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The reflective loss principle in South African company law

A mini dissertation submitted in partial fulfilment of the requirements for the LLM Corporate Law

MINI-DISSERTATION

Prepared by

Ellena Mokwena

Student number: 29302596

Supervisor: Dr Tshepiso Ngoepe

Department of Mercantile Law

Date of Submission: 16 December 2023

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Acknowledgements

First, I would like to thank my supervisor, Dr Tshepiso Ngoepe, for all her patience, valuable guidance and input in writing this mini-dissertation. I would also like to thank my husband, Onalenna Mokwena and my daughter, Thato Mokwena, for all their patience and understanding during this journey. I would also like to thank my mother, Agnes Miya, for her faith in and support of me.

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Chapter 1: Introduction

1.1. Background

The board of directors of a company is the organ through which a company acts. The directors owe duties to the company at common law and in terms of the Companies Act 71 of 2008.[1] When performing as an organ of the company, directors' actions or omissions may cause losses or damages to the company. The losses or damages may lead to a diminution in the company's value. The diminution in the company's value also affects the company's shareholders in the form of a loss in the value of their securities. In the hands of the shareholders, it is considered a reflective loss.[2]

In terms of the principle of separate legal personality, a company can sue and be sued in its name.[3] A company can hold its directors liable for a breach of fiduciary duty for any loss, damages, or costs incurred by the company due to a breach by a director of any duty contemplated in the Companies Act.[4] A director can also be held liable in terms of delict principles for any loss, damages, or costs that the company suffers following a breach by a director of section 76(3)(c), any other provision of the Companies Act, or the company's Memorandum of Incorporation.[5] Therefore, the company has a means of recourse against the directors under the common law and the Companies Act.

1.2. Motivation for the study

The motivation for this dissertation is the recent and ongoing major corporate scandals in South Africa, such as the Steinhoff and African Bank debacles. These matters have resulted in a renewed focus on governance issues, including directors' conduct and companies' internal governance. These scandals have increased shareholder activism regarding protecting the value of the shareholder's investment in the shares of these companies. The share prices of Steinhoff and African Bank, as listed public companies, have been severely impacted by their respective scandals.[6] The pertinent issue addressed in the shareholder lawsuits arising from these scandals has been the ability of shareholders to claim for the loss of value in the shares they hold in each company. In each case, shareholders have approached the courts to argue

[1] Hereafter the "Companies Act" or "the Act".
[2] See Charman and Du Toit *Shareholder actions* (2017) at 185.
[3] See section 19(1)(b) of the Companies Act; *Aron Salomon v A Salomon & Co Ltd* [1897] AC 22 (HL)
[4] See section 77(2)(a) of the Companies Act; *Hlumisa Investment Holdings (RF) Ltd v Kirkinis* (2020) JOL 47567 (SCA) at para 12; and *Organisation Undoing Tax Abuse and another v Myeni and others* [2020] 3 All SA 578 (GP) at para 22.
[5] See section 77(2)(b) of the Companies Act.
[6] See Rossouw and Styan "Steinhoff collapse: a failure of corporate governance" 2019 *International Review of Applied Economics* 163 at 164, Donnelly "Report: African Bank directors were reckless" Available at: https://mg.co.za/article/2016-05-13-myburgh-report-abil-directors-were-reckless/ [Accessed 06 June 2023].

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that the directors of these companies are personally accountable to the shareholders for the losses they claim they have suffered due to the directors' misconduct.[7] Therefore, these lawsuits in response to the scandals warrant the analysis of the reflective loss principle in South African law.

Further motivation for this dissertation is the Guidelines for Corporate Law Reform published on 23 June 2004 ("Guidelines") by the Department of Trade and Industry ("DTI").[8] The Guidelines aimed to commence a review process to modernise South African company law and update South African company law to align with international trends.[9] The DTI deemed the review necessary to ensure that South African company law reflects and accommodates the ever-changing environment for business, both in South Africa and globally.[10] The Guidelines set out further review objectives and proposed modernisation of company law in South Africa. Two important objectives for the DTI review, which serve as additional motivation for this dissertation, were to:

(i) Encourage transparency and high standards of corporate governance, recognising the broader social role of enterprises; and

(ii) Promote innovations and investment in South African markets and companies by providing a predictable and effective regulatory environment and flexibility in the formation and management of companies.[11]

1.3. Problem statement

The DTI, in the Guidelines, expressed a desire that South Africa begin to expand its company law principles beyond the heavy English law influence from which it originates. Section 5(2) of the Companies Act explicitly authorises a court to take cognisance of the principles of foreign company law.[12] The principle of reflective loss in South Africa derives from English law.[13] South Africa has also enacted statutory provisions that impact the application of the principle of reflective loss.[14] It is important to distinguish between cases where claimants are permitted to claim against directors for personal losses arising from directors' actions, and that fall within

[7] See discussion at paras 3.2, 3.3 and 3.5 of Ch 3; See also *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* 1995 (4) SA 790 (A), *Hülse-Reutter & Others v Gödde* 2001 (4) SA 1336 (SCA); *McLelland v Hulett* 1992 (1) SA 456 (D); *Fourway Haulage SA (Pty) Ltd v SA National Roads Agency Ltd* 2009 (2) SA 150 (SCA).
[8] Now the Department of Trade Industry and Competition. See "South African company law for the 21st century: Guidelines for corporate law reform" GN 1183 in GG 26493 of 23 June 2004.
[9] *Ibid* at 5.
[10] *Ibid.*
[11] *Ibid* at 10.
[12] See Scott "An unsuccessful longshot aimed at effecting liability for causing pure economic loss - Itzikowitz v Absa Bank Ltd 2016 4 SA 432 (SCA)" 2017 *THRHR* 483 at 489.
[13] See *Hlumisa v Kirkinis* (2020) *supra* n4 at para 37; and *Gihwala and others v Grancy Property Ltd* [2016] 2 All SA 649 (SCA) at paras 107-112.
[14] See sections 20(6), 77(2), 165 and 218(2) of the Companies Act.

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the categories where claiming for reflective loss is not permitted.[15] Recent case law has confirmed the common law position that a shareholder has no cause of action where the actions of the company directors cause personal damages to the shareholder.[16]

1.4. Research aims

This mini-dissertation determines whether there is scope to develop the South African position on claims for reflective loss for the sake of (i) consistent application and (ii) alignment with international best practices and societal needs.[17]

1.5. Research questions

1.5.1 What is the common law position regarding shareholder claims for reflective loss, and to what extent does the no reflective loss principle apply to third parties who are not shareholders?

1.5.2 Is there a statutory basis for claims for reflective loss in South Africa?

1.5.3 What is the current position in a comparative legal jurisdiction (the United Kingdom) on reflective loss?

1.6. Research methodology

This paper employs comparative research methodology using desktop research. This mini dissertation critically discusses primary sources, including case law and legislation, and secondary sources, such as books and journal articles.

1.7. Limitations and delineations

This mini dissertation is limited to an examination of the importation and subsequent application of the principle of reflective loss in South Africa from English law. This mini dissertation examines the current position in English common law and whether it is similar to or different from the application in South African common law. There is an assessment of the extent of the codification (the collation of rules and laws into an orderly, formal code) of the principle of reflective loss in South African company law legislation and whether the codification (if any) is influenced by English law.

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[15] See Mupangavanhu "Dimunition in share value and third party claims for pure economic loss: The question of director liability to shareholders" 2019 *SA Merc LJ* 107 at 111; *Chemfit Fine Chemicals (Pty) Ltd ta SA Premix v Maake* [2017] ZALMPPHC 27 at para 42 and *Blue Farm Fashion Limited v Rapitrade 6 (Pty) Ltd* [2016] ZAWCHC 35 at para 18.

[16] See *Itzikowitz v Absa Bank Ltd* 2016 (4) SA 432 (SCA) at para 10.

[17] See "South African company law for the 21st century: Guidelines for corporate law reform" *supra* n8 at 14.

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This mini dissertation does not examine nuances in the definition of reflective loss. The focus of this mini dissertation is in respect of reflective loss as experienced by a shareholder of a company in the form of a diminution in the value of shareholding or dividends.

1.8. Chapter outline

1.6.1 Chapter 2: Common law position

This chapter focuses on understanding the meaning of reflective loss as defined in South African law. The chapter begins with a brief exposition on the definition of reflective loss in South African common law. An assessment of the case law treatment of the principle against reflective loss follows, with particular reference to recent case law.

1.6.2 Chapter 3: Reflective loss in the context of the Companies Act 71 of 2008

This chapter assesses whether there are statutory provisions that permit or deny claims for reflective loss in the Companies Act. In an attempt to establish a statutory basis for a shareholder to have permission to claim reflective losses from the company's directors, the cases discussed in chapter 2 refer to several different provisions of the Companies Act. The sections of the Companies Act under assessment are sections 20(6) (Validity of company actions), 77(2) (Liability of directors and prescribed officers), 165 (Derivative actions), and 218(2) (Civil actions).

1.6.3 Chapter 4: Comparative analysis of South African law and English law

This chapter assesses English case law and legislation on reflective loss to understand the origins of the rule against reflective loss. English law, as mentioned above, has, in the past, had a significant influence on South African corporate law. Furthermore, an analysis of the legislative provisions in English law follows for a like-for-like comparison regarding the common law and legislative provisions of South African law assessed in chapters 2 and 3, respectively. Section 260 of the Companies Act (c46) is assessed.

1.6.4 Chapter 5: Recommendations and conclusion

This final chapter provides conclusions drawn from the preceding chapters. It also provides recommendations regarding the development of South African law on the no reflective loss principle. The proposal(s) align with the confirmed desire that South African corporate law begins to move away from the heavy historical reliance on English law as a common law root.

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The recommendations provide considerations to further the DTI's desire to continue developing South African corporate law to keep up with international best practices.

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Chapter 2: Common law position

2.1. Introduction

This chapter commences with a discussion of the principle of separate legal personality, which is the overarching foundation of the principle against claims for reflective loss. What follows is a discussion on the reflective loss principle and an introductory discussion on the case law, which forms the origins of recognising the principle in English law from which South African company law imported the principle. Paragraphs 2.2 and 2.3 discuss the theoretical basis for the reflective loss principle being the principles of separate legal personality and pure economic loss, respectively. The remainder of this chapter delves into a general discussion on the common law pertaining to the reflective loss principle.

2.2. Separate legal personality of a company

South Africa's earlier company legislation reflected English company law.[18] A majority of the fundamental principles of English company law, such as those in *Aron Salomon v A Salomon & Co Ltd*,[19] which established the foundation for the principle of a company's separate personality, and those in *Foss v Harbottle*,[20] were integrated into South African case law.[21] In terms of this principle, a company is entirely distinct from its shareholders.[22] It has been held that the notion of the separate legal personality of a company apart from its shareholders is more than just an artificial and technical concept.[23] Property belonging to the company is not, and cannot be, vested in all or any of its shareholders.[24] A company is not merely another name for the same person.[25] A company's property does not belong to its shareholders.[26] It is one of the foundational principles from which the principle against reflective loss emerges.[27]

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[18] Companies Act 61 of 1973; See also Scott (2017) *THRHR supra* n12 at 489.
[19] See *Aron Salomon* (1897) *supra* n3.
[20] (1843) 2 Hare 461.
[21] See Scott (2017) *THRHR supra* n12 at 489.
[22] See *Dadoo v Krugersdorp Municipal Council* 1920 AD 530 at 550; *Itzikowitz v Absa Bank Ltd* (2016) *supra* n16 at para 9 and 16; *Hlumisa v Kirkinis* (2020) *supra* n4 at para 24; and *Pepkor Holdings Ltd v Ajvh Holdings (Pty) Ltd* 2021 (5) SA 115 at paras 43 and 45.
[23] See *Dadoo v Krugersdorp* (1920) *supra* n22 at 550-551.
[24] *Ibid.*
[25] See *Aron Salomon* (1897) *supra* n3 at 42.
[26] See *Itzikowitz v Absa Bank Ltd* (2016) *supra* n16 at para 9.
[27] See *Hlumisa v Kirkinis* (2020) *supra* n4 at paras 17 and 24.

