Trinity Term
[2021] UKPC 22
Privy Council Appeal No 0089 of 2019

JUDGMENT

Primeo Fund (in Official Liquidation) (Appellant) *v* Bank of Bermuda (Cayman) Ltd and another (Respondents) (Cayman Islands)

From the Court of Appeal of the Cayman Islands

before

Lord Reed
Lord Hodge
Lord Lloyd-Jones
Lord Kitchin
Lord Sales

JUDGMENT GIVEN ON

9 August 2021

Heard on 20 and 21 April 2021

Appellant
Tom Smith QC
Richard Fisher QC
Robert Amey

(Instructed by Mourant Ozannes (Cayman Islands))

Respondents
Richard Gillis QC
William Willson
Toby Brown
Simon Gilson
(Instructed by Campbells (Cayman Islands))

LORD KITCHIN AND LORD SALES:

1. This appeal relates to loss suffered as a result of the Ponzi scheme operated by Bernard Madoff ("Mr Madoff"). The appeal gives rise to a number of issues. The Board gave directions to hear and determine one discrete issue first, which is concerned with the operation of the rule in company law which prevents recovery by a shareholder of loss which reflects loss suffered by the company in which they are invested ("the reflective loss rule"). Another hearing will follow to deal with the other issues on the appeal, including in relation to causation, limitation and contributory negligence.

2. For the present hearing, the parties are agreed that Cayman Islands law regarding the reflective loss rule is the same as English law, which is to say the law as determined by the majority in *Marex Financial Ltd v Sevilleja (All Party Parliamentary Group on Fair Business Banking intervening)* [2020] UKSC 31; [2021] AC 39 ("*Marex*").

Factual background

3. The appellant ("Primeo"), a Cayman Islands company now in official liquidation, carried on business from 1994 as an open-ended mutual investment fund. It raised money from investors (who subscribed for shares in it) which it then invested. Primeo was promoted, marketed and managed by Bank Austria AG ("Bank Austria") as a fund of funds to provide Bank Austria's customers with access to international investment funds and exposure to the US equity market.

4. The respondents are professional service providers. On 21 December 1993 the second respondent ("R2") was appointed as Primeo's custodian and as its administrator pursuant to separate custody and administrator agreements. These agreements were superseded in 1996 when R2 was appointed as custodian for Primeo under an agreement dated 19 December 1996 ("the 1996 Custodian Agreement") and the first respondent ("R1") was appointed as administrator for Primeo under an agreement dated 19 December 1996 ("the 1996 Administration Agreement"). However, again on 19 December 1996, R1 and R2 entered into a delegation agreement whereby R1 delegated most of its duties under the 1996 Administration Agreement to R2. The result was that from that time both the custodian function and the administrator function were in practice carried out by R2.

5. The 1996 Custodian Agreement conferred, by clause 16(B), on R2, as custodian, the power to appoint such sub-custodians as it might think fit, provided that "the Custodian will use due care and diligence in the appointment of suitable sub-custodians and must be satisfied for the duration of the sub-custody agreements as to the ongoing suitability of the sub-custodians to provide custodial services to the Company [Primeo] … [and] will require the sub-custodian to implement the most effective safeguards available under the laws and commercial practices of the sub-custodian's jurisdictions in order to ensure the most effective protection of the Company's assets". These duties have been referred to in these proceedings as the appointment duty, the ongoing suitability duty and the most effective safeguards duty. In addition, clause 6(A) imposed on the custodian a duty, subject to sub-clauses (B) and (C), to "record and hold in a separate account in its books all Securities received by it from time to time and shall arrange for all Securities to be deposited in the Custodian's vault or otherwise held by or to the order of the Custodian as it may think proper for the purpose of providing for the safekeeping thereof".

6. Under the 1996 Administration Agreement R1 was appointed to provide a Secretary and act as Registrar and Accountant for Primeo. Clause 4 set out a series of duties to which R1 was subject and these included a duty to determine in the name and on behalf of Primeo on each valuation day the net asset value (NAV) upon which Primeo and its shareholders could properly rely for the purposes of transacting subscriptions and redemptions. There was no dispute that it was an implied term of the Administration Agreement that, in calculating NAVs, R2 had to exercise reasonable skill and care. However, clause 9.2 relieved R1 from liability for any act or omission in the course of or in connection with the services provided under the agreement in the absence of gross negligence or wilful default on the part of R1 or its servants, agents or delegates. Clause 9.5 imposed on R1 an obligation to use reasonable endeavours to verify pricing information supplied by the Investment Adviser.

7. From Primeo's inception it placed a proportion of its funds with Bernard L Madoff Investment Securities LLC ("BLMIS") for investment ("the direct BLMIS investments").

8. BLMIS was the vehicle by which Mr Madoff carried on his Ponzi scheme. BLMIS purported to operate managed accounts for investors, such as Primeo, which placed funds with it for investment, and the investor had a contractual right for the delivery-up of equivalent securities or cash to those recorded in the managed account. BLMIS purported to adopt an investment strategy involving listed securities, treasury bills and cash. In practice, BLMIS almost invariably reported a move at the month end into holdings of US treasury bills. Periodically BLMIS would purport to carry out valuations of the underlying assets supposedly held by it and if an increase in value was reported, that would be

reflected in the purported value of the investments held by it for its clients so that they appeared in that way to be receiving an appropriate share of the profits purportedly generated.

9. In January 1994 and again in February 1996 Primeo entered into a package of agreements (respectively the 1994 and 1996 Brokerage Agreements) with BLMIS pursuant to which Primeo opened two managed accounts with BLMIS, which functioned as Primeo's investment manager, broker and custodian (or, in due course, sub-custodian) in relation to those accounts. BLMIS had a complete discretion to buy and sell listed securities and financial instruments, the value of which would be reflected in the account in the manner we have described. BLMIS was obliged to report to Primeo on a monthly basis and to allow it to redeem on demand the investments held by it according to their value as reported to Primeo.

10. The courts below held that prior to August 2002, BLMIS was itself the custodian for Primeo in respect of the direct BLMIS investments but that in August 2002 when a sub-custody agreement ("the 2002 Sub-Custody Agreement") was concluded between R2 and BLMIS, R2 became custodian of those investments, with BLMIS as its sub-custodian.

11. Primeo increased its investment in BLMIS and the direct BLMIS investments came to constitute the major part of its investment portfolio. In addition, Primeo also invested funds it received from its clients indirectly in BLMIS. It did this by buying shares in two feeder funds funnelling assets for investment into BLMIS, called Herald Fund SPC ("Herald"), a Cayman-domiciled fund, and Alpha Prime Fund Limited ("Alpha"), a Bermuda-domiciled fund. Where Primeo invested funds in Herald or Alpha it received shares in those companies; in turn, Herald and Alpha placed their funds with BLMIS for investment, and Herald and Alpha were valued according to the value of the investments supposedly acquired and held by BLMIS using those funds. Herald and Alpha placed all of their assets for investment with BLMIS.

12. Primeo's shares, as issued to investors, were valued periodically in line with Primeo's NAV and this set the price at which they could be redeemed when investors wished to disinvest. Primeo's NAV, as stated from time to time, was audited by its auditors Ernst & Young ("EY"). This was assessed, first, by reference to the purported value of its direct investments in BLMIS, which reflected the value of the equities and financial instruments supposedly held for it by BLMIS. For Primeo's indirect investments in BLMIS, Primeo's NAV was assessed by reference to the supposed value of the shares in Herald and Alpha which it owned, which was derived from their respective NAVs which, in similar

manner, were arrived at by reference to the supposed value of their direct investments with BLMIS.

13. Over time, Primeo increased the proportion of its fund which was invested with BLMIS either directly or indirectly until by 1 May 2001 the whole of its fund was invested in this way. By April 2007 approximately 90% of Primeo's investment with BLMIS was direct, with the balance being indirect through Herald and Alpha.

