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CASE COMMENTARY

"DOG-LEG" CLAIMS KICKED INTO TOUCH: BENEFICIARIES EXPOSED?

Gregson v HAE Trustees Ltd & Ors [2008] EWHC 1006 (Ch)

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The recent decision of the High Court in *Gregson v HAE Trustees Ltd & Ors*[1] ("*Gregson*") represents a low point for the potential sustainability of what has become known as a dog-leg claim,[2] a hitherto rarely utilised cause of action. The essence of the dog-leg claim is this. When a trust suffers loss as a result of a breach by a corporate trustee, and that corporate trustee cannot or will not pursue its own directors to recover the losses to the settlement, a dog-leg claim recognises the right of action available to the corporate trustee as being the property of the trust. In the event that the corporate trustee fails to pursue its directors the beneficiaries may do so because the claim belongs to the trust.

Given that the dog-leg claim has formed the basis of the claim in only a handful of cases there is very limited authority to which reference can be made, some of which emanates from other jurisdictions such as Australia and Jersey. This commentary will examine more closely the nature of the dog-leg claim, the circumstances in which such a claim might potentially arise and the impact of the limited judicial decisions in this context. It then goes on to consider whether the court's lack of enthusiasm for such a cause of action has secured protection for the directors of corporate trustees, enabling them to hide behind the corporate veil, in a context where the justification for such protection may be open to question.

GREGSON – THE FACTS

Gregson concerned a trust of shares in a family company, the well known furniture chain, Courts plc, a business which was acquired and built up by members of the Cohen family. HAE Trustees Ltd ("HAE") is a corporate

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1 [2008] EWHC 1006 (Ch).

2 Ibid, at para [9].

trustee which was incorporated in 1960[3] for the purpose of acting as trustee[4] to a number of family settlements, including the one the subject of this claim. The whole of the property of the trust with which this claim was concerned consisted of Courts shares, transferred by the settlor, Henry Cohen, to HAE shortly after the settlement was created. HAE retained the shares from the time they were settled. The claimant is a beneficiary under the discretionary settlement by virtue of an appointment made in 1991, her entitlement being just over 25% of its value. She is also a member of the Cohen family. On 30 November 2004 Courts went into administration, the company having become insolvent with a deficiency of some £70 million. The property of the trust became, to all intents and purposes, worthless.

THE CLAIM AND THE DEFENDANTS' APPLICATION

The claim was brought against HAE, the first defendant, and its directors, the second to fifth defendants.[5] HAE had no assets of its own so whilst it was a party to the action in the High Court it played no part in the proceedings. The primary targets of the action were the directors of HAE.[6] The claim was brought on the basis that the directors were liable to HAE for breach of their duty of care as directors and the claims which HAE were entitled to bring against its directors arising out of these breaches were the property of the settlement. It was argued that as HAE would not and could not be expected to sue its directors for their breaches the claims could be made by the claimant as a beneficiary of the settlement. The basis upon which the claimant alleged that the directors had breached their duty of care was their failure to review the investments of the settlement and consider diversification pursuant to their statutory obligation under section 4(2) of the Trustee Act 2000 ("the 2000 Act").

Following the issue of the claim the second, third and fifth defendants made an application for summary judgment or for the claim to be struck out. The judge had, therefore, to determine whether the claimant's claim, firstly, that the directors had failed to comply with their statutory obligation under section 4(2) of the 2000 Act, and, secondly, that such a claim was the property of the settlement, had any real prospect of success.

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[3] It was incorporated as a company limited by guarantee and had no share capital. The affairs of the company, as prescribed by its Memorandum of Association, were to be conducted without the acquisition of any profit or gain.

[4] It also acted as executor or administrator of estates.

[5] The fourth defendant was the personal representative of a deceased director.

[6] The claim against the directors has been described as a "shameless piece of defendant shopping", Richard Nolan "Shopping for Defendants: Worthless Trust Companies and their Directors" [2008] 67(3) CLJ 472 at 472.

This commentary is largely concerned with the second of these questions, namely whether any claim against the directors can be properly described as the property of the settlement. The court did find that the statutory duties applied to the Courts shares and, thus, that the claim could not have been be struck out on that ground. However, unless the dog-leg claim was determined to be arguable, thus enabling the claim to go to trial, this was of little comfort to the claimant.

