TWILIGHT TRUSTS: *Protection from those you cannot trust?*

Peter Cranston, Eversheds
Hugh Sims, Guildhall Chambers

Introduction

1. Writing in Business Law International in September 2008[1], Philip Wood commented that *"Insolvency law is the root of commercial and financial law becauses it obliges the law to choose. There is not enough to go round, and so the law must decide who to pay. Commercial law is at its most ruthless because it must decide who to pay so that there is a winner and a loser".* Many claims raised in an insolvency context are no more than attempts to establish the priority of one's claim to or interest in an asset over the other creditors. Getting ahead by getting outwith the pool for distribution in which all others compete for what's left is a wholly understandable pursuit.

2. A key, and often the first, practical issue which arises in corporate insolvencies is to establish whether the rights are proprietary rights, or simply personal rights. It is a key issue for a creditor, who wants to maximize his realization by establishing a proprietary claim. It is a key issue for the office holder, who needs to know which are the "free assets" which can be realized for the benefit of the general body of unsecured creditors. The demarcation between "free assets" and assets subject to some security was emphasized by Lord Hoffmann in *Leyland DAF*[2] when he stated as follows (at para 28):

   "*The winding up of a company is a form of collective execution by all its creditors against all its available assets. The resolution or order for winding up divests the company of the beneficial interest in its assets. They become a fund which the company thereafter holds in trust to discharge its liabilities: Ayerst v C & K (Construction) Ltd [1976] AC 167. It is a special kind of trust because neither the creditors nor anyone else have a proprietary beneficial interest in the fund. The creditors have only a right to have the assets administered by the liquidator in accordance with the provisions of the Insolvency Act 1986: see In re Calgary and Edmonton Land Co Ltd [1975] 1 WLR 355, 359. But the trust applies only to the company's property. It does not affect the proprietary interests of others*"

3. For those who seek to share in the free assets of the company, the general principle is that they are to share equally, or rateably, in proportion to the value of their claim – the "pari passu" principle (or what has been described as the "equality of misery"). The scope to obtain, or give, preferential treatment to one creditor is accordingly limited and may be unlawful. Most sophisticated legal systems have some form of clawback mechanism to avoid fragmentation or diminution of the insolvent estate in the period before formal insolvency commences. One area where preferential treatment may be lawfully recognised is by the use of trust funds, established in favour of customers/depositors and suppliers. It achieves escape from the equality of misery not by a priority within the insolvency ranking, but by establishing an entitlement which is outside of the pool. Retention of title fulfils a similar function, albeit by imposition on the estate rather more than by its creation (and we can see from *Churchill Marketing v Curtain Dream*[3], that creation of ROT by the debtor may fail to deliver the intended protection). In *Re Margaretta*, a case concerning an express, or a Quistclose type, trust claim, it was put in these terms[4]:

   "Company liquidations create many situations where it is claimed that a company's obligations have been transformed from contract into property, or from debt to trust, so that a claimant may claim property as his own rather than it being available for distribution amongst the general body of unsecured creditors according to the statutory

[1] Predictions for the future of Financial Law and Lawyers (henceforth "Wood: Predictions")
[2] *Re Buchler and another v Talbot and another and others* [2004] UKHL 9 (the effect of which was subsequently reversed by legislation, which ensures that, where necessary, assets subject to a floating charge are available to fund the general expenses of liquidation)
[3] [1990] BCC 341
[4] [2005]EWHC 582@ [10]

scheme of distribution. A question may arise as to whether a particular asset was or was not the beneficial property of the company at rthe date of its liquidation. If it was not, then subject to the application of any avoidance provisions, it never becomes part of the statutory scheme. If it was, the courts have no power to dissapply the statutory scheme in relation to that asset, by, for example, imposing a remedial constructive trust over it.."

4. Trusts are an important tool which may be used to protect directors who cause companies to continue to trade in the "twilight" period immediately before an administration order is made. The extent to which such trusts provide protection to customers of a company has been the subject of recent review by the Court of Appeal in *BA Peters* [2008] EWCA Civ 1604. Before considering the decision in *BA Peters* however, it is worth considering further here the reasons why the trust tool has been developed in the twilight world, shortly before the onset of insolvency, and the basic building blocks necessary to establish a trust.

