OUP Equity and Trust Update (Summer 2021):

Determining the Terms of Distribution for Trust Assets

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This update considers some of the issues trustees and the courts are faced with when distributing trust assets. The update considers the issue of distribution in two factual matrices: when a company enters insolvency and has utilised the express trust as a means of protecting certain creditors, and when an unincorporated association is dissolved when retaining surplus assets. Although specific matrices are analysed, the issues raised in this update have broad application to all distributions of trust property, and the potential issues faced by trustees.

The matrices addressed in this update are particularly pertinent given the wider context at the time of writing and initial publication. As a result of the Covid-19 pandemic, large swathes of the economy have been placed under restrictions[1] that have meant many companies – particularly those that operate from physical stores or that operate in the leisure industry – have had to close their businesses to customers for prolonged periods. As a consequence of this disruption and drastically decreased revenue, there will be an increase in the number of insolvencies, and thereby an increase in the number of distributions from express trusts created to protect specific creditors. Indeed, as illustrated by the Insolvency Service's statistics, May 2021 saw a 7% increase in the number of insolvencies as compared to May 2020[2]. Although the number of insolvencies during the pandemic has been below the levels seen in 2019[3], the Insolvency Service note that the Government's support for businesses during the pandemic, including temporary restrictions on the use of winding-up petitions[4], are responsible for this suppression in the number of insolvencies by keeping otherwise failing businesses afloat[5]. Hence, although subject to a delay owing to governmental support mechanisms, an increase in the number of insolvencies, and distributions from express trusts, are inventible.

Similarly, although the same data is not available for unincorporated associations due these bodies not having to be registered, it can also be reasonably assumed that because of the pandemic, and the consequential funding constraints encountered by them, that there will be a comparable increase in the number of unincorporated associations that are dissolved, and the assets held needing to be distributed among their members[6].

Thus, given this context, the courts are likely to face an increased number of applications for clarification on how trust assets should be distributed, and will be required to provide clarification in a much more diverse, and potentially complicated, set of circumstances.

The Utility of Utilising Trusts in Insolvency

[1] Coronavirus Act 2020; The Health Protection (Coronavirus) Regulations 2020
[2] Insolvency Service, *Monthly Insolvency Statistics January 2019 to May 2021,* 15th June 2021
[3] Ibid.
[4] Sch 10 Insolvency and Corporate Governance Act 2020
[5] Insolvency Service, *Commentary – Monthly Insolvency Statistics May 2021,* 15th June 2021, https://www.gov.uk/government/statistics/monthly-insolvency-statistics-may-2021/commentary-monthly-insolvency-statistics-may-2021
[6] *Neville Estates v Madden* [1962] Ch 832; *Re Recher's WT* [1972] Ch 526

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The use and utility of the trust in instances of insolvency is apparent and well documented. By granting the beneficiaries to the trust a right *in rem*[7], they are able to assert their proprietary rights against the world at large and obtain priority to the trust assets over other parties. In instances of insolvency, the other parties are creditors that are not beneficiaries to the trust. Hence, the trust can be utilised to protect certain creditors' interest in assets should a company enter insolvency, and s283(3)(a) Insolvency 1986 explicitly acknowledges that trust assets do not form part of the company's asset pool, and so cannot be distributed to other creditors[8].

The effect that trusts can have upon a company's insolvency was illustrated in *Re Kayford*[9]. Here, the directors of Kayford Ltd, a mail order business, placed pre-payments received from customers for goods not yet dispatched into a separate bank account. This was done so on advice provided by the company's lawyers, and the account was later renamed as the "Customers' Trust Deposit Account" to reflect this action. Megarry J, affirming that the word 'trust' is not required to evidence certainty of intention, held that the directors' actions were sufficient to create an express trust for the benefit of Kayford Ltd's customers. In being beneficiaries to the moneys held in the bank account, the customers had priority over Kayford's other creditors to the funds, and so were able to minimise any losses and recover their pre-payments.

In addition to the impact of trusts on insolvencies, *Re Kayford* also evidences the willingness of the courts, particularly regarding consumers, to recognise the existence of an express trust. Megarry J indeed noted that when dealing with members of the public, many "can ill afford to exchange their money for a claim to a dividend in the liquidation, and all of whom are likely to be anxious to avoid this"[10] – meaning that a lack of formal documents should not hinder the recognition of the existence of a trust. This lack of need for formality thereby greatly increases the chances that express trusts could be utilised in instances of insolvency.

