Has a Bright Line Dispelled the Will o' the Wisp?

SEVILLEJA (RESPONDENT) V MAREX FINANCIAL LTD (APPELLANT)

1. Last week the Supreme Court handed down judgement (on 15 July 2020), in one of the most important commercial cases this year, *Sevilleja v Marex Financial Ltd* [2020] UKSC 31 (*Sevilleja*).
2. *Sevilleja* was an appeal against a unanimous Court of Appeal decision to the effect that the rule against reflective loss precluded a claim by a creditor of the company (*Marex*) against a director (Mr Sevilleja) who allegedly stripped the assets of the company.
3. The Supreme Court unanimously allowed the appeal, reversing a case law trend expanding the rule against reflective loss. Importantly, whilst the judges did not agree entirely as to the ambit of the rule against reflective loss, they did agree that the rule does not apply to claims brought by creditors who are not also shareholders of a company. This will mean that such non-shareholder creditors no longer have the rule against reflective loss to contend against when bringing claims against the company's directors.

The rule against reflective loss

4. The rule (or principle) against reflective loss originated in *Prudential Assurance v Newman Industries* (No 2) [1982] 1 Ch 204 (*Prudential*) and was re-stated by the House of Lords in *Johnson v Gore-Wood* [2002] 2 AC 1 (*Johnson*), where it was held that the rule is not limited to claims by shareholders as shareholders but also applied to claims by a shareholder in his capacity as a creditor or an employee.
5. *Sevilleja* represented the first opportunity since *Johnson* for the rule to be revisited at the highest level.
6. *Sevilleja* reverses a case law trend expanding the rule against reflective loss which found its high mark in the Court of Appeal decision in *Sevilleja*. The Supreme Court's decision in *Sevilleja* limits the rule against reflective loss to the prevention of claims by a company shareholder against a wrongdoing defendant in respect of loss suffered by that shareholder as a shareholder.

Significance of the decision

7. The rule against reflective loss has been unclear and in flux, certainly since *Johnson*.
8. Given the current uncertain financial climate, it seems likely that there are likely to be a greater number of claims against company Directors over the next several years.
9. One significant effect of *Sevilleja* (perhaps the most significant effect) will be that creditors who are not shareholders are no longer hampered in bringing claims against company directors alongside claims against the company.
10. Although the Supreme Court was not unanimous with respect to the extent of the rule (or principle), the decision goes some way to clarifying what had been described as "*the current will o' the wisp character of the no reflective loss principle*" by Arden LJ in *Johnson v Gore Wood* (No 2) [2003] EWCA Civ 1728 at [162]. The decision does so by overturning the unanimous finding of the Court of Appeal in the same litigation (in *Carlos Sevilleja Garcia v Marex Financial Limited* [2018] EWCA Civ 1468 (CoA)) which had been to the effect that the rule against reflective loss should apply to all creditor claims, whether brought by creditors who are shareholders or by those who are not.
11. In the Supreme court decision in *Sevilleja*, the majority view *per* Lord Reed (at [79-80]) is that there was a need to

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distinguish between:

"(1) cases where claims are brought by a shareholder in respect of loss which he has 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 by anyone else, in respect of loss which does not fall within that description, but where the company has a right of action in respect of substantially the same loss".

12. Lord Reed's conclusion (at [80]) is that claims in the first category (1) are barred by the rule outlined in *Prudential* but claims in the second category (2) are not. Later in the judgement (at [88]) Lord Reed notes that, as a result, it may be necessary to avoid double recovery in an appropriate manner.
13. As noted above, the Supreme Court did not agree with respect to the ambit of the rule *per Prudential*. In a decision agreeing with Lord Reed's decision, at [109] Lord Hodge characterises the rule *per Prudential* as a "bright line legal rule", upheld in *Johnson*, that should not be departed from. However, Lord Sales (with whom Lady Hale and Lord Kitchen agreed), expressed concern over "a policy-based bright line exclusionary rule" [194], describing the position as more nuanced.
14. In his decision, Lord Sales also outlined his view that *Prudential* was not to the effect that a shareholder's recovery was precluded if, as a matter of fact, the shareholder's loss was different to that of the company [117-118]. Lord Sales, also, saying that *Johnson* (in so far as it endorsed debarring shareholders from recovery of personal loss different to loss suffered by the company) should not be followed [194]. This, although strictly obiter, may mean that findings of fact in relation to shareholder and company losses may be necessary and, in turn, may mean that summary determination of shareholder claims on the basis of the re-stated rule against reflective loss is not appropriate.

