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A shareholder's personal claim against directors for causing pure economic losses through diminution in share value: A South African critical analysis

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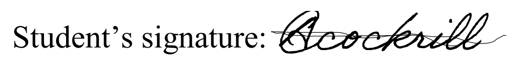
DECLARATION

I, **Chanté Ashley Cockrill**, declare that 'A shareholder's personal claim against directors for causing pure economic losses through diminution in share value: A South African critical analysis', is my original work (except where acknowledgments indicate otherwise) and that neither the whole work nor any part of it has been, is being or is to be submitted for another degree or examination in any other University or academic institution. All sources and materials used are duly acknowledged and properly referenced. I authorise the University of the Western Cape to reproduce for the purpose of research only, either the whole or any portion of the contents in any manner whatsoever.

Student's signature: 

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DEDICATION

This thesis is dedicated to my Heavenly Father who guided and strengthened me throughout my research and to my beloved family.

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ABSTRACT

A shareholder's personal claim against directors for causing pure economic losses through diminution in share value: A South African critical analysis

If a company is harmed by the behaviour of a director as a result of financial misstatements, shareholders may suffer the economic consequences in the form of a diminution in the value of their shares. Failure on directorship level in these circumstances has on more than one occasion resulted in aggrieved shareholders seeking to recover damages suffered and losses incurred in terms of section 218(2) of the Companies Act 2008. This was the situation in the recent cases, *Hlumisa Investment Holdings (RF) Limited v Kirkinis* and in *Itzikowitz v Absa Bank Limited*. While I am unaware of any reported case arising from the much-publicised Steinhoff scandal, there appear to be moves in the direction of court action to recover pure economic loss. Steinhoff shareholders are seeking to hold the retail group's directors to account. Scandals like Steinhoff and African bank are disturbing because it points to a lack of clarity and certainty in South African company laws in respect of director's personal liability in these circumstances. It is for this reason that this study investigates whether shareholders can institute personal liability claims against directors for causing shareholders a diminution of the value of the shares in the company as a result of poor decision making on directorship level, since such a loss is merely reflective of the company's loss. Although, after *Itzikowitz v Absa Bank Limited,* the position seems to be settled in our law, we still have incidences where shareholders are seeking to hold directors personally liable for the diminution in share price under section 218(2) of the Companies Act 2008. It is for this reason that the study explores the scope of section 218(2) and investigates many related questions surrounding section 218(2), in light of directors' personal liability and shareholder protection.

KEYWORDS AND PHRASES:

Companies Act 71 of 2008

Diminution in share value

Directors

Fiduciary duties

Personal liability

Pure economic loss

Reckless trading

Reflective loss principle

Shareholder

Shareholder remedies

LIST OF ABBREVIATIONS

African Bank Limited	African bank
Companies Act 61 of 1973	1973 Act
Companies Act 71 of 2008	Companies Act 2008
Constitution of the Republic of South Africa, 1996	Constitution
Memorandum of Incorporation	MOI
Republic of South Africa	SA
Supreme Court of Appeal	SCA
United Kingdom	UK

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CHAPTER 1: INTRODUCTION AND BACKGROUND TO STUDY

1.1 INTRODUCTION

When a shareholder suffers pure economic loss as a consequence of a diminution in shareholding value, such a shareholder often seeks a remedy that includes a personal claim against a director.[1] This study investigates whether shareholders can institute personal liability claims against directors for causing shareholders a diminution of the value of the shares in the company as a consequence of decision-making which may cause the company a loss, since such a loss is merely reflective of the company's loss. A comparative approach is relevant to this investigation as it could provide invaluable insights which could enrich South African jurisprudence in case where shareholders will seek to claim for reflective loss. I have decided to look at the UK as the English case law has positively influenced South African precedent and jurisprudence in this regard.

Mupangavanhu observes that the default position for shareholders who suffer consequential losses flowing from company losses is to personally sue directors in an attempt to recover economic losses.[2] The author cites two recent examples, namely the *Hlumisa Investment Holdings*;[3] and the *Itzikowitz*[4] cases which will receive attention below in this thesis. The shareholders in these two cases sued former and current directors for having caused them consequential losses flowing from company losses which were blamed on poor decision-making by the directors. The shareholders' cases against directors in both cases revolved around the impact of the poor decision-making by the directors on the concerned companies' share price and the reflective loss suffered by the shareholders. The shareholders' cases of personal liability against the directors for causing diminution in share price in the aforementioned cases were founded on section 218(2) of the Companies Act 2008. Whether section 218(2) is the appropriate legal basis to found a cause of action for a shareholder to recover personal damages against a director simply because a company in which an affected shareholder holds shares, suffered a loss, has become debatable in light of the ambiguities in

[1] Mupangavanhu BM 'Diminution in Share Value and Third-Party Claims for Pure Economic Loss: The Question of Director Liability to Shareholders' (2019) 31 *SAMLJ* 107.
[2] Mupangavanhu (2019) 108.
[3] *Hlumisa Investment Holdings (RF) Limited and Another v Kirkinis and Others* (100390/2015) [2018] ZAGPPHC 676.
[4] *Itzikowitz v Absa Bank Limited* (20729/2014) [2016] ZASCA 43.

the section, as noted by courts[5] and leading writers in this area of law.[6] This study, in addition to analysing the relevant common law principles, will further critically analyse section 218(2) of the Companies Act 71 of 2008 (hereinafter 'Companies Act 2008'). The study explores the scope and interpretation of section 218(2) and investigates many related questions surrounding section 218(2).

1.2 BACKGROUND TO THE STUDY

Over the years, shareholders in companies have been continuously seeking remedies for various wrongdoings they perceived to be caused by the failure of the company's directors to observe their directorial duties during decision-making processes, for example, when approving the company's financial statements. The Companies Act 2008 which came into effect on 1 May 2011 provides some guidance in respect of the remedies available to shareholders.[7] The Companies Act 2008 confers increased powers on the board of directors of a company as well as increasing instances of director liability. It has been argued that in some instances, however, these changes appear to be at the expense of shareholder protection.[8] This is because the changes in the Companies Act 2008 appear to affect the power dynamic between shareholders and the board of directors within the company.[9]

Often poor decision-making by directors may cause the company financial loss. Financial misstatement/misreporting is just one of the many decisions by directors which may cause loss to the company. The Steinhoff scandal, which came to light on 5 December 2017[10] involving the directors' of Steinhoff's failure to observe proper standards in respect of financial reporting has severely tarnished SA's corporate governance image. As was the case with most scandal-ridden corporations over the years, Steinhoff appeared to comply with all legal and listing requirements in its various jurisdictions when in fact they were overstating

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[5] See *Blue Farm Fashion Limited v Rapitrade 6 (Pty) Ltd and others* (unreported case no 22288/2014 (WCC) 1 April 2016) para 31, as cited by Mupangavanhu in Mupangavanhu (2019) 110.

[6] Mupangavanhu (2019) 107 – 128.

[7] Gwanyanya M 'The South African *Companies Act and* the realisation of corporate human rights responsibilities' (2015) 18 *Potchefstroom Electronic Law Journal* 3109.

[8] Chokuda C *The Protection of Shareholders' Rights versus Flexibility in the Management of Companies: A Critical Analysis of the Implications of Corporate Law Reform on Corporate Governance in South Africa with specific reference to protection of shareholders* (published LLD thesis, University of Cape Town, 2017) 80.

[9] Chokuda C *The Protection of Shareholders' Rights versus Flexibility in the Management of Companies: A Critical Analysis of the Implications of Corporate Law Reform on Corporate Governance in South Africa with specific reference to protection of shareholders* (published LLD thesis, University of Cape Town, 2017) 12.

[10]Mahlaka R 'Steinhoff shares plunge after CEO Markus Jooste quits' available at https://www.moneyweb.co.za/news/companies-and-deals/steinhoff-ceo-markus-jooste-quits/ (accessed on5 April 2019).

their sales and profits. This created a false sense of security for both investors and other stakeholders.[11]

While I am unaware of any reported case arising from the much-publicised Steinhoff scandal, there appear to be moves in the direction of court action to recover pure economic loss. There have been a number of legal proceedings that have been instituted against Steinhoff's directors, since the allegations surfaced in 2017, many of which involve shareholders wanting to recover damages suffered as a result of the diminution in share price caused by the material misstatements.[12] A consortium of law firms, acting on behalf of Steinhoff shareholders, applied to the High Court in Johannesburg to institute a class-action. Furthermore former chairman and major shareholder Christo Wiese is seeking to sue the group for damages of fifty nine billion rand, while class-action suits have also been brought on behalf of shareholders in Germany and the Netherlands.[13]

Steinhoff serves as evidence that a scandal involving material misstatements has the effect of dampening the confidence of prospective shareholders which ultimately affects share price.[14] The Steinhoff scandal is but another incidence which raises fundamental questions regarding the liability of the company board to shareholders when poor decision making, for example, misleading financial statements have been presented. It raises the question, to who company directors owe fiduciary duties? Further it raises the question, who suffers the loss when a company's share value depreciates on a stock market, is it the shareholder or the company itself? Thus who has a claim against the directors for causing pure economic losses through diminution in share value? Most of the fundamental questions alluded to above have been addressed in *Itzikowitz v Absa Bank Limited*, yet we still see incidences like Steinhoff where shareholders are seeking to hold directors personally liable.

It is often that we come across scandals such as Steinhoff where shareholders expect directors to maximise the value of the company for the benefit of the shareholders but, because the

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[11] Mahlaka R 'Steinhoff shares plunge after CEO Markus Jooste quits' available at *https://www.moneyweb.co.za/news/companies-and-deals/steinhoff-ceo-markus-jooste-quits/* (accessed on5 April 2019).