The need for protection

5. The driver for the creation of, or the coming into being of twilight trusts, is rarely just altruism. Enlightened self interest is a major motivator. A key concern for directors who are trading in anticipation of an administration or liquidation process is whether or not by continuing to trade they are exposing themselves to personal liability for wrongful trading under section 214 of the IA 86 in the event that the company subsequently enters insolvent liquidation. In particular, where the directors have concluded (or ought to have concluded) that there was no reasonable prospect that the company would avoid insolvent liquidation, then unless the directors can show that they "took every step with a view to minimising the potential loss to the company's creditors as…he ought to have taken", they are susceptible to a finding of personal liability (sub-section (3)). If, for example, there is a good business case for continuing to trade outside an administration but nevertheless it is doubtful whether that continued trading will benefit unsecured creditors, then well advised (or cautious) directors will need protection from this potential liability.

6. In addition, directors will also have in mind the need to have some protection from an allegation of unfit conduct leading to disqualification proceedings being brought against them.

7. For directors in such situations there is a very real dilemma. Their lawyers may remind them of the colourful descriptions from the *Continental Assurance*[5] case that directors of companies in liquidation are assumed to be "rogues or idiots", and that seeking the safe harbour of a formal process too soon is the "coward's way out". For directors wanting to do the right thing in the twilight period, the need to sustain the going concern edifice in the search for maximum value imposes a real strain on their decisions about credit and creditors. They will need to maintain "business as usual" and be cautioned against giving preferences for existing credit from suppliers from whom they seek continued supply. In many pre-pack cases, the recognition that insolvency of one form or another (usually administration) is on the near horizon, creates a very real tension between the duty to obtain the going concern premium for the benefit of the estate as a whole, against the risk of credit essential to sustain the going concern not being discharged as events unfold (and there is little evidence that unsecured creditors participate in the going concern premium[6]).

8. Where the enterprise value breaks below the point where the secured creditors will be repaid in full, any personal guarantee exposure may ease that dilemma for the directors. However, if they are not guarantors, they are entitled to ask that the party who stands to gain from the directors "playing the game" should stand behind them and provide an indemnity against any new credit being left unsatisfied in a subsequent administration. Such requests tend to get kicked into the long grass but, if pressed, some additional working capital may be made available.

[5] [2001] BPIR 733
[6] Per Dr Sandra Frisby, Nottingham University

The basic building blocks necessary to create a trust

9. The trust concept developed as a common law concept. It divides ownership from title. The general feature of a trust (putting charitable trusts aside for present purposes) is that a person in whom property is vested, called the trustee, is compelled in equity to hold the property for the benefit of the other person, called the beneficiary. If the trustee becomes insolvent, the beneficiary retains his property ahead of the creditors of the insolvent trustee. The real owner's property is not taken from him to pay the creditors of the insolvent trustee.

10. Broadly speaking, there are three ways in which a trust can be created: first, where it is agreed by the parties that monies transmitted are to be held on trust; secondly, where there is no such agreement but the beneficiary of those monies (or the "settlor") creates a trust over them; and thirdly, where there is not agreement to create a trust and no intention to settle a trust, but nevertheless the circumstances are such that the court will declare the monies or property is held on trust (this can sometimes, but not always, be referred to as a "constructive trust").

11. As regards the first category, typically this refers to what is known as a "resulting trust". This frequently arises on a presumption about the intentions of the person who transfers property which becomes subject to the trust. If it is unclear whether that person intended to transfer the beneficial interest in it the law will tend to presume it was intended to be held on trust (though there have been some inroads into this principle in the context of matrimonial homes following the decision in *Stack v Dowden* [2007] UKHL 17).

12. The second category is frequently referred to as "the express trust" and arises where a person declares him or herself to be a trustee over property for another. A key feature of express (non charitable) trusts is that for them to be created three things ("the three certainties") are necessary: there must be certainty of words, subject matter and objects. Breaking that down:

    i. Intention: the words must be so used that they should be construed as imperative;
    ii. Subject matter: the trust assets, such as the money being deposited;
    iii. Objects: this means the intended beneficiaries.[7]

13. The third category, the constructive trust, is where a trust is imposed by operation of law, rather than through the express or presumed intention of the owner of the property. The trust may even arise contrary to the intentions of the owner, although English law has set its face against the remedial constructive trust, because "*You cannot grant a proprietary right to A, who has not had one beforehand, without taking some proprietary right away from B. No English court has ever had the power to do that*"[8]

