Revisiting the no reflective loss principle under the South African company law regulation: A reflective assessment through the lens of *Hlumisa Investment Holdings (RF) Ltd v Kirkinis* 2020 3 All SA 650 (SCA)

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SUMMARY

One of the central concepts in company law is that a company is a juristic person with a separate legal personality. Several consequences flow from the doctrine of separate legal personality, among other things, that a company owns its property and assets and may sue or be sued in its name. Therefore, shareholders do not have a direct right of action for a company's loss. The company itself should institute such a claim save for certain exceptional circumstances like derivative actions. Both the High Court (court *a quo*) and the Supreme Court of Appeal in *Hlumisa Investment Holdings (RF) Ltd v Kirkinis* (the *Hlumisa* case) confirmed that shareholders cannot claim diminution of share value that is linked to the misconduct of company directors and auditors. This article concurs with the court *a quo* and the Supreme Court of Appeal's interpretations that as a general rule, directors owe fiduciary duty only to the company and that shareholders cannot rely on a claim for reflective loss in company law. This article assesses the proper plaintiff and reflective loss rules against the backdrop of the *Hlumisa* case.

Keywords: proper plaintiff, reflective loss, separate legal personality, fiduciary duties.

1 Introduction

One of the cornerstone concepts in company law is the principle of separate legal personality.[1] This notion has several consequences flowing out of it. These consequences include the privilege of the limited liability bestowed to shareholders, a perpetual succession of the company, and that the company's property, profits, debts, and liabilities belong to that company and not its shareholders.[2] The two central consequences of the doctrine of separate legal personality that are most relevant to this article are that, first, the assets of the company belong to that company and not

1 *Salomon v Salomon & Co Ltd* (1897) AC 22 (HL) (hereinafter *Salomon v Salomon*).
2 Cassim et al *Contemporary company law* 3rd ed (2021) 39. Cassim et al *Law of Business Structures* 2 ed (2022) 63.

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shareholders.[3] Secondly, a company can sue and/or be sued in its name. Therefore, when a company sustains a loss, it is the proper plaintiff and a shareholder will not have a direct right of action for the loss.[4] The reflective loss rule provides that the company's loss is not a shareholder's loss, although such loss may reduce the shareholder's share value.[5] In such circumstances, the proper plaintiff to seek redress would be the company itself, not its shareholders.[6]

In South Africa, the concept of separate legal personality is established in courts[7] and under section 19(1) of the Companies Act 71 of 2008 (the Companies Act). Section 19(1) of the Companies Act provides that from the date of incorporation, a company becomes a juristic person that has all the legal powers and capacity of an individual except to the extent a juristic person[8] is incapable of exercising any such powers, or the Memorandum of Incorporation (MOI) provides otherwise.[9] There are, however, some exceptions to separate legal personality, for example, lifting, piercing, and/or looking behind the corporate veil and an in-depth discussion of these is outside the scope of this article and are comprehensively dealt with somewhere.[10] Based on the above-settled principles and the approaches adopted by the High Court (court *a quo*) and the Supreme Court of Appeal in *Hlumisa v Kirkinis*, this article seeks to critically examine and demystify the "knotty" issues surrounding the proper plaintiff and reflective loss rules in company law.

This article is divided into several parts. Immediately after the introduction, the concepts of separate legal personality and fiduciary duties are put into perspective, and then the policy rationales behind the reflective loss principle will be explored. This article then surveys the factual matrix and judgment in the *Hlumisa* case and critically assesses the same. Lastly, the article provides concluding remarks.

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3 *Dadoo Ltd v Krugersdorp Municipal Council* 1920 AD 530 (hereinafter *Dadoo*) at 550-551; *Macaura v Northern Assurance Co Ltd* 1925 AC 619 (HL)(lr) at 630 (hereinafter *Macaura*).

4 Cassim et al (2021) 52.

5 *Itzikowitz v Absa Bank Ltd* 2016 JOL 35608 (SCA) (hereinafter *Itzikowitz*) paras 10-12.

6 Cassim et al (2021) 52.

7 The case law includes *Dadoo*; *Hlumisa Investment Holdings (RF) Ltd v Kirkinis* 2020 3 All SA 650 (SCA) (hereinafter *Hlumisa v Kirkinis* (SCA) para 42; *Hughes v Ridley* 2010 1 SA 381 (KZP) para 22; *Itzikowitz* para 27; *Macaura* para 630; *Stellenbosch Farmers' Winery Ltd v Distillers Corporation (SA) Ltd* 1962 1 SA 458 (A) 471-472.

