

# **The No Reflective Loss Principle in England, Singapore and elsewhere**

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## **The origins of the principle**

There are relatively few judge-made principles of such recent origin as the no-reflective loss principle, which addresses the position where a shareholder seeks to claim for loss it has suffered in that capacity, when the company has a claim for the same loss. Although incorporated legal persons have been with us from the first half of the nineteenth century, no attempt was made to address how corporate personality should impact on the shareholder's right to recover for losses he suffered in that capacity until Prudential Assurance v Newman Industries [1982] Ch. 204.

That case raised the issue of whether a shareholder could recover damages for breach of a fiduciary duty owed by a director to the company. The Court of Appeal, comprising Cumming-Bruce, Templeman and Brightman LJ, said that the answer was "no". The primary focus of the case was what might be described as "proper plaintiff rule", expressed by the Court as:

"the elementary principle that A cannot, as a general rule, bring an action against B to recover damages or secure other relief on behalf of C for an injury done by B to C".

The Court noted that:

"A personal action would subvert the rule in Foss v Harbottle and that rule is not merely a tiresome procedural obstacle placed in the path of a shareholder by a legalistic judiciary. The rule is the consequence of the fact that a corporation is a separate legal entity. Other consequences are limited liability and limited rights. The company is liable for its contracts and torts; the shareholder has no such liability. The company acquires causes of action for breaches of contract and for torts which damage the company. No cause of action vests in the shareholder."

This aspect of the reasoning was wholly orthodox. However, the Court also addressed the issue of what would happen if the director owed a fiduciary duty not just to the company but also to the shareholder? The Court asked:

"But what [a 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. The shareholder does not suffer any personal loss. His only 'loss' is through the company, in the diminution in the value of the net assets of the company ...".

It took another 20 years before this principle became unequivocally established as a principle of English law. That came about as a result of the decision of the House of Lords in Johnson v Gore Wood & Co. (No. 1) [2002] 2 AC 1. Having reviewed various cases on the issue, Lord Bingham distilled three propositions which he said were established by the authorities. First:

“Where a company suffers loss caused by a breach of duty owed to it, only the company may sue in respect of that loss. No action lies at the suit of a shareholder suing in that capacity and no other to make good a diminution in the value of the shareholder’s shareholding where that merely reflects the loss suffered by the company. A claim will not lie by a shareholder to make good a loss which would be made good if the company’s assets were replenished through action against the party responsible for the loss, even if the company, acting through its constitutional organs, has declined or failed to make good that loss”.

That was the main and exclusionary rule. This was followed by two areas where the rule did not apply. The first of those was as follows:

“Where a company suffers loss but has no cause of action to sue to recover that loss, the shareholder in the company may sue in respect of it (if the shareholder has a cause of action to do so), even though the loss is a diminution in the value of the shareholding.”

The rule does not apply where company itself has no cause of action: that is to say when the company has never had a cause of action. It is not sufficient that the company no longer has a cause of action, e.g. because the company’s cause of action is time-barred, or has been extinguished, for example by lapse of time.

The second exception was:

“Where a company suffers loss caused by a breach of duty to it, and a shareholder suffers a loss separate and distinct from that suffered by the company caused by breach of a duty independently owed to the shareholder, each may sue to recover the loss caused to it by breach of the duty owed to it but neither may recover loss caused to the other by breach of the duty owed to that other”.

The terms of this second qualification are of particular interest. Where breach of a duty owed by the wrongdoer to the shareholder causes loss in two respects – one which would be made good by recovery by the company on its cause of action and the other which would not – the reflective loss rule does not prevent the shareholder from recovering the second head of loss. This aspect of its application makes it clear that the reflective loss rule is not a rule of law which bars a cause of action, but one which renders certain heads of loss irrecoverable. This point was expressly made by Neuberger LJ in Gardner v Parker [2004] EWCA Civ 781 at [49]:

“It is clear from the analysis and discussion in the cases to which I have referred, that the rule against reflective loss is not concerned with barring causes of action as such, but with barring recovery of certain types of loss.”

Lord Bingham continued:

“... On the one hand the court must respect the principle of company autonomy, ensure that the company’s creditors are not prejudiced by the action of individual shareholders and ensure that a party does not recover compensation for a loss which another party has suffered. On the other, the court must be astute to ensure that the party who has in fact suffered loss is not arbitrarily denied fair compensation.”

That last sentence has formed the basis of numerous merits-based attempts to escape the rule against the recovery of reflective loss, which are further considered below. Since Johnson, the field of application of the reflective loss rule has grown. In a recent judgment of the Cayman Islands Court of Appeal in Xie Zhukin v. Xio GP Limited 14 November 2018, Sir Bernard Rix noted that the doctrine seemed to be “extending its scope wider and wider” (at [95]).

### **The reflective loss rule in Singapore**

The reflective loss rule applies similarly in Singapore. In the 2002 High Court case of Hengwell Development Pte Ltd v Thing Chiang Ching [2002] 2 SLR(R) 454, the plaintiffs were the majority shareholders of a joint venture company (“JVC”). They sued the directors and officers of the JVC’s wholly-owned Chinese subsidiary for breach of fiduciary duties to the JVC. The defendants argued that the principle of reflective loss applied to the plaintiffs’ claim, citing *Johnson*, as the loss suffered by the JVC as a result of the alleged breach of duties of the defendants was simply a reduction in value of its shareholding in the JVC.

