Private trust companies: a future for derivative claims?

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Abstract

This article looks at how the use of a private trust company may affect the legal remedies available to a beneficiary who wishes to complain about the conduct of the trustee or some aspect of the administration of the trust. In particular, it considers whether action can be taken directly against a director of a private trust company—the so-called ‘dog leg’ claim—and the impact of the 2008 decision in Gregson v HAE Trustees.

Introduction

In recent years, private trust companies have become very popular. Almost all offshore financial centres have amended their regulatory and licensing systems to accommodate trust companies which do not provide services on a commercial basis or to the general public but which are intended to act only in relation to the affairs of one family or corporate group.

A typical structure will involve a private trust company (PTC), the shares of which are owned by the settlor and/or his family or, if off-shore, by a trust or other entity such a foundation whose purpose is to hold the shares of the PTC. The PTC is formed for the purpose of acting as trustee of one or more specific trusts. It will not undertake any other activities. The directors of the PTC will be usually be or include members of the settlor’s family who may also be beneficiaries of the trust and business associates or advisers to the family. The power to appoint and remove directors is likely to be under the control of the settlor or a trusted associate through the trust documentation establishing the holding entity or related documentation (eg office of director rules). Where the PTC holds shares in family trading companies, there is likely to be an overlap between the directors of the PTC and the directors of the trading companies.

Potential problems in a PTC structure

However, the features of a PTC which may appear desirable to an intending settlor namely having a trustee who understands and responds to his wishes, the ability to keep control by having family members or long-standing colleagues and advisers as the directors of the PTC, avoiding the need for independent trustees who will be concerned about speculative business venture and diversification of trust assets carry with them the potential for real problems. The trusted advisors may lack the desire or ability to resist the settlor’s wish to treat the trust assets as his own or to use them in ill-advised transactions. Family disagreements may hamper or even paralyse decision making by the PTC.

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The purpose of this article is to consider how the use of a PTC in a trust structure may impact on what a disgruntled beneficiary can do to enforce his rights. In particular, I will look again at the possibility of bringing a claim against a director of a PTC: the so-called ‘dog-leg claim’.

The PTC sits at the intersection of two sets of legal rules which provide the framework in which any claim by the beneficiaries has to be taken: trust law and company law.

**Trust law**

A beneficiary’s basic remedy is to sue his trustee for breach of trust. Alternatively, the beneficiary may bring proceedings to remove or replace the trustee. The fact that the trustee is a company does not affect those rights but, in practice, a PTC will probably not be worth suing. It is unlikely to have insurance or anything else to meet the claim except its minimal paid-up share capital.

Where loss has been caused to the trust assets by the actions of a third party, the cause of action against the third party will belong to the trustee. That is obvious where trust assets have misappropriated or depleted by the third party. Where the claim is against a third party such as an investment manager or accountant to the trust, the analysis is that the benefit of the contract between the trustee and the third party is an asset of the trust.

As Lord Nicholls said when considering the question of liability of third parties for negligence to beneficiaries of a commercial trust in *Royal Brunei Airlines Sdn Bhd v Philip Tan Kok Ming* [1995] 2 AC 378 at 391:

> The majority of persons falling into this category will the hosts of people who act for trustees in various ways: as advisers, consultants bankers and agents of many kinds. This category also includes officers and employees of companies in respect of the application of company funds. All these people will be accountable to the trustees for their conduct. For the most part they will owe the trustees a duty to exercise reasonable skill and care. When that is so, the rights flowing from that duty form part of the trust property.

The problem that the beneficiary may face is that if the board of the PTC is affected by family divisions or there are conflicts of interest (e.g., the third party advisor is a long-standing friend of the settlor), it will be unable or unwilling to take proceedings against the third party.

Where that happens, the beneficiary cannot sue the third party directly because (unless there are exceptional circumstances) the third party will not owe a duty of care to the beneficiary. The beneficiary has two possible courses of action. He could bring an administration claim against the trustee to compel it to sue the third party or he may be able to bring a claim in the name of and on behalf of the trustee directly against the third party. The ability of a beneficiary to bring such a derivative claim is well recognized and was recently considered and confirmed by the Supreme Court in *Roberts v Gill* [2010] 2 WLR 1227. It is clear that a derivative claim is only permitted where there are ‘special circumstances’. Because the Supreme Court decided the case on a procedural point (the inability of the claimant to amend to join the trustee as a party because of a limitation defence), it did not consider what constitutes ‘special circumstances’. However, Lord Collins endorsed the comments of Lord Templeman in *Hayim v Citibank NA* [1987] AC 730 at 747–8:

> …when a trustee commits a breach of trust or is involved in a conflict of interest and duty or in other exceptional circumstances a beneficiary may be

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1. For example, if the third party has assumed responsibility to the third party within the principles developed from *Hedley Byrne v Heller* although even then the claim will be limited to loss suffered by the beneficiary personally rather than loss to the trust fund.
2. See the continuation of the passage in Royal Brunei Airlines at 391.
3. Although the case concerned the administration of an estate rather than a life-time trust.
allowed to sue a third party in the place of the trustee. But a beneficiary allowed to take proceedings cannot be in a better position than a trustee carrying out his duties in a proper manner.