8 Ss 8(3)-(4) of the Constitution of the Republic of South Africa, 1996 (hereinafter the Constitution).

9 S 19(1) of the Companies Act 71 of 2008 (hereinafter the Companies Act).

10 S 20(9) of the Companies Act; Cassim et al (2021) 54-56; Cassim et al (2022) 70-72.

2 Putting the principle of separate legal personality into perspective

One of the central principles in company law is the concept of separate legal personality.[11] Several consequences flow out of the doctrine of separate legal personality. For example, some of the pertinent consequences reflected in this article; include the ability of a company to sue or be sued in its own name and that the assets of the company belong to that company and not its shareholders.[12]

It is trite law that the most apparent sources of power that steer the proper functioning of any company emanate from managing and/or financing the company itself. The most common feature of most companies is that they comprise various stakeholders that may include: shareholders who contribute to the company's equity, creditors who lend money to the company, and directors who manage the company.[13] For example, the two most popular financing methods in companies are the issuing of securities (normally shares) and receiving loans from financial institutions (typically banks).[14] Particularly, section 66 of the Companies Act provides the board of directors all the power and authority to manage the affairs and business of the company, except, where the Companies Act or MOI provides otherwise.[15] When directors discharge their duties, they are governed under common law and are partially codified in the Companies Act.[16] In this context, the partially codified fiduciary duties as identified (to be discussed) include the directors' duty to perform in good faith and proper purpose,[17] in the best interests of the company,[18] and

11 In *Salomon v Salomon*, it was held that a company is an entity that is distinct from its shareholders. In addition, in *Percival v Wright* (1902) 2 421, the corporate separate personality was confirmed, and Eady J ruled that directors owe fiduciary duties to the company and not individual shareholders; *Johnson v Gore* (2000) UKHL 65 (hereinafter *Johnson v Gore*). ; *ABSA Bank Ltd v Blignaut and Four Similar Cases* 1996 4 SA 100 (O); *Dadoo* para 550-1 and *Airport Cold Storage (Pty) Ltd v Ebrahim* 2008 2 SA 303 (C). S 19(1)(a) of the Companies Act provides that: "From the date and time that the incorporation of a company is registered, as stated in the registration certificate, the company… (a) is a juristic person".

12 *Dadoo* para 550-1.

13 Gullifer and Payne *Corporate Finance Law: Principles and Policy* (2020) 15.

14 Cassim et al (2021) 281. Cassim et al *The Law of Corporate Finance* (2021) 1-3.

15 S 66 of the Companies Act.

16 Coetzee and van Tonder "Advantages and disadvantages of Partial Codification of Directors' Duties in the South African Companies Act 71 of 2008" 2016 *Journal for Juridical Science* 3 define partial codification as "an orderly and authoritative statement of the leading rules of law on a given subject while allowing room for the development of the common law legal principles". Partial codification has merits that include making the law uniform; clear, flexible, simple, and certain. However, partial codification may have undesirable consequences like overregulation and legal inconsistencies.

17 S 76(3)(a) of the Companies Act.

18 S 76(3)(b) of the Companies Act.

a separate duty for directors to act with a degree of care, skill, and diligence.[19] In addition, the directors, in discharging their duties, must avoid conflicts of interest.

Fiduciary relationships are based on trust and confidence.[20] These relationships are non-exhaustive and for this article directors and auditors would be the focus.[21] Evidence shows that to a larger extent and if not adequately regulated the directors are prone to abuse their powers at the expense of the company and other stakeholders.[22] Under the common law in South Africa, a director has a fiduciary duty to act in the company's best interests among other duties.[23] This duty was historically translated to mean that shareholders' present and future interests collectively were supposed to always be considered.[24] However, some scholars question this position.[25] Accordingly, legal frameworks are gradually embracing the need to require that companies function for the benefit of shareholders and other stakeholders.[26]

As a general rule, when wrongs are done to a company, that company alone has the right to sue in its own name.[27] On the contrary and in certain circumstances, section 165 of the Companies Act (the derivative action remedy) entitles selected company stakeholders,[28] to sue for the wrongful acts done to the company on behalf of the company.[29] The derivative action remedy is a notable exception to the rule that the company itself is the "proper plaintiff" in circumstances where wrong is done against the company.[30]

19 The duty of care, skill, and diligence is not a fiduciary duty and is based on *Aquilian* action (delictual action), which is found in both common law and s 76(3)(c) of the Companies Act.
20 S 76(3)(c) of the Companies Act.
21 *English v Dedham Vale Properties Ltd* (1978) WRL 93 (Ch) 110.
22 *Gihwala v Grancy Property Ltd* 2016 All SA 649 (SCA); *Mirchandani v Unica Iron and Steel (Pty) Ltd* 2022 JOL 52884 (SCA); *Organization of Undoing Tax Abuse v Myeni* 2020 3 All SA 578 (GP).
23 Esser and Delport "The protection of Stakeholders: The South African Social and Ethics Committee and the United Kingdom's Enlightened Shareholder Value Approach (Part 1)" 2017 *De Jure* 98.
24 Esser and Delport (Part 1) 2017 *De Jure* 98.
25 Greenfield "Sticking the Landing: Making the Most of 'Stakeholder Moment'" 2015 *European Business Law Review* 150-151; Amodu "The Responsible Stakeholder Model: An Alternative Theory in Corporate Law" 2018 *Journal of Comparative Law in Africa* 13.
26 S 172 of the UK Companies Act of 2006; Ss 5 and 7 of the Companies Act; King Report on Governance for South Africa Institute of Directors Southern Africa (King IV) 2016, advocates for a stakeholder-inclusive approach in corporate decision-making.
27 *Dadoo* para 550-1.
28 See s 165(2) of the Companies Act provides the identified stakeholders with *locus standi* to sue on behalf of the company.
29 S 165(2) of the Companies Act.
30 *Foss v Harbottle* (1843) 2 Hare 461, 67 ER 189 (hereinafter *Foss v Harbottle*).

