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Legal update ——— August 2018

Commercial litigation
Reflective loss, impossibility and fraud claims– life after *Marex*

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The rule against reflective loss is a well established product of public policy. As recognised in *Prudential Assurance Co Ltd. v Newman Industries Ltd. (No 2) [1982]* 1 Ch 204, the rule prevents a shareholder from recovering damages for the diminution of the value of his shareholding where the company he has an interest in has suffered loss as a result of a third party's breach of duty. Public policy dictates that, in those circumstances, his loss is a reflection of the company's loss; the company is, therefore, the proper claimant, not the shareholder. The purpose of this rule is to prevent a potential double recovery by the shareholder, and the company, against the defendant. If the company settles for less than the claim is worth, or chooses not to pursue a cause of action, then the shareholder's right of recourse lies firmly at the company's door.

Johnson v Gore Wood [2002] 2 AC reiterated the principle which stemmed from *Prudential* but also clarified and developed the rule, ultimately holding that a shareholder in a company may sue to recover the loss relating to the diminution in the value of his shareholding when the company itself has no cause of action to sue to recover that same loss. In addition, if the shareholder and the company both have causes of action (relating to separate and distinct breaches of duties owed separately to them) then both may sue to recover those losses. This case also widened the applicability of the rule to bar claims by employees and creditors, as well as shareholders.

The first major exception to the rule came from the case of *Giles v Rhind* [2002] EWCA Civ 1428, [2003] Ch 618. The facts of that case are well summarised in the recent decision of *Carlos Sevilleja Garcia v Marex Financial Limited [2018]* EWCA Civ 1468:

"..the claimant and the defendant were directors of a food company holding about 50% of the shares each. After a falling out, the defendant sold his shares to Apax, a venture capital company which had invested in the company. He set up his own rival food company and, using the confidential information gained when he was a director of the company, diverted the company's most lucrative contract to another company in which he had an interest, in effect he stole the company's business, as Waller LJ said at [11]. The company commenced proceedings against the defendant and his companies but soon after went into administrative receivership. The defendant issued an application for security for costs. As Waller LJ records at [13], Apax was not willing to put up security and the company could not, so that the company discontinued the proceedings by a consent order which provided that the company was precluded from bringing any further action against the defendant or his companies.

The claimant then commenced his own proceedings against the defendant alleging breach of the shareholders' agreement. Following a trial, judgment on liability was entered against the defendant. At the subsequent trial of quantum, Blackburne J held that the claimant's claims were precluded by the principle established in Johnson v Gore Wood, since they were reflective of the company's claim for loss and he struck out the claims. On appeal, the Court of Appeal held that certain of the claimant's claims were personal claims, and not reflective clams, so not caught by the rule. They held that in relation to the other claims, the rule should not apply in the particular circumstances of the case."

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As a matter of public policy it is evidently important to prevent the risk of double recovery (for example, the third party may settle with the shareholder only to find that the company then pursues it for a separate claim for the same amount). However, a review of the factual matrix of *Giles* leads to the conclusion that, but for the exception, the claimant in that case would have been left without recourse against the very serious and calculated wrong he had suffered. The *Giles* exception, therefore, affords a claimant the opportunity to recover losses which may otherwise be reflective where it is impossible for the company to recover that loss.

The question of the extent to which it was 'impossible' for the company to pursue that claim was considered recently. In *St. Vincent European General Partner v Robinson & Others [2018*] EWHC 1230 (Comm), the claimant alleged (amongst other things) that it had been the victim of an unlawful means conspiracy perpetrated by several of the defendants which had resulted in valuable development land being unlawfully stripped from its control. The development land was initially held through the ownership of a company in Cyprus **(HHL),** which in turn owned a company in Poland **(HDP)**, which owned the land. The shareholding later changed, following the execution of a shares pledge; the shares in HHL were transferred to a company incorporated in Singapore and controlled by one of the defendants, and the shares in HDP (which was in an insolvency process at that time) were transferred to a company incorporated in the UK, which was also controlled by that same defendant. At the date of the hearing, HDP was in an insolvency process in Poland and HHL had been struck off the register in Singapore. The claimant maintained that it was impossible for HHL or HDP to bring the claim against the defendants (for financial reasons, and otherwise). The defendants maintained that the claimant's losses were reflective of the losses suffered by HHL and/or HDP, and applied to strike out the claim. Males J struck out the claimant's claims and found that it was not impossible at the time of the hearing for HHL or HDP to pursue a claim. On that basis the case was different from *Giles*, where the defendant had disabled the company from pursuing the claim by way of the application for security for costs.

One of the cases relied on in *St Vincent* was *Marex*, the appeal judgment of which at that time had not been available. The claimant in *St Vincent* contended that the first instance decision of *Marex* was good authority that the rule against reflective loss did not apply to claims for damages as a result of an unlawful means conspiracy. In *Marex*, the court have now concluded that in order for the exception to apply, regardless of the cause of action, it is not enough for it to be factually impossible for the company to bring the claim; it must be legally impossible for the company to be able to pursue the claim.

This evidently creates a potential problem for the victims of wrongdoing; it will not be enough for that claimant to be able to prove that it could not fund expensive or satellite litigation (potentially in another jurisdiction) to regain control of a particular company (or otherwise pursue a derivative action). On that basis, we consider there is a potential that those claimants will begin to look for recourse against other parties who control the company; in reality this is likely to be a director or liquidator. The clarity provided by *Marex* highlights the importance of investigating potential wrongdoing as soon as possible and where appropriate engaging with the various interested parties. If funding for investigations or claims is an issue for the company then timely consideration should be given to potential funding opportunities (such as litigation funding or shareholder loans). If a claim is not pursued without justification, those controlling the company may find themselves in the firing line. With that in mind, shareholders will also have to consider whether an assignment of a cause of action ought to be taken from the company (or from the liquidator) so as to ensure that claim can be pursued.

Helen Briant and Christopher Recker of Trowers & Hamlins acted for St Vincent European General Partner Limited in the above litigation and will be running a series of seminars on this article and subject matter in the latter part of the year.

August 2018 © Trowers & Hamlins

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