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Sections 19(1)(a) to (b) of the Companies Act codify the principle of separate legal personality of a company and provides that from when the company's formation, as documented in its registration certificate, the company—

(i) is a juristic person and exists continuously until its name is removed from the companies register per the Companies Act.[28]

(ii) has all of an individual's legal rights and capacities, unless its memorandum of incorporation expressly states differently or a juristic person cannot exercise such rights or capacities.[29]

It is an established principle that the only deviation from this common law principle is in circumstances where the corporate veil of a company must be pierced.[30] South African courts have no general discretion to disregard the separate legal personality of a company even where it considers it just to do so in the circumstances.[31] The principle of separate legal personality of the company in the context of claims for reflective losses by shareholders serves as a bar to such claims.[32] This is because the shareholder has no cause of action or standing to sue.[33] Legally speaking, the shareholders are not at a loss due to the company's assets being depleted.[34] The decline in share value merely reflects the loss to shareholders.[35] The basis of this difference is that a company has a different legal identity from its shareholders and, accordingly, has its own assets.[36]

The proper plaintiff rule, which requires that only the company itself may sue to enforce its rights, developed as a limitation to the principle of separate legal personality of a company.[37] This rule originated from and is one branch of the English case of *Foss v Harbottle.*[38] The second "branch" is the internal management rule, which stipulates that the decision on whether the company will initiate legal action must be taken by management and carried out in line with the principle of majority rule.[39] Both "branches" have been integrated into South

[28] See section 19(1)(a) of the Companies Act.
[29] See section 19(1)(b) of the Companies Act; Delport *et al*, *Henochsberg on the Companies Act 71 of 2008* (2022) at 86; and Locke "The legislative framework determining capacity and representation of a company in South African law and its implications for the structuring of special purpose companies" 2016 *SALJ* 160 at 164.
[30] See *Pepkor Holdings Ltd v Ajvh Holdings (Pty) Ltd* (2021) *supra* n22 at para 45. The concept of piercing the corporate veil will not be assessed in this dissertation as it does not contribute significantly to the rationale for the principle against reflective loss.
[31] Cassim *et al Contemporary company law* (2021) at 63; See also *Cape Pacific supra* n7 at 803.
[32] See Shapira "Shareholder personal action in respect of a loss suffered by the company: The problem of overlapping claims and "reflective loss" in English company law" 2003 *The International Lawyer* 137 at 137.
[33] *Ibid.*
[34] See Mupangavanhu (2019) *SA Merc LJ supra* n15 at 114-115; and *Stellenbosch Farmers' Winery Ltd v Distillers Corporations (SA) Ltd* 1962 (1) SA 458 (A) at 471-472.
[35] See Shapira (2013) *The International Lawyer supra* n32 at 138.
[36] *Ibid.*
[37] See Murray "The company as a separate legal entity" 1968 *Modern LR* 481 at 500-501; *Foss supra* n20 and *Mozley v Alston* (1847) 1 Ph 790 at 801.
[38] See *Foss v Harbottle supra* n20 and Mongalo and Scott *Corporate law and corporate governance* (2023) at 317.
[39] *Ibid.*

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African law.[40] The question of whether the English law of derivative actions has been adopted into South African law has not been expressly answered.[41] The rule essentially means that a shareholder cannot bring an action on behalf of the company unless certain conditions are met, such as showing that the company's management is unwilling or unable to do so.[42] The proper plaintiff rule ensures that the proper parties conduct the company's affairs.[43] The principle of supremacy of the majority applies to corporate rights (when a wrong is done to the company) and not individual rights (when the company does a wrong).[44] Creditors' claims are given precedence over the individual or personal rights of the shareholder.[45] Some legal scholars have criticised the reflective loss principle for limiting the ability of shareholders to hold companies accountable for wrongdoing,[46] particularly in cases where the company has suffered a loss due to the same wrongdoing.

In the end, a shareholder's shares are a right to participate in the company, therefore if their value has decreased and this is merely a reflection of the company's loss.[47]

2.3. Pure economic loss claims

Pure economic loss transpires when a person causes another to incur patrimonial loss without causing physical injury to the victim's body or possessions.[48] The principles of Aquilian liability regulate negligently caused pure economic loss..[49] In South African law, Aquilian liability extends beyond the two founding rules of Aquilian liability being (i) an offender must compensate the victim for patrimonial damage if the offender violates the moral requirement to treat others with respect by failing to take reasonable steps to safeguard the victim's person or property; and (2) a positive act that physically affects another person or their property is negligent only if a reasonable person in the position of the harmed person would have

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[40] Mongalo and Scott (2023) *supra* n38 at 318; *Yende v Orlando Coal Distributors* 1961 (3) SA 314 (W) and *Sammel v President Brand Bold Mining Co Ltd* 1969 (3) SA 629 (A).
[41] See Delport (2022) *supra* n29 at 589; *Naidoo v Dube Tradeport Corp* 2022 (3) SA 390 (SCA) at para 11 and *Lewis Group Ltd v Woollam (1)* [2017] 1 All SA 192 (WCC) at para 29.
[42] See *Foss v Harbottle supra* n20 and Ngalwana "Majority rule and minority protection in South African company law: A reddish herring" 1996 *SALJ* 527 at 528.
[43] See de Jong "Shareholders claims for reflective loss: A comparative legal analysis" 2013 *European Business LR* 97 at 100; Delport *supra* n29 at 589; *Sammel v President Brand Gold Mining (*1969) *supra* n40*; Grancy Property Limited v Manala* [2013] 3 All SA 111 (SCA) at para 32 and *Mbethe v United Manganese of Kalahari (Pty) Ltd* [2016] JOL 35242 (GJ); 2016 (5) SA 414 (GJ) at para 59.
[44] See Delport (2022) *supra* n29 at 592; *Communicare v Khan* 2013 (4) SA 482 (SCA) at paras 5 and 8, Griffin "Shareholder remedies and the no reflective loss principle – problems surrounding the identification of a membership interest" 2010 *Journal of Business Law* 461 at 464 and Ferran "Litigation by shareholders and reflective loss" 2001 *Cambridge LJ* 245 at 247.
[45] See Ferran (2001) *Cambridge LJ supra* n44 at 246.
[46] See de Jong (2013) *European Business LR supra* n43 at 101; and McLennan "Companies, shareholders and 'reflective losses" 2005 17 *SA Merc LJ* 195 at 201.
[47] See discussion at para 4.2 of Ch 4 below.
[48] See Fagan "Aquilian liability for negligently caused pure economic loss — its history and doctrinal accommodation" (2014) *South African Law Journal* 288 at 289.
[49] *Ibid;* see also *Administrateur, Natal v Trust Bank van Afrika* 1979 (3) SA 824 (A).

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expected that the act may cause such harm and refrained from doing it.[50] In our law, claimants have attempted to claim pure economic loss directly from defendant directors due to a diminution in the value of their shares.[51] This is a delictual claim for pure economic loss, which is not *prima facie* unlawful.[52] In *Itzikowitz,*[53] the SCA held that a shareholder has no such claim, thereby confirming the alignment of South African law with English law in this regard.[54] Notwithstanding this clarification, claims of this nature still arise in South Africa.

2.3.1 What is reflective loss?

The principles of *Foss v Harbottle*[55] are the basis of the rule against reflective loss. Through an act or omission (breach of duty) *vis-a-vis* a company, a wrongdoer may cause the company to suffer a loss. A shareholder may simultaneously suffer a loss in the value of the shares held by the shareholder in the company from the same act or omission. The loss incurred by the shareholder is known as reflective loss as it stems from the same act or omission which causes the company to suffer a loss. The established principle in our law is that a company is a separate legal persona from its shareholders.[56] As a result, the company's property vests in the company rather than its shareholders. The rights of shareholders to partake in the company's assets are delayed until the company is wound up, subject always to creditors' claims.[57]

2.3.2 The basis and content of common law principles on reflective loss in South Africa

Section 5(2) of the Companies Act expressly confers a right on our courts to consider foreign company law in interpreting and applying the Companies Act. *Foss v Harbottle*,[58] an English law case, sets out the principles underpinning the rule regarding shareholders' reflective loss claims. The case is a landmark case in the history of corporate law and established the proper plaintiff rule that, in certain circumstances, only the company has the right to sue for damages caused to it, rather than individual shareholders. The court established the "proper plaintiff" principle, which holds that if a wrong has been committed against a company, only the company itself has the right to sue for damages unless the wrong is of such a nature that it

[50] *Ibid* at 288-289.
[51] See *Hlumisa v Kirkinis* (2020) *supra* n4.
[52] See Mupangavanhu (2019) *SA Merc LJ supra* n15 at 117-118.
[53] See *Itzikowitz v Absa Bank Ltd* (2016) *supra* n16.
[54] *Ibid;* see also Mupangavanhu (2019) *SA Merc LJ supra* n15 at 109 and 120.
[55] *Foss v Harbottle supra* n20.
[56] See section 19(1)(a) of the Companies Act and *Salomon* (1897) *supra* n19.
[57] See *Itzikowitz v Absa Bank Ltd* (2016) *supra* n16 at para 9; and *Prudential Assurance Co Ltd v Newman Industries Ltd* (No 2) (1982) Ch 204, CA at 223.
[58] See *Foss v Harbottle supra* n20.

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would be futile to ask the company to sue.[59] The proper plaintiff principle has significant ramifications for shareholders who wish to bring claims against a company. It means that individual shareholders cannot bring claims on behalf of the company unless the wrong is of such a nature that it would be futile to ask the company to sue. The principles of *Foss v Harbottle*[60] are part of South African company law.[61] The original tenets concerning the rule against reflective loss are as follows:

(i) Where a company suffers a loss by a breach of duty owed to it, only the company may sue for that loss. No action lies in the hands of a shareholder suing to make whole a diminution in the value of a shareholder's shareholding in the company where that loss merely reflects the loss suffered by the company.[62] The loss of the shareholder is not personal.[63]

(ii) Even if the loss is a decrease in the share value, a shareholder in the company may only sue for it if the company suffers a loss and has no cause of action to recover that loss.[64]

(iii) The company may suffer a loss due to the breach of an obligation owed to it. Simultaneously, a shareholder suffers a loss due to the violation of a separate duty due to the shareholder. In such an instance, the company and the shareholder can seek compensation for damages. Neither party, however, may act on behalf of the other to recoup the damage sustained by the other.[65]

The above principles form the basis of the rule against reflective loss accepted in South African common law, as evidenced in recent South African case law adjudicating claims for reflective loss.[66] It must be emphasised that the common law power of any individual to litigate on behalf of a company has been abolished.[67]

2.3.3 The exceptions to the rule against claims for reflective loss

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[59] *Ibid* at 492-494.
[60] *Ibid.*
[61] See *Letseng Diamonds Ltd v JCI Ltd; Trinity Asset Management (Pty) Ltd v Investec Bank Ltd* 2007 (5) SA 564 (W) at 573-574; *De Bruyn v Steinhoff International Holdings NV* [2020] JOL 47482 (GJ) at para 137; *Hlumisa v Kirkinis* (2020) *supra* n4 at paras 21 and 50; Scott (2017) *THRHR supra* n12 at 489 and Mongalo and Scott (2023) *supra* n38 at 316.
[62] See *Foss v Harbottle supra* n20; *Edwards v Halliwell* (1950) 2 All E.R 1064; and *Prudential Assurance v Newman* (1982) *supra* n57 at 222-223.
[63] See *Prudential Assurance v Newman* (1982) *supra* n57 at 223; and *Johnson v Gore Wood & Co* (2002) 2 AC 1, HL at 35F-36A.
[64] See *Prudential Assurance v Newman* (1982) *supra* n57 at 210F-211A and *Johnson v Gore Wood* (2002) *supra* n63 at 35G.
[65] See *Johnson v Gore Wood* (2002) *supra* n63 at 35H and *Lee v Sheard* [1956] 1 QB 192 at 196.
[66] See paras 3.2, 3.3 and 3.5 of Ch 3.
[67] See Mongalo and Scott (2023) *supra* n38 at 316.

