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THE NO REFLECTIVE LOSS PRINCIPLE IS NOT AN OLD-FASHIONED CORPORATE LAW RELIC

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ABSTRACT. *Shareholders are not allowed to bring actions for damages due to a fall in share value or loss of dividend, which are "reflective" of their company's loss. Later, this principle also found its application to "reflective" losses of employees and creditors. The Supreme Court, however, in* Marex Financial v Sevilleja*, unanimously held that the principle would apply only to shareholders and not to creditors. The article argues that, while the majority opinion in the* Marex *decision is reasonably balanced, the minority opinion went a step further by even doubting the very existence of the no reflective loss principle without properly appreciating what shareholding entails. If the minority's position becomes the law, it will jeopardise companies' existence as separate legal entities with the capacity to decide with respect to their assets. Further, if the protection of the principle is removed, companies' counterparties will have to worry constantly about facing numerous direct shareholders' actions, whether they settle the dispute with the company or not. As a result, if the minority view becomes the law, it can potentially make the company a less dependable commercial partner.*

KEYWORDS: no reflective loss principle, separate legal personality, delegated management, indoor management, corporate entity, corporate form.

I. INTRODUCTION

How far shareholders of a company are entitled to claim damages for the loss that they suffer due to a wrong committed on the company has been a question that has bothered legal practitioners and courts alike for a long time. Courts enunciated a principle that shareholders cannot recover the damages for losses primarily reflective of the loss that their company suffered (hereafter called the "no reflective loss principle" or "the

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principle").[1] The logical underpinning of the principle is that, if the company could recover its loss, the recovery would naturally put the shareholders in a place where they would have been if the company had not been wronged. Allowing the shareholders also to sue for the company's loss could result in double recovery from the wrongdoer. Therefore, it was thought that shareholders should be foreclosed from pursuing losses that are "reflective" of the company's losses as a matter of policy.[2] Later, the courts extended the principle to other claimants, such as creditors and employees of the company.[3]

Critics of the no reflective loss principle argue that it could put shareholders in a situation where they cannot seek relief for losing the value of their shareholding even in the rare instances where they have a cause of action. According to them, the principle ignores that the shares are shareholders' properties distinct from the company's assets. Further, even after the company is compensated entirely, the share price need not reach the original level. Therefore, the law should permit shareholders – where they have a cause of action – to pursue their own relief for the loss to their properties.[4]

In *Marex Financial Ltd. v Sevilleja (All Party Parliamentary Group on Fair Business Banking intervening)*,[5] the Supreme Court revisited the no reflective loss principle. The court was unanimous in finding that the principle cannot be applied to deny the claims of creditors. In the process, the court overruled some previous decisions that had expanded the principle's application to claimants other than shareholders. While the majority would still retain the no reflective loss principle as a rule of company law applicable only to shareholders in certain circumstances, the minority went one step further in doubting the very existence of such a principle. The minority believed that precedents – properly understood – had not laid down any such principle.[6] This article examines the importance of preserving the principle and how the principle's dilution can weaken basic corporate law concepts, namely separate corporate personality and delegated management.

[1] See *Johnson v Gore Wood & Co. (a firm)* [2002] 2 A.C. 1, 503–04, 521, 532–34 (H.L.); *Prudential Assurance Co. Ltd. v Newman Industries Ltd. and others (No. 2)* [1982] Ch. 204, 221–23 (C.A.).
[2] *Prudential Assurance v Newman Industries* [1982] Ch. 204.
[3] See e.g. *Johnson v Gore Wood* [2002] 2 A.C. 1, 56–68 (H.L.); *Gardner v Parker* [2004] EWCA Civ 781, [2005] 2 B.C.L.C. 554, at [140].
[4] See M.J. Sterling, "The Theory and Policy of Shareholder Actions in Tort" (1987) 50 M.L.R. 468, 470–71; see generally B.J. de Jong, "Shareholders' Claims for Reflective Loss: A Comparative Legal Analysis" (2013) 14 European Business Organization Law Review 97.
[5] [2020] UKSC 31, [2021] A.C. 39.
[6] See the minority's opinion: ibid., at 82–122.

II. Origin and Development of No Reflective Loss Principle

Any discussion of the evolution of the no reflective loss principle must commence from what is known as the rule in *Foss v Harbottle*.[7] The rule stipulates that, when a loss is caused to a company and the company has a cause of action for that loss, only the company can seek to remedy the injury. Moreover, the power to manage the company is vested with the company's directors.[8] The court in *Foss v Harbottle* noted that where the alleged injury was inflicted on the whole company, prima facie, the law would require the company to sue in its own name.[9] Even when a shareholder is allowed to sue derivatively in the name of the company, the court cannot grant relief for irregularities that the general body of the shareholders may ratify.[10] The rule has a profound influence on every aspect of company law.[11]

The question of permitting shareholders to bring actions for wrongs primarily done to the company arose again in *Prudential Assurance Co. Ltd. v Newman Industries Ltd. and others (No. 2)*.[12] Prudential, a minority shareholder in Newman, brought the action against the Newman directors both derivatively for Newman's loss and personally for Prudential's own loss.[13] The personal claim was that, due to the wrong, Newman suffered a reduction in profit, which in turn caused a reduction in the quoted price of shares that Prudential held in Newman.[14]

The Court of Appeal, however, felt that the diminution in the share price or dividend merely reflects the company's loss, which is not the shareholders' personal losses. Moreover, the court observed that the company's loss does not affect the shareholders' right to participate.[15] Only the company acquires a cause of action for the wrong committed to the company. The shareholders are not allowed to recover their personal losses because that would amount to a double recovery from the wrongdoer. Shareholders subscribe to the shares, fully understanding that their fortunes follow that of their company. Therefore, the court held that the shareholders could not recover their reflective losses from the wrongdoers.[16] Apart from this, there are other justifications for the no

[7] (1843) 67 E.R. 189.
[8] Ibid., at 192–94.
[9] Ibid., at 202.
[10] Ibid., at 203–04.
[11] See K. Wedderburn, "Derivative Actions and Foss v Harbottle" (1981) 44 M.L.R. 202, 211–12.
[12] [1982] Ch. 204 (C.A.).
[13] Ibid., at 208.
[14] Ibid., at 222.
[15] But see e.g. J. Lee Suet Lin, "Barring Recovery for Diminution in Value of Shares on the Reflective Loss Principle" [2007] 66 C.L.J. 537, 539–43. The author argues that apart from conferring a right to participate, shares are shareholders' property.
[16] *Prudential Assurance v Newman Industries* [1982] Ch. 204, 222–24 (C.A.). The court felt that Prudential was presenting a personal claim, in addition to a derivative claim, since it was challenging to establish the preconditions for a derivative action.

reflective loss principle, which include preserving the company's centralised management, preventing double recovery, protecting the company's shareholders as a whole as well as its creditors and avoiding a multiplicity of legal proceedings by different shareholders.[17] The *Prudential* decision influenced many subsequent decisions. For instance, in *Stein v Blake and others*,[18] the Court of Appeal found that allowing shareholders to recover their reflective loss from the defendant would reduce the defendant's ability to meet any judgment the company (or the liquidator in case of the defendant's insolvency) might obtain against him.[19]

Despite substantial judicial deference to the principle in the UK, the New Zealand Court of Appeal, in its influential judgment in *Christensen v Scott*,[20] took a contrary view. The court held that the diminution in share price was a *personal loss* of the shareholder. The court found that the shareholders can institute a suit for relief for personal loss suffered when there is a breach of any duty owed to them.

