave.
  - However, and perhaps more importantly, he was told by Shirley that her objective was to ensure that her sons were treated equally. She did not tell him the very relevant fact that she had just made a Will which left her estate between her two sons equally.
  - *Brindley v Brindley* is, however, a salutary warning that an undue influence claim which appears strong on its facts (and clearly was strong on its facts; the Judge found that undue influence was present) can founder at trial.

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Afternoon Tea

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Too controlling or just overprotective? The problem of broad protector powers

Robert Ham QC, Wilberforce Chambers
&
Mark Hubbard, New Square Chambers

#chbaconference

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INSOLVENT TRUSTS

Richard Dew
James Poole
Ten Old Square

Principles

"To talk of an insolvent trust is of course a misnomer. A trust is not a separate legal entity and cannot, as a matter of law, be insolvent."

Re the Z Trusts [2015] JRC 031

Principles

- Trustee Liability and the Trust Assets
- The right of indemnity
- Creditors' rights of subrogation
- Limits on the right of indemnity / subrogation

Investec v Glenalla [2018] 2 WLR 1465

"(1) Where a trustee is a party to any transaction or matter affecting the trust –

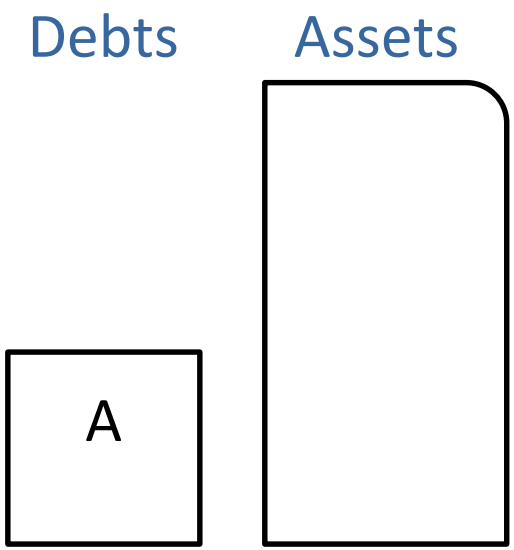
(a) if the other party knows that the trustee is acting as trustee, any claim by the other party shall be against the trustee as trustee and shall extend only to the trust property;

(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."

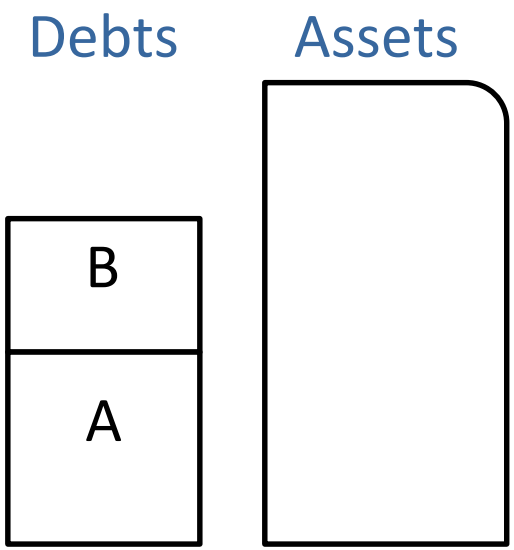
The *Z Trusts* Litigation, [2018] JRC 119

First in time vs *Pari Passu*:



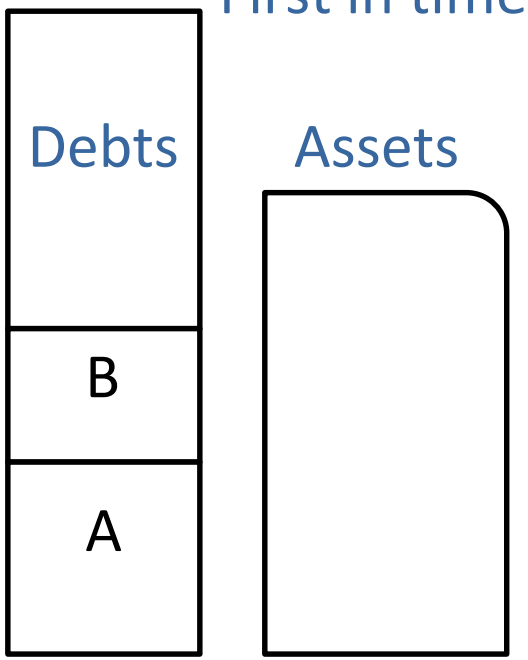
The *Z Trusts* Litigation, [2018] JRC 119