However, the limits of utilising the express trust were acknowledged in *Re Challoner*[11], where although there was a bungled attempt at creating a trust over donated moneys, the terms of the proposed trust were deemed too uncertain to determine when the moneys should be returned to the providers – demonstrating that there is still a minimum bar that must be met to utilise the trust. This is a bar that some, despite the leeway identified by Megarry J, will not meet. However, should professional advice be sought in the drafting of any prospective trust, these potential pitfalls in creating the trust, if not administering it, can easily be minimised by ensuring clarity of the trust's terms.

Moreover, notwithstanding their potential use, Lord Neuberger did note in *Re BA Peters Plc*[12] that the courts should be reticent from a policy perspective in acknowledging the existence of trusts in instances of insolvency – thereby potentially limiting the use of such trusts. Despite this comment, it should be acknowledged that His Lordship's call for reticence was concerned mostly with commercial creditors – creditors who do not require the same level of protection as consumers owing to their greater levels of knowledge and expertise, and who should use their expertise to adequately protect themselves via alternative and more traditional means.

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[7] See also *Re Goldcorp Exchange Ltd* [1995] 1 AC 74; McCormack G, *Proprietary Claims and Insolvency*, (London: Sweet & Maxwell, 1997) at 2
[8] *Heritable Reversionary Company Ltd v Millar* [1892] AC 588, per Lord Watson at 614
[9] [1975] 1 WLR 279
[10] Ibid, at 282
[11] (unreported) *The Times,* 4th November 1997
[12] [2008] EWCA Civ 1604

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Hence, the *obiter* comments in *Re BA Peters* do not inhibit the existence of a trust should the requirements be present, only prevent the courts from actively seeking to impose a trust through inventive interpretations of the facts.

The Problem of Distribution

Although potentially a viable creditor protection mechanism, one substantial issue in utilising the express trust is determining how the trust assets should be distributed. This is particularly problematic should there be no formal trust document[13], or should there be a trust document and the document be silent on the applicable terms[14].

This latter phenomenon occurred in the *Tiny Computers* case[15], where deposits from customers were placed with the company's bank, and instructions were given that the bank should hold the deposits on trust for the customers. Although no express terms were provided for how the trust fund should be distributed, it was held by Pumfrey J that it was possible to determine the beneficial interests of the customers (and so how the trust assets should be distributed) through reference to lists held by company of its customers. Similarly, in *Sendo International,* it was only possible to determine how the trust assets should be distributed by reference to a schedule that set out the debts owed to each beneficiary, rather than the express terms of the trust themselves. Despite it being possible in these two cases to eventually determine the terms of distribution, they also illustrate the expense, time, and acrimony that can be experienced in establishing the terms, thereby reducing the distributable assets available to the beneficiaries through lost legal fees and pitting beneficiaries against one another for a greater share of the assets[16].

Re Hyde – A Contemporary Example

The problems associated with trusts that remain silent on the issue of distribution were recently demonstrated in the complicated case of *Re Hyde*[17], which concerned administrators seeking direction on how they should distribute assets held on trust for the customers of BetIndex, trading as Football Index. Football Index operated a betting platform that permitted players to buy a three-year share in a footballer and receive a dividend depending on the player's performance. Alternatively, they could sell their share in the player to other customers on the platform and retain the sale moneys. Each customer therefore had an account with BetIndex that consisted of moneys deposited but not yet used to purchase shares, winnings from the dividends, and proceeds from the sales of their shares in players[18].

In order to protect the assets deposited in their customers' accounts from the consequences of any potential insolvency, BetIndex created a valid express trust and placed funds into a separate bank account – funds that represented the amounts its almost 280,000 customers had in their

[13] See *Re Kayford* [1975] 1 WLR 279
[14] *Re Hyde* [2021] EWHC 1542 (Ch)
[15] *OT Computers Ltd (in administration) v First National Tricity Finance* [2003] EWHC 1010 (Ch)
[16] Whilst this update is concerned with the use of express trusts, it should be remembered that imposed trusts (both resulting and constructive trusts) can also be utilised in instances of insolvency. Although such trusts might not arise intentionally owing for the need for transfers of property (resulting trusts) or unconscionable conduct (constructive trusts), they can still assist in protecting creditors. Within the context of this update the primary advantage of these imposed trusts is the clarity over the terms of distribution – the beneficiaries are either the transferors of the property (resulting trust) or the victim of the unconscionable conduct (constructive trust).
[17] [2021] EWHC 1542 (Ch)
[18] Ibid, at [13]

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accounts. The trust deed itself stated that the company held the moneys on trust for the customers according to their entitlement, or on a *pro rata* basis if there was a deficiency in the assets held in the account, and that the customers would be paid in priority of any other creditors. Upon BetIndex entering insolvency in March 2021, the account contained £4.5 million, and the amount due to the customers was £3.2 million[19], meaning there was a surplus of £1.3 million.

