➤ ***Further notes***

This area is difficult, and the cases are not easy to reconcile. Yet, if members are to pursue personal claims, then it is essential to know whether the wrong in question is one which has been done to the company or to the member personally, since in the latter circumstances the member, being the proper claimant, is able to sue, subject only to the 'internal management' and 'irregularity' principles (see 'The old common law rule in *Foss v Harbottle*', pp 639ff). The following examples further illustrate the courts' approach.

1. In *Bamford v Bamford* [1970] Ch 212 (for the facts and another part of the decision, see **[4.32]**), Russell LJ held that:

> The harm done by the assumed improperly motivated allotment is a harm done to the company, of which only the company can complain. It would be for the company by ordinary resolution to decide whether or not to proceed against the directors for compensation for misfeasance.

2. By contrast, in *Re a Company* [1987] BCLC 82, at 84, Hoffmann J said:

> Although the alleged breach of fiduciary duty by the board is in theory a breach of its duty to the company, the wrong to the company is not the substance of the complaint. The company is not particularly concerned with who its shareholders are. The true basis of the action is an alleged infringement of the petitioner's individual rights as a shareholder. The allotment is alleged to be an improper and unlawful exercise of the powers granted to the board by the articles of association, which constitute a contract between the company and its members. These are fiduciary powers, not to be exercised for an improper purpose, and it is generally speaking improper 'for the directors to use their fiduciary powers over the shares in the company purely for the purpose of destroying an existing majority, or creating a new majority which did not previously exist'. (See *Howard Smith Ltd v Ampol Petroleum Ltd* **[7.12]**.) An abuse of these powers is an infringement of a member's contractual rights under the articles.

3. Similarly, in *Residues Treatment and Trading Co Ltd v Southern Resources Ltd (No 4)* (1988) 14 ACLR 569, the Supreme Court of South Australia held that an action to challenge an allotment of shares on the ground that the directors had acted for an improper purpose came within the 'personal rights' exception to the rule in *Foss v Harbottle* **[13.01]** (as well as being a breach of duty to the company for which the company itself could have sued), since such an allotment brought about an impermissible dilution of the plaintiff member's voting rights. King CJ said, at 575:

> A member's voting rights and the rights of participation which they provide in the decision-making of the company are a fundamental attribute of membership and are rights which the member should be able to protect by legal action against improper diminution.

(p. 672) (He also expressed doubts whether *Bamford v Bamford*, Note 1, was correct in treating such an act on the part of the directors as ratifiable by the members, but it is suggested that *Bamford v Bamford* may be defended on this point.)

4. Finally, in *MacDougall v Gardiner* (1875) 10 Ch App 606, the member had an undoubted personal right under the articles, but the Court of Appeal nevertheless held that it had no jurisdiction to cure the improper denial of the member's right to call for a poll, since this was an irregularity which could be cured by the majority. James LJ drew attention to the good sense that lies behind the normal constitutional provisions which allow a meeting to be requisitioned, or conducted in a particular manner, only when a significant percentage of supporters can be mustered. (But contrast *Pender v Lushington* **[13.19]**.)

➢ Questions

1. Given the comments in Note 1 of the previous Further notes, was Russell LJ right to say that the harm done by an improperly motivated allotment was a harm to the company of which only the company could complain? Are these various views reconcilable?

2. Is it of any concern to a company who has control of it?

Can the member's personal right be enforced?

The 'irregularity principle'.

[13.20] MacDougall v Gardiner (1875) 1 Ch D 13 (Court of Appeal)

Gardiner, the chairman of the Emma Silver Mining Co, had adjourned a general meeting of the company without acceding to the request of a shareholder, MacDougall, and others, that a poll be held on the question of the adjournment. MacDougall now claimed a declaration that the chairman's action was improper, and an injunction restraining the directors from taking further action. The Court of Appeal held that this was a matter of internal management in which it should not interfere.

> MELLISH LJ: In my opinion, if the thing complained of is a thing which in substance the majority of the company are entitled to do, or if something has been done irregularly which the majority of the company are entitled to do regularly, or if something has been done illegally which the majority of the company are entitled to do legally, there can be no use in having a litigation about it, the ultimate end of which is only that a meeting has to be called, and then ultimately the majority gets its wishes. Is it not better that the rule should be adhered to that if it is a thing which the majority are the masters of, the majority in substance shall be entitled to have their will followed? If it is a matter of that nature, it only comes to this, that the majority are the only persons who can complain that a thing which they are entitled to do has been done irregularly; and that, as I understand it, is what has been decided by the cases of *Mozley v Alston* (1847) 1 Ph 790 (Ch) and *Foss v Harbottle* **[13.01]**. In my opinion that is the rule that is to be maintained. Of course if the majority are abusing their powers, and are depriving the minority of their rights, that is an entirely different thing, and there the minority are entitled to come before this court to maintain their rights; but if what is complained of is simply that something which the majority are entitled to do has been done or undone irregularly, then I think it is quite right that nobody should have a right to set that aside, or to institute a suit in Chancery about it, except the company itself.