First in time vs *Pari Passu*:



The *Z Trusts* Litigation, [2018] JRC 119

First in time vs *Pari Passu*:



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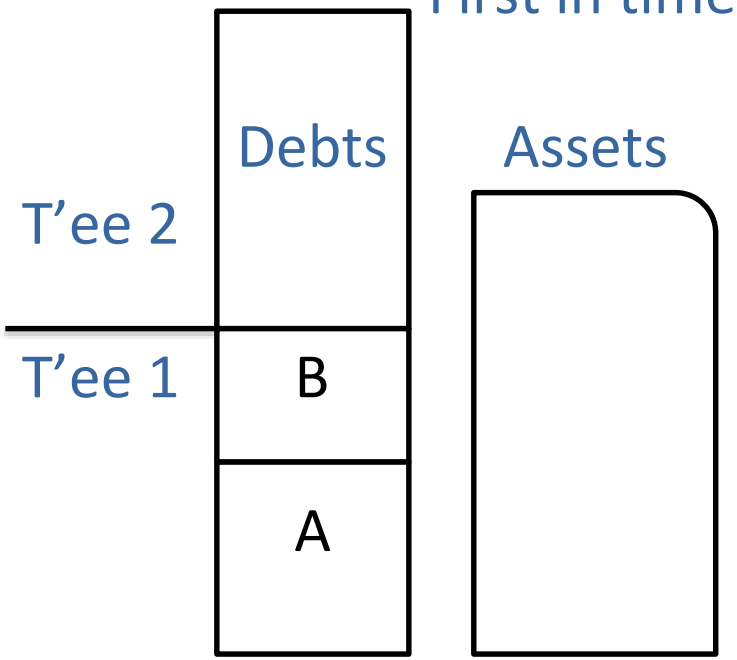

Limitations on liability – s.32 Trusts (Jersey) Law 1984

- What level of knowledge is required?
- What is meant by "not know"?

- At common law:
  - *Muir v City of Glasgow Bank* (1879) 4 App Cas 337 at 355
  - "a question of construction, to be decided with reference to all the circumstances of the case"
  - *Investec v Glenalla* at [59]

    "This liability may be limited by contract, but the mere fact of contracting expressly as trustee is not enough to limit it…There must be words negativing the personal liability which is an ordinary incident of trusteeship"

First Tower Trustees Ltd v CDS (Superstores International) Limited [2018] EWCA Civ 1396

- Implied limitation on liability?
- The need for clarity

Creditors' rights of subrogation

- Principles
  - *In re Johnson* (1880) 15 Ch.D 548
- Limitations
  - E.g. *Investec v Glenalla* at [59](vii)

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IVEY v GENTING AND DISHONESTY – NEW DAWN OR FALSE HORIZON?

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Misunderstanding in the criminal law

R v Ghosh [1982] QB 1053 two-stage test:

> *In determining whether the prosecution has proved that the defendant was acting dishonestly, a jury must first of all decide whether according to the ordinary standards of reasonable and honest people what was done was dishonest. If it was not dishonest by those standards, that is the end of the matter and the prosecution fails. If it was dishonest by those standards, then the jury must consider whether the defendant himself must have realised that what he was doing was by those standards dishonest.*

Uncertainty in the civil law (1)

Royal Brunei Airlines Sdn Bhd v Tan [1995] 2 AC 378 Lord Nicholls:

> *Whatever may be the position in some criminal or other contexts (see, for instance, R v Ghosh), in the context of the accessory liability principle acting dishonestly, or with a lack of probity, which is synonymous, means simply not acting as an honest person would in the circumstances. This is an objective standard.*

Uncertainty in the civil law (2)

Twinsectra Ltd v Yardley [2002] 2 AC 164, the majority of the House of Lords favoured what Lord Hutton called the 'combined test':

> *[This] requires that before there can be a finding of dishonesty it must be established that the defendant's conduct was dishonest by the ordinary standards of reasonable and honest people and that he himself realised that by those standards his conduct was dishonest.*

The only difference between this formulation and the test of dishonesty formulated in *Ghosh* is that the latter test uses the words 'the defendant himself must have realised'.