These authorities demonstrate that a beneficiary has no cause of action against a third party save in special circumstances which embrace a failure excusable or inexcusable by the trustees in the performance of the duty owed by the trustee to the beneficiary to protect the trust estate or to protect the interests of the beneficiary in the trust estate.

If there is a serious question about the merits of suing the third party or, as may well happen in a situation of family conflict, disagreement between the beneficiaries as whether the claim against the third party should be pursued (because of costs, risks or damaging publicity), an administration action will be needed to decide if the derivative claim should be brought.

Company law

The involvement of a corporate trustee superimposes company law considerations on the trust framework. Being a company, the trustee is a separate legal entity distinct from its shareholders. Its assets (including causes of action against third parties who have dealt with the company) belong to the company and not its shareholders.

The trust company acts by its directors who owe their duties to the company alone, not to the shareholders or to the beneficiaries of the trust.

A director may become personally liable under a duty of care or a fiduciary duty to a third party but only in circumstances where there has been an assumption of personal responsibility by the director which has created a special relationship between them justifying a direct duty. In Williams v Natural Life Health Foods [1998] 1 WLR 830, the House of Lords made it clear that the fact that the sole director was responsible for the running of the company and in doing so made representations drawing on his personal knowledge and experience was not sufficient to ‘cross the line’ into assuming personal responsibility.

As a matter of English law, the fundamental principle that a company—even a one-man company—has a separate existence from its directors and shareholders is not easily overcome. The ability of the courts to ‘pierce the corporate veil’ is restricted to cases where the corporate structure has been used to perpetrate a legal wrong or evade existing obligations. In the absence of evidence that the company structure was adopted for some improper motive, the court will not ignore it so as to hold a director responsible for the actions of the company.

It follows that the trust company is the only proper claimant in any proceedings to recover its property or to claim compensation for loss caused to the company by negligent or other breaches of duty by the directors.

Company law recognizes that there may be situations in which the company will not take proceedings against its directors (usually because the wrongdoing directors have control at board and shareholder level) and allows a shareholder to bring proceedings in the name of the company against the directors.

Of course, a director who has improperly assisted in a breach of trust or fiduciary duty or dishonestly dealt with trust property will be open to a direct claim by a beneficiary for compensation for loss or to disgorge any profits made by him. The claim requires proof that the director acted dishonestly by the ordinary standards of reasonable and honest people (the objective element) and was himself aware that by those

4. Companies Act 2006 section 170(1) reflecting the long established common law position.
8. In England, the derivative claim is now governed entirely by statute: the Companies Act 2006 ss 280–3.
standards he was acting dishonestly (the subjective element). 9

**Consequences**

None of these legal points may matter very much to a beneficiary whose corporate trustee is an independent, solvent entity. The company will be responsible for the directors’ breaches. It can be sued by the beneficiary and can bring its own proceedings against the directors. If there are breaches of duty by the directors of the family companies owned by the trustee, the trustee can use its control to procure the company to take action against the directors. If necessary, the beneficiary could apply to the court to compel the trustee to act.

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**Real risk that loss to the trust may go unremedied**

However where a PTC is the trustee, it is unlikely to be worth suing. The wrong-doing directors are not going to authorize proceedings against themselves. The dissatisfied beneficiary is not a shareholder. The close association between the settlor, the entity which owns the PTC and the directors (which is a common feature of PTC structures) means that there may be no independent shareholders willing to act. So there may be a real risk that loss to the trust will go unremedied.

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**The dog-leg claim**

The legal basis of the claim draws on elements of the legal framework set out above as follows:

- A corporate trustee owes a duty to its beneficiaries to avoid causing loss to the trust funds.
- A corporate trustee can only act by its directors.
- A director of a corporate trustee owes duties to the company including a duty to exercise reasonable skill care and diligence and to act in the best interests of the company.
- In performing their duties to the company so far they affect the trust the directors are performing the company’s duty to the trust.
- Where a director acts in relation to the trust, the benefit of what he does and his duties and obligations in so acting form part of the trust assets just as the benefit of a contract between the trustee and a third party agent acting for the trust becomes trust property.
- A beneficiary can in appropriate cases bring a derivative action against a third party to enforce a claim which is trust property.
- A beneficiary should therefore be able to bring a derivative claim against a director if the corporate trustee is unable or unwilling to sue.