14. On 1 May 2007 Primeo's direct investments with BLMIS were restructured. Primeo's direct BLMIS investments were transferred to Herald in consideration for new shares in Herald ("the Herald Transfer"). The change was effected by Primeo assigning its rights under its managed accounts with BLMIS with a reported value of US$465,824,061 in return for newly issued shares in Herald having an equivalent subscription price assessed by reference to Herald's NAV at the assignment: the transaction is described in *Pearson v Primeo Fund (No 2)* [2020] UKPC 3, para 10. From that date, Primeo no longer had any direct investments with BLMIS; all its investments in BLMIS thereafter were indirect investments via Herald (97.5% of the value of Primeo's fund) or Alpha (2.5% of that value).

15. At all material times Herald employed R2 as custodian and as administrator. Herald had no relationship with R1.

16. On 12 March 2003, Alpha entered into a custodian agreement with Bank of Bermuda Limited ("BOBL"). R2 was BOBL's sub-custodian. The sub-custodian agreement provided that R2 was not to be liable to BOBL in the absence of fraud, dishonesty, negligence or wilful default by R2, and BOBL agreed to indemnify R2 for any loss caused other than resulting from matters for which R2 was liable. There is an issue between the parties regarding the identity of Alpha's administrator, but it is common ground that R2 performed the sub-administration function for Alpha. Alpha had no contractual relationship of its own with either R1 or R2.

17. The principal issue in this hearing is whether Primeo can claim against R1 and R2 for losses which it says it suffered by making direct investments with BLMIS before the Herald Transfer. Solely for the purposes of the hearing, in order to examine whether R1 and R2 have a good defence in principle based on the rule against recovery of reflective loss, it is common ground that when Primeo made a direct investment with BLMIS the money was immediately misappropriated by BLMIS acting by Mr Madoff and his associates and used, not for the purpose of investment involving securities, treasury bills and cash as it should have been,

but to fund payments to others in the course of carrying on the Ponzi scheme when clients sought to redeem their BLMIS investments and to give the impression that BLMIS did in fact carry on a legitimate and successful investment business for the benefit of its clients. In other words, each time Primeo placed funds with BLMIS for investment, believing the value of its rights under the managed account to represent real underlying assets held by BLMIS for the benefit of its clients, that money (or a large part of it) was lost at about the time it was paid to BLMIS. The same happened when Herald and Alpha made investments with BLMIS by paying it money derived from their clients (including Primeo). The true value of the BLMIS investments was at all times far below the value which BLMIS and Mr Madoff caused them to appear to have.

18. Accordingly, the Herald Transfer in 2007 involved the assignment by Primeo to Herald of its rights in respect of the direct BLMIS investments believed to be worth US$465,824,061 but in fact worth only a proportion of that. In return, Primeo received Herald shares apparently having the same value, but since those shares only represented part of Herald's own holdings of investments in BLMIS, the true value of the Herald shares received by Primeo was also only a proportion of their apparent value. In consequence of the Herald Transfer, Primeo held 31% of Herald's issued shares as of 2013, when it issued its claims, and has a corresponding interest, as shareholder, in the recoveries made by Herald in its claim against R2 (see below).

19. Primeo's case in relation to the direct BLMIS investments is that if R1 and R2 had performed their duties properly as its administrator and custodian it would have been alerted to problems with investments in BLMIS, would not have placed more funds with BLMIS for investment and would have sought to redeem the BLMIS investments which it already held. Primeo therefore claims that it suffered loss in relation to the direct investments in two ways: (a) each time it placed funds with BLMIS for investment and that money was misappropriated by BLMIS, and (b) by loss of the opportunity to redeem its BLMIS investments at a time when there were sufficient funds in the Ponzi scheme to be used to pay Primeo the reported value of those investments.

20. Primeo has a similar case in relation to its indirect investments in BLMIS via Herald and Alpha. It claims that had R1 and R2 alerted it to problems with investing in BLMIS as they should have done, Primeo would have been protected against losses suffered (a) each time it invested money in Herald shares or Alpha shares, which was passed on to BLMIS for investment and misappropriated by BLMIS, with the effect that the Herald shares and Alpha shares were worth only a fraction of their apparent value, and (b) from loss of the opportunity for Primeo to redeem its shares in Herald and in Alpha, which in turn depended on their redemption of the investments in BLMIS held by them, at a time when the funds circulating in the Ponzi scheme would have allowed that to happen.

21. On 11 December 2008, the Ponzi scheme operated by Mr Madoff and BLMIS collapsed. Mr Madoff surrendered to the authorities in the United States and was charged with fraudulently operating a multi-billion dollar Ponzi scheme.

22. Primeo's board of directors convened the following day and suspended the calculation of its NAV. It was realised that Primeo had suffered heavy losses and it was placed into voluntary liquidation on 23 January 2009.

23. Primeo brought claims against its administrators and custodians, R1 and R2. Herald also brought claims against its custodian and administrator, R2. Alpha too brought claims against R2, as its sub-custodian and sub-administrator.

Claims by Primeo

24. In February 2013 Primeo issued proceedings in which (as its claims came to be formulated) it alleged breaches of duty by R1 and R2 which may be summarised as follows:

(1) R1, as administrator, breached its obligations under the 1996 Administration Agreement in respect of calculating the NAV of Primeo; the keeping of Primeo's accounts and books and records; and failure to exercise reasonable skill and care in the performance of its functions.

(2) R2 breached various duties under the 1996 Custodian Agreement. In addition, R2 appointed BLMIS as its sub-custodian in 1993, in 1996 and pursuant to the 2002 Sub-Custody Agreement, or pursuant to a tri-partite agreement of which the 2002 Sub-Custody Agreement was a part, and was liable for the negligence or wilful breach of duty of BLMIS as sub-custodian (this was referred to as the strict liability claim against R2), and was also alleged to have breached various implied duties.

(3) Primeo claimed that these alleged breaches by R1 and R2 (or for which R2 was responsible in law) caused it loss on the basis that, if they had performed their duties properly, the audit evidence available to EY would have been insufficient for EY to certify Primeo's accounts and NAV in respect of its investments in BLMIS with the result that Primeo would have withdrawn its investments as explained above and it would not have placed further investments directly or indirectly with BLMIS.

25. Primeo's claims went to trial in the Grand Court in 2016-2017. By a judgment dated 23 August 2017 the judge (the Hon Justice Jones QC) held that R1 and R2 owed relevant duties to Primeo and breached those duties, including on the strict liability claim against R2 by reference to breaches of duty constituted by the misconduct of BLMIS as sub-custodian. However, he dismissed Primeo's claims on the grounds that they infringed the reflective loss rule (on the basis that Herald and Alpha also had claims against R1 and R2 which covered the same loss, and if they made recovery on those claims that would eliminate any loss suffered by Primeo); Primeo had not suffered relevant loss for the strict liability claim against R2; causation had not been proven in respect of the breach of duty claims; and claims in respect of certain breaches of duty were statute-barred. The judge also found that any award of damages made against R1 would have been reduced by 75% on account of Primeo's contributory negligence.

26. Each side appealed various issues to the Court of Appeal. The appeals were heard over 10 days in late 2018. By a judgment handed down on 13 June 2019, before the decision of the Supreme Court in *Marex*, the Court of Appeal allowed Primeo's appeal in relation to the loss arising on the strict liability claim and, in relation to causation, held that the judge should have assessed causation in 2005 and 2007 on a loss of a chance basis and overturned his finding that Primeo would have reinvested its funds with BLMIS in any event. However, the court dismissed Primeo's appeal, on the basis that its claims were barred by the reflective loss rule. This was because, by the time Primeo brought its claims against R1 and R2, it was a shareholder in Herald and Herald had its own claim against, in particular, R2, and it was common ground that if Herald succeeded in its claims against R2 (and R2 complied with the judgment) that would fully restore the value of the shares in Herald held by Primeo. The appeals by R1 and R2 on the issues of duty and breach were dismissed, though R2 succeeded in its appeal that Primeo was contributorily negligent in relation to the claims against it.