THE DOG-LEG CLAIM

The potential for a dog-leg claim arises, as illustrated by the facts of *Gregson*, in the context of corporate trusteeship. A company formed for the purposes of acting as a corporate trustee must have directors, as indeed all companies must.[7] A corporate trustee is, after all, a company and is subject to the same statutory regime applicable to any company. The directors of any company owe a number of duties to the company including a duty of care.[8] However, whilst the directors of a company owe duties to the company itself, can it be said that they owe a duty to anyone else, most particularly the beneficiaries of the settlement(s) on whose behalf the company is acting as a corporate trustee? According to the Court of Appeal in *Bath* v *Standard Land Co Ltd*[9] the directors of a corporate trustee owe no fiduciary duty to a beneficiary of the trust:

> "It is of course true that a company acts through its directors. But that does not involve the proposition that if a breach of trust is committed by a company, acting through its board, a beneficiary can maintain any action against the directors in respect of such breach of trust".[10]

It was argued in *Gregson* not that the directors owed a duty directly to the beneficiaries of the settlements but that the duties owed by the directors to the company itself were the property of the settlements for which the company acted as trustee. This is the distinction between a claim against the directors based upon a breach of duty owed directly to the beneficiaries, which is clearly unsustainable in light of the decision in *Bath* v *Standard Land Co Ltd*, and a claim founded upon the settlement's ownership of the claim which the corporate trustee is entitled to bring against its own directors who have breached their duty to the company, but which may, in the alternative, be

[7] Companies Act 2006, s 154(1).
[8] Companies Act 2006, s 174.
[9] [1911] 1 Ch 618 (CA).
[10] Ibid, per Cozens-Hardy MR at 625-626.

brought by a beneficiary of the settlement. Thus, the dog-leg claim was said to facilitate the indirect enforcement of the duty owed to the company.[11]

DISCUSSION OF THE COURTS' APPROACH TO THE DOG-LEG CLAIM

The court in *Gregson* conducted a thorough review of the authorities, including those cases in which a dog-leg claim had been expressly pleaded and that authority which, despite such a claim having not been pleaded, was said to offer support for the proposition that a right of action against the directors of a corporate trustee was the property of the settlement.

(a) Authorities where a dog-leg claim was expressly pleaded

A relatively recent Australian decision of the Victorian Court of Appeal, *Young* v *Murphy*,[12] was concerned with a dog-leg claim. A trustee company, BTPC, had been replaced as trustee of a number of investment trusts. BTPC went into liquidation. The new trustees sought to sue not only BTPC but, inter alia, its directors. During a close examination of the dog-leg claim which was expressly pleaded in that case, Phillips J, rejecting the dog-leg claim, stated:

> "The business activity of BPTC as trustee of these trusts was itself the framework within which the directors came to perform the duties which they owed to the company by virtue of their office as director; but the duties which were owed are none the less general duties and are not owed to the company in some specific role or character, or at least they are not owed to the company in some specific role or character when the duties are alleged to have arisen only in virtue of the office which is held…
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> It follows that if there be a breach by the directors of the duties which they did owe to the company, being the former trustee BPTC, and if the company was thereby damnified, BPTC might have a right of action against the directors for breach of their duties. In so far as those duties were founded in the common law, there might be a right of damages and, if they be fiduciary duties, there might be a right to equitable compensation. Either way, it is the company in which the right of action is vested. The plaintiffs [the new trustees] now claim to have succeeded to that right of action by virtue of their appointment as

[11] [2008] EWHC 1006 (Ch), at para [45].
[12] [1996] 1 VR 279.

> new trustees, but by what right can that be so? The right of action held by the former trustee cannot be shown to have been trust property; there is no basis upon which to conclude it was…the directors cannot be said on the pleading in this case to have owed their duties to the company only in relation to some particular trust or trusts; nor were those duties imposed upon them in relation to some particular item or items of trust property as such. Rather the existence of both the trusts and the trust property was but the context in which the duties fell to be discharged by those who owed duties to the company generally as its officers. There is no basis then, for supposing that the right of action was trust property in the hands of BPTC or for supposing that the right of action passed to the new trustees, upon their appointment as such.
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> On that basis, it follows that any right of action against the former directors for breaches of duties said to have been owed to BPTC remains with that company. The company is now in liquidation and so it is a matter for the liquidator whether to pursue the directors for those alleged breaches of duty. Whether he could be persuaded to bring such proceedings (perhaps, if indemnified as to costs) is a matter which does not fall for decision. But the benefit of such proceedings will belong to the creditors generally, in the liquidation, consistently with my view that the directors owe their duty to BPTC and not to BPTC in a particular capacity."[13]