But the *Christensen* decision did not stop the House of Lords, in *Johnson v Gore Wood & Co.*,[21] from elevating the no reflective loss principle to a higher pedestal. In this case, Mr. J instructed GW as solicitors of his company to exercise an option to purchase a piece of land. Mr. J's company then brought an action against GW for professional negligence in exercising the option. After the parties reached a compromise in that action, Mr. J brought another action against GW seeking compensation for his personal loss. Mr. J claimed that GW owed him a duty of care because GW was advising not only his company but also him.[22]

GW defended the case, arguing that Mr. J's claims were merely reflective losses. On the other hand, Mr. J argued that GW had breached the duty of care that they owed him.[23] After examining a plethora of decisions, Lord Bingham summarised the law governing reflective loss in the following three propositions:

> (1) Where a company suffers a loss because of a breach of duty owed to the company, only the company may sue for the loss. The shareholders cannot sue for the loss, which is reflective of the company's loss. This prohibition on shareholders suing the wrongdoer applies even if the company chooses not to bring any action against the wrongdoer.

[17] See de Jong, "Shareholders' Claims for Reflective Loss", 99–102; but see also P.L. Davies, *Gower and Davies: Principles of Modern Company Law*, 8th ed. (London 2008), 625–26 (arguing that the justifications supporting the no reflective loss principles may not be very sound).
[18] [1998] 1 All E.R. 724 (C.A.).
[19] Ibid., at 730 (Millett L.J.).
[20] [1996] 1 N.Z.L.R. 273 (New Zealand Court of Appeal).
[21] [2002] 2 A.C. 1 (H.L.).
[22] Ibid., at 17–19.
[23] Ibid., at 34–35.

(2) However, when the company suffers a loss and does not have a cause of action, the shareholders, if they have a cause of action, can sue for the diminution of share value.
(3) If the company suffers a loss and the shareholders suffer a *separate and distinct* loss, the company and shareholders may sue for the respective losses that they have suffered. Nevertheless, the shareholders' loss must be one arising from the breach of a duty separately owed to them. Neither the company nor the shareholders may recover for the loss caused to the other.[24]

Applying the above principles, the House of Lords struck out Mr. J's two claims as reflective losses. One claim concerned the contribution that the company would have made to the pension fund had it not been for the company's loss caused by the wrong committed to the company. Mr. J claimed that his pension value diminished because the company could not contribute to the pension fund. The other claim concerned the diminution in the value of his shares.[25]

Although Lord Bingham's opinion won the approval of all of the Lords, Lord Millett's opinion is said to have "most comprehensively" developed "[t]he case for striking out … overlapping claims".[26] In the opinion of Lord Millett, a share "represents a proportionate part of the company's net assets". In the case of small private companies, the correspondence between asset depletion and share value diminution is exact. However, it may not be so in the case of publicly traded companies.[27] When a company suffers a loss due to a breach of duty owed to both the company and its shareholders, the shareholders' loss in terms of share value diminution and dividend loss is merely a reflection of the company's loss.[28] Allowing shareholders also to make such a claim can cause double recovery.

Lord Millett reasoned further that shareholders could not recover more than what they would have recovered if they had done business in their own names.[29] In cases where the company has settled the claim cheaply or has chosen not to pursue its claim, the shareholders' loss is attributable to the company's decision to settle or not to pursue its claims.[30] Allowing shareholders to bring their own actions will make it harder for the company and the liquidator to settle the company's

[24] Ibid., at 35 (Lord Bingham).
[25] Ibid., at 36–38; the court also struck out other claims for mental agony and aggravated damages for other reasons.
[26] P. Watts, "The Shareholder as Co-Promisee" (2011) 117 L.Q.R. 388, 389.
[27] *Johnson v Gore Wood* [2002] 2 A.C. 1, 62 (H.L.) (Lord Millett).
[28] Ibid., at 62–63.
[29] Ibid., at 67.
[30] Ibid.; for similar reasoning regarding the cause of shareholders' loss, see also *Gerber Garment Technology Inc. v Lectra Systems Ltd. and Another* [1997] R.P.C. 443, 471 (C.A.).

claims.[31] In Lord Millett's view, the principle would apply not just to the diminution in the share value and dividend but to "all other payments which the shareholder might have obtained from the company if it had not been deprived of its funds".[32]

The decision, especially Lord Millett's explanation of the no reflective loss principle, has its supporters[33] and opponents.[34] Naturally, the *Johnson* case could not settle the issue. In *Giles v Rhind*,[35] the court carved out an exception to the *Johnson* principle. When the defendant's alleged wrong has disabled the company from pursuing its own remedies, the shareholder – if she has a cause of action – can bring an action to recover damages for her loss even though the loss is reflective of the company's loss.[36] However, in *Gardner v Parker*,[37] the court clarified that the *Giles* exception would not apply merely because the company chose to settle its claim against the defendant in what appeared to be a comparatively generous settlement.[38] Moreover, perhaps more importantly, the judgment also extended the principle to creditors. In the court's view, insofar as the House of Lords in *Johnson v Gore Wood* extended the principle to include employees' claims to receive a contribution to pension funds, there is no reason why the principle should not apply also to the claims of the company's creditors against third parties.[39] It is not only English courts that have adopted the principle. The principle applies in several other jurisdictions, including Germany, the Netherlands, Singapore and the US.[40] Recently, in *Miao Weiguo v Tendcare Medical Group Holdings Pte Ltd.*,[41] the Singapore Court of Appeal followed the majority's view in *Marex Financial v Sevilleja* – discussed immediately below – in upholding the principle's applicability to shareholders.

[31] *Johnson v Gore Wood* [2002] 2 A.C. 1, 66 (H.L.) (Lord Millett).
[32] Ibid.
[33] See E. Ferran, "Litigation by Shareholders and Reflective Loss" [2001] 60 C.L.J. 245, 246–47. See also G. Shapira, "Shareholder Personal Action in Respect of a Loss Suffered by the Company: The Problem of Overlapping Claims and 'Reflective Loss' in English Company Law" (2003) 37 The International Lawyer 137, 149–51; even when Giora Shapira argues that the no reflective loss principle is unrealistic, she concedes that the "policy considerations" behind Lord Millett's reasoning "are compelling" (at 150).
[34] See e.g. Lee Suet Lin, "Barring Recovery", 537–58; Sterling, "Theory and Policy", 490 (arguing that justifications in *Prudential Assurance v Newman Industries* [1982] Ch. 204 (C.A.) for the no reflective loss principle – double recovery, prejudice to the creditors and multiplicity of suits – are "overstated"). See also Watts, "Shareholder as Co-Promisee".
[35] [2002] EWCA Civ 1428, [2003] Ch. 618.
[36] Ibid., at [34]–[40] (Waller L.J.).
[37] [2004] EWCA Civ 781.
[38] Ibid., at [60] (Neuberger L.J.).
[39] Ibid., at [70] (Neuberger L.J.).
[40] See de Jong, "Shareholders' Claims for Reflective Loss", 102–10; C.R. Yuan, "The Spectre of Reflective Loss" [2022] Singapore Journal of Legal Studies 309. In the US, the principle is known as the "non-conductor principle": see Sterling, "Theory and Policy", 474–79.
[41] [2021] SGCA 116, [2022] 1 S.L.R. 884 (Singapore Court of Appeal).

III. *Marex Financial v Sevilleja*

Despite *Johnson v Gore Wood*, there were still debates about the exact scope of the principle.[42] The Supreme Court revisited the no reflective loss principle in its decision in *Marex Financial v Sevilleja*.[43] The facts of the case, relevant to our discussion, are straightforward. M, the appellant, had brought an action against two companies that Mr. S owned and controlled. The judge shared the judgment draft with the parties, awarding more than US$ 5.5 million to M from the companies. Soon after receiving the judgment draft, the companies' funds were transferred to accounts that Mr. S personally controlled. After that, the companies were put under liquidation for debts allegedly payable to Mr. S and other entities associated with him. M was the only outside creditor of the companies. The liquidator, too, did not take any steps to recover the companies' funds.[44] In these circumstances, M brought the action directly against Mr. S for intentionally causing loss by unlawful means, which led to this Supreme Court decision.[45] Both the majority and the minority rejected the defence based on the no reflective loss principle and allowed M to proceed against Mr. S for intentionally causing damages to it. But the majority and minority have different opinions about the principle's applicability to the shareholders, which are discussed below.