➢ Note

For a comment on this case, and a suggested reconciliation with the apparently contrary ruling in *Pender v Lushington* **[13.19]**, see C Baxter, 'Irregular Company Meetings' [1976] JBL 323, **(p. 673)** and the same author's 'The Role of the Judge in Enforcing Shareholder Rights' [1983] CLJ 96. His view is that 'the court will not interfere in the affairs of a company unless it is necessary to do so and that interference is always unnecessary when it has no practical consequence'. In the context of irregularities in company meetings, references to *Foss v Harbottle* are often gratuitous and irrelevant.

➢ Questions

1. The company's articles of association gave any five or more members the right to demand a poll, and MacDougall had the necessary support. Was there not a wrong done here to MacDougall, a denial of his rights as a member? If so, how do you think he might have enforced them?

2. Is the *ratio decidendi* of this case the same as that of the court in *Foss v Harbottle* ?

The 'no reflective loss' principle

The 'no reflective loss' principle ensures that a defendant can be sued only once for the same loss, *and*, in doing that, prioritises the company's claim as a matter of principle. Regardless of the type of claim (common law or equity), or the form of remedy (compensation or restitution), or the status of the member (majority or minority), the principle prevents a person other than the company suing for the loss even when the person has a cause of action against the defendant, and even if the cause of action is different from the company's.

A member has no right to sue in a personal capacity where the loss merely reflects the loss suffered by the company (the 'no reflective loss' principle).

[13.21] Prudential Assurance Co Ltd v Newman Industries Ltd (No 2) [1982] Ch 204 (Court of Appeal)

The plaintiff, a large institutional investor, held 3% of the shares in Newman. It brought an action against Bartlett and Laughton, two directors of Newman who, the plaintiff alleged, had defrauded Newman of over £400,000. These directors did not have a majority of the shares in Newman and so did not formally have 'control' of it. The transaction by which Newman had been allegedly defrauded had been approved by the shareholders in general meeting, but it was claimed that the shareholders had been misled into doing so. The plaintiff sought declaratory relief and damages on three grounds: (i) its own personal cause of action against the defendants (of interest here); (ii) its derivative claim against the defendants on behalf of Newman; and (iii) its representative claim on behalf of Newman shareholders. Vinelott J, after hearing all the evidence, found the case proved and held that there had been a 'fraud' by those in 'control' (in the sense that the wrongdoers had *de facto* control). The Court of Appeal allowed the appeal in part, and expressed the view that the plaintiff should not have been allowed to bring a derivative suit. Here, the Court of Appeal expressed the view that the plaintiff's claim in its own right was 'misconceived'.

> [The judgment of the Court of Appeal (CUMMING-BRUCE, TEMPLEMAN and BRIGHTMAN LJJ) included the following:] In our judgment the personal claim is misconceived. It is of course correct, as the judge found and Mr. Bartlett did not dispute, that he and Mr. Laughton … owed the shareholders a duty to give … advice in good faith and not fraudulently. It is also correct that if directors convene a meeting on the basis of a fraudulent circular, a shareholder will have a right of action to recover any loss which he has been personally caused in consequence of the fraudulent circular; this might include the expense of attending the meeting. But what he cannot do is to **(p. 674)** 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, in which he has (say) a 3 per cent. shareholding. The plaintiff's shares are merely a right of participation in the company on the terms of the articles of association …
>
> Counsel for the plaintiffs sought to answer this objection by agreeing that there cannot be double recovery from the defendants, but suggesting that the personal action will lie if the company's remedy is for some reason not pursued. But how can the failure of the company to pursue its remedy against the robber entitle the shareholder to recover for himself? What happens if the robbery takes place in year 1, the shareholder sues in year 2, and the company makes up its mind in year 3 to pursue its remedy? Is the shareholder's action stayed, if still on foot? Supposing judgment has already been recovered by the shareholder and satisfied, what then?