FACTS

15. Mr Sevilleja was the owner and controller of two British Virgin Island (BVI) companies, Creative Finance Limited and Cosmorex Limited (the companies), that were both vehicles for forex trading and were both customers of Marex Financial Ltd (Marex), a forex broker.
16. Marex claimed against the two companies in contract, for sums due on account, obtaining a draft judgement from Field, J. in the High Court on 19 July 2013, for over USD $5.5 million and costs of around £1.65 million.
17. In the current proceedings, Marex alleged that, following provision of Field, J.'s draft judgment on 19 July 2013 and a freezing order granted against the companies, Mr Sevilleja asset-stripped the companies by arranging the transfer of funds (of over USD $9.5 million) from the company bank accounts in London to his personal control so that, by the end of August 2019, disclosure of assets under the freezing order revealed that the companies only had funds of around USD $4,000. The result was that Marex could not obtain its judgement debt and costs from the companies.
18. In December 2013, Mr Sevilleja placed the companies into liquidation in the BVI. Marex further alleged that the liquidation process was, in effect, on hold with the liquidator failing to investigate claims made to him, to act to locate Marex's funds or issue proceedings against Mr Sevilleja.

LITIGATION

19. Marex subsequently obtained permission to serve out English proceedings on Mr Sevilleja under the 'tort gateway', bringing claims against Mr Sevilleja in tort for (a) inducing or procuring the violation of its rights under Field J.'s judgement and orders and (b) intentionally causing Marex loss by unlawful means.

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20. Mr Sevilleja then applied to set aside the order granting permission for service out. Mr Sevilleja argued that Marex's claim for (a), namely, inducing or procuring the violation of its rights under Field J.'s judgement and orders, was barred by the rule against recovery of reflective loss and, consequently, that Marex did not have a good arguable case in this respect.
21. The Commercial Court found in favour of Marex that the rule against reflective loss did not bar Marex's claim (a). Mr Sevilleja appealed and the Court of Appeal agreed with Mr Sevilleja, finding that the rule against reflective loss applied to claims for reflective loss by all unsecured creditors of the companies. However, in addition to claiming the amounts found by Field J. to be due to it under contract (this being around 90% of the total value of the claim), Marex claimed its costs in seeking to enforce the judgement and the Court of Appeal decided that that, as this claim for enforcement costs was not a reflective loss (but a loss that was personal to Marex), permission to serve out should be granted in relation to the claim for costs only.
22. Marex appealed to the Supreme Court against the finding that the rule against reflective loss applied to claims for reflective loss by unsecured creditors of the companies, barring Marex' claim against Mr Sevilleja for the amounts Field J. had found were due.
23. Although Mr Sevilleja disputed the material facts alleged by Marex, for the purposes of the proceedings including the Supreme Court hearing, the facts were taken to be as alleged (with Mr Sevilleja having open to him the opportunity of challenging Marex's factual allegations later).

JUDGEMENT

24. The Supreme Court unanimously allowed the appeal; Lord Reed giving the leading judgement and with Lords Hodge and Sales giving separate judgements.
25. In the leading judgement, Lord Reed outlined how:

> *"This appeal is concerned with a particular type of situation in which two persons, A and B, suffer loss as a result of the conduct of a third person, C. The situation in question is one in which A is a company, B is a creditor of that company, and B's loss is consequential upon the loss suffered by A, because C's conduct has rendered A insolvent and unable to pay its debt to B" [8].*

26. Lord Reed then analysed the decisions in *Prudential* [23-39]and *Johnson* [40-67]; concluding that *Prudential* concerned diminution in value of a shareholding or in distributions to shareholders caused by a wrong committed by the defendant and that, at law, this was not loss or damage that is separate from the loss or damage suffered by the company [28]. Lord Reed noting at [26] the statement in *Prudential* at pp 222-223:

> "*But what he [the shareholder] 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."*

27. Lord Reed explaining at [33] that:

> "*…there are also circumstances where there may not be a close correlation between the company's loss and any fall in share value. The avoidance of double recovery cannot, therefore, be sufficient in itself to justify the rule in Prudential*."

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28. Lord Reed also discussed the rule in *Foss v Harbottle* (1843) 2 Hare 461 [35-39], namely that the only legal entity that can seek relief for injury to a company is the company itself (the exception to this being the derivative action), concluding that the *Foss v Harbottle* rule would be subverted if a shareholder could pursue a personal action in these circumstances; whilst noting complexities that might arise if there were to be a proliferation of claims (potentially in different proceedings, at different times and in different jurisdictions) [38].
29. At [60] Lord Reed discusses what he describes as "the most serious difficulty" with the approach taken by Lord Millet in *Johnson*, namely that double recovery can arise in situations where concurrent claims exist brought by companies and persons who have suffered loss other than in a capacity as shareholders; explaining that "*Lord Millett's approach has been interpreted in subsequent cases as extending to such persons the same categorical exclusion of claims as he applied to shareholders*".
30. At [80] Lord Reed states that there is a need to distinguish between:

> *"(1) cases where claims are brought by a shareholder in respect of loss which he has 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 by anyone else, in respect of loss which does not fall within that description, but where the company has a right of action in respect of substantially the same loss".*

