Who suffered the loss? A comment on the "Reflective Loss" Principle

The Court of Appeal judgment in Burnford and ors. v Automobile Association Developments Limited [2022] EWCA Civ 1943 provides an opportunity to reflect on the "Reflective Loss" principle, and consider the current position.

In recent years, there have been a number of cases decided in respect of the "Reflective Loss" principle (the "Principle") - that is the principle that a shareholder cannot make a claim in respect of diminution in the value of his shareholding if this is merely a reflection of the loss suffered by the company itself.

Following years of uncertainty, the Supreme Court handed down its landmark judgment on the Principle in *Sevilleja v Marex Financial Ltd [2020] UKSC 31* in 2020. In that case, the Court confirmed that '*a shareholder cannot bring a claim in respect of a diminution in the value of his shareholding, or a reduction in the distributions which he receives by virtue of his shareholding, which is merely the result of a loss suffered by the company in consequence of a wrong done to it by the defendant.'* It is immaterial to the Principle whether the company has itself issued proceedings in respect of the wrongdoing.

Since *Sevilleja v Marex,* it has been clear that the Principle exists as a matter of law. While guidance was given as to its scope, disputes continued to arise. By way of example, the Courts have been asked to consider *when* it should be considered whether a loss is reflective - see *Primeo v Bank of Bermuda [2021] UKPC 22.,* where the Privy Council found this should be assessed at the time when the cause of action accrues, as opposed to the time when the claim was brought. The Courts have also been asked to consider the extent to which the Principle applies in cases of fraud (see *Breeze v Chief Constable of Norfolk [2022] EWHC 942 (QB)*), as well as whether the Principle applies to indirect shareholders (see *Broadcasting Investment Group Ltd v Smith [2022] 1 WLR 1*).

Background to the Burnford case

The Burnford claimants were individuals who were former shareholders in a company called Motoriety (UK) Limited ("Motoriety"). Part of Motoriety's business involved keeping an electronic record of a vehicle's service history, enabling it to send prompts and marketing material to customers when a service or MOT was due.

In 2015, Motoriety sought further investment and entered into investment agreements with Automobile Association Developments Limited ("AAD") with the aim of expanding its customer base. AAD made numerous representations during negotiations including that it would provide access to AAD's member base.

Upon the conclusion of the investment agreement, it emerged that several of the representations allegedly made during negotiations were untrue. According to the claimants, the misrepresentations had been made fraudulently.

In 2017, Motoriety went into administration and the company was dissolved in 2019. The shareholders issued proceedings against AAD in May 2021, claiming damages equivalent to the value of their shares in the company.

The Court of Appeal's decision

The matter was first heard by the High Court, which allowed AAD's strike out application on the basis that the Principle applied. The questions for the Court of Appeal were whether the sitting judge had erred, firstly, on the basis that the law relating to the Principle was uncertain and, secondly, on the facts, as to which the claimants pleaded the Principle did not apply.

The Court of Appeal dismissed the Burnford claimants' assertion that the matter was fact sensitive and therefore not suitable for summary determination. In *Sevilleja v Marex* the Supreme Court had confirmed the existence of the Principle and explained its scope. Although the Court acknowledged that certain issues pertaining to the Principle remain unresolved, this did not mean there were uncertainties in respect of this particular case.

The Court of Appeal then rejected the claimants' second argument that the Principle did not apply. Endorsing the first instance judge's reasoning that '*even though the claims are limited to the amounts paid for the shares, the loss suffered by the claimants is still the loss of their value'* which in turn was 'reflective' of the loss to the company and fell squarely within the meaning of "Reflective Loss". The Court also rejected the claimants' assertion that AAD was in breach of a contractual term. However, even if that were the case, any contractual obligation would also have been owed to Motoriety so the Principle would still bar the claimants from pursuing the claim.

CPB Comment

Burnford is, itself, not ground-breaking, but it makes clear that although the "Reflective Loss" principle may still be developing, its existence is firmly established in English case law, and the Courts are likely to take a firm line in striking out claims that are not brought by the proper claimant(s).

The Principle is likely to attract further scrutiny in years to come, as an increase in claims against both Directors and Officers, as well as other professionals, is anticipated as a result of the looming recession. Insurers should be alert to this, in order to identify and avoid claims of this nature as early in the claims process as possible.

December 2022

Any questions

If you have any questions regarding the issues highlighted in this article, please get in touch with Simon or Lisbeth.

You can also review a range of articles on similar insurance and reinsurance topics in the Publications section of our website.

Simon Thomas
Partner

T: 0203 697 1909
M: 0746 985 6128
simon.thomas@cpblaw.com
LinkedIn

Lisbeth Poulsen
Solicitor / European Qualified Lawyer

T: 0203 697 1905
M: 07823 467563
lisbeth.poulsen@cpblaw.com
LinkedIn