A personal action could have the most unexpected consequences …

The plaintiffs in this action were never concerned to recover in the personal action. The plaintiffs were only interested in the personal action as a means of circumventing the rule in *Foss v. Harbottle*. The plaintiffs succeeded. 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. When the shareholder acquires a share he accepts the fact that the value of his investment follows the fortunes of the company and that he can only exercise his influence over the fortunes of the company by the exercise of his voting rights in general meeting. The law confers on him the right to ensure that the company observes the limitations of its memorandum of association and the right to ensure that other shareholders observe the rule, imposed upon them by the articles of association. If it is right that the law has conferred or should in certain restricted circumstances confer further rights on a shareholder the scope and consequences of such further rights require careful consideration. In this case it is neither necessary nor desirable to draw any general conclusions …

The 'no reflective loss' principle.

[13.22] Johnson v Gore Wood and Co [2002] 2 AC 1 (House of Lords)

A company, WWH, commenced proceedings against a firm of solicitors, GW, for professional negligence related to the exercise of an option to purchase land. That claim was eventually settled. Subsequently, Johnson, a majority member in the company, commenced proceedings against the same firm for personal losses sustained which arose out of the same circumstances. It was argued by the firm that Johnson could not recover his own personal losses as these were essentially the same as the losses sustained by the company. The House of Lords explained the relevant legal rules.

LORD BINGHAM:… GW's first argument before the House … was in principle very simple. It was that this damage, if suffered at all, had been suffered by WWH, and Mr Johnson, being for this purpose no more than a shareholder in the company, could not sue to recover its loss. As the Court of Appeal pointed out in *Prudential Assurance Co Ltd v Newman Industries Ltd (No 2)* **[13.21]**, 210:

'A derivative action is an exception to 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 **(p. 675)** done by B to C. C is the proper plaintiff because C is the party injured, and, therefore, the person in whom the cause of action is vested.'…

Mr Johnson's response was equally simple. It was accepted, for purposes of the application to strike out the damages claim, that GW owed a duty to him personally and was in breach of that duty. Therefore, subject to showing that the damage complained of was caused by GW's breach of duty and was not too remote … he was entitled in principle to recover any damage which he had himself suffered as a personal loss separate and distinct from any loss suffered by the company.

[The authorities we were referred to] support the following propositions:

(1) 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[[36]] 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. So much is clear from *Prudential Assurance Co Ltd v Newman Industries (No 2)* **[13.21]**…

(2) 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 …

(3) 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 …

[It follows that the task of the court is to] ascertain whether the loss claimed … is one which would be made good if the company had enforced its full rights against the party responsible, and whether (to use the language of *Prudential Assurance Co Ltd v Newman Industries (No 2)*… the loss claimed is 'merely a reflection of the loss suffered by the company'. In some cases the answer will be clear, as where the shareholder claims the loss of dividend or a diminution in the value of a shareholding attributable solely to depletion of the company's assets, or a loss unrelated to the business of the company. In other cases, inevitably, a finer judgment will be called for. … [Applying these principles to the facts, Lord Bingham held that, prima facie, the claim for sums which Mr Johnson, acting on GW's advice, invested in … companies and lost; the cost of personal borrowings made necessary because of other losses; the increased tax liability; and perhaps the diminution in value of his pension were all potentially recoverable; whereas the loss in value of his majority shareholding in WWH was merely a reflection of the company's loss and should be struck out.]

LORD MILLETT:… A company is a legal entity separate and distinct from its shareholders. It has its own assets and liabilities and its own creditors. The company's property belongs to the company and not to its shareholders … If the company has a cause of action, this represents a legal chose in action which represents part of its assets. Accordingly, where a company suffers loss as a result of an actionable wrong owed to it, the cause of action is vested in the company and the company alone can sue. No action lies at the suit of a shareholder suing as such, though exceptionally he may be permitted to bring a derivative action in right of the company and recover damages on its behalf: see *Prudential Assurance Co Ltd v Newman Industries Ltd (No 2)*. Correspondingly, of course, a company's shares are the property of the shareholder and not the company, and if he suffers loss as a result of an actionable wrong done to him, then prima facie he alone can sue and the company cannot. On the other hand, although a share is an identifiable piece of property which belongs to the **(p. 676)** shareholder and has an ascertainable value, it also represents a proportionate part of the company's met assets, and if these are depleted the diminution in its assets will be reflected in the diminution in the value of the shares. The correspondence may not be exact, especially in the case of a company whose shares are publicly traded, since their value depends on market sentiment. But in the case of a small private company like this company, the correspondence is exact.