Claims by Herald

27. Herald commenced proceedings in Luxembourg against R2, its administrator and custodian, on 3 April 2009 seeking damages of about US$2 billion on the basis of an obligation on R2 to restore securities deposited with it as custodian according to accounts rendered by R2 and restitution of cash held by R2 as custodian; alternatively, on the basis of a contractual claim for return of those securities; alternatively, on the basis of breach of contract, breach of statutory duty and a claim in tort against R2 as administrator and custodian.

28. On 22 March 2013 the Luxembourg District Court dismissed Herald's claim for the restitution of the securities. R2 and Herald both appealed in respect of

different aspects of that judgment. The appeal remains outstanding. The remainder of Herald's claim has yet to be determined.

29. On 29 October 2018 Herald commenced further proceedings against R2 and HSBC Bank plc seeking restitution of about US$520 million plus interest which Herald alleges was transferred by R2 to BLMIS without transfer instructions from Herald.

30. On 27 November 2018, shortly before the 10-year anniversary of Mr Madoff's arrest, reflecting the 10-year limitation period in Luxembourg, Herald commenced further claims against R2 for damages, including in respect of loss of profits and loss of a chance to extract its investments from BLMIS. The new claims increased the sums claimed as against R2 to US$5.6 billion. These claims have yet to be determined.

31. Herald did not have any contractual relationship with R1 and has not issued any claims against it.

Claims by Alpha

32. On 20 October 2009 Alpha commenced proceedings against R2 in Luxembourg claiming damages of US$346 million for breach of contract and in tort. Alpha applied for temporary suspension of those proceedings, which was granted in February 2015. They remain suspended.

33. On 7 December 2018 Alpha commenced further proceedings against R2 and other defendants. Alpha alleges that R2 breached its duties as sub-custodian and sub-administrator in a manner similar to the allegations made by Primeo in these proceedings. Damages are claimed on various bases, with the principal claim being for US$1.16 billion. These claims also have yet to be determined.

34. Alpha has not issued any claims against R1.

Findings relevant to the reflective loss issue in relation to Primeo's claims

35. The judge found that the loss claimed by Primeo against R1 and R2 was not recoverable because Primeo's claims infringed the reflective loss rule. He held that the loss was not separate and distinct from the losses claimed, or capable of being claimed, by Herald and Alpha. He also held that the merits threshold which the claims by Herald and Alpha needed to cross in order to engage the reflective

loss principle was "a realistic prospect of success" rather than "likely to succeed on the balance of probabilities", and found that those claims had a realistic prospect of success.

36. The Court of Appeal dismissed Primeo's appeal on this issue. The court upheld the decision of the judge and found that Primeo's loss was reflective of Herald's loss and Alpha's loss, so that Primeo had no right of recovery against R1 and R2 in respect of either its direct investments or its indirect investments in BLMIS.

37. The present hearing is concerned with determining whether these rulings by the judge and the Court of Appeal are correct. If they are, it may be unnecessary to resolve other issues arising variously on the appeals by the parties to the Board. The hearing has therefore proceeded on the basis that it is to be assumed, without determining, that other aspects of the judgment of the Court of Appeal are correct.

38. The assumed position which is the foundation for the submissions on the reflective loss issues to be determined in this hearing can be summarised as follows:

Primeo's custody claim against R2

(1) R2 owed no safekeeping duty to Primeo in respect of its BLMIS investments before 7 August 2002 because in that period BLMIS, rather than R2, acted as custodian in respect of those assets under the Brokerage Agreements. However, as part of an implied tri-partite agreement arising from R2 and BLMIS entering into the 2002 Sub-Custody Agreement, R2 owed custodial obligations to Primeo including a duty of safekeeping of funds deposited with R2, as well as other duties arising under the 1996 Custodian Agreement. Those duties included obligations imposed on R2 to satisfy itself about the ongoing suitability of BLMIS as its sub-custodian and to require BLMIS to implement the most effective safeguards available under the laws and practices applicable to the sub-custodian.

(2) As from 7 August 2002 R2 was, as a matter of construction of the 1996 Custodian Agreement, strictly liable to Primeo for any loss caused by a breach of duty by its sub-custodian, BLMIS. The Court of Appeal held that Primeo suffered loss every time it invested money in BLMIS, since it was misappropriated by BLMIS to prop up Mr Madoff's Ponzi Scheme in breach of its duty of safekeeping; the court also held that the Herald Transfer did not extinguish such loss. The present hearing proceeds on the basis that these findings are correct (though this will be contested by R1 and R2 in the further

hearing of the issues in the appeal). The Court of Appeal was not in a position to assess the extent of Primeo's loss and would if necessary have remitted the case to the Grand Court to carry out this task.

(3) From October 2002 R2 was in breach of its ongoing supervisory duties under clause 16(B) of the 1996 Custodian Agreement in failing to recommend to Primeo that BLMIS be required to introduce certain appropriate and available safeguards.

Primeo's administration claim against R1

(4) Under the terms of the 1996 Administration Agreement, R1 may only be liable if gross negligence is proved. R1 was negligent (but not grossly negligent) in calculating the NAV of Primeo from October 2002 onwards in that R1, as part of its obligation to calculate an accurate NAV, had failed to verify adequately the existence of underlying assets to justify that NAV through the process of reconciliation, since it had relied only on BLMIS as a source for information about that. However, R1 was grossly negligent from 2 May 2005 onwards because R1 (through R2) knew from then that Primeo's auditors, EY, were no longer willing to rely on work carried out by the auditors of BLMIS and knew that the custody confirmations issued by R2 were based entirely on information provided by BLMIS, such that EY's audit opinion no longer provided any legitimate comfort as to the existence and value of the underlying assets.

Causation of loss

(5) Primeo would have ceased making investments in BLMIS and would have withdrawn its investment from BLMIS in the absence of an unqualified audit opinion from EY and would not have reinvested with one or more feeder funds such as Herald and Alpha in such circumstances. There is an issue as to the extent of the chance that EY would have refused to issue unqualified audit opinions in the absence of custody confirmations from R2 in 2005 or 2007 and also an issue as to whether, if Primeo had given notice to withdraw its direct or indirect investments in BLMIS at those times, BLMIS would have been in a position to pay the amount which it sought to withdraw. The Court of Appeal was not in a position to assess these matters and so far as necessary would have remitted the case to the Grand Court to do so.

39. It is common ground that, if Herald and Alpha succeed in their claims against R2 (and any relevant judgment is satisfied), one consequence would be that Primeo would be repaid the full apparent value of its indirect investments in

BLMIS outstanding at the time of its collapse and hence would have suffered no loss from either the direct or the indirect investments it made or held in BLMIS. This is the foundation for the submission by Mr Richard Gillis QC for R1 and R2 that Primeo is precluded by the reflective loss rule from obtaining damages or other relief in relation to any of its direct or indirect investments in BLMIS.

40. Against this, Mr Tom Smith QC for Primeo emphasises that it is far from certain that Herald and Alpha will recover the full measure of compensation they claim from R2. Mr Smith accepts that to the extent that Herald and Alpha do make recovery from R2 in respect of BLMIS investments held by them which were supposed to support that part of their NAVs represented by shares in Herald and Alpha held by Primeo (ie Primeo's indirect investments in BLMIS, including pursuant to the Herald Transfer), and that is passed on to Primeo, Primeo will have to give credit for that in its own claims against R1 and R2. Mr Smith submits that this is simply a consequence of the usual rules regarding reduction of damages where there has been mitigation in fact of the loss which has been suffered; Primeo is not precluded in principle by the reflective loss rule from making any recovery at all from R1 and R2.