The issue faced by the administrators, however, was that although the account had sufficient assets to cover the amounts due to the customers, the trust deed was silent on how the funds should be distributed. Owing to the ongoing contractual relationship between BetIndex and the customers, the customers were still contractually entitled to ongoing dividends from the shares that they had purchased in the players for 3 years[20], increasing the entitlements of the customers by roughly £500,000 a month. Hence, should the predicted dividends be incorporated into the calculations for distribution, the account would not contain sufficient assets to cover the amounts due to BetIndex's customers – an occurrence that had already occurred by 22nd April 2021[21], a month after BetIndex's insolvency.

In interpreting the trust document to identify the relevant terms for distribution, Vos J referred to Lord Neurberger's comments in *Marley v Rawlings*[22], where his Lordship set out the principles applicable to interpreting a contract – the same principles that apply equally to the interpretation of trust instruments[23]. His Lordship stated that:

> "When interpreting a contract, the court is concerned to find the intention of the party or parties, and it does this by identifying the meaning of the relevant words,
>
> (a) in the light of (i) the natural and ordinary meaning of those words, (ii) the overall purpose of the document, (iii) any other provisions of the document, (iv) the facts known or assumed by the parties at the time that the document was executed, and (v) common sense, but (b) ignoring subjective evidence of any party's intentions."

Consequently, Vos J was required to interpret the trust instrument in light of the purpose of the trust, the facts known to the parties when the trust document was executed, and general common sense.

Two different interpretations of the trust document were proffered – one interpretation by some of BetIndex's newer customers, and the other by BetIndex's administrators. The customers submitted that because the trust deed was silent on the issue, distribution of the trust assets should only occur after the 3-year contractual period had expired, and the customers' right to the player dividends had been calculated[24]. They argued that as there was a 'surplus' of over £1 million held in the account at the time of BetIndex's insolvency, it would be 'an afront to

[19] Ibid, at [18]
[20] Ibid, at [17]
[21] Ibid, at 18
[22] [2015] AC 129 [at 19]
[23] Other cases to apply the same principles include *First National Trustco (UK) Limited v McQuitty* [2020] EWCA Civ 107 [at 30-33]); *Fafalios v Apodiacos* [2020] EWHC 1189 (Ch) [at 31-33]
[24] *Re Hyde* [2021] EWHC 1542 (Ch) at [43]

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common sense and fairness'[25] to permit this surplus to be remitted back to the company and be made available to the other creditors. More importantly, they submitted that as the trust deed's terms did not require the immediate payment of the funds upon the occurrence of BetIndex's insolvency, the natural interpretation of the deed was for the distribution to be made on the basis of their entitlements at the date of distributions – meaning that the customers should be permitted to receive the accrued dividend entitlements, even if this resulted in the entitlements exceeding the account balance, and a *pro rata* distribution became necessary. In putting forward this interpretation, it was acknowledged that permitting the accrual of dividend payments would benefit newer customers, as it was unforeseeable that they would have accrued substantial entitlements in their accounts owing to their lack of dividend payments[26].

It was alternatively submitted by the administrators that the entitlements should be fixed at the date of BetIndex's insolvency – 26th March 2021 – and that distributions should be made 'as soon as possible'[27]. This, consequently, meant that the customers would not be entitled to subsequent dividend payments as the moneys had already been distributed, and thereby benefiting longer term customers who had already accrued dividend payments[28]. This submission was founded upon the trust instrument being interpreted in light of the purpose of the trust – that its purpose was to protect the accrued entitlements of the customers at the time that the company entered insolvency. Hence, the trust assets should be distributed as soon as possible, with the company's insolvency the relevant date for determining entitlements.

Applying the principles espoused by Lord Neuberger in *Marley v Rawlings,* Vos J held that the correct interpretation of the trust was that the customers' entitlements had crystalised upon BetIndex's insolvency (26th March 2011), and that distribution of the assets should be made as soon as possible to comply with the requirements of the UK Gambling Commission for returning customer funds[29]. Consequently, the longer-term customers with established entitlements benefited over newer customers.

