Neutral Citation Number: [2021] EWCA Civ 912

Case No: A3/2020/1723

IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM THE HIGH COURT OF JUSTICE
(Chancery Division)
BUSINESS AND PROPERTY COURTS OF ENGLAND AND WALES
Mr Andrew Simmonds QC
(Sitting as a Deputy High Court Judge)
[2020] EWHC 2501 (Ch)

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 18/06/2021

Before :

LADY JUSTICE ASPLIN
LORD JUSTICE COULSON
and
LORD JUSTICE ARNOLD

- -

Between :

Broadcasting Investment Group Limited	**1st Appellant**
Visual Investments International Limited	**2nd Appellant**
Mr Kenneth Burgess	**3rd Appellant**
- and –	
Mr Adam Smith	**1st Respondent**
Mr Dan Finch	**2nd Respondent**

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Mr Dan McCourt Fritz (instructed by **Withers LLP**) for the **Appellants**
Mr Joseph Sullivan and Ms Maya Chilaeva (instructed by **Gowling WLG (UK) LLP**) for the **Respondents**

Hearing date: 25th May 2021

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Approved Judgment

Covid-19 Protocol: This judgment was handed down remotely by circulation to the parties' representatives by email, release to BAILII and publication on the Courts and Tribunals Judiciary website. The date and time for hand down is deemed to be 11.00 A.M. on Friday 18th June 2021.

Lady Justice Asplin:

1. This appeal and the cross-appeal are concerned with the scope and effect of the rule in *Prudential Assurance Co Ltd v Newman Industries Ltd (No 2)* [1982] Ch 204 ("Prudential") as recently explained by the Supreme Court in *Sevilleja v Marex Financial Limited* [2020] 3 WLR 255. In particular, they are concerned with the effect of the rule in *Prudential* when taken together with the Contract (Rights of Third Parties) Act 1999 (the "1999 Act"), in respect of a contract that benefits a company, but to which the company is not a party. These appeals also concern: the extent to which the rule in *Prudential* applies where a shareholder seeks specific performance (and/or damages in lieu of specific performance) in respect of a breach of contract to which it is a party, where the company in which the shareholding is held also has a cause of action; and the application of the rule in *Prudential*, if any, to shareholders in corporate shareholders of the company which has a cause of action.

2. These issues arise in the context of an application by the Respondent, Mr Adam Smith, to strike out certain claims made against him by the Appellant, Broadcasting Investment Group Limited ("BIG"), Visual Investment International Limited ("VIIL") and Mr Kenneth Burgess (together referred to as the "Claimants") pursuant to CPR 3.4, or alternatively, for reverse summary judgment under CPR 24.2. Mr Burgess is the majority shareholder of VIIL which in turn owns 51% of the issued share capital of BIG.

3. In summary, the Claimants seek to enforce an alleged oral agreement made in October 2012 between BIG, Mr Burgess, Mr Smith and the second defendant, Mr Dan Finch, amongst others, for the transfer of shares in two broadcasting technology companies to a joint venture vehicle, the fifth defendant, Streaming Investments PLC ("SS Plc") in which Mr Smith, Mr Finch, BIG and one other investor became shareholders (the "Agreement"). SS Plc is in creditors' voluntary liquidation and took no part either in the hearing before the judge or in the appeals before us.

4. The strike out/summary judgment applications were heard by Andrew Simmonds QC, sitting as a deputy High Court judge. In summary, he held (insofar as relevant to these appeals) that BIG's claims to enforce the Agreement, including both its claims for damages and specific performance, should be struck out. He held that the claims were barred by the rule in *Prudential*, on the basis that SS Plc, in which BIG owned shares, itself had a right to enforce the Agreement under the 1999 Act. However, the Judge declined to strike out Mr Burgess' equivalent claim. The citation of his judgment is [2020] EWHC 2501 (Ch).

5. The deputy judge gave permission to appeal in relation to the Appellants' first ground of appeal, concerning the relationship between section 4 of the 1999 Act and the rule in *Prudential.* Permission was granted subsequently by Newey LJ in relation to their second ground, concerning whether the rule in *Prudential* barred a claim for specific performance.

6. In his Respondents' Notice, Mr Smith seeks to uphold paragraph 1 of the deputy judge's order (pursuant to which BIG's claims were struck out) on the different

or additional ground that BIG's contractual claims engage the rule in *Prudential* because, on the facts as assumed by the deputy judge, SS Plc would have had a claim against him for breaching his fiduciary duties as its director.

7. Mr Smith also cross-appeals the deputy judge's refusal to strike out the claims by Mr Burgess in respect of the Agreement and was given permission to do so by Newey LJ. In his cross-appeal, Mr Smith contends that because Mr Burgess owns shares in BIG, which in turn holds shares in SS Plc, the rule in *Prudential* bars Mr Burgess' claims in contract. He submits that the rule applies not only to claims brought by the direct shareholders in a company, but also to claims brought by those further up the shareholding chain. This has been referred to as the "Russian doll" argument or effect.

Background in more detail

8. I take the relevant background to this matter from the judgment. Reference should be made to the judgment itself for a full explanation of the facts. The account contained in the judgment was taken, in turn, from the Amended Particulars of Claim, the contents of which were treated as factually correct for the purposes of the applications before the deputy judge. It was made clear in the judgment that were the claims to proceed, many of the allegations in the pleading would be contested. The position remains the same before us.

9. The background is complicated but is necessary to understand the issues before us. Mr Burgess says that he was introduced to Mr Smith in February 2012. Mr Smith was associated with a company named Simplestream Ltd ("SS Ltd"). Its directors were Mr Smith and Mr Finch. It is said that Mr Smith told Mr Burgess that SS Ltd could develop software which Mr Burgess required but that the company required investment. As a result, Mr Burgess and/or VIIL were invited to invest in SS Ltd. Mr Burgess told Mr Smith that he/VIIL would not themselves invest in SS Ltd but that outside investors, being a Mr Goddard and a Mr Macpherson and companies associated with them, would be introduced.