Lai J, after a careful examination of *Johnson*, allowed the plaintiffs to proceed with their action as there was no possibility of double recovery against the defendants, nor would the claim prejudice the creditors and shareholders of the JVC. The judge found, on the evidence of an expert opinion from a Chinese lawyer which was not challenged by the defendants, that under Chinese law, the courts would not give any consideration to a company’s claim against its debtors if there was a deadlock situation in the company which disabled it from passing a resolution to sue.

Referring to the policy reasons behind the exceptions to the reflective loss rule, Lai J said:

“... A litigant is not to be lightly turned away from bringing a genuine cause before our courts. *A fortiori*, if there is no risk of double recovery and there is no prejudice to the creditors or shareholders of the company, which has no remedy in any event under Chinese law, the policy reasons behind the decision in [*Johnson*] do not apply. Accordingly, the joint venture company as the sole shareholder of [the Chinese subsidiary] has the right and title to bring the action to recover the claims. ...”

In Townsing Henry George v Jenton Overseas Investment Pte Ltd (in liquidation) [2007] 2 SLR(R) 597, the Court of Appeal confirmed that the reflective loss rule applies in Singapore. Chan Sek Keong CJ referred to Lai J’s judgment in Hengwell Development, and held that the “principle of reflective loss has in fact been accepted as good law in Singapore”. In doing so,

the Chan CJ considered the New Zealand Court of Appeal's refusal to apply the rule in Christensen v Scott [1996] 1 NZLR 273. Chan CJ considered that, from a doctrinal point of view, the rule is a variant of the "proper plaintiff" rule that has previously been applied in the realm of company law. The proper plaintiff rule seeks to ensure that wrongs against a company are efficiently and fairly disposed of by regulating the category of persons who can recover what is effectively the company's loss. According to Chan CJ, the need to regulate such claims is an unavoidable consequence of the corporate venture which a company represents. The various and diverse interest groups that are potentially affected when a wrong is suffered by a company create the need to ensure that these losses are remedied in an orderly manner, *ie*, through the company as the claimant. This is the basis and justification for the reflective loss rule as accepted in Singapore.

Ultimately, however, the Court of Appeal declined to apply the reflective loss rule. This was on the basis that the issue had not been pleaded or canvassed at first instance; thus, Jenton had not had the opportunity to adduce evidence to establish, *inter alia*, that the Giles v Rhind exception (a possible exception to the rule) applied. That exception is an issue considered below.

### **Reflective loss and the conflict of laws**

The no reflective loss principle has the potential raise a number of conflict issues.

First, as noted above, the company must itself have a cause of action for the loss which the shareholder seeks to claim for the principle to apply. That might raise an issue of foreign law, where the existence of such a cause of action is governed by foreign law (for example because the company is incorporated in another jurisdiction, and the issue of whether what the defendant has done gives the company a cause of action is governed by the law of its place of incorporation). That was issue in Shaker v Al-Bedrawi [2003] Ch. 350, where company in question was a Pennsylvania company. The Court of Appeal held that it was for the party seeking to rely on the exclusionary rule to establish the ingredients for its operation, and that included showing that the company had its own cause of action for the loss. The issue of reflective loss had been considered there as preliminary issue and no evidence of Pennsylvania law had been adduced. The Court refused to proceed on basis of a presumption that Pennsylvania law and English law were the same, not least because the-then English Companies Act 1985 was heavily influenced by European Union Directives on Company Law which would have no application in Pennsylvania.

What happens when the shareholders' own claim is governed by a law other than English law? Does the reflective loss principle rule apply nonetheless as rule of the forum, or is it necessary for the defendant to show that the rule would also provide a defence under the foreign law governing the shareholders' claim? There is no clear answer on this question. A number of cases assume that this is not a question for the law of the forum. In Bank of St Petersburg v Arkhangelsky [2013] EWHC 3529 (Ch), for example, Hildyard J. assumed that this was a question for Russian law, without it being clear whether that was because the company in question was Russian, or because the shareholder's cause of action was governed by Russian law. Hildyard J. noted at [20]:

"These are deep waters. There may be issues as to the interplay between (a) the laws of the forum and the law of incorporation on issues of the standing and rights of a shareholder (see, for example Konamaneni v Rolls Royce Industrial Power Ltd [2002]

1 WLR 1269 at [45]-[50]); (b) the law of the settlement (it would appear, BVI law), the law of the forum and the law of incorporation); (c) personal and derivative claims”.

At the trial, it was common ground that this was an issue of Russian law: [2018] EWHC 1077 (Ch) at [1563], although there was no analysis of the principles which led to this conclusion.

It was also assumed that the issue of reflective loss was one of Manx law, both the place of incorporation and the law of the shareholder’s claims, in Kazakhstan Kagazy Plc v Zhunus [2013] EWHC 3618 (Comm) at [66]. The same assumption was made in LIC Telecommunications SARL v VTB Capital Plc [2018] EWHC 169 (Comm).

One interesting case which considered whether the reflective loss principle should apply is the unusual case of Bank Mellat v Her Majesty’s Treasury [2017] Q.B. 67. The claimant was an Iranian bank and shareholder in an English bank, PIB, which said it had a claim for damages under the Human Rights Act 1998 by reason of an order made under the Counter Terrorism Act 2008 which was held by the United Kingdom Supreme Court to have been made unlawfully. The Court of Appeal proceeded on the basis that it was necessary to establish that the jurisprudence of the European Court of Human Rights, the principles of which the English court was required to follow under the Human Rights Act 1998, recognized a rule against the recovery of reflective loss. That suggested that the place of incorporation of the company in question was not the determinative factor, although the Human Rights Act 1998 Act may require a special rule.

