In the matter of the Arasbridge Unit Trust
Royal Court
15th January, 2015

JUDGMENT 02/2015

Application by a trustee to the Court, seeking directions in relation to a number of matters that have arisen in connection with a multi-class open-ended unit trust.

Approved Text
15.01.2015

IN THE ROYAL COURT OF GUERNSEY

ORDINARY DIVISION

IN THE MATTER OF THE ARASBRIDGE UNIT TRUST

Between: **KLEINWORT BENSON (GUERNSEY) LIMITED**
as Trustee of the Trust
and
ARAS INVESTMENT MANAGEMENT LIMITED
as Manager of the Trust
and
ACTIVE FUND SERVICES LIMITED
as Administrator of the Trust
and
JEREMY LE TISSIER
as representative of the Representative Group

Hearing date: 8 December 2014

Judgment handed down: 15 January 2015

Before: Sir Richard Collas, Bailiff

Advocate for the Trustee: **Advocate J P Greenfield**
Advocate for the Administrator: **Advocate A M Ozanne**
The Representative: **Advocate J T Le Tissier**
The Manager did not appear

Cases, legislation and references referred to:

Public Trustee v Cooper

Bathurst v Kleinwort Benson (Channel Islands) Trustees (Royal Court unreported judgment 38/2004)

Schmidt v Rosewood Trust Limited [2003] 2 A.C. 709

Marley v Mutual Security Merchant Bank [1991] 3 All ER 198

In Re Esteem Settlement and the No 52 Trust [2001] JLR N-8

Lewin on Trusts 18th Edition paragraph 29-301

JUDGMENT

1. This is an application by a trustee to the Court, surrendering its discretion to the Court under the third category of case identified in the leading decision of Public Trustee v Cooper, seeking directions in relation to a number of matters that have arisen in connection with a multi-class open-ended unit trust.

2. The application before me is dated the 23 June 2014. The matter has a lengthy and somewhat complex background, both factually and procedurally, having commenced with an application for directions dated 16 February 2011, supported by an affidavit of the same date sworn by Keith Geoffrey Park, a director of the Trustee. Since then a lot of work has been undertaken and the issues before me can be summarised succinctly.

3. The principal documents before me, in addition to the application, are an affidavit of Cordelia Miller, in-house legal counsel of the Trustee, sworn on 24 October 2014 and an exhibit thereto comprising nearly 600 pages (I refer to pages of the exhibit in the form "**CM1, page XXX**"); a skeleton argument and supporting materials filed by the Trustee; a skeleton argument and supporting affidavit filed by Advocate Jeremy Le Tissier, the Court appointed representative of the unitholders; and a document entitled an "Executive Summary".

4. The Arasbridge Unit Trust ("**the Fund**") was constituted by a Trust Instrument dated 17 November 2006 (CM1, page 501) of which the Trustee was the original trustee and has remained a trustee throughout. It initially comprised seven Class Funds and a further thirteen Class Funds have been created subsequently. The First Respondent has at all times been the Fund's Manager. The original administrator was Nerine Fund Administrators Limited who resigned with effect from 4 January 2009 in favour of the Second Respondent. The Fund was authorised by the Guernsey Financial Services Commission under the Protection of Investors (Bailiwick of Guernsey) Law, 1987 but it was later suspended by letter from the GFSC dated 28 January 2009. At that time there were concerns *inter alia* over the accuracy of calculations of the Net Asset Values ("**NAVs**"), dealing instructions and the accuracy of the register of unit holders. Since then considerable work has been undertaken to reconstitute the relevant records.

5. As a result, many of the initial concerns and issues have been addressed by agreement between the parties but there remain some residual issues which they consider can only be resolved by the Court. These concern three broad areas:

    1) A Class Fund known as the Arasbridge Legal Lending Fund ("**the LLF**");
    2) Six investors who sought to use funds borrowed from the Fairbairn Bank in the Isle of Man to leverage their initial investment values ("**the Fairbairn Six**"); and
    3) Instructions to switch investments between two Class Funds known as the Arasbridge Property Solutions Fund and the Arasbridge International Property Solutions Fund ("**the Swaps**").