10. SS Ltd was owned as to 80% by a Ms Cynthia Franklin and as to 20% by Mr Smith. Another company, TV Player Ltd ("TVP"), was said to be owned as to 75% by Ms Franklin, as to 20% by Mr Smith and as to 5% by Mr Finch. Mr Burgess says that in August 2012, Mr Smith told him about a dispute between himself and Ms Franklin which had been resolved by an agreement providing for the transfer of all Ms Franklin's shares in SS Ltd and TVP to Mr Smith, giving Mr Smith total, or nearly total, control of the two companies.

11. It is pleaded that in about October 2012 Mr Burgess and Mr Smith agreed that BIG, as the vehicle of VIIL and ViiomniTV Limited (an investment vehicle of Mr Goddard and Mr McPherson, "Vii"), should be entitled to 39% of the equity in a company to be called Simplestream Group on the basis that it would become the holding company for SS Ltd and TVP. BIG was incorporated on 15 October 2012 and its shares were held as to 51% by VIIL (which in turn was controlled by Mr Burgess) and as to 49% by Skoosh Investments Ltd ("Skoosh") (at one time, the Fourth Defendant), another Goddard/Macpherson investment vehicle.

12. Later that month, at a meeting on 30 October 2012, it is alleged that the Agreement was entered into by BIG (acting by Mr Burgess), Mr Burgess, Mr Smith, Mr Finch and two companies acting by Mr Macpherson, Skoosh and Vii. Insofar as relevant to this appeal, the features of the Agreement were as follows. First, Mr Smith would procure the incorporation of the Simplestream Group holding company, and its shares would be held by the participants as follows: 39% by BIG, 48% by Mr Smith, 5% by Mr Finch and 8% by a company to be nominated by Mr Macpherson. Second, once a loan of £150,000 made by BIG to SS Ltd had been repaid, BIG would transfer the loan to the holding company in order to capitalise it (the "Capitalisation Condition"). Third, Mr Smith would, within a reasonable time of the fulfilment of the Capitalisation Condition, procure the transfer of SS Ltd and TVP, the operating subsidiaries, to the Simplestream Group holding company.

13. The Claimants allege that both BIG and Mr Burgess personally were parties to, and therefore, entitled to enforce the Agreement. The Simplestream Group holding company, however, was not in existence at the date of the Agreement and therefore could not be a party to it.

14. It is pleaded that the following steps were taken to give effect to the Agreement. On 20 November 2012, the holding company was incorporated, with its shares allocated as set out above. This company is the Fifth Defendant, SS Plc which was originally named Simplestream Group Plc. On 12 February 2013, BIG fulfilled the Capitalisation Condition. The Claimants allege, however, that in breach of the Agreement, the shares in SS Ltd and TVP were never transferred.

15. On 4 August 2015, SS Plc went into creditors' voluntary liquidation. The Liquidator has, thus far, declined to pursue any claims which SS Plc may have in relation to the Agreement.

16. In their Amended Particulars of Claim, the Claimants plead that by reason of the breach of the Agreement:

> "32. … BIG has suffered loss by reason of the consequent diminution in the value of its shareholding in SS PLC and loss of dividend income from SS PLC. Further, it was a foreseeable consequence of the aforesaid breaches that (by reason of lacking the revenues they would have supplied) SS PLC subsequently entered insolvent liquidation, such that BIG's shares in SS PLC lost the entirety of their value".

Insofar as relevant to these appeals, the relief claimed by the Claimants is as follows:

> "42. BIG and/or Mr Burgess claim specific performance of the [Agreement] as regards the transfer to SS PLC of the shares in SS Ltd and TVP, alternatively damages in lieu of specific performance.

> 43. Further or alternatively, BIG claims damages for breach of the [Agreement] in respect of the consequent diminution of the value of its shares in SS PLC (equating to the market value of the shares which BIG should have obtained) and loss of past and future dividend income."

There were other claims which are not relevant for these purposes.

The strike out application

17. As I have already mentioned, Mr Smith applied for strike out or reverse summary judgment of the claim. In respect of BIG's claim, Mr Smith contended that this fell within the scope of the rule in *Prudential*, as explained by Lord Reed in *Marex Financial Ltd v Sevilleja* [2019] QB 173. It is said that the claim concerns a loss suffered by SS Plc; BIG is a shareholder in SS Plc and the pleaded loss is merely reflective of that suffered by SS Plc. By virtue of section 1(1)(b) of the 1999 Act, SS Plc has its own claim against Mr Smith under the Agreement; it follows that SS Plc and BIG have concurrent claims against Mr Smith, and therefore, BIG's claim is barred by the rule in *Prudential*. As demonstrated by *Marex*, that bar extends both to the claim for damages and to the claims for specific performance and other relief made by the shareholder.

18. In the alternative, Mr Smith contended that BIG's claim was also barred under the rule in *Prudential* because, on the facts alleged in the Claimant's Amended Particulars of Claim, Mr Smith's failure to procure the share transfer was inevitably a breach of his fiduciary duties as a director of SS Plc, a breach which is actionable at the suit of SS Plc.

19. In respect of Mr Burgess' claim, Mr Smith submitted that this was also barred by the rule in *Prudential.* Mr Burgess is a shareholder in VIIL which is a shareholder in BIG which, in turn, is a shareholder in SS Plc. On the Claimants' pleaded case, Mr Burgess' only loss is a reduction in the value of his shareholding in VIIL consequent upon a reduction in the value of VIIL's shareholding in BIG which in turn is consequent upon a reduction in the value of BIG's shareholding in SS Plc.

The judge's reasoning

20. As I have already mentioned, the deputy judge struck out BIG's claims on the basis of the rule in *Prudential* but declined to strike out Mr Burgess' claims.