Typical scenarios and the categories of twilight trusts

14. There are two beneficiary categories directors frequently wish to give protection to: customers who make deposits or advance payments for goods or services where partial prepayment is not uncommon, and suppliers on whom the company depends to be able to continue trading. We propose to consider each of these categories in turn. Twilight trusts are usually, but not exclusively, attempts to create express trusts, and it is worth reminding ourselves of the difference between those and resulting or constructive trusts: *"Express trusts are fundamentally dependant upon the intention of the parties, whereas the role of intention in resulting trusts is a negative one, the essential question being whether the provider intended to benefit the recipient and not whether he or she intended to create a trust".*

15. It must be remembered that the successful establishment of a trust has a binary effect. The beneficiary becomes a winner and the corollary is that the creditors as a whole are the losers (as Lord Neuberger recognised in *B A Peters*--see further below).On the other hand

[7] See discussion in Snell's Equity, 31st Edition @ 20-15

[8] *Polly Peck Internqational plc (No. 2)* [1998] 3 All ER 812,830, per Nourse LJ

(Twinsectra @ [100]), *"if the purpose for which the money or other asset was given is frustrated, the money returns to the donor …because the donor was always its owner and because the resulting trust in his favour is no longer subject to any power or duty on the part of the trustee to make use of the money"*[9]

The first category: customer deposits/advances

16. In the *Twinsectra*[10] case. Lord Millett observed (@ [73]); "…*payments in advance for goods or services are paid for a particular purpose, but such payments do not ordinarily create a trust. The money is intended to be at the free disposal of the supplier and may be used as part of his cashflow. Commercial life would be impossible if this were not the case."* Hence, the search for protection must go beyond simply commercial expectations.

17. The starting point in relation to twilight trusts and in particular trusts relating to customer advances is the decision of Megarry J in *Re Kayford* [1975] 1 WLR 279. That case concerned a trust set up for customer deposits. Notwithstanding the fact that no formal trust deed had been executed it was concluded that the three requirements or "certainties" of an express trust were established on the facts of that case. Subject to satisfaction of the "three certainties" it was generally thought, following this case, that there should not be any difficulty in setting up a trust for the protection of customers making deposits or advances during the "twilight period". It has been followed and applied in subsequent cases where such trusts have been upheld: It was followed and applied in relation to customer deposit/advances trusts in *Re Lewis's of Leicester Ltd* [1995] 1 BCLC 428 (Robert Walker J) and in *OT Computers Ltd v First National Tricity Finance Ltd* [2003] EWHC] 1010 (Ch) (Pumfrey J). However the *Re Kayford* line of authority has not escaped academic criticism as to its preferential effect - see e.g. Adrian Walters in *Vulnerable Transactions in Corporate Insolvency* (Armour & Bennett, eds, Hart Publishing, 2003) at paragraph 4.36 and Vanessa Finch in *Corporate Insolvency Law* (CUP, 2002) at Ch.14). It is with this background in mind that the decision of Mann J in *Farepak Food & Gifts Limited* [2006] EWHC 3272 falls for consideration.

18. In *Farepak* the administrators sought directions as to whether and how they should distribute certain funds held by them, and in particular whether the monies were held by them on trust in favour of customers of a Christmas hamper company. The application was issued and heard for one day in December 2006, primarily with a view to permitting distributions to the intended beneficiaries immediately after Christmas. Such rapidity meant that some of the material was less than might otherwise have been the case and, given that insufficiency, the judge treated the application as equivalent to one for summary judgment. The judge declined to make the directions sought.

19. The salient facts are as follows: Essential to an understanding of the judgment is the difference between the Farepak customer, who "saves" for Christmas by making payments throughout the year to buy the hamper or voucher, and the Farepak agent, who receives the payments from the customer (who may also be a customer and who is usually a friend, neighbour or relative of the other customers). The judge concluded that the Farepak agent was the agent of Farepak for the purposes of receiving deposits from the customer. On 11 October 2006 the directors concluded that the company would have to cease trading and be placed into administration. On the same day they took steps to obtain confirmation from the Bank that monies received from that morning would be excluded from the bank's charge and they received that confirmation late in the day. A declaration of trust was executed on the 12 October 2006 which stated that Farepak would hold the monies paid into the account on or after the 11 October 2006 on trust as trustee for the benefit of the relevant payors. The declaration of trust executed by the company contained a mistaken, although ultimately rectifiable, reference to an empty bank account rather than the one holding the alleged trust funds. The administrators were appointed on the 13 October 2006. They were holding funds gathered in the three days prior to the administration, which the directors sought to ring fence for the benefit of the customers who had paid them.