**The Gregson case: facts**

The case concerned a discretionary family settlement established by Henry Cohen who, with his brothers, had created the Courts furniture business. The trustee, HAE Trustees Ltd, was a company which had been set
up to act as trustee or administrator. Its original directors were Henry Cohen and his two brothers, Alfred and Edwin, after whom the company was named. The trust assets consisted almost entirely of shares in Courts plc. In 2004, Courts went into administration. It was hugely insolvent. Its shares, and therefore the assets of the settlement, were worthless. The Claimant, Mrs Gregson, was a beneficiary of the settlement, who alleged that the trustee was in breach of trust in failing to consider the need to diversify the settlement’s investments. She claimed if the trustee had done so, it would have diversified out of Court shares and so avoided the loss which had occurred. As the trustee company had no assets, she brought a claim against the current directors. The directors applied to strike that claim out on the ground that the dog-leg claim had no prospect of success and also that under the terms of the settlement there was no duty to consider diversification. The judge, Mr Robert Miles QC sitting as a deputy, rejected the argument that the duty to review diversification was excluded but upheld the challenge to the claim against the directors.

**The judge’s reasoning**

In rejecting the claim, the judge, made these points:

- The judge was very concerned about the scope of a dog-leg claim, pointing out it could not apply to all duties owed by directors, many of which would either have nothing to do with the administration of the trust (eg preparing accounts, dealing with take-over bids) or (in the case where the trustee was trustee of various trusts) have nothing to do with the trust in question.
- The judge did not accept the argument that the claim could apply to the limited duty to take reasonable care to avoid loss to the particular trust fund. He took the view that the directors’ duties were as set out in the Companies Act 2006 (ie to exercise reasonable skill and care in performing his functions for the company) and could not defined as a duty to avoid loss to the trust funds.
- The judge said that the dog-claim would cut across established principles of law. If the corporate trustee was insolvent, its property (including claims against directors and others) should be available for its creditors generally; claims should not be ‘carved out’ to benefit particular trusts. If the claims against directors were trust property, the shareholders could not ratify or sanction the breach (as they could do on normal company law principles).
- Finally, the judge was clearly influenced by the lack of support for the dog-leg claim in case law and legal writing. Attempts to advance the claim in Australia and Jersey have been unsuccessful: see *Young v Murphy* [1996] VR 279 and *Alhamrani v Alhamrani* [2007] JLR 44.

**The dog-leg claim in the future**

The prospects for bringing a dog-leg claim seem pretty bleak. However it is worth noting that none of the cases where the claim has been rejected involved a PTC structure of the type mentioned earlier. The corporate trustee in *Young v Murphy*, was trustee of various investment trusts. It seems to have been a professional trustee with auditors and indemnity insurance. In *Alhamrani*, the trust companies...
were large companies with many client trusts. Although the trustee in *Gregson* was a trust company established by a family, it is clear from the facts of the case that it had not been established for the purpose of acting as trustee of the settlement in dispute, it was the trustee of various other family trusts established at different times and, importantly, it had outside creditors.

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In those cases, the judge’s view that company law principles are paramount and exclude a claim by a beneficiary against a director is understandable. But where there is a much closer identity of interest between the settlor, the trust company, its directors and the trust with no outside interests, a strict company law analysis can seem artificial. For example, if the PTC structure is established with the intention that the appointment and removal of directors is controlled by the settlor, the directors are family advisers or associates and the holding vehicle of the PTC is a purpose trust, the distinction drawn in *Gregson* between an outsider adviser and a director on the basis that one is engaged by the trustee but the other is appointed by the organs of the company is harder to justify.

Similarly, the distinction between the director’s duties (owed to the company) and the performance of those duties (dealing with the trust) becomes more difficult to draw. In passing, it is worth noting section 172 of the Companies Act 2006. Subsection (1) states that a director must act in the way he considers would be most likely to promote the success of the company for the benefit of its members. Subsection (3) says that where or to the extent that the purposes of the company consist of or include purposes other than the benefit of its members, subsection (1) has effect as if it referred to achieving those purposes.

The suggestion that the nature of the corporate trustee and the scope of its activities are relevant to whether a dog-leg claim can be brought has some, albeit limited, judicial support. In *HR v JAPT* [1997] OPLR 123, the corporate trustee only had conduct of one trust, it had no other business or assets and no general body of creditors. Lindsay J refused to strike out a dog-leg claim, saying that in those circumstances it was not unarguable that the directors’ duties were trust property since the directors’ involvement in the trust was deeper and more extensive than that of a third party adviser who, following Lord Nicholls’ dicta in *Royal Brunei Airways* (mentioned above) would be open to a claim by the trustee. Significantly, Lindsay J said that the question of whether a particular cause of action against a third party was trust property had to be decided on the particular facts of a particular case.