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Since the principles against claims for reflective loss were enunciated in *Foss v Harbottle*, several exceptions have developed to this rule. The exceptions provide for circumstances where a personal claim by a shareholder for losses suffered by such shareholder is permitted. The exceptions are as follows:

(i) Where the company has no cause of action, then the shareholder in the company may recover that loss, even though the loss is a diminution in the value of the shareholding.[68]

(ii) The shareholder can demonstrate a personal loss separate and distinct from the loss suffered by the company caused by a breach of a duty independently owed to the shareholder.[69] The company and the shareholder may sue to recover the loss caused by the breach of a duty owed to it, but neither may recover the loss caused to the other by a breach of a duty owed to the other.[70]

(iii) Where the company has been disabled from bringing the claim by the wrongdoers,[71] however, insolvency is not an impediment.[72]

The decision of *Sevilleja Garcia v Marex Financial Limited,* as discussed below,[73] is relevant regarding the third exception listed above and its continued recognition in English law.[74] As noted below,[75] the supreme court did not accept all the exceptions developed since the decision in the *Prudential* case,[76] especially the exception recognised in *Giles*.[77]

2.4. Conclusion

In terms of South African common law, without evidence of being wronged independently, a shareholder's claim for pure economic loss in respect of a diminution in such shareholder's share value is not permitted in South Africa. As evidenced by the discussions above, English law is the basis of the recognition of the principle against reflective loss in South Africa's common law. It informs the continued implementation of the principle against the recovery of reflective loss by a shareholder in South African common law. The principle aims to prevent a double recovery of the same loss at the expense of the wrongdoer.[78] The Companies Act also

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[68] See *Johnson v Gore Wood* (2002) *supra* n63; see also discussion in para 4.2 of Ch 4.
[69] See *Johnson v Gore Wood* (2002) *supra* n63 at 62.
[70] *Ibid;* see also discussion in para 4.2 of Chapter 4.
[71] See *Giles v Rhind* (2003) Ch. 618, CA.
[72] See *Gardner v Parker* [2004] EWCA Civ 781; [2005] B.C.C. 46; and Charman and Du Toit (2017) *supra* n2 at 200; see also discussion in para 4.3 of Ch 4.
[73] See para 4.5 of Ch 4 below.
[74] [2020] UKSC 31; [2020] B.C.C. 783. See para 4.4 of Ch 4.
[75] *Ibid.*
[76] See *Prudential Assurance v Newman* (1982) *supra* n57.
[77] See *Giles v Rhind* (2003) *supra* n71; see also para 4.4 of Ch 4, for a full discussion.
[78] See *Johnson v Gore Wood* (2002) *supra* n63.

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endorses the consideration of foreign company law in interpreting and applying the Companies Act.[79] Chapter 3 assesses the relevant sections of the Companies Act in these claims.

[79] See section 5(2) of the Companies Act.

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Chapter 3: Reflective loss in the context of the Companies Act 71 of 2008

3.1. Introduction

The cases assessed in Chapter 2 above refer to sections of the Companies Act which are relevant in evaluating claims for reflective loss. Cassim believes the no reflective loss principle may extend to sections 20(6) and 218(2).[80] These sections are scrutinised in this Chapter 3 to understand the scope of their relevance and applicability in claims for reflective loss by assessing relevant provisions of the Companies Act, namely: (i) section 20(6) - validity of company actions; (ii) section 77(2) - liability of directors and prescribed officers; (iii) section 165 - derivative actions; and (iv) section 218(2) - civil actions.

3.2. Section 20(6) – Validity of company actions

Section 20 of the Companies Act deals with the validity of company actions. It sets out provisions related to limitations, restrictions, and qualifications on a company's purposes, powers, or activities, as well as the authority of its directors. The provision is intended to promote corporate governance, accountability, and compliance with the Companies Act.[81] It also intends to protect the interests of shareholders and third parties dealing with the company.[82]

Relevant to this research is section 20(6) of the Companies Act, which reads as follows:

> "Each shareholder of a company has a claim for damages against any person who intentionally, fraudulently or due to gross negligence causes the company to do anything inconsistent with—
> (*a*) this Act; or
> (*b*) a limitation, restriction or qualification contemplated in this section, unless that action has been ratified by the shareholders in terms of subsection 2."

At first glance, the section appears to find application in the context of reflective losses suffered by shareholders due to the diminution in the value of their shares in a company caused by the action of the company's directors. This section has been considered in the context of such a claim in *De Bruyn*. The shareholders claimed that the directors of SIHL and Steinhoff NV, with

[80] See Cassim (2021) *supra* n31 at 1133.
[81] See *De Bruyn v Steinhoff* (2020) *supra* n61 at paras 232-237.
[82] *Ibid* at para 232.

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gross negligence, caused SIHL and Steinhoff NV to conduct themselves in a manner inconsistent with the Companies Act, alternatively, inconsistent with a limitation, restriction or qualification contemplated in section 20.[83]

In *De Bruyn,* the court had to determine whether section 20(6) confers a right of action on the Steinhoff shareholders to claim from the directors of the involved companies for damages suffered by the shareholders due to the directors causing the companies to act inconsistently with the Companies Act or *ultra vires* their powers.[84] The court found that section 20(6) cannot reasonably be used to grant a right of action against SIHL or Steinhoff NV.[85] This reasoning is based on the logic that a company cannot cause itself to do something; instead, persons cause the company to act.[86] With the aforementioned in mind, the court was of the opinion that liability is with the person(s) who caused the company to act rather than the company itself.[87] The court acknowledged the uncertainty in the phrasing of section 20(6) regarding whose damages may be sought by a shareholder.[88] With this ambiguity in mind, the court found that section 20(6) imposes liability on the person(s) who cause a loss to the company.[89]

In support of this, the court gave the following reasons. Firstly, that section 20 addresses the consequences of any actions taken by a company which fall outside the limits, restrictions or qualifications of the purposes, powers or activities of the company as set out in its memorandum of incorporation.[90] Secondly, according to the court, there is no justification for the legislature to compensate shareholders instead of the company itself for harm that third parties have caused the company.[91] Thirdly, the court declared that there is no justification for the legislature to compensate shareholders to the exclusion of the company and third parties who might have suffered a loss due to the company acting outside of its legal authority or acting illegally.[92] Finally, the court held that the common law is instructive in deciding the meaning of section 20(6).[93] In this respect, the common law is against the compensation for reflective loss caused to shareholders by the directors' actions.[94]

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[83] See *De Bruyn v Steinhoff* (2020) *supra* n61 at para 222.
[84] *Ibid* at para 224.
[85] *Ibid* at para 225.
[86] See *De Bruyn v Steinhoff* (2020) *supra* n61 at para 225; and section 66(1*)* of the Companies Act which provides that: “The business and affairs of a company must be managed by or under the direction of its board, which has the authority to exercise all of the powers and perform any of the functions of the company, except to the extent that this Act or the company’s Memorandum of Incorporation provides otherwise.*”*
[87] See *De Bruyn v Steinhoff* (2020) *supra* n61 at para 225.
[88] *Ibid* at para 226.
[89] *Ibid* at para 230.
[90] See section 20 of Companies Act 71 of 2008 and *De Bruyn v Steinhoff* (2020) *supra* n61 at para 231.
[91] See *De Bruyn v Steinhoff* (2020) *supra* n61 at para 234.
[92] *Ibid* at para 235.
[93] *Ibid* at para 236.
[94] *Ibid.*

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According to the *De Bruyn* case, section 20(6) is an additional remedy to the derivative action in terms of section 165 of the Companies Act.[95] Section 20(6) is a claim for damages in addition to the section 165 statutory derivative action.[96] Allowing shareholders to proceed under section 20(6) to achieve a recovery for the company without any procedural safeguards, such as giving the company a first opportunity to take action to recover its own damages, has been critiqued.[97] The criticism is that such an interpretation is entirely at odds with the proper plaintiff principle and the cautious approach of section 165 (derivative action).[98] The fundamental tenet of the common law and the Companies Act is that when a wrong is committed against a company, the company should be the proper plaintiff as a separate juristic person.[99] The emphasis on assigning liability for a company's losses to its directors, as opposed to other parties, results in directors not being perceived as proper plaintiffs to pursue legal action to recover losses suffered by the company.[100] This is due to the possibility that seeking compensation for the company's losses may be viewed as an action that is counterproductive or even harmful to the directors themselves.[101] Regarding this, Van der Linde states that the derivative action (section 165 of the Companies Act) falls under the same standards and that section 20(6) has not, in this case, displaced the proper plaintiff rule.[102] Delport believes the court's remarks do not consider that directors are under a common law fiduciary duty (where fault is not an element) not to exceed their power or limitations (or ultra vires the company) and that the shareholder then has the remedies of section 165.[103]

A strong indication that the shareholder's losses are the main focus of section 20(6) is the provision that states the shareholder's claim for damages may be extinguished by consent from shareholders.[104] The interpretation of section 20(6) as a unique derivative action is, according to some commentary,[105] inconsistent with the language of the provision and goes against the fundamental principles of company law, such as juristic personality and the proper plaintiff rule.[106]

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[95] See Delport (2022) *supra* n29 at 105 and *De Bruyn v Steinhoff* (2020) *supra* n90 at para 232.
[96] See Delport (2022) *supra* n29 at 105.
[97] See Van der Linde "The Steinhoff corporate scandal and the protection of investors who purchased shares on the secondary market" 2022 *Potchefstroom Electronic LJ* 1 at 14.
[98] *Ibid.*
[99] See *Foss v Harbottle supra* n20 and Van der Linde (2022) *supra* n97 at 14.
[100] See *De Bruyn v Steinhoff* (2020) *supra* n61 at para 233.
[101] *Ibid.*
[102] See Van der Linde (2022) *Potchefstroom Electronic LJ supra* n97 at 14.
[103] See Delport (2022) *supra* n29 at 594.
[104] *Ibid.*
[105] *Ibid.*
[106] *Ibid* at 15.

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The court in *De Bruyn* stated that there was no justification for the legislature to compensate shareholders to the exclusion of the company and others who may have suffered a loss due to the company's unlawful or *ultra vires* actions.[107] This argument evidences a lack of understanding of the fundamental principles of company law by the court.[108] For a shareholder to utilise section 20(6), they must still demonstrate that they suffered a genuine loss due to the violation or contravention and that this loss is not merely reflective.[109]

The court ultimately found that section 20(6) affords no claim for personal losses suffered by shareholders.[110] According to *De Bruyn*, there is no cause of action in section 20(6) for damages that the company's shareholders may suffer due to a company acting in a manner that is contrary to the Companies Act, as contemplated in section 20(6).[111] The court's overall interpretation of section 20(6) has received justified criticism and is not at all persuasive.[112] Unfortunately, the court failed to explain why the suggested objective of this provision could not be addressed by section 165.[113] The section's plain language clarifies that shareholders are granted a personal claim for damages under this provision.[114] The fundamental principles of the common law remain applicable. Section 20(6) is not, as illustrated by the court in *De Bruyn*, a special form of derivative action.[115] A literal interpretation of section 20(6), which provides shareholders with a right to claim damages they have incurred, is preferred, according to Cassim.[116] This point is not central to the discussions of this mini-dissertation and therefore is not explored in further detail.