However, there remains scope for arguing that the reflective loss rule is akin to the issue of when a shareholder can bring a derivative claim, and that is an issue which under English conflict of laws principles is governed by the law of the place of incorporation: Konamaneni v Rolls Royce Industrial Power India [2002] 1 WLR 1269 at [45]-[50]. There Lawrence Collins QC noted that there were strong arguments for holding that the law applicable to the ability to bring a derivative claim was the law of the forum, or the law of the place of corporation. At [45] he said that

“There is little to be said for another possible candidate, the law of the underlying claim which it is sought to bring on behalf of the company.”

He ruled in favour of the law of the place of incorporation.

The issue of whether the rule against reflective loss is a procedural rule of the forum, or part of the law of the place of incorporation, may have important implications for the issue of whether a court should be able to disapply the rule by imposing procedural safeguards intended to protect the company’s interest.

### **Can the operation of the reflective loss principle be avoided by procedural mechanisms?**

There have been two relatively recent English decisions which have held it is arguable that the rule against reflective loss will not apply where the relief sought is one which will lead to payment to the company.

The first decision was that of Mr Justice Birss in Peak Hotel and Resorts Ltd v Tarek Investments Ltd [2015] EWHC 3048 (Ch). In that case, the parties had entered into a joint

venture shareholders' agreement which was to govern the control of a hotel group. The relationship of the parties broke down, the claimants saying that the defendants had reduced the value of the joint venture company by transferring valuable assets out of it. The problem was that the shares in the joint venture company were split between the claimants and the defendants, and the board and the shareholders were deadlocked, meaning that the company itself had not brought a claim. But the claimants sought to get around the no reflective loss rule by seeking as the relief on their claim an injunction requiring the assets wrongfully transferred out of the company to be transferred back to it, rather than damages for the loss suffered

And at [69] and [73] Birss J held that this legal solution to the reflective loss issue was arguable. He held that the rules on reflective loss were to prevent double recovery, and to protect the company, other shareholders and the company's creditors. He held that it was arguable that the claim for an injunction did not undermine those policies, but on the contrary served to advance them.

That decision was relied upon, and taken further, by Teare J. in Latin American Shipping Co. v Maroil Trading Inc. [2017] EWHC 1254 (Comm), a case in which I appeared for the unsuccessful defendant. This was another case in which shareholders in a joint venture company fell out, the company was deadlocked, and the claimants brought a claim on the shareholders agreement for loss suffered by the company. They sought to argue that the relief they were seeking was specific performance of the obligations in the shareholders agreement, which therefore did not fall foul of the reflective loss rule. Teare J was not persuaded that the relief sought was properly characterised as a claim for specific performance. But he said this at [22]:

“If the remedy of specific performance is available, as arguably it is, where the Claimant has its own cause of action under the Shareholders Agreement I find it difficult to see why the remedy of damages should not also be available. Of course, if either remedy breached the reflective loss principle it would not be available but neither remedy appears to do so because in both cases the order is that payments be made to the Joint Venture Companies. Such orders are consistent with the principle of company autonomy (because they recognise that the payee is the company and not the shareholder), do not prejudice creditors of the company (because the sums are paid to the company) and do not enable a shareholder to recover compensation for a loss suffered by the company (because the compensation is payable to the company). At any rate there appears to be a good arguable case that these propositions are correct”.

In effect, therefore, he found that it was arguable that the no reflective loss rule would not apply where the claimant sought an order for damages to be paid to the company or undertook that any damages would be so paid. This decision raises a number of issues.

First, it might be said wrongly to assume that the rule against the recovery of reflective loss exists solely to prevent double recovery and prevent the company being prejudiced. However, case law suggests that the rule also exists to ensure legal coherence, and to avoid the incoherence which would follow from two entities simultaneously having the right to bring a claim for the same loss.

Second, the solution held that to be arguable would give rise to serious practical difficulties: for example claims being pursued simultaneously, perhaps in different jurisdictions on

different evidence, with each claimant being able to obtain freezing order relief, or perhaps with one claim in arbitration and the other in court.

Third, if Birss J is right, and the shareholder is entitled to seek an injunction, then it involves the difficulty of the shareholder being able to seek injunctive relief, but only the company being entitled to damages in lieu of such an injunction under what was once Lord Cairns Act 1858 and is now s.50 Senior Courts Act 1981.

Finally, it would enable a shareholder to avoid the controls applicable to the right to bring a derivative action both as a matter of the law of the place of incorporation (e.g. Konamaneni v. Rolls-Royce [2002] 1 WLR 1269 at [50]) and under the procedural rules of the forum (c.f. CPR 19.9(1)).

In the Court of Appeal of the Cayman Islands in Xie Zhukin v. Xio GP Limited 18 November 2018, Sir Bernard Rix considered and approved another “workaround”. He held that the rule was limited to attempts to recover in respect of a loss the company had already suffered, and did not extend to a claim for an injunction intended to prevent the company from suffering loss in the first place. The case concerned the corporate limited partner in a Cayman investment fund and involved an application for an injunction by a shareholder in that limited partner to prevent the company complying with what were alleged to be unlawful capital calls. Sir Bernard Rix held that it was strongly arguable that the reflective loss rule did not prevent a shareholder seeking injunctive relief to prevent the company suffering loss in the first place, and he rejected the appellant’s argument that Peak Hotel and Maroil were both wrong and per incuriam. In particular, he rejected the argument that the Court of Appeal’s decision in Heron International Ltd. v Lord Grade [1983] BCLC 244 precluded injunctive relief to prevent a reflective loss, holding that the case was merely a decision to refuse injunctive relief on particular facts, rather than a decision which intended to establish a general principle of law.