21. As the application of the rule in *Prudential* is dependent upon a cause of action being vested in the company as well as the shareholder and as SS Plc had not been incorporated at the date of the Agreement, the judge considered first whether SS Plc had a cause of action arising out of the Agreement, by virtue of the 1999 Act. He held that: section 1(1)(b) of the 1999 Act applied because on the Claimants' case, the Agreement purported to confer a benefit upon SS Plc in that it required Mr Smith to procure the transfer of SS Ltd and TVP to SS Plc, and SS Plc was to hold the shares in those companies beneficially; and section 1(1)(b) was not dis-applied by section 1(2). That sub-section dis-applies section 1(1)(b) if "on a proper construction of the contract it appears that the parties did

not intend the terms to be enforceable by the third party." Accordingly, SS Plc was entitled to enforce the Agreement pursuant to section 1 of the 1999 Act. See [48] - [52]. This part of the judge's reasoning is not in dispute.

22. His reasoning in relation to the interaction of sections 1 and 4 of the 1999 Act and the rule in *Prudential*, however, is the basis for the first ground of appeal. The judge rejected Mr McCourt Fritz's argument which was based upon three steps. They were as follows: (i) it is section 1 of the 1999 Act which confers a right of action upon SS Plc to enforce the Agreement which is concurrent with the rights of the promisees (BIG and/or Mr Burgess); (ii) it is the existence of that right in SS Plc conferred by section 1 which enables the rule in *Prudential* to be invoked which would bar BIG's claim under the Agreement; (iii) accordingly, the effect of section 4 must be to override the rule in *Prudential* so far as it relates to BIG's claim.

23. The judge held that the "obvious purpose and effect of section 4 is to make it clear that the right to enforce conferred on the third party by section 1 is additional to any right of enforcement which the promisee may have". ([53]). The judge went on to reason as follows:

> "53. . . That [the purpose] is confirmed by paragraphs 11.1-11.4 of the Law Commission Report and is reflected in the Explanatory Notes published with the 1999 Act. There is no reason to think that, in passing section 4, Parliament had in mind the rule in *Prudential* which would only be relevant in the specific case where the third party was a company and the promisee was a shareholder in that company and no reason at all to conclude that Parliament intended, by section 4, to override the rule where it would otherwise be applicable. Therefore, the "right" of the promisee to enforce a contract which is preserved by section 4 can only be a right which is subject to generally applicable legal principles, including (where applicable) the rule in *Prudential*."

24. Despite having decided that SS Plc already had a concurrent claim to enforce the Agreement, the judge, nonetheless, went on to consider Mr Smith's alternative submission that SS Plc also had a concurrent claim against Mr Smith for breach of a fiduciary duty. He held that, in the context of a strike out application, he would not have acceded to that argument, because it raised questions of fact that had not formed part of the Claimants' case. The Claimants had not pleaded that Mr Smith was a director of SS Plc; there was no Defence from Mr Smith pleading to his own breach of fiduciary duty owed to SS Plc; and even if there had been such pleading, it might raise disputed questions of fact requiring resolution at trial: [54]. This is the basis for Mr Smith's Respondent's Notice point.

25. At [56], the deputy judge turned to consider two arguments made by the Claimants to the effect that *Prudential* could not bar BIG/Mr Burgess' claims, even if SS Plc did have a concurrent claim. First, the Claimants relied on Lord Reed's dicta at [9] of *Marex*, where he held that *Prudential* applied where the diminution in the value of the shareholding (or distributions) was "merely the result of a loss suffered by the company in consequence of a wrong done to it

by the defendant". The Claimants submitted their claims were based on Mr Burgess/BIG's contract with Mr Smith, and not any loss to SS Plc, which was not party to the contract. The deputy judge rejected this argument too. He concluded that Lord Reed cannot have been suggesting that the loss must have resulted "merely" from loss actionable at the suit of the company: that would mean there were no concurrent claims at all, and the rule in *Prudential* was not engaged. There is no appeal in this regard.

26. Second, the Claimants argued that even if *Prudential* barred their damages claim, it was not applicable to their claim for specific performance, as the latter was not a claim about diminution in the value of the shareholding or distributions. The judge's reasoning in this regard forms the basis for the second ground of appeal. He rejected the argument on the basis that it was contrary to the Court of Appeal's judgment in *Prudential* itself, as endorsed by Lord Reed in *Marex* at [35]. There, Lord Reed articulated the principle as barring a shareholder from bringing an action against a wrongdoer "to recover damages or secure other relief" for an injury done to the company (emphasis added): "other relief" would include an order for specific performance: [57].

27. The judge also rejected Mr McCourt Fritz's submission that Lord Reed's disapproval of *Latin American Investments Ltd v Maroil Trading Inc* [2017] EWHC 1254 (Comm) at [52]-[53] of *Marex*, was limited to the claim for the payment of contractual damages and did not extend to the claim for specific performance. He held that:

> "58. . . It is clear from the judgment of Teare J in *Latin American* that the claim for "specific performance" referred to in his paragraphs [4] and [6] *was* the claim for an order that the defendants pay the relevant sums to the company: see also [10]. There was no distinct claim for specific performance of which Lord Reed did not disapprove. Indeed, as appears from [13], the successful argument in *Latin American* (which Lord Reed considered should have been rejected) substantially replicates the argument advanced by Mr McCourt Fritz to the effect that BIG's claim for specific performance of Mr Smith's obligation to procure a transfer of the shares in SS Ltd and TVP to SS PLC is not barred by the rule in *Prudential*:
>
> > "Rather, Mr Shah submitted that there is a good arguable case that the "reflective loss" principle does not bar a shareholder with a cause of action seeking a remedy which requires *property or* payments to be restored to the company. The Claimant, as a party to the Shareholder Agreements, should be entitled to maintain a claim under those agreements to compel the First Defendant to restore to the Joint Venture Companies payments which should have been made to them. The remedy which Mr Shah seeks is the remedy of specific performance" (my emphasis).

28. On that basis, the judge held that BIG's claim was a "paradigm example" of a claim that is barred by the rule in *Prudential*. As the Supreme Court made clear

in *Marex*, the *Prudential* rule is a rule of law and does not confer any discretion in applying that rule on the judge hearing the claim. [59] - [60].

