went on to distinguish the right of rescission under section 17, which "totally nullifies the contract". This, he observed, "is appropriate where the cause, the want of good faith, has preceded and been material to the making of the contract. But, where the want of good faith first occurs later, it becomes anomalous and disproportionate that it should be so categorised and entitle the aggrieved party to such an outcome." That, he noted, would be the effect of accepting the defendant insurer's argument in the case. The idea that a failure of good faith by the insured at the end of the insurance period should entitle the insurer to recover the amount of a good faith claim paid earlier in the period "cannot be reconciled with principle".

Finally, concerning "whether the duty of good faith and disclosure continues to apply unqualified once the parties are engaged in hostile litigation", Lord Hobhouse said that when a writ is issued, "the rights of the parties are crystallised". He noted that there "is no longer a community of interests. The parties are in dispute and their interests are opposed. Their relationships and rights are now governed by the rules of procedure ... The battle lines have been drawn and new remedies are available to the parties. The disclosure of documents and facts are provided for with appropriate sanctions." There is no longer the need for a remedy outside the rules of procedure. The House affirmed the decision of the Court Appeal, which included the view of Leggatt L.J. ([1997] 1 Lloyd's Rep. 360, 372) that there is "no reason why adversaries should be under a duty to provide ammunition to one another".

MALCOLM CLARKE

LITIGATION BY SHAREHOLDERS AND REFLECTIVE LOSS

MANY of the details surrounding the circumstances when shareholders can sue are shrouded in obscurity, but it is clear that where a company and a shareholder have overlapping claims the shareholder cannot pursue its personal claim if its loss is merely reflective of the company's loss. The scope and rationale of the rule barring shareholders from bringing personal actions to recover reflective loss were authoritatively restated by the House of Lords in *Johnson* v. *Gore Wood & Co.* [2001] 2 W.L.R. 72.

A simple example can set the scene: take a company with a net present value of £1 million and four shareholders, A, B, C and D; £2 million has been extracted from the company by wrongdoers in

https://doi.org/10.1017/S0008197301670624 Published online by Cambridge University Press

breach of duties owed to the company and to its shareholders personally. All four shareholders would be fully and equally compensated if the company sued successfully to recover the lost £2 million: the shareholders' loss is *reflective* of the company's loss. What if, say, A, could sue personally to recover its share of the loss as reflected in the value of its shares—£500,000? That £500,000 would be for A's benefit alone. If the company were then to pursue its claim, the wrongdoers could not be held liable for more than £1.5 million since that would offend against basic principles. Should the company succeed, the value of each individual shareholding would increase to £625,000, not the £750,000 that would have been recovered if the company had been able to sue for the full £2 million. But in the absence of court orders taking into account what has already occurred, A would end up considerably better off than the others since it holds shares now worth £625,000 plus the £500,000 recovered in its personal action.

The House of Lords in *Johnson* has held that in these circumstances A cannot sue. But why not? According to *Prudential Assurance Co. Ltd.* v. *Newman Industries Ltd. (No. 2)* [1982] Ch. 204, 222–223, A would not have suffered any personal loss, but this denial of the existence of any personal loss caused difficulty in later cases and attracted academic criticism. In *Johnson* Lord Hutton acknowledged the force of the criticism of the *Prudential* approach: that there is personal loss in these circumstances "is a more realistic assessment" (at 113). But for Lord Millett, whose speech contains the most persuasive analysis of the position, whilst there is a personal loss to the shareholder, that is not the decisive point. Instead, the disallowance of A's claim is driven by policy considerations.

In principle, the problems generated by the simple example above could be solved either by disallowing the corporate claim and requiring each of the shareholders to sue individually or by disallowing the individual claims. Lord Millett explained that the principal policy consideration in favour of the latter approach relates to the position of creditors. Supposing a company becomes insolvent as a result of wrongdoing, it would be its creditors, not shareholders, that would benefit from the corporate action. Disallowing the company's claim would prejudice its creditors since it would subvert the normal respective positions of creditors and shareholders in insolvency. In effect, an asset that should have been available to the creditors—the right to sue the wrongdoers—would have gone to the shareholders instead.

The clear ruling that creditor considerations give the corporate claim precedence over the shareholders' personal action removes

https://doi.org/10.1017/S0008197301670624 Published online by Cambridge University Press

doubt that had stemmed from the New Zealand Court of Appeal decision in *Christensen* v. *Scott* [1996] 1 N.Z.L.R. 273. That case had suggested that there was no necessary reason why the company's claim should "trump" that of the shareholder. Secondary policy considerations also come into play to explain the absolute nature of the rule that A cannot sue for reflective loss where the company also has a cause of action. If a company agrees a compromise settlement with a defendant, principles of certainty and fairness dictate that shareholders should not then be able to re-open the case by seeking to pursue the defendant in a personal capacity. Shareholder complaints about the terms of a compromise should properly be directed at those who agreed the compromise on the company's behalf, not the original wrongdoer. This point was particularly relevant in *Johnson* where the shareholder who sought to bring the personal action controlled the company and had made the decision to compromise the company's claim; as Lord Millett noted, "Mr Johnson cannot be permitted to challenge in one capacity the adequacy of the terms he agreed in another" (at 125).

Johnson was a decision on a strike out application. Nevertheless, it can be argued that, rather than classifying shareholder claims for reflective loss as being irrecoverable as a matter of law, it could be left to trial judges to evolve detailed principles for the protection of creditors and other shareholders in such cases. So it could be left to the trial judge to devise orders ensuring that A in our example does not achieve a better position than that of the other shareholders. However, shareholders should not recover at the expense of creditors or other shareholders and the absolute disallowance of shareholder reflective loss claims, as firmly endorsed in *Johnson* (albeit with a difficult speech from Lord Cooke), is an efficient way of achieving that result. The position is entirely different if the loss is not reflective and the interesting questions now relate to drawing the line between reflective and other losses. Marginal cases need to be considered at trial, as their Lordships accepted. One issue that *Johnson* raises that will require close examination should the case proceed to trial concerns the loss suffered by, for example, an employee who is also a shareholder, for this is irrecoverable reflective loss. With the D.T.I. inspectors' report on the collapse of the Maxwell empire finally published, restrictions, both in terms of duties and of recoverable losses, on when employee-shareholders can proceed directly against fraudsters who abscond with company funds that had been earmarked for the employees' pension fund have a heightened contemporary relevance.

EILÍS FERRAN

https://doi.org/10.1017/S0008197301670624 Published online by Cambridge University Press