3.3. Section 77(2) – Liability of directors and prescribed officers

Section 77 of the Act sets out the circumstances under which a director may be held liable for losses, damages, or costs sustained by the company. Of relevance is section 77(2), which provides as follows:

> "A director of a company may be held liable—

[107] See *De Bruyn v Steinhoff* (2020) *supra* n61 at para 235.
[108] See Van der Linde (2022) *Potchefstroom Electronic LJ supra* n97 at 15.
[109] *Ibid* at 16.
[110] See *De Bruyn v Steinhoff* (2020) *supra* n61 at para 237.
[111] *Ibid.*
[112] See Delport (2022) *supra* n29 at 105 and 593-594; Cassim (2021) *supra* n31 at 223 and 1129 and Van der Linde (2022) *Potchefstroom Electronic LJ supra* n97 at 13-16.
[113] Cassim (2021) *supra* n31 at 223; see also discussion at para 3.4 below.
[114] Cassim (2021) *supra* n31 at 1129.
[115] *Ibid.*
[116] *Ibid.*

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(*a*) in accordance with the principles of the common law relating to breach of a fiduciary duty, for any loss, damages or costs sustained by the company as a consequence of any breach by the director of a duty contemplated in section 75, 76(2) or 76(3)(*a*) or (*b*); or
(*b*) in accordance with the principles of the common law relating to delict for any loss, damages or costs sustained by the company as a consequence of any breach by the director of—
(i) a duty contemplated in section 76(3)(c);
(ii) any provision of this Act not otherwise mentioned in this section; or
(iii) any provision of the company's Memorandum of Incorporation."

A director is liable to the company for any breach of fiduciary duties that causes the company damages, loss, or costs in line with the common law standards.[117] This mini dissertation will, however, not discuss the full scope and content of directors' fiduciary duties. Section 77(2), as quoted above, is relevant and has been considered in the legal discourse surrounding reflective loss in the company law sphere. In this regard, the *Hlumisa* case is relevant as the Supreme Court of Appeal ("SCA") considered this section in deliberating the matter.[118] The SCA was clear in its assertion that the legislature had determined who should be entitled to compensation for losses incurred due to directors' actions violating particular provisions of the Companies Act and where accountability for such conduct should lay.[119] The SCA acknowledged that to promote a harmonious blending of the legislation and common law, there was a retention of certain common-law concepts by the legislature.[120] Section 77(2)(a) and (b) make specific reference to liability being determined under the "principles of the common law", with the specific principles being those relating to breach of a fiduciary duty and delict.[121] The high court stated expressly that section 77(2) is of no assistance to a shareholder in any pursuit to recover reflective loss as reflected in a diminution in share value from the directors of a company.[122] The SCA did not overrule this on appeal and, in fact, expressly agreed with the high court ruling that the legislature was clear on who was entitled to institute a claim against directors for breach of fiduciary duties.[123] This declaration by the SCA is binding on all courts until the SCA or a higher court overrules it. Therefore, section 77(2) offers

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[117] See section 77(2)(a) of the Companies Act; Delport (2022) *supra* n29 301 and *Hlumisa v Kirkinis* (2019) *supra* n4 at para 48.
[118] See *Hlumisa v Kirkinis* (2020) *supra* n4.
[119] *Ibid* at para 50.
[120] *Ibid.*
[121] See section 77(2)(a) and (b). See also summary in *Breetzke and Others NO v Alexander* [2020] 4 All SA 319 (SCA).
2020 (6) SA 360 (SCA) at para 36.
[122]See *Hlumisa Investment Holdings (RF) Ltd and Another v Kirkinis and Others* 2019 (4) SA 569 (GP) at para 41.
[123] See *Hlumisa v Kirkinis* (2020) *supra* n4 at para 50.

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no recourse to a shareholder who wishes to rely on it to recover a diminution in share value caused by the actions or omissions of the company's directors. Such right of recovery lies with the company as a proper plaintiff.[124]

3.4. Section 165 – Derivative actions

Section 165 of the Companies Act is a lengthy section comprising sixteen subsections and will not be quoted in full. The pertinent subsections of this section are instead discussed. Section 165 is a hybrid provision resulting from American and Australian law influence.[125] Section 165 contains a portion of the statutory provisions relating to derivative actions. Minority protection is an extensive topic comprising common law and statutory principles and provisions. This mini dissertation does not deal comprehensively with the topic of minority protection and only discusses section 165 in so far as it is relevant to reflective loss claims.

In terms of the common law, where another party perpetuates a wrong against a company, only the company may institute proceedings against the wrongdoers, known as the "proper plaintiff" rule.[126] The action is derivative if a shareholder may depend on an exception to pursue legal action on the company's behalf.[127] Derivative actions become relevant when the wrongdoers are in control of the company such that they can prevent any actions from being initiated against them.[128] Section 165 provides for a statutory derivative action. The derivative action permits a defined category of individuals (including representatives or employees) to bring an action in the name of and on behalf of the company against wrongdoers.[129] The relief is granted to the company.[130] In this regard, the applicant seeks not the protection of their rights but rather the company's rights.[131] The section also replaces the common law right to launch a derivative action and repeals the common law right of any person other than the company to pursue legal action on the company's behalf.[132] However, the common law shareholder's personal and statutory derivative actions co-exist.[133] Despite this, the distinction

[124] See *Foss v Harbottle supra* n20 and Delport (2022) *supra* n29 at 308.
[125] See Stoop "The derivative action provisions in the Companies Act 71 of 2008" 2012 *SALJ* 527 at 550.
[126] See Delport (2022) *supra* n29 at 589; *Foss v Harbottle supra* n20; *Prudential Assurance v Newman* (1982) *supra* n57; *Johnson v Gore Wood* (2002) *supra* n63; *Sevilleja Garcia v Marex Financial Ltd* [2018] ECWA Civ 1468 and *Burland v Earle* [1902] AC 83 (PC) at 93.
[127] Mongalo and Scott (2023) *supra* n38 at 319.
[128] See *Hlumisa v Kirkinis* (2020) *supra* n4 at para 32 and Delport (2022) *supra* n29 at 589.
[129] See *Mbethe v United Manganese of Kalahari (Pty) Ltd* 2017 (6) SA 409 (SCA) at para 6.
[130] *Ibid.*
[131] See Cassim "The statutory derivative action under the Companies Act of 2008: The role of good faith" 2013 *SALJ* 496 at 497.
[132] *Ibid*; see also *Mbethe v United Manganese* (2017) *supra* n129 at para 6; Mongalo and Scott (2023) *supra* n38 at 320; Cassim (2021) *supra* n31 at 14 and Delport (2022) *supra* n29 at 589.
[133] See Cassim (2021) *supra* n31 at 1131-1132 and *Communicare v Khan* (2013) *supra* n44 at para 20.

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between personal and derivative actions is still unclear.[134] The current statutory derivative action is wider than the common law derivative action and the now repealed section 266 of the previous Companies Act.[135] There is an opinion that the enactment of section 165 constitutes a "condemnation" of the rule in *Foss v Harbottle* and exceptions to the rule.[136]

Cassim submits that in the absence of conditions that warrant a court permitting the launch of a derivative action, the proper plaintiff rule will continue to apply in South African company law.[137] According to Cassim, this implies only a partial abolition of the rule and not a complete "condemnation".[138] In this regard, Cassim argues that the exceptions to the proper plaintiff rule no longer have application in South African company law due to the enactment of section 165(1).[139]

I respectfully disagree with Cassim in this regard. The new derivative action differs from the now-abolished common law and the old statutory derivative actions.[140] The effect of the enactment of section 165 of the Companies Act was to increase the circumstances in which the common law derivative action cannot be applied.[141] It addresses the shortcomings of the common law derivative action.[142] The *Foss v Harbottle* rule and its acknowledged exceptions still apply, but only in the specific circumstances described in section 165 will it not be applied, and a derivative action will be permitted.[143]

Section 165 outlines several requirements for an applicant to use the derivative action.[144] Section 165(5)(b) provides that the court will only grant the relief sought if:

> "the court is satisfied that—
> (i)the applicant is acting in good faith;
> (ii)the proposed or continuing proceedings involve the trial of a serious question of material consequence to the company; and

[134] See Cassim (2021) *supra* n31 at 1132.
[135] See Cassim (2013) *SALJ supra* n131 at 500; see also the Companies Act 61 of 1973.
[136] See *Foss v Harbottle supra* n20; see also para 2.3.3 of Ch 2 and Cassim (2013) *supra* n131 at 496.
[137] *Ibid* at 498.
[138] *Ibid.*
[139] *Ibid.*
[140] See sections 266 to 268 of the Companies Act 61 of 1973; see also Idensohn "The fate of Foss under the Companies Act 71 of 2008" 2012 *SA Merc LJ* 355 at 359.
[141] *Ibid.*
[142] See Stoop (2012) *SALJ supra* n125 at 550.
[143] *Ibid.*
[144] See sections 165(2) to (6) of the Companies Act.

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(iii)it is in the best interests of the company that the applicant be granted leave to commence the proposed proceedings or continue the proceedings, as the case may be."

A court, however, is not compelled to grant the relief sought if the applicant meets the requirements.[145] The necessity to prevent a multiplicity of actions by several shareholders provides a compelling justification for the court's decision not to provide such relief.[146]

Five requirements must be satisfied before a court considers granting a shareholder leave to invoke the section 165 derivative action.[147] Firstly, the shareholder who has knowledge of a wrong committed against the company and who wishes for the wrong to be rectified must serve a demand on the company to institute or to continue legal proceedings to protect the company's legal interests.[148] Secondly, the company must: (i) serve a notice in which it indicates its refusal to comply with the demand or (ii) have failed to take any step required by section 165(4) of the Companies Act, or (iii) appoint an investigator or committee who was not independent and impartial, or (iv) accept a report that was inadequately prepared or contained irrational or unreasonable conclusions/recommendations, or (v) act in a manner that was inconsistent with the reasonable report of an independent, impartial investigator or committee.[149] Thirdly, the court must be satisfied that the applicant is acting in good faith.[150] Fourthly, the court must be satisfied that the proceedings involve the trial of a serious question of material consequence to the company.[151] Lastly, the court must be satisfied that it is in the company's best interests that the applicant is granted leave to commence or continue the proposed proceedings.[152] Each of the above-mentioned requirements should be considered together and not in isolation.[153]

Under common law, in order to safeguard the company's administration against arbitrary or vexatious claims, or claims that are not in the best interests of the company, the court will not interfere based on the principle of majority rule (the non-intervention rule).[154] A shareholder who seeks to rely on a derivative action does not seek compensation for the infringement of their shareholder rights but rather compensation for an injustice done to the company.[155] In

[145] See *Mbethe v United Manganese* (2017) *supra* n129 at para 18.
[146] See Cassim (2013) *SALJ supra* n131 at 501.
[147] *Ibid.*
[148] *Ibid*; see also section 165(2) of the Companies Act
[149] *Ibid*; see also section 165(5)(a) of the Companies Act.
[150] See section 165(5)(b)(i) of the Companies Act.
[151] See section 165(5)(b)(ii) of the Companies Act
[152] See section 165(5)(b)(iii) of the Companies Act.
[153] See *Mbethe v United Manganese* (2017) *supra* n129 at para 19.
[154] *Ibid* at para 16 and Delport (2022) *supra* n29 591; Mongalo and Scott (2023) *supra* n38 at 315 and *Yende v Orlando Coal Distributors* (1961) *supra* n40 at 316.
[155] See *Mbethe v United Manganese* (2017) *supra* n129 at para 59.

