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# Reflective loss in claims against solicitors and accountants after *Marex*

August 2020

The so called "rule against reflective loss" has been clarified in an important decision handed down by the Supreme Court in *Marex Financial Ltd v Sevilleja* [2020] UKSC 31. The reflective loss principle has long been a useful tool to defend third party claims against accountants and solicitors, but does this decision have a significant impact on the utility of the defence in future?

## General Principles of Reflective Loss

The rule against reflective loss was established in the case of *Prudential Assurance Co Ltd v Newman Industries Ltd (No 2)*[1]. In that case, the Court of Appeal held that a shareholder cannot bring a claim in respect of a diminution in the value of his shareholding, or a reduction in his distributions as shareholder, which is merely the result of a loss suffered by the company and caused by the defendant.

This applies even if the shareholder has a cause of action against the defendant, and even if no proceedings have been brought by the company. The shareholder's loss is not recognised in law as being distinct from the company's loss.

The principle is rooted in the rule of company law established in *Foss v Harbottle*[2] that where a company has incurred loss and the company has a cause of action, only the company itself may seek relief for that loss.

Following the decision in *Prudential*, the courts have grappled with the application of this rule. In *Johnson v Gore Wood & Co*[3] the House of Lords purported to follow and endorse the principles set down in *Prudential*. Lord Bingham's speech in *Johnson* was consistent with the decision in *Prudential*. However, Lord Millet suggested that the rule was not limited to company law. He treated the reflective loss principle as a wider principle of the law of damages, based on the need to avoid double recovery.

Lord Millet's reasoning was wider in ambit than the restrictive decision in *Prudential* and has led to a number of subsequent decisions which have sought to expand the scope of the rule to other classes of claimants, beyond those brought by shareholders.

## The Supreme Court decision in *Marex*

Lord Reed (with whom Lady Black and Lord Lloyd-Jones agreed) delivered the leading judgment. He scrutinised the development of the case law in this area, and in particular the application of *Prudential* in *Johnson*. He held that the rule in *Prudential* was not rooted in avoiding double recovery as Lord Millet had suggested in *Johnson*; an award of damages to a company will not always restore a shareholder's share value. He also dismissed the various policy reasons relied on by Lord Millet.

He held that Lord Bingham's speech in *Johnson* was consistent with *Prudential* but that Lord Millet's and the other speeches should not be followed. He also held that various cases that had relied on Lord Millet's reasoning were wrongly decided[4].

Lord Reed held that it was necessary to distinguish between

- cases where claims are brought by a shareholder in respect of loss which it 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
- 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.

In cases concerning the first category, the shareholder is prevented from pursuing his claim. The shareholder has not suffered a loss which is regarded by the law as being separate and distinct from the company's loss, and therefore has no claim to recover it. The principle in *Prudential* applied.

The position was different in cases concerning the second category. There were circumstances where these claims could succeed; there was no rule of law preventing it but there may be arguments around double recovery which could limit or extinguish the claim.

Whilst the enlarged seven justice panel were unanimous that the Court of Appeal decision on the facts should be overturned, they were unable to agree on how the reflective loss principle more generally should be treated. Lord Hodge, agreeing with Lord Reed, felt that *Prudential* decision established a "bright line legal rule" founded in company law and should not be departed from.

Lord Sales (with whom Lady Hale and Lord Kitchin agreed) delivered the minority judgment. He allowed the appeal but for different reasons. He queried the efficacy of the principle altogether. He considered that the Court of Appeal in *Prudential* did not seek to set down a rule of law but rather sought to decide that case by assessing whether the claimant had suffered no loss.

He noted that whilst there was clearly a relationship between a company's loss and a reduction in value of a shareholder's shareholding, they were not equivalent. Accordingly, a shareholder who had a personal right of action should not be prevented from bringing his claim; there were other ways of ensuring that there was no double recovery by the claimant. He considered that the issue of double recovery was critical in determining whether a claimant could recover his loss, whether the claimant was a shareholder or creditor.

## Consequences in claims against solicitors and accountants

Reflective loss issues often arise in the professional negligence context and the principle has long been a useful tool to limit the circumstances where third party claimants seek to recover personally for losses suffered by a company. On its face therefore, the reduction in scope of the reflective loss principle is perhaps an unwelcome development. However, it is clear that the door is open to defend claims by claimants other than shareholders on a more general basis under the law of damages, by raising arguments of double recovery.

The split in judicial opinion suggests that this is an area where we may see further developments in future. That could see the abolition of the rule in its entirety if Lord Sales' analysis is developed and endorsed. However, it seems likely that in whichever way the law evolves, there will still be scope to defend these types of claim, whether on the basis of a "bright line legal rule" of company law or on the basis of the more general application of the law of damages.


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### Notes

1. [1982] Ch 204
2. (1843) 2 Hare 461
3. [2002] 2 AC 1
4. Lord Reed analysed the decisions in *Giles v Rhind* [2002] EWCA Civ 1428, *Perry v Day* [2004] EWHC 3372 (Ch), and *Gardner v Parker* [2004] EWCA Civ 781 and found that they were all wrongly decided.