Uncertainty in the civil law (3)

Lord Hoffmann said:

> *…I consider that those principles [in Tan] require more than knowledge of the facts which make the conduct wrongful. They require a dishonest state of mind, that is to say, consciousness that one is transgressing ordinary standards of honest behaviour.*

In contrast, Lord Millett was in favour of adopting an objective approach as being more apposite to civil as distinct from criminal liability. Lord Hoffmann described Lord Millett's point of view as being that:

> *It is sufficient that the defendant knew all the facts which made it wrongful for him to participate in the way in which he did.*

Uncertainty in the civil law (4)

Over time, the civil appellate courts clarified that an objective test for dishonesty is appropriate for purposes of the civil law.

Barlow Clowes v Eurotrust International Ltd [2006] 1 WLR 1476 Lord Hoffmann:

> *… the statement (in [20] in Twinsectra) that a dishonest state of mind meant 'consciousness that one is transgressing ordinary standards of honest behaviour' was in their Lordships' view intended to require consciousness of those elements of the transaction which make participation transgress ordinary standards of honest behaviour. It did not also…require him to have thought about what those standards were.*

Dishonesty and disciplinary proceedings (1)

In the context of disciplinary proceedings, however, the courts declined to follow this line of authority.

In *Bryant and Bench v Law Society* [2007] EWHC 3043 (Admin), [2009] 1 WLR 163, Richards LJ referred to *Bultitude v Law Society* [2004] EWCA Civ 1853 and concluded:

> *In our judgment, the decision of the Court of Appeal in Bultitude stands as binding authority that the test to be applied in the context of solicitors' disciplinary proceedings is the Twinsectra test as it was widely understood before Barlow Clowes, that is a test that includes the separate subjective element.*

Dishonesty and disciplinary proceedings (2)

However, confusion persisted and misgivings were expressed. In *Kirschner v GDC* [2015] EWHC 1377 (Admin) Mostyn J concluded:

> *It would, however, be a step too far for me, notwithstanding my great misgivings, to hold that Bryant does not represent the law concerning dishonesty in disciplinary proceedings. Or that the Twinsectra/Ghosh test has not been adapted as suggested in Hussain. As things stand the test is [that] … The tribunal should first determine whether on the balance of probabilities, a defendant acted dishonestly by the standards of ordinary and honest members of that profession; and, if it finds that he or she did so, must go on to determine whether it is more likely than not that the defendant realised that what he or she was doing was by those standards, dishonest.*

Resolution of the issues (1)

All these problems have been resolved by the decision of the Supreme Court in *Ivey v Genting Casinos (UK) Ltd (t/a Crockfords Club)* [2018] AC 391.

Lord Hughes said: (1) that 'there can be no logical or principled basis for the meaning of dishonesty (as distinct from the standards of proof by which it must be established) to differ according to whether it arises in a civil action or a criminal prosecution'; (2) that there are 'convincing grounds for holding that the second leg of the test propounded in *Ghosh* does not correctly represent the law and that directions based upon it ought no longer to be given'; and (3) that for purposes of both civil and criminal law the test of dishonesty is the same.

Resolution of the issues (2)

Lord Hughes said at [74]:

When dishonesty is in question the fact-finding tribunal must first ascertain (subjectively) the actual state of the individual's knowledge or belief as to the facts. The reasonableness or otherwise of his belief is a matter of evidence (often in practice determinative) going to whether he held the belief, but it is not an additional requirement that his belief must be reasonable; the question is whether it is genuinely held. When once his actual state of mind as to knowledge or belief as to facts is established, the question whether his conduct was honest or dishonest is to be determined by the fact-finder by applying the (objective) standards of ordinary decent people. There is no requirement that the defendant must appreciate that what he has done is, by those standards, dishonest.

What about the future?

The general perception seems to be that the *Barlow Clowes* test was reaffirmed in civil actions, and introduced into criminal proceedings (over-turning the test laid down in *Ghosh*) by the Supreme Court in *Ivey*.

The concept of dishonesty remains elusive.

This difficulty of definition leads on to further questions as to whether the objective test of 'the standards of ordinary decent people' is (i) appropriate and (ii) workable.

The Supreme Court in *Ivey* seized the opportunity to sort out the concerns that have troubled the law for the past few decades arising from the second limb of the test in *Ghosh*. But there are problems underlying the first limb of that test, which is now part of both the civil and the criminal law, which are likely to provide grounds for debate for years to come.

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