The decision in *Young* v *Murphy*,[14] whilst not binding, is entirely consistent with the English company law principle that a company director owes a duty to the company,[15] no-one else.[16] In light of this recognition is there any authority which does offer support for the concept of the dog-leg claim? It is sparse but does, however, exist.[17]

Limited support for the possibility of such a claim can be derived from the decision of Lindsay J in *HR* v *JAPT*.[18] This was an application by the third of six defendants for the claimant's claim to be struck out on the ground that the claim disclosed no reasonable cause of action against him. The claimants in the action were the present trustees and a beneficiary of a company pension

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[13] Ibid, at 302.
[14] [1996] 1 VR 279.
[15] This is repeated in Companies Act 2006, s 170(1), which provides that the statutory duties owed by a director are owed to the company.
[16] Eg shareholders or employees.
[17] The extent to which such a claim is limited is acknowledged in *Lewin on Trusts* (London: Sweet & Maxwell, 18th edn, 2007) paras 40-51.
[18] [1997] OPLR 123.

scheme. The third defendant was a director of the former corporate trustee. The claim was concerned with losses to the scheme which ran to several million pounds as a result, it was alleged, of various acts of mismanagement by the former corporate trustee. One of the grounds of claim was that the third defendant owed a duty to the former trustee,[19] that he breached that duty, that the former corporate trustee thereby suffered loss (in that it was obliged to make good a deficit to the scheme) and that the chose in action against the third defendant thus acquired by the former corporate trustee was trust property which, by succession, passed to and could be sued upon by the present trustees. After reviewing the authorities, including *Young* v *Murphy*, Lindsay J concluded that he was not prepared to describe the claimant's dog-leg claim as unarguable.

This stance is clearly contrary to that which was adopted in *Young* v *Murphy* in which any suggestion that a right of action against the directors of a corporate trustee could belong to anyone other than that particular corporate trustee was roundly rejected. However, the apparently less strict approach adopted in *HR* v *JAPT*[20] was, according to Lindsay J, justified on the particular facts of the case. In contrast with the factual circumstances in *Young* v *Murphy* this case concerned the liability of, inter alia, a director of a one-trust corporate trustee thereby, in Lindsay J's view, making the case for the claimant stronger. This is because a one-trust corporate trustee has only one trust to administer, hence it has no responsibility for anything but the administration of that one trust. In this context there is arguably a much stronger connection between the corporate trustee, its directors and the trust.

The decision in *HR* v *JAPT* was, admittedly, simply a refusal to strike out the claimant's claim; not a decision on the merits. However, the fact that the dog-leg claim was considered arguable, in the context in which it arose in *HR* v *JAPT*, is sufficient to indicate that there may be circumstances in which such a claim might be sustainable.

The recent case of *Alhamrani* v *Alhamrani*,[21] a decision of the Royal Court of Jersey, is also instructive. The dog-leg point arose in the context of an application for leave to amend pleadings in order to introduce the claim. In refusing the application Commissioner Page said:[22]

> "33. Mr Taylor conceded, as he had to, that if the pleaded dog leg claim is valid in the present case it will apply equally to any director of any corporate trustee company whose negligence results in loss to the trust fund and consequential liability on the part of the company,

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[19] It was claimed that the duty was owed both in tort and as a fiduciary duty.
[20] [1997] OPLR 123.
[21] [2007] JRC 026.
[22] At paras [33] and [34] of his judgment.

> irrespective of the state of that company's business, the possibility of such liability being satisfied from its own resources or those of its insurers, or any other circumstance.
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> 34. But the notion that the right to performance of the standard statutory duties owed by a director to his company (as it is put in the first party's pleading) or the duty of a director not to cause loss to his company or the company's cause of action arising from breach of any such duty (as it is put elsewhere) is, in the ordinary way to be regarded in law as the "asset" or "property" *of the trust* of which the company is trustee, seems to have a degree of artificiality and awkwardness about it that is not easy to accommodate – at least in circumstances which are not such that the imperatives of justice leave no other alternative…."[23]

Following consideration of this decision in *Gregson* it was noted that Jersey previously had legislation[24] which made the directors of a corporate trustee guarantors of the damages awarded by the Court against the corporate trustee for breach of trust, thereby making provision for the payment of damages in the event that the corporate trustee was unable to meet such claims. However, that provision was repealed in 2006 and has not been replaced, thereby providing far more extensive protection for the directors of corporate trustees.

The force of these authorities is self evident, there being only negligible support for the dog-leg claim from *HR* v *JAPT*. However, the court in *Gregson* was taken to further authority which counsel for the claimant argued was helpful.