[12] Thompson W 'Steinhoff's legal woes mount as shareholders to sue for R185bn' available at *https://www.businesslive.co.za/bd/companies/retail-and-consumer/2018-08-10-steinhoffs-legal-woes-mount-as-shareholders-to-sue-for-r185bn/* (accessed 11 June 2019).

[13] Thompson W 'Steinhoff's legal woes mount as shareholders to sue for R185bn' available at *https://www.businesslive.co.za/bd/companies/retail-and-consumer/2018-08-10-steinhoffs-legal-woes-mount-as-shareholders-to-sue-for-r185bn/* (accessed 11 June 2019).

[14] Crotty A 'Grim news for Steinhoff shareholders' available at *https://www.businesslive.co.za/fm/money-and-investing/2018-10-18-grim-news-for-steinhoff-shareholders/* (accessed 11 June 2019).

directors may have little or no stake in the company, they may not be motivated to maximise shareholder value.[15] If anything, they may be tempted to use their position to benefit themselves at the expense of the shareholders.[16] If a company is harmed by the behaviour of directors in dealing with financial statements, or other poor decision making on the part of directors, shareholders may suffer the economic consequences in the form of a reduction in the value of their shares.[17] In such cases, shareholders may want to sue the director for damages. Case law, however, clearly illustrates that confusion may arise in the determination of the damages to be awarded to a shareholder in a situation where the directors' tortious conduct has also entitled the company to a cause of action.[18] A problem is encountered where the company claims for the loss suffered and the shareholder claims as his loss, the reduction in the value of his shares. It has been argued that the awarding of damages in both actions would result in the shareholder enjoying a 'double recovery' of his loss.[19]

In English Company Law, the basic rule is that a shareholder's personal claim against a director for pure economic losses arising from diminution of shareholding value is not allowed.[20] The reason for this is that a company is a juristic person that is capable of suing and being sued in its own name. Consequently, where a wrong by the directors is done as a result of poor decision making, it is considered to be a wrong to the company and the 'proper plaintiff' is the company itself and not its shareholders.[21]The same seems to be the case in South African Company Law. The reason for this is that the harm is only a reflection of the company's loss, so the company should be the party entitled to recover pure economic loss and not the shareholders.[22] This is referred to as the 'no reflective loss' rule.[23] The origins of

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[15] Chokuda C 'The Protection of Shareholders' Rights versus Flexibility in the Management of Companies: A Critical Analysis of the Implications of Corporate Law Reform on Corporate Governance in South Africa with specific reference to protection of shareholders.' (published LLD thesis, University of Cape Town, 2017) 9.

[16] Chokuda C 'The Protection of Shareholders' Rights versus Flexibility in the Management of Companies: A Critical Analysis of the Implications of Corporate Law Reform on Corporate Governance in South Africa with specific reference to protection of shareholders.' (published LLD thesis, University of Cape Town, 2017) 9.

[17] De jong B 'Shareholders' Claims for Reflective Loss: A Comparative Legal Analysis' (2013) 14 *European Business Organization Law Review* 1.

[18] *Johnson v Gore Wood & Co (a firm)* [2001] 1 All ER 481 (HL) 502 *Prudential Assurance Co Ltd v Newman Industries Ltd (No 2)* [1982] 1 All ER 354 (CA) 222h-223b.

[19] Balfour P 'A Shareholder's Action in Tort: The Difficulty in Assessing Damages' (1981)19 *University of Ontria Law Review* 2.

[20] De jong B 'Shareholders' Claims for Reflective Loss: A Comparative Legal Analysis' (2013) 14 *European Business Organization Law Review* 1.

[21] Cassim M *The new derivative action under the Companies Act* (2016) Cape Town: Juta and Company (Pty) Ltd.

[22] De jong B 'Shareholders' Claims for Reflective Loss: A Comparative Legal Analysis' (2013) 14 *European Business Organization Law Review* 1.

[23] De jong B 'Shareholders' Claims for Reflective Loss: A Comparative Legal Analysis' (2013) 14 *European Business Organization Law Review* 1.

the rule are to be found in the decision in *Prudential Assurance v Newman Industries*.[24] In *Prudential Assurance v Newman Industries,* the court opined that the rationale for the 'no reflective loss' principle is that it prevents double recovery if the company were also to sue.[25] It, moreover, prevents the individual shareholder from recovering at the expense of the company and its creditors and other shareholders.[26] If one looks at the history of reflective loss claims, one will see that our courts have been repeatedly denying shareholders any right to seek reflective loss as a result of damage which directors caused to the company by breaching their fiduciary duties.

In instances where the shareholders have suffered a loss, they may have other remedies at their disposals none of which, however, seems to benefit them personally. Shareholders may bring a shareholder derivative action against a director on behalf of the company.[27] Such proceedings are only commenced by the shareholders when the corporation has refused to pursue the action directly.[28] If the derivative action succeeds, any damages awarded go to the corporation, not to the shareholders who sought relief in court.[29] Over time it has been proven that the shareholder derivative claims have become a natural part of our corporate arena with more or less clear boundaries. Although it can be instituted by shareholders on behalf of the company in terms of section 165 of the Companies Act 2008, questions arise whether a derivative claim is a good alternative to protect shareholders. [30]

The fiduciary duty debate is one of the reasons that the issue of directors' liability in situations involving shareholders suffering pure economic losses is a contentious area in our law. Despite the contention in our law, little has been written on the subject. Whether directors could be personally liable to shareholders for the diminution in value of share price resulting from a material misstatement in particular, has been a topic of little discussion. The lack of clarity in this regard has resulted in the fact that shareholders are still pursuing personal claims against directors when they feel that share prices have dropped due to the negligence or fraudulent conduct of a director, particularly when they have purchased shares

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[24] Corsi A 'Shareholder claims and the "no reflective loss" rule' available at https://www.nortonrosefulbright.com/en/knowledge/publications/0688bcea/shareholder-claims-and-the-no-reflective-loss-rule (accessed on 1 April 2019).

[25] *Prudential Assurance v Newman Industries* (NO 2): CA 1982.

[26] Cassim M 'Judicial discretion in derivative actions under the Companies Act of 2008' (2013) 130 *SALJ* 778.

[27] S165 of the Companies Act 71 of 2008.

[28] Cassim M *The new derivative action under the Companies Act* (2016).

[29] Cassim M *The new derivative action under the Companies Act* (2016).

[30] Cassim M *The Statutory Derivative Action Under the Companies Act of 2008: guidelines for the Exercise of the Judicial Discretion* (published PHD thesis, University of Cape Town, 2014).

based on public statements made by directors as to the company's financial strength or other aspects that may impact the decision to purchase shares. There is thus a clear gap in our law which if left unsettled would lead to further unnecessary claims by shareholders seeking to hold directors personally liable for the diminution in their share price arising from poor decision making.

1.3 PROBLEM STATEMENT AND INTRODUCTION TO RESEARCH QUESTION

It is trite that directors are more than ever coming under increasing scrutiny, particularly in respect of their personal liability, due to the increased influential position they hold, as their actions may affect not only shareholders but a wide range of stakeholders.[31] While the provisions of the Companies Act 2008 relevant to directors' personal liability certainly bring something new to South African company law, the Companies Act 2008 stands to be criticised for its failure to fully ensure good corporate governance by holding those responsible to account.[32] Despite the developments made by the Companies Act 2008 and directors expressing their commitment to ensure good corporate governance, often in practice, there is a failure on the part of directors to implement the spirit and guidelines which the Companies Act 2008 promotes and ultimately a failure to promote good corporate governance. This can be seen, for example, in the prevalence of financial misstatements by directors.[33] The results of financial misstatements can range from inconvenience to major problems. The financial and ethical decisions of directors have a significant impact on the company and in particular its shareholders as shareholders expect and rely on directors to protect and further their interests.[34] When directors are involved in poor decision making, the expectation and reliance that shareholders have are disrupted and shareholders often suffer the consequences in the form of a diminution in their share price. Failure on directorship level

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[31] Conlon E 'What causes the Biggest Bad Decisions' available at *https://www.forbes.com/2010/08/02/big-mistakes-challenger-deepwater-horizon-leadership-managing-ethisphere.html#532e09bd3f9d* (accessed on 14 April 2018).

[32] S7 of the Companies Act 71 of 2008.

[33] For example in *Hlumisa Investment Holdings (RF) Limited and Another v Kirkinis and Others* (100390/2015) [2018] ZAGPPHC 676, the shareholders wanted to hold former African Bank directors jointly and severally liable for the loss of value in their shares when the bank collapsed. The shareholders argued that by pursuing aggressive accounting practices and authorising the publication of misleading financial statements, among other things, the directors of African Bank were in breach of the Companies Act and were thus liable for shareholders' losses. More recently South Africa has been hit by a shares collapse to mirror what happened with African Bank. Steinhoff 's share price dropped due to accounting irregularities. Steinhoff directors had been inflating its value and hiding it's financially distressed position.

[34] Langager C ' Who is Responsible for Shareholder interests' available at *https://www.investopedia.com/ask/answers/05/shareholderinterest.asp* (accessed on 1 April 2018).

in these circumstances has on more than one occasion resulted in aggrieved shareholders seeking to recover damages suffered and losses incurred in terms of section 218(2) of the Companies Act 2008.[35]

The scope of section 218(2) of the Companies Act 2008 has been debated since the law was enacted and seems to be the reason behind continued shareholder litigation in circumstances where the conduct of directors results in a diminution in share price. The subsection reads:

> Any person who contravenes any provision of this Act is liable to any other person for any loss or damage suffered by that person as a result of that contravention.[36]

Section 218(2) of the Companies Act 2008 is worded widely in respect of individuals who fall within its ambit and has been the reason for the influx of claims by shareholders against directors.[37] Due to section 218(2) of the Companies Act 2008's general enabling nature, it potentially exposes directors to personal liability not only to the company, but also third parties, including shareholders. Although *prima facie* section 218(2) of the Companies Act 2008 creates an avenue through which shareholders may have recourse against company directors for the recovery of damages, it must be borne in mind that acts of directors which cause harm to shareholders are likely to also cause loss to the company. Thus the 'no reflective loss' principle may come into play, preventing the shareholder from recovering personally from directors if his loss is reflective of the loss suffered by the company.[38] Although the position seems to be settled in our law, we still have incidences where shareholders are seeking to hold directors personally liable for the diminution in share price.[39] It is for this reason that the study investigates many related questions surrounding section 218(2) of the Companies Act 2008, in light of directors' personal liability and shareholder protection.

