

## Reflecting on Loss

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Most lawyers practising in common law jurisdictions will be familiar with the rule in **Foss v. Harbottle** (1843) 2 Hare 461. The rule provides that the proper plaintiff in an action for a loss suffered through a wrong done to a company will normally be the company itself, not its shareholders. This rule, which forms part of Jersey law, is often referred to as the reflective loss principle.

A number of exceptions have been developed by the courts in relation to the reflective loss principle but those exceptions are limited in their effect. The starting point is, therefore, that a shareholder cannot generally sue for a loss suffered by the company even though the effect of this might have been to reduce the value of the shares owned by that shareholder.

In the recent case of **Freeman v. Ansbacher Trustees (Jersey) Limited** [2009] JRC003, the Royal Court was required to consider the application of the reflective loss principle in the case of a company which was a wholly owned asset of a Jersey discretionary trust (the “Trust”). The court was asked to consider this issue in the

context of an application by the trustee, Ansbacher, to strike out the plaintiffs’ pleaded case. The plaintiffs in this case were beneficiaries of the Trust. The strike out application was brought on a number of bases, including that the pleaded case offended the reflective loss principle. This was the first time the Royal Court had been called upon to consider this issue.

### CONVENTIONAL DISCRETIONARY SETTLEMENT

The facts in **Freeman v. Ansbacher** can be stated relatively shortly. Ansbacher had been appointed as the original trustee of the Trust which had been established in 1978. The Trust was a conventional discretionary settlement. In common with many trusts, trading and investment activities on behalf of the Trust were undertaken principally through a company which was a wholly owned asset of the Trust.

In this case the company was a Jersey registered company called S.D. & R. Trading Limited (“SDR”). The beneficiaries were asserting various breaches of trust on the part of Ansbacher which

had allegedly resulted in losses to SDR and, through the interest of the Trust in SDR, to the assets of the Trust. In essence, the claim was that there had been a failure on the part of Ansbacher as trustee to ensure that its employees (who were directors of SDR) managed the investments of SDR prudently.

Ansbacher's strike out application proceeded on the basis that because the losses which the plaintiffs were seeking to recover from Ansbacher were losses which had been suffered by SDR, the losses claimed were merely reflective of the company's losses and ought not, as a matter of principle, to be recoverable. In terms, the argument put forward by Ansbacher was that the proper claimant in relation to losses suffered by SDR as a result of the acts or omissions of its directors and officers was SDR itself and not the beneficiaries of the Trust which owned the shares in SDR.

## REFLECTIVE LOSS PRINCIPLE

Ansbacher argued therefore that the Royal Court should apply the reflective loss principle and strike out the plaintiffs' Order of Justice. The Royal Court declined to do so, stating that it was not satisfied that the reflective loss principle should necessarily be applied to a situation involving a discretionary trust such as the one in **Freeman v. Ansbacher**.

## NOT A GOOD REFLECTION ON JERSEY

In giving judgment the Deputy Bailiff stated that in his view, he did not consider that it would reflect well on the law or on Jersey for a beneficiary of a discretionary trust to be required to go through the potentially onerous steps which would be required for a claim to be brought by the company itself. He went on to state that:

*"I consider that it is strongly arguable that the law of Jersey provides this simple and effective remedy in a case such as the present 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 [reflective loss] principle."*

It is clear from the judgment that in reaching this view the Deputy Bailiff focussed heavily on the traditional rationale or policy reasons for the existence of the reflective loss principle. The first of these is the risk of double recovery from the defendant i.e. if both the company and a shareholder are able to sue and recover for the same wrong, the defendant might find itself paying out twice for what is, in effect, the same loss.

## RISK OF PREJUDICE TO CREDITORS

The second is the risk of prejudice to creditors of the company i.e. if the shareholder is successful, the monies will be paid directly to the shareholder rather than to the company and would not, therefore, be available to creditors of the company. The Deputy Bailiff stated, however, that in the case of a discretionary trust where the company is a wholly owned asset of the trust, it was strongly arguable that both of the reasons for the application of the reflective loss principle could be removed by the court ordering the trustee to reconstitute the trust fund by reimbursing the company itself for its losses. This could potentially be done by either ordering the trustee to pay the monies directly to the company or by requiring the trustee to use the monies to subscribe for further shares in the company.

## NO CONCLUSIVE DETERMINATION

It is important to recognise that the judgment in **Freeman v. Ansbacher** does not conclusively determine the issue. The judgment was given in the context of a strike out application where the court is only required to consider whether it is plain and obvious that the case will not succeed.

Whilst the Deputy Bailiff considered that there were strong arguments in favour of the reflective loss principle not applying in the case of a discretionary trust such as that in **Freeman v. Ansbacher**, the law in this area remains uncertain. In particular, it remains to be seen how the court will approach more complex situations where trust investments are held through various corporate structures, some of which may not be wholly owned by the trust.

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