A. The Majority's Reasoning

The majority opinion held that the no reflective loss principle applies only to shareholders claiming compensation for diminution of share value or diminution in dividend.[46] In the majority's opinion, *Prudential Assurance v Newman Industries* merely held that the law does not recognise the company's loss resulting in a share value fall as a shareholder's *distinct and separate* loss. There is no exact correlation – especially in the case of big companies – between the company's loss and the fall in share value. The majority found that Lord Millett's assumption in *Johnson v Gore Wood*, that a share "represents a proportionate part of company's net assets", is not tenable.[47] The majority did not view the prevention of double recovery as a proper justification for the principle. For example, when the company does not pursue its claims, there is no risk of double recovery, yet the shareholders are not allowed to pursue their claims.[48]

[42] See R. Cheung, "The No Reflective Loss Principle: A View from Hong Kong" (2009) 20 International Company and Commercial Law Review 223.
[43] [2020] UKSC 31.
[44] Ibid., at 57–58.
[45] Ibid., at 58.
[46] Ibid., at 61–62 (Lord Reed, with whom Lady Black and Lord Lloyd-Jones agreed).
[47] Ibid., at 66–67; *Johnson v Gore Wood* [2002] 2 A.C. 1, 62 (H.L.) (Lord Millett).
[48] *Marex Financial v Sevilleja* [2020] UKSC 31, 56, 75–77 (Lord Reed).

At the same time, they acknowledged that issues such as avoiding double recovery, difficulty ascertaining which part of the share value loss is attributable to the wrongdoer and the risk of a multiplicity of legal claims by different shareholders are relevant considerations behind the *Prudential* rule.[49]

While holding that the no reflective loss principle applies to shareholders, the majority tried to preserve the company's autonomy.[50] They noted that shareholders invest in their company by accepting that the majority of the shareholders will determine the company's course. When the share value falls due to a wrong committed against the company, the remedy available to shareholders is to exercise their control over the company's decision-making. Further, in certain instances, the minority shareholders can institute a derivative action in respect of the wrong done to the company or seek relief against the "unfairly prejudicial conduct" of the directors.[51] Since there could be divergences of interests among the shareholders, allowing concurrent claims of the company and shareholders could prevent the company from making decisions concerning its claims in the company's best interest.[52]

The majority considered the *Prudential* principle as "a rule of company law, applying specifically to companies and their shareholders in the particular circumstances described" and not applying to creditors' claims.[53] Since there is no correlation between the value of the company's assets and the value of the debt due to a creditor, the creditor's loss cannot be treated as a reflection of the company's loss. Therefore, the diminution of the company's assets is not reflected in the diminution in the value of creditors' property. The no reflective loss principle cannot have application in the case of anyone claiming other than as shareholders.[54] If the creditors were dealing with individual debtors, the creditors could seek relief under tort or contract law. They will not cease to have that relief merely because the debtor is a company.[55]

B. The Minority's Reasoning and What It Misses

Lady Hale, Lord Kitchin and Lord Sales formed the minority. Lord Sales, the most junior among the Supreme Court Justices who decided the case, is

[49] Ibid., at 63.
[50] See P. Davies, "Reflecting on 'Sevilleja v Marex Financial'", available at https://blogs.law.ox.ac.uk/research-subject-groups/commercial-law-centre/blog/2020/10/reflecting-sevilleja-v-marex-financial (last accessed 1 May 2024) (arguing that the majority's approach increases "the conceptual coherence of company law").
[51] *Marex Financial v Sevilleja* [2020] UKSC 31, 62 (Lord Reed).
[52] Ibid., at 63.
[53] Ibid., at 56; but see Davies, "Reflecting on 'Sevilleja v Marex Financial'", where it is urged that the rule is about organisations, not just companies.
[54] *Marex Financial v Sevilleja* [2020] UKSC 31, 76 (Lord Reed).
[55] Ibid., at 70–71.

likely to have a more significant influence in shaping judicial trends in the future.[56] Further, Lord Hodge – who authored a separate opinion agreeing with the other three Justices in the majority – offered nothing in defence of the no reflective loss principle. He merely felt that "we should not depart from [the bright-line legal rule laid down in the *Prudential* case] *now*".[57] In short, after the judgment, the principle precariously survives on a wafer-thin majority. Therefore, the minority opinion is worthy of serious deliberation.

While the majority limited the principle to shareholders alone, the minority opinion even doubted whether the no reflective loss principle exists.[58] According to these justices, the *Prudential* principle did not bar shareholders from making their own claims.[59] The claimant in *Prudential* had not proved any facts showing that the claimant personally suffered any loss. Thus, the court was not considering a case where the wrongdoer intentionally harmed the shareholder.[60] Rather than proving its own cause of action, the claimant in *Prudential* argued that it suffered a loss "in relation to the value of its shares equivalent to that part of the loss suffered by Newman which was proportionate to its shareholding in Newman".[61] In short, the minority asserted that the shareholder in *Prudential* was trying to claim damages based on the company's cause of action, not its personal loss.

Like the majority, the minority also disputed Lord Millett's opinion in *Johnson* that a share represents a proportionate share in the company's assets. There is no simple correspondence between the value of the company's assets and the shares. The minority's view does not, however, completely negate the relationship between the company's loss and fall in share value. But their opinion was that the company's loss "is not *the same*" as the shareholders' loss.[62]

The minority argued that the share price is not merely the price of the company's assets, but that it includes the value of both the company's assets and the right to participate in the company's future commercial performance/prospects. A company with relatively low asset value can have strong future income or profit prospects.[63] Therefore, the share value of a company can be more than the value of its assets. The minority opinion seems to advance this point to assert that loss of share value and diminution in dividend can be over and above what the

[56] Though Lord Kitchin, too, was junior to the other Supreme Court Justices, he chose to retire early in September 2023.
[57] *Marex Financial v Sevilleja* [2020] UKSC 31, 82, emphasis added.
[58] Ibid., at 120 (Lord Sales, with whom Lord Kitchin and Baroness Hale agreed).
[59] Ibid., at 84.
[60] Ibid., at 93–94.
[61] Ibid., at 95.
[62] Ibid., at 88, emphasis in original.
[63] Ibid., at 85, 94–95.

company can recover for the loss of its assets. However, the question is, how should one determine the value of shares? There are different methods for valuing a share. Nevertheless, it is broadly accepted that the value of a share is the present value of future dividends.[64] And a company can distribute dividend only from its profits.[65] Therefore, the share value of a company is directly connected to its profit. Moreover, a company is not just entitled to recover the loss of its assets but also the consequential loss of future profits from the wrongdoer. In other words, shareholders are not likely to suffer a loss in share value more than what the company is entitled to recover by its own action. Therefore, the minority's supposition that shareholders' loss will not be fully compensated even if the company exercises its legal rights fully does not appear correct. Since a large part, if not the entirety, of the loss to the company's future profit is legally recoverable by the company, the diminution of share value on that account is also a reflection of the company's loss. The shareholders may, however, suffer a loss if the company decides to forgo its claim.

One possible objection to the principle may be that every loss to the company may not be recoverable. Even for an unrecoverable loss, there could be a fall in the share price. However, those limitations come from the rules of damages. The short point is that a company can recover as much damages as a proprietor in its place can. Allowing both the company and its shareholders to recover (i.e. the company recovering damages for the loss of assets and future profit and the shareholders recovering the fall in share value due to the company's loss in assets and future profit), as contemplated by the minority, would result in a situation where a shareholder can effectively recover more damages for loss of profit than a proprietor. The minority opinion does not view the risk of double recovery as a consequence that courts should necessarily avoid. The minority considered that, between compensating an innocent claimant who suffered loss and risking that a wrongdoer might have to pay excessive compensation, compensating the innocent claimant should be preferred.[66] The minority also did not consider it necessary that the loss of the shareholders is different and separate from that of the company. In the minority's view, if the shareholders' loss and the companies' loss are not identical, both the company and shareholder should be permitted to claim damages.[67]

[64] See e.g. N. Molodovsky, C. May and S. Chottiner, "Common Stock Valuation: Principles, Tables and Application" (1965) 21 Financial Analysts Journal 104, 104; R.J. Fuller and C. Hsia, "A Simplified Common Stock Valuation Model" (1984) 40 Financial Analysts Journal 49; J. Laws, *Essentials of Financial Management* (Liverpool 2018), ch. 3, 57–70.
[65] See Companies Act 2006, s. 830.
[66] *Marex Financial v Sevilleja* [2020] UKSC 31, 99 (Lord Sales).
[67] See ibid., at 110.