3 Functional purposes and policy rationales for the no reflective loss rule

Notably, losses to companies that result from the wrongful acts that are perpetrated against them, generally have the possible direct consequence of making shareholders personally suffer a diminution of the value of their shares. However, such a loss is reflective of company loss.[31] Reflective loss is the loss suffered by the company which would be fully compensated should the company sues, accordingly, shareholders are not able to recover the loss that is merely reflective of the company's loss and/or that arises from similar facts.[32] The no-reflective rule applies to the overlap between the personal claims of shareholders and derivative actions or other corporate actions in terms of ss 20(9) and 218 of the Companies Act.[33] In many jurisdictions, in principle, shareholders do not receive personal recourse in respect of their reflective loss.[34] Accordingly, the company alone should recover and/or settle the claim. Despite some possible harsh consequences, the no reflective loss principle has received huge support from the courts. [35]

The no reflective loss principle has been extensively dealt with in the United Kingdom (UK) law. Notably, section 39(1) of the Constitution of the Republic of South Africa, 1996 (the Constitution) and section 5 of the Companies Act provide that courts may seek guidance from foreign law when interpreting the law. Hence, our courts are justified to look beyond our borders in instances where our law has not sufficiently developed and where other jurisdictions provide persuasive value to our judiciary in enhancing their decision-making. In this light, one of the UK *locus classicus* in the context of the no-reflective principle is *Johnson v Gore*, which lays out some persuasive policy rationales for regulating the reflective loss rule.[36] The first policy rationale for frowning upon the reflective loss is to avoid double recovery. Lord Millett in the *Johnson* case,[37] held that where the company suffers loss caused by the breach of duty owed to both the company and shareholder, the shareholder's loss in respect of the diminution and loss of dividends merely reflects the loss of a company.[38] Therefore, allowing the shareholder to claim would result in double recovery.[39]

Secondly, another policy rationale for regulating the reflective loss principle is to avoid double jeopardy for the wrongdoer. This rationale

31 Cassim et al (2021) 1134.
32 Gullifer and Payne (2020) 105 and 582.
33 Cassim et al (2021) 1134.
34 Koh "Reconstructing the Reflective Loss Principle" 2016 *Journal of Corporate Law Studies* 373.
35 *Johnson v Gore*; *Prudential Assurance Co Ltd v Newman Industries Ltd* (No 2) (1982) 1 Ch 204 (CA) (hereinafter *Prudential v Newman*).
36 See *Johnson v Gore* para 62.
37 As above.
38 *Johnson v Gore* para 62.
39 As above.

entails that regulation should curb the effect of having the wrongdoers unjustly compensate their victims twice for single wrongdoing.[40] For instance, the law ought to curb the likely consequences of allowing shareholders to claim a lower price for the loss of value in their shares as a personal claim on the one hand.[41] Whereas, on the other hand, the company then separately sues to recover a higher share value in a similar claim.[42] Accordingly, in as much as in these circumstances, the shareholder would not gain from the increased share value in the company's claim *per se*, the wrongdoer bears the risk to compensate twice for a similar claim.[43]

Thirdly, the implementation of the no reflective loss rule promotes settlement. It is argued that the wrongdoer would safely come to a settlement agreement with the company without fear that there may be further claims from shareholders in respect of the company's loss.[44]

Fourthly, the no reflective loss principle avoids prejudice to company creditors. Lord Millett, in the *Johnson v Gore* case, held that "protection of the interests of the company's creditors requires that the company be allowed to recover at the exclusion of the shareholders".[45] In agreement with Koh, the prejudice of creditors becomes more apparent especially if the company is insolvent.[46]

Lastly, the no reflective loss reinforces the respect for the company's internal governance structure. It has been held by Lord Bingham *Johnson v Gore*, that the court should practice deference in corporate affairs.[47]

4 Revisiting the no reflective loss principle: *Hlumisa*

4 1 Factual matrix

The first and second appellants in this appeal were the first and second plaintiffs in the Gauteng Division of the High Court (the court *a quo*) and Hlumisa Investment Holdings (RF) Ltd and Eyomhlaba Investment Holdings, respectively.[48] The first and second appellants are shareholders who own 1.73 per cent and 3.24 per cent, respectively of the issued share capital of African Bank Investment Holdings (ABIL) a listed Johannesburg Stock Exchange (JSE) company which is also a holding company that wholly owns African Bank Limited (the African

40 Koh 2016 *Journal of Corporate Law Studies* 381.
41 As above.
42 As above.
43 As above.
44 Koh 2016 *Journal of Corporate Law Studies* 382-383.
45 *Johnson v Gore* para 62.
46 Koh 2016 *Journal of Corporate Law Studies* 383-84.
47 *Johnson v Gore* para 36.
48 *Hlumisa v Kirkinis* (SCA) para 2.