6. At a hearing on 8 December, I gave directions in relation to the Swaps and on some of the issues concerning the LLF but I adjourned the remaining issues until the Manager could be invited to be present. I had excused the Manager's attendance at the present hearing although it is not known whether the Manager is able to appear at any time as all its directors have resigned. The company should have been struck off the register of Guernsey companies but the Registrar has not done so pending the outcome of this litigation. With the agreement of the parties present, I also adjourned the application in respect of the Fairbairn Six to enable further enquiries to be made and/or further discussions to take place.

7. The application for directions was made under sections 68, 69 (1)(a)(i), (iii) and (iv), 69 (2) (b) and 71 of The Trusts (Guernsey) Law, 2007 as well as Rule 35 of The Royal Court Civil Rules 2007. In the Trustee's skeleton argument, it also invoked the Court's inherent jurisdiction if necessary, applying the principles set out in Bathurst v Kleinwort Benson (Channel Islands) Trustees (Royal Court, unreported judgment 38/2004) which followed the Privy Council's decision in Schmidt v Rosewood Trust Limited [2003] 2 A. C. 709. In my view, there was no need to invoke the inherent jurisdiction as the wide provisions in the Trusts Law are sufficient to establish a statutory jurisdiction.

8. It is well established that a trustee faced with a conflict of interest that disables the trustee from acting may surrender its discretion to the court. In the present matter, whatever decision is reached on each of the three issues before the Court, the decision will have the effect of favouring one group of investors at the expense of another group. For that reason, the Trustee feels unable to act. In my initial view, this was not a clear case where the Trustee should surrender its discretion but I became convinced that it was appropriate to do so because of events that occurred prior to the suspension of the Fund. There are a number of unitholders, possibly the majority of them, who are very aggrieved that it became necessary to suspend the Fund and who are also aggrieved at its present financial situation. None of the parties involved, whether as trustee, administrator or manager are seeking to attract litigation, or discussing the possibility of the same, but I can draw the reasonable inference that there may be some investors who will be considering bringing a claim against one or more of those parties with a view to recovering all, or least some, of the losses they will have suffered as a result of investing in the Fund. Advocate Greenfield assured me that the Trustee is acting in what it considers to be the best interests of the investors without taking account of its own position. I fully accept what he says and I have neither read nor heard anything in my dealings with this matter to suggest otherwise. However, I consider that the Trustee is in a situation where if it were to

take a decision on these outstanding issues there would be a perception, or a real risk of a perception, that it was acting in its own interests.

9. Advocate Le Tissier is faced with a similar dilemma. He represents the entire body of investors and owes duties to each and every one of them such that he cannot recommend a course of action that favours one group of his constituents at the expense of another group.

10. Both Advocate Greenfield and Advocate Le Tissier are well aware that in this application there is a heavy duty on them to ensure that there has been full and frank disclosure of all relevant matters to enable me to take a decision (see for example Marley v Mutual Security Merchant Bank [1991] 3 All ER 198 and In Re Esteem Settlement and the No 52 Trust [2001] JLR N-8) and they have assured me that to the best of their knowledge, that duty has been properly discharged.

11. In all the circumstances, I accept the Trustee's decision to surrender its discretion to the Court on the matters considered in this judgment.

LLF

12. The LLF was a Class Fund of the Fund. The investment objective, as set out in the Scheme Particulars of the Fund, was to *"seek consistent returns in excess of 3 month Euro LIBOR with low levels of volatility".* The Investment Strategy was *"to invest in funds in the UK with exposure to a portfolio of loans providing funding to personal litigants and solicitors seeking recompense through the UK courts on a "no win, no fee" basis".* Although not expressly stated in the Scheme Particulars, the intention was to invest solely in Puritan International Fund PCC Limited ("**Puritan**").

13. The Intended Exposures for the investments was set out as *"0% to 100% - UK Legal Funding; 0% to 10% Cash or cash equivalents".* If the Fund were to be invested less than 90% in UK Legal Funding, there would be no provision for investing the balance without breaching the limit for exposure to cash or cash equivalents. Thus it is clear that the intention was for the LLF be substantially invested in UK Legal funding with only a small balance of cash to cover working and operational requirements. Investors were advised of the risks involved.

