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Systems Ltd at [1997] RPC 443 at 471 and referred to by Lord Millett in *Johnson v Gore Wood & Co (a firm)* [2001] 1 BCLC 313 at 369, [2002] 2 AC 1 at 66.

[64] I have described that problem earlier in this judgment; but, at the risk of repetition, it is convenient to set out the passage in which it was raised, so succinctly, by Hobhouse LJ in the *Gerber* case ([1997] RPC 443 at 471):

> 'As the judgment of the Court of Appeal [in *Prudential Assurance Co Ltd v Newman Industries Ltd (No 2)* [1982] 1 All ER 354 at 366–367, [1982] Ch 204 at 222–223] implies, the shareholder will ordinarily have difficulty in proving that he has suffered a loss caused by the fault of the third party. If the company is able to recover from the third party, the company will be indemnified and the value of the shareholder's shares will not have been reduced. If the company chooses not to exercise its remedy, the loss to the shareholder will have been caused by the decision of the company not to pursue its remedy, not by the defendant's fault.'

[65] The effect of the judge's decision in the present case is that the shareholder cannot recover even in a case where he can prove that the loss which he has suffered was caused by the fault of the defendant; that is to say, in a case where he can show that the decision (or failure) of the company to pursue its remedy was not a 'new and independent' cause or, as it was formerly described, a novus actus interveniens (see *Weld-Blundell v Stephens* [1920] AC 956 at 975, 983–984, 986).

[66] To put the point more starkly, the effect of the judge's decision – 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 ([2001] 1 BCLC 313 at 338, [2002] 2 AC 1 at 36) that 'the court must be astute to ensure that the party who has in fact suffered loss is not arbitrarily denied fair compensation'.

[67] In my view the reasoning in *Johnson v Gore Wood* does not compel the conclusion that the law requires that result. The relevant principle in the speech of Lord Bingham of Cornhill is set out as proposition (3) ([2001] 1 BCLC 313 at 337–338, [2002] 2 AC 1 at 35–36):

> '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 owed to the shareholder, each may sue to recover the loss caused to it by the 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*.' (My emphasis.)

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He explained the principle further in a passage ([2001] 1 BCLC 313 at 338, [2002] 2 AC 1 at 36):

> '... the court must respect the principle of company autonomy, ensure that the company's creditors are not prejudiced by the action of individual shareholders and ensure that a party does not recover compensation for a loss which another party has suffered .... the object is to ascertain whether the loss claimed appears to be or is one which would be made good *if the company had enforced its full rights against the party responsible* ...' (My emphasis.)

[68] Lord Bingham derived the principle formulated as proposition (3) – as he said ([2001] 1 BCLC 313 at 338, [2002] 2 AC 1 at 36) – from *Lee v Sheard* [1955] 3 All ER 777 at 778, [1956] 1 QB 192 at 195–196, *Heron International Ltd v Lord Grade* [1983] BCLC 244 esp at 262, *R P Howard Ltd v Woodman Matthews & Co* [1983] BCLC 117 esp at 123, the *Gerber* case and *Stein v Blake (No 2)* [1998] 1 BCLC 573 at 575, [1998] 1 All ER 724 esp at 726. In three of those cases – *Lee v Sheard, Heron International,* and *Stein* v *Blake* – the shareholder had no cause of action of his own. They were, on their facts, cases within Lord Bingham's proposition (1). In *Gerber* the subsidiary companies, in which the primary loss had been suffered, had no cause of action. It was, on its facts, a case within proposition (2). The particular factual situation to which proposition (3) is directed – where there has been a breach of duties owed to both the company and the shareholder – arose in *R P Howard Ltd v Woodman Matthews & Co.* In that case the shareholder was entitled to recover for the loss which he had, himself, suffered, by reason of the fact that his shares had become less readily saleable – see the analysis in the speech of Lord Millett ([2001] 1 BCLC 313 at 368, [2002] 2 AC 1 at 65). In none of those cases to which Lord Bingham referred did the court address the question whether a shareholder could recover for reflective loss in circumstances where the wrong done to the company had made it impossible for the company to pursue its own remedy.