[9] *Re Margaretta Ltd*, supra, [12]
[10] *Twinsectra Ltd v Yardley* [2002] 2 AC 164

20. The administrators (and a representative customer/agent) advanced four avenues for the trust status: a "Quistclose" type trust; a constructive trust based upon the unconscionability of retaining customer money following a decision to cease trading; or an express trust (alternatively an implied trust based on the same facts); and the rule in *Ex parte James*. The judge concluded that none of these arguments justified him making directions for a distribution.

21. First, the Quistclose trust argument was advanced on the basis that, irrespective of the declaration of trust, the customer paid monies to Farepak for a particular purpose and since that purpose had failed the monies were held on resulting trust. The judge concluded that the facts did not support a conclusion that there was a Quistclose/purpose trust. It was apparent that the customers were making advance payment towards the price of goods or vouchers to be supplied by the company. That was a contractual relationship, not a trustee/beneficiary relationship. In addition, amongst other things, the fact that the monies were mixed by the agent and also by Farepak itself militated against such a conclusion. So did the fact that this argument, if successful, would apply to all customers of Farepak in the 2006 Farepak year.

22. Secondly, the judge accepted that a constructive trust might arise if and insofar as it could be established that monies were paid to Farepak by customers at a time when Farepak had decided that it had ceased trading, and indeed at a time when it had indicated that payments should not be received. The difficulty which arose however was that on the facts the judge could not determine that all the monies in relation to which he was asked to make a decision fell within that argument. That was because the date of receipt should be taken as the date the agent received the money, not the date the monies were received by Farepak in its bank account.

23. Thirdly, the judge was willing in principle to give effect to a (rectified) express trust. However the judge concluded that an additional problem presented itself in relation to this argument; namely that insofar as the money had already been paid to the company (via the agent) the relevant customers were already creditors. Accordingly by declaring the trust the company was apparently giving a preference. The judge considered that there was no obvious answer to this problem, though he noted the point was not argued before him. We return to this point further below.

24. The fourth and final avenue explored by the administrators was whether or not the rule in *Ex parte James* (as officers of the court) might require them to return the monies to the customer. Mann J concluded that the principle could not to be used to override the company's interest in the monies, or to dispense with the preference issue, even if to do so might produce a "fair" result for the contributing customers. That may produce "palm tree justice", but was not sufficient to bring it within the principle in *Ex parte James*.

25. In his concluding observations, Mann J was assiduous to leave open the opportunity for the parties to return to court on more substantial material to justify the proposed distribution, and expressed regret that he could not endorse the distributions which the administrators wished to make. However, even if some of the obstacles might be seen as technical points, they were nevertheless real, and had to be disposed of properly and on the basis of law, not purely on the basis of "sympathy and Christmas". We are not aware that the administrators have sought to re-open the matter on the basis of a fresh application.

26. The first comment to make in relation to the *Farepak* case is that it was not a pre-pack. In fact the directors were seeking to institute trusts to protect payments which the company was thought to be receiving from its customers in its bank account/s after cessation of trading. In fact, as it turned out, in all probability those funds were received by the company, through its agents, before the decision to cease trading was made. So the facts in *Farepak* were quite unusual and do not provide much helpful guidance to the typical pre-pack scenario.

27. Secondly, the decision in *Farepak* is not considered to be a valid authority for the proposition that a company cannot effectively retrospectively constitute itself a trustee of customer deposits (in respect of customers who had become creditors). The first point to note is that

Farepak was to be treated as summary judgment application. Secondly, the preference point was not argued before the judge (it was a point of his own). Thirdly, whilst the judge's conclusion could be justified on the facts in *Farepak*, in most pre-pack cases the directors' motivation will be to be able to continue trading (whilst reducing, as far as possible, the risk of an allegation of wrongful trading or unfit conduct). In these circumstances it is suggested the directors may well have a good basis for contending that the requisite desire to prefer under section 239 of the IA 86 is absent; see *Re Lewis's of Leicester Ltd* [1995] 1 BCLC 428 (Robert Walker J). See also the comments below in the context of trusts in relation to suppliers, and as we will see later, judicial notice of the preferential impact of twilight trusts has been gaining traction since *Farepak*.