14. Matters started to go wrong on 30 October 2007 when Puritan suspended trading. Later, on 28 February 2008, Puritan was placed in liquidation without having resumed trading. LLF did not suspend trading until September 2008. Throughout the period from the suspension of trading in Puritan, investors continued to invest in LLF and were allocated units in LLF based on NAVs calculated by the Administrator. In the documents before me, the Trustee has identified three distinct groups of investors in LLF: those invested prior to the suspension of trading in Puritan "**the Initial Investors**"; those invested during the period from when Puritan trading was suspended until Puritan was placed in liquidation "**the Interim Investors**"; and those who invested in LLF after Puritan went into liquidation "**the Last Investors**".

15. It was thought that the Interim Investors were distinguishable from the Last Investors on the ground that the former were allocated units in LLF and the latter were not allocated any units but I was advised during the hearing that in fact they all had units allocated to them. I therefore see no reason to distinguish between these two groups of investors. The monies that both groups invested were paid, via the Manager, to the Fund after deduction of any charges. (Those charges included an Establishment

Charge deducted at the rate of 12%. The questions of whether that was correct and whether any or all the charges should be repaid form part of the application that has been adjourned for further hearing and hence do not fall to be discussed in this judgment.)

16. The Fund was unable to invest those monies in the suspended Puritan fund and the Trustee did not look for any other investments to replace Puritan. Consequently, the balance of the monies invested by the Interim Investors and the Last Investors, after deduction of charges, remains in a bank account. Three options, for dealing with their investments, were suggested by Advocate Le Tissier and adopted by the Trustee:

    1) Treat all three groups of investors in the LLF the same so that the total value of the investments held in LLF (including the cash) be shared among all three groups pro rata to their unitholdings ("**Scheme 1**"):
    2) Treat the Interim Investors and the Last Investors differently from the Initial Investors by returning the monies invested after Puritan suspended trading to the Interim and Last Investors and distributing the remainder of the LLF's assets to the Initial Investors ("**Scheme 2**"); and
    3) Treat the Last Investors differently from the Initial and Interim Investors by returning to them what they invested after Puritan went into liquidation and distributing the remainder amongst the others ("**Scheme 3**").

17. The reason for distinguishing between Schemes 2 and 3 was because it was thought the Interim Investors had been allocated units in LLF but the Last Investors had not. After it was confirmed in Court that they had all been allocated units, there was no other reason to continue to distinguish between those two groups and therefore I was faced with a choice between Schemes 1 and 2.

18. Units in LLF were allocated to the Interim Investors and the Last Investors on the basis of NAVs in LLF that may not have accurately reflected the value of the Puritan holding after that fund suspended trading. Thus there could be an issue as to whether those investors received a fair allocation or whether some or all of them were issued either with too many or too few units. The uncertainty over those NAV valuations favours Scheme 2 but is not the reason why I decided to prefer that Scheme.

19. The principal argument in favour of Scheme 1 was that having been allocated units in the LLF all the investors should be treated the same, regardless of when they invested.

20. Counsel were unable to direct me to any judicial authority that would assist me directly in deciding the legal principles that I must apply in approaching my decision. In Marley, Lord Oliver said *"the court is essentially engaged solely in determining what ought to be done in the best interests of the trust estate and not in determining the rights of adversarial parties."* In this matter, the objective is to distribute the whole of the trust estate but I am not determining the rights of the investors. As I said above, some of them may have a basis of a claim for damages against one or more of the entities that was involved in their decision to invest in LLF and/or in the operation of LLF but I can form no view on the merits of such claims and in my decision I have to ignore the fact that there may be a prospect of some or all of them making a recovery under such claims.

21. Advocate Greenfield informed me that the Trustee favoured Scheme 2 but I ignored their view because it might be thought that the Trustee had a personal interest in

seeing the Interim and Last Investors recover their investments from LLF rather than risk being sued for having failed to take steps to suspend trading in LLF after Puritan had suspended its trading.