41. It is important to emphasise that the greater part of the value at stake in the present hearing is concerned with whether the reflective loss rule applies to prevent Primeo from suing R1 and R2 on the basis of causes of action which arose in relation to its direct investments in BLMIS made before the Herald Transfer. On the assumption we make for the purposes of this hearing, at the times when Primeo made those investments, on each occasion it suffered a loss because BLMIS and Mr Madoff misappropriated the funds invested by Primeo. Primeo's case against R1 and R2 is that, but for their breaches of duty as administrator and custodian, (i) it would not have made certain of those investments and so would not have suffered the loss of the money it used to make them and (ii) insofar as it had already made direct investments in BLMIS, it would have applied to redeem those investments at their apparent value as declared by BLMIS (including any increased value declared to reflect supposed profits made by BLMIS) well before the Ponzi scheme was discovered and at a time when Mr Madoff and BLMIS would have arranged to repay Primeo the apparent value of its investments. However, although Primeo had suffered loss in respect of which it had causes of action against R1 and R2 acquired before the Herald Transfer, as a result of the Herald Transfer it ceased to be a direct investor with BLMIS and instead became a shareholder in Herald, which itself placed funds with BLMIS for investment. Herald has its own similar claims against R2 for breach of duty, including in relation to losing the opportunity to redeem all its BLMIS investments (including those acquired from Primeo by the Herald Transfer) at their full supposed value, and if its claim against R2 is successful and the judgment is satisfied then that would have the effect of restoring full value to the shares in Herald which Primeo acquired by the Herald Transfer. In this very particular and limited sense, the loss which Primeo claims to recover

from R1 and R2 in relation to its direct investments in BLMIS can be said to reflect the loss for which Herald claims compensation from R2. It would, however, be more accurate to say that the recovery which Primeo claims to make from R1 and R2 reflects (in the sense of, would be affected by) the recovery which Herald claims to make from R2.

42. The reflective loss rule applies in relation to claims against a person who is a common wrongdoer, in the sense that they have by their action or omission committed wrongs both against the claimant who is a shareholder in a company and against the company itself. Before the Court of Appeal, as regards Primeo's claim against R1 for breach of duty as its administrator and the position of Herald, Primeo submitted that the reflective loss rule could not apply because Herald had no claim of its own against R1, so R1 could not be regarded as a common wrongdoer in the requisite sense for the purposes of the rule. The Court of Appeal rejected this submission (para 424(b)), saying:

> "… we accept Mr Gillis' submission that despite the apparent (legal) asymmetry, the effect of the delegation, exemption, exoneration and indemnity arrangements in the 1996 agreements … mean that in economic reality symmetry remained and the situation was within the ambit of the reflective loss principle. The effect of those arrangements was that R2 in fact did the administration for both Primeo and Herald and that a claim by Primeo against R1 for breach of administration duties would in substance be passed through as a claim against R2 in negligence and/or wilful breach of duty. Accordingly, it would compete with claims against R2 by Herald, potentially scooping the pool and extracting value or funds from Herald at the expense of other shareholders and creditors."

43. As regards Primeo's claim against R2 for breach of duty as its custodian and the position of Alpha, Primeo made a similar submission that the reflective loss rule could not apply because Alpha had no claim of its own against R2, so R2 could not be regarded as a common wrongdoer in the requisite sense. The Court of Appeal rejected this submission as well (para 425):

> "In the case of Alpha, if the Administrator (whether it was [BOBL], HSBC Institutional Trust Services (Bermuda) Ltd or Management International (Bermuda) Ltd) failed to take care in supervising the delegate, R2, and suffered loss by reason of the delegate's breach of duty, the Administrator would be liable to Alpha for breach of a common law duty to take reasonable care in the supervision of R2 but would have a claim over against R2 for breach of duty giving rise to the loss complained of by Alpha."

44. In this way, the Court of Appeal adopted what in one sense might be described as a test of substance over form in relation to identifying whether there is a common wrongdoer and who it is. On the other hand, to approach these questions in that way is capable of having major substantive effects. Primeo submits that the Court of Appeal erred in adopting the approach it did.

45. The specific issues which arise in this hearing in relation to the reflective loss rule are:

(1) What is the relevant time to determine whether the reflective loss rule applies? Is it the time when the relevant claimant (here, Primeo) issued proceedings against, in particular, R2 - ie 2013, by which time Primeo was a shareholder in Herald, which had its own similar claims against R2 and Primeo's loss could be said to reflect Herald's loss in the limited sense referred to above – or is it the time when Primeo acquired its causes of action against R1 and R2, when it acted on its own behalf and was not a shareholder in any relevant sense in Herald? ("the timing issue")

(2) If the latter, as Primeo contends, did Primeo nonetheless lose its right to claim for the losses it suffered and become subject to the reflective loss rule by reason of the Herald Transfer, by which it ceased to be a direct investor in BLMIS and became an indirect investor via its replacement shareholding in Herald? ("the Herald Transfer issue")

(3) The reflective loss rule operates where there is a common wrongdoer whose actions have affected both the claimant shareholder (Primeo) and the company (focusing here on Herald). Herald has no claim of its own against R1, but R2 has an onward claim against R1 in relation to the losses for which Herald claims against R2. Does this degree of overlap mean that R1 is to be regarded as a common wrongdoer vis-à-vis Primeo and Herald for the purposes of the reflective loss rule, so that Primeo is precluded from suing R1 as well as R2? ("the common wrongdoer issue")

(4) The common wrongdoer issue in relation to Herald also had the effect, according to the Court of Appeal, that Primeo is precluded by the reflective loss rule from suing R1 in relation to loss suffered by Primeo from investing indirectly through Herald and from loss of a chance to withdraw its indirect investments in BLMIS effected through Herald. Similarly, the Court of Appeal held that Primeo is precluded by the rule from suing R2 in relation to loss suffered by Primeo from investing indirectly through Alpha and from loss of a chance to withdraw its indirect investments in BLMIS effected through Alpha. Alpha has no claim of its own against R2, but its administrator

(whoever it was) would have an onward claim against R2 in relation to the losses for which Alpha claims against its administrator. In relation to losses suffered by Primeo in relation to these indirect investments, is R1 to be regarded as a common wrongdoer vis-à-vis Primeo and Herald for the purposes of the reflective loss rule and is R2 to be regarded as a common wrongdoer vis-à-vis Primeo and Alpha for the purposes of that rule, so that Primeo is precluded from suing R1 in relation to its losses arising from its indirect investments in BLMIS via Herald and precluded from suing R2 in relation to its indirect investments via Alpha? ("the indirect claims issue")

(5) Were the judge and the Court of Appeal correct to say that the reflective loss rule is brought into operation where the company (Herald or, as the case may be, Alpha) has a realistic prospect of success, as opposed to being likely to succeed on the balance of probabilities? ("the merits issue")

Analysis

(1) and (2): The timing issue and the Herald Transfer issue

46. These issues are connected and it is convenient to examine them together.

47. The starting point is consideration of the judgments of Lord Reed and Lord Hodge, for the majority, in *Marex*. Lord Reed (para 9) stated the reflective loss rule in this way:

> "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."

48. Lord Reed (paras 10, 35-37, 39, 54 and 80) explained the reflective loss rule as an aspect of the rule in *Foss v Harbottle* (1843) 2 Hare 461, "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." Lord Hodge (paras 96-100) explained the reflective loss rule in the same way. As set out by Lord Reed and Lord Hodge, the rule is a rule of substantive company law, not a principle for the avoidance of double recovery. As Lord Reed said (para 83), "[t]he critical point is that the shareholder has not suffered a loss which is regarded by the law as being separate and distinct from the company's loss, and therefore has no claim to recover it." It therefore does not matter whether the company brings a claim of its own or decides not to claim. There are also practical advantages associated with identifying the reflective loss rule as a bright line rule of law: *Marex*, para 38 (Lord Reed) and para 109 (Lord Hodge).