This causes no difficulty where the company has a cause of action and the shareholder has none; or where the shareholder has a cause of action and the company has none … Where the company suffers loss as a result of a wrong to the shareholder but has no cause of action in respect of its loss, the shareholder can sue and recover damages for his own loss, whether of a capital or income nature, measured by the diminution in the value of his shareholding. He must, of course show that he has an independent cause of action of his own and that he has suffered personal loss caused by the defendant's actionable wrong. Since the company itself has no cause of action in respect of its loss, its assets are not depleted by the recovery of damages by the shareholder.

The position is, however, different where the company suffers loss caused by the breach of a duty owed both to the company and to the shareholder. In such a case the shareholder's loss, in so far as this is measured by the diminution in value of his shareholding or the loss of dividends, merely reflects the loss suffered by the company in respect of which the company has its own cause of action. If the shareholder is allowed to recover in respect of such loss, then either there will be double recovery at the expense of the

defendant or the shareholder will recover at the expense of the company and its creditors and other shareholders. Neither course can be permitted. This is a matter of principle; there is no discretion involved. Justice to the defendant requires the exclusion of one claim or the other; protection of the interests of the company's creditors requires that it is the company which is allowed to recover to the exclusion of the shareholder. These principles have been established in a number of cases, though they have not always been faithfully observed …

[After discussing two cases he regarded as incorrectly decided, he continued:] I cannot accept this reasoning as representing the position in English law. It is of course correct that the diminution in the value of the plaintiff's shares was by definition a personal loss and not the company's loss, but that is not the point. The point is that it merely reflected the diminution of the company's assets. The test is not whether the company could have made a claim in respect of the loss in question; the question is whether, treating the company and the shareholder as one for this purpose, the shareholder's loss is franked by that of the company. If so, such reflected loss is recoverable by the company and not by the shareholders.

[One of the judges in the cases criticised] acknowledged that double recovery could not be permitted, but thought that the problem did not arise where the company had settled its claim. He considered that it would be sufficient to make an allowance for the amount paid to the liquidator. With respect, I cannot accept this either. As Hobhouse LJ observed in *Gerber Garment Technology Inc v Lectra Systems Ltd* [1997] RPC 443, 471, if the company chooses not to exercise its remedy, the loss to the shareholder is caused by the company's decision not to pursue its remedy and not by the defendant's wrongdoing. By a parity of reasoning, the same applies if the company settles for less than it might have done. Shareholders (and creditors) who are aggrieved by the liquidator's proposals are not without remedy; they can have recourse to the Companies Court, or sue the liquidator for negligence.

But there is more to it than causation. The disallowance of the shareholder's claim in respect of reflective loss is driven by policy considerations. In my opinion, these preclude the shareholder from going behind the settlement of the company's claim. If he were allowed to do so then, if the company's action were brought by its directors, they would be placed in a position where their interest conflicted with their duty; while if it were brought by the liquidator, it would make it difficult for him to settle the action and would effectively take the conduct of the litigation out of his hands. The present case is a fortiori; Mr Johnson cannot be permitted to challenge in one capacity the adequacy of the terms he agreed in another …

(p. 677) For the reasons given by Lord Bingham, I too would strike out Mr Johnson's claims to damages for mental distress and anxiety and aggravated damages. Accordingly, I would dismiss the cross-appeal while varying the order of the Court of Appeal in the manner proposed …

Despite the 'no reflective loss' principle, if a company is unable to pursue its own cause of action precisely because of the actions of the wrongdoer, a member may be able to recover all the personal losses arising out of the same wrongdoing.

[13.23] Giles v Rhind [2002] EWCA Civ 1428, [2003] Ch 618 (Court of Appeal)

G and R had been members in a company which became insolvent following the diversion by R of a contract to a third party, in contravention of a shareholders' agreement. The company discontinued its proceedings against R as a consequence of its insolvency, but G sought to pursue in his own right damages against R. G contended that his claims were not merely reflective of the company's loss. Accepting this argument, the Court of Appeal held G had a cause of action against R separate from that of the company. In any case, with regard to G's losses which reflected those of the company, G was entitled to proceed with his personal claim, as the company had been prevented from pursuing its own action as a result of R's wrongdoing. Hence, this case can be distinguished from *Johnson v Gore Wood*, where additional claims by a member in relation to reflective losses were barred where the company was in fact able to pursue its own action (and had pursued it to settlement).

