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Reflecting on "reflective loss": Case note on *Sevilleja v Marex Financial Ltd* [2020] UKSC 31

Introduction & Summary

The appeal to the Supreme Court in *Sevilleja v Marex Financial Ltd* [2020] UKSC 31 re-states the principle that a company's shareholders cannot recover damages against a wrongdoer for loss which is "reflective" of a loss caused by the wrongdoer to the company itself.

The Court confined the principle to loss suffered by a shareholder in the form of a reduction in the value of his shares, or in the loss of some other distribution of the company's profits which he might have received by virtue of his being a shareholder, but for the wrong of the defendant. The majority held that this was a rule of company law, as distinct from a rule of the law of damages.

The Court criticised some of the reasoning in the decision of the House of Lords in *Johnson v Gore Wood* [2002] 2 AC 1. In particular, it held that the reasoning of Lord Millett was in several respects wrong, and ought no longer to be followed; the analysis of Lord Bingham in *Johnson* was approved.

The Court also overruled various cases in the Court of Appeal which had explored potential exceptions to the rule against the recovery of reflective loss.

In essence, therefore, the decision restricts the scope of the rule debarring recovery of reflective loss: but, it held that where the principle applies, the rule is strict.

Previous Authority

The "reflective loss" principle derives from *Prudential Assurance Co Ltd v Newman Industries*[1]. In that case, the Court of Appeal held that a shareholder could not bring a personal claim[2] for damages for a fall in the value of his shareholding or loss of dividend, where such losses were merely the result of damage suffered by the company, and actionable by the company, even though the actions of the wrongdoer also amounted to a wrong against the shareholder.

For example, in *Prudential* itself, the company's directors fraudulently induced shareholders to approve the purchase of assets at an overvalue from an entity in which the directors had

[1] [1982] Ch 204
[2] A shareholder can, in relevant circumstances, bring a derivative claim on behalf of the company [123]

an interest; it was said that any resulting fall in the value of the shareholders' shares would merely be a reflection of loss suffered by the company.[3]

The principle does not apply if the company has no cause of action to recover the loss: see e.g. *Lea v Sheard* [1956] 1 QB 192, approved in *Johnson* and in *Sevilleja* [44].

In subsequent cases, the courts had considered the scope of the "reflective loss" principle. In particular, the decision in *Johnson v Gore Wood &* Co[4] had been said to demonstrate that the principle also applied to losses suffered by employees and creditors of a company even if they were not shareholders.[5]

In some cases, where the application of the principle as articulated per Lord Millett in *Johnson* had been perceived as working injustice, it had been sought to develop exceptions. These cases have now been overruled.

Facts

The material facts[6] in *Sevilleja v Marex* were relatively simple. The Defendant, Mr Sevilleja, owned and controlled two companies, Creative Finance Ltd and Cosmorex Ltd ("the Companies") [16]**.** In July 2013, the Claimant, Marex Financial Ltd ("Marex") obtained judgment in the Commercial Court for around US$5.5m plus costs against the Companies in respect of sums due to it under contracts ("the Judgment") [16]. Mr Sevilleja immediately procured the transfer offshore of large sums from the Companies' accounts, so that Marex could not obtain payment of the Judgment debt. In December 2013, the Companies went into liquidation, with Marex the only creditor not connected with Mr Sevilleja [17-18]. Marex also alleged that the liquidator then effectively acted under Mr Sevilleja's control, and did not investigate the claims submitted to him by Marex, or issue any proceedings against Mr Sevilleja [19].