29. In relation to Mr Burgess' claim, however, the judge held that the rule in *Prudential* did not apply. He gave four reasons: (1) *Marex* was clear that the *Prudential* rule only bars claims by shareholders in the loss-suffering company; (2) the Supreme Court had stressed the rule was a highly specific exception, reflective of the unique position of a shareholder in relation to the company, and was antipathetic to any incremental extension to non-shareholders; (3) a second- or third-degree shareholder is not a shareholder in the relevant company, and blurring that distinction would ignore the separate legal personality of the companies forming the intervening links in the chain; and (4) a shareholder contracts into the *Prudential* rule when he acquires shares in a company, and accepts it will affect the recovery of losses incurred by that company; the same cannot be said of an indirect shareholder. [64]. This reasoning gives rise to Mr Smith's cross-appeal.

The 1999 Act and *Marex*

30. The issues which arise in this case require the careful consideration of the relevant provisions of the 1999 Act and rule in *Prudential,* as explained in the *Marex* case. The arguments can only be understood against that background. Accordingly, I turn to them now.

31. First, section 1 of the 1999 Act provides as follows:

> **"1 Right of a third party to enforce a contractual term**
>
> (1) Subject to the provisions of this Act, a person who is not a party to a contract (a "third party") may in his own right enforce a term of the contract if –
>
> (a) the contract expressly provides that he may, or
>
> (b) subject to subsection (2), the terms purport to confer a benefit on him.
>
> (2) Subsection 1(b) does not apply if on a proper construction of the contract it appears that the parties did not intend the term to be enforceable by the third party.
>
> (3) The third party must be expressly identified in the contract by name, as a member of a class, or as answering a particular description but need not be in existence when the contract is entered in to."

These provisions must be read in light of sections 4 and 7(1) which state:

> **"4 Enforcement of a contract by promise**
>
> Section 1 does not affect any right of the promisee to enforce any term of the contract.

…

7 Supplementary provisions relating to third party

(1) Section 1 does not affect any right or remedy of a third party that exists or is available apart from this Act."

32. Secondly, as I have already mentioned, it is important to consider the *Marex* decision in some detail. In that case, the claimant was a creditor of two companies which, it alleged, had been unlawfully stripped of their assets by the defendant, from whom the claimant sought damages. The defendant applied to set aside service of the claim form on the basis that the claimant's claim was barred by the rule in *Prudential*, as the liquidator of the two companies could pursue a claim against the defendant for the same loss. At first instance, the judge rejected the application, but he was overturned by the Court of Appeal, which held that the rule against reflective loss was not limited to shareholders, and extended to unsecured creditors. The matter was appealed to the Supreme Court, which took the opportunity to conduct a "root and branch" reconsideration of the doctrine.

33. The majority in the Supreme Court allowed the appeal, Lord Reed giving the leading judgment and Lord Hodge providing a short concurring judgment. In essence, they decided that the rule in *Prudential* is restricted to a principle of company law, whereby a shareholder cannot bring a claim in respect of the diminution in the value of his shareholding, or a reduction in the dividends he receives, which is merely the result of loss suffered by the company as a result of the defendant's wrongdoing. In so holding, the majority reined in the expansion of the *Prudential* rule that had followed the House of Lords' decision in *Johnson v Gore Wood & Co* [2002] 2 A.C. 1.

34. Lord Reed set out his view of the narrow ambit of the rule in *Prudential* at [9]-[10] in the following terms:

> "9. The fact that a claim lies at the instance of a company rather than a natural person, or some other kind of legal entity, does not in itself affect the claimant's entitlement to be compensated for wrongs done to it. Nor does it usually affect the rights of other persons, legal or natural, with concurrent claims. There is, however, one highly specific exception to that general rule. It was decided in the case of *Prudential Assurance Co Ltd v Newman Industries Ltd (No 2)* [1982] Ch 204 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, even if the defendant's conduct also involved the commission of a wrong against the shareholder, and even if no proceedings have been brought by the company. As appears from that summary, the decision in *Prudential* established a rule of

> company law, applying specifically to companies and their shareholders in the particular circumstances described, and having no wider ambit.
>
> 10. The rule in *Prudential*, as I shall refer to it, is distinct from the general principle of the law of damages that double recovery should be avoided. In particular, one consequence of the rule is that, where it applies, the shareholder's claim against the wrongdoer is excluded even if the company does not pursue its own right of action, and there is accordingly no risk of double recovery. That aspect of the rule is understandable on the basis of the reasoning in *Prudential*, since its rationale is that, where it applies, the shareholder does not suffer a loss which is recognised in law as having an existence distinct from the company's loss. On that basis, a claim by the shareholder is barred by the principle of company law known as the rule in *Foss v Harbottle* (1843) 2 Hare 461: a rule which (put shortly) states that the only person who can seek relief for an injury done to a company, where the company has a cause of action, is the company itself."

35. He turned to consider the Court of Appeal's judgment in *Prudential* in detail at [23]. Prudential, a minority shareholder, brought a personal and derivative action against the company's directors, claiming that they had committed the tort of conspiracy against the company and its members. The Court of Appeal held the claim was barred, but, as Lord Reed explained at [26], the ambit of its decision was limited:

> "26. The court disallowed Prudential's claim on the ground that it had not suffered any personal loss. It stated at pp 222-223:
>
> > "But what he [the 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."
>
> As that passage makes clear, the decision was concerned only with a diminution in the value of shares or in distributions, suffered by a shareholder merely because the company had itself suffered actionable damage. It was not concerned with other losses suffered by a shareholder, or with situations where the company had not suffered any actionable loss."

36. Lord Reed then went on to consider the basis for the rule in *Prudential*, and concluded that the avoidance of double recovery was not a sufficient explanation for it. First, that explanation could not account for circumstances where there may not be a close correlation between the company's loss and any fall in share value, and second, it failed to have regard to the role of company autonomy. Explaining his second point, Lord Reed said:

"34. … What if the company fails to pursue a right of action which, in the opinion of a shareholder, ought to be pursued, or compromises its claim for an amount which, in the opinion of a shareholder, is less than its full value? If that opinion is shared by a majority of the shareholders, then the company's articles will normally enable them to direct the company's course of action by passing a suitable resolution at a general meeting. Even if the shareholder finds himself in a minority, he has a variety of remedies available to him, including the bringing of a derivative action on the company's behalf, equitable relief from unfairly prejudicial conduct, or a winding up on the "just and equitable" ground, if (put shortly) those in control of the company are abusing their powers. But what if the company's powers of management are not being abused, and a majority of shareholders approve of the company's decision not to pursue the claim, or its decision to enter into a settlement? Should the minority shareholder not then be able to pursue a personal action?

