BREACH OF TRUST, DIRECTORS AND CORPORATE TRUSTEES:

MULTIPLE DERIVATIVE CLAIMS FOLLOWING MCGAUGHEY V USS

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It is commonplace now for the trustee of almost any sort of trust to be a company, and for the individuals who may colloquially be referred to as "the trustees" to in fact not be trustees at all, but to be the directors of the trustee company. Occupational pension schemes have been particularly keen adopters of this structure. In some respects it makes little difference to the beneficiaries: the trustee is the trustee, whether an individual or a company. But when the individuals involved are alleged to have acted in breach of their duties, the corporate structure allows for more complex claims than the ordinary breach of trust claim that would be brought against individual trustees.

In particular, the company itself will often have a claim against its directors for breaches of their statutory duties (under sections 171 to 177 of the Companies Act 2006) which are owed to the company. Where the company has shown no inclination to pursue such claims itself, beneficiaries of the trust may wish to do so in its place. When (if ever) that sort of claim is possible was the subject of the lengthy and detailed judgment of Leech J in McGaughey v Universities Superannuation Scheme Ltd [2022] EWHC 1233 (Ch) (24 May 2022).

The claims

The Claimants in McGaughey v USS are both members of the Universities Superannuation Scheme (the Scheme), and the Defendant (USS), a company limited by guarantee, is the Scheme's Trustee. The Scheme has both defined benefit and defined contribution elements. Following the Scheme's 2020 valuation, USS proposed and then introduced an increase in both employer and member contributions, together with changes that would reduce benefits for some members.

The Claimants subsequently made four allegations against the directors of the Trustee, all relating to the administration of the Scheme: the directors were said to have breached their statutory and fiduciary duties (i) in relation to the conduct of the 2020 valuation, (ii) by changing the benefit and contribution structure in a manner which amounted to unlawful discrimination, (iii) by allowing management costs and expenses to increase significantly, and (iv) by failing to create a credible plan for divestment from fossil fuels.

Test for permission to continue the claims

The legal context was the need for the Claimants to obtain the Court's permission to continue the claim. Leech J accepted that this was not a "derivative claim" as defined by section 260 of the Companies Act 2006, because the Claimants were not members of the Trustee company. In Boston Trust Co Ltd v Szerelmey Ltd [2021] EWCA Civ 1176, Sir David Richards further distinguished

"double derivative claims", where the members of a holding company bring a claim on behalf of a direct subsidiary company, and "multiple derivative claims" where there are multiple intermediate companies (see [17]-[18]). Leech J followed this classification, but expanded the definition of a "multiple derivative claim" to include all derivative claims which are not within the section 260 definition or Sir David Richards' definition of a "double derivative claim" (see [19], [21]-[22]). The Judge also followed Boston Trust in applying the permission and procedural requirements in CPR 19.9 by analogy (see [20]). The test for permission was held (uncontroversially) to require the Claimants to satisfy four requirements (see [23]):

(1) They have sufficient interest or standing to pursue the claims on a derivative basis on behalf of the company or other entity;

(2) They establish a prima facie case that each individual claim falls within one of the established exceptions to the rule in Foss v Harbottle;

(3) They establish a prima facie case on the merits in respect of each claim; and

(4) It is appropriate in all the circumstances to permit them to pursue the derivative claim or claims.

First, in relation to "sufficient interest or standing", Leech J held that it was possible in principle for members of a pension scheme to have standing to bring a derivative claim, such as "where the directors of the corporate trustee conspire to misappropriate the scheme's assets on an industrial scale" and the directors are the only members of the corporate trustee ([28]). But Leech J also accepted USS's submission that "members of a pension scheme would only have standing if the loss which the subject company (or the scheme) is claimed to have suffered is reflective of their own loss" (see [29]-[30]). The Judge did not, however, accept that the possibility of the beneficiaries bringing an alternative claim (e.g. a breach of trust claim) would necessarily deprive them of standing in relation to the multiple derivative claim (at [32]-[33]).