IV. Why Is The *Marex* Decision – Especially the Minority Opinion – Disquieting?

The *Marex* case primarily concerned the applicability of the principle to creditors, and the court unanimously held that the principle did not apply to them. The majority would apply the principle to shareholders alone. However, the majority did not treat the prevention of double recovery as the reason behind the principle. If it had, the principle would have also been applicable to creditors.[68] Given that creditors lend to a company (like shareholders' investing in the company), being fully aware of the legal position that the majority of the shareholders and directors control the company, why should they be exempted from the principle? However, creditors are different because, unlike shareholders, creditors do not have the power to vote. Moreover, creditors lack the remedies that shareholders have in company law. They have to invoke remedies in contract or tort law to get relief for their loss. Therefore, the court's conclusion is sound as far as creditors are concerned.

The majority must be credited with a well-reasoned approach towards the no reflective loss principle. On the point of identifying the cause of the shareholders' loss, the majority disagreed with Lord Millett's view in *Johnson* that shareholders suffer reflective loss not because of the wrong done to the company but because the company failed to enforce its claims. The majority felt that it was "bizarre" to attribute the shareholder's loss to the company's failure rather than to what the wrongdoer did.[69] The majority's position was that shareholders' reflective losses are not recoverable because they are not *distinct and separate* from those of the company. The majority accepted that "the value of [a shareholder's] investment follows the fortunes of the company".[70] But in my view, Lord Millett's proposition attributing the cause of loss to the company's decision concerns the reflective losses alone. If the company recovered its losses from the "wrongdoer", the shareholders would not have suffered "reflective losses". The "wrongdoer" remains responsible to the company for the losses it caused, including loss of profit, and to the shareholders – when they have an independent cause of action – for their *separate and distinct* losses.

Investigating who actually caused shareholders' reflective loss does not help to resolve the conundrum. But it is helpful to consider the position of shareholders with respect to the claims of third parties against the company. Shareholders have chosen to incorporate themselves into a company and remain immune from direct claims from the company's counterparties. The actions and decisions of the company are the cause of the

[68] Ibid., at 66–69, 70–71 (Lord Reed).
[69] Ibid., at 69.
[70] Ibid., at 63 (quoting from *Prudential Assurance v Newman Industries* [1982] Ch. 204, 224 (C.A.)).

counterparties' claims. The shareholders are not responsible to the counterparties as the *company's real owners*. Their immunity from their company's counterparties is because of the legal fiction called the company. If one applies the same reasoning to claims against counterparties, one will find that, as far as reflective losses are concerned, only companies have causes of action against them, not the shareholders.

One good starting point is to examine what shareholding entails. Shares in a company are not property that merely confers the right to transfer or receive dividends. Shares enable shareholders to hold the directors/management of the company accountable. Since it is not practicable for shareholders to control the company directly, the immediate control of the company is vested in the board of directors. But company law ensures that shareholders have control over the directors. Directors must act primarily for the benefit of shareholders as a whole, although it may be legitimate for the directors to consider the interests of employees, creditors and customers.[71] The directors' duty to act for the shareholders' benefit applies even if there is a real risk of the company becoming insolvent. Only circumstances like imminent insolvency or probable insolvency liquidation will justify giving precedence to creditors' interests over shareholders' interests.[72]

Apart from the directors' duty to act for the benefit of the shareholders, shareholders have the power to control the directors. The most obvious example of this is the power to remove the directors through a shareholders' ordinary resolution.[73] Further, directors can make certain decisions only with the members' approval.[74] Fundamental changes, like an amendment to the company's articles, can be done only through a members' special resolution.[75] In short, a share in a company bestows a bundle of rights on its holder to participate significantly in the company. Therefore, directors cannot do things shareholders disapprove of without risking their jobs. Moreover, large shareholders often have their nominees on the board. In fact, the majority in *Marex Financial v Sevilleja* broadly acknowledged this scheme of ultimate control by shareholders in different parts of their opinion.[76] In sum, shareholders have significant power to influence the company's/board's decisions and have remedies available against directors for breach of their duties.

[71] See Companies Act 2006, ss. 172(1), 172(3); see also L.A. Bebchuk and R. Tallarita, "The Illusory Promise of Stakeholder Governance" (2020) 106 Cornell Law Review 91, 164–68 (arguing that permitting the board to take into account other stakeholders' interests, such as those of employees, customers, society and creditors, could reduce the shareholders' ability to hold the board to account).
[72] See *BTI 2014 L.L.C. v Sequana S.A.* [2022] UKSC 25, [2024] A.C. 211.
[73] See Companies Act 2006, s. 168.
[74] See ibid., ch. 4.
[75] Ibid., s. 21.
[76] See especially *Marex Financial v Sevilleja* [2020] UKSC 31, 63, 81 (Lord Reed).

Given these factors one cannot argue that shareholders' loss is independent of the company's choice to settle or forgo a claim.

The majority and the minority were critical of Lord Millett's opinion in *Johnson.* But they did not acknowledge that Lord Millett, like the other Justices of the Supreme Court who decided the case, allowed Mr. J to bring action against the defendant for all other losses, where he seemed to have a cause of action and to have sustained *separate and distinct* losses. At the outset, the minority opinion, which doubted the existence of the principle even in the case of shareholders, was overreaching. The minority was not required to express doubt about the principle's applicability to shareholders when the *Marex* case was about creditors' right to sue a third-party wrongdoer. There was no specific factual background which justified holding the principle inapplicable to the shareholders. On the other hand, the *Johnson* case, with which the minority sharply disagreed, was a very appropriate case to decide when shareholders can bring a direct action.

Unfortunately, the minority opinion ignores some fundamental principles of company law. The opinion disregards the importance of the shareholders' collective control over the company and the requirement to consider the interests of the "shareholders as a whole". The collective control of shareholders over the company is not the same as that of any one shareholder or a few shareholders. Shareholders often have diverse conflicting interests. Therefore, if the individual shareholders are permitted to represent what is primarily the company's case, that can cause serious prejudice to the company's cohesiveness as a single entity.

Further, the minority opinion does not take into account the nature of the company as a nexus of contracts between different parties;[77] these contracts are not meant to keep shareholders unharmed even from the company's failures. To put this into perspective, take Mr. J's conduct in the *Johnson* case. Mr. J chose to incorporate a company and practically owned all of its shares. His company was entitled to recover as much as he would have recovered if he had constituted the business as a proprietorship. But the company – of which he had complete control – chooses to settle the claim. Therefore, he is bound by the settlement the company arrived at with its lawyers and, over and above the settlement, he cannot bring a personal action to recover his reflective losses.

Even the opponents of the principle do not argue that all shareholders have a right to proceed against their company's counterparties. Their argument is about the few cases in which shareholders may have an independent cause of action to bring a suit in their personal capacity.

[77] See e.g. M.C. Jensen and W.H. Meckling, "Theory of the Firm: Managerial Behavior, Agency Cost and Ownership Structure" (1976) 3 Journal of Financial Economics 305, 311; F.H. Easterbrook and D.R. Fischel, "The Corporate Contract" (1989) 89 Columbia Law Review 1416, 1426–28, for the nature of "nexus of contracts".