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The Royal Court of Justice in *Alhamrani* also acknowledged that the courts might recognize a dog-leg claim in certain circumstances. Commissioner Page said:10

This is what the dog-leg claim is all about: trying to pigeon-hole the trustee’s rights against its directors as chose in action belonging to the trust...and one in respect of which a beneficiary may therefore sue if the trustee is unable or unwilling to do so. Given the fact that...whether or not something is a trust asset is very much a matter of fact rather than high principle, this clearly leaves the court with considerable scope for either granting or withholding a remedy according to its view of where the justice of the matter lies so long as it can be accomplished without doing too much violence to accepted notions of property and

10. At pages 60–1.
ordinary language. That the court should take the view that a dog-leg type claim... ought not to be struck out in a case as strong as HR v JAPT where the beneficiaries might otherwise have been without an effective remedy is therefore not altogether surprising.

This passage highlights what I think is a very important consideration to which insufficient attention was perhaps paid in Gregson. Derivative claims in both the trust and company law context are procedural devices designed to avoid injustice that would occur if a wrong is suffered for which no redress can be claimed. That is shown clearly by the comments of Lord Justice Browne-Wilkinson (as he then was) in Nurcombe v Nurcombe11 [1985] 1 WLR 370 at 378:

Since the wrong complained of is a wrong to the company, not the shareholder, in the ordinary way the only competent plaintiff in an action to redress the wrong would be the company itself. But where such a technicality would lead to manifest injustice, the courts of equity permitted a person interested to bring an action to enforce the company’s claim. The case is analogous to that in which equity permits a beneficiary under a trust to sue as plaintiff to enforce a legal right vested in trustees (which right the trustees will not themselves enforce). (emphasis added)

Derivative claims in both the trust and company law context are procedural devices designed to avoid injustice that would occur if a wrong if suffered for which no redress can be claimed

**Derivative claim as means of avoiding injustice**

Looking at the problem from this perspective may provide some answers to the points raised in Gregson. The judge was very concerned that the rule in Bath v Standard Land was being circumvented. But the fact that a director does not owe a duty directly to the company’s shareholders does not prevent a minority shareholder bringing a derivative claim in appropriate circumstances.

If it is not possible or practicable for the beneficiary to procure the appointment of a liquidator to pursue the claims against the directors, why should the courts of equity not impose a trust to prevent the injustice of allowing the claim to fail. Or, more radically, the beneficiary could be allowed to bring the claim, on behalf of the company, on the basis that he or she is a person with a legitimate interest in doing so.

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That approach has been adopted in the context of a company derivative claim in a case in Hong Kong called Waddington Ltd v Chan Chun Hoo Thomas [FACV No 15 of 2007]. The Claimant, Waddington, was a minority shareholder in a Bermudan company called Playmates Holdings Limited (‘Playmates’). Playmates had various wholly owned subsidiaries and sub-subsidiaries. Mr Chan was a director of these companies and had caused them to enter into various transactions that were detrimental to them pursuant to an arrangement under which Mr Chan benefited personally. Waddington applied to bring a derivative claim on behalf of the subsidiaries against Mr Chan who resisted the application on grounds analogous to the reasoning in Gregson.

The principle plank of his argument was that the claim contravened fundamental principles of company law because:

- as director he only owed his duties to the companies and not the shareholders of the parent company;
- any cause of action against him was vested in the companies, not in Waddington;

11. A minority shareholder claim in the context of a husband and wife company.
Waddington, as shareholder in the parent company, had no title to or interest in the shares of the subsidiaries and no rights in relation to the conduct of the subsidiaries’ affairs; and
- he also made the point that this was not a case where a wrong would be without redress because Waddington could bring unfair prejudice proceedings.

The Court of Final Appeal rejected these arguments and held that Waddington could sue on behalf of the subsidiaries. Lord Millett, who gave the main judgment, said the decisive issue was whether Waddington had a legitimate interest in the relief claimed sufficient to justify him in bringing proceedings to obtain it. He held that Waddington clearly did: if the case was proved, the subsidiaries had suffered depletion of their assets which had caused indirect loss to Waddington. Waddington therefore had a legitimate and sufficient interest to taking steps to redress the situation through a derivative action.

Lord Millett emphasized the public policy behind the decision saying:

If wrongdoers must not be allowed to defraud a parent company with impunity, they must not be allowed to defraud its subsidiary with impunity.

In an one-trust company with no outside interests, why does the beneficiary not have a legitimate and sufficient interest in bringing proceedings to redress the wrong done indirectly to the trust? If not there may be situations where no redress can be obtained.

The interposition of a company as trustee would have the result that wrong-doing directors are immune. Such a result flies in the face of the long-standing approach of equity that fraud should not be protected by legal niceties.

**Conclusion**

There is no doubt that trustees of professional trust companies can sleep easier at night as a result of the Gregson decision. However, trustees of closely controlled family PTCs who breach their duties may find that there is some equitable life left in the dog-leg claim.

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