Marex sued Mr Sevilleja, seeking to recover the judgment debt as damages in tort for inducing or procuring violation of Marex's rights under the Judgment and for intentionally causing loss to Marex by unlawful means. The sums claimed were (i) the Judgment debt, interest and costs awarded by the Commercial Court, and (ii) further costs incurred by Marex in attempting to obtain payment [21]. An order was made giving Marex permission to serve the proceedings outside the jurisdiction. Mr Sevilleja applied to set aside that order, arguing that the losses allegedly suffered in (i) were "reflective" of loss suffered by the Companies [14]. The judge

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[3] *Prudential,* p.222-223
[4] [2002] 2 AC 1
[5] *Gardener v Parker* [2004] EWCA Civ 781 per Neuberger LJ at [70]
[6] Strictly, the facts alleged by Marex, since the question was whether Marex had a good arguable case [14-15]

decided against Mr Sevilleja. However, the Court of Appeal disagreed. Marex appealed to the Supreme Court.

Decision

The Supreme Court unanimously allowed the appeal, the majority judgment being per Lord Reed (with whom Lady Black and Lord Lloyd Jones agreed), and Lord Hodge delivering a concurring judgment. Lord Sales delivered the judgment of the minority (Lady Hale and Lord Kitchin agreeing with him). It can be seen, therefore, that the Court was split 4 to 3 as to the correct legal analysis.

Majority Judgments

Lord Reed held that, properly understood, *Prudential* had established a principle of company law, based on the particular relationship between a company and its shareholders [9].

By contrast, Lord Millett in *Johnson v Gore Wood & Co* had regarded the decision in *Prudential* as based on the need to avoid double recovery; this was a mistake and had caused the "reflective loss" principle to be expanded too far [51]. Lord Millett's other reasons also received criticism; we consider all of these points further, below.

Central to Lord Reed's judgment (and that of Lord Hodge) is an examination of the issues of company law thrown up by reflective loss arguments.

Lord Reed made the following points of company law:

a. It is artificial to state that a shareholder the value of whose shares has been damaged by wrongdoing has not suffered a loss (in practical terms). The *Prudential* rule is that the loss is not a loss recognised by the law, in circumstances where the company has a cause of action against the wrongdoer [26-28];
b. This is consistent with the rule in *Foss v Harbottle* (1843) 2 Hare 461, to the effect that where a company has a cause of action against a wrongdoer, only the company may prosecute that claim [10];
c. It is also important to recall that a share is not equivalent to a proportionate part of the company's assets. It is a right of participation in the company. Shareholders thus have a right to vote in general meetings, a right to participate in profits, rights to share a surplus in the event of winding up, etc [31]. Shareholders also have other rights e.g. in appropriate circumstances to bring an unfair prejudice petition or to mount a derivative action. Thus, a shareholder is not always without a remedy if the company fails to bring its own claim [34];

d. It is unrealistic to suggest that in all circumstances where the company brings a successful claim, this will restore the value of the shareholding, and also to suggest that a loss to the company invariably gives rise to a commensurate fall in the value of its shares [32]. In so far as Lord Millett's speech in *Johnson* rested on this thesis it was wrong. Lord Sales agreed with this point and criticised the very use of the word "reflective" [132, 145-146];
e. Where a shareholder invests in a company he accepts that the value of his investment follows the fortunes of the company, which will be directed by the decisions the company takes in accordance with its decision making organs [35].

Thus, Lord Reed approved the decision in *Prudential* and held that it was a "bright line" rule of company law.

Lord Reed then went on to consider subsequent authorities, in particular *Johnson v Gore Wood*. Whilst holding that the understanding of *Prudential* outlined above was consistent with the speech of Lord Bingham in *Johnson*, Lord Reed criticised the other speeches, in particular, that of Lord Millett [67].

Lord Millett had considered that *Prudential* was indeed addressing the problem of double recovery [50]. Lord Reed said that this failed to explain why the shareholder could not pursue a claim where the company chose not to, or where the company settled its claim at an undervalue [55].

Lord Millett in *Johnson* took the view that in those circumstances, the shareholder's loss was caused by the company's decision, rather than by the defendant's wrongdoing. Lord Reed found this causation point entirely unpersuasive. It could be that the company was unable to sue due to its own impecuniosity brought about by the defendant's wrongdoing, or the defendant might have actually intended the shareholder to suffer loss; in such cases it was "bizarre" to say that the defendant did not cause the shareholder's loss [57]. Lord Sales also rejected the causation argument [151-152].