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[35] *Hlumisa Investment Holdings (RF) Limited and Another v Kirkinis and Others* (100390/2015); *Itzikowitz v Absa Bank Limited* (20729/2014) [2016] ZASCA 43; Steinhoff Report *Audited Results for the Year Ended 30 September 2017* available at *http://www.steinhoffinternational.com/downloads/2019/latest-results/STEINHOFF-ANNUAL-REPORT-2017.pdf* (accessed on 13 June).

[36] S218(2) of the Companies Act 71 of 2008.

[37] *Hlumisa Investment Holdings (RF) Limited and Another v Kirkinis and Others* (100390/2015) [2018] ZAGPPHC 676; *Itzikowitz v Absa Bank Limited* (20729/2014) [2016] ZASCA 43.

[38] Chokuda C *The Protection of Shareholders' Rights versus Flexibility in the Management of Companies: A Critical Analysis of the Implications of Corporate Law Reform on Corporate Governance in South Africa with specific reference to protection of shareholders* (published LLD thesis, University of Cape Town, 2017) 101.

[39] *Hlumisa Investment Holdings (RF) Limited and Another v Kirkinis and Others* (100390/2015) [2018] ZAGPPHC 676; *Itzikowitz v Absa Bank Limited* (20729/2014) [2016] ZASCA 43.

1.4 KEY RESEARCH QUESTION AND SUB-INQUIRIES

This thesis involves a critical evaluation of the effect of the no reflective loss principle and section 218(2) of the Companies Act 2008 on shareholders seeking to hold directors personally liable for diminution in share price. The primary question in this regard is whether shareholders can sustain personal claims against directors on the basis of section 218(2) of the Companies Act 71 of 2008 for suffering pure economic losses arising from diminution of shareholding value, say through directors' negligent behaviour such as approving misleading financial statements. This question appears to have been answered recently in the *Itzikowitz v Absa Bank Limited* case. The fact that after *Itzikowitz* there are still cases of shareholder personal claims against directors for causing pure economic losses makes it a question worth investigating.

1.4.1 Sub-questions

In determining whether shareholders can hold directors personally liable for the diminution in share price, it is necessary to explore the following sub-research questions which are relevant to the central question:

1. Whether section 218(2) as a general remedy under the Companies Act 2008 is appropriate to found a shareholder's remedy for claiming against directors for pure economic losses suffered?
2. Whose loss is it when a company's share value depreciates on a stock market?
3. Who owns the assets of the company – the shareholders or the company as a separate legal person?
4. Do company directors owe fiduciary duties to shareholders individually or collectively?

1.5 SIGNIFICANCE AND LIMITATION OF THE STUDY

1.5.1 Significance of the study

Any reduction in the value of shareholders share price will be of concern to shareholders particularly if they perceive the cause to be actions or decisions of the directors with which

they do not agree.[40] Generally speaking, however, remedies available to shareholders in this scenario are not straightforward. In particular, such claims are restricted due to the 'no reflective loss' principle, which has traditionally prevented shareholders from bringing claims where their loss merely reflects the loss suffered by the company.[41] This principle applies when both the company and the shareholder have a claim against the directors or other defendants based on the same set of facts, and the shareholder's loss, in so far as this may be a diminution in the value of his or her shares or a loss of dividends, merely reflects the loss suffered by the company.[42] In such cases the shareholder's claim is restricted by the principle that the shareholder cannot recover a loss that is simply reflective of the company's loss.

In cases of poor decision making by directors, an adverse consequence is that the shareholding may reduce in value due to acts or omissions which are entirely or significantly outside of the shareholder's control but are the cause of poor leadership on the part of directors. When this happens, the shareholder will not have a personal remedy at his or her disposal because he or she is barred from recovering such loss by the no reflective loss principle. Yet we still see incidences where shareholders are seeking to hold directors personally liable for the diminution in share price under section 218(2) of the Companies Act 2008. This study is thus important as it will attempt to clarify the legal position regarding section 218(2) as a general remedy. It is hoped that this clarity about the limitations of section 218(2) of the Companies Act 2008 will provide guidance regarding the inappropriateness of section 218(2) as a shareholder remedy for holding directors' personally liable for causing pure economic losses to shareholders through diminution in their share value.

It is hoped that this thesis will be a novel contribution to company law, particularly in the areas of directors' personal liability and shareholder remedies.

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[40] Corsi A 'Shareholder claims and the "no reflective loss" rule' available at *https://www.nortonrosefulbright.com/en/knowledge/publications/0688bcea/shareholder-claims-and-the-no-reflective-loss-rule* (accessed on 1 April 2019).

[41] Corsi A 'Shareholder claims and the "no reflective loss" rule' available at *https://www.nortonrosefulbright.com/en/knowledge/publications/0688bcea/shareholder-claims-and-the-no-reflective-loss-rule* (accessed on 1 April 2019).

[42] Cassim F et al Contemporary *Company Law* 2 ed (2012).

1.5.2 Limitation of the study

This thesis is limited to a discussion of the provisions of the Companies Act 2008 relevant to directors' personal liability and shareholder remedies. This thesis only deals with shareholder remedy for pure economic losses, particularly the question whether shareholders may hold directors personally liable for pure economic losses arising from diminution in share price. This thesis does not focus on the protection of other stakeholders such as creditors. I should also stress that my study has been primarily concerned with shareholders' diminution in share value claims under section 218(2) of the Companies Act 2008. I should add that this study does not propose to discuss financial reporting standards in South Africa. Reference to financial misstatements above, was simply reference to one type of a decision by directors that could result in diminution of share value in a manner that could cause consequential loss as is evident in the Steinhoff scandal referred to above.

1.6 OBJECTIVES OF THE STUDY

The following are the aims that this study hopes to achieve at the end of this research:

(i) To critically analyse the appropriateness of section 218(2) as a general remedy under the Companies Act 2008, to claim against directors for pure economic losses suffered by shareholders.

(ii) To identify and analyse who suffers the loss when a company's share value depreciates on a stock market.

(iii) To identify and analyse who owns the assets of the company.

(iv) To identify and critically analyse to whom company directors owe fiduciary duties to.

1.7 METHODOLOGY

This thesis is of a descriptive nature setting out the legal framework under which directors may incur personal liability for causing a diminution in shareholding value. Given the purpose of the study, an analytical and comparative research, desktop methodology is appropriate. The methodology adopted in this study involves an analysis of primary and secondary sources of law such as legislation, judicial precedent, journal articles, text books and internet sources in order to substantiate arguments throughout this thesis.

A comparative analysis is employed as borrowing from other jurisdictions is imperative and beneficial to improving the interpretation and understanding of South African Company law. The consideration of foreign and international law is encouraged in so far as it is consistent with the Constitution of the Republic of South Africa, 1996.[43] Section 5(2) of the Companies Act 2008 also allows us to look at international jurisdiction for guidance. It encourages the use of foreign company law which deal with comparable provisions to the Company's Act to serve as tools of interpretation.[44] In particular the UK's position on reflective loss claims will be utilised in the comparative study for the reason that English company law principles have had a long standing relationship with South African company law.

1.8 CHAPTER OUTLINE

The proposed dissertation will be divided into five chapters as set out below. Listed below are the chapter headings with a brief outline of the major issues dealt with in each of those chapters.

Chapter 1: Introduction and Background to Study

Chapter 1 introduces the research topic and the objectives of the thesis. It provides background information as well as the context or setting of the research problem. It explains the significance of undertaking this research as well as its limitations. It also sets out the research methodology used in examining the research objectives.

Chapter 2: Conceptual Framework

This Chapter will provide an in-depth analysis of the conceptual basis of the relationship of the company, directors and shareholders. Chapter two outlines the various corporation theories with a focus on those theories most relevant to the topic. Furthermore, chapter 2 reflects on the legal nature of a company, the assets of a company vis-à-vis assets of shareholders, the legal nature of a share in South African law, implications of the fiduciary relationship between a director and a company and whether directors owe any fiduciary duties to shareholders.

Chapter 3: A Comparative Analysis of UK and South African Approaches to Diminution in Share Value Claims

[43] S39 of the Constitution of the Republic of South Africa, 1996.
[44] S5(2) of the Companies Act 71 of 2008.

The comparative study in chapter 3 provides invaluable insights which could enrich South African jurisprudence on shareholders seeking to claim for reflective loss. The international experiences are drawn from the UK. Chapter 3 begins by considering the position in the UK. Thereafter we looked at how the UK position has influenced the position in SA.

Chapter 4: Appropriateness of the section 218(2) general remedy

Section 218(2) of the Companies Act 2008 is used as the legislative basis for the personal liability of directors to shareholders. This chapter will contain a brief discussion of the scope and interpretation of section 218(2) of the Companies Act 2008. In this chapter, section 218(2) will be under scrutiny, looking at its appropriateness to be relied upon to hold directors personally liable for the diminution in share price. Distinguishing it from successful reckless trading cases instituted under section 218(2).