In coming to this conclusion, Vos J provided a number of justifications. First of all, it was noted that as the trust deed needed to have provided a mechanism for the distribution of the its assets, for 'It would be very odd if the terms of Trust Deed left such a significant gap.'[30] Given that the UK Gambling Commission requires that customer funds must be held in a separate account for distribution should the company enter insolvency, and that the trust was created to comply with these regulations[31], the correct interpretation must be that the company's insolvency should be the crystalising event for determining the customers' entitlements[32]. This was indeed expressed, if obliquely, in BetIndex's terms of use, which stated that "we have also put in place trust arrangements with our bank to ensure funds in this account are distributed to customers in the unlikely event of insolvency." Consequently, from the purpose of the trust, and broader context of seeking to abide by regulatory duties, it was possible to determine the intended terms of the trust.

[25] Ibid, at [40]
[26] Ibid, at [20]
[27] Ibid, at [20]
[28] Ibid, at [20]
[29] Ibid, at [58]
[30] Ibid, at [59]
[31] Ibid, at [23]
[32] Ibid, at [60]

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It was also held that that although the trust account included a surplus of almost £1.3 million at the time of the insolvency, this was no hindrance to there being a trust. Indeed, owing to BetIndex's administration of the account – whereby they 'topped up' the account on a weekly or monthly basis, rather than on a daily basis, to reflect the customers' account balances[33] – the surplus in the account was merely a by-product of ensuring the customers were protected and acted as a contingency, rather than a manifestation of any intention to protect any future entitlements customers may have to dividend payments[34]. This, it was held, was a reasonable and self-evident interpretation of BetIndex's actions.

Re Hyde thus demonstrates the difficulties that trustees can face in administering all trusts. Notwithstanding the existence of the three certainties[35], and that the trust has been fully constituted[36], should the draftsman of the trust fail to set out the terms of the trust in the trust document, or there be no trust document and discussion of the finer terms at all, then the trustees will not know how the trust should properly be administered in many circumstances. This will consequently, as in the case of *Re Hyde,* require the trustees to seek directions from the court. Although *Re Hyde* does also demonstrate that, utilising the principles established in *Marley v Rawlings,* the terms can eventually be determined, it also evidences the litigation costs involved and the animosity that can be encountered when differing interpretations favour different groups of beneficiaries. As noted by Vos J, "there will be winners and losers"[37] to any decision the court makes, and the losers will in most instances be bitter about their losses. This outcome is particularly true to trusts utilised in insolvency, owing to the company already having insufficient assets and the beneficiaries potentially also having incurred losses on other, unprotected debts. The courts, therefore, have an unenviable position in trying to determine the applicable terms and navigate a fair and equitable course for those involved, with only limited principles as points of reference.

Distribution of Unincorporated Association Assets

Another matrix in which the courts have had to address the issue of distributing trust assets has been with the dissolution of unincorporated associations. As noted at the beginning of this update, as with companies, owing to the Coivd-19 pandemic and disruption to income streams, it is expected that the number of unincorporated association dissolutions, and so distributions of unincorporated association assets, will increase for the foreseeable future, and occur in an increasingly diverse multitude of circumstances.

The primary problem faced by unincorporated associations, both practically and theoretically[38], has been how they hold any assets they have acquired owing to their lack of independent legal personality. Previous, but inadequate, attempts to resolve the issue included interpretations that they were purpose trusts[39], or that assets transferred to them were gifts to present members[40]. However, the issue was largely resolved by Cross J in *Neville Estates v Madden[41],* who proffered (but did not apply) the 'mutual contract holding' theory – that whilst a gift to an unincorporated association was a gift to the members, it was 'subject to their

[33] Ibid, at [65]
[34] Ibid, at [68]
[35] *Knight v Knight* [1840] 3 Beav 148 at 173
[36] *Milroy v Lord; Re Cozens; Choithram International v Pagrani*
[37] *Re Hyde* [2021] EWHC 1542 (Ch) at [5]
[38] Warburton, *Unincorporated Assoications: Law and Practice,* 2nd edn (London: Sweet & Maxwell, 1992)
[39] *Re Drummond* [1914] 2 Ch 90; *Re Price* [1943] Ch 422
[40] *Leahy v A-G of New South Wales* [1959] AC 457
[41] [1962] Ch 832

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respective contractual rights and liabilities towards one another as members of the association'[42]. Consequently, given the subsequent adoption of the theory in *Re Recher*[43], it has been clarified that whilst assets are the property of the members, the members are not free to do as they wish with the assets, and their actions are limited by their contractual obligations – such as withdrawing their share of the assets[44].