49. In *Marex* at para 39 Lord Reed explained the reflective loss rule derived from the *Prudential* case in this way:

> "… *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."

50. Lord Reed (para 79) distinguished two types of case:

> "… (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."

In the first type of case, the reflective loss rule applies and the shareholder is barred from seeking recovery for loss they may have suffered. In the second type of case, the reflective loss rule has no application and the claimant can sue for

loss they have suffered, even though they happen also to be a shareholder in a company which has a cause of action against the same wrongdoer. Lord Hodge (para 98) stated the position in similar terms: "[the rule excluding recovery] … relates only to the diminution in value of shares or in distributions which the shareholder suffers in his capacity as a shareholder as a result of the company having itself suffered actionable damage. When a shareholder pursues a personal claim against a wrongdoer in another capacity … the exclusion has no application".

51. The present hearing is concerned with identifying where the boundary lies between these two types of case. It is helpful to focus first on Primeo's claims in respect of its direct investments in BLMIS. Primeo submits that its claims against R1 and R2 for losses in respect of its direct investments fall within the second category, and that the reflective loss rule has no application. R1 and R2 submit that Primeo's claims fall within the first category and that the judge and the Court of Appeal were therefore right to hold that Primeo is barred by the reflective loss rule from recovery for its losses.

52. In *Marex*, the Supreme Court was concerned to ensure that the reflective loss rule was kept within proper bounds and given limited scope. Lord Reed and Lord Hodge explain the ambit of the rule as limited to cases where a claimant suffers loss in its capacity as shareholder in a company through a diminution in the value of its shares in that company, ie through the mechanism of a wrong done to that company which has a knock-on effect on the value of the shares held by the shareholder. They explain the justification for the rule, as derived from the principle in *Foss v Harbottle*, as based on the fact that by becoming a member of the company the shareholder agrees to "follow the fortunes of the company" in relation to losses suffered by it as a result of wrongs done to the company and agrees that the company's organs will have the right to decide whether claims should or should not be brought in respect of such wrongs (see paras 35 and 37 per Lord Reed and paras 99 and 108 per Lord Hodge). As Lord Reed said (para 81), "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." Lord Hodge said (para 100), "[the reflective loss rule] 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."

53. In the Board's judgment, on proper application of the reasoning of Lord Reed and Lord Hodge in *Marex*, the reflective loss rule has no application to bar Primeo from claiming in respect of the losses it suffered each time it made a direct investment in BLMIS, nor from claiming in respect of the losses it maintains it suffered by loss of the chance to redeem its BLMIS investments

down to the time of the Herald Transfer. In the Board's view, those losses were not suffered by Primeo "in its capacity as shareholder" of Herald. So far as is relevant, at the time Primeo suffered such losses it was not a shareholder in Herald. This point is not affected by the fact that in the period up to 1 May 2007 Primeo also held some indirect investments in BLMIS via Primeo's ownership of shares in Herald; those investments were completely separate from Primeo's direct investments with which the Board is concerned at this point in this judgment.

54. The Board considers first the losses suffered when, as a result of breaches of duty by R1 and R2, Primeo paid money to BLMIS and it was misappropriated. On the assumptions upon which the Board is presently proceeding and which are summarised above, the correct analysis here is that Primeo suffered an immediate loss by giving BLMIS money in return for the contractual right to redeem the investments reported in Primeo's managed accounts with BLMIS which were falsely over-valued by reference to the fictitious fund of equities and financial instruments supposedly in BLMIS's hands, whereas in reality and unbeknown to Primeo it only acquired a precarious right (if that is the appropriate word) to participate in Mr Madoff's Ponzi scheme so long as it remained on foot and a right to participate in BLMIS's insolvency when the scheme collapsed. Those rights were worth only a fraction of the money paid to BLMIS. Therefore, on each such occasion that it made a payment to BLMIS, Primeo acquired a cause of action as against R1 and R2 in respect of the loss it suffered at that time. On misappropriation of the money by BLMIS, Primeo suffered an immediate loss measured by the value of the money misappropriated, less any money actually recovered (see the judgment of the Court of Appeal, para 217). That loss was suffered by Primeo in its personal capacity and had nothing to do with Herald. It was not loss suffered by Primeo in its capacity as a shareholder in Herald, nor could it be said that it was "merely the result of a loss suffered by [Herald]" (*Marex*, para 39 per Lord Reed), that is as a knock-on consequence of a wrong suffered by the company itself. At the time Primeo acquired its cause of action on each such occasion, no relevant wrong had been committed by R1 or R2 against Herald at all in respect of the loss suffered by Primeo. The cause of action acquired by Primeo on each such occasion was property of Primeo which formed part of its fund of assets, albeit it did not appreciate the true position. To the extent that Primeo happened to redeem some of its BLMIS investments from time to time before May 2007 and BLMIS paid their full value out of the money circulating in the Ponzi scheme, Primeo's loss was diminished as there was mitigation in fact.

55. It is important to note that the reflective loss rule is, as was made clear in the majority judgments in *Marex*, a rule of substantive law associated with the rule in *Foss v Harbottle* and concerned with the recognition in law of particular types of loss. It is not a procedural rule concerned only with the avoidance of double recovery. Applied as a substantive rule of law, whether the reflective loss rule is

applicable or not falls to be assessed as at the point in time when the claimant suffers loss arising from some relevant breach of obligation by the relevant wrongdoer. In this case, on each occasion when Primeo suffered loss on placing funds with BLMIS for investment it did so in circumstances where the law recognises its loss as real and of a type which is recoverable. In principle, on each occasion Primeo invested by paying money to BLMIS and had its money misappropriated as set out above, Primeo could have sued R1 and R2 in respect of their breaches of duty which caused such loss, which was of a form recognised in law according to ordinary principles and did not arise in circumstances which brought the exclusionary reflective loss rule into operation.

56. As Mr Smith submitted, according to the analysis of the majority in *Marex* the focus is on the nature of the loss, which involves consideration of the capacity in which the claimant suffered the loss and the form of the loss (ie whether it was suffered as a diminution in the value of shares held by the claimant or as a reduction in the dividends payable to them). The issue is one of the characterisation of the loss, which depends upon its status (that is, whether it is recognised or not by the law) at the time it is suffered. The test of whether the substantive rule is engaged or not in relation to a cause of action which arises as property in the hands of a person is to look at the nature of the loss at that time: see *Marex*, paras 79 and 89 per Lord Reed.

57. The same point can also be made in another way. On each occasion when Primeo made a direct investment in BLMIS it suffered loss at a time when it was not subject to any agreement to "follow the fortunes" of any company (let alone Herald) arising from membership of the company, which is the foundation and justification for the reflective loss rule: see para 52 above. So there is no sound reason to apply the reflective loss rule to preclude Primeo from being recognised in law as being able, in principle, to make recovery in respect of such loss pursuant to usual general legal principles.

58. Similar reasoning applies in relation to the other type of loss in respect of which Primeo seeks to claim against R1 and R2 in respect of its direct investments, namely the loss of opportunity to disinvest from BLMIS by redeeming its BLMIS investments for their full apparent value. That also is loss suffered by Primeo in its personal capacity at a time before it was a shareholder (in a relevant sense) in Herald. Of course, after the Herald Transfer Primeo no longer held any direct BLMIS investments itself and so could not have sought then to redeem them. But that does not mean that it did not suffer genuine loss from loss of an opportunity to redeem them before that transfer took effect.