Only controlling shareholders will likely have an independent cause of action against the company's counterparties. In *Johnson*, Mr. J claimed that the solicitors had an independent duty towards him as they used to advise him as well. Since Mr. J was in complete control of the company, it was not easy to distinguish whether the solicitors were advising the company or Mr. J. A major shareholder in control of the company's decisions cannot have a grievance that the company settled its claim cheaply and independently institute a suit for reflective loss. On the other hand, it is unlikely that a third party dealing with the company would have an independent duty of care towards a small shareholder of the company. In short, neither in the case of a major shareholder nor a small shareholder can one find a good practical purpose to permit shareholders to institute an action for the company's loss.

The minority opinion does not address the impact of individual shareholders' actions for reflective losses on the company as an entity. The minority opinion, if made the law, would allow shareholders to bring an action for loss of share value even concerning matters that the company has, considering its best interests, decided to forgo or settle. Where the shareholders can institute action irrespective of the company's decision to forgo or settle a claim, it will severely limit the company's ability to function as an entity. And, despite the settlement, the counterparty will still be liable to shareholders to the full extent of the fall in share value and diminution in dividend.

A situation where companies' decisions do not effectively bind the shareholder can have a considerable adverse impact not just on the company but also on the company's counterparties. They will potentially face multiple shareholder suits with respect to matters that they have settled with the company. The possibility of liability towards shareholders would have a chilling effect on a third party proposing to enter into a transaction with a company. Its chilling effect influences not just "wrongdoers" but anyone dealing with a company. Dealing with a company is already more onerous in terms of the due diligence required, such as ensuring whether the company has passed a proper resolution and has the necessary power. Naturally, the minority's proposition will make dealing with a company even costlier and more uncertain. The greater the possibility of shareholders bringing a personal claim, the less attractive companies would be as a counterparty.

In the minority's opinion, a court should compensate a claimant shareholder's reflective loss even if it means double recovery from the wrongdoer. This view of preferring to compensate a claimant shareholder over avoiding "the risk of the defendant being liable twice over"[78] would exacerbate counterparties' concerns. The minority's view gives the

[78] *Marex Financial v Sevilleja* [2020] UKSC 31, at [159].

impression that the purpose of the principle is to insulate wrongdoers from compensating shareholders. However, the possibility of shareholder's action has an impact not only on parties who conclude a transaction with a company but also on those who propose to enter into one. The no reflective loss principle serves to assure counterparties that they can make decisions without worrying about what numerous shareholders might do about the company's loss.

It is not that the minority is entirely unmindful of double recovery. The minority even suggests a solution to the problem of double recovery. However, the solution that the minority suggests seriously compromises the company's autonomy. To "manage coincidence of claims",[79] the minority opinion suggests that, when shareholders file an action for recovering reflective loss, the court can issue a notice to the company to join as a party, and the court shall allow the company to bring its action. After receiving the notice, if the company decides not to bring an action, the company will be estopped from bringing one later. However, if the company brings an action and succeeds, the recovery that the company makes would be taken into account when granting relief to the shareholders.[80] Under this method, even if the company decides not to bring an action for a good reason, the counterparties will still remain liable to the shareholders for the entire claim. The scheme, in effect, nullifies the company's ability to determine its course of action concerning its claim against its counterparties. Moreover, even when the company fully recovers its claim, the method envisages that counterparties could be liable to shareholders for the remainder of their claim. This method casts an additional liability on counterparties over and above what would have been their liability had they been dealing with a proprietor.

Further, the controlling shareholders in the company can potentially misuse the method that the minority suggests in order to corner the entire benefit of the company's claim for themselves. In the minority's opinion, shareholders can claim damages based on the company's total loss if the company decides not to bring a suit. A shareholder's claim amount would be proportionate to her shareholding. If they allow their company to bring an action, the controlling shareholders would have to share the benefit of the company's recovery with other constituencies, such as the company's creditors and employees. But by means of this method a controlling shareholder can ensure that the company does not bring an action and can be unduly enriched by virtue of bringing only their personal action.

[79] Ibid., at [161].
[80] Ibid., at [161]–[162].

Further, in the opinion of the minority, if a shareholder is the first to bring an action, the company should decide immediately whether it should also bring an action. If the company does not bring an action, the court should permit the shareholder to proceed with their claim. It is debatable how far it is appropriate to compel the company to decide on bringing an action before the limitation period expires. The company might be evaluating its options or talking to the counterparty to resolve the dispute. The compulsion to initiate an action can scuttle the company's attempt to resolve the matter more constructively. Even if the company is permitted to bring an action notwithstanding the earlier shareholder's action, the recovery made by the shareholder directly will have to be adjusted from what the company can realise. While the shareholder who brings a direct action keeps all of her recovery, the corresponding reduction in what the company recovers later is shared by all the shareholders. The shareholders who recover their loss by direct action will, like any other shareholder, further benefit from any recovery that the company makes. This effectively places the company's assets – which should be in the board's control – in the shareholder's hands. This method would result in shareholders stripping the company's assets, causing severe prejudice to the company's other shareholders and constituencies. Therefore, this solution encourages opportunistic shareholders' direct action and diminishes the company's ability to make decisions with respect to its properties. This possibility to benefit twice by bringing an early action can create a race among the shareholders to be the first to bring an action defeating the company's corporate form.

V. Why Are the Objections to the Principle Not Sound Enough?

While the restriction of the application of the no reflective loss principle to shareholders alone in *Marex* is widely welcomed, its application in the case of shareholders remains controversial. In support of applying the principle to shareholders, it is argued that the shareholders, in exchange for a bundle of rights in the company, left the company's assets in the control of the company's organs.[81] On the contrary, in support of completely discarding the principle, it is argued that, when the shareholders have a cause of action for the personal loss in the form of loss in share value, they cannot be left remediless. According to opponents of the principle, the rule in *Foss v Harbottle* only creates a proper plaintiff rule. It does not bar a shareholder's action when the shareholder has an independent cause of action.[82] Charles Mitchell has raised the concern that the principle prevents shareholders who have a cause of action from bringing

[81] See A. Tettenborn, "Less Law Is Good Law? The Taming of Reflective Loss" (2021) 137 L.Q.R. 16, 19.
[82] Yuan, "Spectre of Reflective Loss", 309, 320–25.

an action in some circumstances.[83] Criticisms of the rule prohibiting shareholders from directly initiating actions include (1) that an absolute bar on recovering reflective loss would lead to courts rejecting some meritorious claims[84] and (2) that it is an excessive restriction since the courts in equity have sufficient means at their disposal to grant relief in shareholders' actions without causing prejudice to the company's creditors.[85] Another argument is that a priority rule – where the shareholders are permitted to bring a personal action if the company decides not to bring an action or the company's recovery falls short of fully compensating the shareholders – should be adopted instead of a complete prohibition of the shareholders' claim.[86]

Finding an answer depends on whether shareholders have an interest in the assets of the company. Originally, shareholders were thought to have an interest in the company's assets.[87] But the law is now settled that shareholders do not have any interest in the company's property. The shareholders' lack of interest in the company's assets became evident in *Macaura v Northern Assurance Co. Ltd., and others*,[88] where the court held that a shareholder had no insurable interest in the assets of her company that were lost in a fire. The court observed that, when the fire destroyed the company's assets, the claimant shareholder was "directly prejudiced by the paucity of the company's assets, not by the fire".[89] Another landmark decision illustrative of the legal position that shareholders do not have any interest in the company's assets is *Short and others v Treasury Commissioners*.[90] In this case, the court held that the shareholders were not "part owners" of the company's undertaking.[91] The court in *Bank voor Handel en Scheepvaart N.V. v Slatford and Another* further established that a company does not hold properties on behalf of its shareholders.[92] These decisions clearly establish that only a company can seek damages for a loss due to injury to its assets.