28. As mentioned at para 5 above, enlightened self interest is a key driver. In the wake of the Farepak collapse, the sector suffered a crisis of confidence in the business model which even threatened the Christmas savings club business as a whole. The biggest player in the market, Park Group, sufferred a 30% turnover drop in the immediate aftermath. Its response to restore confidence included the establishment of a trust for customer/agents prepayments. A copy of The Park Prepayments Trust (which has external trustees) can be viewed via the Park Group website[11]. At its heart is protection for the funds providers until their goods are acquired or delivered. As a document, it also has the advantage of time for consideration over many of the express trusts sought to be established in haste and under stressed conditions , with imperfect information, by boards and their advisers as insolvency looms into view, and the decision to cease or to continue trading has to be taken.

29. Where the company facing difficulties depends for part of its working capital financing on customer prepayments, its capacity to carve out such an essential component of its operating cash flow in the pursuit of protection for the credit in the twilight zone may be limited or impossible, and may produce the unintended consequence of killing off any plan to trade through the trough and end up assuring failure and loss to the existing creditors. This was precisely the dilemma faced by the directors in the disqualification case of *Uno/World of Leather*[12]*,* in which Blackburne J declined to find unfitness in the conduct of the directors who continued to trade. On advice, they continued to accept customer deposits for furniture in the pursuit of a solution to the company's trading problems, rather than to cease trading and condemn the existing customers and creditors to the certainty of nothing.

Re B A Peters plc: a new priority?

30. This brings us to the most recent decisions in this area: *BA Peters* and *Global Trader*[13]. BA Peters Plc, prior to its entry into administration on 14 August 2007, was engaged in various business activities connected with boats and shipyards, including in particular the sale and purchase of boats, both on its own account and as a broker for clients. It used to bank accounts with Barclays – a client account and a current account. At all relevant times the current account was overdrawn. There was a surplus in the client account after taking into account potential proprietary claims against that account. Customers made deposit payments for the purchase of yachts subsequently not delivered. Three key issues arose in respect of which the administrators sought directions, joining a number of interested customers as respondents: the first was whether or not the customers had a proprietary claim in relation to payments made into the client account; the second was whether or not customers who paid into the overdrawn customer account could nevertheless still maintain a proprietary claim in that respect; the third issue was whether those customers could mount some proprietary claim in relation to the company's money standing to the credit of the client account after satisfaction of any "direct" claims in that respect.

31. On the first issue, the judge at first instance (Nicholas Strauss QC) made the important finding that at all times the client account had a surplus in excess of any customer payments made into it. Accordingly, to the extent any funds were drawn from the client account they would be treated as drawings from the company's own money. It followed that, notwithstanding the fact that the monies had been mixed in the client account, each customer was beneficially entitled

[11] www.getpark.co.uk/CORPORATE/declaration.pdf
[12] [2004] EWHC 933 (Ch.)
[13] *In the matter of Global Trader Europe Limited* [2009] EWHC 602 (Ch)

to the value of the payment made into the client account. This was a conventional application of the *Re Kayford* line of cases referred to above.

32. On the second issue, whether or not customers whose money was paid into the overdrawn customer account could maintain a claim in relation to those monies, because that account was at all times overdrawn, the monies paid into were effectively used to reduce the company's liability with the bank and this asset effectively disappeared; *Bishopsgate Investment Management Ltd (In Liquidation) v Homan* (1995) Ch 211 CA (Civ Div).

33. The third issue or question was more novel, and was the focus of an appeal by two of the customers (the Atkinsons and the Clarkes). The company had a surplus in its client account. Both the Atkinsons and the Clarkes had been promised by the company that the deposits received by the company from them would be paid into the client account. They were not (or substantially were not) and instead were paid into the overdrawn current account. So the company was a defaulting trustee at least in this respect. The Atkinsons and the Clarkes had a substantial grievance, which arguably went beyond the case of a customer who paid for goods in advance without seeking any security, or assurance. They sought to persuade the judge at first instance, and the Court of Appeal, that they should be granted a proprietary claim in relation to the surplus standing in the client account. They failed to do so, principally because they could not establish any trust fund over which a proprietary claim could operate. There was a trust fund in relation to the client account, but there had been no breach in that respect by the company. As regards the customer account, as soon as the money was received by the company in its current account, its identity was extinguished in favour of the Bank. The fact that the company was a defaulting trustee by paying the monies into this account did not assist; there was a breach of trust claim but the only remedy in that respect was an unsecured personal claim.