Second, in relation to the "established exceptions to the rule in Foss v Harbottle", the Claimants relied on the fourth exception, namely that a "fraud has been committed and the minority (or other interested stakeholders) are prevented from remedying the fraud because the subject company is controlled by the wrongdoers" ([34]). Leech J followed the decision of McCombe LJ in Harris v Microfusion 2003-2 LLP [2016] EWCA Civ 1212 that this required the Claimants to "establish a prima facie case that the defendants have committed a deliberate or dishonest breach of duty or that they have improperly benefitted themselves at the expense of the company (although the nature of that benefit need not be exclusively financial)." Mere "equitable fraud" or "fraud on a power" would not be sufficient ([40]-[43]).

Third, in relation to whether there is a "a prima facie case on the merits", Leech J held that, where the relevant facts are disputed, "the appropriate course is to find that a prima facie case has been made out only where I am satisfied that there are issues of fact on which it would be wrong to accept the Company's evidence without cross-examination", reflecting the fact that there is no live evidence at the permission stage ([44]-[45]).

Fourth, in relation to whether it is "appropriate in all the circumstances" to give permission, Leech J held that he would consider, inter alia, the alternative claims said to be available to the Claimants ([33], [46]-[47]).

The Claimants, however, failed to obtain the Court's permission in relation to any of the four claims.

Claim 1: the 2020 valuation

The first claim concerned the 2020 valuation of the Scheme, which was alleged to have been conducted by the directors in a manner which did not promote the best interests of the Scheme's beneficiaries, failed to take into account relevant considerations (including possible ways of avoiding the need to raise contribution rates or to reduce benefits) or to exclude irrelevant considerations, and which improperly fettered their discretion ([70]). These alleged breaches of duty were said to have been intended to reduce future defined benefit accrual in the Scheme ([72]).

Permission was refused by Leech J because the Trustee did not itself suffer any loss by carrying out the 2020 valuation as alleged, and even if it did, that loss was not reflective of a loss suffered by the Claimants. The Claimants' benefit entitlements will be lower, but that will cause a reduction in the Trustee's liabilities. The increased contributions due from both employers and members will cause the Trustee's assets to increase: the Trustee will in fact be better off as a result of the changes. Leech J consequently found that the Claimants did not have a "sufficient interest or standing" in relation to the first claim ([130]-[132]).

Had this claim not failed on the first limb of the permission test, Leech J would also have turned it down on the basis that it was not within the fourth exception to Foss v Harbottle, because there was not "sufficient evidence from which to draw the inference that the Directors were pursuing their own ends or motivated by their own personal interests" ([145]), or a prima facie case on the merits.

Interestingly, though, Leech J would not have refused permission on the fourth limb, if the others had been satisfied, notwithstanding the other possible routes to bringing a claim in these circumstances. Leech J recorded that:

> The Claimants submitted that any complaint to the Pensions Ombudsman or breach of trust claim was fraught with difficulty, that a complaint to the Ombudsman was not suited to a group or class action of this kind and that a court claim by a beneficiary would face considerable and practical hurdles. In his oral submissions Mr Grant emphasised that beneficiary claims are rare (as opposed to employer or trustee claims) and that the practicalities involved in trying to ensure that 470,000 members were properly represented meant that I could not be confident that it would be straightforward or that the Claimants would be able to make or fund a claim. ([153])

Leech J accepted that "the Claimants were not overstating the difficulties which they would have faced in pursuing a trust claim (and which they may still face)" ([155]). The Judge clearly felt some discomfort at permitting the Claimants to avoid the effect of CPR 19.3, which provides that "[w]here a claimant claims a remedy to which some other person is jointly entitled with him, all persons jointly entitled to the remedy must be parties unless the court orders otherwise", but nevertheless would not have refused permission on

this basis, since "If the Claimants had been able to bring themselves squarely within the fourth exception to the rule in Foss v Harbottle, then the constitution of a company limited by guarantee clearly lends itself to wrongdoer control. Moreover, McDonald v Horn provides authority (if it is needed) that the Court could give permission to members to bring a multiple derivative claim in those circumstances." ([157]).

