

Mixed and multiple derivative claims to address reflective loss problems

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Abstract

Few modern trusts exist without the use of corporate and quasi-corporate holding vehicles. This article seeks to explore the potential for beneficiaries to bring mixed, multiple derivative claims to recover against wrongdoers whose actions have caused the loss of trust assets, when a superficially simple claim against trustees for mismanagement may be met with arguments about exclusion clauses and reflective loss. Recent case law suggests it to be feasible for a beneficiary to use multiple derivative suits.

Introduction

What happens when a beneficiary finds that the trustee holds no funds other than shares in the principal trust holding company, which have become worthless? What if the loss is occasioned in an underlying company? What difference does it make that the underlying company is not a wholly subsidiary? What rights does the beneficiary have to pursue wrongdoers? These questions reflect problems not infrequently encountered by beneficiaries in complex trust structures, complicated by the inevitable need to consider multiple jurisdictions.

In common law countries it is trite that a beneficiary cannot sue a third party for loss occasioned to

the trust funds. This is a question of title: the chose in action belongs to the trustee, at least whenever it arises out of a relationship concluded in the ordinary administration of the trust.¹

Often the beneficiary has no direct cause of action against anyone. Quite apart from the prevalence of anti-*Bartlett* clauses² seen in most trust instruments, there are now real conceptual difficulties in suing trustees who preside over corporate structures, as can be seen from the criticism of *Walker v Stones*.³

Similarly, a shareholder cannot bring proceedings to the extent that such claims belong to the company. Indeed the rule is more restrictive for corporate disputes in that a shareholder often cannot even rely on a direct cause of action of his own if the damages overlap with those which the company could also recover.⁴

Derivative claims in general

Derivative actions are exceptionally allowed to enable beneficiaries to proceed against third parties. Until recently such so-called ‘dog-leg’ claims were rare. It is now clear that a derivative claim can be brought whenever there are ‘special circumstances’ (see *Roberts v Gill & Co*⁵). An example of the flexibility of the principle can be seen from the recent High Court decision in *Bayley v SG Associates*, which incidentally concerned a BVI Trust with a BVI Trustee.

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1. See *HR v JAPT* [1997] Pens LR 99, *Royal Brunei Airlines v Tan* [1995] 2 AC 378 at 391 *Young v Murphy* [1996] 1 VR 279, 291, 317, *Bayley v SG Associates* [2014] EWHC 782 (Ch).

2. That is, the duty to supervise management as per *Bartlett v Barclays Bank* [1980] Ch 515.

3. [2001] QB 902 and see also criticism of *Re Lucking* [1968] 1 WLR 686 in *Gardner v Parker* [2005] BCC 4).

4. *Johnson v Gore Wood* [2002] 1 AC 1.

5. [2011] 1 AC 240.

Going back to the case of decimated trust assets, a derivative trust claim is really the only option. Although a beneficiary can also bring a claim for administration claim a court will not force him to bring a claim when the trust assets have been lost.⁶ Such impecuniosity on the part of the trustee might now constitute a 'special circumstance' to allow the beneficiary to bring a claim in the right of the trust.⁷

Double and multiple derivative corporate actions

Having a derivative trust claim only gets the beneficiary so far. If the trustee has used a corporate structure it will be rare even for the trustee to have a cause of action against anyone who has caused loss to the trust company.⁸ If the beneficiary is to make a recovery other than through the most circuitous route, a multiple derivative suit is necessary. Moreover, this must be capable of accommodating companies in different jurisdictions. A number of recent developments render it feasible that a beneficiary could recover against a wrongdoer in an appropriate case by means of multiple, multi-jurisdictional, mixed derivative suits.

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Following the decision of the Hong Kong Court of Final Appeal in *Waddington Ltd v Chan Chun Hoo Thomas*⁹ it is now clear that multiple derivative suits are possible in most common law jurisdictions.¹⁰ Indeed, as *Waddington* itself showed it is possible to

bring a single suit seeking derivative remedies through a chain of companies, particularly when there are intermediate holding companies, as will frequently be the case in trust structures.