But opponents of the principle criticise the fact that the principle does not permit shareholders to pursue some of their own claims. They argue that the law must permit shareholders to pursue their claims because their loss arising out of the fall of the share value is distinct from the company's loss due to harm to the company's assets. In this connection, it is fruitful to refer to how Lord Bingham and Lord Millett address this issue in the

[83] C. Mitchell, "Shareholders' Claims for Reflective Loss" (2004) 120 L.Q.R. 457, 469–75.
[84] Lee Suet Lin, "Barring Recovery", 557–58.
[85] See Sterling, "Theory and Policy", 470–71, 484, 488–91.
[86] See A.K. Koh, "Reconstructing the Reflective Loss Principle" (2016) 16 Journal of Corporate Law Studies 373, 390–400.
[87] P. Ireland, "Company Law and the Myth of Shareholder Ownership" (1999) 62 M.L.R. 32, 38–41.
[88] [1925] A.C. 619 (H.L.).
[89] Ibid., at 630 (Lord Sumner).
[90] [1948] 1 K.B. 116 (C.A.).
[91] Ibid., at 122 (Evershed L.J.) and also at 120.
[92] [1953] 1 Q.B. 248, 276–77 (C.A.).

Johnson case. According to Lord Bingham's proposition, when a company and its shareholders suffer *distinct losses* and have distinct causes of action, both the company and its shareholders can bring an action. The *Johnson* case itself is illustrative of this nuance. The court upheld Mr. J's right to bring an action to recover his losses that are *separate and distinct* from that of the company.[93] The only two claims that the court disallowed as reflective of the company's loss were (1) damages for diminution in value of shareholding and (2) the claim that Mr. J's pension value was diminished due to the company's failure to make its contribution because of the wrong committed to the company.[94] If the company recovered its losses, the losses suffered by Mr. J would be made good. The court, nonetheless, unanimously allowed Mr. J to maintain his own action with respect to his other claims – for which the company had neither a cause of action nor had suffered a loss – namely, for the additional personal borrowing he had to make, the additional tax burden he had to bear and the loss of shares transferred as security to a lender.[95] Lord Bingham's proposition allows: (1) the company to preserve its decisional autonomy concerning its assets and claims; and (2) shareholders to seek redressal for their distinct losses. A company's management is entrusted with different company organs. Therefore, shareholders cannot directly recover their loss even if the company acting through those organs does not fully recover (or does not recover at all) so as to replenish the fall in share value or diminution in dividend.[96] One possible exception to the argument based on the company's autonomy can be when the company completely loses its assets due to the wrong committed against it, like in the *Giles* case. In such a case, since the company's assets are entirely lost, there is no purpose in still preserving the decisional autonomy of the company.

Lord Millett approached the issue differently. In his view, the reason for the shareholders' reflective loss is the company's decision to settle or not to pursue its claim. In such a case, the shareholders do not have a cause of action against third parties at all. On the other hand, when the shareholders suffer a direct loss, the principle does not apply and a cause of action accrues to the shareholders against the wrongdoers. Even before the *Johnson* case, this distinction between reflective loss and a direct loss of shareholders existed in English law. A case that illustrates this distinction is *Heron International Ltd. and others v Lord Grade, Associated Communications Corp. plc and others*.[97] In a contested takeover, the company's directors (who also held the majority of the

[93] *Johnson v Gore Wood* [2002] 2 A.C. 1, 37 (Lord Bingham), 66–68 (Lord Millett).
[94] Ibid., at 67 (Lord Millett).
[95] Ibid.
[96] *Marex Financial v Sevilleja* [2020] UKSC 31, at [81], [83] (Lord Reed).
[97] [1983] B.C.L.C. 244 (C.A.).

shares in the company) would have accepted the lower of the two bids received. The loss accruing to the shareholders because of the company accepting the lower of the two bids received is a direct loss to the shareholders. Only an action by the shareholders in their capacity as shareholders will remedy the loss that the shareholders sustain. Similarly, in *R.P. Howard Ltd. & Richard Alan Witchell v Woodman Matthews and Co.*,[98] a condition in a lease obligated the lessee's principal shareholder to obtain the lessor's consent before selling its shares. The court treated the condition as entitling the shareholder to bring an action against the solicitors who drafted the lease for loss of share value.

The prime concern that shareholders are denied a remedy for their reflective loss when the directors fail to pursue the company's claims does not hold up for an economic reason also. In their celebrated paper, entitled "Theory of the Firm: Managerial Behavior, Agency Cost and Ownership Structure", Michael Jensen and William Meckling argue that the risk of management behaving not in the best interests of the shareholders is factored into the contractual relations that form the company. The price prospective minority shareholders are willing to pay for their shares will reflect the agency cost of delegating the authority to directors. The higher the agency cost, the lower would be the share price a shareholder would pay.[99] In other words, the initial share price is discounted by the risk of loss arising from the directors not diligently pursuing the company's claims.

In fact, although shareholders cannot bring a direct action for loss to the company's assets, they are not remediless against a director's negligence. They may institute a derivative action against erring directors (in some cases, also against third parties). But the derivative action's scheme is such that all the company's constituents benefit from the action, as if it is the company's own action. Shareholders may pursue only the company's claim in a derivative action. A derivative action balances the shareholders' interest in ventilating their grievances with the concern about compromising the autonomy of the company when shareholders directly sue for what is primarily the company's loss. We have seen that, when individual shareholders pursue a personal action, it benefits only the shareholders bringing the action at the cost of other constituencies. But shareholders can institute a derivative action in respect of the company's cause of action, seeking relief on behalf of the company alone.[100] Shareholders cannot seek redress for their individual grievances through a derivative suit. Since the court would grant relief to the company, a derivative action puts the company's assets back in the

[98] [1983] B.C.L.C. 117 (Q.B.).
[99] Jensen and Meckling, "Theory of the Firm", 312–13.
[100] Companies Act 2006, s. 260(1).

company's hands which benefits not just the shareholders who bring the derivative action but all the constituencies. Therefore, derivative actions strengthen the corporate form and preserve the company as a single economic entity.

A further argument in favour of permitting both the company and its shareholders to bring their direct action is that in cases where a wrongdoer has promised both the shareholders and the company, there is no prejudice caused to the wrongdoer in being responsible to both the company and the shareholders. Such a wrongdoer must not be insulated from a direct shareholder action.[101] This argument, though very forceful on its face, needs to address the impact of permitting direct shareholders' action on the company as an entity and its counterparties. If restriction on the shareholders is removed, a counterparty can potentially face direct shareholders' action not just in cases where they have direct contract with the shareholders but also in cases of implied contracts or alleged torts. At present, instances – whether based in contract or tort – in which the company has suffered a loss do not result in a large number of direct shareholder actions to the extent of threatening the corporate form and unity of interest of companies because the principle forbids the shareholders from doing so. It is true that in many cases, shareholders will eventually fail to show that they have a direct cause of action against their company's counterparty. But in the absence of the principle, shareholders can bring actions against their companies' counterparties in many instances where there is a fall in share value or a diminution in dividend in the hope of proving a cause of action. Remarkably, despite the criticism of the majority's view in *Marex* that it forbids many legitimate claims of shareholders, the Singapore Court of Appeal in *Miao Weiguo v Tendcare Medical Group* endorsed it[102] and identified the preservation of the unity of interest and authority of the company's management as reasons behind the principle.[103] Without the principle, shareholders' direct action will not be rare. A significant number of direct shareholder actions can put the counterparties and the unity of interest and authority of the company's management in serious jeopardy.

While the principle prohibits shareholders' direct actions for reflective losses, it does not result in the mechanical rejection of shareholders' claims. It is important to recognise that the impact of the principle is not that the court will reject shareholders' losses at the very threshold as reflective losses. In *Johnson* itself, the House of Lords recognised that a claim must not be struck out if there is any doubt as to whether compensating the company would make good the shareholders' loss or

[101] See also Watts, "Shareholder as Co-Promisee", 390.
[102] *Miao Weiguo v Tendcare Medical Group* [2021] SGCA 116, at [6].
[103] Ibid., at [201], [202].

not. Courts must decide such claims at trial.[104] The decisions after *Marex* in the UK show that it is still possible for shareholders to show that their loss is *separate and distinct* from that of the company. For instance, in *Burnford and others v Automobile Association Developments Ltd.*,[105] the Court of Appeal held that, if the application of the principle depended on the resolution of a factual issue, the court should not strike out a claim summarily.[106]

It may not be out of place to note that the *Marex* case is based on a claim of a creditor against an insolvent company. Section 423 of the Insolvency Act 1986 provides for a remedy to creditors of insolvent companies. The court can set aside a transaction at undervalue if the transaction was meant to put the assets beyond the reach of creditors.[107] Thus, in the *Marex* case, the liquidator could initiate a proceeding to set aside transactions meant to defeat Marex's claims. If the liquidator wrongfully refused to bring an action, the creditors could also bring an action for negligence against the liquidator.