Chapter 5: Conclusion and recommendations

Chapter five concludes the thesis by summarising the findings of the research. Recommendations will be made on how the Companies Act 2008 may be amended to address the shortcomings highlighted by the research.

1.9 CONCLUSION

Even though in *Itzikowitz* the SCA clarified the well-known distinction between the legal personalities of a company and its shareholders,[45] we still find personal claims by shareholders or investors against directors for their actions which caused the company losses. Section 218(2) of the Companies Act 2008 is used as the legislative basis for the personal liability of directors who caused a diminution in share price. Section 218(2) of the Companies Act 2008 is ambiguous and requires appropriate interpretation and possibly an amendment in order to prevent frivolous claims in the future. The question answered in this thesis is: Whether shareholders can sustain personal claims against directors on the basis of section 218(2) of the Companies Act 71 of 2008 for suffering pure economic losses arising from diminution of shareholding value, say through directors' negligent behaviour such as approving misleading financial statements. This research question will be answered by looking at the common law position and the statutory position in SA.

[45] *Itzikowitz v Absa Bank Limited* (20729/2014) [2016] ZASCA 9.

CHAPTER 2: A SHAREHOLDER'S PERSONAL CLAIM AGAINST DIRECTORS - A CONCEPTUAL FRAMEWORK

2.1 INTRODUCTION

The law surrounding the personal liability of directors has been evolving overtime to attribute greater liability on directors in respect of breach of their duties. The basis for holding directors liable for negligent and fraudulent conduct lies in the directors' fiduciary obligations as regulated by common law and statutory law. With the introduction of the Companies Act 2008, a number of developments were made in respect of director liability and at the same time progress has been made in the area of shareholder protection, particularly for the loss they may suffer as a result of the wrongful conduct by directors. Shareholders in companies often seek remedies for the losses that they suffer which they perceive to be caused by the failure of the company's directors to observe proper financial reporting standards, resulting in a breach of the duties owed by directors. When a shareholder insists on claiming personally from a director for pure economic loss arising from the actions of the director as an agent of the company, it presupposes a duty owed to shareholders.[46] Thus, in this part of chapter 2, whether directors generally owe duties to shareholders, individually or collectively, is explored and answered.

Many legal scholars, in criticising directors' duties to shareholders, advance theoretical objections to such a duty.[47] These objections are often related to the view that a particular legal scholar has regarding the nature of the corporation and its theoretical underpinnings. As a point of departure, some of the theories underlying the concept of the corporation will thus be analysed in order to assess how these theories lend themselves to make provision for a duty to shareholders and the circumstances in which directors can be said to owe a duty to shareholders. The chapter begins by defining key concepts relevant to the study. Thereafter, the chapter will consider the nature of the relationship between the company, director and shareholder in light of relevant theories on the nature of the company as espoused in literature. The chapter will also critically analyse the nature of the fiduciary relationship. Chapter 2 will also briefly examine the legal status of a company in SA before the conclusion to the chapter. In this chapter an analysis of these inquiries are undertaken to identify and

[46] Mupangavanhu (2019) 115.

[47] Black B 'The Principal Fiduciary Duties of Boards of Directors' Presentation at Third Asian Roundtable on Corporate Governance Singapore, 4 April 2001.

critically analyse who owns the assets of the company, to whom company directors owe fiduciary duties to and whether an extension of directors' duties to protect the interests of shareholders could be justified on a sound conceptual basis.

2.2 DEFINITIONS AND INTRODUCTION OF KEY CONCEPTS

2.2.1 Company Director

The term 'director' has been defined in the law dictionary by Farlex as 'the head of an organisation, either elected or appointed, who generally has certain powers and duties relating to management or administration.'[48] Like in most jurisdictions,[49] however, in SA the term 'director' has been defined by statute. The term 'director' has been defined in the Companies Act 2008 to mean: 'A member of the board of a company, as contemplated in section 66, or an alternate director of a company and includes any person occupying the position of director or alternate director, by whatever name designated'.[50] The definition of director in section 1 of the Companies Act 2008 appears, however, to be less of a definition but more descriptive in nature. The word 'includes' in the definition of a 'director' in section 1 indicates that the definition is inclusive of different types of directors and is not exhaustive.[51] As a result, the term 'director' is defined broadly but at the same time appears to some extent unclear. The term 'directors' used throughout the Companies Act 2008 causes confusion as it is generally used not only to indicate the plural of an individual director but also the board of directors as a whole.[52] The term 'board' is defined in the Companies Act 2008. The term 'board' is defined to mean 'the board of directors of a company'.[53] Thus to know who constitutes the 'board', one has to know what constitutes 'director'. These interconnected definitions of 'director' and 'board' are cumbersome and counter-intuitive.

The effect of making the definition of a director expansive appears to be an attempt by the legislature to include as many situations which could be classified as directorial functions.[54]

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[48] This definition is available at *https://legal-dictionary.thefreedictionary.com/director* (accessed 13 June 2019) This is a law dictionary by Farlex West's Encyclopaedia of American Law, edition 2. Copyright 2008 The Gale Group.

[49] See s9 of the Australian Corporations Act; s741(1) English Companies Act 1985; s126(1)(*a*) New Zealand Companies Act.; s2(1) of the *CBCA* (Canadian).

[50] S1 of the Companies Act 71 of 2008.

[51] Blackman R 'Commentary on the Companies Act 2008' (2004) 1 *SALJ*.

[52] Cilliers H et al *Corporate Law* 2 ed (1992) 112.

[53] S1 of the Companies Act 71 of 2008.

[54] Mupangavanhu BM Directors' standards of care, skill, diligence, and the business judgment rule in view of south Africa's companies act 71 of 2008: Future implications for corporate governance (published LLD

This means that the formalities are not crucial in attempting to identify those persons who are directors of a particular company, and that the meaning of 'director' must be derived from the words of the Companies Act 2008 as a whole.[55] It is interesting to note that the definition of 'director' in section 1 of the Companies Act 2008 includes not only those individuals that are appointed to the board of the company, but it also includes 'any person occupying the position of a director or alternate director, by whatever name designated.'[56] In doing so, the provisions will apply not only to members of the board, but also to *de facto* directors who are not formally appointed as directors.[57] The court in *Corporate Affairs Commission v Drysdale*[58] held that the phrase 'occupying the position of a director', implies that one who acts in the position of a director, with or without lawful authority is deemed a director for the purposes of the old Companies Act 61 of 1973 (hereafter, the 1973 Act).[59] Thus it is the substance of a person's activities or the power exercised or power performed that is of importance for the purpose of defining the term 'director'.[60]

In addition to the different types of directors clearly identified in section 1 of the Companies Act 2008, the term 'director' also includes other types of directors which are recognised for the purpose of South African company law. Section 66 of the Companies Act 2008 recognises a director appointed in terms of the Company's MOI. In terms of section 66, the company's MOI may provide for the appointment of a person as an *ex officio* director by virtue of that person holding a position elsewhere which qualifies him/her for appointment as an *ex officio* director.[61] An *ex officio* director refers to a person who is a director of a company as a consequence of holding some other office, title designation or similar status.[62] Another type of a director recognised by the Companies Act 2008 and who can be appointed

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thesis, University of Cape Town, 2016) 22.

[55] Cassim F et al *Contemporary Company Law* 2ed (2012) 404.

[56] S1 of the Companies Act 71 of 2008.

[57] Deloitte 'Duties of Directors' available at https://www2.deloitte.com/content/dam/Deloitte/za/Documents/governance-risk-compliance/ZA_DutiesOfDirectors2013_16042014.pdf 9. (accessed 13 July 2019); "A de facto director is a person who assumes to act as a director. He is held out as a director by the company, and claims and purports to be a director, although never actually or validly appointed as such. To establish that a person is a de facto director of a company, it is necessary to plead and prove that he undertook the functions in relation to the company which could properly be discharged only by a director." *Re Hydrodam (Corby) Ltd* [1994] 2 BCLC (Ch); [1994] BCC 161 at 183.

[58] *Corporate Affairs Commission v Drysdale* (1978) 141 CLR 236.

[59] *Corporate Affairs Commission v Drysdale* (1978) 141 CLR 242.

[60] Cassim F et al *Contemporary Company Law* 2 ed (2012) 404.

[61] Mupangavanhu BM Directors' standards of care, skill, diligence, and the business judgment rule in view of south Africa's companies act 71 of 2008: Future implications for corporate governance (published LLD thesis, University of Cape Town, 2016) 22.