(b) Potentially relevant authority where a dog-leg claim was not expressly pleaded

In *Gregson* as well as having been referred to cases in which a dog-leg claim had been expressly pleaded the court was also directed to the dictum of Lord Nicholls in *Royal Brunei Airlines Sdn Bhd* v *Philip Tan Kok Ming*[25] ("*Royal Brunei*") where he said:

> "It is against this background that the question of negligence is to be addressed. This question, it should be remembered, is directed at whether an honest third party who receives no trust property should be

[23] Reproduced in Gregson at para [40].
[24] Trusts (Jersey) Law 1984, Art 56.
[25] [1995] 2 AC 378.

liable if he procures or assists in a breach of trust of which he would have become aware had he exercised due diligence. Should he be liable to the beneficiaries for the loss they suffer from the breach of trust?

The majority of persons falling into this category will be 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 are 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. As such they can be enforced by the beneficiaries in a suitable case if the trustees are unable or unwilling to do so. That being so, it is difficult to identify a compelling reason why, in addition to the duty of skill and care vis-à-vis the trustees which the third parties have accepted, or which the law has imposed upon them, third parties should also owe a duty of care to the beneficiaries. They have undertaken work for the trustees. They must carry out that work properly. If they fail to do so they will be liable to make good the loss suffered by the trustees in consequence, This will include, where appropriate, the loss suffered by the trustees, being exposed to claims for breach of trust."[26]

Counsel for the claimant in *Gregson* relied upon this passage, in particular the reference to the category of persons which was described as including officers and employees of the company, as authority that claims against the officers and employees of a trust company, which would include directors, flowing from a breach of their duty were trust property, enforceable, if the trustees were unable or unwilling to act, at the suit of the beneficiaries.[27] It was argued that this passage supported the claimant's contention that any action which HAE may be entitled to bring against its directors for their alleged breaches of duty was the property of the trust, thereby enabling the beneficiaries to bring that action in the event that the trustee failed to do so.

Robert Miles QC, sitting as a Deputy Judge of the High Court, rejected this proposition. He did so on the basis that Lord Nicholls' dictum was not restricted to the context of corporate trustees but was concerned with companies generally. He also accepted the validity of the submission of Counsel for the second and third defendants that Lord Nicholls was speaking of the application of company funds, in other words the corporate trustee's

[26] Ibid, at 391.
[27] *Gregson*, at para [32].

own funds, rather than the application of the funds of any settlement being managed by the corporate trustee. However, he did regard the sentence which referred to the inclusion of officers and employees of companies as coming within the category of persons who would be accountable to the trustees, any corresponding claim being the property of the trust, as being not easy to follow, it having the appearance of a parenthetical afterthought. He then speculated that it was more likely Lord Nicholls was referring to a case where company funds are entrusted by the directors to other officers or employees who then misapply it, the company thereby being in a position of beneficiary and entitled to bring proceedings to recover their losses.

With respect, it is not at all clear that this is what Lord Nicholls had in mind when making the observations which he did, and to draw this conclusion requires something more to be read into the passage than is evident on a plain reading of it. However, Counsel for the claimant did, himself, describe the reference to officers and employees in the context used as mysterious, which, indeed, it is.

On the application of *Royal Brunei* to the facts in *Gregson* it was regarded as most significant that the decision concerned a director's liability as an accessory to the trustee's breach which could only be established if the director was shown to be dishonest. In *Gregson* it was noted that if Lord Nicholls had thought that the duties of the defendant, as a director of the trustee, were held on trust for the claimant there would, in *Royal Brunei*, have been no need to establish dishonesty in order to establish accessory liability. Ergo, in *Gregson*, in order for the directors to be directly liable to the beneficiaries of the trust, on the application of this line of reasoning it would be necessary to establish that the directors had been dishonest; there was no such allegation.

THE DECISION IN GREGSON

In light of the foregoing, rather unsurprisingly the High Court rejected the possibility of the claimant having any real prospect of success in her dog-leg claim against the directors of HAE. Therefore the claims against the defendant directors were struck out. In view of this latest blow to the sustainability of a dog-leg claim it would appear that unless such a claim were brought against the directors of a one-trust corporate trustee, thereby bringing itself squarely within the *HR* v *JAPT* factual matrix, its prospects of success are moreorless non-existent.