Lord Reed further criticised Lord Millett's statement that the "reflective loss" principle would also apply 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"*[7]. This appeared to extend the "reflective loss" principle to cover all personal claims against a wrongdoer, in respect of sums which the company would have paid to the claimant but for the wrongdoing (provided that the company had its own cause of action), and went too far [63].

[7] *Johnson* [2002] 2 AC 1, at p.67

For example, if the wrongdoer breached both a contract with a creditor of the company and his duties to the company, causing the company to become unable to pay the creditor, then the creditor should be entitled to sue the wrongdoer for damages, notwithstanding that the company also had a claim and notwithstanding that, if the company had not been wronged, the creditor would have been paid the amounts owed to him [63].

Lord Reed then addressed decisions in which Lord Millett's approach in *Johnson* had been followed. In *Giles v Rhind*[8] it was held that a shareholder was not prevented by the "reflective loss" principle from bringing a claim where the company's own claim had been discontinued because it could not provide security for costs as a result of impecuniosity caused by the defendant's wrongdoing. Lord Reed said that the rule in *Prudential* was that a shareholder whose shares have fallen in value, as a result of a loss suffered by the company in respect of which it has a cause of action, has not suffered a loss recoverable in law. That conclusion did not depend on whether the company had the financial means to bring proceedings [70].[9] *Giles* was therefore overruled despite the fact that the driving force behind the Court of Appeal's decision had been to avoid the injustice which the principle led to, on the facts.

In *Gardener v Parker*[10] Neuberger LJ said that the "reflective loss" principle was not limited to claims brought by shareholders and should apply to claims brought by employees or creditors not in their capacity as shareholders, or even if those employees or creditors were not shareholders at all. Lord Reed said that such claims might involve problems of double recovery, but did not fall within the scope of the "reflective loss" principle, properly understood [76].

Lord Reed distinguished (1) cases where claims were brought by a shareholder in respect of loss suffered in that capacity, in the form of a diminution in share value or in distributions, which is the consequence of loss sustained by the company, in respect of which the company has a cause of action against the same wrongdoer, and (2) cases where claims are brought, whether by a shareholder or anyone else, in respect of losses not falling within that description, but where the company has a right of action in respect of substantially the same loss. (1) was the proper domain of the "reflective loss" principle, and (2) was not, although cases within (2) might raise issues of double recovery [79-80]. The facts of *Sevilleja*, where the claim was brought by a creditor, did not therefore fall within the proper scope of the "reflective loss" principle and the appeal should be allowed.

Lord Hodge's concurring judgment also emphasised the status of the rule in *Prudential* as a rule of company law. He said that the *Prudential* rule was "a principled development of company law which should be maintained" [102].

[8] [2003] Ch 618
[9] The same criticism was said to apply to *Perry v Day* [2004] EWHC 3372 (Ch)
[10] [2004] EWCA Civ 781; [2004] 2 BCLC 554

Minority Judgment

The minority was also of the view that the appeal should be allowed. However, they did not consider that *Prudential* laid down a rule of company law, or any rule of law at all. Instead, they considered that *Prudential* decided only that the shareholders had suffered no loss as a matter of fact [118].

Lord Sales regarded this conclusion in *Prudential* as unsustainable, and said it was not correct to re-characterise the decision as laying down a rule of company law, barring the recovery of reflective loss.