35. In *Prudential*, the court answered that question in the negative, stating at p 224 that the rule in *Foss v Harbottle* would be subverted if the shareholder could pursue a personal action. The rule, as stated in *Edwards v Halliwell* [1950] 2 All ER 1064 and restated in *Prudential* at pp 210-211, has two aspects. The first is that "the proper plaintiff in an action in respect of a wrong alleged to be done to a corporation is, prima facie, the corporation". As was explained in *Prudential* at p 210, one of the consequences of that aspect of the rule is that a shareholder cannot, as a general rule, bring an action against a wrongdoer to recover damages or secure other relief for an injury done to the company. The second aspect of the rule is that "[w]here the alleged wrong is a transaction which might be made binding on the corporation and on all its members by a simple majority of the members, no individual member of the corporation is allowed to maintain an action in respect of that matter because, if the majority confirms the transaction, *cadit quaestio* [the question falls]; or, if the majority challenges the transaction, there is no valid reason why the company should not sue." This second aspect of the rule reflects the fact that the management of a company's affairs is entrusted to the decision-making organs established by its articles of association, subject to the exceptional remedies mentioned in para 34 above. When a shareholder invests in a company, he therefore entrusts the company - ultimately, a majority of the members voting in a general meeting - with the right to decide how his investment is to be protected. As the court stated in *Prudential* at p 224:

> "When the shareholder acquires a share he accepts the fact that the value of his investment follows the fortunes of the company and that he can only exercise his influence over the

> fortunes of the company by the exercise of his voting rights in general meeting."

37. Lord Reed then returned to the true ambit of the rule in *Prudential* which he summarised as follows:

> "39. In summary, therefore, *Prudential* decided that a diminution in the value of a shareholding or in distributions to shareholders, which is merely the result of a loss suffered by the company in consequence of a wrong done to it by the defendant, is not in the eyes of the law damage which is separate and distinct from the damage suffered by the company, and is therefore not recoverable. Where there is no recoverable loss, it follows that the shareholder cannot bring a claim, whether or not the company's cause of action is pursued. The decision had no application to losses suffered by a shareholder which were distinct from the company's loss or to situations where the company had no cause of action."

38. Lord Reed went on at [40] – [51] to examine the House of Lords' decision in *Johnson*, deprecating Lord Millet's reliance on the avoidance of double recovery as the explanation for the rule in *Prudential*. He suggested this approach had led to a loophole which had been "exploited" by claimants and went on as follows:

> "52. One problem with reasoning based on the avoidance of double recovery is that the principle is one of the law of damages. It does not deny the existence of the shareholder's loss, as the rule in *Prudential* does, where the loss falls within its ambit, but on the contrary is premised on the recognition of that loss. Applying an approach based on the avoidance of double recovery, it is therefore possible for a shareholder to bring a personal action based on a loss which would fall within the ambit of the decision in *Prudential*, and to obtain a remedy which that decision would have barred to him, provided the relief that he seeks is not an award of damages in his own favour. This device has been exploited in a number of cases subsequent to *Johnson*, in ways which circumvent the rule in *Foss v Harbottle*: a rule which is not confined to actions for damages but also applies to other remedies, as explained at para 35 above.
>
> 53. For example, in *Peak Hotels and Resorts Ltd v Tarek Investments Ltd* [2015] EWHC 3048 (Ch), the judge considered it arguable that the "reflective loss" principle, as explained by Lord Millett in *Johnson*, did not bar proceedings by a shareholder, who complained of a fall in the value of his shares resulting from loss suffered by the company in respect of which the company had its own cause of action, where the relief that he sought was not damages but a mandatory injunction requiring the defendant to restore property to the company. A similar view was taken in

> *Latin American Investments Ltd v Maroil Trading Inc* [2017] EWHC 1254 (Comm), where the shareholder complained of a fall in the value of its shares resulting from a breach of obligations owed to the company, which also involved a breach of contractual obligations owed to itself. It responded to the argument that its claim was for "reflective loss" by seeking an order for the payment of the contractual damages not to itself but to the company. A further example is *Xie Zhikun v Xio GP Ltd*, Cayman Islands Court of Appeal, unreported, 14 November 2018. Summarising complex facts, in that case the shareholder applied for a *quia timet* injunction to prevent the breach of fiduciary duties owed both to the company and to himself, which would cause the company to suffer loss, and would consequently affect the value of his interest in it. Sir Bernard Rix JA observed at para 66 that he did not see "how, other than perhaps in terms of pure formalism … the present case differs from … a derivative action".
>
> 54. Those cases demonstrate how right the Court of Appeal was in *Prudential* in considering that the rule established in that case, based on the absence of separate and distinct loss, was necessary in order to avoid the circumvention of the rule in *Foss v Harbottle*. The exception to that rule is the derivative action. Whether a shareholder can bring such an action depends on whether the relevant conditions are satisfied."

39. Another aspect of Lord Reed's treatment of *Johnson* which is worthy of note for present purposes is his conclusion at [66] that the case was not authority for the *Prudential* rule barring "claims brought otherwise than in the capacity of a shareholder". Further, he said at [67] that the speech of Lord Bingham in *Johnson*, who took a different line to Lord Millett, "gave authoritative support to the decision in *Prudential* that a shareholder is normally unable to sue for the recovery of a diminution in the value of his shareholding or in the distributions he receives as a shareholder, which flows from loss suffered by the company, for the recovery of which it has a cause of action, even if it has declined or failed to make good that loss.".