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this regard, the company is ultimately the proper plaintiff as the company is a separate, distinct legal persona.[156] A shareholder should only be permitted to use a derivative action where the company's directors have refused to do so, despite their power to do so under section 66(1) of the Companies Act.[157] Therefore, on reading the five requirements as set out above, it is clear that they embody the requirement that the court only grants leave for a derivative action where the company has failed or refused to act in its own name.

It is quite evident that section 165 addresses wrongs committed against the company, not the shareholder.[158] The proper plaintiff rule remains supreme to any shareholder's right to institute a derivative action. On this basis, it is submitted that the derivative action in section 165 of the Companies Act is not a basis on which a shareholder can rely to recover any reflective loss.

3.5. Section 218(2) – Civil actions

Section 218 of the Companies Act addresses the legality of agreements, resolutions, and provisions of a company's memorandum of incorporation or rules. According to this section, an agreement, resolution, or provision cannot be rendered void by the Companies Act unless expressly declared void in the Companies Act.[159] However, if an agreement, resolution, or provision is against the law as set out in the Companies Act, a court can declare it void even if it is not explicitly prohibited in the Companies Act.[160] This section also holds a person accountable for any loss or damage caused due to contravention of the Companies Act without affecting the right to any other legal remedies available to the affected person. Section 218(2) provides that—

> "[a]ny 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."

A bare reading of section 218(2) of the Companies Act indicates that when a wrongdoer "contravenes" the Companies Act and causes loss to another person, the wrongdoer is liable to that person.[161] In *De Bruyn,* the court remarked that the generality of the language of section

[156] *Ibid* and *Foss v Harbottle supra* n20; see also section 66(1) of the Companies Act and Cassim (2013) *SALJ supra* n131 at 502.
[157] See Cassim (2013) *SALJ supra* n131 at 502.
[158] See Delport (2022) *supra* n29 at 596.
[159] See section 218(1) of the Companies Act.
[160] See Delport (2022) *supra* n29 at 639.
[161] See *De Bruyn v Steinhoff* (2020) *supra* n61 at para 188.

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218(2) does not answer two questions.[162] First, what obligation arises from the contravention of section 218(2) that gives rise to liability, and second, to whom is the obligation owed?[163]

The high court in *Hlumisa* thoroughly analysed section 218(2) in the context of reflective loss claims.[164] The high court analysed this provision in line with the overarching aim and purpose of the Companies Act, the common law and the Guidelines.[165] The high court ruled that the plaintiff would need to demonstrate how section 218(2) changed the common law to permit a claim for reflective loss to pursue a claim of infringement of section 76(3) under section 218(2).[166] This would have been a drastic departure from a core principle of company law if proven.[167]

The high court emphasised that a statutory provision should not significantly alter the common law, a well-established tenet of statutory interpretation.[168] However, this presumption is not without exception and is rebuttable.[169] Section 218(2) did not imply that the legislature intended to amend the common law to allow reflective loss claims, the high court ruled.[170] In the appeal from the ruling of the high court, the SCA made specific reference to the Guidelines in support of the retention of the common law principles, which, as mentioned in the preceding chapters, are primarily imported from English law.[171]

In further analysis, the high court affirmed that the provisions of section 77(2) must be taken into account when interpreting section 218(2), mainly when a plaintiff relies on a defendant's violation of section 76(3) to prove that the defendant is obligated to pay it damages under section 218(2).[172] The high court ruled that section 77(2), which establishes the liability for a breach of section 76(3), must be invoked for a claim, alleging that directors are responsible for damages as a result of a violation of section 76(3), to be admissible.[173] A claim for a breach of section 76(3) must be made "in accordance with the principles of the common law," as stated explicitly in section 77(2).[174] The consequence of the explicit reference to "in accordance with the principles of the common law" is that the law does not permit a claim for

[162] *Ibid.*
[163] *Ibid.*
[164] See *Hlumisa v Kirkinis* (2019) *supra* n122.
[165] *Ibid* at paras 41-44.
[166] *Ibid* at para 31.
[167] *Ibid.*
[168] *Ibid* at para 32 and *Casserley v Stubbs* 1916 TPD 310 at 312.
[169] See *Hlumisa v Kirkinis* (2019) *supra* n122 at para 35.
[170] *Ibid* at para 39 and *Hlumisa v Kirkinis* (2020) *supra* n4 at para 43.
[171] See *Hlumisa v Kirkinis* (2020) *supra* n4 at para 43; see also para 1.3 of Ch 1 and paras 2.2 and 2.3 of Chapter 2.
[172] See *Hlumisa v Kirkinis* (2019) *supra* n122 at para 40.
[173] *Ibid* at para 29.
[174] *Ibid.*

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reflective loss claim in terms of section 77(2).[175] Since the common law, which is incorporated by reference in section 77(2)(a), does not recognise this obligation, section 218(2) cannot be interpreted to make directors accountable to shareholders for breach of their responsibilities under section 76(3).[176] As discussed above,[177] section 77(2) does not provide a shareholder with any basis to claim compensation for a reduction in the value of their shares caused by the company directors' actions or omissions.[178] The right to recover such compensation lies with the company as the proper plaintiff.[179]

The court in *De Bruyn v Steinhoff International Holdings NV*[180] differed in opinion with the *Hlumisa* case and found that section 218(2) creates a statutory scheme of liability without displacement of the common law.[181] The court specifically referred to the *Hlumisa* case regarding claims made under section 218(2).[182] The companies involved in both cases differed in their possible ability to restore value to their shareholders.[183] In *Hlumisa,* there was potential to enhance shareholder value by recovering losses from the directors and auditors.[184] In contrast, in *De Bruyn,* the companies could not rectify the issue of overvaluation by advocating for the reinstatement of the overstated value or the difference between their actual financial position and the grossly exaggerated and misrepresented position.[185] *De Bruyn* and *Hlumisa* recognised the importance of the common law principles of *Prudential* and *Johnson* in assessing claims for reflective loss under section 218(2).[186]

In *De Bruyn*, the court determined that section 218(2) should not be interpreted as meaning that a person could be punished for any wrongdoing related to a company.[187] The court was of the opinion that this would make the provision too broad and unnecessary.[188] Criticism of the court's analysis of section 218(2) correctly states that the section should only be used if no other provision provides a right of action for specific wrongdoing under the Companies Act.[189]

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[175] See *De Bruyn v Steinhoff* (2020) *supra* n61 at para 189.
[176] *Ibid.*
[177] See Chapter 3, paragraph 3.3.
[178] See *Foss v Harbottle supra* n20*;* and Delport (2022) *supra* n29 at 308.
[179] *Ibid.*
[180] See *supra* n61.
[181] *Ibid* at para 193 and *Hlumisa v Kirkinis* (2019) *supra* n4 at para 52.
[182] See *De Bruyn v Steinhoff* (2020) *supra* n61 at paras 185-186, 192-193 and 210.
[183] See Van der Linde (2022) *Potchefstroom Electronic LJ supra* n97 at 18.
[184] *Ibid.*
[185] *Ibid.*
[186] See *De Bruyn v Steinhoff* (2020) *supra* n61 at para 186; *Hlumisa v Kirkinis* (2020) *supra* n4 at paras 26 and 42.
[187] See *De Bruyn v Steinhoff* (2020) *supra* n61 at para 214.
[188] *Ibid* at para 189.
[189] See Van der Linde (2022) *Potchefstroom Electronic LJ supra* n97 at 11.

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According to Van der Linde, the court failed to demonstrate the necessity of section 218(2) in relation to other statutory damages claims in the Companies Act.[190] Van der Linde correctly pointed out that section 218(2) imposes liability rather than a right of action.[191] This is clear from a plain language reading of the section. Further, the court appears to have ignored section 218(3) when it analysed the decision in *Steenkamp v Provincial Tender Board, Eastern Cape*, which states that statutory and common-law liability are ordinarily mutually exclusive.[192] The court ultimately decided to disagree with the high court findings of *Hlumisa*.[193] It ruled that the statutory claim based on section 218(2) could not be upheld since the contraventions cited did not give shareholders a cause of action against the defendant companies or directors.[194] The court clearly ruled that the financial statement contraventions to be relied on by class members to establish statutory claims had no validity under the Companies Act.[195] The court emphasised that the civil liability recognised for such violations is stated in section 77(3)(d) (i) and this type of liability is imposed on directors at the behest of the company that has incurred damage not the shareholders as was the case in *De Bruyn*.[196]Van der Linde's criticism regarding the analysis of section 218(2) in *De Bruyn* cannot be faulted.

The court a quo ruling of *Hlumisa*[197] emphasised that just because the company's share price has decreased does not mean that the shareholder has suffered a loss due to a breach of obligations due to the company.[198] South African courts have ruled that there is an inadequate causal connection between injury to a company resulting from a breach of a duty owed to it and any loss to its shareholders due to a decline in the company's share price.[199] According to the high court in *Hlumisa,* there was no reason to believe that the legislature meant to deviate from the approach mentioned above when it passed section 218(2).[200]

On appeal to the SCA, the court a quo ruling of *Hlumisa* concerning section 218(2) was not overruled by the SCA.[201] The SCA specifically stated as follows:

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190 *Ibid*
191 *Ibid.*
192 *Steenkamp v Provincial Tender Board, Eastern Cape* 2006 3 SA 151 (SCA) at paras 21 to 22 and Van der Linde (2022) *Potchefstroom Electronic LJ supra* n97 at 13.
193 See *De Bruyn v Steinhoff* (2020) *supra* n61 at paras 185 and 193.
194 *Ibid* at para 219.
195 *Ibid* at para 218.
196 *Ibid.*
197 See *Hlumisa v Kirkinis* (2019) *supra* n122.
198 *Ibid* at para 50 and *De Bruyn v Steinhoff* (2020) *supra* n61 at para 189.
199 See *Hlumisa v Kirkinis* (2019) *supra* n122 at para 50.
200 *Ibid.*
201 See *Hlumisa v Kirkinis* (2020) *supra* n4 at para 54.

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"From what is set out above it is clear that the rule against claims for reflective loss has not expressly been abolished by section 218(2), nor does it follow by The court emphasised that the civil liability recognised for such violations is stated in section 77(3)(d) (i) and this type of liability is imposed on directors at the behest of the company that has incurred damage by necessary implication. Section 218(3) does not assist the appellants. It reads as follows:

"The provisions of this section do not affect the right to any remedy that a person may otherwise have." "

Leave to appeal to the constitutional court was denied, which indicates the end of the inquiry.[202] Therefore, in South African law, it is not permissible to base a claim for reflective loss on section 218(2) of the Companies Act.[203] If shareholders' claims based on a diminution in the value of their shares were allowed by courts, it would impinge on the company's right to claim damages from its directors for any losses sustained due to a breach by those directors of a duty owed to the company.[204] This is preserved by section 218(3) of the Companies Act.[205] *Hlumisa* and *De Bruyn* show that section 218(2) must be construed in accordance with common law precedent, including liability limitations and the reflective loss principle.[206]

With this in mind, while it may seem ideal to recommend an amendment to the wording of section 218(2), the sections of the Companies Act are not meant to be read in isolation.[207] Section 218(3) is a clear qualifier to section 218(2) as was stated in the *Hlumisa* case.[208] It is submitted that our case law (as endorsed by the highest court of appeal), legislative provisions and common law are robust enough to ensure that section 218(2) is read correctly to ensure that reflective loss claims cannot be unduly invoked under section 218(2).[209] To interpret section 218(2) to permit claims for reflective loss whereas the common law specifically prohibits it would fly in the face of the golden rule of statutory interpretation.[210]

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[202] See Cassim (2021) *supra* n31 at 696 and 799.
[203] *Ibid* at para 41; see also Mongalo and Scott (2023) *supra* n38 at 341 and Cassim (2021) *supra* n31 at 1131.
[204] *Hlumisa v Kirkinis* (2019) *supra* n122 at para 41.
[205] *Ibid.*
[206] See Cassim (2021) *supra* n31 at 373 and 869-871.
[207] *S v Zuma* 1995 (2) SA 642 (CC) at para 15.
[208] See *Hlumisa v Kirkinis* (2019) *supra* n122 at para 50.
[209] *Ibid*; see also section 218(3).
[210] See *Zuma* (1995) *supra* n207.