VI. Why Should the No Reflective Loss Principle Be Defended?

Those who support and oppose the no reflective loss principle use the principle of separate legal personality to drive home their points. As discussed above, on the one hand, it is argued that, when the company has suffered a loss, only the company can seek redressal for its loss. On the other hand, it is also argued that the shares are shareholders' personal property as distinct from companies' assets. Therefore, the diminution of share price gives shareholders a separate cause of action from that of the company. The fact that the company's assets also suffered a loss should not deny shareholders (or creditors) relief for the loss they have suffered.[108]

Since the views about how the principle of separate legal personality applies vis-à-vis the no reflective loss principle remain ambivalent, one will not resolve the conundrum by considering the separate legal personality principle alone. When we consider another essential feature of companies, namely the delegated management through a board of directors, the no reflective loss principle makes more sense. Because of the numerous shareholders and frequent changes in the shareholders, it is unworkable to leave the company's management to the shareholders.[109] Moreover, the shareholders, especially in a large public company, may

[104] See *Johnson v Gore Wood* [2002] 2 A.C. 1, 36–37 (H.L.) (Lord Bingham).
[105] [2022] EWHC 368 (Ch).
[106] Ibid., at [33]–[34].
[107] See S. Gee, "Asset Stripping Reflective Loss and Injunctions: Garcia v Marex" (2019) 2 Journal of Business Law 89, 93.
[108] See Lee Suet Lin, "Barring Recovery", 553.
[109] See J. Armour, H. Hansmann, R. Kraakman and M. Pargendler, "What Is Corporate Law?" in R. Kraakman et al. (eds.), *The Anatomy of Corporate Law: A Comparative and Functional Approach*, 3rd ed. (Oxford 2017), ch. 1, 11–13, for a brief discussion on delegated management.

not have the necessary information or expertise to run the company. Therefore, articles invariably entrust the company's general management to the board of directors. The shareholders cannot issue binding directions to the board regarding the exercise of power vested in the board.[110] A body of shareholders can control the board's power only by amending articles, removing the directors or refusing to re-elect the directors.[111]

The directors' ability to bind the company[112] plays a critically important role in making delegated management feasible. The Companies Act 2006 has adopted a course that would reduce the scope for avoiding the consequences of directors' actions. It is apposite briefly to set out the previous state of the law regarding when a company could avoid directors' actions in order to appreciate the change brought about by the Companies Act. A director is bound to act according to the company's constitution. But under the doctrine of indoor management, a person dealing with the company is not under an obligation to verify whether the company has taken the necessary internal approvals. At the same time, the law formerly required everyone dealing with a company to have notice of the company's registered constitutional documents.[113] In other words, the company's counterparties would not get protection when directors' actions became void or voidable for violation of the company's constitution.[114] This left an avenue for companies to avoid the consequences of a director's action.

The Companies Act tries to prevent companies from later disowning directors' actions by arguing that the directors were acting not in accordance with the company's articles. Now, a person dealing with companies in good faith is not required to investigate whether the director has the power under the constitution of the company to do what he proposes.[115] At the same time, the directors themselves are not absolved from their liability to the company. To put it differently, the company's recourse against the directors' excesses and failures is only against the directors and not against the counterparties who, in good faith, relied on the directors. The no reflective loss principle also seeks to preserve this very ability of the company's management to bind the company against counterparties effectively. A proposition that when the company has not taken steps against its wrongdoer for compensating its loss, shareholders should be allowed to do so may appear reasonable.

[110] *Scott v Scott* [1943] 1 All E.R. 582 (Ch.D.).
[111] See e.g. *Automatic Self-Cleansing Filter Syndicate Co. Ltd. v Cuninghame* [1906] 2 Ch. 34 (C.A.); *John Shaw and Sons (Salford), Ltd. v Peter Shaw and John Shaw* [1935] 2 K.B. 113.
[112] See Companies Act 2006, ss. 171–177, 40.
[113] See e.g. *The Royal British Bank v Turquand* (1856) 119 E.R. 886; *Mahony (Public Officer of National Bank of Ireland) v East Holyford Mining Co. Ltd.* [1874–80] All E.R. Rep. 427.
[114] See Davies, *Principles of Modern Company Law*, 499.
[115] Companies Act 2006, s. 40(2).

But allowing shareholders to sue a counterparty for the alleged wrong committed to the company (even when the company chooses to settle or not to sue) tends to undermine the ability of the directors to bind the company effectively. A counterparty takes the directors'/board's decisions as the company's decisions. A company can reliably act only if its board's decisions are not subverted through direct shareholders' actions.

A company is a complex nexus of contracts. Its shareholders are not the owners of the company.[116] The shareholders only have rights as outlined in the law and in the company's articles. Under the law, the company's management is vested in the directors except in certain cases where the members' approval is stipulated.[117] The shareholders must be deemed to have accepted the fact that the company's decision to pursue, settle or abandon its claim binds them. In turn, the directors are restrained by the shareholders' power to remove them.

One objection to the deference to management decisions could be that the law should provide shareholders with remedies for losses due to management's breaches. At the outset, one must note that the principle does not absolve the directors/management from liability to the shareholders. As discussed previously, shareholders may institute a derivative suit for the directors' negligence, breach of duty, breach of trust or default.[118] Here again, the law protects counterparties from being proceeded against. A derivative action can ordinarily be brought against a director. While a third party can also be proceeded against, the circumstances in which a derivative suit may be instituted against third parties are narrow. For instance, if a third party knowingly received money or property of the company transferred to it negligently or in breach of trust by directors, shareholders can seek relief against such a third party.[119] Shareholders, however, cannot bring a derivative suit for a claim based on a tort or breach of contract against the company by third parties.

Even when the Companies Act permits derivative action, it considers it vital to preserve the company's unitary nature and the board's legitimate authority. Therefore, the court will grant permission for a derivative suit only if it considers that a person acting to "promote the success of the company" for the benefit of "its members as a whole" would pursue the suit.[120] If the board or management would decide not to initiate an action

[116] See M.A. Eisenberg, "The Conception That the Corporation Is a Nexus of Contracts, and the Dual Nature of the Firm" (1999) 24 Journal of Corporate Law 819, 825–26.
[117] Proposals implementing fundamental changes, such as amending articles and mergers, require shareholders' approval by special resolution/supermajority.
[118] Companies Act 2006, s. 260(3).
[119] See Explanatory Notes, Companies Act 2006, s. 260.
[120] Companies Act 2006, s. 263(2)(a) read with s. 172.

for valid business reasons,[121] the court should refuse permission for the derivative action.[122]

The provision concerning the duty of directors to promote the company's success also highlights the law's concern for preserving the company's unitary nature and the incompatibility of individual shareholders' actions with the scheme of company law.[123] The directors must act – including when they settle or forgo a claim – for the benefit of the "members as a whole". Why does the law consider the interests of "members as a whole" and not those of the individual shareholders? Since the shareholders of a company are not a homogenous group, often their interests do not coincide.[124] For example, block-holders, venture capitalists and hedge funds may have different preferences as shareholders. While some shareholders would be more interested in the company's long-term performance, others may be interested in short-term profits. Similarly, shareholders may have different approaches to matters like employee rights and environmental protection.[125] The interests of dominant shareholders and minority shareholders often do not coincide.[126] Further, shareholders are not the only constituency that the directors should take into account. Even when their primary duty is towards the shareholders, the directors are bound to have regard to the interests of employees; the need to foster good relationships with suppliers, customers and others; the impact of the company's operation on the community and environment; the standards of business conduct; and – when the law requires it – the interests of the creditors.[127] If shareholders can bring personal actions effectively nullifying the company's decision to forgo or settle a claim, they may do so ignoring many legitimate interests of other shareholders and constituencies.