Ultimately, Sir Bernard considered that the reflective loss rule has always been advanced as arising in respect of a reflective loss already suffered by a company, and an injunction which seeks to prevent a loss would prima facie seem to lie outside its reach. As a matter of fairness and justice, Sir Bernard saw little reason to extend the reflective loss rule to delegitimize an attempt to prevent a threatened loss, and more so a threatened dishonesty, from happening. The need to see the company maintained whole, where the loss has not yet occurred, seems to reflect good sense in not extending the rule to cover an injunction being used to *prevent*, as opposed to recoup, loss.

These cases raise an interesting issue as to the correct characterisation of the rule against the recovery of reflective loss, and whether there is a process of re-characterisation underway which might make the doctrine more flexible. The law offers rival analogies to this question, which might be said to point in different directions.

First, there is the way in which the court has approached the issue of whether an equitable assignee should be able to commence legal proceedings without the assignor being party to the proceedings. Like the reflective loss principle, this is a “proper plaintiff” rule. However, it is one which has come to be regarded as raising a procedural obstacle which admits of a procedural solution. The requirement that the assignor be a party to the action to enforce the claim began as an absolute rule: the assignor had to be a party and had to be joined before judgment could be given: Performing Right Society Ltd v London Theatre of Varieties

[1924] A.C. 1. However, it has come to be pragmatically applied, in which the action will be allowed to proceed to its conclusion if the court is satisfied that there is no risk of double recovery: Raiffeisen Zentralbank Osterreich AG v Five Star General Trading LLC [2001] EWCA Civ 1344 at [60].

By contrast, the courts have been unwilling simply to impose a post-judgment trust where a legal claimant seeks to recover lost actually suffered by a third party and offers to undertake to the Court to hold any damages on trust. The law requires a genuine and clear intention to create a trust before the claimant can recover someone else's loss: Re Cook's Settlement Trusts [1965] Ch. 902. Here, the "proper plaintiff" issue is not treated as a practical problem to be overcome by appropriate procedural measures at trial, but as an issue of substantive law.

And courts have similarly been reluctant to accept that undertakings by a claimant as to how the damages recovered will be used can determine whether or not damages are recovered, or how they should be measured: Ruxley Electronics and Construction Co v Forsyth [1996] A.C. 344 at 357, 359.

Quite where the rule against the recovery of reflective loss fits on this spectrum remains a matter of debate. Sir Bernard Rix in Xie Zhukin v. Xio GP Limited 18 November 2018 expressly drew an analogy between the reflective loss rule and the right of the equitable assignee to sue without joining the assignor (at [94]). He suggested that:

"The basis of the doctrine is ultimately as much a procedural as a substantive matter, so as to ensure that the claim is procedurally sound ...".

### **The Giles v Rhind exception**

As noted above, Lord Bingham in Johnson v Gore-Wood suggested that:

"The court must be astute to ensure that the party who has in fact suffered loss is not arbitrarily denied fair compensation."

This sentiment has underlain numerous attempts to create exceptions to the rule, the most famous of which is the exception formulated by the Court of Appeal in Giles v Rhind [2002] EWCA Civ 1428. The Claimant and the Defendant were directors of and each held 50% in a company. The Defendant used confidential information stolen from the company to divert the company's business away from it, driving it into receivership. The company sued the defendant but was forced to abandon the proceedings because it could not meet an order for security for costs which the Defendant had obtained.

The Court of Appeal held that there was an exception to the reflective loss principle where the wrong done to the company had made it impossible for the company to pursue its own remedy against the wrongdoer, and that in this case the effects of the defendant's wrongs on the company had not only been foreseeable but positively intended:

"The effect of the judge's decision ... is that a wrongdoer who, in breach of his contract with the company and its shareholders, 'steals' the whole of the company's business, with the intention that the company ... cannot pursue its remedy against him, and who gives effect to that intention by an application for security for costs



which his own breach of contract has made it impossible for the company to provide, is entitled to defeat a claim by the shareholders .... I would not find it easy to reconcile the result with Lord Bingham of Cornhill's observation .... that 'the court must be astute to ensure that the party who has in fact suffered loss is not arbitrarily denied fair compensation'.

As is apparent from the quotation, Chadwick LJ felt that something would be seriously amiss with the law if matters were otherwise.

A similar argument succeeded before His Honour Judge Rich in Perry v Day [2004] EWHC 372 (Ch). In that case the claimant and the defendant were shareholders in a small company. The defendant sold land to the company, but the conveyance failed to include a key strip of land by mistake. D demanded a ransom price to transfer the strip to the company, in breach both of his duties under the shareholding agreement and his fiduciary duty to the company. It was held that the no reflective loss rule did not prevent the claimant from recovering, because the company had been disabled from pursuing its claim for rectification by the Defendant's wrongdoing, in insisting on the company giving up its claim on terms which were generous to the Defendant.

At least so far as English law is concerned, those two cases represent the high-watermark of Giles v Rhind, and we have seen a steady rowing back from it. In Gardner v Parker [2004] 2 BCLC 554, the Court of Appeal held that the rule would apply even if the company had chosen not to pursue its claim, or settled it on unfavorable terms, in circumstances in which there was no evidence that this state of affairs had been caused by the defendant's wrongdoing.