34. The Court of Appeal recognized there was some attraction to the idea of granting a person who was promised security some security. However the difficulty the appellants had was that their appeal recognized that any claim they had would rank behind the claims of those whose money had been paid directly into the client account. So what they were proposing was a new class of creditor sitting between those with direct proprietary claims and those with unsecured claims. Lord Neuberger, sitting in the Court of Appeal, gave the only judgment with which Dyson and Jacob LJJ agreed, and concluded (@ para 21) that such a claim would conflict, or at least was unsupported by, principle and authority:

"*In my view, the court should not be too ready to extend the circumstances in which proprietary or other equitable claims can be made in insolvent situations, bearing in mind the consequences to unsecured creditors. To raise those in the commercial world, it must sometimes seem almost a matter of happenstance as to whether or not a particular creditor, with no formal security, has a proprietary or equitable claim. However, the fact is that every time such a claim is held to exist in the case of an insolvent debtor, the consequence is that one commercial creditor gets paid in full to the detriment of all other commercial creditors, who also have no formal security, but are found to have no proprietary claim.*"

35. It is questioned however whether this was an opportunity missed. The presence of different classes of creditors, different from the typical secured and unsecured positions, is not unheard of in the insolvency context. Furthermore, the case of *BA Peters* might have been the opportunity to review the principles of remedial constructive trusts, to see whether a remedy could have been fashioned in this respect[14]. Why shouldn't the Court apply the maxim that equity treats as done that which ought to be done so as to allow the intended beneficiary to impound other assets of the defaulting party? Some commentators have questioned whether an analogy could have been drawn with that line of authority which imposes a trust over a bribe received in breach of a fiduciary duty; see *Attorney-General for Hong Kong v Reid* [1994] 1 AC 324[15]. In such cases a remedial constructive trust is imposed.

[14] Although it must be remembered that Mann J declined to embrace that challenge in *Farepak*. And in *Polly Peck,* its existence as a remedy known to English law was denied

[15] See for example McMeel, Restitution Law Review [2009] Review of 2008

36. As matters currently stand however, it must be concluded *BA Peters* has not created a new priority. The judgment appears to be a strong statement of orthodoxy in this area, particularly in the insolvency context, and it has been applied in the recent decision of Sir Andrew Park in *Global Trader.* In *Global Trader* it was found that clients of a derivatives broker, whose money had mistakenly not been paid into a segregated account to be held on trust for them, were not entitled on the broker's liquidation to have the monies owed to them treated as being held on trust.

The second category: trusts for suppliers

37. It was expressly noted by Megarry J in *Re Kayford* above that different considerations might apply in relation to a trust set up in relation to suppliers/creditors. That turned out to be the case in *OT Computers Ltd v First National Tricity Finance Ltd* [2003] EWHC 1010 (Ch) (Pumfrey J). *OT Computers* concerned both a customer deposit/advance type trust and a supplier/creditor trust. The judge upheld the former but concluded the latter was ineffective by reason of the fact that there was insufficient certainty of beneficiaries (objects). In particular the trust referred to the beneficiaries being “urgent suppliers” and the judge concluded this was an inherently uncertain concept. The draftswoman who prepared the trust deeds in *Re Sendo* may well have had this decision in mind when drafting the trust deeds for that company.

38. *Re Sendo International Ltd* [2006] EWHC 2935 (Blackburne J, 24 November 2006) was (to all intents and purposes) a pre-pack case. The company operated as a manufacturer and distributor of mobile telephones, and depended for its financial support upon its major supplier, Celestica, which was also a secured creditor owed in the region of $220m. The indebtedness was considerably greater than the security available, but it was agreed that money should be carved out from the security to establish a trust fund to correspond (at least in theory) to the liabilities being incurred as the sales process was explored. Two separate trust deeds were established to provide for liabilities incurred by an insolvent company during the process of seeking a sale of its businesses.

39. The validity of the trusts was not in issue; the definition of trust creditors was clearly set out in the trust deeds and there was no question of there being a lack of certainty as regards the objects of the deed. The court found that the clear purpose of the trust deeds was to permit SIL (and the group companies) to continue trading notwithstanding their insolvency, by ensuring that sufficient monies were carved out of Celestica’s security and placed into trust to cover the trading liabilities. The funds ceased to be available to SIL’s creditors generally, but became subject to the trust deeds instead.

