

THE PRINCIPLE OF REFLECTIVE LOSS AFTER MAREX -v- SEVILLEJA

Hugh Sims QC & Jamie Hannant

Rising Rates of Reflection

- The rule in *Foss v Harbottle* (1843) 2 Hare 461
- The decision in *Prudential Assurance Co Ltd v Newman Industries Ltd (No 2)* [1982] 1 All ER 354
- *Gardner v Parker* [2004] 2 BCLC 554
- *Marex Financial Ltd v Sevilleja* [2018] EWCA Civ 1468, [2019] QB 173 **(CA)**

The Japanese Knotweed



Twenty-five years ago the principle was little more than a curiosity of company law, mainly of importance to disgruntled shareholders suffering a loss of value due to some wrong committed against the company. Since then, however, its tentacles have spread alarmingly, rather like some ghastly legal Japanese knotweed. Today it promises to distort large areas of the ordinary law of obligations unless drastic steps are taken to prune it.

(A Tettenborn L.Q.R. 2019, 135(Apr), 182-186)

Prudential Assurance Co Ltd v Newman Industries Ltd (No 2) [\[1982\] Ch](#) 204, 222 – 223

‘...if directors convene a meeting on the basis of a fraudulent circular, a shareholder will have a right of action to recover any loss which he has been personally caused in consequence of the fraudulent circular; this might include the expense of attending the meeting. But what he cannot do is to recover damages merely because the company in which he is interested has suffered damage. He cannot recover a sum equal to the diminution in the market value of his shares, or equal to the likely diminution in dividend, because **such a "loss" is merely a reflection of the loss suffered by the company.** The shareholder does not suffer any personal loss. His only "loss" is through the company...’

Prudential Assurance Co Ltd v Newman Industries Ltd (No 2) [1982] Ch 204, 222 – 223

The Cash Box (£100k - £100k = ?)



Johnson v Gore Wood & Co [2002] 2 AC 1

“If the shareholder is allowed to recover in respect of such loss, then either there will be double recovery at the expense of the defendant or the shareholder will recover at the expense of the company and its creditors and other shareholders. Neither course can be permitted ... Justice to the defendant requires the exclusion of one claim or the other; protection of the interests of the company’s creditors requires that it is the company which is allowed to recover to the exclusion of the shareholder.”

(Lord Millett at p. 62)

Giles v Rhind [2002] EWCA Civ 1428

The exception that (does not) prove the rule.



Creditor Claims

- ***Gardner v Parker* [2004] EWCA Civ 781**

‘The same applies to other payments which the company would have made if it had had the necessary funds even if the plaintiff would have received them qua employee and not qua shareholder and even if he would have had a legal claim to be paid. His loss is still an indirect and reflective loss which is included in the company's claim’

(Lord Millett in *Johnson v Gorewood*)

- ***Marex* [2018] EWCA Civ 1468 (CA)**

Marex in the Supreme Court

Facts

- Claim against two BVI companies
- Draft judgment distributed on 19 July 2013
- Companies asset stripped
- Judgment handed down on 25 July 2013

The court and additional parties

- Constitution of 7.
- All Party Parliamentary Group on Fair Business Banking

Marex – The issues

1. Whether the No Reflective Loss Rule applied in the case of claims by company creditors
2. The *Giles v Rhind* exception

Marex – Lord Reed

- Founded on the rule in *Foss v Harbottle*
- Lord Bingham in *Johnson v Gore Wood* consistent with that
- Lord Millett’s decision based on the law of damages
- ‘...unrealistic assumption that there is a universal and necessary relationship between changes in a company's net assets and changes in its share value’

Marex – Lord Reed

The rule in *Prudential* is limited to claims by shareholders that, as a result of actionable loss suffered by their company, the value of their shares, or of the distributions they receive as shareholders, has been diminished. Other claims, whether by shareholders or anyone else, should be dealt with in the ordinary way.

(Lord Reed at [85])

Marex – Lord Sales

I respectfully consider that the court conflated the rationale for the rule in *Foss v Harbottle* with the rationale for the reflective loss principle, and assumed as correct what was actually in question (*namely*, whether a personal action would in fact subvert the rule in *Foss v Harbottle*)

(Lord Sales at [142])

Marex – Lord Sales

But the rule only achieves this by deeming that the shareholder has suffered no loss, when in fact he has, and deeming that the shareholder does not have a cause of action, when according to ordinary common law principles he should have.

(Lord Sales at [167])

Marex – The *Giles v Rhind* exception

That conclusion does not depend on whether the company is financially able to bring proceedings or not. If the shareholder has not suffered a recoverable loss, he has no claim for damages, regardless of whether, or why, the company may have failed to pursue its own cause of action.

(Lord Reed at [70])

Broadcasting Investment Group Ltd v Smith

Facts

- JVA to transfer shares
- Receiving company unformed at time of JVA
- C1 shareholder of C2's shareholder.
- C2 was the shareholder of the receiving company.