In other words, if bringing the sort of multiple derivative claim envisaged here was the only way to see justice done, the Court would not stand in the Claimants' way if the first three limbs of the permission test could be met just because they might proceed in another way, with different procedural requirements.

Claim 2: unlawful discrimination

The second claim concerned the benefit changes introduced by USS, which were alleged to "indirectly discriminate against women, younger and black and ethnic minority members contrary to section 19 of the Equality Act 2010" ([101]). This was said to amount to a breach by the directors of their duties to the Trustee, which exposed the Trustee to discrimination claims by Scheme members ([103]).

Leech J refused permission for the same reason as in the first claim: neither Claimant has a discrimination claim himself, and "[i]f an individual member brings a claim in the Employment Tribunal or a civil court, the liability of the Company to pay compensation is not reflective of any loss which the individual member has suffered because he or she has a direct claim against the Company." (]160]) Furthermore, that liability of the Trustee to the member discriminated against does not give the Claimants a sufficient interest to bring a claim against the directors, there being no "causal connection between the Company's liability to pay compensation to members for indirect discrimination and the benefits to which the Claimants are entitled" ([161]).

The second claim would also have failed on the second and third limbs of the test (it being relevant to the prima facie case on the merits that, even if unlawful discrimination could be proved, the directors had acted on legal advice that the benefit changes did not amount to unlawful discrimination ([171])). Permission would also have refused as a matter of discretion: "[i]f individual members have claims for discrimination, it is far better that they should make them directly against the Company either individually or in group litigation" ([174])

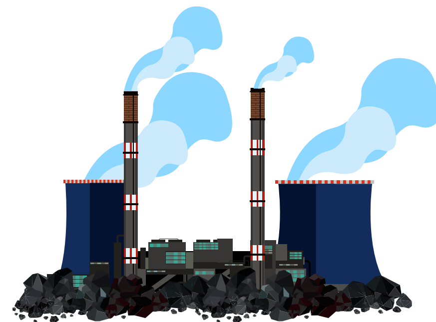
Claim 3: costs and expenses

The third claim concerned the Scheme's costs expenses, which were said to have increased by 320% from 2007 to 2020, including a 1318% increase in investment management personnel costs ([109]). This was said to amount to a breach by the directors of their duties to the Trustee, and to have been to the personal advantage of the directors ([110]).

This claim did not fall down on "sufficient interest or standing": the Trustee conceded that "the wrongful depletion of the Scheme's assets would involve a loss to the Company and potentially a reflective loss to members if the Scheme was unable to pay promised benefits as a result" and Leech J held that this was enough to meet the first limb ([175]-[176]).

It did, however, fail on the second limb, there being no allegation that the directors "used their control over the Company to confer benefits on themselves through increased fees or salary" ([178]), and on the third, the Claimants not having made a sufficiently particularised case on the merits ([184]). Leech J would, though, have been prepared to give permission if the first, second and third limbs had been satisfied, for the same reasons as in relation to the first claim.

Claim 4: fossil fuels



The fourth claim concerned the Scheme's investment in fossil fuels. The Claimants alleged that the directors' failure to divest from fossil fuels or to make an adequate plan for divestment was a breach of their duties to act for proper purposes and to promote the success of the Trustee ([120]).

Leech J here refused permission on the first limb, the Claimants not having satisfied the Court that the Trustee had suffered any immediate financial loss, or, if they had, that it was reflective of any financial loss that they had suffered, there being no causal link alleged between fossil fuel investment and the benefit changes which had been implemented ([191]). It would also have failed on the second and third limbs, and would have been refused on the fourth limb as a matter of discretion, Leech J stating that he: "would not have exercised my discretion to permit the Claimants to continue Claim 4 but would have left them to pursue a direct claim for breach of trust. The Claimants have not sought an injunction to compel the Directors to adopt an immediate plan for divestment or specified what plan they should adopt and I am not satisfied that the Court would be prepared to grant declaratory relief in the vague terms sought in the prayer for relief or, indeed, that any useful purpose would be served by doing so" ([197]).