40. Lord Reed drew together the strands of his reasoning in the following way:

> "79. Summarising the discussion to this point, it is necessary to distinguish between (1) cases where claims are brought by a shareholder in respect of loss which he has suffered in that capacity, in the form of a diminution in share value or in distributions, which is the consequence of loss sustained by the company, in respect of which the company has a cause of action against the same wrongdoer, and (2) cases where claims are brought, whether by a shareholder or by anyone else, in respect of loss which does not fall within that description, but where the company has a right of action in respect of substantially the same loss.

> 80. In cases of the first kind, the shareholder cannot bring proceedings in respect of the company's loss, since he has no legal or equitable interest in the company's assets: *Macaura* and *Short v Treasury Comrs*. It is only the company which has a cause of action in respect of its loss: *Foss v Harbottle*. However, depending on the circumstances, it is possible that the company's loss may result (or, at least, may be claimed to result) in a fall in the value of its shares. Its shareholders may therefore claim to have suffered a loss as a consequence of the company's loss. Depending on the circumstances, the company's recovery of its loss may have the effect of restoring the value of the shares. In such circumstances, the only remedy which the law requires to provide, in order to achieve its remedial objectives of compensating both the company and its shareholders, is an award of damages to the company.
>
> 81. There may, however, be circumstances where the company's right of action is not sufficient to ensure that the value of the shares is fully replenished. One example is where the market's valuation of the shares is not a simple reflection of the company's net assets, as discussed at para 32 above. Another is where the company fails to pursue a right of action which, in the opinion of a shareholder, ought to have been pursued, or compromises its claim for an amount which, in the opinion of a shareholder, is less than its full value. But the effect of the rule in *Foss v Harbottle* is that the shareholder has entrusted the management of the company's right of action to its decision-making organs, including, ultimately, the majority of members voting in general meeting. If such a decision is taken otherwise than in the proper exercise of the relevant powers, then the law provides the shareholder with a number of remedies, including a derivative action, and equitable relief from unfairly prejudicial conduct."

41. He went on to conclude:

> "89. I would therefore reaffirm the approach adopted in *Prudential* and by Lord Bingham in *Johnson*, and depart from the reasoning in the other speeches in that case, and in later authorities, so far as it is inconsistent with the foregoing. … The rule in *Prudential* is limited to claims by shareholders that, as a result of actionable loss suffered by their company, the value of their shares, or of the distributions they receive as shareholders, has been diminished. Other claims, whether by shareholders or anyone else, should be dealt with in the ordinary way."

42. As I have said, Lord Hodge gave a concurring judgment, focusing on the "central role of company law in the Court of Appeal's judgment in the *Prudential* case" ([95]). In this regard, he said:

> "99. … I agree with Lord Reed (para 28 above) that what the Court was saying is that where a company suffers a loss as a result of wrongdoing and that loss is reflected to some extent in a fall in the value of its shares or in its distributions, the fall in the share value or in the distributions is not a loss which the law recognises as being separate and distinct from the loss sustained by the company.
>
> 100. That is the full extent of the "principle" of reflective loss which the *Prudential* case established. It was not articulated as a general principle to be applied in other contexts; it is a rule of company law arising from the nature of the shareholder's investment and participation in a limited company and excludes a shareholder's claim made in its capacity as shareholder."

Ground 1 – Interrelationship between the 1999 Act and the rule in Prudential

43. With that background in mind, I turn to the first ground of appeal. As I have already mentioned, Mr McCourt Fritz, on behalf of BIG, does not challenge the judge's conclusion that although SS Plc had not been incorporated at the date on which the Agreement was entered into, it nevertheless acquired a right to enforce the Agreement by virtue of section 1(1)(b) of the 1999 Act. He says, however, that the judge's conclusions are contrary to the terms of section 4 of the 1999 Act and as a result of the terms of that section, SS Plc's acquisition of rights under section 1 cannot affect BIG's right as a contractual promisee under the Agreement, to enforce it. He says that by holding that SS Plc's cause of action as a result of section 1 engages the rule in *Prudential*, so as to bar BIG's claim to enforce the Agreement, the judge caused section 1 to do what Parliament expressly proscribed by section 4. The effect of that reasoning, therefore, is to cause section 1 to negate BIG's contractual rights entirely in a manner which is impermissible by statute.

44. Mr McCourt Fritz described the reasoning, that the right acquired by SS Plc after the Agreement was made, by virtue of section 1 of the 1999 Act, prevents BIG as a shareholder of SS Plc from pursuing its cause of action for breach of the Agreement because of the rule in *Prudential*, as a parasite which kills its host. He says that it would be surprising if the 1999 Act barred a claim of the type which was recognised in *George Fischer (Great Britain) Ltd v Multi Construction Ltd* [1995] BCLC 260, where it was held that a corporate shareholder was entitled to damages for breach of a contract it had entered into with the defendant for the installation of equipment at its subsidiary's premises, as the subsidiary did not have its own cause of action on the contract (as the case pre-dated the 1999 Act). He pointed out that it was no part of BIG's bargain that its primary rights under the Agreement would be subsumed by the rights of a company which was not yet in existence. He also pointed out the irony that if Mr Smith had failed to comply with his obligation to incorporate SS Plc, BIG could have enforced the Agreement, but because he complied with that part of the bargain, it is said that BIG is deprived of its rights under the Agreement.

45. In essence, Mr Sullivan, on behalf of Mr Smith, submits that: section 4 of the 1999 Act cannot be construed to mean that it abrogates the rule in *Prudential* and as a result, subverts the principle of the autonomy of the company in *Foss v Harbottle* as explained and relied upon by Lord Reed in *Marex*; and that it is clear from *Marex,* in particular, at [10] and [39], that where the shareholder and the company have concurrent claims, the law does not recognise the shareholder's loss. The loss is that of the company. The promisee's cause of action preserved by section 4 is still subject to the rules of law, including the rule in *Prudential*.

Discussion and conclusion on Ground 1

46. There is no dispute that SS Plc acquired a right to enforce the Agreement by virtue of section 1(1)(b) of the 1999 Act. Furthermore, it is not in dispute that BIG, which became a shareholder in SS Plc after the latter was incorporated pursuant to the Agreement, was a contractual promisee under the Agreement. Does section 4 preserve BIG's right to enforce the Agreement or has the creation of a right in SS Plc as a result of section 1(1)(b) destroyed those rights?

