The principle of 'no reflective loss' following the decision of the Supreme Court in Sevilleja v Marex Financial

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It is trite law that double recovery should be avoided in a claim for damages. This means that where party A and party B have concurrent claims against party C, the court cannot award damages to both where an award of damages to party A, for example, would lead to party B being compensated for the loss suffered by the actions or omissions of party C. This does not mean that the law cannot compensate both party A and party B, but the remedial route by which the law would achieve that objective would have to be modified. For example, the law can avoid double recovery when awarding compensation by prioritising the rights of one party over another, or through subrogation (i.e. by one party stepping into the shoes of another).

This approach, however, is subject to a limited and confined exception, which is very specific to the area of company law, and was decided in the case of *Prudential Assurance Co Ltd v Newman Industries Ltd (No 2)* [1982] Ch 204. In particular, the Court in *Prudential* held that a shareholder cannot bring a claim in respect of a diminution in the value of his/her shareholding, or a reduction in the distributions which s/he receives by virtue of his/her shareholding, which would occur merely as a result of a loss suffered by the company because of the defendant's wrongdoing, even if the defendant's wrongdoing also caused the shareholder to suffer loss. This would be the case even where the company did not bring proceedings against the wrongdoer, and there would thus be no risk of double recovery. This is known as the 'reflective loss' doctrine.

The principle of 'no reflective loss'

The principle of 'no reflective loss' was gradually developed through case law following the case of *Johnson v Gore Wood & Co* [2002] 2 AC, where the House of Lords considered, among other things, the applicable principles when determining an application to strike out damages claimed by a shareholder. The court held that when determining this issue, it would need to scrutinise the pleadings closely to determine whether the relevant losses were due to the shareholder or the company, resolving any reasonable doubt on that issue in favour of the shareholder. It was held that the majority of the losses claimed in the particular case were recoverable by the individual shareholder, on the basis that his losses were not merely a reflection of the losses suffered by the company. In reaching its conclusion, the House of Lords based its decision on the principles in *Prudential.* The House of Lords' reasoning in *Johnson* – particularly that of Lord Millett - was subsequently followed and adopted in a number of authorities, and has gradually morphed into what became known as the principle of 'no reflective loss'; effectively an extension of the reflective loss principle in *Prudential.* The principle of 'no reflective loss' has been the subject of considerable debate; some have argued that the Court in *Johnson* went beyond the circumstances of the kind which *Prudential* was concerned with, and has thus stretched the principle of reflective loss beyond what the court in *Prudential* intended it to be stretched.

Sevilleja v Marex Financial Limited

The Supreme Court had the opportunity to address the rather controversial principle of 'no reflective loss' in the recent case of *Sevilleja v Marex Financial Limited* [2020] UKSC 31. In this case the Court was concerned with a claim against the owner of two companies which had been stripped of their assets in order to avoid satisfying judgments entered against them. The claim was brought by Marex Financial Ltd ("Marex") against Mr. Sevilleja, who was the owner and controller of the two companies in question. Marex sought damages in tort against Mr. Sevilleja for (i) inducing or procuring the violation of its rights under the judgment and order against the companies, and (ii) intentionally causing it to suffer loss by unlawful means.

The key issue the Court had to determine was whether the 'no reflective loss rule' applies in the case of claims by company directors, where the claims are in respect of loss suffered as unsecured creditors, and not solely to claims by shareholders. The Supreme Court held that the rule in *Prudential* had no application to the facts of *Marex,* as it did not concern a shareholder. The Court restated that according to *Prudential*, a shareholder's loss in respect of a diminution in share value was not, in the eyes of the law, damage which was separate from the damage suffered by the company, and was therefore not recoverable. Where there was no recoverable loss, the shareholder could not bring a claim even where s/he had also been wronged by the defendant's conduct, and even if the company had not brought proceedings. The Court reiterated that the situation was confined specifically to companies and their shareholders and was consistent with the rule in *Foss v Harbottle* (1843) 2 Hare 461.[1] *Johnson* gave authoritative support to the decision in *Prudential* that a shareholder was normally unable to sue for the recovery of a diminution in value of their shareholding flowing from loss suffered by the company, for the recovery of which it had a cause of action, whether or not it had pursued such recovery. However, it was held that Lord Millett's reasoning sought to expand the scope of the rule to include other justifications for excluding a shareholder's claim whenever the company had a concurrent claim available to it. Lord Millett's approach made it possible for a shareholder to bring a personal action based on a loss which fell within the ambit of *Prudential* and hence to obtain a remedy which would have otherwise been barred by the decision in *Prudential*, thus circumventing the rule in *Foss v Harbottle*. The Court concluded that parts of the reasoning in *Johnson* had thus departed from *Prudential* and should not be followed.

What now?

The Supreme Court has finally clarified the extent of the reflective loss doctrine, and has confirmed that the 'no reflective loss' principle as interpreted following the case of *Johnson* should not be followed. A shareholder[2] cannot bring an action in his/her personal capacity for a loss caused by the defendant to the company, even where the individual shareholder has also suffered loss, and even where the company has not brought separate proceedings against the party at fault. The notion that a shareholder's loss can somehow be distinguished from the company's loss was rejected.

The reasoning of the Supreme Court in *Marex* was recently applied in the case of *Broadcasting Investment Group Ltd v Smith* [2020] EWHC 2501 (Ch) where the High Court held that a shareholder's claims for damages and specific performance were barred by the rule in *Prudential*, as they were reflective of the company's losses. It was reiterated that the rule in *Prudential* applied only to shareholders and therefore did not bar an individual's claim

[1] It is a general principle of company law that an individual shareholder cannot sue for wrongs done to a company. This principle is commonly known as the rule in Foss v Harbottle.
[2] The principle as clarified in *Marex* only applies to shareholders.

who was connected to the company by a chain of shareholdings but was not, in fact or law, a shareholder. The court also rejected an argument that a claim for specific performance would not be barred under the principle in *Prudential,* as it was not a claim in respect of diminution in value of shareholding or a reduction in dividend income. It was held that there was no suggestion in *Prudential* or *Marex* that any particular remedies would be exempt from the rule. Most importantly, the High Court held that the rule in *Prudential* was a rule of law, and that it did not confer any discretion on the court.

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