31. Lord Reed's conclusion is that claims in the first category (1) are barred by the rule outlined in *Prudential* but claims in the second category (2) are not.
32. At [88] Lord Reed notes it may be necessary to avoid double recovery, saying:

> *"It is also necessary to consider whether double recovery may properly be avoided by other means than the prioritising of one claim over the other, such as those mentioned in paras 5-7 above. The judgments of Gibbs CJ and Brennan J in Gould v Vaggelas [1984] HCA 68; (1984) 157 CLR 215, at pp 229 and 258-259 respectively, raise the possibility that subrogation, in particular, may provide a solution to issues of double recovery arising in connection with creditors' claims."*

33. It is worth nothing that there was an important, and controversial, exception to the bar (outlined in *Giles v Rhind* [2002] EWCA 1428), namely that a claim for reflective loss could be brought where a defendant's wrongdoing had caused it to be impossible for the company to pursue a claim (or for a third party to pursue a claim in the company's name) against that defendant. In the majority decision, Lord Reed (with whom Lady Black and Lord Lloyd-Jones agreed) held that *Giles v Rhind* and the subsequent case of *Perry v Day* [2004] EWHC 3372 (Ch) were wrongly decided saying "*… the fact that a wrongdoer has unmeritoriously avoided his liability in damages to A is not a reason for requiring him to pay damages to B*", and noting that "*The solution which company law provides, in a situation of that kind, is the derivative action*" (at [70 – 71]).
34. Lord Hodge in a separate judgement agrees with Lord Reed's reasoning, noting how departure from the approach in *Prudential* has lead to uncertainties [95-108] and noting that the "bright line legal rule" in Prudential is principled and should not be departed from [109].
35. For his part, Lord Sales allows the appeal but notes his view that the rule in *Prudential* should not preclude recovery by a shareholder where, as a matter of fact, the shareholder's loss was different to the loss suffered by the company, saying at [118]

> *"…in my opinion the Court of Appeal in Prudential did not lay down a rule of law that a shareholder with a claim against a third party defendant in parallel with, and reflective of, a claim by the company against the*

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same defendant simply had to be deemed to suffer no different loss of his own which he could recover, whatever the true position on the facts. It did not purport to do so. Rather, the court set out reasoning why it thought the shareholder in such a case in fact suffered no loss".

36. Lord Sales then explains why that portion of the reasoning in *Prudential* cannot be supported in his view, as *Prudential* conflated the rationale for the rule in *Foss v Harbottle* (at [1982] Ch 204, [223H-224A]) and the rationale for the reflective loss principle, whilst assuming that a personal action would subvert the rule in *Foss v Harbottle* and leaving open the possibility of the law conferring additional rights on shareholders [142]. Lord Sales points out that a shareholder might have a personal cause of action based on intentional infliction of harm by unlawful means that depends on the shareholder establishing facts that are not relevant to the company's cause of action [142].
37. Lord Sales' conclusion is that a shareholder should not be prevented from pursuing a valid separate and personal cause of action, but that double recovery (which can be prevented using other means) should not be permitted [149-155].
38. At [194], Lord Sales also says that *Johnson* should not be followed in so far as it endorsed debarring shareholders from recovery of personal loss different to loss suffered by the company.

DISCUSSION

39. As noted above, it seems likely that a significant effect of *Sevilleja* will be that creditors who are not shareholders will no longer be hampered in bringing claims against company directors alongside claims against the company. This is important as, in some circumstances, bringing a claim against a company director directly may be a more straightforward (and cheaper) course of action than other options. This likely to be particularly so in the case of insolvent companies, where persuading a liquidator to pursue a claim against a director might prove difficult.
40. Given the uncertain economic outlook, increased company insolvencies seem likely; a proportion of these insolvencies will almost certainly be caused (or said to be caused) by the wrongdoing of company directors and, as recovery from such insolvent companies by creditors may be unlikely, this may in turn make company directors attractive targets for claims.
41. Against this backdrop and considering the Supreme Court's decision in *Sevilleja*, it would seem to continue to be prudent for potential claimants to carefully consider whether the company has a valid cause of action or not against a wrongdoing director and to consider other options (including applications for injunctive relief and specific performance and the possibility of derivative action).
42. Defendants will, naturally, be well advised to continue to assess whether or not claims against them are barred by the rule insofar as it has been clarified by *Sevilleja*.
43. Of relevance to potential claimants and potential defendants: As also noted above, in his decision Lord Sales outlined how in his view (with which Lady Hale and Lord Lloyd-Jones agreed) a shareholder's recovery should not be precluded if, as a matter of fact, the shareholder's loss was different to the company's loss [117-118]. This may mean that summary determination of shareholder claims against directors based on the rule against reflective loss will not be appropriate in all cases.
44. In conclusion, it seems to us that, whilst the majority decision in *Sevilleja* has provided clarity, the will o' the wisp may not have been entirely dispelled.

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