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UPDATE

Court finds that reflective loss principle applies in Guernsey

Update prepared by Gordon Dawes and Iona Mitchell (Guernsey)

The Royal Court of Guernsey has confirmed, for the first time, that the principle known as the rule against reflective loss applies in Guernsey.

Introduction

Until now, a Guernsey court had never decided the question of whether the principle known as the rule against reflective loss applies in Guernsey. In *Jefcoate v Spread Trustee Company Limited* 2014 GLR Note 10, the Royal Court had considered the issue, but had left open the question of whether it forms part of Guernsey law.

The rule against reflective loss prevents shareholders of a company from bringing a claim for personal losses arising from a breach of duty to or contract with a company. The principle is intended to avoid the double recovery of losses.

In the recent case of *Pilatus (PTC) Limited v RBC Trustees (Guernsey) Limited* [2021] GRC 012, the Bailiff decided that the majority judgment of the English Supreme Court in *Sevilleja v Marex Financial Ltd* [2020] UKSC 31 (Marex) sets out an approach to this issue that can properly be adopted in this jurisdiction. However, the Bailiff declined to expand the test to apply the principle to the facts of the present case in the context of a discretionary trust and a wholly-owned company.

Facts

This was a claim by the existing trustee of a Guernsey discretionary trust against the former trustees for breach of trust. The Defendant raised reflective loss as *an exception de fond* (a category of defence amounting to an absolute bar) which was tried as a preliminary issue.

The Plaintiff as trustee held all of the shares in a company, which was in turn the ultimate beneficial owner of a company pursuing unfair prejudice proceedings in the BVI. The Defendant claimed that any loss that the trust had suffered was merely reflective of the loss that the company had suffered, remedies for which were being pursued against the wrongdoers in the BVI proceedings.

Should the principle of reflective loss apply in Guernsey?

The Bailiff noted that there were two primary issues:

- whether the reflective loss principle should operate in Guernsey; and
- if so, whether it should operate in the context of a discretionary trust with a wholly-owned company involved (as opposed to in a 'pure' company law context).

With regard to the first issue, the Bailiff considered at length the Supreme Court's decision in Marex and other relevant English authorities. Prior to *Marex*, the case of *Johnson v Gore Wood & Co* [2002] 2 AC 1 and subsequent cases had expanded the principle, but this had been the subject of criticism. Marex disapproved this line of authority and narrowed the principle's application.

The Bailiff observed that that the origins of Guernsey company law are found in English company law, whose statutes have tended to be taken into account and, to the extent applicable, then enacted domestically (albeit with some adjustments to suit local circumstances). In light of that, regard could sensibly be had to English authority to see whether developments in that jurisdiction are appropriate in Guernsey. The Foss v Harbottle rule (that it is for the company itself to bring proceedings where a wrong has been done to the company) upon which the reflective loss principle is based, had been accepted as part of Guernsey law. Consequently, the extension of that rule into the reflective loss principle was likely to be an uncontroversial development.

Accordingly, the Bailiff found that the reflective loss principle forms part of Guernsey law.

Application in the trusts context in the present circumstances

The next question was whether Guernsey law ought to recognise any principle wider than that now stated in the *Marex* case, or even whether there is any further narrowing in the context of the present case.

The Bailiff preferred the following summary used by Lord Reed in *Prudential Assurance Co. Ltd v Newman Industries Ltd* (No.2) [1982] 1 Ch 204:

> '...*where a company suffers actionable loss, and that loss results in a fall in the value of its shares (or in its distributions), the fall in share value (or in distributions) is not a loss which the law recognises as being separate and distinct from the loss sustained by the company. It is for that reason that it does not give rise to an independent claim to damages on the part of the shareholders*'.

Put in this fashion, the Bailiff found that it was clear that the principle had no application to the present case. This was not a claim by a shareholder at all, other than coincidentally, and was rather a claim by a trustee against a previous holder of that office. The outcome of the underlying company's unfair prejudice claim in the BVI proceedings would always need to be taken into account, to avoid double recovery, but the BVI claim did not operate to bar the Plaintiff from proceeding with this action.

The Bailiff also observed that, even if he had found that the rule against reflective loss could apply to the present proceedings, he would still have rejected it, accepting the Plaintiff's contention that it operates only where the third party wrongdoer, against whom the shareholder and the company both have concurrent claims, is the same person. The Guernsey and BVI proceedings had common facts, but they addressed different allegations where the remedies, in the sense of recovering losses and the nature of those losses, were not necessarily the same.

As the reflective loss principle did not apply, the claim could proceed.

Conclusion

The case provides a welcome clarification of the law in this area. This much needed certainty will be of benefit to the trust administration industry and the jurisdiction as a whole. However, this is a developing area and whether the reflective loss principle applies in any given situation will depend on the often complex circumstances. Early legal advice should be obtained.

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