59. In the Board's view, this reasoning provides the answer to Mr Gillis's submission that the relevant time to assess whether the reflective loss rule is applicable is

when the claimant (Primeo) happened to bring its claim, ie in 2013, by which time there was an overlap in the limited sense described above in terms of the claims available to Primeo against R1 and R2 and the claims available to Alpha and, in particular, Herald against those companies. The submission, in effect, treats the reflective loss rule as a matter of procedure rather than as a substantive rule of law governing the nature of loss suffered by a claimant which the law will recognise. In the Board's view, since the rule is substantive rather than procedural in character, the relevant time to assess whether it applies or not is when the loss which is said by the claimant to be recoverable in law is suffered by it. The timing of the bringing of a claim and the circumstances which may pertain at that point in time are adventitious happenstance and have nothing to do with the operation of the rule.

60. The question of the application of the reflective loss rule in the circumstances of this case raises different considerations from those arising under the first category of case referred to above (para 50). The present case is concerned not with the conversion of a loss which is not recoverable into one which is, but rather with the conversion of a loss which is recoverable into one which, on R2's case, is not. There is no warrant for the application of the reflective loss rule to produce that effect. The relevant losses suffered by Primeo are not "merely" the result of a loss suffered by Herald in consequence of a wrong done to it by R2 (cf *Marex*, para 39); and they do not take the form of a diminution in share value which is the consequence of a loss sustained by Herald (cf *Marex*, para 79). It is true to say that, by operation of the Herald Transfer, Herald has come to acquire a right of action against R2 which could potentially restore to Primeo the value of the losses it has suffered, but that is not sufficient in itself to bring the reflective loss rule into operation. Albeit the quantum of recovery by Herald might be at a level which might have that effect, the losses which Herald claims to have suffered are not the same as the losses suffered by Primeo: necessarily so, since it was Primeo, not Herald, which paid the relevant sums to BLMIS in the first place and suffered loss thereby, and it was Primeo, not Herald, which lost the opportunity to redeem the BLMIS investments in the period up to the Herald Transfer.

61. In support of his submissions on the timing issue Mr Gillis sought in particular to rely on *Nectrus Ltd v UCP Plc* [2021] EWCA Civ 57, a decision of Flaux LJ, sitting as a single judge of the Court of Appeal, upon an application by Nectrus for reconsideration of his earlier order refusing to give it permission to appeal. The origin of the dispute lay in the engagement by UCP and its 100% subsidiary, Candor, of Nectrus to provide investment advice. Acting on that advice, UCP made a number of investments through Candor which were, in effect, lost. UCP later sold its shareholding in Candor at a price which was discounted to reflect the value of the lost investments. In these proceedings it sought damages from Nectrus to reflect that discount. One of the issues which arose was whether, as Nectrus contended, the claim was barred by the reflective loss rule. The judge

below held it was not and in declining to reconsider his earlier refusal to give Nectrus permission to appeal, Flaux LJ held that the possibility that the rule was applicable to an ex-shareholder in the position of UCP was unarguable; and the applicability of the rule should be assessed when the claim is made, at a time when the loss claimed has crystallised. But in the Board's view, that case is wrongly decided. Indeed, it serves to illustrate the very odd results to which Mr Gillis's submission would lead. A shareholder which suffers a loss in the form of a diminution in value of its shareholding which is not recoverable as a result of the application of the reflective loss rule cannot later convert that loss into one which is recoverable simply by selling its shareholding. It is necessary to focus on the nature of the loss in respect of which the shareholder's claim is made. It is not enough to consider the position as at the date of the issue of proceedings without regard to the nature of the loss and a consideration of whether it is, in the eyes of the law, separate and distinct from that of the company.

62. Testing the application of the reflective loss rule at the time when proceedings are brought rather than at the time the relevant loss is suffered would lead to other strange consequences, as Mr Smith pointed out. To say, as R1 and R2 do, that the test applies when the claim is brought by a person who happens to be a shareholder at that time and where there may happen to be some relationship between what he recovers by his claim and what the company recovers by its claim, would produce strange and unprincipled results which in fact undermine the *Marex* principle itself and the values it protects: (a) what if the shareholder commences proceedings at a time before the company appreciates it has a claim of its own or before it commences its claim? It seems that on Mr Gillis's argument the shareholder should succeed if its claim can be progressed fast enough, but this is contrary to the point in *Marex* that the rule is a substantive rule of law; (b) it leads to the conclusion, per Flaux LJ in *Nectrus*, that the shareholder can sell its shareholding and then seek to vindicate its own causes of action against the wrongdoer; but this would make the reflective loss rule easy to circumvent and would subvert its intended effect, since the wrongdoer would be wary of settling with the company for fear that, by selling its shares, a shareholder and prospective claimant could free itself to pursue its own claims; (c) it would mean that where the company's claim comes to be statute-barred, the shareholder's claim can be pursued; but such an event cannot change the proper characterisation of the loss suffered by the shareholder for the purposes of the substantive rule stated in *Marex*; (d) it would imply that if the company happened to settle its claim quickly, the shareholder could at that point bring its distinct claim; but, again, it is difficult to see how that event could change the proper characterisation of the loss suffered by the shareholder for the purposes of that substantive rule.

63. Overall, to test the application of the reflective loss rule at the time when proceedings are brought rather than when the loss is suffered would have the effect of making the wrongdoer very wary of settling with the company, if the

practical outcome of doing so is made uncertain and precarious by the future conduct of the company and shareholder and the vagaries of procedural law. That would undermine the intended effect of the rule (reflecting the rule in *Foss v Harbottle*), which is to ensure that the company has a full opportunity to decide how to pursue its own cause of action, where properly identified as such, and to obtain as good value from it as is possible. It would also undermine the certainty of effect which the reflective loss rule is intended to achieve, as a bright line rule of law: cf *Marex*, para 38 (Lord Reed).

64. Mr Gillis's alternative or supplementary argument, which gives rise to the Herald Transfer issue is that, even if Primeo had valid causes of action against R1 and R2 before the Herald Transfer, by reason of the new relationship with Herald after that transaction and the rights to claim compensation in respect of the BLMIS investments transferred to it which Herald came to acquire against R2 thereafter (and similar rights which R2 came to acquire to claim compensation in turn from R1), Primeo became subject to the reflective loss rule and lost any right to claim compensation from R1 and R2 in respect of its direct investment in BLMIS which it might previously have had. The Board cannot accept this argument.

65. In so far as the argument depends upon the timing issue, it has been rejected above. The question then is whether the Herald Transfer changes things. This turns on the nature of the "follow the fortunes" bargain when someone becomes a shareholder in a company and on the policy ambit of the reflective loss rule. Insofar as the argument depends on some additional feature of the agreement comprising the Herald Transfer to preclude Primeo from being entitled to seek to vindicate the causes of action it had already acquired against R1 and R2 before the Herald Transfer, the Board considers that it is unsustainable.

66. In the Board's view, the "follow the fortunes" bargain which arises from membership of a company is forward-looking, not backward-looking. It is directed to characterisation of loss suffered by a claimant after they become a shareholder in the company and they then suffer loss of the requisite type arising as a consequence of a wrong done to the company and is directed to limiting the ability of a shareholder to acquire a right of action from that time on. Thus far in the authorities, the reflective loss rule has been prospective in effect. It covers situations where there are parallel causes of action against a common wrongdoer which arise after a person becomes a shareholder affecting both the shareholder (in the requisite manner, by reduction in the value of their shares or loss of dividends) and the company. In such a situation, the shareholder is precluded from asserting that they have suffered a separate loss because of the "follow the fortunes" bargain they made upon becoming a member of the company, according to which they agreed that in such a situation the company alone should be in a position to pursue a remedy against the wrongdoer, thereby protecting the

company asset (in the form of the company's own cause of action) and company autonomy to the extent required by *Foss v Harbottle*.

