

**Legal note as to whether the Ferry Reserve Fund can lawfully be ‘ringfenced’ from the Ferry Company and, in the case of its insolvency, liquidators**

1. The Inspector made the following request of the applicants:

*“She is mindful that many objectors raise concerns about the legal enforceability of the intended ring-fencing of the ferry replacement reserve (“FRR”) and the change in company policy in relation to the payment of dividends. She asks for a supplementary note to be submitted to the Inquiry in this regard, explaining how the intended measures will be secured over the coming years and what will happen to the FRR should, for instance, the company be wound up. No doubt the matter will be addressed in chief by Mr Thomas, but the Inspector requires written confirmation too, which will need to be provided in writing before the close of the Inquiry.”*

**The mechanisms and guarantees put in place by the Ferry Company**

2. The Applicant has offered, in addition to the change in policy [I/p191], two mechanisms to ensure that funding the FRR will be given priority over the payment of dividends:
  - a. The policy has been formally adopted by the board and compliance will be documented in the Applicant’s accounts each year. Following on, proper compliance with such a policy will be something which the Applicant’s auditors will have to consider and formally report on each financial year in their annual audit report. The accounts and the auditor’s report are then provided, annually, to the Secretary of State to whom the undertaking has been given [s35 1923 Ac: [Supplementary bundle/13]; and,

- b. The provision of a formal written undertaking by Fairacres Group Limited (the shareholder which receives any dividend) to the Secretary of State for Transport to maintain the Applicant's net assets at a certain level and proposed to be not less than £15million [1/p67] and that it refers to the Applicant was confirmed by Mr Kean in evidence.
3. Compliance with the undertaking will rest not just with Fairacres Group Limited but also with its individual directors both at the time the undertaking was given, as well as future directors appointed (and whilst the undertaking was still in force). The individual directors have been given advice that in addition to the penalties for specific breaches of the undertaking any breach would be prima facie evidence for a finding of unfitness in an application to disqualify a director pursuant to the Company Directors Disqualification Act 1986.

**The impossibility of additional legal mechanisms by way of legal 'ringfencing'**

4. The alternative proposals advanced (to varying degrees) by the objectors are dealt with below.

**A trust**

5. A trust is a mechanism whereby a settlor transfers an asset (which can include cash) to a trustee, for that trustee to control for the benefit of a beneficiary or for a specified purpose.
6. A trust allows legal ownership and beneficial interest to be separated: the trustees become the legal owners of the trust property as far as third parties are concerned, and the beneficiaries can expect the trustees to manage the trust property for their benefit.
7. If the FRR was transferred into a trust then:

- a. The Applicant, as the settlor, will no longer own the FRR. Each year the Applicant would give the FRR contribution to a Trustee and the Trustee (or another person on behalf of the trustee) will then hold the legal title to the FRR.
  - b. The trustee will have the power and duty to manage, employ or dispose of the assets according to the terms of the trust and his/her special duties at law. Professional trustees expect to be remunerated.
  - c. The beneficial interest in the FRR will however be held by the beneficiaries of the trust. Colloquially they will “own” the FRR in the sense that it is held entirely for their benefit.
8. It is agreed that Trusts can be used in commercial transactions. For example a limited company can give part of its annual income (by way of contribution) to pension trustees for the benefit of the company’s employees and former employees. The key point however is that the company is paying out this money. The contributions now belong legally to the trustees for the benefit of a third party being the employees and former employees.
9. The money is no longer owned by the company and so the pension fund is not available to the company’s creditors. Legal title to it is held by the trustees and beneficial interest by the pension fund.
10. The difference in this case is that the Applicant would be both settlor and the entire beneficiary of the trust fund. This is likely to be considered to be a sham trust. A “sham” trust is one where the settlor wants the benefits of a valid trust (such as protection from creditors) but does not wish to give up the benefits of absolute ownership. A trust is a sham where it is intended that there should be

no genuine passing of control of trust property from settlor to trustee and there is an intention to mislead third parties. Sham trusts are void.