Lord Sales therefore considered that it was not just Lord Millett's speech in *Johnson v Gore Wood* which had gone too far, but the court in *Prudential* itself (although it had reached the correct decision on the facts of *Prudential*). Lord Sales stressed that the plaintiff shareholders in *Prudential* did not actually attempt to establish that there had been a fall in the value of the company's shares [148], and that the value of the company's shares had actually increased following the relevant transaction [134]. In fact, the plaintiffs in *Prudential* had in essence argued that their loss was simply a proportionate share of the company's loss [148]. Lord Sales said that the court in *Prudential* was therefore right to hold that a shareholder could not recover damages *merely* because the company had suffered loss. However, the court went too far when it indicated that a shareholder could *never* recover damages for a fall in the value of his shares caused by loss to the company in respect of which the company had a cause of action on the basis that such a fall was merely a "reflection" of the loss suffered by the company and on the basis that the shareholder suffered no personal loss [143]. Lord Sales indicated that a shareholder might well be able to plead and establish a personal loss resulting from a fall in shareholding value, and also that there was no necessary and perfect correspondence between a company's loss and the fall in the value of the shares (here agreeing with the majority) [122, 153].

Lord Sales criticised the idea proposed by Lord Reed, that when a shareholder invests, he assumes an obligation to give up personal rights of action he may have, or that a shareholder's obligations to use his powers as set out in the articles of association in good faith for the benefit of the company extend to preventing him bringing a claim for damages against a wrongdoer [125-127]. Ultimately Lord Sales argued, there was no conceptual difficulty in permitting a shareholder to recover losses resulting from a fall in the value of shares or a diminution of dividends even where the company also had a cause of action in respect of a related loss to the company; if, on the facts of the instance case, the Companies had been an individual, this would not have made any difference in principle [199-201]. The shareholder should be entitled to sue if he thinks he can prove personal loss since the company does not control the shareholder [154], and the real issue was indeed one of double recovery [119] or the proper assessment of quantum, which could be done by having regard to any recovery or potential recovery by the company [156].

As to these issues, Lord Sales proposed that:

a. Whilst a defendant ought not to be liable twice over for the sale loss, the losses suffered by the company and shareholder were distinct [155].
b. Provided the company continued to trade after the wrongdoing, the company's claim against the defendant *was* brought into account for the credit of the defendant on a claim brought by the shareholder, because the value of the shares after the wrongdoing would reflect the fact that the company had its own claim. In a case where the shareholder had sold his shares at an undervalue before the company made a recovery, a loss would have crystallised which could be recovered (and indeed this happened in *Johnson*, where the claimant had parted with some of his shares as security for a loan, and was not able to redeem them: his claim in this respect was not struck out) [156-158].
c. It was preferable to ensure an innocent claimant was fully compensated than to eliminate any risk of the defendant being liable twice over [159].
d. Practical issues, to the extent that they arose in a particular case, could be addressed by other means than a rule of law preventing the shareholder from ever bringing a claim, for example by sensible case management [161-162], subrogation, or, on the facts of the instant case, allowing Mr Sevilleja a right of reimbursement in respect of Marex's rights against the Companies [198].

Lord Sales held that the potential complexities (and potential injustices) arising from the complexity of a "reflective loss" situation were not a reason of policy supporting a "bright line" rule: rather, he took the view that these matters supported the argument that case management and procedural tools were a better solution [167].

Comment

The Supreme Court achieved an outcome that plainly met the interests of justice in the particular case. In US proceedings brought by Marex, the liquidation of the Companies had been described as *"the most blatant effort to hinder, delay and defraud a creditor this Court has ever seen"* [20]. The judgment reverses the development in the law whereby the "reflective loss" principle had been expanded to cover claims not only by shareholders, but also by creditors and employees. The panel were unanimous that this development was no longer sustainable. Lord Sales would have preferred to overturn the "reflective loss" principle altogether, but for the time being the principle survives, with its scope clearly restricted to cases where a shareholder seeks to claim in his capacity as such.

The decision also contains a helpful analysis at a conceptual level of precisely what a share in a company is; and of the interplay between the various remedies available to wronged shareholders.

It was plainly intended that *Sevilleja* would provide authoritative guidance: hence the convening of a 7 member Court. However, the decision (in terms of its analytical basis) was reached by a bare majority. The Supreme Court has not been shy of revisiting controversial areas of law in recent years (e.g. vicarious liability and ex turpi causa), so it may be that a further attempt will be made in due course to abolish the principle entirely.

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