In Webster v Sandersons Solicitors [2009] EWCA Civ 830, a firm of solicitors who owed duties to both the company and a shareholder allowed the company's and the client's claims to become time-barred. The issue was whether the claimant could recover from the solicitors in respect of the benefits he would have obtained from the proceedings in his capacity as a shareholder, but which were lost because the lawyers had allowed the company's claim to become time-barred. The Court was asked to consider whether Giles v Rhind remained good law in England, and held for the moment it did. But the attempt to invoke the principle failed on the facts due to the absence of a direct relationship between the acts of the wrongdoer and the inability of the company to recover from him.

In Kazakhstan Kagazy Plc v Zhunus [2014] EWCA Civ 381, the reflective loss issue arose because of an argument that the company's claim was time-barred, because the defendant had successfully concealed his own fraud. The Court said that the fact that the company's claim was time-barred did not itself prevent the rule against the recovery of reflective loss applying. The issue was whether Giles v Rhind could ride to the rescue. The Court of Appeal held that the Giles v Rhind exception was "very limited" (at [33]) and limited to where the wrongdoer had made it *impossible* for the company to bring the claim. In the case at hand, the relevant time bar only began to run from when the company could reasonably have been aware it had a claim. It could not be said the wrongdoer's conduct had made it impossible for the company to bring a claim during a period beginning from that date.

The next unsuccessful effort was in St Vincent European General Partner Ltd v Robinson [2018] EWHC 1230 (Comm). In that case the claimant alleged that the Giles v

Rhind exception was engaged because the defendant wrongdoer was still in control of the company. Males J. held that that was not enough because even where a wrongdoer is in control of the company, there remain procedural mechanisms which can be used to force the company to sue such as the derivative or minority shareholders' action. The Judge held at [102]:

“I would accept that the wrongdoers' continuing control of the company is a relevant factor, but the question remains whether the company has been disabled by the wrongdoing from pursuing its remedy. Where a derivative action is possible, that will not be the case. Mr Downes submitted that, if this is so, Giles v. Rhind must have been wrongly decided, but the issue simply was not considered in that case. It was treated as a case where, as a matter of fact, the wrongdoing did prevent the company from pursuing its remedy and, on that factual basis, the rule against recovery of reflective loss was held not to apply.”

The final case is Sevilleja Garcia v Marex Financial Ltd [2018] EWCA Civ 1468. Flaux LJ once again stressed the limited nature of the Giles v Rhind exception and the need for the wrongdoer's acts to be – in the judge's words – “directly causative” of the impossibility the company faces in bringing the claim (at [56]). Flaux LJ went on to say that it had to be legally, and not simply factually, impossible for the company to bring a claim. It was not enough, he said, that the wrongdoer had deprived the company of assets to fund the bringing of a claim. So if, by injection of funds from a third party, the company could bring a claim, or a shareholder could bring a derivative claim in the company's name, Flaux LJ said that the exception did not apply: [58].

This re-interpretation of Giles v Rhind may fairly be said to narrow the exception out of existence. It makes Giles v Rhind turn on a provision in the discontinuance in that case preventing the company from bringing a claim again, but even that may not provide an answer because it must follow that at least up until that point, the company was able to bring a claim.

### **The Giles v Rhind exception elsewhere**

The Singapore Court of Appeal alluded to the Giles v Rhind exception in Townsing Henry George v Jenton [2007] 2 SLR(R) 454. As noted above, the court declined to apply the reflective loss rule because the issue had not been pleaded or canvassed at first instance. As such, Jenton had not had the opportunity to adduce evidence to establish, *inter alia*, that the Giles v Rhind exception applied. However, the court did not discuss whether the exception was correctly established in the first place; it had simply assumed it applied in Singapore.

The Singapore International Commercial Court in BCBC Singapore Pte Ltd and another v PT Bayan Resources TBK and another [2017] SGHC(I) 6 was confronted with a similar situation in which the reflective loss rule was not adequately pleaded. As such, the court decided that to apply the rule would deny the plaintiff from adducing evidence that loss which it claims is not reflective, or that if it is reflective, it falls within the Giles v Rhind exception. The court therefore did not need to go into the precise interpretation of the exception.

However, the court did note that after the decision in Townsing, the Hong Kong Court of Final Appeal delivered its judgment in Waddington Ltd v Chan Chun Hoo Thomas [2009]

2 BCLC 82. In that case, Lord Millett NPJ observed, and the other Court of Final Appeal judges agreed, that Giles v Rhind had been wrongly decided and the exception found there did not actually exist. While the SICC did not need to consider Waddington – principally because the parties did not address the court on it – the Hong Kong Court of Final Appeal’s treatment of the Giles v Rhind exception is certainly of interest.

In Waddington, PH Limited owned a number of subsidiaries and sub-subsidiaries. The first defendant was director of these companies. W, a shareholder in PH, alleged that the first defendant had acted in breach of fiduciary duty so as to cause loss to several of the sub-subsidiaries. W brought a derivative action on behalf of PH to recover losses which PH suffered as a result of the first defendant conduct. The first defendant applied to strike out the claim on the ground that PH’s losses were reflective of those of the sub-subsidiaries. In the Court of Final Appeal, W conceded that this was the case, but asserted that its claim fell within the Giles v Rhind exception. Referring to Giles v Rhind, Lord Millett held that it could not be right to allow the shareholder to bring an action for its own benefit, because that would entail recovery by the wrong party to the prejudice of the company and its creditors. Indeed, this would lead to the very result which Lord Millett himself had identified as unacceptable in Johnson v Gore Wood, that is, it would allow the claimant to obtain by a judgment of the court precisely the same extraction of value from the company at the expense of its creditors that the defendant was alleged to have obtained by fraud.