WALLER LJ:… There are certain facts which distinguish our present case from *Johnson v Gore Wood &*

Co **[13.22]**. First, *Johnson v Gore Wood & Co* was a case as emphasised by Lord Bingham and Lord Millett where Mr Johnson carried on his business through a small private company. His position was practically indistinguishable from that of his company. It was a case where the depletion in the value of the assets reflected in the diminution in the value of the shares was likely to correspond exactly (in the words of Lord Millett at 121B). Second, W Ltd had brought an action and compromised the same; indeed Johnson was the directing mind of the company when it agreed to the compromise. There is no reason to think that the company would not have recovered if it had chosen to do so precisely that value which would have reflected the diminution in value of the shares which Johnson was claiming. There was no question of W Ltd having been disabled from bringing the claim by the very wrongdoing which by contract the defendant had promised the plaintiff he would not carry out. Third, the action was tried on the assumption that the solicitors owed an independent duty to Johnson, but the nature of the case was such that it was not easy to assume such a totally independent duty. Fourth, it could not be argued ultimately that the loss of value was other than reflective of the company's loss despite the way the claim was pleaded. But, so far as the damage in relation to investment in shares in this case is concerned, Mr Giles' losses are not as it seems to me 'merely reflective'. The shares became valueless on his case because the company's business as a whole was destroyed. Obviously the value of his shares reflect to some extent the value of the assets of the company but in his case they also reflect what Lord Millett described as market sentiment or what would have been considered their value because of the potential which the business had. Fifth, it certainly is not in my view in reality a case where Mr Giles is seeking to recover as damages, damages which the company could have recovered. The company's claim for damages for breach of contract would have been of a quite different nature based on an assessment of profits lost by virtue of the confidential information being used to take the Netto contract. Mr Giles' loss relates to the fact that the business as a whole was totally destroyed. Indeed even if the company had recovered damages the Netto contract would never have been restored, the business would never have been the same and Mr Giles' share would inevitably have been devalued by Mr Rhind's activities. The value of the shares when Mr Rhind obtained £300,000 for them in 1993 **(p. 678)** reflected not only the assets of the company but the good prospects of the company into the future and that loss of value could not be recovered by SHF in any action that it might have brought. …

… [N]either Lord Bingham nor Lord Millett would I think argue with the following propositions. First that the principle which *Johnson v Gore Wood & Co* establishes will not in the words of Sir Christopher Slade in *Walker v Stones* [2000] 4 All ER 412 at 438:

> 'operate to deprive a claimant of an otherwise good cause of action in a case where (a) the claimant can establish that the defendant's conduct has constituted a breach of some legal duty owed to him personally (whether under the law of contract, torts, trusts or any other branch of the law) *and* (b) on its assessment of the facts, the court is satisfied that such breach of duty has caused him personal loss, separate and distinct from any loss that may have been occasioned to any corporate body in which he may be financially interested.'

Second (as they both recognised) if shareholders have a cause of action in relation to damage suffered by the company in which they hold the shares where that company does not have a cause of action, the shareholders may bring a claim even if in reality they are claiming damages reflective of the loss suffered by the company. The logic of that second exception ought to be based on the injustice of a wrongdoer being able to defeat a claim by suggesting that the loss being suffered was suffered by the company and is thus irrecoverable by the shareholder although the company does not or may not have a cause of action. But it is right to say that Lord Millett justifies that exception on the basis that 'since the company itself has no cause of action in respect of its loss, its assets are not depleted by the recovery of damages by the shareholder'. Thus Lord Millett appears to have in mind the concept that the cause of action which a company has (if it has) is one which enables the company to bring about full recovery. …

In my view there are two aspects of the case which Mr Giles seeks to bring which point to Mr Giles being entitled to pursue his claim for the loss of his investment. First, as it seems to me, part of that loss is not reflective at all. It is a personal loss which would have been suffered at least in some measure even if the

company had pursued its claim for damages. Second, even in relation to that part of the claim for diminution which could be said to be reflective of the company's loss, since, if the company had no cause of action to recover that loss the shareholder could bring a claim, the same should be true of a situation in which the wrongdoer has disabled the company from pursuing that cause of action. I accept that on the language of Lord Millett's speech there are difficulties with this second proposition, but I am doubtful whether he intended to go so far as his literal words would take him. Furthermore it seems to me that on Lord Bingham's speech supported by the others, it would not be right to conclude that the second proposition is unarguable. …

In my judgment Mr Giles should be entitled to pursue his head of damage relating to his case that his shares became valueless as a result of the activities of Mr Rhind.