22. It was agreed by all present in Court that trading in LLF should have been suspended as soon as Puritan suspended its trading. If that had happened, the Interim and Last Investors would never have invested in LLF. The Initial Investors would have been left with their investment being worth no more than the value of LLF's underlying investment in Puritan which is the risk they accepted when they chose to invest in LLF. The liquidators of Puritan have not yet made a final distribution and the precise value of their final distribution is not known. There will be a distribution but it will be a small percentage of the value of the original investments.

23. If Scheme 1 were to be approved, the Initial Investors would receive an additional recovery from their share of the later investments that have remained in cash and were never placed in Puritan; in effect, they would receive a windfall although they might not view it as such as they would still not recover the whole of their initial investment. Under Scheme 2, the Initial Investors will recover less than under Scheme 1 but only because of the performance of the Puritan fund, in which they were invested through the LLF.

24. On the other hand, under Scheme 2, the Interim and Last Investors will recover the full value of their original investment in LLF (subject to any decision I may make in relation to the deduction of charges and in relation to any interest accrued). The Initial Investors will recover only a small percentage of their original investment.

25. I struggled to find a legal principle to apply to assist me in reaching a decision in these circumstances where the two proposed Schemes offer such significantly different financial outcomes to the investors concerned. I found some assistance in paragraph 29-301 of the 18th edition of Lewin on Trusts:

> *"Where the trustees surrender their discretion to the court, it acts in their place by giving directions. In doing so, the court will act as a reasonable trustee could be expected to act having regard to all the material circumstances and is not bound by the wishes of any beneficiary. The court has, however, no greater powers than the trustees have either under the trust instrument or under the general law."*

26. In this case the trust instrument provided no assistance and there is no specific provision of the general law that is directly applicable.

27. A reasonable trustee would decide upon a course of action that achieved a balance of fairness as between the conflicting interests of the different groups of investors. I decided to take as my starting point the fact that the LLF should have suspended trading when Puritan was suspended. In doing so I had in the back of my mind the equitable maxim that Equity looks on that as done which ought to be done. I recognise that it is not a strict application of that maxim and indeed what I was applying was to regard as done that which ought to **have been** done.

28. That approach led me to decide that Scheme 2 is the one to be applied. The Initial Investors will suffer the loss of most of their original investment but that loss has been caused by the performance of Puritan, the fund in which they were, indirectly,

invested and does not arise from my decision. On the other hand the Interim and Last Investors will recover their investment. They thought they were going to be invested in Puritan but that was never possible as that fund was already suspended when they invested. In my view, the balance of fairness favours Scheme 2 over Scheme 1.

29. The second matter I was asked to determine was the treatment of any interest that may have been earned by the Trustee attributable to the monies representing the investments of the Interim and Last Investors. I determined that the same approach should be applied namely to treat the matter as if LLF had been suspended when Puritan was suspended. Hence any interest is to be distributed to the Interim and Last Investors. (The monies have been held in Euros, Euro interest rates have been poor in recent times and no one was able to tell me whether any interest had in fact been earned.)

Swaps

30. The final issue decided by me at this hearing concerned applications submitted by 24 investors requesting that their investment in one of the Class Funds, the Arasbridge Property Solutions Fund ("**PSF**") be swapped for an investment in the Arasbridge International Property Solutions Fund ("**IPSF**"). The requests were never actioned. The reason for the investors' desires to swap between the two funds appears to be that the IPSF was performing better than the PSF.

31. There is no provision in the Scheme Particulars enabling swaps to be made between Class Funds. The only mechanism available was to redeem units in PSF and apply for units in IPSF, thereby incurring both Redemption Charges and Establishment Charges. The Investors were asked to confirm whether they wished to proceed in that manner and none of them responded before trading in the Fund was suspended.

32. The Trustee considered at the time how it might be able to give effect to the request and decided it would have to transfer assets held in PSF to IPSF; in other words to transfer investments with a poor rate of return to the better performing IPSF, to the detriment of the investors in IPSF. If that were to be done now, it would be difficult to decide which assets to transfer.

33. My decision in this case was simple. The only instructions received from these investors were instructions that could not be actioned as there was no mechanism to permit transfers between Class Funds. For that reason, I directed that the applications could be ignored and those investors would continue to be treated as investors in PSF.