Lord Millett suggested an alternative approach to the problem in Giles v Rhind: that some way needed to be found to permit the company to recover damages despite the discontinuance of its own proceedings. In that case, the court could have given the shareholder leave to apply to direct the administrative receiver to bring the action if the shareholder was willing to fund it. Moreover, Lord Millett rejected the assumption by the Court of Appeal that the no reflective loss principle is not engaged where the company has lost the right to sue. He held that the House of Lords in Johnson v Gore-Wood had expressly applied the principle not only where the company had the right to sue but also where it had declined or failed to sue

In the end, Lord Millett held:

“The facts of the present case do not bring it within measurable distance of the exception described in Giles v Rhind. But Mr Justice Barma (at first instance) went further and held that the supposed exception does not exist, and I respectfully agree with him. The case has been followed in England at first instance in Perry v Day...and referred to without enthusiasm by the Court of Appeal in Day v Cook...and Gardner v Parker...But in all these cases the court was bound by the decision in Giles v Rhind. But in my opinion Giles v Rhind and Perry v Day were wrongly decided and should not be followed in Hong Kong.”

Giles v Rhind is obviously not binding on the Singapore courts. Given the SICC’s reference to Waddington, and the good number of cases that have narrowed the Giles v Rhind exception, it may well be that Singapore law may follow the path taken by the Hong Kong Court of Final Appeal.

More recently, in the Cayman Court of Appeal, Sir Bernard Rix had to consider whether the rule against reflective loss prevented the shareholder suing when the wrongdoer was in control of the company in Xie Zhukin v. Xio GP Limited 18 November 2018. He felt unable

to apply Giles v Rhind, in view of the run of English Court of Appeal cases narrowing the scope of that exception to a vanishingly small area. However, he achieved essentially the same outcome by saying that the claim by the 100% beneficial owner of the shares in the company was in substance a derivative action, even though none of the requisite formalities for bringing such an action had been complied with. He criticized any other approach as “pure formalism” ([66]). In language redolent of the spirit which animated the Giles v Rhind exception in the first place, he held that allowing the shareholder to obtain injunctive relief in these circumstances reflected “good sense, justice and fairness” ([71]).

### **The position on unfair prejudice petitions and similar applications for statutory discretionary relief**

There are a number of discretionary statutory forms of relief which are intended to avail a minority shareholder who is prejudiced by the conduct of the majority in control of the company. Such a shareholder might well have a contractual claim against the majority, arising from the shareholders agreement which almost invariably precede the formation of private joint venture companies. The fact that the majority’s conduct involves the breach of a shareholders’ agreement may very well be relied upon as one of the factors said to establish a basis for discretionary relief. Does the rule against recovery of reflective loss apply in this context?

The answer seems to be no both in England and Singapore.

Taking England first, the issue first surfaced in Atlasview Ltd v Brightview Ltd [2004] BCC 542, before Jonathan Crow sitting as a Deputy High Court judge on the hearing of what was then a s.459 unfair prejudice petition. He rejected the suggestion that a principle of law concerned with “writ actions” – by which he meant assertions of private law rights, as opposed to the exercise of a court’s discretionary power. He held that as a matter of statutory interpretation, there was no basis for reading the broad discretion of s.459 down by reference to the rule against the recovery of reflective loss. He did note at [63]:

“In deciding on the appropriate form of relief, the trial judge will no doubt be astute to ensure that the B shareholders do not achieve double recovery by receiving financial compensation directly from the A shareholders and also retaining their B Shares in Brightview in circumstances where the company is able (if it is) to recover in respect of the same loss: indeed, it seems to me most likely that the trial judge would, if the petition succeeded, order the respondents to acquire the Barton parties’ shares, valued on the basis that there had been no transfer to Freshbox, rather than making an award of damages (however described). But that is a matter for his discretion, if and when it comes to considering the appropriate form of relief”.

In the matter of Chime Corporation Ltd [2004] 3 HKLRD 922 at [46], a Hong Kong decision, Lord Scott cast doubt on the decision in Atlasview:

“The deputy judge was plainly of the view that it was obvious that the court’s jurisdiction on a s.459 petition would enable the court to order payment to the company of the compensation to which the company would at law have been entitled in a derivative action. Whether the judge was right in holding also that s.459 enabled an order to be made for the payment by the wrongdoers of part of that compensation to the petitioners seems to me, if I may say so, highly questionable. An order for

payment or transfer of a part of the company's assets to the petitioning shareholders is, I would think, an order that could only properly be made in a winding-up of the company, or as a distribution of the company's profits, or as part of a reduction of the company's capital (see s.168A(2)(c)). Otherwise the interests of the company's creditors would be at risk."

However, in Re Hart Investment Holdings Ltd [2013] EWHC 2067 (Ch), HHJ Roger Kaye QC identified reflective loss as an issue to be catered for in the terms of the relief granted in unfair prejudice, rather than something preventing relief altogether.