Bank).[49] The first to tenth respondents are either current or former ABIL and African Bank directors. The eleventh respondent is Deloitte and Touche (Deloitte), who acted as the auditor of both ABIL and the African Bank.[50] The appellants made this appeal with leave of appeal of the Gauteng Division of the High Court (court *a quo*), Pretoria per Molopa-Sethosa J.[51] The main point of contention was whether section 218(2) of the Companies Act,[52] permits the claims by a shareholder concerning the diminution in the value of shares due to misconduct by directors.[53] The second concern was whether shareholders had a claim based on a diminution in share value related to alleged misconduct by auditors.[54]

Initially, the appellants instituted an action in the court *a quo* in terms of section 218(2)[55] read with sections 76(2)[56] and 22(1)[57] as well as section 74[58] of the Companies Act on the one hand and on the other hand, section 46(3) of the APA.[59] The appellants made two claims. In their claim against the directors (Claim A), the appellants alleged that between 2012 and 2014, and in breach of section 76(3) of the Companies Act, the directors failed to exercise their powers in good faith and in the best interests of ABIL and African Bank, which resulted in the business of ABIL and African Bank being carried out recklessly or with

49 As above.
50 As above.
51 *Hlumisa v Kirkinis* (SCA) para 1.
52 S 218(2) of the Companies Act provides that: "Any person who contravenes any provision of this Act is liable to any other person for any loss or damage suffered by that person as a result of the contravention".
53 *Hlumisa v Kirkinis* (SCA) para 1.
54 As above.
55 See s 218(2) of the Companies Act deals with civil actions and *locus standi*.
56 See s 76(2) of the Companies Act provides that "a director (including auditing committees) must – (a) not use the position of the director, or any information obtained while in a capacity of a director – (i) to gain an advantage for the director, or for another person other than the company, or a wholly-owned subsidiary of the company, or (ii) to knowingly cause harm of the company or subsidiary of the company or; (b) communicate at the earliest practicable opportunity of such information that comes into director's attention unless the director – (i) reasonably believes that it is immaterial to the company …available to the general public … (ii) not bound to disclose". (My own emphasis).
57 S 22(1) of the Companies Act provides that: "A company must not – (a) carry on its business recklessly, with gross negligence, with intent to defraud any person or for any fraudulent purpose or; (b) trade under insolvent circumstances". (My own emphasis).
58 S 74 of the Companies Act regulates majority directors' decisions other than those made in a directors' meeting but the ones that are based on written consent made and communicated to the other directors.
59 S 46(3) of the Auditing Profession Act provides that "in respect of any opinion expressed or report or statement made by a registered auditor in the course of duties, the registered auditor does not incur liability to a client or third party, unless it is proved that the opinion was expressed, or the report or statement made, maliciously, fraudulently or pursuant to negligent performance of registered auditor's duties".

gross negligence in contravention of the provisions of section 22(1) of the Act.[60] The significant losses as recorded by the Bank and ABIL, were through a share price drop from R28.15 per share as of April 2013 to 0.31 per share as of August 2014, computing a total diminution in the price per share of R27.84.[61] The first and second appellants alleged to have lost R721,384,512 and R1,341,224,294 respectively, an amount obtained after multiplying the number of the shares they held and the diminution value in ABIL.[62]

In addition, the particulars of claim set out various instances of directors' alleged misconduct.[63] These include publishing false statements for both ABIL and African Bank, authorising publishing rights issues and prospectus with misleading information, contravening section 74 meetings, contravening section 45 financial assistance, and reckless accounting practices.[64] The applicants based their claim against directors on section 218(2) of the Companies Act and provided that directors are liable to compensate the first and second plaintiffs for the damages they have suffered.[65]

The directors raised exceptions regarding the particulars of claim on three bases as follows.[66] First, the directors excepted the fact that the claim by plaintiffs was premised on the defendants in their capacities of directors of ABIL and African Bank, in turn, such conduct is alleged to have resulted in losses and a share drop of ABIL, which indirectly caused loss to the plaintiffs.[67] The directors further allege that ABIL and African Bank suffered a loss, and the plaintiffs' claim is for loss reflected in the share drop of ABIL.[68] In addition, the directors concluded that the plaintiffs failed to set out facts or alleged any basis (i.e. the pleadings lacked averments necessary to sustain a claim), entitling them to recover losses suffered by them as a consequence of the diminution in the share price of ABIL.[69]

Secondly, the defendants excepted the reliance by plaintiffs on section 218(2) of the Companies Act.[70] In particular, section 218(2) states "Any person who contravenes any provision of this Act is liable to any other person for any loss or damage suffered by that person as a result of that contravention".[71] The defendants averred that the plaintiffs alleged that the directors contravened sections 76(3), 22(1), 74 and 45 of the

60 *Hlumisa v Kirkinis* (SCA) para 4.
61 As above.
62 As above.
63 *Hlumisa v Kirkinis* (SCA) para 5.
64 As above.
65 As above.
66 *Hlumisa v Kirkinis* (SCA) para 6.
67 As above.
68 As above.
69 As above.
70 As above.
71 As above.