Where does this leave beneficiaries?

Leech J's judgment is necessarily a long and detailed one, which is dominated by a meticulous analysis of the four claims and the complex facts and allegations which underpin them. Much of what is said is therefore of relevance only to the parties. It is nevertheless clear that there are a number of important lessons for trust beneficiaries (and their advisers) contemplating claims against the directors of a corporate trustee, perhaps as part of a wider consideration of other possible claims, including breach of trust claims against the corporate trustee itself.

First, and perhaps most importantly, Leech J accepted that this sort of claim would be possible in the right circumstances. If the mere existence of an alternative claim would suffice to deprive beneficiaries of standing, that would almost always make this sort of claim impossible, since a breach of trust claim will generally be available against the corporate trustee. As already noted (at paragraphs 15 and 16 above) there are real difficulties involved in bringing such a claim, and the Court is entitled to have regard to those difficulties in deciding whether to give or refuse permission. Beneficiaries may be motivated to pursue a multiple derivative claim, notwithstanding the enormous difficulties it presents, because of its undoubted procedural advantages in other respects: in particular, there being no need to join every other beneficiary or make arrangements for them to be represented (see paragraph 15 above), and the possibility of obtaining a prospective costs order (though this was refused in this case at [198]).

It is notable that in this case Leech J would have given permission (had the other limbs of the test been satisfied) on the first and third claims, but not the second or fourth. In the latter two, there was either a more obviously sensible way to proceed, or no useful purpose in the claim proceeding. The door is therefore left open, in principle, for a multiple derivative claim to succeed in the trust context.

Second, the major hurdle to surmount will often be establishing a "sufficient interest or standing" since that entails establishing both that the corporate trustee has suffered a loss and that this loss is reflective of the claimant beneficiaries' own loss. Where the claim is for the misappropriation of trust assets, Leech J's treatment of the third claim suggests that this will not cause much difficulty (see paragraph 21 above): if the trustee's money is stolen, it has less with which to pay members or beneficiaries. But in every other case this hurdle was insuperable: in the first and fourth claims it was far from clear that any loss was actually suffered by the Trustee, and in the second claim there was held to be no link between the Trustee's (hypothetical) liability to pay damages for discrimination and the Claimants' benefit entitlement.

The latter point is perhaps particularly difficult in defined benefit pension cases, where members' benefit entitlements are usually prescribed by the scheme rules, and do not depend (as long as the scheme is sufficiently funded) on the actual assets held by the scheme's trustee. It may still be open to argue that exposing a trustee to damages claims for discrimination would cause a loss to the trustee which is reflective of a beneficiary's own loss if the beneficiary were entitled to part of the trust fund, the value of which is diminished by the liability to pay damages.

Third, Leech J's rejection of the Claimants' argument that the fourth exception to Foss v Harbottle could be satisfied in cases of "equitable fraud" or "fraud on a power" ([36], [42]-[43] – see paragraph 7 above) will rule out this sort of claim in most cases, except where a director has acted dishonestly. It will only be in rare cases that beneficiaries will be able to meet the high hurdle of making even a prima facie case that "the defendants have committed a deliberate or dishonest breach of duty or that they have improperly benefitted themselves at the expense of the company" ([43]).

> ***The practical effect of this is that where directors have arguably committed lesser breaches of duty – such as ordinary negligence – but control the company, a multiple derivative claim will not provide a route f or beneficiaries to pursue the claim that the company will not.***

This is said to accord with the rationale for the fourth exception to Foss v Harbottle, with Leech J holding that "parties are free to choose majority rule and that equity will only step in where the majority have abused that power to excuse their own dishonest and deliberate breaches of duty or to excuse their actions in improperly benefitting themselves at the expense of the subject company". In such cases the beneficiaries will have to look to other routes to relief.