The position in Singapore appears to be similar. In Leong Chee Kin v Ideal Design Studi Pte Ltd [2017] SGHC 192, the defendant argued that the plaintiff's action for minority oppression on the basis of diversion of business is an abuse of the oppression remedy under s 216 of the Companies Act, in that the plaintiff is using s 216 to pursue a remedy for what is in essence a wrong to the company. Coomaraswamy J held that the proper plaintiff principle and the reflective loss principle establish a conceptual distinction between personal rights and corporate rights. A breach of a right vested in a shareholder ought to be vindicated at the suit of the shareholder, whereas a breach of a right vested in the company ought to be vindicated at the suit of the company. Accordingly, a shareholder's attempt to use s 216 of the Act to vindicate a right vested in the company – such as a company's rights against a director who has breached his fiduciary duties to the company – could be considered an abuse of process.

However, the learned judge observed that there are often overlaps between personal rights and corporate rights. It is not uncommon for acts which are alleged to be oppressive also to constitute a wrong to the company. As such, he formulated the following propositions to be borne in mind on an application under s 216 where the principle barring recovery of reflective loss is raised:

- (a) The same acts can be oppressive conduct within the meaning of s 216 of the Act and also a breach of duty owed to the company. It is not invariably the case that a shareholder should be barred from pursuing a remedy for the oppressive conduct by an application under s 216 just because the compensation to be awarded to him, if he succeeds, will reflect in whole or in part the loss suffered by the company by the breach of duty owed to the company.
- (b) In ascertaining whether the shareholder is barred from seeking relief under s 216, the court must determine the true nature of the shareholder's complaint and the essence of the relief sought by the complainant.
- (c) An application under s 216 will be appropriate where the unlawfulness of the wrongdoer's conduct is merely used as evidence of the wrongdoer's disregard of the complainant's interest as a shareholder and where the complaint cannot be adequately addressed by the remedy provided by law.
- (d) Another important consideration is whether the policy concerns underlying the reflective loss principle would be contravened if the complainant is allowed to pursue a personal action under s 216. If there is no such danger, then any insistence on complying strictly with the reflective principle loses much of its force.

More recently, the Court of Appeal in Ho Yew Kong v Sakae Holdings Ltd and other appeals and other matters [2018] 2 SLR 333 affirmed that s 216 should not be used to vindicate wrongs which are in substance wrongs committed against a company and which are thus corporate rather than personal in nature.

What is interesting about these decisions is the suggestion that the issues raised by reflective loss can simply be dealt with in the context of framing discretionary relief, rather than raising insuperable bars to recovery. That reflects the inherent flexibility of broad statutory discretions, and it should not be supposed that the same approach can easily be carried off to private law claims advanced as of right.

### **Indirect shareholders**

Almost all cases on the no reflective loss rule concern a direct shareholder and the company in which the direct shareholding is held. What happens, however, where someone who is an indirect shareholder in a company seeks to claim in respect of loss suffered as a result of loss sustained by the company?

The application of the principle of “no reflective loss” in these circumstances is supported by the Hong Kong case of Waddington Ltd. v. Chan Chun Hoo Thomas [2009] 2 BCLC 82 at [74]-p75]:

“[74] ... Any depletion of a subsidiary’s assets causes indirect loss to its parent company and its shareholders. In either case the loss is merely reflective loss mirroring the loss directly sustained by the subsidiary and as such it is not recoverable by the parent company or its shareholders for the reasons stated in Johnson v Gore Wood. But this is a matter of legal policy. It is not because the law does not recognise the loss as a real loss; it is because if creditors are not to be prejudiced the loss must be recouped by the subsidiary and not recovered by its shareholders ...

[75] This is not to allow economic interests to prevail over legal rights. The reflective loss which a shareholder suffers if the assets of his company are depleted is recognised by the law even if it is not directly recoverable by him. In the same way the reflective loss which a shareholder suffers if the assets of his company’s subsidiary are depleted is recognised loss even if it is not directly recoverable by him. The very same reasons which justify the single derivative action also justify the multiple derivative action. To put the same point another way, if wrongdoers must not be allowed to defraud a parent company with impunity, they must not be allowed to defraud its subsidiary with impunity.”

The application of the rule can be justified in cases of indirect shareholding where the law recognises the double derivative action, allowing the ultimate shareholder to bring a claim which forces the company to enforce its claim. Double derivative actions have been upheld in Hong Kong in Waddington Ltd v Chan Chun Hoo Thomas and England in Universal Project Management Services Ltd v Fort Gilkicker Ltd [2013] EWHC 348 (Ch) and in the Cayman Islands in Renova v Gilbertson [2009] C.I.L.R. 268. Given that procedural remedies exist to allow an indirect shareholder to force a company to sue, and the “proper plaintiff” element which is one of the justifications of the rule against reflective loss, there is no obvious reason why the rule against reflective loss should not also apply to indirect shareholders.

## **Is the reflective loss principle restricted to losses suffered by a shareholder in its capacity as a shareholder?**

In Gardner v Parker [2003] EWCA Civ 1728, the shares in a company called BDC were owned as to 85% by the defendant and 15% by a trust held for the benefit of the claimant and his family. BDC owned shares in another company called Scoutvale, of which the defendant was a director, and the defendant arranged for Scoutvale to transfer an asset to another company of his at an undervalue. BDC was also a creditor of Scoutvale. When BDC sued the defendant for the transfer, he alleged that the rule against reflective loss applied because the loss had been suffered by Scoutvale. BDC contended in response that in so far as it was also a creditor of Scoutvale, the rule did not apply. This argument was rejected by the Court of Appeal because the damage which BDC had suffered would have been made good if Scoutvale had made good its claim against the defendant, whether in its capacity as shareholder or creditor. The Court suggested (at [70]), that even if BDC had not been a shareholder but just a creditor, it was hard to see why the rule would not apply.