40. Rather, the issue was the extent of the trust creditor’s interests in the fund. That was an issue of construction of the trust deed/s.

41. The administrators sought to distribute balances in the trust accounts, in each case by way of pro rata distribution (net of expenses and remuneration) to the creditors identified in the schedules which had been created in accordance with the trust deeds. There were discrepancies between the identities and amounts of the creditor claims in the schedules and those which the creditors claimed for themselves. The administrators said that it was clear that the funds were held on trust and were no longer part of the company’s property, and urged the court to avoid detailed investigations as to the entitlement of those interested in the funds in the interests of economy and expedience.

42. Few creditors attended the application. One claimed a greater sum than was listed, but wanted an early distribution in any event. The other, a trade creditor, also said its claim was substantially understated, and sought to participate in the trust fund distribution on a more accurate reflection of its claim.

43. The administrators argued that the trust deeds identified the trust property and the beneficiaries as listed in the trust account schedules (being those which the company reasonably believed were unsatisfied liabilities in the relevant period), and that such identities and amounts represented the funding in the trusts for the liabilities incurred during the trust

period. It was not necessary to look beyond the schedules themselves to establish to whom the trust funds should be distributed. They contended that the trust deeds and the schedules created pursuant to those deeds were definitive of the beneficial interests of the trust creditors.

44. Against that proposition, it was argued that the deeds contemplated an objective standard for ascertaining the extent of the creditors' claims. It was contended that the intention of the settlor was an accurate identification of the creditor claims. Reliance upon the schedules carried the risk of intrinsic error, and distributions which could be arbitrary or capricious. The schedules should not be viewed as being determinative but merely operative machinery. Properly understood, the trust deeds were intended to provide that the trust funds were to be ring fenced to meet actual liabilities incurred in the relevant period. The creditors' claims should be assessed no differently than if no trust fund had been established for their benefit.

45. In the event, Blackburne J favoured the administrators' approach on the construction of the deeds. Even though an oversight in a creditor's claim may give cause for a grievance, it did not provide any enhancement in the trust fund declared in that creditor's favour. He ordered that the funds be distributed in accordance with the administrators' protocol (i.e. pari passu in favour of those listed in the schedules to the trust deeds). The only consolation for the disgruntled creditor was that the judge ordered that its costs of representation be paid as an expense of the administration of the trust funds as he considered their participation had been of assistance.

46. Although the settlor of the trust property was the insolvent company, it was not the real provider of the funding, which came from funds which would otherwise have fallen subject to Celestica's security, and could only be used to meet the trading liabilities with Celestica's agreement. There was no debate as to whether, upon such release, the company found itself declaring a trust over its own monies (i.e. which upon release became its own property, albeit for a specific purpose). Instead of a general pro rata application, the trust deeds set out a mechanism under which some of the liabilities could have been either omitted or understated. To the extent of such inaccuracies, the advantaged parties might have been preferred to the detriment of the disadvantaged, but such an argument was not addressed in the judgment, nor was any issue of conflict for the administrators acting as de facto trustees of the funds. That said, the pragmatic approach urged by the administrators appealed to the expediency of the situation.

47. In addition, and more generally, simply because it might be said that certain creditors were preferred over others, it does not follow that the declarations of trust constituted unlawful preferences under section 339. As commented above in relation to the Farepak decision, if the true motive was to enable the company to continue to trade then the requisite desire to prefer under section 239 of the IA 86 might well have been absent. Nevertheless, the preferential impact has found further judicial recognition recently from Sir Andrew Park in *Global Trader* above @[110].

A comparative glance around the world

48. More than half of the world's legal systems do not recognise the trust[16]. China does, but Russia does not. The trust has been described in terms of the most distinctive creation of English law. It is a concept of the common law and as such it is well established in the Anglo-Saxon and Commonwealth jurisdictions. In the USA and Canada, where the remedial constructive trust has taken root, they have arguably taken the concept a stage further still. Indeed, the *Goldcorp Exchange*[17] case, in which gold bullion buyers sought to establish (by tracing) proprietary claims to gold held in unallocated bulk by the insolvent dealer, rather than endure the ignomy of a mere unsecured claim, started its journey to the Privy Council in New Zealand.