Fourth, it follows that the sort of multiple derivative claim pursued in McGaughey v USS is likely to be exceptional in future: this was a bold attempt to make use of this procedural route to obtain relief in the context of a pension scheme trust, and it is hard to see how the Claimants (or their advisers) could have done more to succeed. But it is clear from Leech J's judgment that, as the law stands, the odds are stacked against trust beneficiaries being given permission to continue a multiple derivative claim.

A director who dishonestly misappropriates trust funds to the disadvantage of the beneficiaries and then stymies any attempt by the corporate trustee to bring a personal or proprietary claim may well find that the court would be willing to permit the beneficiaries to bring the corporate trustee's claim against the director. Following McGaughey v USS, it is hard to see a less extreme case succeeding.

DOES A THIRD PARTY OWE A DUTY OF CARE TO A BENEFICIARY?

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Establishing that a duty of care is owed to a beneficiary by a third party (i.e. someone other than the trustee or a person with whom the beneficiary has a contract) is not a straightforward exercise. In practice, it will usually require the beneficiary to show either that there has been an assumption of responsibility by the third party towards the beneficiary or that denying such a duty would lead to an absence of accountability on the part of the third party by analogy with the approach in White v Jones.[1]

This important issue for private client and trust lawyers was recently considered in depth by the Privy Council in JP SPC 4 v Royal Bank of Scotland International Ltd[2]. The decision provides a useful discussion of the relevant considerations and the general approach the Courts will take when deciding whether a duty of care exists.

The claimant was an investment fund based in the Cayman Islands which established a scheme by which investors were to lend money to solicitors for the pursuit of litigation. The loans were to be advanced and repaid through an Isle of Man company, called Synergy, using bank accounts Synergy held with RBS. The claimant issued proceedings against RBS in the Isle of Man for the recovery of losses which it alleged to have suffered as a result of a fraud carried out by Synergy and its owners. Under the fraud, money beneficially owned by the claimant was paid out of Synergy's accounts with RBS for the benefit of its owners rather than for the loans the scheme was intended to make.

RBS applied for summary judgment/strike out on the basis that it did not owe a duty of care to the claimant. This issue made it all the way up to the Privy Council.

Importantly, for the purposes of the application, it was assumed (reflecting the claimant's factual case): (i) that RBS knew (or ought to have known) that the claimant was the beneficial owner of the moneys in the accounts; and (ii) the circumstances were such that a reasonable banker would have had grounds for considering that there was a real possibility that the claimant was being defrauded.

When approaching whether a duty of care is owed, Courts will usually consider first whether such a duty falls within an established category of duties based on existing authority and, if not, whether such a duty should be found by way of incremental development of the law. This was the approach the Privy Council also followed.

The Privy Council considered first the Quincecare[3] duty of care which is a duty owed specifically by a bank to its customer (arising as an aspect of a bank's implied contractual duty and co-extensive tortious duty of care) to refrain from executing a customer's order if the bank has reasonable grounds for believing that the order is an attempt to defraud the customer. This basis for a duty to the claimant was rejected because the Privy Council confirmed that the Quincecare duty is owed only to a bank's customer which in the present case was Synergy and not the claimant.

The claimant also relied on the decision of Baden v Société Générale pour Favoriser le Développement du Commerce et de l'Industrie en France SA[4] in which Peter Gibson J had accepted that:

1 [1995] 2 AC 207

2 [2022] UKPC 18, [2022] 3 WLR 261

3 Barclays Bank plc v Quincecare Ltd [1992] 4 All ER 363

4 [1993] 1 WLR 509 at [349]. This is a decision better known for its (now discredited) five-fold classification of the scale of knowledge in relation to dishonest assistance.