As regards his other heads of loss, again on the basis that Mr Rhind disabled the company from pursuing any claim for damages, I would suggest that Mr Giles should not be precluded from proceeding with those claims. In any event I do not see that the other heads are pure 'reflective loss'. If Mr Giles had not been a shareholder but simply an employee or a lender with an enforceable covenant in his favour, those losses surely would have been recoverable. The fact that he is also a shareholder should not deny him his claims under those other heads. There will of course have to be detailed consideration given to the quantification of those claims. It may be relatively straightforward to demonstrate that the shares should have had the value of £330,000 as at April 1994 and that he would also have recovered his loan plus arrears of remuneration if the breach of contract had not taken place when it did. But what might have happened if the Netto contract had not been taken wrongfully as it was, is far more speculative. Would Mr Giles have continued with the company? What would the company's fortunes have been? Certainly he would not be entitled as it seems to me to have the value of his shares as at April 1994 and future remuneration because the sale of the shares would presumably have meant resignation from the company. In any event all those matters need proper enquiry and investigation at assessment. All it is necessary for us to decide is whether **(p. 679)** the heads of claim should be struck out as at this stage and I would be in favour of allowing them to go forward. I would thus allow the appeal. …

CHADWICK LJ:… Subject to two reservations, I do not quarrel with the propositions which the judge derived from the speeches in *Johnson v Gore Wood*. They are, I think, consistent, with the analysis of those speeches in the judgments in this Court in *Day v Cook*. As Lady Justice Arden put it, where the loss suffered by the shareholder is merely a reflection of the loss suffered by the company, 'the company's claim, if it exists, will always trump that of the shareholder'. [He then introduced his two reservations, and continued:]

The first issue: is this a case in which the no reflective loss principle should be applied?

The paradigm case in which, by reason of the wrong done to it, the company is unable, in practice, to pursue its claim against the wrongdoer is one in which the company is obliged to abandon its claim because the wrong has deprived it of the funds needed for that purpose. *Johnson v Gore Wood* was not such a case. The company (WWH) had pursued its claim against Gore Wood & Co to trial. It had compromised that claim, in the sixth week of that trial, upon payment of a substantial sum. Although the company was in financial difficulties at the time of the compromise, those difficulties were caused by other factors …

… To put the point more starkly, the effect of the judge's decision [Lord Bingham in *Johnson v Gore Wood*] —as he himself recognised—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 should be so denuded of funds that it 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 on the grounds that their claim is 'trumped' by the claim which his own conduct was calculated to prevent, and has in fact prevented, the company from pursuing. If that were, indeed, the law following the decision in*Johnson v Gore Wood*, I would not find it easy to reconcile the result with Lord Bingham's observation, at [2002] 2 AC 1, 36C–D, that 'the court must be astute to ensure that the party who has in fact suffered loss is not arbitrarily denied fair

compensation'.

In my view the reasoning in *Johnson v Gore Wood* does not compel the conclusion that the law requires that result. …

I confess that I have found it difficult to reconcile the point which Lord Millett appears to be making in the sentence 'The test is not whether the company could have made a claim in respect of the loss in question; the question is whether, treating the company and the shareholder as one for this purpose, the shareholder's loss is franked by that of the company' with the second of Lord Bingham's propositions [see **[13.22]**] or with the decision in *Gerber*,[37] which Lord Millett did not criticise. In a case where the company never had a cause of action in respect of the wrong which has caused it loss, the shareholder may sue on his own cause of action (if he has one) even though the loss is a diminution in the value of the shareholding—see [2002] 2 AC 1, 35H, 43B. I do not think that Lord Millett could have intended it to be understood, from that sentence, that the question whether the company ever had a cause of action in respect of the wrong which has caused its loss is irrelevant. And, in the light of his approval (in the following paragraph) of Lord Justice Hobhouse's reasoning in *Gerber*, he could not have intended it to be understood that the circumstances in which the company fails to pursue its remedy are necessarily irrelevant.

It is clear, however, that Lord Millett did not think that the inability of the shareholder to establish causation was the sole reason for the no reflective loss principle. In the paragraph which immediately follows that which I have just set out Lord Millett said this (*ibid* at page 66F–G):

> 'But there is more to it than causation. The disallowance of the shareholder's claim in respect of reflective loss is driven by policy considerations [etc, see**[13.22]**].'

