Marex: UK Supreme Court Reflects on Loss

In its long-awaited judgment in *Sevilleja v Marex Financial Ltd* [2020] UKSC 31, the UK Supreme Court has clarified the rule barring the recovery of reflective loss, which is likely to be of importance in most common law jurisdictions. The Court has narrowed the application of the rule to shareholders seeking to recover loss suffered in their capacity as shareholder. The rule has no application to creditors. It was this latter point that was dispositive of this appeal. Although the seven justices unanimously allowed the appeal, there was a 4:3 split as to the reasons, which were set out in three separate speeches.

What is the Reflective Loss rule?

A defendant wrongs and causes loss to a company, giving the company a cause of action against the defendant. A shareholder suffers loss by way of a reduction in the value of his shareholding in the company, as a result of an actionable wrong by the same defendant. The shareholder is barred from bringing a personal claim against the wrongdoer. This principle developed from the English Court of Appeal in *Prudential Assurance v Newman Industries Ltd (No 2)* [1982] Ch 204 and the House of Lords in *Johnson v Gore Wood* [2002] 2 AC 1.

Factual Background

Marex obtained judgments against companies controlled by Mr Sevilleja. Before the judgments were handed down, he put those companies' assets out of reach in his own name, apparently to avoid the companies paying the judgment debt. The companies are in liquidation and Marex is the only external unsecured creditor; the rest are Mr Sevilleja and entities controlled by him. The liquidator of the companies has not pursued Mr Sevilleja for the apparent breaches of duty in transferring the assets of the companies into his own name.

Marex wanted to bring a claim directly against Mr Sevilleja. The courts below did not give permission to Marex to serve Mr Sevilleja with such a claim out of the jurisdiction because they considered that the reflective loss rule was engaged.

Issues and Decision of the UK Supreme Court

Two important issues arose on the scope of the rule. First, does it apply to creditors of a company, where their claims are in respect of loss suffered as unsecured creditors and not solely to claims by shareholders? If so, the second issue was whether there is scope for the Court to permit such a claim if it were to produce injustice.

Marex's appeal was unanimously allowed because all of the justices held that the reflective loss rule does not apply to a creditor (as opposed to a shareholder). No question of an exception (the second issue) therefore arose.

There was significant disagreement among the justices, however, about whether the rule (insofar as it concerns a shareholder) should be preserved. A majority of 4 held that it should; a minority of 3 were more equivocal, questioning whether the reflective loss rule exists as a bright line rule of law at all.

The majority held that the exception in *Giles v Rhind* [2003] Ch 618, allowing a shareholder to bring a claim for reflective loss in circumstances where the company was unable to pursue the claim itself, was unsupportable. Even if the company does not or cannot pursue its cause of action, the shareholder is still barred from bringing his personal claim against the defendant.

The Reflective Loss Principle Now

The rule and (for the majority) the reason as stated in *Prudential* survives the appeal in *Marex*. In the majority speeches, the relevant principle is whether or not the shareholder has suffered a recoverable loss. The majority view was that:

- In *Prudential*, the Court decided that a diminution in the value of a shareholding or in distributions to shareholders, which is merely the result of a loss suffered by the company in consequence of a wrong done to it by the defendant, is not in the eyes of the law damage which is separate and distinct from the damage suffered by the company, and is therefore not recoverable by the shareholder.
- Where there is no recoverable loss, it follows that the shareholder cannot bring a claim, whether or not the company's cause of action is pursued. The decision had no application to losses suffered by a shareholder which were distinct from the company's loss or to situations where the company had no cause of action.
- This principle is intended to avoid circumvention of the rule in *Foss v Harbottle*, which does not allow a shareholder to pursue a cause of action of the company, since the shareholder has entrusted the management of the company's right of action to its decision-making organs, including, ultimately, the majority of members voting in general meeting.

The minority considered such a principle to be a poor foundation for a bright line rule of law. The shareholder's loss is not indistinguishable from the loss suffered by a company. For example, in a publicly traded company, movements in the share price do not correspond directly to changes in the assets of the company.

The perceived expansion of the ambit of the rule in *Johnson* does not appear to survive *Marex*. In particular, the avoidance of double recovery at the expense of the defendant was rejected by the majority as an underlying rationale of the rule.

The majority held there is no *Giles v Rhind* exception. It will not matter whether the company in fact brings a claim or even if it is financially capable of bringing a claim. The shareholder's action is barred. This is because the underlying rationale is that the shareholder has not suffered a recoverable loss.

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