Companies Act without necessary claims based on such contraventions.[72] However, as apparent, the plaintiffs only alleged that the damages they suffered resulted from the diminution in value of ABIL shares, which resulted from losses sustained by African Bank and ABIL.[73] Thus, according to the defendants the claim by the plaintiffs did not contain the allegations entitling the plaintiffs to rely on section 218(2) of the Companies Act, thus, the particulars of claim were excipiable.[74]

Thirdly, the directors excepted that in the amended claim the plaintiffs allege that the defendants authorised the publication of a prospectus containing false and misleading statements.[75] The plaintiffs failed to allege that they relied on misrepresentation allegedly made by defendants, or that they acted on the strength of the misrepresentation and that they suffered damages because of the misrepresentation.[76] Therefore, the defendants pointed out that the plaintiff's particulars of claim lacked sufficient averments to sustain a cause of action based on misrepresentations hence the claim was excipiable.[77]

In terms of the claim against Deloitte (claim B), the appellants alleged that when Deloitte was tasked to audit ABIL and African Bank between December 2012 and December 2014, Deloitte presented that the financial statements fairly presented the financial position of the Bank.[78] However, the said statements were allegedly "false" since they did not reveal the true state of affairs of the Bank.[79] The falsity was alleged to be a result of the deliberate, alternatively, negligent failure on the part of auditors to take sufficient steps to rectify and disclose to the investors and shareholders of African Bank and ABIL in contravention of section 46(3) of the Auditing Profession Act (APA).[80] The plaintiffs alleged that Deloitte could reasonably be expected to know that the audit reports would induce them to act or refrain from acting in some way, as contemplated in section 46(3) of APA.[81]

Deloitte, however, made two exceptions to the allegations of the appellants.[82] The first exception was that the plaintiffs were shareholders of ABIL, a holding company of African Bank.[83] Deloitte argued that ABIL's shareholders have no claim over any assets of ABIL and/or African Bank and merely have a personal right to participate in ABIL in terms of its MOI.[84] Hence, the failure of Deloitte to discharge its duties pursuant

72 As above.
73 As above.
74 As above.
75 As above.
76 As above.
77 As above.
78 *Hlumisa v Kirkinis* (SCA) para 7.
79 As above.
80 As above.
81 As above.
82 *Hlumisa v Kirkinis* (SCA) para 9.
83 As above.
84 As above.

to its appointment as an auditor constitutes a breach of duties to ABIL and African Bank and not ABIL's shareholders.[85]

The second exception by Deloitte was based on the fact that it owed no legal duty to the plaintiffs as individual ABIL shareholders.[86] Deloitte pointed out that the plaintiffs' claim was a delictual claim for pure economic loss based on misstatements allegedly made by Deloitte in expressing audit opinions in respect of African Bank.[87] At common law, a statutory auditor owes its legal duties to the company and the shareholders in a general meeting, not individual shareholders.[88] Further the reliance on section 46 of APA does not change the common law position. Therefore, the appellants lacked the necessary allegations to sustain a cause of action.[89] In summary, Deloitte argued that the claims by the appellants, if proven, were unsustainable at common law and could not be brought in terms of section 218(2) of the Companies Act.[90]

4 2 The reasoning of the court *a quo*

The court *a quo* sought the interpretation of sections 76(3) and 218(2) of the Companies Act in making its judgment in claim A that was made by the applicants.[91] Section 76(3) requires the directors to, among other things, exercise their powers and perform their functions in good faith and proper purpose; in the best interests of the company, with the degree of care, skill and diligence expected of a person.[92] Whilst, section 218(2) is widely worded in respect of individuals who fall in its ambit; however, it is restricted to apply to "damage suffered by that person as a result of that contravention".[93] Only the person who suffered damage as a result of particular contravention must be the person to invoke the claim of damages.[94] The plaintiffs' recourse to section 218(2) of the Companies Act was articulated as follows, the directors' conduct constituted a breach of section 76(3) of the Companies Act resulting in the business of ABIL and African Bank being carried recklessly and with gross negligence.[95]

The court *a quo* correctly held that section 76(3) of the Companies Act does not deal with the liability of directors, but, section 77 of the Companies Act does.[96] Molopa-Sethosa J correctly held that the liability

85 As above.
86 As above.
87 As above.
88 As above.
89 As above.
90 *Hlumisa v Kirkinis* (SCA) para 10.
91 *Hlumisa Investment Holdings (RF) Ltd v Kirkinis* 2019 (4) SA 569 (GP) (hereinafter *Hlumisa v Kirkinis* (GP)) paras 28 and 30.
92 *Hlumisa v Kirkinis* (GP) para 27.
93 *Hlumisa v Kirkinis* (GP) paras 26, 40, 50 and 66.
94 *Hlumisa v Kirkinis* (GP) para 26.
95 As above.
96 *Hlumisa v Kirkinis* (GP) para 28.

of breaching section 76(3) must be brought in terms of section 77(2) of the Companies Act.[97] The court *a quo* confirmed the principle in *Gentoruco AG v Firestone SA (Pty) Ltd*,[98] that the *generalia specialibus non derogant* maxim which means that the general provisions do not derogate from special provisions.[99] Therefore, the court *a quo* correctly held that the reliance on sections 218(2) and 76(3) would be a departure from a core principle of company law.[100] In addition, the court *a quo* correctly rejected the reliance on section 22, by referring to section 77(3)(b) which deals with liability when losses are suffered by a company as a consequence of a director having carried the company's business, despite knowing that it was in contravention with section 22.[101]