11. An illusory trust is similar:

*“a trust under which the trustee [who is also the settlor] retains such control that the proper construction is that he did not intend to give or part with control over the property sufficient to create a trust...the trust as constituted has the attributes of a trust, including the imposition on the Trustee of the obligation to act honestly and in good faith; but the powers given to the Trustee...are so broad that the Trustee can “basically...do whatever he wants with the property.” (Clayton v Clayton [2016] NZSC 29, at paragraph 119.).*

12. If a trust is illusory then a valid trust is not created.

13. The objectors (in particular Studland Parish) state that the objective they wish to obtain through a trust or some other legal mechanism is to preserve the reserve fund exclusively for the purpose of buying a new ferry. However it is not lawfully possible to create a private purpose trust<sup>1</sup>; that is, a trust set up for a specific purpose, such as to buy a ferry. A private trust must be set up for the benefit of a beneficiary rather than a purpose.

*“the gift will fail upon the ground that the court cannot compel the use of the property in furtherance of a stated purpose unless, of course, the purpose is a charitable one. As \*369 Viscount Simonds said in Leahy v. Attorney-General for New South Wales [1959] A.C. 457, 478:*

*““If the words ‘for the general purposes of the association’ were held to import a trust, the question would have to be asked, what is the trust and who are the beneficiaries? A gift can be made to persons (including a corporation) but it cannot be made to a purpose*

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<sup>1</sup> Charitable trusts can be set up for a specific charitable purpose and there is a limited class of private trust set up for purposes that are similar, such as maintaining a gravestone or saying private masses for the souls of the dead.

*or to an object: so also, a trust may be created for the benefit of persons as cestuis que trust but not for a purpose or object unless the purpose or object be charitable. For a purpose or object cannot sue, but, if it be charitable, the Attorney-General can sue to enforce it."*

14. Any private trust therefore requires a beneficiary. If the Applicant were the beneficiary of the FRR under a fixed trust (one where the where the interests of the beneficiary or beneficiaries are determined at the outset) then beneficially the FRR will still be owned by the Applicant. In such a trust the trustee cannot refuse to make payments to a liquidator who stands in the shoes of the liquidated beneficiary.
15. A trust, where the beneficiary has an immediate and absolute right to both the capital and income of the trust, is usually transparent for tax purposes, that is, the beneficiary is taxed as if it owned the assets
16. In Mr Reynolds' cross-examination of Mr Eric Stobart, Mr Stobart suggested that the 'passengers of the ferry company' could be the beneficiary of (in that context) an escrow fund. Defining the beneficiaries thus would render the trust void for a lack of certainty (as the class would be ever changing at any given time).
17. The Applicant therefore contends that there is no trust structure that will have the effect of protecting the FRR from liquidation and indeed any such arrangement will probably be void as a sham or illusory. Indeed, if this were possible it would be consistently used in the corporate world by companies to ringfence parts of their income to prefer or secure key creditors such as landlords or banks. It would subvert the law of insolvency. It is not possible for the reasons above.

## **Escrow account**

18. Escrow accounts are widely used in the commercial world. They are normally used when a specific current or future liability has been identified which by definition must be to a third party, for example when a buyer has agreed to pay deferred consideration after completing a transaction. The money is put in a designated bank account or into the hands of a trusted third party to be dealt with in accordance with an escrow agreement drawn up between the two contracting parties.
19. The Applicant's position is however than escrow account does not change the ownership of the funds, it is simply a separate designated account. Only if the escrow agreement creates a trust (which would for example frequently occur in pension fund scenarios) as above, is the actual ownership of the money in the account altered.
20. As such the same considerations as apply above equally apply here. For an escrow account to exist there must be a settlor and separate beneficiary. Here they would be one and the same.

## **Transferring Company Assets to another Limited Company**

21. The Applicant will, it is submitted, face almost insurmountable legal difficulties were it to transfer part of its revenue, the FRR, for no consideration or consideration at an undervalue to another corporate entity, especially one that was not a group company. Briefly these difficulties include:
  - a. a breach of the director's duties set out in Chapter 2 of Part 10 of the Companies Act 2006 (CA 2006) specially the duty to promote the success

of the company, to exercise independent judgment and to exercise reasonable care, skill and diligence.