In addition to the issue of how assets are held, the courts have also faced the issue of how assets should be distributed upon the dissolution of an association – especially as the legal title will usually be held on trust for members[45]. The approach to distributing the assets was succinctly set out by Walton J in *Re Bucks Constanbulary Fund (No.2)*[46], who held that the assets should be distributed between the members of the association at the time of the dissolution[47] – meaning to those members that already have beneficial title to the assets under the mutual contract holding theory. However, notwithstanding the simplicity of this proposition, identifying the association's members at the time of its dissolution still remains a practical hurdle – as was recently demonstrated in *Gibbons v Smith*[48].

Gibbons concerned land that had been gifted, and then held on trust, in October 1997 for the members of the Hollingwood Welfare Association. The association was dissolved in March 2013, and prior to its dissolution, had been run in a mildly disordered and chaotic manner[49], with few records having been maintained. Given the association's dissolution, it was necessary to dispose of the land and distribute the proceeds between those who were members at the time of the dissolution. Despite the relative simplicity of the requisite actions, determining who was a member at the time of the dissolution was evidentially problematic owing to the lack of coherent records – thereby requiring the trustees to seek guidance from the court on how any proceeds should be distributed.

In assistance to the court, the membership books of the association had finally been identified. Although these documents did to some degree assist the court in identifying the members, they were 'not complete and may not be accurate'[50]. It was therefore proposed, and was accepted by the court, that a mechanism should be put in place to assist in identifying the members. It was consequently held that:

a) An advertisement should be placed in the Derbyshire Times (the appropriate local newspaper) detailing the intended distribution, and a one-year deadline for members to come forward;
b) For the advertisement to be sent to all individuals contained in the membership books;
c) For a junior Chancery barrister to adjudicate, after the submission of evidence by the prospective members, on whether they were or were not members in March 2013, with that adjudication being final; and

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[42] Ibid, at 849
[43] *Re Recher's WT* [1972] Ch 526
[44] *Hanchett-Stamford v Attorney-General* [2009] Ch 173
[45] Pearce R and Barr W, *Pearce and Stevens' Trusts and Equitable Obligations,* 7th edn (Oxford: OUP, 2018)
[46] [1979] 1 WLR 936
[47] *Trustees of the Graphic Reproduction Federation v Wellcom London Ltd* [2014] EWHC 134 (Ch) at 30 – "Entitlement goes with membership. If membership goes, entitlement to any funds goes."
[48] [2021] EWHC 1278 Ch
[49] Ibid, at [7]
[50] Ibid, at [7]

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d) For distribution of the proceeds to be made one year after the applications have been resolved[51].

In ordering such a scheme for distribution, Roth J acknowledged that it was similar to a scheme approved in *National Westminster Bank v Lucas*[52], save that in *Gibbons* the trustees were permitted to distribute the proceeds after a year without liability. This permission was as a result of Roth J also issuing a *Re Benjamin* order absolving the trustees of liability should a member subsequently be identified after the year long cut-off point. In approving the scheme, and the *Re Benjamin* order, Roth J concluded that it was "fair and practical to make such an order in the best interests of those who will have been found to be members and of the proper administration of the trust. Without it, the claimants could not confidently make any distribution."[53]

From *Gibbons,* as with *Re Hyde,* it can again be seen that the court are, eventually, able to identify the means of distribution for trust assets. Although the complication differed from *Re Hyde* – identification of beneficiaries, as opposed to the timing that distribution should occur – *Gibbons* does also illustrate the impediments trustees face in distributing the assets of valid trusts. Notwithstanding that *Gibbons* did not involve competing parties of beneficiaries, the potential for animosity still remains (over who should be classified as a member), and does indeed evidence the financial cost associated with resolving the issue – in this case involving not only the court and advocate fees, but also the payment of a Chancery barrister to administer the process of determining who was a member, an expensive undertaking.

Conclusion:

Both of the cases analysed in this update demonstrated some of the issues trustees face when distributing trust assets, and the means by which the courts can resolve these issues. Notwithstanding the preferability of the settlors to a trust providing the terms of distribution and a complete list of beneficiaries – elements that are vital for trustees in fulfilling their duties – should these elements be missing, then the courts are, through guiding principles, able to clarify the applicable distribution terms. However, this update has also shown how difficult this process can be, with the competing beneficiaries putting forward alternative and clashing interpretations that may cause conflict, and the need for directions from the court being a financial drain on the trust assets through the incurrence of legal costs.

[51] Ibid, at [8]
[52] [2014] BPIR 551
[53] *Gibbons v Smith* [2021] EWHC 1278 Ch, at [11]

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