> *'where a paying bank is on notice that its customer is a fiduciary in respect of moneys in an account with the bank it owes a duty of care to the persons beneficially interested in those moneys, as soon as the bank is put on such notice'.*

However, whilst Baden clearly supported the claimant's position, the Privy Council considered it was clear that in the light of subsequent developments in the law of negligence, Baden no longer represented good law. This was because Peter Gibson J had based his decision on the two-stage approach to determining whether a duty of care was owed as laid down in Anns v Merton London BC[5], i.e. (i) whether it was reasonably foreseeable to the defendant that the claimant would be likely to suffer loss from the defendant's careless conduct; and if so (ii) were there good policy reasons why that prima facie duty should be negatived or limited. However, Anns v Merton and the approach it espoused had long since been overruled[6].

The Privy Council considered whether a duty of care based on an 'assumption of responsibility' by RBS towards the claimant should be held to exist. The factors which have particular relevance in determining whether there has been an assumption of responsibility in relation to a task or service include: (i) the purpose of the task or service and whether it is for the benefit of the claimant; (ii) the defendant's knowledge and whether it knows (or ought to know) that the claimant will be relying on it to act with reasonable care; and (iii) the reasonableness of the claimant's reliance. In the present case, the claimant had pleaded no factual basis (and there was no evidence) on which a duty of care based on an assumption of responsibility could be established.

Turning to the incremental development of the law, the claimant argued that a duty of care should be held to exist by analogy with the decision of White v Jones (and similar cases), otherwise there would be a lacuna. However, the Privy Council considered that there was no lacuna in the present case because RBS's customer, Synergy, had a valid claim for negligence against RBS under which, if successful, Synergy would have been entitled to recover the loss suffered by the claimant for whom it was trustee. It did not matter that, in practice, Synergy was unlikely to bring an action against RBS. Furthermore, the claimant would have a claim to recover its loss against Synergy for breach of fiduciary duty. Therefore, White v Jones was distinguishable and there was no need for the law to fashion a remedy. Therefore, the Privy Council (upholding the decision of the Staff of Government (Appeal Division)) concluded that no duty of care was owed by RBS to the claimant. The key lessons from this important decision for those looking to establish that a third party owes a duty of care to a beneficiary (in a category not already covered by existing case law) are:

- A duty of care may be owed to a beneficiary by a third party on the basis of an 'assumption of responsibility'. This is likely to require that the service provided by the third party is for the benefit of the beneficiary and that the beneficiary (to the third party's knowledge) reasonably relies on the third party to exercise reasonable care. Importantly, the test for establishing a duty based on an assumption of responsibility is objective. Therefore, it will normally need to be shown that there were relevant exchanges crossing the line between the third party and the beneficiary.
- If one can show that there is truly a lacuna in legal accountability – by analogy with White v Jones – then that will provide a good basis for establishing a duty of care owed to a beneficiary. However, the Courts will consider carefully whether that is the case, taking account of other avenues of relief.
- The scope of duties owed by banks are increasingly well developed. The Courts are reluctant to extend those duties in a way which risks placing an unacceptable burden on banks going outside of their contractual relationship with their customers. The Courts' reluctance may be less forceful in relation to other service providers.
- The Courts will also be reluctant to impose a duty of care where to do so would cut across the requirements of accessory liability. In order to establish accessory liability for assisting in a breach of fiduciary duty, one must prove dishonesty[7]. On the assumption that there had been a breach of fiduciary duty by Synergy to the claimant, if RBS was liable to the claimant for the tort of negligence, this would be tantamount to holding RBS liable for having negligently assisted a breach of fiduciary duty.

5 [1978] AC 728

6 See Murphy v Brentwood DC [1991] 1 AC 398

7 Royal Brunei Airlines Sdn Bhd v Tan [1995] 2 AC 378; Twinsectra Ltd v Yardley [2002] 2 AC 164; Barlow Clowes International Ltd v Eurotrust International Ltd [2006] 1 WLR 1476.

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