- b. present and future shareholders will be able to challenge the arrangements pursuant to s994 CA 2006

*“that the company's affairs are being or have been conducted in a manner that is unfairly prejudicial to the interests of members generally or of some part of its members (including at least himself), or  
(b)that an actual or proposed act or omission of the company (including an act or omission on its behalf) is or would be so prejudicial.”.*

- c. such transfer will be subject to certain statutory criteria and will be reviewable and reversible by a Liquidator or the Official Receiver as “preferences” or “transactions at an undervalue”.

Section 238 Insolvency act 1986 (IA86) provides. *“A company enters into a transaction with a person at an undervalue if – (a)the company makes a gift to that person or otherwise enters into a transaction with that person on terms that provide for the company to receive no consideration, or(b)the company enters into a transaction with that person for a consideration the value of which, in money or money's worth, is significantly less than the value, in money or money's worth, of the consideration provided by the company”*

Section 239 IA86 provides *“a company gives a preference to a person if –  
(a)that person is one of the company's creditors or a surety or guarantor for any of the company's debts or other liabilities, and  
(b)the company does anything or suffers anything to be done which (in either case) has the effect of putting that person into a position which, in the event of the company going into insolvent liquidation, will be better than the position he would have been in if that thing had not been done.”*

Action would probably lie not only against the Applicant and the recipient of the funds but also against individual directors who had authorised them (as misfeasance).

- d. Finally, a challenge could be made to the transactions pursuant to s423 Insolvency Act 1986, relating to '*Transactions defrauding creditors*'. Despite the heading it is not necessary to show fraudulent intent. Nor is it necessary to show, as with preferences and transactions at an undervalue (as above), that the company was insolvent at the time or become insolvent. Essentially the test is that the transaction was intended to put assets beyond the reach of creditors or potential creditors. The consequences of entering into these types of arrangements are that the court has very wide powers to reverse the transaction and protect the interests of creditors.

*Transactions defrauding creditors.*

*(1) This section relates to transactions entered into at an undervalue; and a person enters into such a transaction with another person if –*

*(a) he makes a gift to the other person or he otherwise enters into a transaction with the other on terms that provide for him to receive no consideration;*

*(b) he enters into a transaction with the other in consideration of marriage [F1 or the formation of a civil partnership]; or*

*(c) he enters into a transaction with the other for a consideration the value of which, in money or money's worth, is significantly less than the value, in money or money's worth, of the consideration provided by himself.*

*(2) Where a person has entered into such a transaction, the court may, if satisfied under the next subsection, make such order as it thinks fit for –*

*(a) restoring the position to what it would have been if the transaction had not been entered into, and*

*(b) protecting the interests of persons who are victims of the transaction.*

*(3) In the case of a person entering into such a transaction, an order shall only be made if the court is satisfied that it was entered into by him for the purpose –*



*(a)of putting assets beyond the reach of a person who is making, or may at some time make, a claim against him, or*  
*(b)of otherwise prejudicing the interests of such a person in relation to the claim which he is making or may make."*

22. The identical difficulties would, of course, be faced by the recipient company and its directors when it came to transfer the FRR back to the Applicant in 2032 so that the ferry could be purchased, save that they would only be amplified as no benefit at all would accrue to the recipient company and it will be placing itself in a position where it was disposing of all its assets.

### **Altering the Bank Guarantee**

23. The cross-bank guarantee secures the assets of the group companies, including Fairacres Group Limited assets, which assets includes the shares of the Applicant. Therefore the Bank will continue to be able to enforce against the Applicant's shares, as Fairacre's assets, even if the guarantee were no longer specifically offered by the Applicant.

### **Disaggregation.**

24. Disaggregation or distributing the shares in spec means transferring the shares in the Applicant to new owners. This will have the effect of removing the key protections set out in this application prioritisation of payments into the FRR and the shareholder undertaking. The undertaking does not apply if the Applicant ceases to be a subsidiary of FGL [1/p67].

25. It is and remains the Applicant's position, following extensive consultation with its advisors prior to making this application, that what has already been offered is the best protection that the Applicant can reasonably offer or indeed put in place.

**Paul Reynolds**

**1, Crown Office Row**

**Temple**

**London**

**Capstick Dale and Partners**

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