[69] Lord Bingham's proposition (3) is based on two principles which are not in doubt: (i) that a shareholder cannot recover for a loss which he has not suffered and (ii) that a shareholder has not suffered loss which is attributable to (or reflective of) loss suffered by the company in circumstances where the company itself can recover in respect of that loss. It may be said that proposition (3) – taken in conjunction with the further passage to which I have referred – is authority, also, for the principle that a shareholder cannot recover from the wrongdoer for a loss which is reflective of loss suffered by the company in circumstances where the company could itself have recovered in respect of that loss but has chosen not to. In that case, as Hobhouse LJ explained in the *Gerber* case, the shareholder's loss is not caused by the wrongdoer. But Lord Bingham did not address directly the question whether a shareholder could recover for reflective loss in circumstances where the wrong done to the company had made it impossible for the company to pursue its own remedy against the wrongdoer. He did not need to do so; and it is not, I think, to be assumed that he had that question in mind when he

explained that a shareholder could not be allowed to recover for a loss 'which would be made good if the company had enforced its full rights against the party responsible'.

[70] Lord Cooke of Thorndon ([2001] 1 BCLC 313 at 345, [2002] 2 AC 1 at 43) expressed agreement with Lord Bingham's three numbered propositions; but he went on to say that the propositions were not to be taken as comprehensive. There is nothing in his speech, nor in the speech of Lord Goff of Chieveley, which suggests that they had in mind the question whether a shareholder could recover for reflective loss in circumstances where the wrong done to the company had made it impossible for the company to pursue its own remedy against the wrongdoer; and nothing which lends support to a contention that they would have regarded Lord Bingham's proposition (3) as providing the answer to that question.

[71] Lord Hutton ([2001] 1 BCLC 313 at 354, [2002] 2 AC 1 at 51–52) identified what he described as 'the *Prudential Assurance* principle' in these terms which he cited from the court's judgment in that case:

> 'But what [a shareholder] cannot do is to recover damages merely because the company in which he is interested has suffered damage. He cannot recover a sum equal to the diminution in the market value of his shares, or equal to the likely diminution in dividend, because such a "loss" is merely a reflection of the loss suffered by the company. The shareholder does not suffer any personal loss. His only "loss" is through the company, in the diminution in the value of the net assets of the company, in which he has (say) a 3% shareholding. The plaintiff's shares are merely a right of participation in the company on the terms of the articles of association. The shares themselves, his right of participation, are not directly affected by the wrongdoing. The plaintiff still holds all the shares as his own absolutely unencumbered property ....'

[72] He took the view ([2001] 1 BCLC 313 at 357, [2002] 2 AC 1 at 54) that the decision in the *Prudential* case could not be explained on the ground of causation advanced by Hobhouse LJ in *Gerber* – to which I have already referred. He thought that the question to be decided was whether the House should follow the reasoning set out in the *Prudential* case in preference to the reasoning set out in the judgments of the Court of Appeal of New Zealand in *Christensen v Scott* [1996] 1 NZLR 273. While recognising the force of the reasoning in the New Zealand case, he held that the *Prudential Assurance* principle should be applied. His speech has relevance in the context of the present appeal not, I think, because of his rejection of Hobhouse LJ's reasoning in *Gerber* – a rejection that finds no support in the speeches of the other members of the House – but for the following passage ([2001] 1 BCLC 313 at 358, [2002] 2 AC 1 at 55):

> 'I further consider that [the *Prudential Assurance*] principle has the advantage that, rather than leaving the protection of creditors and other shareholders of the company to be given by the trial judge in the complexities of a trial to determine the validity of the claim made by the plaintiff against the defendant, where conflicts of interest may arise between directors and some shareholders, or between the liquidator and

some shareholders, the principle ensures at the outset of proceedings that where the loss suffered by the plaintiff is sustained because of loss to the coffers of the company, there will be no double recovery at the expense of the defendant nor loss to creditors of the company and other shareholders.'