[62] Cassim F et al *Contemporary Company Law* 2ed (2012) 405.

in line with a provision in the company's MOI is an *alternate director*. The definition of a 'director' in section 1 of the Companies Act 2008 makes specific reference to an 'alternate director.' An alternate director is defined in section 1 of the Companies Act 2008 to mean 'a person elected or appointed to serve, as the occasion requires, as a member of the board of a company in substitution for a particular elected or appointed director of that company.'[63] Generally, alternate directors are in the eyes of the law in the same position as any other director.[64] They are recognised by the courts as independent directors in their own right such that they alone are responsible for their own actions after their appointment.[65]

Although not expressly mentioned in the Companies Act 2008, there are a number of other types of directors who are also recognised in South African law. The definition provided in section 1 of the Companies Act 2008 makes provision for and includes any person who is not formally appointed as a director of a company but may nonetheless be deemed to be a director if he or she exercises the authority of a director, regardless of whether he or she is properly appointed at law.[66] These include *de jure* directors[67], temporary directors[68] and nominee directors.[69]

Directors are generally divided into two distinct categories, namely; executive and non-executive directors.[70] The Companies Act 2008 does not distinguish between, executive and non-executive directors, but a clear distinction is noticeable between these types of directors. Although no statutory distinction is drawn between an executive and a non-executive director, in SA the distinction is recognised in practice,[71] as well as the *King Report on Corporate Governance for South Africa 2002.*[72] Involvement in the day-to-day management

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[63] S1 of the Companies Act 71 of 2008.
[64] Cassim F et al *Contemporary Company Law* 2ed (2012) 405.
[65] Cassim F et al *Contemporary Company Law* 2 ed (2012) 405; Australian *Securities and Investments Commission v Doyle* (2001) WASC 187.
[66]Cassim F et al *Contemporary Company Law* 2 ed (2012) Ltd 404.
[67] A *de jure* director can be defined to mean a person validly and formally appointed to the position of a company director who has freely consented to that appointment.
[68] The board of directors may appoint a person who satisfies the requirements for election as a director to fill a vacancy and serve as a director on a temporary basis until such time as the vacancy has been filled by a director who has been elected by the shareholders. Such a temporary director has all the powers, functions and duties, and is subject to all of the liabilities of any other director of the company.
[69] Cassim F et al *Contemporary Company Law* 2 ed (2012) 406; A nominee director is a *de jure* director who owes his or her nomination as a director to a shareholder or other third party such as a bank or financier.
[70] Koornhof G 'An Overview of Recent Changes to Corporate Governance Frameworks as it Pertains to Executive Remuneration' (2012) 26 *Speculum Juris* 2.
[71] *Fisheries Development Corporation of SA Ltd v Jorgensen; Fisheries Development Corporation of SA Ltd v A W J C Investments (Pty) Ltd* 1980 (4) SA 156 (W) 165; and *Cronje v Stone* 1985 3 SA 597 (T) 610.
[72] Institute of Directors *King Report on Corporate Governance for South Africa 2002* (hereinafter *King II*) Ch4 of Section 1 defines "executive director" as:

of the company or being in the full-time salaried employment of the company or both, defines the director as executive.[73] On the other hand a non-executive director is not involved in the day to day management of the company and is not a salaried employee of the company. Though a distinction is drawn between the executive and non-executive directors both are bound by the duties imposed on them by law and have an obligation to fulfil their fiduciary duties as well as their duty to exercise care, skill and diligence when performing company functions.[74] In *Howard v Herrigel*, the Court held that 'it is unhelpful and even misleading to classify company directors as "executive" or "non-executive" for purposes of ascertaining their duties to the company or when any specific or affirmative action is required of them'.[75] Goldstone AJ, also expressly stated that 'at common law, once a person accepts appointment as a director, he becomes a fiduciary in relation to the company and is obliged to display the utmost good faith towards the company and in his dealings on its behalf.'[76] He went further to say that the 'legal rules are the same for *all directors*', whether the inquiry be related to negligence, reckless conduct or fraud.[77] Commentators agree that holding the office of non-executive director does not safeguard such a director against personal liability.[78] Nonetheless, the courts will take into account all relevant factors such as the nature of the company's business, any particular functions assigned by the board to the director whose conduct is being judged and whether the director also holds a position under the company.[79]

It can therefore be said that in principle, no reason exists why a non-executive director should not incur liability equivalent to that of an executive director for breach of fiduciary duties. Therefore, in discussing the liability of directors it must be noted that the word 'directors'

An individual involved in the day-to-day management and/or in the full-time salaried employment of the company and/or any of its subsidiaries (*id* par 7.1); and a "non-executive director" as [a]n individual not involved in the day to day (*sic*) management and not a full-time salaried employee of the company or of its subsidiaries. An individual in the full-time employment of the holding company or of its subsidiaries, other than the company concerned, would also be considered to be a non-executive director unless such individual by his/her conduct or executive authority could be construed to be directing the day-to-day management of the company and its subsidiaries (*id* par 7.2).

[73] Deloitte 'The Different Types of Directors' (2014) *Deloitte & Touche* 1.

[74] Mupangavanhu BM *Directors' standards of care, skill, diligence, and the business judgment rule in view of south Africa's companies act 71 of 2008: Future implications for corporate governance* (published LLD thesis, University of Cape Town, 2016) 24.

[75] *Howard v Herrigel* 1991 (2) SA 660 (A).

[76] *Howard v Herrigel* 1991 2 SA 660 (A) 678.

[77] *Howard v Herrigel* 1991 (2) SA 660 (A).

[78] Lombard S *Directors' Duties to Creditors* (Published PHD thesis, university of Pretoria, 2006).

[79] Mupangavanhu BM *Directors' standards of care, skill, diligence, and the business judgment rule in view of south Africa's companies act 71 of 2008: Future implications for corporate governance* (published LLD thesis, University of Cape Town, 2016) 24.

must, for the purposes of determining personal liability, be applied in a wider sense than is first obvious.

2.2.2 Shareholders and shareholding

The two main organs of a company are the board of directors and the shareholders.[80] Both have control over their companies, but in very different ways. The supremacy of shareholders as primary, if not sole, corporate constituents, is illustrated by numerous traditional company law principles. According to Lombard, among these is the fact that for a long time shareholders have been regarded as the exclusive indirect recipients of directors' duties.[81] This is illustrated by the fact that the general meeting of shareholders is endowed with the power to ratify a breach of directors' duties, or to institute action on behalf of the company against directors who are in breach of their duties.[82] In adopting this view, Lombard is saying something which is not supported by common law. In terms of the common law the fiduciary relationship exists between a director as an agent of the company, which company is the principal. A fiduciary relationship between a director and shareholder may only exist under special circumstances, where there is factual evidence of such a relationship.[83] The notion of shareholder supremacy is however, coming more and more under scrutiny as there have been judicial pronouncements on the need to consider the interests of other corporate constituents.

It is important at the outset to appreciate what exactly is meant by 'holding a share in a company.' Shareholding can be defined as 'an allocation of shares held in a company.'[84] Holding one of several shares in a company means that you own part of the company's capital but you are not held personally liable for the company's debts.[85] Consequently, holding a share in a company makes one a shareholder of that company. This gives a shareholder certain rights, including the right to attend annual shareholders' meetings and to cast votes. In *Cooper v Boyes,*[86] Van Zyl J said that there is no simple definition of a share.[87]

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[80]Cassim F et al 'Governance and Shareholders 'in Cassim et al *contemporary Company Law* 2 ed (2012) 355.
[81]Lombard S *Directors' Duties to Creditors* (Published PHD thesis, university of Pretoria, 2006) 45.
[82]Lombard S *Directors' Duties to Creditors* (Published PHD thesis, university of Pretoria, 2006) 45.
[83] *Sharp & Others v Blank & Others* [2015] EWHC 3220 (Ch).
[84] Definition by Oxford dictionary. Available at *https://www.lexico.com/en/definition/shareholding* (accessed 23 October 2019).
[85] Simon A 'Are Shareholders Liable for Company Debts?' available at *https://www.companydebt.com/shareholders-liable-company-debts/* (accessed 24 October 2019).
[86] *Cooper v Boyes* 1884 (4) SA 521 (C) 535.
[87] It is noteworthy that the term 'security' is often used interchangeably with the term 'share'. This is incorrect as the terms 'security' is wider than 'share'. In terms of section 1 of the new Companies Act 'securities' has the

The various definitions emphasise a complex of characteristics[88] which are peculiar to it. The gist thereof is that a share represents an interest in a company.[89] The term share is, however, accordingly defined in the new Companies Act 2008 to mean 'one of the units into which the proprietary interest in a profit company is divided.'[90]

The term 'shareholder' is defined in section 1 of the Companies Act 2008 to mean 'the holder of a share issued by a company and who is entered as such in the certificated or uncertificated securities register,[91] as the case may be.'[92] This definition of a shareholder is subject to section 57(1) of the Companies Act 2008, which contains a specific definition of a 'shareholder' that applies only to Part F of Chapter 2 of the Companies Act 2008, dealing with the governance of companies. Under section 57(1) of the Companies Act 2008, the term shareholder is defined as having the meaning set out in section 1 of the Companies Act 2008, but also includes 'a person who is entitled to exercise any voting rights in relation to a company, irrespective of the form, title or nature of the securities to which those voting rights are attached.'[93] The term 'member' has often been used interchangeably with the term 'shareholder'.[94] Under the Companies Act 2008, however, the term 'member' is not used when making reference to a shareholder of a company, whether registered or not.[95] The term 'member' is reserved for use in respect of non-profit companies.[96]

Although the Companies Act 2008 does not distinguish between different types of shareholders, a distinction is however, recognised in practice and can be inferred from the Companies Act 2008's use of the term 'class of shares'.[97] Generally there are two types of shareholders, those who own ordinary shares and individuals with preference shares.[98] The basic presumption is that all shareholders enjoy equal rights.[99] However, it is possible for

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meaning set out in section 1 of the Securities Services Act 36 of 2004 and includes shares held in a private company.