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3.6. Conclusion

As is evident from the analysis above, no section of the Companies Act affords a shareholder the ability to claim reflective loss from the directors of a company. The underlying rationale for this prohibition is the principle that a company has a separate legal personality. This discussion shows that the common law rule against reflective loss has not been abolished in South African law. This signifies that neither the legislature nor the judiciary in South Africa is ready to recognise or endorse any form of the abolishment or significant development of the principle against reflective loss. What remains to be assessed is whether a comparable jurisdiction has further developed the principle around the rule against reflective loss.

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Chapter 4: Comparative Analysis of South African Law and English Law

4.1. Introduction

The principle of reflective loss has been a subject of much legal debate and development in English law over the years. The principle generally prohibits a shareholder from bringing an action in their own right for a loss suffered by the company, as this loss is said to be reflective of the loss suffered by the shareholder as a result of the diminution of the value of their shares. This principle has been considered and clarified by various English law cases. Chapter 4 examines the importance of the cases below concerning the principle of reflective loss. The provisions of section 260 of the English Companies Act 2006 (c46) which addresses the derivative action in English law, are also discussed and compared to the South African derivative action.

4.2. The foundation of the reflective loss principle - *Prudential Assurance Co. Ltd v Newman Industries Ltd*[211]

This case comprises the core foundational principles of the reflective loss principle and therefore is the genesis of any discussion relating to the principle. The ruling of the high court, in this case, was taken on appeal by the second and third defendants, and it is from the ruling of the court of appeal from which the foundational principles in respect of the principle against reflective loss are derived.

The key finding of the court of appeal was that a shareholder cannot seek damages simply because the company in which the shareholder owns shares has suffered damage.[212] Under the articles of company, shares are a right to participate in the company, so the shareholder cannot recoup the loss in market value or dividends if the loss is only a reflection of the company's loss.[213] A shareholder's ownership is unencumbered personal property, thus, a fraud against the company does not cause a loss to the shareholder.[214] A personal action would overturn the rule in *Foss v Harbottle*.[215] Contract breaches and wrongful acts that affect the company give the company grounds for action under separate legal personality.[216] Therefore, shareholders understand that their investments will fluctuate with the company.

[211] See *Prudential Assurance v Newman* (1982) *supra* n57.
[212] *Ibid* at 222H.
[213] *Ibid* at 222H-223A.
[214] *Ibid* at 223D.
[215] 1843 2 Hare 461.
[216] See *Prudential Assurance v Newman* (1982) *supra* n57 at 224B; see also discussion at para 2.2 of Ch 2.

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4.2.1 The relevance and importance of the key findings

This case has been the benchmark for the rule against reflective loss and is part of South African common law.[217] However, the case has, rightfully, not been spared criticism. The claim that the shareholder "does not suffer any personal loss" is justifiably criticised.[218] Shares have worth beyond a right to participate in a company.[219] Shares carry income-generating value in that they can be sold by the owner.[220] Therefore, when share value or dividends decrease, shareholders lose.[221] This aspect of the *Prudential* case has been correctly departed from in subsequent decisions.[222]

This case is South Africa's authority on the reflective loss principle.[223] Since reflective loss is ingrained in South Africa's common law, it will likely remain the authority for its origin. There is no scope nor justification for any consideration of eradicating this case as the foundation of the principles against reflective loss.[224] However, South African courts should consider this case's criticism when citing it. *Sevilleja* is also of importance in respect of the recognition of the original tenets of the *Prudential* case in English law.[225]

4.3. Reflective loss policy considerations - *Johnson v Gore Wood & Co*[226]

The court noted several authorities on reflective loss claims in this case. Lord Millet stressed that if the shareholder and company have experienced a loss due to the same wrongdoing, the shareholder is legally entitled to sue and obtain compensation for the loss measured by the diminution in their shares' value.[227] However, the shareholder has no right of action

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[217] See Mitchell "Shareholders' claims for reflective loss" 2004 *Law Quarterly Review* 457; *R.P. Howard Ltd v Woodman Matthews & Co* [1983] B.C.L.C. 117; *Heron International Ltd v Grade* [1983] B.C.L.C. 244, CA; *Gould v Vaggelas* (1985) 157 C.L.R. 215; *George Fischer (Great Britain) Ltd v Multi Construction Ltd* [1995] 1 B.C.L.C. 260, CA; *Christensen v Scott* [1996] 1 N.Z.L.R. 273, NZCA; *Barings Plc v Coopers & Lybrand* [1997] 1 B.C.L.C. 427; *Gerber Garment Technology Inc v Lectra Systems Ltd* [1997] R.P.C. 443, CA; *Stein v Blake* [1998] 1 All E.R. 724, CA; *Brunninghausen v Glavanics* (1999) 46 N.S.W.L.R. 538, NSWCA; *Walker v Stones* [2001] Q.B. 902, CA; Charman and Du Toit (2017) *supra* n2 at 189; McLennan (2005) *SA Merc LJ supra* n46 at 196 and *Golf Estates (Pty) Ltd v Malherbe* 1997 (1) SA 873 (C) at 878.

[218] See *Prudential Assurance v Newman* (1982) *supra* n57 at 222-224; Koh "Reconstructing the reflective loss principle" 2016 *Journal of Corporate Law Studies* 373 at 375; Sterling "The theory and policy of shareholder actions in tort" 1987 *Modern LR* 468 at 470-472 and Mitchell (2004) *supra* n217 at 459.

[219] Mitchell (2004) *Law Quarterly Review supra* n217 at 459.

[220] *Ibid;* and *Christensen v Scott* (1996) *supra* n217 at 280.

[221] *Ibid.*

[222] See *Johnson v Gore Wood* (2002) *supra* n63 at 61-62 and *Gerber v Lectra* (1997) *supra* n217 at 475.

[223] See *Itzikowitz v Absa Bank Ltd* (2016) *supra* n16 at paras 10-12; *Hlumisa v Kirkinis* (2019) *supra* n4 at paras 26, 34, 35 and 42; *De Bruyn v Steinhoff* (2020) *supra* n61 at para 186; *Kalinko v Nisbet* 2002 (5) SA 766 (W) at 778E and *Offbeat Holiday Club v Sanbonani Holiday Spa Shareblock Ltd* 2016 (6) SA 181 (SCA) at paras 47-48.

[224] See discussion at para 2.3.2 of Ch 1.

[225] See *Sevilleja v Marex* (2020) *supra* n74 and the discussion at para 4.5 below.

[226] See *Johnson v Gore Wood* (2002) *supra* n63.

[227] *Ibid* at 61G-67F.

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regarding the loss.[228] The shareholder must establish a separate cause of action and that a personal loss resulted from the defendant's actionable wrong.[229] In this instance, recovery of damages by the shareholder does not deplete the company's assets.[230]

Conversely, when a company experiences a loss due to a breach of a duty due to both the company and the shareholder, the shareholders' loss (diminution in share value and dividends) reflects the company's loss.[231] The company has its own cause of action.[232] Allowing the shareholder to recover in respect of such loss will result in either a double recovery of damages at the defendant's expense or a double recovery of damages at the expense of the company, its creditors and other shareholders.[233] Justice for the wrongdoer necessitates the exclusion of one claim, and protection for the company's creditors requires the company's ability to recover damages to the exclusion of the shareholder.[234]

The test is not whether the company could have claimed in respect of the loss in question.[235] The question is whether treating the company and the shareholder as one will cause the shareholder's loss to be justified by the company's loss.[236] Lord Millet conceded rightfully that a diminution in the value of a shareholder's shares is indeed a personal loss to a shareholder.[237] However, that is not the crux of the determination as to whether the shareholder may institute a recovery action.[238] The shareholder's claim for reflective loss is denied due to policy considerations restricting the shareholder from going behind the company's claim settlement.[239] Reflective loss encompasses the diminution in share value, the loss of dividends and any additional payments from the company that the shareholder would have received if the company had not been divested of its funds.[240] The "no reflective loss" principle may apply to any payments that the shareholder would (in any capacity and on any legal basis) have received if the duty had not been breached.[241] The reflective loss principle is based on two pillars, namely (1) to whom the breached duty was owed and (2) the avoidance of double recovery of the same loss.[242]

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[228] *Ibid* at 62C-62D.
[229] *Ibid.*
[230] *Ibid.*
[231] *Ibid* at 62E
[232] *Ibid.*
[233] *Ibid.*
[234] *Ibid.*
[235] *Ibid* at 66C.
[236] *Ibid.*
[237] *Ibid.*
[238] *Ibid.*
[239] *Ibid* at 66F and *Prudential Assurance v Newman* (1982) *supra* n57 at 224D.
[240] *Ibid at 66G and Prudential Assurance v Newman* (1982) *supra n57 at 223A*.
[241] See *Johnson v Gore Wood* (2002) *supra* n63 at 66H-67C and Charman and Du Toit (2017) *supra* n2 at 192.
[242] See *Johnson v Gore Wood* (2002) *supra* n63 at 67C-67F and Charman and Du Toit (2017) *supra* n2 at 192.

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The court's exclusion of other rightful claims in favour of the company's claim has been criticised, with good reason.[243] First, the rationale misses the potential of a double recovery when a defendant has undertaken to perform specified obligations for both a company and shareholder and all parties had expected double liability in the event of a breach.[244] Second, dual recovery is not possible if the company chooses not to sue the offender, settles the dispute for less than its full value, or cannot recover the amount owed due to a valid defence.[245] Third, protecting the company's creditors and shareholders suggests that a policy forbidding the recovery of reflective losses may be redundant in a financially secure one-person company where neither party is at risk.[246] Fourth, the court's stance regarding cases where a company and a shareholder possess grounds for litigation against a wrongdoer is inflexible.[247] The claim that the shareholder's loss is always substantiated by that of the company and, therefore, reflective loss should be prohibited on principle without any discretion may be considered insufficient.[248]

Although not mentioned in the remarks of the Lordships adjudicating in the *Johnson* case, the court identified one circumstance in which a shareholder may recover reflective loss (in the instance of a defendant who has never owed a duty to the company that suffered the loss).[249] The justifications they provided for rejecting recovery in other circumstances do not apply in every instance.[250] It is alleged by a critic that, as a result, claimants have felt empowered to argue for recognition of further exceptions to the bar against double recovery.[251] This is evident from the cases referenced.[252]

When this case was adjudicated, the inflexible tenets of capital maintenance were prominent as a mechanism for safeguarding the interests of creditors.[253] The capital maintenance focus has changed not only in English law but in South Africa as well.[254] According to the Companies

[243] Mitchell (2004) supra n217 at 464.
[244] *Ibid* at 464 and *Henderson v Merrett Syndicates Ltd* [1995] 2 A.C. 145 at 195.
[245] *Ibid.*
[246] *Ibid.*
[247] *Ibid.*
[248] See *Johnson v Gore Wood* (2002) *supra* n63at 66C and 66F and Mitchell (2004) *Law Quarterly Review supra* n217at 464.
[249] See Mitchell (2004) *Law Quarterly Review supra* n217 at 458 to 459.
[250] *Ibid.*
[251] *Ibid*; see also *John v Price Waterhouse* [2001] EWHC 438 (Ch); *Barings Plc v Coopers & Lybrand* [2002] 2 B.C.L.C. 364; *Chantrey Vellacott v Convergence Group Plc* [2002] EWHC 3048 (Ch); *Gardner v Parker* (2004) *supra* n72*; Day v Cook* [2001] EWCA Civ 592; [2002] 1 B.C.L.C. 1; *Ellis v Property Leeds (U.K.) Ltd* [2002] EWCA Civ 32; [2002] 2 B.C.L.C. 175*, Giles v Rhind* (2003) *supra* n71; *Shaker v Al- Badrawi* [2002] EWCA Civ 1452; [2003] Ch. 351*;* and *Johnson v Gore Wood* (2002) *supra* n63.
[252] See *supra* n251.
[253] See Koh (2016) *Journal of Corporate Law Studies supra* n218 at 383.
[254] *Ibid*; see also Delport (2022) *supra* n29 at 184(8) and Cassim (2021) *supra* n31 at 14.