Gardner v Parker directly only addressed the position of a creditor who was also a shareholder. In Fortress Value Fund v Blue Sky Opportunities LP [2013] EWHC 14 (Comm), Flaux J had to consider whether the rule applied to a party who was in substance a creditor of the company, for loss suffered by the company, and also to a secured creditor for loss suffered by reason of the diminution in the value of its security. The loss suffered by reference to the value of the security was conceded to be arguable, and rightly so. For this is a loss which can fairly be said to be unique or special to the creditor. The same conclusion was reached by Edward Bartley-Jones QC in International Leisure Limited v First National Trustee Company UK Limited [2012] EWHC 1971 (Ch) at [36]–[47].

Flaux J held that the position of a pure creditor was also arguable, notwithstanding Lord Neuberger's comments. However it fell to him finally to decide the point, at least below the Supreme Court, in Sevilleja Garcia v Marex Financial Ltd [2018] EWCA Civ 1468. Having surveyed the authorities, he concluded there that rule was not simply one which addressed the relationship of a company and its shareholders, and that there was no principled basis for distinguishing between the creditor who was also a shareholder, where Gardner v Parker had held the rule did apply, and the pure creditor. In particular, if a creditor was able to recover his own loss *qua creditor* the result would be to subvert the *pari passu* principle and prejudice other secured creditors of the company.

One point the Court considered, but left open, was whether the rule should extend to creditors of an individual who suffer loss in that capacity, on the basis that allowing the creditor to recover for loss *qua creditor* would subvert the *pari passu* principle in bankruptcy.

In Townsing Henry George v Jenton Overseas Investment Pte Ltd [2007] SGC 13, the Singapore Court of Appeal did not say definitively whether the reflective loss rule is restricted to shareholders. However, it considered that if the principle had been pleaded in that case, Jenton, being the sole shareholder *and creditor* of NQF, could have given an undertaking to the court, binding on NQF, that NQF would not seek double recovery of the Relevant Sum from the appellant. This seems to suggest that the rule may not apply to a creditor, although the court did not decide this directly. Indeed, the court's holding that the reflective loss rule may not apply was premised not so much that Jenton was a creditor, but that in its capacity as a shareholder and creditor, it could give an undertaking that would disapply the rule.

There is the separate question of whether the reflective loss rule applies to beneficiaries of a trust. This was addressed by the Royal Court of Guernsey in Jefcoate v Spread Trustee Company Limited Judgment 14/2014, where the losses had been suffered by a company owned by a discretionary trust. The plaintiff there was a beneficiary of the Lesterps Settlement, a Guernsey discretionary trust. He alleged that a number of properties were transferred at a significant undervalue to entities connected with the sixth defendant, to the detriment of the trust. Specifically, he alleged that the trustee defendants had been in breach of trust and/or duty by allowing the properties to be disposed in such a manner. These properties were owned by Holborn Investments Limited (HIL), a Guernsey company indirectly owned by the first defendant, Spread Trustee Company Limited (the Trustee) in its capacity as trustee of Lesterps.

The defendants argued that neither Lesterps, nor, therefore, the plaintiff, could recover losses arising from the disposal of the properties at an undervalue because Lesterps' loss was simply reflective of the underlying loss that had been suffered by HIL as owner of the properties. HIL should therefore have brought the claims, and not the plaintiff. The defendants argued that the reflective loss rule applied equally to beneficiaries of a trust as it did to an ordinary shareholder. Lieutenant Bailiff Marshall accepted that the rule against reflective loss, as applied in English law, could extend to claims made by beneficiaries of trusts, although whether the rule does apply can be highly fact specific, because the issue of whether a claimed loss is totally reflective of a loss for which the company can claim is fact specific.

The position is somewhat unsettled in Hong Kong. In Hotung v Hillhead Limited [2008] HKCFI 211, Reyes J rejected the submission that the reflective loss rule should not apply to beneficiaries. Citing extensively from *Lewin on Trusts*, he held that the court's focus should be on the type of loss claimed as opposed to the cause of action being asserted. As such, it cannot be that the rule applied where the action was taken by a shareholder but did not apply where it was taken by a beneficiary. In both cases, the underlying company would have been able to make good the losses had it sued. However, in Hotung v Ho Yuen Ki [2010] HKCA 385, the Court of Appeal referred to the very same passages in *Lewin on Trusts* and decided that the law was not clear as to whether the reflective loss rule applied to beneficiaries. As it was a striking out application, the court did not need to come to a clear conclusion on the law, just that there was an arguable case that the reflective loss rule may not apply to beneficiaries. This was sufficient for the court to reverse the lower court's decision to strike out the plaintiff's claim on the basis that the rule prevented his claim.

Perhaps the better view is that taken by the Royal Court in Jefcoate v Spread Trustee Company Limited. That is, the reflective loss principle could potentially apply to beneficiaries, but whether it actually does in a particular case needs to be decided by reference to the precise facts and whether the purpose behind the rule is invoked. By bearing the purpose of the rule in mind, we can avoid the unnecessary confusion that may come about by an otherwise technical application of the reflective loss rule. On this issue, as on many others, the decision of the Supreme Court in Marex may decide whether the principle becomes an inflexible rule of law, or a weighted policy issue to be responded to as the circumstances of a particular case require.

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