The second point to note is that there is no reason why a multiple derivative cannot involve a mixture of jurisdictions. *Waddington* itself involved a derivative action in Hong Kong in respect of Bermudan entities. There is no reason in an appropriate case why the forum should refuse to allow a derivative action in respect of a foreign company.¹¹

Thirdly, as Richards J explained in *Abouraya*,¹² multiple derivative suits require the claimant to satisfy the essential ingredients of a derivative action at each stage. The circumstances in which shareholders can bring derivative claims are somewhat less flexible than 'the special circumstances' test for derivative trust claims. Thus in England a corporate derivative suit requires 'wrongdoer control' and at least self-serving negligence by the wrongdoer. An alternative remedy is normally a bar to such a claim.

Fourthly, the companies further down the corporate chain do not need to be wholly owned by the holding vehicle. In the Cayman Islands case that followed *Waddington* the Plaintiff was the 50 per cent holder of the limited company. In the English case of *Universal Project Management Services* the claimant was a 50 per cent limited partner in a limited liability partnership which itself owned the SPV with the ultimate claim.

Fifthly, although *Abouraya* also restates the principle that a derivative corporate claim can only be against insiders who benefit from the wrongdoing, the case law on derivative trust claims contemplates that the beneficiary can proceed against third party wrongdoers such as advisers such as in *Bayley v*

6. See *Bradstock Trustees v Nabarro Nathanson* [1995] 1 WLR 1405, *Re Nordea Trust Co (Isle of Man) Ltd* [2010] WTLR 1393.

7. cf *Lewin on Trusts* (18th edn) para 43-05 which relies on *Bradstock* for this proposition in the context of derivative claims but which text predates and therefore does not consider the impact of *Roberts v Gill* [2011] 1 AC 240.

8. In *Walker v Stones* [2001] QB 902.

9. [2008] HKCFA 63.

10. The UK, Hong Kong, the US, Australia, New Zealand, Singapore, and the Cayman Islands allow multiple derivatives; see *Renova Resources v Gilbertson* [2009] CILR 268 (Cayman Islands), *Universal Project Management Services Ltd v Fort Gilkicker Ltd* [2013] Ch 551 adopted by Richards J in *Abouraya v Triangle Metals and Minerals (Hong Kong)* [2014] EWHC 277 but cf *BVI Microsoft v Vadem*.

11. See *Konamaneni v Rolls Royce Power (India)* [2002] 1 WLR 1269.

12. See fn 10.

SG Associates. Whether this difference will survive remains to be seen but at present it limits the type of mixed derivative claim which can be brought.

Finally, it is now clear that the Courts will entertain mixed multiple derivative suits which might, for example, start with a derivative trust claim, followed by a derivative partnership claim, terminating with a derivative corporate claim. Since a derivative claim can be brought in respect of a limited liability partnership,¹³ it would not be surprising to see a derivative trust claim superimposed when special circumstances exist.

In a case such as *Walker v Stones* if the Plaintiff could not have proceeded against the Trustee, the

Plaintiff beneficiaries, finding themselves in that position today, could have brought a derivative trust claim combined with a derivative corporate claim against the trustee who also happened to be a director of the trust company.

Conclusion

Dog-leg claims were at one time controversial. It ought now to be much less daunting for a beneficiary to bring derivative proceedings against wrongdoers in complex trust structures that holds assets through special purpose companies, or corporate or limited partnerships.

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13. In the UK *Re Henderson PFI Secondary Fund LLP* [2013] 2 WLR 129 accepted a derivative claim could be brought on behalf of an LLP. In *Renova Resources* the derivative claim was in respect of the corporate general partner of a limited liability partnership. That LLP had itself been appointed as the general partner of a second LLP. The losses of the second LLP being reflective loss for the first LLP. *Universal Project Management* also involved a mixed derivative claim.