DISCUSSION

The decision in *Gregson*, rejecting the dog-leg claim, is clearly consistent with well established company law principles. These principles limit the potential liability of company directors in circumstances where those directors have breached their duty to the company, thereby causing loss to a third party, and for which loss an action may be brought against the company. However, this decision provides little comfort to beneficiaries under a settlement that sustains losses through the mismanagement of the property of the settlement by the directors of a corporate trustee. The implications are particularly harsh where the corporate trustee has no assets of its own. In such circumstances, where a loss is sustained by the settlement (invariably as a result of some failure or breach on the part of its directors), the beneficiaries will have little chance of recovering those losses if the corporate trustee is the only prospective defendant.

As a consequence of this decision it seems the only legitimate way in which the claimant could pursue her claim would be highly convoluted. She would have to sue the corporate trustee and obtain judgment against it. HAE's inability to meet any prospective judgment, given that it has no assets of its own, would enable the claimant to obtain a winding up order. The claimant could then get the liquidator to pursue the directors on behalf of the company. This would almost certainly require the claimant to indemnify the liquidator against the expense of such litigation given that there would be no funds in the liquidation from which to discharge such costs. Furthermore, any judgment would represent a credit to the general coffers of the corporate trustee and would have to be shared with any other creditors.

Despite the court's response to the dog-leg claim according with well established principles of company law it exposes a significant flaw in the protection afforded to beneficiaries under settlements which are managed by corporate trustees. Corporate trustees have no obligation to hold insurance; in fact, unless insurance is for the benefit of the settlement as opposed to just being for the benefit of the trustees in order to indemnify them against claims for breach of trust, the payment of insurance premiums out of the settlement is not permitted.[28] Furthermore, where a corporate trustee has no assets or income of its own it inevitably has no means by which to fund the payment of insurance premiums.

The problem of uninsured corporate trustees is less likely to be an issue in the context of professional trustee companies who operate commercially and will most likely have insurance. However, in the context of corporate trustees which are set up to manage settlements on a non-profit making basis and

[28] See *Kemble* v *Hicks* [[1999] PLR 287 and *NBPF Pension Trustees Limited* v *Warnock-Smith* [2008] EWHC 455 (Ch).

which have no assets out of which to meet the costs of insuring against claims for breach of trust, the impact upon the beneficiaries can be, as we have seen in *Gregson*, of seismic proportions.

CONCLUSION

The potential injustice to the beneficiary in this context is obvious, the context being one in which a corporate trustee is impecunious and unable to satisfy any prospective judgment against it. A corporate trustee is not obliged to insure itself against claims arising out of its own breach or the breach of its directors. Nor is the corporate trustee obliged to bring an action against its own errant directors whose breaches have caused loss to the settlement. The only way of compelling an action against the directors is, in appropriate circumstances, to obtain a winding up order against the corporate trustee and get the liquidator to sue the directors, if possible.

This situation illustrates what may be perceived by some as a lack of adequate regulation regarding the extent to which beneficiaries will be protected against losses caused by corporate trustees. Admittedly it is not inconsistent with many other jurisdictions which do not impose personal liability upon the directors for breaches committed by a corporate trustee.[29] In fact de-regulation such as that which has recently occurred in Jersey suggests an inclination towards further protecting the directors of corporate trustees in circumstances where it was previously considered appropriate to impose liability.[30] However, in contrast, Australia has recently introduced legislation designed to make directors of corporate trustees personally liable in prescribed circumstances,[31] demonstrating some recognition that there may be circumstances in which the director of a corporate trustee ought to be exposed to the possibility of personal liability.

Whilst the stance towards the concept of the dog-leg claim adopted by the courts may be consistent with established company law principles, it has worrying implications regarding the exposure to risk of beneficiaries in this context and is arguably inconsistent with the protectionist approach normally adopted by the courts regarding losses suffered by beneficiaries through the fault of others. Whether or not this tension is sufficient to justify the court adopting a novel approach to the question of indirect liability of the directors of corporate trustees through the dog-leg claim appears to have been answered

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[29] None of the offshore jurisdictions impose liability in this context.

[30] Guernsey, like Jersey, has also had and repealed legislation which sought to impose personal liability on the directors of corporate trustees in the event of a breach of trust; Trusts (Guernsey) Law 2007.

[31] Corporations Act 2001, s 197. For a slightly fuller discussion of this provisions see Halsbury's Laws of Australia [430-5300].

in the negative. The introduction of legislative protection, either imposing personal liability upon the directors or requiring those acting as corporate trustees to insure against liability for breach of trust, would appear to be the only tenable solution for better protecting the beneficiaries of settlements which are mismanaged by corporate trustees and who do not have sufficient assets to discharge liabilities which arise out of a breach of trust.