[88] Shares define and allocate income rights, the incidence of the risk of loss, power of control.
[89] *Cooper v Boyes* 1884 (4) SA 521 (C) 535.
[90] S1 of the Companies Act 71 of 2008.
[91] A 'securities register' is defined in s1 of the Companies Act 71 of 2008 as meaning 'the register required to be established by a profit company in terms of s50(1).
[92] S1 of the Companies Act 71 of 2008.
[93] S57(1) of the Companies Act 71 of 2008.
[94] Cassim F et al 'Governance and Shareholders 'in Cassim et al Contemporary Company Law 2 ed (2012) 356.
[95] Cassim F et al 'Governance and Shareholders 'in Cassim et al Contemporary Company Law 2 ed (2012) 356.
[96] S1 of the Companies Act 71 of 2008.
[97] S36(1)(*b*) of the Companies Act 71 of 2008.
[98] JSE 'Different types of shares' available at ***https://www.jse.co.za/grow-my-wealth/different-types-of-shares*** (accessed on 9 July 2019).
[99] S36(1) Companies Act 71 of 2008.

shareholders to enjoy different rights, in which case the company has ‘classes of shares’.[100] Where the rights of classes of shares differ on the basis of rights to priority with regard to dividends and/or return of capital, the class or classes that enjoy preference rights are referred to as preference shares.[101] The shares that enjoy no preferred rights are referred to as ordinary shares.[102]

Further it is interesting to note the Companies Act 2008 does also not distinguish between minority or majority shareholders. A majority shareholder however is a shareholder who owns and controls most of a corporation’s shares. Only those persons who own more that 50 percent of a company’s shares can be a majority shareholder.[103] A minority shareholder on the other hand is, in short, a shareholder who does not hold full control over a company. A minority shareholder can hold some power, but they do not hold full majority control as they, individually, own less than half of the shares in a company.[104] As a consequence of the majority shareholder owning over 50% of the company shares, majority shareholders have power over the company’s decisions, limiting the power held by the minority shareholders.[105]

Despite the existence of different categories of shareholders, fair and equal treatment of all shareholders by directors is one of the key principles of effective corporate governance.[106] Thus the Companies Act 2008 empowers all shareholders to protect their interests against the negligent or fraudulent conduct committed by company directors.[107] The remedies under the Companies Act 2008 are available to all aggrieved shareholders irrespective of their shareholding.

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[100] Catchpole H ‘What Types of Share Can a Company Have?’ available at *https://www.informdirect.co.uk/shares/types-of-share-a-company-can-have/* (accessed 21 October 2019).

[101] Cassim F et al ‘Governance and Shareholders ‘in Cassim et al Contemporary Company Law 2 ed (2012) 216.

[102] Cassim F et al ‘Governance and Shareholders ‘in Cassim et al Contemporary Company Law 2 ed (2012) 216.

[103] Definition available at *https://definitions.uslegal.com/m/majority-shareholder/* (accessed 28 June 2019).

[104] O’Flaherty K ‘What Are Minority Shareholders? | What Power Does a Minority Shareholder Have? Available at *https://www.oflaherty-law.com/learn-about-law/what-are-minority-shareholders-what-power-does-a-minority-shareholder-have* (accessed on 9 July 2019).

[105] O’Flaherty K ‘What Are Minority Shareholders? | What Power Does a Minority Shareholder Have? Available at *https://www.oflaherty-law.com/learn-about-law/what-are-minority-shareholders-what-power-does-a-minority-shareholder-have* (accessed on 9 July 2019).

[106] Pearse Trust ‘The Core Principles Of Good Corporate Governance’ available at *https://www.pearse-trust.ie/blog/bid/108866/the-core-principles-of-good-corporate-governance* (accessed 1 July 2019).

[107] Myburgh E ‘Holding Delinquent Directors Personally Liable’ available at *http://www.derebus.org.za/holding-delinquent-directors-personally-liable/* (accessed 21 October 2019).

2.3 THEORIES ON THE NATURE OF A COMPANY

Historically, the courts have said that directors' duties are owed to the company, and not to the company's shareholders.[108] In *Sharp & others v Blank & Others*[109], the High Court affirmed this approach and said that directors do not owe shareholders fiduciary duties, unless some special factual relationship exists between them, over and above the usual director/shareholder relationship.[110] It was not sufficient that: the directors had more knowledge of the company's affairs than a shareholder and that the directors' actions would potentially affect the shareholders.[111] The court, however, said that a director could owe a fiduciary duty to a shareholder if, for example, there was a personal relationship between them, or a specific dealing or transaction triggering a fiduciary duty.[112] The theories on the nature of a company serve the purpose of giving insight into the origin and proper purpose of the corporate form.[113] The theories on the nature of a company are considered in search of answers to questions such as: Do company directors owe fiduciary duties, if any, to shareholders individually or collectively? The importance of the various models should not be undervalued. It has been said that

> [d]ifferent theories concerning the origin and purpose of corporations influence the model of company adopted and thus shape the relationship that companies have with all the participants in their economic activity and with their regulators.[114]

History has revealed that there is a never-ending evolution of theories on the nature of a company.[115] This is because commentators have various viewpoints on the theoretical foundations underpinning the corporation.[116] The various theories can be mutually contradictory, complementary or neutral. Four theories, namely the contractual theory, agency theory, the concession theory and the authoritative theory, are of relevance to this

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[108] *Sharp & others v Blank & Others* [2015] EWHC 3220.
[109] *Sharp & others v Blank & Others* [2015] EWHC 3220.
[110] *Sharp & others v Blank & Others* [2015] EWHC 3220.
[111] *Sharp & others v Blank & Others* [2015] EWHC 3220.
[112] *Sharp & others v Blank & Others* [2015] EWHC 3220.
[113] Mupangavanhu BM *Directors' standards of care, skill, diligence, and the business judgment rule in view of south Africa's companies act 71 of 2008: Future implications for corporate governance* (published LLD thesis, University of Cape Town, 2016).
[114] Botha D 'Confusion in the King Report' 1996 *SA Merc LJ* 26 39.
[115] Abdullah H & Valentine B 'Fundamental and Ethics Theories of Corporate Governance' (2009) 4 *EuroJournals* 88.
[116] Cilliers & Benade *Corporate Law* (2000) par 1.16 n 18 refer to Wolff 'On the Nature of Legal Persons' 1938 *Law Quarterly Review* 494 496, according to whom there are sixteen theories pertaining to the legal nature of the juristic person. According to these authors, however, none of these theories individually offers a satisfactory explanation of the legal of the juristic person, and of companies specifically.

study. In this section a closer look is taken at what each of these relevant theories entail and how a duty to shareholders could be influenced by a predisposition to a particular theory.

2.3.1 The Agency theory

The agency theory having its roots in the economic theory was exposited by Alchian and Demsetz.[117] Later writers like Jensen and Meckling expanded the idea of the distinctive feature of "separation of ownership and control" in corporations, which came to be known as 'Agency Theory of corporation'.[118] The agency theory examines the relationship between the agents and principals in the business. In an agency relationship, two parties exist, the agent and principal, whereby the agent acts and takes decisions on behalf of the principal. The agency theory revolves around the relationship between the two parties and the issues that may surface due to their different risk perspectives and business goals. The agency relationship exists because both the principal and the agent share in the benefits of the relationship.[119]

The most common agency relationship exists between shareholders and the directors of a corporation where the directors are elected to act in the interest of the true owners of the company.[120] The shareholders, the true owners of the corporation, as principals, elect the directors to act and take decisions on their behalf. According to Simpson and Taylor '[t]he directors are agents for the shareholders as principals since they are conferred with the principals' money and powers to generate profits and increase the value of investment for their investors.'[121] The view held by Simpson and Taylor that directors are agents of shareholders is, however, not correct, doctrinally in corporate law. These views conflict with case law. The English case of *Sharp v Blank* strongly condemns such an understanding.

Since shareholders have to delegate the control of their business to directors to run the company on their behalf, there is a potential risk that directors and managers will pursue their

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[117] Abdullah H & Valentine B 'Fundamental and Ethics Theories of Corporate Governance' (2009) 4 *EuroJournals* 89.

[118] Abbasi M 'Legal analysis of Agency Theory: an inquiry into the nature of corporation' (2009) 51 *International Journal of Law and Management* 6 401.

[119] Mason H 'The Contractual Theory of the Corporation' (1989) 4 George Mason University Law and Economics Research Paper Series 109.

[120] Esser I *Recognition of Various Stakeholder Interests in Company Management* (published PhD thesis, University of South Africa, 2008) 28.

[121] Simpson J and Taylor J 'Corporate Governance Ethics and CSR' (2014) 25.

own interests to the detriment of the shareholders.[122] This is a potential problem following the separation of ownership and control, that is, how the principal can ensure that his 'agents', company directors, serve the shareholders' interests rather than their own.[123] The mechanisms proposed by agency theory to mitigate director opportunism are, invariably, market-based. The aim is to align the interests of shareholders with those of directors/managers by mitigating potential conflicts of interests between directors and shareholders.[124] Nevertheless, in practice, it hardly implies that the objective of the company is to manage in the exclusive interest of its shareholders.

Berle asserts that because directors are agents of the shareholders they have a responsibility to take decisions for the benefit of those shareholders.[125] He argued that all powers granted to the management of a corporation were 'at all times exercisable only for the rateable benefit of all the shareholders'.[126] His general belief was that because the power to run a company had been delegated from the shareholders to the directors, the directors had the sole responsibility to run the corporation in the interests of those shareholders.[127] This argument presupposes that directors are agents for the shareholders and owe them a fiduciary duty to act for their benefit. However, the argument that directors are agents to the shareholders and owe their fiduciary duties to the shareholders directly is legally incorrect. This is because the law treats the company as an institution directed by persons who are primarily fiduciaries for the institution rather than for its members.[128] The company is legally a separate entity distinct from its shareholders and directors are fiduciaries to the company and owe their duties exclusively to the company, not to the shareholders.[129]

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[122] Smith A. 'An inquiry into the nature and causes of the wealth of nations' (1981) 3.

[123] One way is in the form of 'shirking' which in the governance context can be seen in terms of a lack of attention to maximising shareholder returns, or in terms of 'self-interested opportunism', accruing wealth to themselves rather than shareholders, the principal is vulnerable to the self-interest of their agents.

[124] Keay A & Zhang H 'Incomplete Contract, Contingent Fiduciaries and a Director's Duties to Creditors' 32 *Melboune University Law Review* 141.

[125] Adolf Berle, 'Corporate Powers as Powers in Trust' (1930) 44 *Harvard Law Review* 1049.