(p. 680) The policy consideration to which, as it seems to me, Lord Millett is referring in that passage is the need to avoid a situation in which the wrongdoer cannot safely compromise the company's claim without fear that he may be met with a further claim by the shareholder in respect of the company's loss. That, I think, is what he had in mind when he referred to the difficulty which a liquidator would have in settling the action if a shareholder, or creditor, were able to go behind the settlement. He had recognised, in the previous paragraph, that an aggrieved shareholder or creditor could sue the liquidator; his concern was to limit their remedy to a claim against the liquidator. Similar considerations apply where the company's claim is settled by the directors. But, in such a case, there is the further consideration that directors who are also shareholders (or creditors) should not be in a position where settlement of the company's claim at less than its true value (or abandonment of that claim) leaves them with a claim which they can pursue against the wrongdoer in their own interest. If that is a correct analysis of that passage, then the passage presents no difficulty in the case where the company has not settled its claim, but has been forced to abandon it by reason of impecuniosity attributable to the wrong which has been done to it. In such a case the policy considerations to which Lord Millett referred are not engaged. And it is difficult to see any other consideration of policy which should lead to the conclusion that a shareholder or creditor who has suffered loss by reason of a wrong which, itself, has prevented the company from pursuing its remedy should be denied any remedy at all. …

For those reasons, I am satisfied that the decision in *Johnson v Gore Wood* does not compel the conclusion … that the no reflective loss principle is applicable. …

The second issue: is the loss of future benefits properly to be regarded as reflective of the company's loss?

The question turns on whether the loss which Mr Giles has suffered as a result of the termination of his employment by the receivers is reflective of loss suffered by the company by reason of the wrong done to it by Mr Rhind. In my view the judge was wrong to hold that it was. I think that he fell into error by confusing the loss claimed under this head with the circumstances which had given rise to that loss. There is a distinction to be drawn between the claim for accrued remuneration under the first head and the claim for

loss of future benefits under the second head. In the first case, the loss suffered by Mr Giles as an employee is reflective of the company's own loss; if the company had been able to enforce its rights against Mr Rhind, it would have the funds needed to pay its debts. In the second case, the loss suffered by Mr Giles is not reflective of any loss suffered by the company; it flows from the termination of his employment following the destruction of the company's business. If the company had been able to enforce its rights against Mr Rhind, following the destruction of its business, the damages which the company might recover would not compensate Mr Giles for the loss which flows from the termination of his employment. I would allow the appeal, in relation to the second head of loss, on this ground also. …

➣ Notes

1. In *Humberclyde Finance Group Ltd v Hicks* [2001] All ER (D) 202 (Nov), the court held that the 'no reflective loss' principle from *Johnson v Gore Wood* did not infringe the European Convention on Human Rights, as embodied in the UK's Human Rights Act 1998.

2. Both *Johnson v Gore Wood* **[13.22]** and *Giles v Rhind* **[13.23]** were considered in *Gardner v Parker* [2004] EWCA Civ 781, [2004] 2 BCLC 554. G, the assignee of the rights of action of B, a company, sought recovery for an alleged breach of fiduciary duty by P (the sole director of B) and S, a second company in which B held a minority of shares. G claimed that P had sold an asset of S at an undervalue, forcing S into administrative receivership. G argued that the 'no reflective loss' principle should not apply where: (i) the shareholder's claim concerned a breach of fiduciary duty; (ii) P's actions had prevented S from commencing legal proceedings to recover its losses from P; and (iii) the shareholder's claim was in the capacity of creditor. Dismissing the case, the Court of Appeal held that: (i) the 'no reflective loss' principle was applicable where **(p. 681)** breaches of fiduciary duty were concerned, as the principle governed recovery for particular kinds of loss and thus the cause of action and relief sought in any particular case was irrelevant; (ii) a lack of evidence prevented the conclusion being drawn that P's actions precluded S from seeking recovery; and (iii) applying *Johnson v Gore Wood*, no reason existed to disapply the 'no reflective loss' principle where the shareholder's claim as creditor was based on his position as an employee. All these cases do, however, emphasise the need for careful assessment of the facts to determine accurately whether the loss being pursued is indeed a 'reflected' loss.

3. In *Perry v Day* [2004] EWHC 3372 (Ch), [2005] 2 BCLC 405, P and D were both shareholders in a private company. P sought damages from D for breach of a shareholders' agreement which bound the shareholders, inter alia, to use their 'best endeavours to promote the interests and prospects of the company'. D had sold a parcel of land to the company, but as the consequence of a mistake, an important strip of land had been excluded from the conveyance. The mistake only became evident when the company tried to sell the land to a third party, and then D would only agree to transfer the excluded strip of land on payment of further consideration. The court upheld P's claim on the basis that: (i) D's demand for more money was a clear breach of his obligations under the shareholders' agreement; (ii) it was only D's demand for more money in exchange for the transfer of the strip that caused the relevant loss, as the loss caused by the defective sale itself could be repaired by D's agreement to transfer the strip; and (iii) though P's loss was reflective of the company's loss, and the company could have successfully brought a claim for rectification of the title, the company was precluded from doing this because of D's wrongdoing. By demanding the company surrender its claim on terms generous to D, D had breached his obligations, and this constituted a wrongdoing sufficient to bring the situation within the parameters of the *Giles v Rhind* exception to the no reflective loss principle upheld in *Johnson v Gore Wood*.