[73] As Waller LJ has said, it is difficult to do justice to Lord Millett's speech in *Johnson v Gore Wood* by citing passages selectively. Waller LJ has set out substantial passages from that speech, and it is unnecessary for me to repeat that exercise. To my mind the most important passages in the present context are to be found at [2001] 1 BCLC 313 at 365–366, 369, [2002] 2 AC 1 at 62, 66.

[74] In the first of those passages Lord Millett explained the general rule in terms which present no difficulty in the context of the present appeal:

> 'In such a case [where the company suffers loss caused by the breach of a duty owed both to the company and to the shareholder] 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.'

The premiss which underlies that passage is that the company has, and can pursue, its own cause of action. Absent that premiss there would be no danger of double recovery at the expense of the defendant; and no occasion to protect the interests of the creditors and other shareholders of the company. It is, I think, clear that Lord Millett was not addressing his observations, in that passage, to a case where the company has abandoned its cause of action against the wrongdoer; a fortiori, he was not addressing those observations to a case where the company has had to abandon its cause of action because of the wrong done to it by the wrongdoer.

[75] Lord Millett reviewed the earlier authorities ([2001] 1 BCLC 313 at 366–369, [2002] 2 AC 1 at 62–66), commencing with the *Prudential* case and including *Stein v Blake (No 2)*, *Heron International Ltd v Lord Grade*, *R P Howard Ltd v Woodman Matthews & Co* and *Christensen v Scott*. In rejecting the reasoning in *Christensen*, he approved the approach to causation adopted by Hobhouse LJ in the *Gerber* case. He said ([2001] 1 BCLC 313 at 369, [2002] 2 AC 1 at 66):

> '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. Thomas J [in *Christensen v Scott*] 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 at 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 a remedy; they can have recourse to the Companies Court, or sue the liquidator for negligence.' (My emphasis.)

[76] But for the sentence which I have emphasised, those passages would present no difficulty in the context of the present appeal. They contain express recognition that one reason, at least, why a shareholder cannot recover in a case where the company (acting through its directors or its liquidator) has chosen not to pursue its claim, is that (in such a case) the shareholder's loss is not caused by the wrongdoer. In such a case the shareholder's remedy lies against the directors or the liquidator (as the case may be). If the shareholder can surmount that problem of causation, then (but for the sentence which I have emphasised) those passages do not lead to the conclusion that his claim must fail.

[77] 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 or with the decision in *Gerber*, 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 ([2001] 1 BCLC 313 at 337, 346, [2002] 2 AC 1 at 35, 43). 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 Hobhouse LJ'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.

[78] 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 ([2001] 1 BCLC 313 at 370, [2002] 2 AC 1 at 66):

> '*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 liquidation out of his hands.' (My emphasis.)

[79] 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.

[80] For those reasons, I am satisfied that the decision in *Johnson v Gore Wood* does not compel the conclusion which the judge reached on the preliminary issue which he had to decide. In my view, on the particular facts alleged in this case, it cannot be held – on what is, in effect, an application to strike out the claim to damages without a trial – that the no reflective loss principle is applicable. The question whether or not the wrong done to the company by Mr Rhind was a direct cause of the receiver's decision to discontinue the claim made by the company in proceedings 1994 S 755 cannot be determined without a trial in the present proceedings. If and so far

as that question is not raised squarely on the pleadings, I would think it right (in the circumstances in which the question arose) to give permission to amend. I would allow the appeal on that ground.

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

[81] 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

KEENE LJ.

[82] I agree with both judgments. In particular, it does not seem to me that the House of Lords in *Johnson v Gore Wood & Co (a firm)* [2001] 1 BCLC 313, [2002] 2 AC 1 was contemplating or seeking to deal with the circumstances which are to be taken to exist in the present case. I too would allow this appeal.

Appeal allowed.

Kenneth Dow Esq Barrister.