47. Section 4 states expressly that "section 1 does not affect any right of the promisee . . .". What is the proper construction of that section? First, it seems to me that it is clear from the natural meaning of the words used that the right conferred upon a third party under section 1 is additional to any right the contractual promisee has to enforce the contract. Such a construction is consistent with the Explanatory Notes to the 1999 Act. It is also consistent with the clear terms of the 1999 Act as a whole which reflect the fact that it was intended to create only a limited and tightly constrained incursion into the rule of privity of contract. This is implicit not only in section 4, but also, for example, from the fact that parties are able to contract out of the 1999 Act. Section 4 makes clear that the rights created in section 1 are not intended to affect what already existed. They take nothing away.

48. The real question, therefore, is whether the rule in *Prudential* "affects" BIG's right to enforce the Agreement rather than section 1. If section 1 is the proximate cause of BIG's rights being extinguished, section 4 prevents such an outcome. If the rule in *Prudential* is the proximate cause and it stands alone from the rights granted to SS Plc under section 1 of the 1999 Act, the rights are extinguished and section 4 provides no protection to BIG as promisee.

49. It seems to me that it is quite clear that it is the rights created under section 1 which enable Mr Smith to seek to invoke the rule in *Prudential* which in turn would have the effect of destroying BIG's right to enforce the Agreement. The possibility would not arise without the operation of section 1. It is section 1, therefore, which affects the right of the promisee and is prevented from doing so by the clear terms of section 4 of the 1999 Act. It would be entirely artificial to treat the rule in *Prudential* as if it were independent of the right in SS Plc which exists as a result of section 1 and causes the rule to apply. The acquisition by SS Plc of a right under section 1 cannot affect BIG's right as contractual promisee. As Mr McCourt Fritz put it in his written argument, if one separates the application of the rule in *Prudential* from the right created by section 1, which enables it to be applied, section 1 not only affects BIG's rights to enforce

the Agreement but negates them entirely. That is impermissible as a matter of statute.

50. I also agree with Mr McCourt Fritz that the judge's reasoning at [53] to the effect that the right of the promisee to enforce a contract which is preserved by section 4 "can only be a right which is subject to generally applicable legal principles, including (where applicable) the rule in *Prudential*" takes the matter no further. It seems to me that such an approach is contrary to section 4 and defeats the purpose of that section. The rule in *Prudential* can only come into play, if at all, as a result of the statutory right which is vested in SS Plc under section 1 of the 1999 Act. That right is conferred purely by statute and is subject to the terms and limitations imposed by statute. Section 4 expressly provides that section 1 (and therefore, the right created by section 1) does not affect the right of the promisee. In circumstances such as these, if the rule in *Prudential* were treated as if it were entirely separate from the statutory right under section 1, section 4 would be sidestepped. That cannot be correct.

51. In my judgment, therefore, it would be a nonsense if section 4 were construed in any other way. As a matter of proper construction, it seems to me that "affect" must include something which would destroy the right which section 4 seeks to protect. This construction is reinforced when section 4 is read in conjunction with section 7(1) of the 1999 Act. That section makes clear that section 1 is not intended to affect any right or remedy of a third party which exists apart from the 1999 Act. It is clear, therefore, that the inroad into the principle of privity of contract created by section 1 was not intended to derogate from any right vested in the promisee or a third party. It seems to me that the words of the statute are clear. They are supported by the Explanatory Notes. There is no need to go any further. There is no uncertainty as to the mischief which the 1999 Act, and section 4 in particular, was intended to cure. Accordingly, it was not permissible to turn to the Law Commission Report which led to the enactment of the 1999 Act as the judge did at [53]. It is not a tool which can be used in order to determine the proper construction of the provisions of the 1999 Act themselves: *Pepper (Inspector of Taxes) v Hart* [1993] AC 593 at 630G. It is therefore unnecessary to consider Mr McCourt Fritz's argument that, on a proper reading, the Report does not support the judge's conclusions.

52. It is unnecessary, therefore, to consider Mr McCourt Fritz' further argument based upon a detailed analysis of Lord Reed's judgment in *Marex*. I will outline it nevertheless. He argued that following the conclusions of the majority in *Marex*, the rule in *Prudential* has been revealed to be a very specific and narrow exception to the norm. It is a rule of company law. Where it applies, the shareholder does not suffer a loss which is recognised in law as having an existence distinct from the loss suffered by the company itself. He 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. A claim by the shareholder, therefore, is barred by the principle in *Foss v Harbottle* which, put shortly, states that the only person who can seek relief for an injury done to a company, where the company has a cause of action, is the company itself. See *Marex* at [9], [10], [28], [35] and [37]. However, Mr McCourt Fritz argued that the primary

obligations owed to a contractual promisee are different from the secondary entitlement granted to SS Plc by section 1 of the 1999 Act and in this case, BIG was not binding its fortunes to that of a company in which it held shares. Its rights under the Agreement preceded the incorporation of SS Plc and were different in nature. In this regard, he relied upon the *George Fischer* case.

53. As I have already mentioned, it is not necessary to consider this argument in any detail. Suffice it to say that I consider it to be a difficult one upon which to succeed given that the shareholder's loss would be of the very nature described by Lord Reed as falling within the rule in *Prudential* even though the shares were not to be allotted until after the Agreement was entered into. I should also add that as Lord Reed explained in *Marex* at [45], *George Fischer* was a case in which the wrong was committed against the shareholder and not the company in circumstances in which the company had no cause of action. In those circumstances, there was no reason why the shareholder could not recover its loss by means of an award of damages, in accordance with ordinary principles. It follows that it is of no assistance here.

54. In any event, in my judgment, BIG's claims under the Agreement are not barred by the rule in *Prudential*. To the contrary, they are expressly protected by section 4 of the 1999 Act. It follows that I consider that the judge was wrong to strike those claims out.

Respondent's Notice – fiduciary duties?