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16 Wood: Predictions
17 [1995] 2AC 74

49. As an instrument of creditor protection, the trust can be seen at work in several jurisdictions. The need for protection of advance payment in the travel trade has received recognition in Australia[18], and in Canada where the Travel Industry Act 2002 deems all money received for travel services to be held in trust and used only for the purchase of the travel services contracted for by the customer when the booking is made and payment received[19].

50. Paradoxically, the trust concept as used in Australian deeds of company arrangement (DOCA) as a means by which the creditors entitlements are substituted for right in a trust established under the DOCA, so that the DOCA may then be terminated, has received judicial criticism because such trusts are outwith the court supervisory provisions of the Australian Corporation Act[20]. In those circumstances, the judge opined that DOCA administrators carried a heavy burden to explain the shift from a regime with court protection to one in which creditors become passive trust beneficiaries.

51. In the US, amendments to the Bankruptcy Code have provided a partial legislative response to the issue of the "tail end Charlie" supplier. By section 503(9) of the Code, those who supply goods in the ordinary course of business within the period of 20 days prior to the opening of a case under the Code, now enjoy administrative priority (i.e. are an expense of the case) for payment. In two cases under that provision of the Code, bankruptcy courts in Eastern Pennsylvania and Delaware[21] have declined to give the creditors immediate payment, so it still is a delayed benefit (and little different to our own administration expenses regime under para 99 Sch B1). Whilst such a provision is not on any horizon in England & Wales, the equivalent protection is a legitimate concern for directors to raise.

52. Historically, in continental Europe where civil codes apply the concept of a trust has not been recognized. In 1984, the Hague Convention on Private International Law set out certain principles applicable to the recognition of trusts. The UK signed up to the Convention in 1986 (and implemented it by the Recognition of Trusts Act 1987). Among other signatories was France, but the French civil code as it then stood, did not recognise trusts at all! Notwithstanding attempts in the intervening years to create a trust law of their own at various times in the intervening years, it was not until 2008 that "la fiducie" became part of French law.

53. Before the EC Regulation (1346/2000) came into force on 31 May 2002 the Brussels Convention (11968) allocated exclusive jurisdiction in civil and commercial matters to the relevant local court in the country where the property is situate, though insolvency proceedings were generally excepted from this rule under Article 1. Article 16 confers exclusive jurisdiction in the matter of rights in rem in immovable property on the court of the contracting state in which the property is situated. However in cases such as *Ashurst v Pollard* [2001] Ch 595 this did not prevent the Courts in this country from holding that an English trust existing over land held abroad might be enforceable since the order sought was an order in personam (to perfect the trustee's title in the property held in Portugal).

54. Under the EC Regulations the general rule is that the administration of insolvency proceedings in a particular member state is to be governed by the law of those proceedings (Article 4). Article 5 provides that the opening of insolvency proceedings does not affect the rights in rem of creditors or third parties in relation to assets of the debtor situated outside the territory of that member state, which rights are to be determined by reference to the law applicable to such rights under conflict of laws rules (private international law principles).

Concluding thoughts & the future

55. The above decisions show the narrow dividing line between the personal and proprietary claims. Whether a deposit is protected by a trust fund may be somewhat arbitrary: a customer who sought, and was promised, security may not obtain it (as in *BA Peters*),

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18 *Stephens Travel v Qantas* [1988]13 NSWLR 331
19 see the Guidelines for Wholesalers on Trust Accounting issued by the Travel @Industry Council of Ontario [*tico.ca*]
20 *Parkview Constructions Pty Ltd v Tayeh* [2009] NSWSC 186
21 *Bookbinders & Global Home Products*

whereas another customer who had not asked for security may obtain it (as in the *Re Kayford* line of cases).

56. The decisions in *BA Peters* and the *Sendo* also raise serious questions for directors, or agents of the company. If trust arrangements which are put in place allow for unsecured credit to increase the directors must conceivably be at risk of liability under section 214. Whilst an objective standard for ascertaining creditors was contemplated in *Re Sendo* the judge concluded it was not a condition precedent. In these circumstances it might be said that the directors had not taken every step with a view to minimising the potential loss to the company's unsecured creditors as they ought to have taken. Similarly, in *BA Peters* the failure to ensure funds were paid into the client account must surely result in the potential for a personal claim against the directors or other agents of the company.

Peter Cranston, Eversheds
Hugh Sims, Guildhall Chambers
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