67. By contrast, to apply the reflective loss rule to preclude the new shareholder from enforcing rights of action which had already accrued to them before they became a member of the company would, in the Board's view, be an unwarranted extension of the rule. It would deprive the new shareholder of property rights, in the form of choses in action, which it already owned and in relation to which it is not possible to identify any agreement, whether express or implied, in the articles of association of the company that the shareholder agreed to this. Where parties contract with each other, clear words are required to exclude any ordinary remedies they might have against each other: *Gilbert-Ash (Northern) Ltd v Modern Engineering (Bristol) Ltd* [1974] AC 689, 717H per Lord Diplock. The presumption is that they do not intend to waive or abandon the ordinary remedies which the law affords them. Still more strongly is that the case where what is in issue is whether a person who becomes a member of a company has agreed thereby to abandon or forgo existing valid claims against third parties which have already accrued to them.

68. In the Board's view, on the assumptions we make for the purposes of this hearing, the Herald Transfer does not have the effect of removing Primeo's rights to claim against R1 and R2 in respect of its direct investments in BLMIS. In the first place, Primeo did not recoup its loss in relation to those investments by subscribing for the Herald shares in the Herald Transfer transaction. More specifically, the Herald Transfer did not confer a benefit on Primeo that nullified the losses that it had already suffered. As the Court of Appeal summarised the position (para 221), Primeo exchanged a direct exposure to loss resulting from its investment in a Ponzi scheme to an indirect exposure to the same loss. To the extent that Primeo receives back some value through Herald in relation to those investments, it will have to give credit therefor according to ordinary damages principles, on the basis that its loss will have been mitigated to that degree. But that is very different from saying that it must be taken to have suffered no loss at all.

69. Secondly, at the time of the Herald Transfer, Primeo owned two sets of choses in action: (i) the choses in action comprised in the BLMIS investments it held at the time and (ii) its separate choses in action constituted by its claims against R1 and R2. When Primeo subscribed for the Herald shares in the Herald Transfer it did so by giving as consideration one set of choses in action which it possessed, namely its rights to redeem the BLMIS investments (ie (i) above). No reference was made to the separate set of choses in action which (unbeknown to Primeo) had already accrued to Primeo as against R1 and R2 at that time (ie (ii) above), so it cannot be inferred that Primeo agreed to abandon, waive or forgo its right to seek to vindicate those claims. The Board notes that this is subject to any

argument at the second stage of the appeal that there was an implied assignment of those choses in action by Primeo to Herald, which is an argument which the Board has not been asked to consider at this first hearing. Subject to any such argument, the Board considers that it cannot be said that the "follow the fortunes" bargain made when Primeo subscribed for Herald shares in the Herald Transfer on 1 May 2007 implicitly involved an agreement by Primeo to abandon, waive or forgo those assets in the form of its rights of action against R1 and R2 in addition to what it explicitly agreed to give in exchange for the Herald shares, ie the BLMIS investments. That would go beyond the nature of the "follow the fortunes" bargain as it is usually conceived; would be difficult to explain or justify by any principle of implication of terms; and would have the effect that Primeo paid twice over for the Herald shares in the Herald Transfer, first by assigning its rights to redeem the BLMIS investments to Herald and secondly by abandoning, waiving or forgoing its choses in action against R1 and R2 for the benefit of Herald.

70. It is true that as events have transpired the vindication of Primeo's claims against R1 and R2 will to some degree conflict with the vindication of Herald's claims against R2, but Primeo has not promised (whether in the "follow the fortunes" bargain it made when subscribing for Herald shares in the Herald Transfer or otherwise) that it would forego its right to vindicate those claims in the usual way, using the usual options open to it.

71. This means that the issue of possible double recovery by Primeo will have to be managed in some way. Primeo retains its own cause of action against R2 in respect of the losses it suffered in relation to the direct investments in BLMIS prior to the Herald transfer; and it has been issued with shares in Herald and stands to make good all of these losses through the restoration of the value of those shares if Herald prevails in the Luxembourg proceedings and a judgment in its favour is satisfied.

72. Since Primeo is not debarred by the reflective loss rule from having acquired valid causes of action against R1 and R2 when it suffered loss, issues may arise as to the order in which Primeo on the one hand and Herald and Alpha on the other may pursue their separate claims against R1 and R2 and as to the procedural mechanisms by which any risk of double recovery by Primeo by being able to rely on its own causes of action and through the scope for it to benefit indirectly may be managed: see *Marex*, paras 5-7 and 87-88 per Lord Reed, and paras 124-125, 150 and 161-164 per Lord Sales. Certainly, the Board considers that the acceptance by Mr Smith (para 40 above) that Primeo would have to give credit for any recovery referable to the BLMIS investments it acquired and then transferred to Herald in the Herald Transfer is correct. In the Herald Transfer in May 2007 Primeo exchanged all the BLMIS choses in action

in its hands at that time for Herald shares (which also had a fictitious apparent value far in excess of their true value). To the extent that its holding of Herald shares yields value (including value realized through Herald's proceedings against R2), Primeo rightly accepts that it has to give credit for that: to that extent its original loss will have been reduced by mitigation in fact, as is the case with redemption payments by BLMIS in respect of BLMIS investments down to May 2007. But the Board has not been addressed on the ways in which the parallel claims against R1 and R2 by Primeo and by Herald and Alpha should be handled as a matter of case management and it makes no further observations about that.

73. From the outset of the proceedings, Primeo's claims against R1 and R2 covered both its direct investments in BLMIS and its indirect investments through Alpha and Herald in the period before the Herald Transfer. Primeo's case in relation to its claims regarding the direct and indirect investments was in substance the same, namely that but for the relevant breaches of duty by R1 and R2 Primeo would not have invested the money it used to acquire direct or indirect interests in BLMIS and that insofar as it already held BLMIS investments or Alpha or Herald shares it would have applied to redeem those investments or shares at their declared value (with the declared value of the Alpha shares and the Herald shares reflecting the declared value of the underlying BLMIS investments held by Alpha and Herald) and there would have been a significant possibility that Mr Madoff and BLMIS would have arranged for funds to be paid out of those circulating in the Ponzi scheme to allow such redemptions to take place. The viability of this aspect of Primeo's claim is considered below.

(3) The common wrongdoer issue

74. In addition to its submission that the Court of Appeal erred in respect of the timing issue and the Herald Transfer issue and was for that reason wrong to apply the reflective loss rule, Primeo submits that the Court of Appeal was wrong to apply the rule in relation to Primeo's claims against R1 as its former administrator because neither Herald nor Alpha have any claim against R1. Primeo points out that, as explained by Lord Reed in *Marex* (para 79), the reflective loss rule only applies where "the company has a cause of action against the same wrongdoer" as the shareholder. Primeo submits that the Court of Appeal was wrong to elide the position of R1 and R2 as it did (see para 42 above) and to hold that, since pursuant to the contractual arrangements between them R1 would have a corresponding onward claim against R2 in respect of R1's liability to Primeo as administrator, R2 was to be treated as a common wrongdoer as regards Herald and Primeo for the purposes of the application of the rule so that pursuant to the rule no part of Primeo's loss would be recoverable from either R1 or R2.

75. Primeo makes the same submission in relation to its claim against R2 so far as that relates to its indirect investment in BLMIS through its acquisition of shares in Alpha, because Alpha has no claim against R2. Primeo submits that the Court of Appeal was wrong to elide the position of BOBL as custodian and administrator for Alpha (or any other company identified as Alpha's administrator) and R2 (as sub-custodian and delegated administrator) as it did (see para 43 above) and to hold that, since Alpha's custodian and administrator would have a corresponding onward claim against R2 in respect of that custodian's or that administrator's liability to Alpha as administrator pursuant to the contractual arrangements between them, R2 was to be treated as a common wrongdoer as regards Alpha and Primeo for the purposes of the application of the reflective loss rule.