55. What of Mr Sullivan's argument on behalf of Mr Smith, that the judge's order should be upheld on the additional ground that on the facts pleaded by the Claimants, SS Plc would have a cause of action against Mr Smith for breach of his fiduciary duties as a director of SS Plc to promote the success of the company for the benefit of its members, to exercise reasonable care, skill and diligence and to avoid conflicts of interest and accordingly, the rule in *Prudential* applies to that claim?

56. It is common ground that at the material time, Mr Smith was one of the directors of SS Plc. Further, it is the Claimants' case that pursuant to the Agreement, Mr Smith promised to transfer assets he owned in the form of the shares in SS Ltd and TVP to SS plc. The judge found that SS Plc had a right under the 1999 Act to enforce the Agreement and there is no appeal in that regard. Mr Sullivan submits, therefore, that if the Claimants' case is correct, Mr Smith owed a personal contractual duty, enforceable by SS Plc, to transfer assets, but he did not do so and did not cause SS Plc to take steps to enforce the contractual right against him.

57. It is said that in relation to both the decision whether to comply with the Agreement and transfer his personal assets to SS Plc and the decision whether to cause SS Plc to take steps to enforce the Agreement, Mr Smith's personal interests and those of SS Plc were in conflict. If the facts pleaded by BIG are true, Mr Smith would have preferred his own interests over those of the company and would be have been in breach of fiduciary duty. The judge found that SS Plc would, if the Claimants' case is true, have a right to enforce the Agreement under the 1999 Act. In such circumstances, it is said that SS Plc

would have a separate cause of action against Mr Smith in addition to its claim under the 1999 Act and, therefore, BIG's appeal in relation to section 4 of the 1999 Act becomes otiose.

58. First, in this regard, I should say that I consider that the judge was wrong to decide that the hypothetical claim for breach of fiduciary duty might require disputed questions of fact which would require resolution at trial as he did at [54] of his judgment. It seems to me that the claim should have been considered on the basis of what had been pleaded at the time that the matter came before the judge, assuming for the purposes of the strike out application that all of the facts and matters pleaded were true. In that context, it was not a matter for further factual enquiry.

59. Secondly, and in any event, it seems to me that the hypothetical claim is fatally flawed in two ways. First, such a fiduciary duty arises after the personal obligation upon Mr Smith. SS Plc obtained a cause of action in relation to breaches of the Agreement, and therefore, any breach of the personal obligation, as soon as it was incorporated, by virtue of section 1 of the 1999 Act. It is not clear what the fiduciary duty would add. In any event, the fiduciary duty would necessarily depend upon the existence of SS Plc's right to enforce the Agreement pursuant to the 1999 Act and would have no existence independent of the Agreement and the rights under section 1. It seems to me, therefore, that section 4 of the 1999 Act would operate in respect of the hypothetical fiduciary duty claim in just the same way as it does in relation to SS Plc's direct claim to enforce the Agreement. The position is just the same. Although fiduciary duties are owed by a director of a company to that company, in this case, the alleged content and breach of those duties are entirely parasitic upon the Agreement and the right of SS Plc to enforce it pursuant to the 1999 Act. I agree with Mr McCourt Fritz, therefore, that even if the claim were made out, it would not engage the rule in *Prudential* because it too is reliant upon section 1 and subject to section 4 of the 1999 Act.

60. Lastly, it seems to me that in any event, the hypothetical breach of fiduciary duty fails at the first hurdle. Mr Smith's personal duty under the Agreement and his fiduciary duty to SS Plc to take steps to get in the assets to which it is entitled are entirely in parallel. There is no conflict between them. It is to be assumed that Mr Smith intends to and will fulfil his contractual obligations. As a result, there is no breach of fiduciary duty upon which Mr Smith can rely for the purposes of this ingenious argument.

61. To conclude, therefore, in my judgment, the rule in *Prudential* is not engaged either in relation to the direct claim to enforce the Agreement or the hypothetical fiduciary duty claim and that claim is not another basis for upholding the judge's decision.

Ground 2 – Specific performance

62. In the light of my conclusion in relation to ground 1, it is unnecessary to consider Mr McCourt Fritz's second ground of appeal. It poses difficult questions. Although Lord Reed's reference to a shareholder being unable to bring an action against a wrongdoer to recover damages "or secure other relief

for an injury done to the company" at [35] in *Marex* and his treatment at [53] and [54] of *Peak Hotels and Resorts Ltd v Tarek Investments Ltd* [2015] EWHC 3048 (Ch), *Latin American Investments Ltd v Mariol Trading Inc [2017] 2 CLC 45 and Xie Zhikun v Xio GP Ltd* (unreported) 14 November 2018, Cayman Islands Court of Appeal, together with the application of the principle in *Foss v Harbottle,* might on superficial consideration lead one to the conclusion that claims for specific performance (whether with or without seeking additional or alternative relief in the form of equitable damages) also fall within the rule in *Prudential*, the matter is complex. It is best left to a case in which it is essential to determine the issue.

The Cross-Appeal – the "Russian Doll" argument

63. In the light of my conclusion under Ground 1 and in relation to the alternative hypothetical fiduciary duty claim that the rule in *Prudential* is not engaged, it is also not necessary to consider Mr Sullivan's "Russian doll" argument on the cross-appeal (regarding the application of the *Prudential* rule to indirect shareholders) and I say no more about it.

Conclusion

64. For all the reasons set out above, I would allow the appeal.

Lord Justice Coulson:

65. I agree with both judgments.

Lord Justice Arnold:

66. I agree that this appeal should be allowed for the reasons given by Asplin LJ. I would only add that I consider it well arguable that the rule in *Prudential* can apply to indirect shareholders in appropriate circumstances. Suppose A owns 100% of the shares in B Ltd which owns 100% of the shares in C Ltd. Suppose that a wrong is done to C Ltd by D which results in a diminution of the value of B Ltd's shares in C Ltd which in turn results in a diminution of the value of A's shares in B Ltd. Suppose that A has a concurrent right of action and sues D to recover his loss as result of that diminution. I find it difficult to see why, on those hypotheses, the rule should not apply.