[126] Adolf Berle, 'Corporate Powers as Powers in Trust' (1930) 44 *Harvard Law Review* 1049.

[127] John Macintosh, 'The Issues, Effects and Consequences of the Berle-Dodd Debate' (1999) 24 *Accounting, Organizations and Society* 139 144.

[128] Quinn J 'The Corporate Objective: Reinterpreting Directors' Duties' (published PHD thesis, Dublin City University, 2015) 20.

[129] Quinn J 'The Corporate Objective: Reinterpreting Directors' Duties' (published PHD thesis, Dublin City University, 2015) 20.

2.3.2 Contractarian theory

The agency theory provides the theoretical bases for the contractual theory of the corporation. The contractarian theory is thus often combined with the agency theory.[130] The contractarian approach has been very influential in shaping company law doctrine and it is in fact argued by some that the contractarian paradigm developed by law and economics scholars, dominates the theory of corporate law.[131] In a nutshell, the contractarian theory focuses on the contractual relationships that exist between persons involved in the affairs of the company, and, accordingly supports the principle of sanctity of contract.[132]The fundamental insight of the Berle and Means theory, that shareholders should be concerned about delegating control over their financial capital to corporate managers, provides the cornerstone of the contractual theory of the corporation.[133]The Contractarian theory sees the company as a consequence of private individuals exercising their freedom to contract with each other out of their free will.[134] Contractarians view the company as nothing more than a number of 'complex, private consensual contract-based relations, either express, or implied',[135] also referred to as a "nexus of contracts".[136]

The contractual theory views the corporation as founded in private contract, where the role of the state is limited to enforcing contracts.[137] In this regard, a state charter merely recognises the existence of a "nexus of contracts" called a corporation. Each contract in the "nexus of contracts" warrants the same legal and constitutional protections as other legally enforceable contracts.[138] In terms of the Contractarian theory, the purpose of corporate law is therefore, that of providing an enabling set of rules empowering stakeholders to establish contractual

[130] Mäntysaari P 'Theories of Corporate Law and Corporations: Past Approaches n: Organising the Firm' (2012) *Springer* 69.
[131] Lombard S *Directors' Duties to Creditors* (Published PHD thesis, university of Pretoria, 2006) 16.
[132] Keay A 'Directors duties to creditors' (2013) 66 *The Modern Law Review* 5.
[133] Mason H 'The Contractual Theory of the Corporation' (1989) 4 George Mason University Law and Economics Research Paper Series 100.
[134] Mupangavanhu BM Directors' standards of care, skill, diligence, and the business judgment rule in view of south Africa's companies act 71 of 2008: Future implications for corporate governance (published LLD thesis, University of Cape Town, 2016) 37.
[135] Keay A 'Directors' Duties to Creditors: Contractarian Concerns Relating to Efficiency and Over-Protection of Creditors' (2003) 66 *Modern Law Review* 665 672.
[136] Lombard S *Directors' Duties to Creditors* (Published PHD thesis, university of Pretoria, 2006) 16.
[137] Mason H 'The Contractual Theory of the Corporation' (1989) 4 George Mason University Law and Economics Research Paper Series 100.
[138] Mason H 'The Contractual Theory of the Corporation' (1989) 4 George Mason University Law and Economics Research Paper Series 100.

relationships.[139] Section 13 of the Companies Act 2008 reflects a core essential principle of corporate law reform in South Africa.[140] This principle provides that the formation of a company is an action by persons in the exercise of their constitutional right to freedom of association,[141] combined with their common law right to freedom of contract.[142] The core innovation of the contractarian theory was thus to conceptualise the relationship between management and shareholders of a public company as one of a "corporate contract."[143] Under this theory, however, shareholders are not considered to be owners of the corporation, but merely one type of investor among many.[144] Consequently, shareholders cannot thus personally claim losses arising from a diminution in their share value where the company has suffered losses. These are consequential losses and the owner of assets lost is the company and the shareholder is not viewed in corporate law as 'owning' the company or its assets.

2.3.3 The concession theory

In terms of the concession theory, a corporation's existence and operation is a concession granted by the State to use this corporate tool.[145] Parkinson states that the concession theory regards the company as owing its existence to an exercise of State power. The company is therefore a creature of the State that should promote public welfare. The State has the right to interfere in the internal affairs of the company and need not confine itself to external or general law regulation. This theory does not indicate precisely who the beneficiaries of directors' fiduciary duties should be. It is, however, acknowledged that the beneficiaries include a wider variety of interests than the contractarian theory, which focuses on shareholders as the main beneficiaries.[146]

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[139] Mason H 'The Contractual Theory of the Corporation' (1989) 4 George Mason University Law and Economics Research Paper Series 100.
[140] Mupangavanhu BM Directors' standards of care, skill, diligence, and the business judgment rule in view of south Africa's companies act 71 of 2008: Future implications for corporate governance (published LLD thesis, University of Cape Town, 2016) 37.
[141] S18 of the Constitution of the Republic of South Africa, 1996.
[142] Mupangavanhu BM Directors' standards of care, skill, diligence, and the business judgment rule in view of south Africa's companies act 71 of 2008: Future implications for corporate governance (published LLD thesis, University of Cape Town, 2016) 37.
[143] Easterbrook F & Fischel D 'The Economics Structure of Corporate Law' (1991) 1-39.
[144] Mupangavanhu BM Directors' standards of care, skill, diligence, and the business judgment rule in view of south Africa's companies act 71 of 2008: Future implications for corporate governance (Published LLD thesis, University of Cape Town, 2016) 38.
[145] Sheehy B 'The Reluctant Stakeholder: Theoretical Problems in the Shareholder-Stakeholder Debate' (2005) 14 *University of Miami Business Law Review* 1 232.
[146] Esser I *Recognition of Various Stakeholder Interests in Company Management* (published PhD thesis, University of South Africa, 2008) 29.

2.3.4 Associative theories

The crux of the associative theory is that the members form an association, the focus of which is to pool capital. The use of the capital contributed by the members determines the purpose, common affairs, organisation and criteria of membership. 'The company' is the association and exists between members and management in the conception of the internal affairs of the company. An important characteristic of this theory, however, is that it should not be assumed that the members as contributors of the capital comprise only shareholders.[147] Thus membership of the company is deemed to be a flexible concept.

2.4 SEPARATE LEGAL PERSONALITY OF A COMPANY

With regard to the meaning of the term 'company', the Companies Act 2008 defines a company in terms of its juristic personality. This is for the reason that the very foundation of our company law rests on the concept of a company's separate legal personality.[148] The Companies Act 2008 defines the term 'company' to mean 'a juristic person incorporated in terms of this Act, a domesticated company, or a juristic person that, immediately before the effective date…'[149] The definition provided for in section 1 of the Companies Act 2008 is lengthy as it takes into account the previous legislative positions.[150] This definition makes it clear that the provisions of the Companies Act 2008 applies both to companies formed under the Companies Act 2008 of 2008 and to companies formed under the Companies Act of 1973. Section 1 of the Companies Act 2008 further defines the term 'juristic person' to include a foreign company and a trust.[151]

The foundation of company law rests on the concept that a company has a separate legal personality.[152] Yet, although this is a fundamental concept, it has proved extremely intractable to define and to describe satisfactorily. At common law a company is regarded as a separate legal entity that needs to be distinguished from its shareholders and/or

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[147] Esser I *Recognition of Various Stakeholder Interests in Company Management* (published PhD thesis, University of South Africa, 2008) 29.
[148] *Salomon v Salomon* & Co Ltd [1897] AC 22.
[149] S1 of the Companies Act 71 of 2008.
[150] Mupangavanhu BM *Directors standards of care, skill, diligence, and the business judgment rule in view of south Africa's companies act 71 of 2008: Future implications for corporate governance* (published LLD thesis, University of Cape Town, 2016) 46.
[151] S1 of the Companies Act 71 of 2008.
[152] Cassim et al 'The Legal Concept of a Company' in Cassim et al *contemporary Company Law* 2 ed (2012) 28.

incorporators.[153] A company as a legal person is thus capable of acquiring rights and duties distinct from its incorporators, from the time of and by virtue of its incorporation.[154] The principle that a wrong done to a company alone gives only the company a cause of action appears to flow logically from the doctrine of separate legal personality accorded to companies.[155]

The separate legal personality of a company and the distinction between the personalities of a company and its shareholders is affirmed in section 19(1) of the Companies Act 2008 and confirms the common law position regarding the legal consequences of incorporation on the legal personality of a company. In this regard the Act provides that from the date of its incorporation, a company -:

> …
>
> (a) is a juristic person which exists continuously until its name is removed from the companies register in accordance with this Act;
>
> (b) has all of the legal powers and capacity of an individual, except to the extent that
>
> (i) a juristic person is incapable of exercising any such power, or having any such capacity, or
>
> (ii) the company's Memorandum of Incorporation provides otherwise.[156]

The corporate veil created at incorporation of a company provides limited liability for investors and shareholders and also, importantly, for directors.[157] This concept lies at the core of company law and makes investing or participating in company business more attractive given the limitation of risks to a shareholder's investment.[158]

Similarly to section 19(1)(*b*) of the Companies Act 2008, section 8(4) of the Constitution[159] provides that a juristic person is entitled to the same fundamental rights as natural persons, to the extent that such rights can be exercised by legal persons such as companies.[160] Thus

[153] Pickering M 'The Company as a Separate Legal Entity' (1968) 31 *The Modern Law Review* 5 1.
[154] *Cold Storage (Pty) Ltd v Ebrahim* 2008 (2) SA 303 (C).
[155] Hale C 'What's Right with the Rule in *Foss v. Harbottle*?' (1997) 2 *Company Fin. Insolvency* 219.
[156] S19(1) of the Companies Act 71 of 2008.
[157] Mupangavanhu (2019) 114.
[158] Mupangavanhu (2019) 114.
[159] Constitution of the Republic of South Africa, 1996.
[160] S8 of the Constitution of the Republic of South Africa, 1996.

section 8(4) of the Constitution renders the Bill of Rights applicable to juristic persons. A juristic person accordingly has the right to be treated equally to other persons, and may sue for defamation if its reputation is injured, or to protect its right to privacy. However, in *Dadoo Ltd v Krugersdorp Municipal Council*, the court remarked that a company may not be attributed human qualities such as race.[161] As a juristic person, a company cannot form any intent to commit an act, criminal or civil. This is because the company does not have a mind of its own. Neither is a company a natural person with a mind nor conscience.[162] A company therefore acts only through its officers, employees or agents. As a general rule courts would attribute the actions of the officers of the company to the company through vicarious liability, if the officers are acting within their scope of employment.[163] The directors of the company are usually the brains behind corporate decision-making and other corporate activities. Directors act on behalf of the company but due to its juristic personality and vicarious liability directors are as a general rule not liable for the debts of the company except in some exceptional circumstances and unless the company's MOI provides otherwise.[164] This does not however absolve the directors from all kinds of liability.