76. In the Board's view, these submissions are correct. It is an inherent part of the reflective loss rule that it only applies to exclude a claim by a shareholder where what is in issue is a wrong committed by a person who is a wrongdoer both as against the shareholder and as against the company. As Lord Reed said in *Marex* (para 39), the reflective loss rule established in the *Prudential* case, as endorsed by the majority in *Marex*, "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". The Court of Appeal erred in holding that the common wrongdoer requirement was satisfied in relation to R1 and R2, respectively, in the circumstances highlighted by Mr Smith for Primeo.

77. As Mr Smith submits, to apply the reflective loss rule in these circumstances would amount to a significant extension of the rule beyond its current boundary and ignores the relevance of the separate legal personality of the administrators and custodians involved in favour of an ill-defined test based on the potential economic effects of a series of inter-locking contracts. In any given case, such economic effects may be very uncertain, depending as they will do on analysis of possibly subtle differences between the contractual duties which exist in different agreements between different contracting parties and also potentially on the decisions made or likely to be made by those parties as regards enforcement of their rights. An extension of the reflective loss rule in this way would be contrary to the decision of the Supreme Court in *Marex*, which was directed to keeping the operation of the rule within narrow parameters. It would also undermine the position which the majority of the court sought to establish in that case, to lay down a clear bright-line and easy-to-apply test to govern the application of the reflective loss rule.

78. The Board agrees with Mr Smith's submission that the separate legal identity of R1, R2, BOBL and (possibly) others who carried out various different administrator and custodian roles for Primeo, Herald and Alpha, as the case may be, is of critical importance in the application of the reflective loss rule. Each of

them is a separate company with its own fund of assets available to meet claims made against it (any of which might be inadequate for that purpose). In line with the analysis set out in *Marex*, each of them has its own right to decide what to do with any cause of action it may have (whether to enforce it, waive it, or seek to settle in relation to it) and each has its own separate decision-making organs to take such decisions having regard to the interest of the entity itself. Accordingly, there is nothing automatic or certain about passing through the liability of R1 as administrator for Primeo to R2 as sub-administrator, or about passing through the liability of BOBL or others as custodian or administrator for Alpha to R2. A court cannot simply assume that onward claims will be brought or that they will in substance provide a fair opportunity for Primeo to achieve recovery in practice in relation to the losses it has suffered by reason of R1's breaches of duty (so far as Primeo's investments in BLMIS covered by its shareholding in Herald are concerned) or in relation to the losses it has suffered by reason of R2's breaches of duty (so far as Primeo's investments in BLMIS covered by its shareholding in Alpha are concerned). Therefore, extension of the reflective loss rule to cover this sort of case would magnify the scope for the rule to work injustice. This could not be justified: as Lord Reed explained in *Marex* (para 2) the general position is that a claimant is entitled to seek compensation for a wrong done to them and (para 9) "[t]he 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", but the reflective loss rule operates as a "highly specific exception to that general rule". The situation which the Board has to address in relation to this aspect of the appeal is one where the general position applies, justice requires that Primeo should be able to seek compensation for the wrongs done to it, and R1 and R2 can only seek to answer Primeo's claim (so far as this issue is concerned) by arguing that the exception to this as represented by the reflective loss rule should be expanded in a highly unspecific and vague way. Yet, as Mr Smith observed in relation to the first of these situations, by way of example, it is very difficult to see why R1 should escape all liability for its own breaches of duty just because it might be able to have a claim of its own against R2 to recoup itself in respect of any compensation it might have to pay to Primeo.

79. Further, in the Board's view it cannot be said that by becoming a shareholder in Herald and in Alpha Primeo agreed to "follow the fortunes" of Herald and Alpha so far as concerns claims not by Herald and Alpha respectively against their own contractual counterparties, but as regards onward claims which those counterparties might or might not have or bring against different companies and the speculative impact such claims might have on the financial position of Herald and Alpha. There is no clear limit how far a chain of onward claims might have to be traced nor how many separate legal persons might be involved if the reflective loss rule were taken to operate in the way R1 and R2 submit it should do. A person who becomes a shareholder in a company is not on notice that by doing so claims against third parties potentially available to them according to

ordinary principles of law might be rendered valueless by virtue of such indefinite onward chains of liability.

(4) The indirect claims issue

80. For the purposes of this hearing, Primeo says that it has a good claim against R1 for losses it suffered on the basis set out above in relation to the indirect investments it made in BLMIS via its purchases of shares in Herald and Alpha prior to the Herald Transfer in May 2007. It accepts that it has no claim against R2 in respect of these indirect investments since, by contrast with Primeo's claims in respect of the direct investments, it has been established that R2's responsibility as Primeo's custodian in relation to these investments only extended to keeping safe the relevant shares in Herald and Alpha (which R2 did), not to keeping safe the monies actually placed with BLMIS and misappropriated by it. Primeo has not alleged that the indirect investments are included in its strict liability claim against R2.

81. The first point which arises in relation to this part of Primeo's case is whether it is open to Primeo to advance this aspect of its claim at this stage. Mr Gillis submits that Mr Smith did not pursue this matter in his submissions in the Court of Appeal, but accepted instead that this part of Primeo's claim was excluded by the reflective loss rule, and that he should not be permitted to pursue it before the Board.

82. The Board is satisfied that this aspect of Primeo's case was pleaded and was pursued before the judge at first instance. The Board does not find it necessary to take up time considering the detail of how Primeo's arguments were presented in the Court of Appeal since it is also satisfied that this aspect of Primeo's appeal gives rise to a pure point of law and does not depend upon any new allegations of fact other than those explored fully in the courts below. R1 and R2 have had full notice of the submissions to be presented at this hearing on this part of the case and have had a fair opportunity to respond to them, as indeed Mr Gillis did. The submissions made are intimately connected with those made in relation to the other parts of Primeo's case at this hearing, in particular in respect of the common wrongdoer issue. The Board has therefore, in substance, had the benefit of the reasoning of the courts below which is applicable to the indirect investments issue. In the Board's view, Primeo is entitled to raise the indirect investments issue at this hearing and, to the extent that permission to do so is required, it grants it.

83. As it transpired at the hearing, it was common ground that the points of contention which arise in relation to this aspect of Primeo's case are the same as

those in relation to the common wrongdoer issuer. Mr Smith accepts that two of the criteria for application of the reflective loss rule are made out: (i) Primeo's loss in respect of its indirect investments made prior to the Herald Transfer through the purchase of shares in Herald and in Alpha was suffered at a time when it was a shareholder in those companies (since the loss occurred by the misappropriation by BLMIS of the monies paid on by Herald and Alpha for investment with BLMIS) and (ii) Primeo's loss resulted from a loss in the value of its shares in Herald and Alpha. Therefore, Mr Smith has to rely on his submissions in relation to the common wrongdoer issue to succeed on this part of the appeal. For the reasons given above in relation to that issue, the Board considers that Primeo's appeal in relation to this issue ought also to be allowed.

(5) The merits issue

84. In view of the Board's rulings on the main issues arising on this hearing, as set out above, it is not necessary to decide this issue and the Board considers that it is appropriate to leave it to be decided in another case where the point has a practical impact. The Board would observe, however, that since the judge and the Court of Appeal reached their decisions on this issue without the benefit of the decision in *Marex* and after adopting a materially different approach to the reflective loss rule than that laid down in *Marex*, what they have said about this issue should not be treated as authoritative.

Conclusion

85. For the reasons set out above, the Board will humbly advise Her Majesty that Primeo's appeal in relation to the application of the reflective loss rule should be allowed to the extent explained in this judgment.