Broadcasting Investment Group Ltd v Smith

The Arguments

- No concurrent claims
- Contract claims as a class apart
- Specific performance
- C1 not a shareholder

Reflective Loss - the future

Contraction

- The sweeping away of the Japanese Knotweed with creditor claims no longer effected

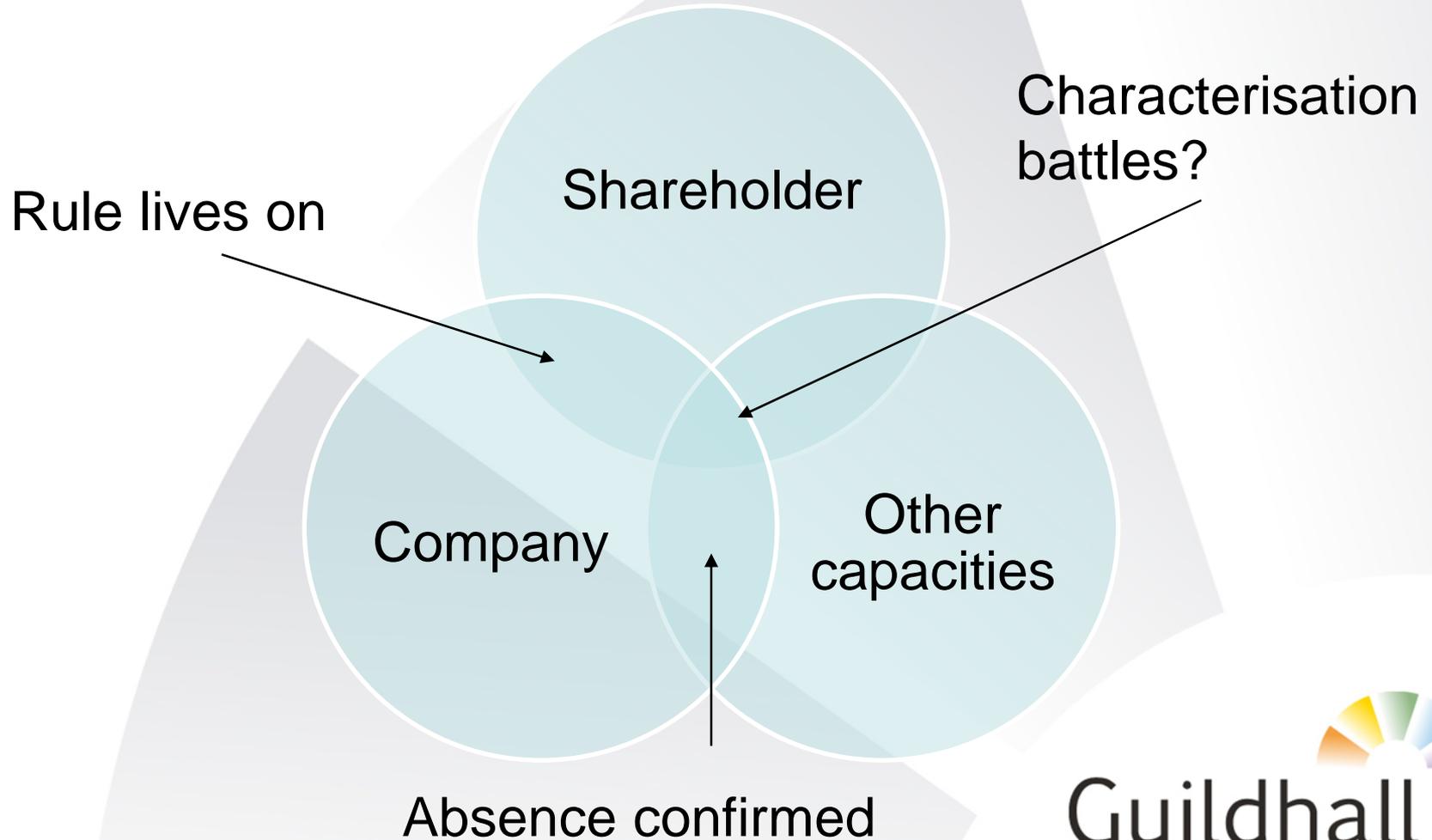
Limited expansion

- No more equitable remedies
- The end of the *Giles v Rhind* exception
- But consider: derivative actions; unfair prejudice petitions under section 994 CA 06, ss. 112, 167, 212 and para 75 Sch B1 IA 1986).

Areas of uncertainty and points to consider

- Overlap claims – narrow or expansive view?
- Avoiding double counting
- More complex company structures
- Characterisation battles?

Where do we now stand?



THE PRINCIPLE OF REFLECTIVE LOSS – QUESTIONS?

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