The court *a quo* also referred to *Itzikowitz v Absa Bank Ltd*[102] particularly when discussing the principle of reflective loss. First, the underlying principle is that the company has a separate legal personality.[103] Secondly, holding shares in a company merely gives shareholders the right to participate in the company in terms of the MOI, which remains unaffected by a wrong done to the company, and, in light thereof, a personal claim by a shareholder against a wrongdoer who caused loss to the company is misconceived.[104] The above argument, therefore, reinforces the argument that the plaintiffs could not rely on section 218(2) of the Companies Act.[105]

The court *a quo* then decided on Claim B against Deloitte and related exceptions.[106] The court *a quo* rejected the reasoning that plaintiffs sue for a loss caused by a third party (Deloitte) to African Bank which allegedly resulted in an equivalent loss to ABIL and the plaintiffs as minority shareholders.[107] Accordingly, it was established that African Bank suffered the loss and the court *a quo* concluded that it was the proper plaintiff. [108]

4 3 The reasoning of the Supreme Court of Appeal

The Supreme Court of Appeal undertook to decide on whether section 218(2) of the Companies Act provides a basis for a claim by the appellants, in their capacity as individual shareholders in ABIL, against the directors based on the contraventions by the directors of sections 22(1), 45 and 74 and breaches of section 76(3) of Companies Act.[109] In

97 As above.
98 1972 (1) SA 589 (A) at 603.
99 *Hlumisa v Kirkinis* (GP) para 30.
100 *Hlumisa v Kirkinis* (GP) para 31.
101 *Hlumisa v Kirkinis* (GP) para 42.
102 *Itzikowitz* paras 8-17.
103 *Hlumisa v Kirkinis* (GP) para 50.
104 *Hlumisa v Kirkinis* (GP) para 51.
105 As above.
106 As above.
107 *Hlumisa v Kirkinis* (GP) paras 68 and 70.
108 As above.
109 As above.

addition, with regards to the alleged breaches of the auditors, to find out whether the applicants' pleadings contain a sustainable cause of action in terms of section 46(3) of APA and section 218(2) of the Companies Act.[110]

The Supreme Court of Appeal extensively relied on case law, especially on the rule against claims by shareholders for reflective loss.[111] The Supreme Court of Appeal upheld the decision in *Itzikowitz* that separate legal personality is not a mere technicality. Therefore, it is trite law that the assets of a company are distinct from its shareholders.[112] In addition, in *Prudential Assurance Co Ltd v Newman Industries Ltd*,[113] it was held that "what a shareholder cannot do is to recover damages merely because the company in which he is interested has suffered damage".[114] Further, the Supreme Court of Appeal referred to *Garcia v Marex Financial Ltd*,[115] where Flaux LJ upheld the no reflective loss principle in line with Lord Millet's conclusions in *Johnson v Gore*,[116] and these are not repeated here.

The Supreme Court of Appeal went on to quote Blackman, Jooste, and Everingham's view,[117] on the rule against the reflective loss principle.[118] The authors assert that the rule against double recovery is justified because allowing personal actions subverts the rule in *Foss v Harbottle*.[119] The authors further postulate that the depreciation of shares because of the harm done to the company will cause shareholders to suffer indirect harm.[120] Accordingly, when harm is caused directly to A (e.g. a company) and indirectly to B (e.g. the company shareholders), the law gives a claim for compensation to A.[121] It is so because if the compensation is given to B, then A's creditors would be prejudiced.[122] In addition, it may result in a multiplicity of claims that may be small sums.[123] Therefore, the law should ensure that A does not suffer loss and in turn B will not suffer loss, because, if the financial position of A is not affected then the financial position of B would not be affected.[124]

110 As above.
111 *Hlumisa v Kirkinis* (SCA) para 24.
112 As above.
113 *Prudential v Newman* paras 222-223.
114 *Hlumisa v Kirkinis* (SCA) para 26.
115 (2018) EWCA Civ 1468.
116 *Johnson v Gore* para 35B-36B; and *Giles v Rhind* 2002 EWCA Civ 1428.
117 Blackman, Jooste and Everingham *Commentary on the Companies Act* (2012) pages 9-67 to 9-68.
118 *Hlumisa v Kirkinis* (SCA) para 31.
119 The classic definition of the rule in *Foss v Harbottle* is confirmed in the judgment of Jenkins LJ in *Edwards v Halliwell* 1950 2 All ER 1064 at 1066-7.
120 *Hlumisa v Kirkinis* (SCA) para 31.
121 As above.
122 As above.
123 As above.
124 As above.

More so, the Supreme Court of Appeal referred to *Novatrust Limited v Kea Investments Limited*.[125] It held that in situations where wrongdoers control the company, they could be prevented from continuing to take such steps through derivative actions.[126] Derivative actions are regulated in the UK by Part 11 of Chapter 1 of the Companies Act 2006 and in South Africa by section 165 of the Companies Act.[127] However, derivative actions were not an issue in this appeal.[128] I submit that the failure of the appellants to invoke the derivative actions in the court *a quo* and the Supreme Court of Appeal was fatal to their case and had they pleaded in accordance with the derivative actions they would have succeeded in their application.