As discussed in the previous section, although the board is vested with the power to make most decisions, company law allows shareholders to influence the corporate decisions that boards make. A view that the shareholders can maintain an action for compensation for the fall in

[121] For different valid reasons for which a company may refrain from suing a wrongdoer, see Davies, *Principles of Modern Company Law*, 605–06.

[122] Companies Act 2006, s. 263(2).

[123] Ibid., s. 172.

[124] For example, executives, board members and employees who are also shareholders may resist an otherwise efficient takeover bid to protect their employment: see I. Anabtawi, "Some Skepticism About Increasing Shareholder Power" (2006) 53 UCLA Law Review 561, 586–88.

[125] See D.S. Boss, B.L. Connelly, R.E. Hoskisson and L. Tihanyi, "Corporate Governance: Ownership Interests, Incentives, and Conflicts" in M. Wright, D.S. Siegel, K. Keasey and I. Filatotchev (eds.), *The Oxford Handbook of Corporate Governance* (Oxford 2013), ch. 11, 247–60; see also S. Cools, "The Dividing Line Between Shareholder Democracy and Board Autonomy: Inherent Conflicts of Interest as Normative Criterion" (2014) 11 European Company and Financial Law Review 258, 287. Shareholders – who are also suppliers, employees, customers and creditors – may vote to protect their interests as suppliers, employees, customers and creditors even if it may not be in their interest as shareholders: see H. Hansmann, *The Ownership of Enterprise* (Cambridge, MA 1996), 62.

[126] See L. Enriques, H. Hansmann, R. Kraakman and M. Pargendler, "The Basic Governance Structure: Minority Shareholders and Non-Shareholder Constituencies" in Kraakman et al. (eds.), *The Anatomy of Corporate Law*, ch. 4, 79–88.

[127] See Companies Act 2006, s. 172(1).

share value against the company's counterparty will relieve shareholders of the responsibility to participate in the running of the company and to exercise control over the board. Company law's answer to the directors' failure to discharge their duties towards the shareholders is the power shareholders wield over the directors and the remedies within the company law's framework.

Shareholders are not entitled to more than they bargained for. Among a company's stakeholders, the shareholders benefit the most if the company succeeds. They are the sole claimants to the residual assets after satisfying all other claims. At the same time, the law requires the shareholders to be the biggest risk-bearers. In the case of a company turning insolvent, the share capital gets wiped out first.[128] Even when the shareholders are the first to lose their investment, they, in the case of companies limited by shares, do not lose anything more than what they have invested in the company. Their liability is limited. In short, while the shareholders can keep all the residual benefits when the business succeeds, they are not required to absorb the losses beyond what they have invested in the company.[129] On the other hand, a proprietor will not have protection similar to that of the shareholders. She has to bear the consequences of business failure to the full extent. But the proprietor can sue her wrongdoers to recover all the damages that she has suffered. Similarly, a company would be liable to the full extent. It can also sue its wrongdoers without restrictions. In other words, both a company and a proprietor are entirely liable for their obligations, and they can sue their wrongdoers without restriction. The law governing damages allows a company to recover a loss that a proprietor in its place can recover. Allowing the shareholder also to recover for the fall in share value will be over and above what the ordinary law of damages would permit. One cannot reasonably argue that the law expects counterparties of companies to bear such additional burden as compared to the counterparties of proprietorships.

One must also assess the impact of such additional potential liability towards shareholders from the standpoint of the company's counterparties. One of the benefits of incorporating a company is to avoid dealing with numerous individuals with conflicting interests. The

[128] The priority of distribution in case of insolvency is the combined effect of different provisions of the Insolvency Act 1986: see *In re Nortel GmbH (in administration) and related companies; In re Lehman Bros. International (Europe) (in administration) and related companies* [2013] UKSC 52, [2014] A.C. 209, at [39] (Lord Neuberger).

[129] It is beyond doubt that shareholders' limited liability is critically important for companies to exist as a workable form for enterprises; see F.H. Easterbrook and D.R. Fischel, "Limited Liability and the Corporation" (1985) 52 University of Chicago Law Review 89, for a discussion of the advantages of limited liability; see also P. Halpern, M. Trebilcock and S. Turnbull, "An Economic Analysis of Limited Liability in Corporation Law" (1980) 30 University of Toronto Law Journal 117, 126–31, for discussion on how limited liability helps in the working of the capital market; H. Hansmann, R. Kraakman and R. Squire, "Law and the Rise of the Firm" (2006) 119 Harvard Law Review 1333, 1343–50. This article argues that limited liability can even work to creditors' advantage by shielding a borrower's assets from the creditors of companies in which the borrower holds shares.

law should ensure that the counterparties can proceed based on the company's decisions. If individual shareholder actions are permitted (even if the company considers the action not to be in the best interest of "its members as a whole"), they could weaken the company as a single separate entity. The protection that the no reflective loss principle gives to counterparties from direct shareholders' actions is not meant to protect a few wrongdoers. The protection serves a larger purpose of strengthening the corporate form. Making it more complicated and riskier for third parties to deal with companies makes companies less reliable business partners in the long run. If the principle is done away with, the significant possibility of shareholders directly bringing actions against counterparties will discourage them from engaging with companies. Therefore, it is necessary that company law vigorously discourages shareholders from undermining corporate decisions, whether directly or indirectly.

Those who seek to abolish the principle need to address many profound questions. As a logical extension of the argument that counterparties are liable to shareholders, can shareholders also be directly liable to counterparties? If shareholders are so liable to counterparties, will the company's separate legal personality survive? Will there be a chilling effect on potential shareholders subscribing to companies' shares? The opponents of the principle have mostly ignored these questions. It is tempting to disregard the legal fiction that creates companies and see the "real owners" behind them. But to hold shareholders liable, disregarding the fiction, means forgoing or at least limiting the benefits of the fiction. What are those benefits? A company as a separate legal personality offers a platform for a large number of (even unknown) people to come together to incorporate themselves as a company. Often, the amount of capital an individual can bring into a venture will be grossly inadequate to undertake most modern business enterprises. The fiction makes it possible to mobilise large amounts through smaller contributions from each participant. Another advantage is that, unlike individual enterprises, a company's duration is not linked to the lifespan of its owners.[130] The dominance of companies as the most favoured form of enterprise testifies to the importance of the fiction. Overall, allowing the shareholders to sue the companies' counterparties based on what they are alleged to have done to the company tends to weaken the legal fiction called the company and everything for which the fiction forms the foundation.

[130] See generally M.M. Blair, "Locking in Capital: What Corporate Law Achieved for Business Organizers in the Nineteenth Century" (2003) 51 UCLA Law Review 387, for an account of how "separate legal personality" has helped business organisers.

VII. Conclusion

The no reflective loss principle plays a vital role in maintaining the company as a single entity and preserving the ability of the company's organs to make decisions with respect to the company's assets. The principle is critically important for the counterparties of companies as well. It protects them from facing a multitude of shareholder (often opportunistic) litigation and the risk of double recovery. The majority's position in *Marex* – that the shareholders' reflective losses are not recoverable because they are not *distinct and separate* from the company's losses – is a well-reasoned approach. At the same time, the majority disagrees with Lord Millett's opinion in *Johnson* that shareholders' loss is due to the company's refusal or failure to pursue its claims. But the minority challenges the principle directly by even doubting its existence. The minority opinion – if it becomes the law – creates more opportunities for shareholders to bring personal suits to avoid the consequences of the company's decisions. It will likely limit the sanctity of the company as a reliable legal entity. Therefore, we must remind ourselves of the significance of the principle in preserving companies as reliable legal entities and preventing them from becoming groups of shareholders moving in different directions.