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UPDATE

No reflective loss in Guernsey?

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In *Jefcoate v Spread Trustee Company Limited* the Royal Court of Guernsey considered, for the first time, the question of whether the rule against reflective loss formed part of Guernsey law and, if so, whether it applied to cases where the losses have been suffered by a company owned by a discretionary trust.

The facts

The case concerned an alleged arrangement between the Plaintiff, Mr Jefcoate, and the Sixth Defendant, Mr Nicholson, whereby a number of properties in Wales (the **Properties**) were to be acquired and developed with the net proceeds being primarily shared between two Guernsey discretionary trusts of which the Plaintiff and Mr Nicholson were beneficiaries, namely the Lesterps Settlement (**Lesterps**) and the Trust of Paraguay (**Paraguay**), respectively.

The Properties were owned by Holborn Investments Limited (**HIL**), a Guernsey company indirectly owned by the First Defendant, Spread Trustee Company Limited (the **Trustee**) in its capacity as trustee of Lesterps, Paraguay and another trust called the Genoa Trust. HIL was dissolved in 2008.

The Second to Fifth Defendants (the **Trustee Defendants**) were wholly owned subsidiaries of the Trustee. In common with many Guernsey trusts, the Second and Third Defendants were appointed as directors of HIL and the Fourth and Fifth Defendants indirectly held the shares in HIL as nominees for the Trustee.

In short, the Plaintiff alleged that a number of the Properties were transferred at a significant undervalue to entities owned by or connected with Mr Nicholson or his interests or associates, to the financial detriment of Lesterps.

The Plaintiff sued (for the benefit of Lesterps) for restitutionary compensation or damages in the amount of approx £1.94m.

He alleged that:

- The Trustee Defendants had acted in breach of trust and/or breach of duty for allowing the Properties to be disposed of at an undervalue.
- Alternatively that by effecting the disposal of the Properties at an undervalue, all of the Defendants had conspired to cause loss to Lesterps by unlawful means.

The Plaintiff's claims were denied in their entirety by the Defendants and the matter went to trial in August 2014. Mourant Ozannes acted on behalf of Mr Nicholson and the Seventh Defendant, Mr Field, who owned two companies that had been the recipients of a number of the Properties allegedly disposed of by HIL at an undervalue.

Judgment

Following a 15 day trial all of the Plaintiff's claims were dismissed save for a finding against the Trustee in relation to one of the Properties that was held to have been disposed of at an undervalue of £125,000. Specifically, the court found that the Trustee had acted in breach of trust and was grossly negligent in not ensuring that the disposal by HIL was at proper current open market value. Lesterps' proportionate share

of the consequential loss was £59,375. After taking into account the likelihood of expenses being incurred in securing either a fully arm's length sale or an improved offer, judgment was given against the Trustee in the amount of £55,000.

The parties' submissions on reflective loss

The Trustee Defendants argued that neither Lesterps, nor, therefore, the Plaintiff, could recover losses allegedly arising from the disposal of the Properties at an undervalue because Lesterps' loss was simply reflective of the underlying loss that had been suffered by HIL as owner of the Properties.

Any claim in respect of those losses could and should therefore have been brought by HIL and the Plaintiff's claim was thereby barred by the rule against reflective loss.

The eponymous rule in *Foss v Harbottle* [1843] 67 ER 189, provides that the proper plaintiff in respect of losses suffered by a company is the company itself and not its shareholders. The rationale behind the principle is to prevent double recovery (ie the company and shareholder suing for the same loss) and to ensure that the company's creditors are not prejudiced (ie by a shareholder recovering for his own benefit losses which are merely reflective of losses suffered by the company).

The Trustee Defendants, relying on English authorities, argued that the rule against reflective loss applied equally to beneficiaries of a trust which held shares in a company as it did to an ordinary shareholder [citing *Ellis v Property Leeds (UK) Ltd* [2012] EWCA Civ 32], and that the doctrine was a matter of principle as to which 'there is no discretion involved' (per *Lord Millet in Johnson v Gore Wood (a Firm)* [2002] 2 AC1).

In response the Plaintiff relied on the Jersey case of *Freeman v Ansbacher Trustees (Jersey) Ltd* [2009] JRC 003, where, similarly to this case, the plaintiff beneficiaries sued the defendant trustee for losses suffered by an underlying company which held trust assets. In that case, then Deputy Bailiff Birt concluded that whilst the rule against reflective loss did form part of Jersey law it was arguable that it did not apply to situations involving a discretionary trust. Rather, the Deputy Bailiff suggested that the court could provide 'a simple and effective remedy … of enabling the court to order the defaulting trustee to reconstitute the trust fund by reimbursing the company for its losses, thereby removing both reasons for the application of the [rule against reflective loss]'.

The Trustee Defendants urged caution in following the approach in Freeman, arguing that it was a (first instance) judgment on an interlocutory application, that the Court had held only that it was arguable that the rule against reflective loss did not apply in that case, that it was inconsistent with well-established English authorities, that it would, if followed, leave the law 'in a mess' rather than improving it and that it had only been considered in the case of a company which was wholly owned by the trust, which was not the case here.

The Court's ruling on the reflective loss issue

Lieutenant Bailiff Marshall ultimately left open the question of whether the rule against reflective loss was part of Guernsey law, though she commented that she was 'far from entirely satisfied that it needs or ought to be'. Instead, she held that, even if it was part of Guernsey law, it was not necessarily applicable to this case because:

- The Plaintiff had only succeeded in one of his negligent breach of trust claims against the Trustee. Any claim by HIL would prima facie be brought against its directors, and the Trustee was not a director. The Court had heard no argument on the basis of the Trustee as shadow director of HIL or how far and to what extent this concept formed a part of Guernsey law. Whether, therefore, HIL would have had a claim against the Trustee in the situation in which the court found for the Plaintiff was not necessarily a foregone conclusion.
- In any event, the fact of HIL's dissolution in 2008 all but eliminated any risk of double recovery or prejudice to HIL's creditors and the two policy reasons for imposing the doctrine therefore did not arise.

Lieutenant Bailiff Marshall did however accept that the rule against reflective loss, as applied in English law, could extend to claims made by beneficiaries of trusts, although whether the rule does apply can be highly fact specific, because the issue of whether a claimed loss is totally reflective of a loss for which the company can claim is fact specific.

The Judge was also warned against the wholesale adoption of English law 'where developments may have become over-complicated or over-refined'. Rather, the Lieutenant Bailiff encouraged Guernsey as a practical, independent jurisdiction to 'find and formulate its own laws in ways which are consonant with underlying principles of Guernsey law, completing the detail in the way which best suits its small jurisdiction and the characteristics of its law and economy'.

Discussion

Ultimately the Jefcoate decision takes us no further in establishing whether the rule against reflective loss forms part of Guernsey law and whether, if it does, it applies to cases where the losses have been suffered by a company owned by a discretionary trust. Despite the Lieutenant Bailiff finding favour with Freeman, neither case has conclusively determined the issue and this developing area of law remains uncertain in the Channel Islands.

However, the 'simple and effective remedy' proposed by Deputy Bailiff Birt in Freeman would appear to be a practical, cost effective solution to what might otherwise be an unwelcome complication (at least so far as beneficiaries are concerned) in the Channel Islands' trust administration context. Certainly such an approach would appear to sit well with Lieutenant Bailiff Marshall's bid to encourage the finding of solutions which are fit for purpose.

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