The Supreme Court of Appeal held that a submission by the appellants which attempted to show that diminution in value of the appellants' shares from *inter alia*, losses suffered by African Bank and ABIL, is fallacious.[129] No doubt, on the appellants' version of events, that ABIL would have a claim against the directors, and at common law, the existence and viability of that claim precluded personal claim by the shareholders.[130] However, the shareholders failed to assert oppression by a majority of shareholders and no hint of a derivative action, or that ABIL was hindered or obstructed in pursuing a claim against directors.[131] Accordingly, the Supreme Court of Appeal correctly held that when section 218(2) of the Companies Act is interpreted within the context of the ethos under sections 5 and 7 of the Companies Act[132] it is not applicable in relation to the claim of the appellants against the directors.[133] In rejecting the applicants' claim the Supreme Court of Appeal held that section 1 of the Companies Act defines a company as a separate juristic person and such is not a mere technicality but foundational to company law.[134]

The Supreme Court of Appeal further correctly held that the duties owed by the directors in terms of section 76(3) of the Companies Act are owed to the company and not individual shareholders.[135] Further, in circumstances of a wrong done to the company in terms of that subsection's provisions, the company is the proper plaintiff to sue for damages.[136] Section 77(2)(a) provides that a director of a company may be held liable for breaches of fiduciary duties resulting in any loss or damage sustained by the company.[137] The Supreme Court of Appeal

125 (2014) EWHC 4061 (Ch).
126 *Hlumisa v Kirkinis* (SCA) para 31.
127 As above.
128 As above.
129 As above.
130 As above.
131 As above.
132 Ss 5 and 7 of the Companies Act.
133 *Hlumisa v Kirkinis* (SCA) para 41.
134 As above.
135 *Hlumisa v Kirkinis* (SCA) para 48.
136 As above.
137 As above.

correctly held that reliance on sections 22(1), 45, and 76(3) of the Companies Act was unsustainable and upheld the decision of the court *a quo*.[138]

On claim B, the appellants argued that the directors mismanaged the Bank's affairs, resulting in the company sustaining significant losses.[139] Deloitte was the Bank's auditor and was obliged to perform this function with reasonable care and skill.[140] The appellants argued that the Bank audits by Deloitte in 2012 and 2013 were false and did not reveal losses sustained, however, Deloitte presented them as fairly representing the Bank's financial position.[141] Such false reports were due to failure to perform the audit with the requisite reasonable care and skill.[142] The applicants based the claim on the fact that the Bank suffered a primary loss, thus, Deloitte must accept that it wrongfully and negligently or deliberately caused the loss.[143] Ordinarily, the Bank would have had statutory and contractual claims against the directors and Deloitte for recovery of the Bank's loss.[144] As pleaded, ABIL suffered a loss in the second degree, a reflection of the Bank's loss.[145] The appellants as shareholders of ABIL, thus, suffered losses in the third degree.[146] They only suffered because of ABIL's loss.[147] The Supreme Court of Appeal reiterated that claims for reflective loss by a shareholder are generally untenable.[148] I reiterate that had the appellants invoked derivative actions in either the court *a quo* or Supreme Court of Appeal they could have succeeded in their claim to a larger extent.[149]

The applicants based their claims on sections 46(2) and 46(3) of APA.[150] The Supreme Court of Appeal held that the appellants failed to connect how and why their claims were justified, in other words, they failed to establish wrongfulness.[151] In their pleading on claim B appellants did not rely on section 218(2) of the Companies Act.[152] However, the appellants contended that they were entitled to rely on that section if such reliance could be inferred.[153] They then referred to section 30(2)(a) of the Companies Act, which provides that the annual financial statements of companies like ABIL and African Bank must be audited if read with the definition of "audit" in section 1 of the

138 *Hlumisa v Kirkinis* (SCA) para 53.
139 As above.
140 *Hlumisa v Kirkinis* (SCA) para 55.
141 As above.
142 As above.
143 *Hlumisa v Kirkinis* (SCA) para 56.
144 As above.
145 As above.
146 As above.
147 As above.
148 *Hlumisa v Kirkinis* (SCA) para 58.
149 *Hlumisa v Kirkinis* (SCA) para 71.
150 *Hlumisa v Kirkinis* (SCA) para 72.
151 As above.
152 *Hlumisa v Kirkinis* (SCA) para 73.
153 As above.

Companies Act, it must mean in accordance with prescribed or applicable auditing standards.[154] The appellants contended that the auditors contravened section 30(2)(a) of the Companies Act.[155] Therefore, they argued that they rely on section 218(2), however, the Supreme Court of Appeal held that such reliance is fallacious.[156] The Supreme Court of Appeal correctly held that the duty of auditors is primarily owed to the company, hence, liability by Deloitte to shareholders in the circumstances of this case is untenable.[157] Accordingly, the Supreme Court of Appeal dismissed the appeal with costs for all the above reasons.

4 4 A critical assessment of the decision in *Hlumisa*

It is trite law that directors owe fiduciary duties to the company and not any stakeholder including shareholders and directors.[158] The approach in both the court *a quo* and the Supreme Court of Appeal decisions is sound, and it appropriately rejects the approach adopted in *Mthimunye-Bakoro v Petroleum and Oil Corporation of South Africa (SOC) Ltd,*[159] wherein the said case the court erred in upholding that directors owe fiduciary duties to fellow directors. The *Hlumisa* case not only clarified the law but it now provides the correct approach and reinforced a position that directors owe their fiduciary duties only to the company. In *Hlumisa*, the court *a quo* and the Supreme Court of Appeal correctly maintained that directors and auditors owe fiduciary duties to the company, not shareholders. Accordingly, the premise logically reached the conclusion that shareholders cannot claim a diminution of their shares based on reflective loss.