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Act of 2006, private companies in English law do not need to rely on legal capital, as their solvency status is the determining factor.[255] Similar changes have occurred in South African legislation.[256] Under this new regime, solvency and liquidity are the main concerns in respect of any distributions by a company.[257] The solvency and liquidity test ensures that creditors will not be harmed if the company uses its capital for reasons outside its normal operations.[258] This mini dissertation will not cover the transition from capital maintenance to solvency and liquidity.

A blanket reflective loss rule fails to account for the company's solvency and is difficult to understand or rationalise.[259] Unlike shareholders' claims, the company's pursuit of restitution against wrongdoers affects the pool of assets and creditors' interests.[260] The interests of a financially sound and solvent company's creditors are not in danger.[261] A regulation that prioritises creditors above shareholders may be enough to safeguard creditors. When both parties seek restitution from the same perpetrator, a court can favour the company's claims over the shareholders.[262] Since South Africa has relaxed capital maintenance laws, the above observation suggests that courts should follow this approach.

4.4. Exceptions - *Giles v Rhind*[263]

This case is significant regarding the reflective loss principle. It addresses whether shareholders can recover losses suffered by the company due to the directors' actions or inaction.

The court of first instance found that the defendant had breached certain obligations to the plaintiff.[264] When assessing the damages, the question arose whether Giles could recover any of the claimed damage categories since they represented a personal loss for him rather than a loss reflective of the company's loss in light of the judgment in *Johnson*.[265]

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[255] See sections 464-465 of the Companies Act 2006 (c46); and Koh (2016) *Journal of Corporate Law Studies supra* n218 at 383.
[256] See Hanks "The new legal capital regime in South Africa" 2010 *Acta Juridica* 131 at 141-147 and Bradstreet "Regulating legal capital reduction: A comparison of creditor protection in South Africa and the state of Delaware" 2012 *SALJ* 736.
[257] See section 4 of Companies Act.
[258] See Delport (2022) *supra* n29 at 33 and *Capitex Bank Ltd v Qorus Holdings Ltd* 2003 (3) SA 302 (WLD).
[259] See Koh (2016) *Journal of Corporate Law Studies supra* n218 at 384.
[260] *Ibid.*
[261] *Ibid*; see also Koh "The shareholder's personal claim: Allowing recovery for reflective losses" 2011 *Singapore Academy of Law Journal* 863 at 872 and Mitchell *supra* n217 at 464-465.
[262] See Koh (2016) *Journal of Corporate Law Studies supra* n218 at 385.
[263] See *Giles v Rhind* (2003) *supra* n71.
[264] *Ibid* at para 15
[265] *Ibid* at paras 16 and 19; see also *supra* n63.

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The court discussed the principles established in the *Johnson* case concerning the assessment of damages and the recoverability of personal losses suffered by shareholders. The court noted that *in casu* the plaintiff had not suffered a separate and distinct loss due to the defendant's wrongful conduct. Therefore, the plaintiff could not receive any damages he claimed, such as the value of his company shares and his expected remuneration.[266] The court noted that applying the principle in *Johnson*[267] did not prevent the assessment of damages from proceeding.[268] It was decided that the defendant could make a claim for reflective loss even where a portion of the claim is reflective of the company's loss if the company has no cause of action to recover the loss for the wrongdoer.[269] This is known as the *Giles* exception.

The *Giles* decision has been criticised as being incorrect.[270] However, with the ruling in *Sevilleja,* there is no longer any *Giles* exception in English law.[271] Critics predicted that the *Johnson* case would lead to further arguments in favour of further exceptions.[272] The court of appeal curtailed the *Giles* exception in *Gardner v Parker*, which clarified that it only applied in cases where the shareholder could prove that the company's inability to pursue its cause of action against the wrongdoer was due to the wrong committed against it.[273]

In South Africa, the SCA has recognised but not applied the *Giles* exception in the latest decisions on reflective loss, which proves that the exception is narrower in South Africa compared to the former English position.[274] The SCA in *Itzikowitz* did not refer to *Giles* in its decision. The *Sevilleja* case, discussed below, is the end in respect of the continued recognition of the *Giles* exception in English law.[275]

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[266] *Ibid* at para 81.
[267] See *supra* n63.
[268] *Giles v Rhind* (2003) *supra* n71 at para 30.
[269] *Ibid* at para 35.
[270] See *Sevilleja v Marex* (2020) *supra* n74 at paras 70 and 92; *Waddington v Chan Chun Hoo* (2008) HKCFA 370 at paras 85 and 86; Charman and Du Toit (2017) *supra* n2 at 198; de Jong (2013) *supra* n43 at 105; and Sin "The no reflective loss principle in *Marex v Sevilleja*: One step forward, one step back" 2021 *Journal of Business Law, Forthcoming, available at SSRN: https://ssrn.com/abstract=3723114 or http://dx.doi.org/10.2139/ssrn.3723114* [accessed on 22 January 2023].
[271] See discussion at para 4.5 below.
[272] See n270 *supra*.
[273] See paragraph 4.3 above; *Gardner v Parker* (2004) *supra* n72 at para 47; see also discussion at para 4.5 below in which the supreme court held that this case was wrongly decided.
[274] See *Hlumisa v Kirkinis* (2019) *supra* n4 at paras 33 to 34; see also Koh (2016) *Journal of Corporate Law Studies supra* n218 at 378.
[275] See para 4.5; see also *Sevilleja v Marex* (2020) *supra* n126.

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4.5. The reset - *Sevilleja Garcia v Marex Financial Limited*[276]

The primary question was whether the limitation on reflective loss applied to claims by unsecured creditors where the loss claimed is the same loss experienced by the company as a result of the defendant's activities.[277] The court sought to set out the correct ambit of the rule against reflective loss, a desire for which the court in *Johnson* had earlier expressed.[278] It was acknowledged that the scope and reasoning of the reflective loss rule had progressed beyond the "proper plaintiff" rule in *Foss v Harbottle*.[279] It was determined that creditors of a company, whether or not shareholders, must avoid causing prejudice to other creditors.[280] The reflective loss rule should apply to all company creditors because the factors that support the principle also apply to all creditors.[281]

Following the aforementioned determination, the ambit of the *Giles* exception was considered in the court a quo case in 2018.[282] The court a quo in the 2018 case held that the exception only applies in limited circumstances.[283] The reflective loss principle only applies when the defendant's actions have rendered the company unable or impeded its ability to bring a claim against the defendant.[284] The inability must be legal, and a mere factual inability to do so is insufficient.[285] The exception does not apply if a third-party shareholder or creditor provides financial resources to a company that allows it to pursue legal action against an alleged offender.[286] The exception does not apply if a third party can take up the company's legal claim.[287]

The court of appeal permitted Marex to appeal to the supreme court.[288] The appeal[289] consisted of a re-examination of the reflective loss principle.[290] The supreme court ruled categorically that the decisions in *Giles v Rhind*, *Perry v Day*, and *Gardner v Parker* were incorrect.[291] This wholesale rejection is unfortunate and does not consider a founding basis of

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[276] *Ibid.*
[277] *Ibid* at para 12.
[278] *Ibid* at para 13 and *Johnson v Gore Wood* (2002) supra n63 at para 162.
[279] See *Foss v Harbottle supra* n20 and *Sevilleja v Marex* (2018) *supra* n126 at para 14.
[280] *Ibid* at para 37.
[281] *Ibid.*
[282] See *Sevilleja v Marex* (2018) *supra* n126 at para 39-61.
[283] *Ibid* at para 53 and 56; and *St Vincent European General Partner Ltd v Robinson* [2018] EWHC 1442 (Comm) at para 94.
[284] See *Sevilleja v Marex* (2018) *supra* n126 at para 54 and 56 and *Gardner v Parker* (2004) *supra* n72 at para 47.
[285] See *Sevilleja v Marex* (2018) *supra* n126 at para 57.
[286] *Ibid.*
[287] *Ibid.*
[288] See *Sevilleja v Marex* (2018) *supra* n126 at para 71.
[289] See *Sevilleja v Marex* (2020) *supra* n74.
[290] See Sin (2021) *Journal of Business Law supra* n270 at 286.
[291] See *Perry v Day* [2004] EWHC 3372 (Ch); [2005] 2 B.C.L.C. 405; *Gardner v Parker* (2004) *supra* n72; *Giles v Rhind* (2003) *supra* n71 and *Sevilleja v Marex* (2020) *supra* n74 at para 89.

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the principle against reflective loss, being the avoidance of double recovery.[292] The minority opinion adopted a more extreme stance, refusing to acknowledge the existence of any principle against claims for reflective loss.[293]

Ultimately, this supreme court ruling allows English law to disregard the reflective loss concept altogether, save for shareholder's claims.[294] There is, however, further scope for discussion on this matter within English law.[295] As is evident from the above on the South African case law,[296] our courts have consistently referred to the founding cases being *Foss v Harbottle* and *Prudential*.[297] Therefore, it is likely that the majority judgment of *Sevilleja* will find favour within South African company law [298]

De Bruyn[299] was delivered eleven days after the decision in *Sevilleja.*[300] As a result, there was no opportunity to review the supreme court's conclusions. However, South African courts will certainly consider this judgment in future adjudications of claims for reflective loss – since it restored the reflective loss concept to its roots.[301]

4.6. Companies Act 2006 (c 46)

The South African case law analysis has revealed a disjointed approach regarding the legislative provisions relied on in reflective loss claims.[302] However, the consideration and application of derivative actions is similar between English and South African law. This is because English law focuses on preventing double recovery in reflective loss claims and preventing the defendant from exposure to a multiplicity of actions based on the same act.[303] Therefore, the derivative action provisions in terms of the Companies Act 2006 (c46) are considered below.

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[292] See Laing "Reflective loss in the UK Supreme Court" (2020) *Cambridge LJ* 411 at 413.
[293] *Ibid* at para 198.
[294] See Tettenborn, "Less Law is Good Law? The Taming of Reflective Loss" (2021) *Law Quarterly Review* 16 at 18.
[295] See Sin (2021) *Journal of Business Law supra* n270 at 297; and *Sevilleja v Marex* (2020) *supra* n74 at para 212.
[296] See paras 2.2 and 2.3.2 of Ch 2; see also paras 3.2-3.5 of Ch 3.
[297] See *Itzikowitz v Absa Bank Ltd* (2016) *supra* n16 at para 10-12; *De Bruyn v Steinhoff* (2020) *supra* n61 at para 186 and *Hlumisa v Kirkinis* (2020) *supra* n4 at paras 24-33 and 37.
[298] [2020] UKSC 31; [2020] B.C.C. 783.
[299] [2020] JOL 47482 (GJ).
[300] [2020] UKSC 31; [2020] B.C.C. 783.
[301] See discussion at para 4.2 *supra*.
[302] See paras 3.2, 3.3 and 3.5 of Ch 3.
[303] See Koh (2011) *Singapore Academy of Law Journal supra* n261 at paras 13 and 14.