4. By contrast, in *International Leisure Ltd v First National Trustee Co Ltd* [2012] EWHC 1971 (Ch), Mr Edward Bartley Jones QC (sitting as a Deputy High Court Judge) refused the application of the 'reflective loss' principle where the secured debenture holder (secured creditor) of a company had suffered loss as a result of the receiver's breach of his duties. Drawing a distinction between the position of secured and unsecured creditors, the judge held that the primary duty of an administrative receiver was owed to the debenture holder

(see ‘Receivership generally’, pp 778ff), so the secured creditor here had a primary entitlement to obtain and retain all damages awarded for the breaches of duty, whereas the unsecured creditor’s prejudice arose only through the depletion of the assets of the company. The court was also persuaded by policy considerations, recognising that invoking the reflective loss principle would have the deleterious effect of denying the secured creditor his right to pursue his claims directly and under his own control.

Unfairly prejudicial conduct of the company’s affairs

So far in this chapter the focus has been on maladministration that constitutes a legal wrong, either to the company itself or to its members. CA 2006 ss 994ff give the court, on the application of a member, a wide-ranging power to remedy conduct of a company’s affairs that is ‘unfairly prejudicial to the interests of members generally or to some part of its members’.[38] The most **(p. 682)** common complaint is that a controlling majority has acted in a manner that is ‘unfairly prejudicial’ (the meaning of this term is explored later). The most common remedy sought is an order that the majority purchase the minority’s shares at a price that reflects their proportion of the company’s value. This is despite s 996(1), which gives the court the power to make ‘such order as it thinks fit’, with s 996(2) merely providing examples of possible orders, including compulsory share purchases. Most of the cases concern ‘quasi-partnerships’, although the provision has general application.

➢ Note

By way of linking the previous section on derivative claims to this one on ‘unfair prejudice’, note Lewison J in *Iesini v Westrip Holdings Ltd* (facts at **[13.10]**):

> 81 In parallel with a derivative action, there was (and is) the possibility of bringing a petition for unfair prejudice. This procedure is now governed by section 994 of the Companies Act 2006. The relief which the court may give under section 996 is very wide-ranging (‘such order as it thinks fit’); but the section specifically provides that the court may require the company to do an act that the petitioner has complained that it has omitted to do; or authorise civil procee dings to be brought in the name and on behalf of the company by such person or persons and on such terms as it may direct. If a petition is brought the court will decide (on the balance of probabilities) in the course of the petition whether the affairs of the company have been conducted in a manner unfairly prejudicial to the petitioner. It is only if the court has decided that they have that it will go on to consider the appropriate relief. It will be noted that section 260(1) contains a general definition of ‘derivative claim’ and section 260(2) envisages two different ways in which such a claim may be brought. One is ‘under this Chapter’, in which case the restriction on the permissible cause of action contained in section 260(3) applies (‘A derivative claim *under this Chapter* may only be brought …’). The other is pursuant to an order made in proceedings under section 994, in which case the restrictions in section 260(3) do not apply. In that case, the general definition in section 260(1) is the only relevant definition of a derivative claim.
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> 82 Accordingly it seems to me that where the petitioner’s complaint is that the company has failed to assert a good claim against a third party the court’s powers under section 996 would include the making of an order requiring the company to assert that claim, if necessary by taking or defending proceedings. Since the company’s claim would be a claim against a third party, once the court had decided that a failure to assert that claim had unfairly prejudiced the petitioner, the directors would not need to be parties to the subsequent claim against the third party. In addition the width of the court’s jurisdiction under section 996 enables the joinder of third parties to the petition itself, at least where relief is claimed against them: *Re Little Olympian Each-Ways Ltd* [1994] 2 BCLC 420; *Lowe v Fahey* [1996] 1 BCLC 262.
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> 83 On the other hand, it may be that the company’s cause of action is a cause of action only against the directors for loss suffered as a result of their default or breach of duty (etc.). In such a case the directors will be necessary parties to the company’s claim. It may be, therefore, that different procedural routes will be