I applaud the court *a quo* and the Supreme Court of Appeal's use of foreign guidance in articulating the no reflective loss principle, in this context, as shown above.[160] It is submitted that tracing the evolution of principles and seeking guidance from other foreign jurisdictions is important in identifying the weaknesses and strengths of different approaches. I further submit that the judgments of the court *a quo* and the Supreme Court of Appeal are consistent with the policy rationales behind regulating the no reflective loss principle as presented in the *Johnson* case above[161] and these will not be repeated here.

This article has shown that the approach of both the court *a quo* and Supreme Court of Appeal is to a larger extent supportive of the no reflective loss rule. The court *a quo* and the Supreme Court of Appeal

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154 As above.
155 As above.
156 As above.
157 As above.
158 Delport et al *Henochsberg on the Companies Act 71 of 2008* (2019) 296; *Percival v Wright* (1902) 2 Ch 421.
159 2015 6 SA 388 (WCC) (hereinafter *Mthimunye-Bakoro*) page 12.
160 S 5 of the Companies Act, and s 39 of the Constitution encourage the use of foreign law in enhancing our jurisprudence.
161 *Johnson v Gore* para 62.

demystified the position of the no reflective loss principle in South African law and it seems to be clearer now. It is submitted that the court *a quo* and the Supreme Court of Appeal were correct when they held that the appellants were mistaken when they pleaded their claims in terms of section 218(2) of the Companies Act without substantiating the cause of action and the link thereof. The detailed reasoning is not repeated here. On the contrary, it appears the appellants were ill-advised when they omitted to invoke section 77 of the Companies Act, a provision that holds directors personally liable when they breach *inter alia*; their fiduciary duties and/or other duties as within the *Hlumisa* case's context, sections 76(3), 22(1), 45, and 74.[162] I submit that should the appellants invoke section 77 of the Companies Act, they would have increased their chances of succeeding in their claim.

More so, the court *a quo* and the Supreme Court of Appeal correctly pointed out that the failure by the appellants to invoke the section 165 remedy was fatal to the appellant's claim. Since section 165 was not pleaded the court *a quo* and the Supreme Court of Appeal could not decide based on section 165. It is trite law that courts only decide on the pleadings in front of them, because, should the courts decide on the facts and issues that are not in front of them then they stop being neutral arbiters. In support of the conclusions by the court *a quo* and the Supreme Court of Appeal, the *Hlumisa* case has offered good law that offers guidelines on how to treat the no reflective loss rule. It is submitted that had the appellants pleaded the section 165 remedy it is highly likely that both the court *a quo* and the Supreme Court of Appeal were going to decide in favour of the appellants. The court *a quo* and the Supreme Court of Appeal reinforced the principle that both directors and auditors owe fiduciary duties to the company and claims for breaches of fiduciary duties to a company that leads to diminution of shareholders' share value can only be correctly instituted by the company. Therefore, *Hlumisa* stands to be one of the case laws that solidifies the position of the no reflective loss principle in South Africa. Further, *Hlumisa* entrenches the confirmed principle of separate legal personality by confirming that the property of the company belongs to the company and that the company can sue and be sued in its own name.[163]

5 Conclusions

The article reinforces that the principle of separate legal personality is the cornerstone of company law and some of the pertinent consequences that were dealt with in the reviewed case law include that a company can own assets and can sue or be sued in its own name.[164] It is a fact that the principle of separate legal personality is entrenched under section 19(1) of the Companies Act as well accepted in the *locus classicus* case

162 S 77 of the Companies Act.
163 S 19(1) of the Companies Act; *Dadoo* para 550-1.
164 *Dadoo* para 550-1; *Macaura* para 630.

laws.[165] The other extremely important principles that are related to the concept of separate personality include ascertaining the proper plaintiff in the context of directors' breach of fiduciary duties and the principle of no reflective loss in company law. In particular, the overarching objective of this article was to find out how courts interpret the no reflective loss principle against the backdrop of *Hlumisa*. This article concurs with the policy rationales utilised by the court *a quo* and the Supreme Court of Appeal in *Hlumisa* in articulating the concept of no reflective loss and the decisions thereof. Both the court *a quo* and the Supreme Court of Appeal in *Hlumisa* confirm and reinforce the no reflective loss principle in line with its known policy rationales held by Lord Millett in *Johnson v Gore*.[166] In addition, the decision in *Hlumisa* lays a foundation of law that effectively avoids the prejudice to creditors[167] and also respects the company's internal governance structure.[168] Conclusively, the decision in *Hlumisa* is extremely important to the South African corporate law jurisprudence on the no reflective loss principle because it confirms the principle and reinforces it.

165 S 19(1) of the Companies Act; *Salomon v Salomon* paras 42-43.
166 *Johnson v Gore* para 62.
167 As above.
168 *Johnson v Gore* para 36.