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4.6.1 Common law derivative action

English law recognises separate legal persons. A company is legally distinct from its shareholders or members. This doctrine, introduced in *Salomon v Salomon & Co Ltd,*[304] has substantial ramifications for the rights of shareholders to recover reflective losses. Once a company has been constituted and registered in full compliance with relevant company law, it has a separate legal personality.[305]

There are exceptions to this principle. In *Foss v Harbottle,*[306] the court ruled that shareholders might file a derivative action on behalf of the corporation to recover damages caused by the company's wrongful conduct.[307] This rule recognised the company's fundamental power, through its organs, to make litigation decisions about a breach of a duty owed to the company.[308] This recognition of a derivative action at common law permitted circumvention of this right only in minimal circumstances.[309]

4.6.2 Statutory derivative action

Section 260 of the United Kingdom Companies Act is a critical provision that governs statutory derivative actions.[310] In England, Wales, Northern Ireland, and Scotland, shareholders can file

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[304] [1897] AC 22.
[305] *Ibid* at 30; Charman and Du Toit (2017) *supra* n2 at 12; see also discussion at para 2.2 of Ch 2; sections 16(2) and (3) of Companies Act 2006 and *Salomon v Salomon* (1897) *supra* n19 at 55.
[306] See *supra* n20.
[307] *Ibid* at 491.
[308] See Kershaw "The Rule in Foss v Harbottle is Dead; Long Live the Rule in Foss v Harbottle" (January 30, 2013). LSE Legal Studies Working Paper No. 5/2013, Available at SSRN: https://ssrn.com/abstract=2209061 or http://dx.doi.org/10.2139/ssrn.2209061 [Accessed 07 February 2023].
[309] *Ibid.*
[310] See Companies Act 2006 (c46); section 260 provides that "(1) This Chapter applies to proceedings in England and Wales or Northern Ireland by a member of a company–
(a) in respect of a cause of action vested in the company, and
(b) seeking relief on behalf of the company.
This is referred to in this Chapter as a "derivative claim" .
(2) A derivative claim may only be brought–
(a) under this Chapter, or
(b) in pursuance of an order of the court in proceedings under section 994 (proceedings for protection of members against unfair prejudice).
(3) A derivative claim under this Chapter may be brought only in respect of a cause of action arising from an actual or proposed act or omission involving negligence, default, breach of duty or breach of trust by a director of the company. The cause of action may be against the director or another person (or both).
(4) It is immaterial whether the cause of action arose before or after the person seeking to bring or continue the derivative claim became a member of the company.
(5) For the purposes of this Chapter–
(a) "director" includes a former director;
(b) a shadow director is treated as a director; and
(c)references to a member of a company include a person who is not a member but to whom shares in the company have been transferred or transmitted by operation of law."

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derivative proceedings on behalf of a company if a director breaches a duty. Derivative actions benefit the company, not shareholders.[311]

Reflective loss in derivative proceedings is not directly addressed under the Companies Act 2006. However, *Prudential* and *Johnson's* criteria have been used in subsequent cases. For example, in *Gardner v Parker*,[312] the court held that the rule applied where the shareholder's loss was a "mirror image" of the loss suffered by the company.

The United Kingdom Companies Act and the South African Companies Act[313] provide shareholder derivative proceedings, and the rules regarding reflective loss have evolved similarly.[314] However, they are not the same.[315] As evidenced by the discussions above, both jurisdictions have applied the *Prudential* case rule to preclude shareholders from pursuing claims for reflective loss.[316] However, both jurisdictions have acknowledged that the rule does not apply where the shareholder's loss is distinct and separate from the company's loss.[317] Reflective loss in derivative actions is not directly addressed under the UK Companies Act 2006 (c46). As mentioned above, the question of whether the English law of derivative actions has been adopted into South African law has not been expressly answered.[318] No clear rules are in the Companies Act either. However, courts have applied the principle to shareholder derivative actions in both jurisdictions.[319] The common law can adequately handle reflective loss claims, thus, the Companies Act need not be revised.

4.7. Conclusion

The notion of reflective loss in English law prohibits shareholders from recovering losses that reflect company losses. As mentioned previously, the *Prudential* case established this

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[311]See Hardman "Sevilleja v Marex Financial Ltd: Reflective Loss and the Autonomy of Company Law" 2022 85 *Modern LR* 232 at 234.
[312] See *Gardner v Parker* (2004) *supra* n72.
[313] See section 260 of Companies Act 2006 (c46); section 165 of the Companies Act 71 of 2008; and para 3.4 of Ch 3 for a full discussion of the South African derivative action in the context of reflective loss claims.
[314] See *Hlumisa v Kirkinis* (2020) *supra* n4 at para 37; and *Gihwala v Grancy* (2016) *supra* n13 at para 107-112.
[315] See Cassim "Judicial discretion in derivative actions under the Companies Act of 2008" 2013 130 *SALJ* 778 at 805.
[316] See *Foss v Harbottle supra* n20; and *Prudential Assurance v Newman* (1982) *supra* n57 at 222H-223A; *Letseng Diamonds v JCI* (2007) *supra* n61 at 573-574; *De Bruyn v Steinhoff* (2020) *supra* n61 at para 137; *Hlumisa v Kirkinis* (2020) *supra* n4 at para 21 and 50; and Scott (2017) *THRHR supra* n12 at 489; see also discussions in para 3.4 of Ch 3 and this Ch 4.
[317] See *Giles v Rhind* (2003) *supra* n71 at paras 24 and 35; *Prudential Assurance v Newman* (1982) *supra* n57 at 223B and *Johnson v Gore Wood* (2002) *supra* n63 at 35H-36A.
[318] See para 2.2 of Ch 2; see also Delport (2022) *supra* n29 at 589; *Naidoo v Dube Tradeport Corp* 2022 (3) SA 390 (SCA) at para 11; and *Lewis Group Ltd v Woollam (1)* [2017] 1 All SA 192 (WCC) at para 29.
[319] See Shapira (2003) *The International Lawyer supra* n32 at 148; *Johnson v Gore Wood* (2002) *supra* n63 at 61H; *Prudential Assurance v Newman* (1982) *supra* n57 at 210D; *Sevilleja v Marex* (2020) *supra* n74 at paras 71, 81 and 83; Mupangavanhu (2019) *SA Merc LJ supra* n15 at 118-119 and *Hlumisa v Kirkinis* (2020) *supra* n4 at para 32.

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principle. Recent events have restored the principle to its foundations.[320] The reflective loss principle is applicable in limited circumstances, and there are exceptions to this principle. The supreme court in *Sevilleja* did not accept all the exceptions developed since the *Prudential* case. In English law, derivative actions must be brought in the company's name under section 260 of the Companies Act 2006 (c46). In South African law, section 165 of the Companies Act applies to derivative actions and therefore reflective loss claims are also assessed under this section of the South African Companies Act. Sevilleja's advancements have not yet been accepted into South African law. It is suggested that South African courts adopt the supreme court's *Sevilleja* ruling, which rejects the *Giles* exception and re-establishes the *Prudential* principles on the reflective loss.

[320] *Sevilleja v Marex* (2020) *supra* n74.

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Chapter 5: Conclusion

5.1. Introduction

Chapter 5 provides conclusions drawn from the preceding chapters, which assessed both South African and English company law regarding the reflective loss principle.[321] This mini dissertation aims to determine whether there is scope to develop the South African position on claims for reflective loss for the sake of (i) consistent application and (ii) alignment with international best practices and societal needs.

5.2. Key findings

As discussed above, the common law notion of reflective loss in South African law was heavily influenced English law.[322] This mini dissertation is, therefore, a comparison of English and South African law. The DTI's company law reform initiative was intended to update the framework of South African company law, which was heavily inspired by English company law under the Companies Act 61 of 1973 and preceding iterations.[323] This mini dissertation determines the potential scope for the development of the reflective loss principle as applied in South Africa.

5.2.1. The status quo in South African company law

In assessing the status quo in South African law, it was revealed that the principle of separate legal personality remains the foundation behind the rejection of reflective loss claims.[324] This is in terms of both the common law and legislation.[325] The cases investigated in South Africa suggest that the original common law doctrines relevant to the reflective loss principle continue to hold sway. Further, it was revealed that no section of the Companies Act currently should be interpreted to allow a shareholder to claim reflective loss.[326] The South African courts and legislature have not altered common law principles.[327]

5.2.2. The status quo in English company law

[321] See Ch 2, 3 and 4.
[322] See para 2.3.2 of Ch 2.
[323] See discussion at para 1.3 of Ch 1.
[324] See discussion at paras 2.2 and 2.3.2 of Ch 2 and paras 3.3-3.6 of Ch 3.
[325] *Ibid.*
[326] See discussion at paras 3.2-3.5 of Ch 2.
[327] See Ch 2 and 3.

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In the United Kingdom, while the original cases from which the common law reflective loss concept is derived still apply, exceptions and adaptations to the principle have emerged.[328] Some of these developments can be tied to other developments in English company law.[329] South Africa's company legislation has undergone a similar transformation in terms of capital maintenance, necessitating a rethinking of how the reflective loss concept is used in South Africa as a result.

However, the English courts have recently disregarded several of the developments in the reflective loss principle, specifically concerning the exceptions developed.[330] The reflective loss concept has effectively been reset to its fundamentals, although the repealed exceptions have not been applied in South Africa as in the United Kingdom.[331]

5.2.3. Key assessments

How does this evaluation square with the DTI's goal that South Africa begin to broaden its company law principles beyond the heavy English law influence from which it stems?[332] Perhaps our courts have been prudent in not engaging in the over-development of the reflective loss principle. However, it would be valuable for the South African judiciary to assess the reasoning and findings of the *Sevilleja* case. Furthermore, it is crucial to recognise that the Companies Act of South Africa has been developed with influence from other jurisdictions. Some of the Companies Act's provisions relevant to the reflective loss principle are not precisely the same as their counterpart provisions in the UK Companies Act 2006 (c46).[333] Hence, in assessing claims for reflective loss claims premised on these provisions, the courts should not only focus on the common law principle of reflective loss as it stands but also have regard to the laws of the jurisdictions from which the provisions have taken influence. Justice is inevitably context-driven, and as Koh has properly noted, a judicial system needs uniformity and predictability, but not at the expense of justice.[334] A strict rule may not give the impacted party the right remedy.

In *Giles,* it was held that a shareholder has the right to bring a claim even for that portion of the claim reflective of the company's loss, as long as the company has no legal basis to

[328] See discussion at paras 4.2-4.4 of Ch 4.
[329] See discussion at para 4.3 of Ch 4.
[330] See discussion at para 4.5 of Ch 4.
[331] *Ibid.*
[332] See discussion at para 1.3 of Ch 1.
[333] See discussion at para 4.6.2 of Ch 4.
[334] See Koh (2011) *Singapore Academy of Law Journal supra* n261 at 888.

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recover that loss (*Giles* exception). However, the supreme court has recently, in the case of *Sevilleja,* banished the Giles exception by expressly holding that it did not exist.

5.3. Conclusion

5.3.1 Remarks

In conclusion, the desire of the DTI for the continued development of South African corporate law to keep up with international best practices remains of utmost importance. However, it should be implemented in a structured and prudent manner. The development of the reflective loss principle must go beyond the English law influence only. It should also reflect market practices and societal needs, thereby promoting a harmonious blending of legislation and common law. In the past, there has been inconsistent application of the principle against reflective loss in South Africa.[335]

5.3.2 Recommendations

Since the Companies Act has deviated from traditional capital maintenance rules, South African courts should grant preferential treatment to company claims in reflective loss claims where a company is insolvent or close to insolvency.[336] Reassessing the flaws of the *Prudential* case and considering the findings in *Sevilleja* would ensure that the development of the reflective loss principle in South Africa is consistent with international best practices.

[335] See paras 3.2, 3.3 and 3.5 of Ch 3.
[336] See Koh (2011) *Singapore Academy of Law Journal supra* n261 at para 19 and discussion at para 4.3 of Ch 4.

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