An understanding of the concept of the separate legal existence of a company is fundamental to the understanding of company law as a whole. The leading case on the separate legal personality of a company is *Salomon v Salomon & Co Ltd.* [165] *Salomon v Salomon & Co Ltd* was the first case to establish the principle that a company is a separate legal person distinct from its shareholders and directors; and that shareholders are in principle not liable for the debts and liabilities of the company.[166] Lord Macnaghten expressed the legal principle as follows:

> [t]he company is at a law a different person altogether from the subscribers to the memorandum; and, though it may be that after incorporation the business is precisely the same as it was before, and the same persons are

[161] *Dadoo Ltd v Krugersdorp Municipal Council* 1920 AD 345.
[162] *Fisheries Development Corporation of SA Ltd v Jorgensen & Another* 1979 (3) SA 1331 (W).
[163] Millard D & Bascerano EG 'Employers' Statutory Vicarious Liability in Terms of the Protection of Personal Information Act' (2016) 19 *PELJ* 21.
[164] S19(3) of the Companies Act 71 of 2008.
[165] *Salomon v Salomon & Co Ltd* [1897] AC 22 (HL).
[166] Cassim F et al 'The Legal Concept of a Company' in Cassim et al contemporary Company Law 2 ed (2012) *33*.

manager, and the same hands receive the profits, the company is not in law the agent of the subscribers or a trustee for them.[167]

A company is an association incorporated under the Companies Act 2008. The effect of incorporation gives the company a separate legal personality, distinct from its directors and shareholders. It can enter into contracts, sue and be sued in its own right. As the company is a separate legal entity, generally its directors are not personally liable for the company's actions. However, increasingly, shareholders are pursuing recovery personally from company directors who may have breached their duties under the Companies Act 2008. In certain circumstances, directors can, however, be held personally liable for losses of the company.

2.4.1 Legal personality of a company: implications for its assets

Several legal implications or consequences flow from the concept that a company has a separate legal personality. One real implication is that the property or assets, profits, debts and liabilities of the company vest in the company itself.[168] Hence, it cannot be regarded as the property of the shareholders of a company.[169] Even a shareholder holding all the shares in a private company does not have a proprietary interest in the company's assets.[170] It is only once the company is liquidated that the shareholders have a right to share in a division of the company's assets.[171] The principle that a company does not hold its property as an agent or trustee of the shareholders, all property purchased by the company belongs to the company itself and not its shareholders, is clearly illustrated by *Dadoo Ltd v Krugersdorp Municipal Council.*[172] The same position applies to the profits of a company. The company's profits belong to the company itself and not to the shareholders. The shareholders have a right to profits only once the company declares a dividend. Not even a sole shareholder of a company

[167] *Salomon v Salomon & Co Ltd* [1897] AC 22 (HL) 50.
[168] Mupangavanhu BM *Directors' standards of care, skill, diligence, and the business judgment rule in view of south Africa's companies act 71 of 2008: Future implications for corporate governance* (Published LLD thesis, University of Cape Town, 2016) 44.
[169] Cassim F et al 'The Legal Concept of a Company' in Cassim et al *contemporary Company Law* 2 ed (2012) 29.
[170] Cassim F et al 'The Legal Concept of a Company' in Cassim et al contemporary Company Law 2 ed (2012) 36.
[171] Cassim F et al 'The Legal Concept of a Company' in Cassim et al contemporary Company Law 2 ed (2012) 36.
[172] *Dadoo Ltd v Krugersdorp Municipal Council* 1920 AD 530.

may help him or herself to the profits of the company, and should he or she do so, he or she would be guilty of the criminal offence of theft.[173]

A shareholder's claim to the assets of a company is limited to a dividend due and the fact that a shareholder is a residual claimant of a company's assets.[174] If it is to be accepted that shareholders are residual claimants to corporate assets, then this legal consequence of separate legal personality of a company has implications for the need to separate ownership and management or control in the corporate form.[175] This also has far-reaching implications of the legal position of and the role of directors in a modern company.[176] While share capital is the property of the company, a share is the property of the shareholder.[177]

It can therefore be said that, because a company has a legal personality distinct from its shareholders, it is capable of owning property/assets in its own right. A company's assets are not to be confused or conflated with those of its shareholders.[178] Consequently, the company owns its assets, including its share capital. Just as a share is the property of the shareholder, share capital is the property of the company.[179] Ownership of a share in a company does not entitle a shareholder to ownership or part-ownership of a company's assets. Entitlement to an aliquot share in the distribution of assets on winding up indicates a financial interest in the success of the company business only; it is not indicative of a right or title to any assets of the company.[180]

2.5 THE NATURE OF THE FIDUCIARY RELATIONSHIP

In this part, it is considered vital to sketch an understanding of the ever evolving nature of the fiduciary relationship. Closely connected to this is the need to establish to whom do directors owe their fiduciary duties. This is in light of a considerably transformed and still evolving company law framework globally and more particularly in South Africa.

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[173] *S v De Jager* 1965 (2) SA 616.
[174] Mupangavanhu (2019) 114.
[175] Mupangavanhu BM *Directors' standards of care, skill, diligence, and the business judgment rule in view of south Africa's companies act 71 of 2008: Future implications for corporate governance* (Published LLD thesis, University of Cape Town, 2016) 45.
[176] Mupangavanhu BM *Directors' standards of care, skill, diligence, and the business judgment rule in view of south Africa's companies act 71 of 2008: Future implications for corporate governance* (published LLD thesis, University of Cape Town, 2016) 45.
[177] Mupangavanhu (2019) 113.
[178] Mupangavanhu (2019) 115.
[179] Mupangavanhu (2019) 115.
[180]Mupangavanhu (2019) 115.

2.5.1 To whom do the directors owe their fiduciary duties?

Corporate law, as a constitutive law in the corporate system, includes the legal theory concept of fiduciary duties.[181] Most notably, the attribution of fiduciary duties turns on the existence of a 'fiduciary relationship.' [182] The content of the duty varies depending on the nature of the relationship between the parties.[183] A fiduciary relationship has been defined to mean 'a relationship in which one party places special trust, confidence, and reliance in and is influenced by another who has a fiduciary duty to act for the benefit of the party.'[184] There is no closed list of fiduciary relationships.[185] In *English v Dedham Vale Properties Ltd,*[186] Slade J ruled that the classes of fiduciary relationships are never closed. Fiduciaries are not limited to a fixed number of defined relationships.[187] Certain relationships are always classified as fiduciary, such as the relationship between a trustee and beneficiary.[188] This relationship is, however, not the only one which is of a fiduciary nature. Directors also stand in a fiduciary position.

Fiduciary relationships are relationships in which one actor, the fiduciary, has consented to act solely in the interest of another actor, the beneficiary.[189] In *Bristol and West Building Society v Mothew,*[190] the court held that 'a fiduciary is someone who has undertaken to act for or on behalf of another in a particular manner in circumstances which gives rise to a relationship of trust and confidence between the parties.'[191] The hallmark of a fiduciary relationship is thus a relationship of trust and confidence.[192] A beneficiary entrusts a fiduciary

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[181] Styhre A 'What We Talk About When We Talk About Fiduciary Duties: the Changing Role of a Legal Theory Concept in Corporate Governance Studies' (2018) 13 *Management & Organizational History* 2.
[182] Miller B & Gold S *Philosophical Foundations of Fiduciary Law* (2014).
[183] Cassim F et al 'The Legal Concept of a Company' in Cassim et al contemporary Company Law 2 ed (2012) *512*.
[184] Definition by Merriam Webster available at *https://www.merriam-webster.com/legal/fiduciary%20relationship* (accessed 23 October 2019).
[185] Cassim F et al 'The Legal Concept of a Company' in Cassim et al contemporary Company Law 2 ed (2012) *512*.
[186] *English v Dedham Vale Properties Ltd* [1978] CH 1 18.
[187] *English v Dedham Vale Properties Ltd* [1978] CH 1 18.
[188] Rahman L 'Defining the Concept 'Fiduciary Duty' in the South African Law of Trusts' (published LLM thesis, University of the Western Cape, 2006) 19.
[189] Mitnick B 'Fiduciary Relationships' available at *http://www.pitt.edu/~mitnick/MESM10/FiduciaryRelationships.pdf* (accessed 22 October 2019).
[190] *Bristol and West Building Society v Mothew* [1998] Ch. 1 (24 July 1996).
[191] *Bristol and West Building Society v Mothew* [1998] Ch. 1 (24 July 1996).
[192] Cassim F et al 'The Legal Concept of a Company' in Cassim et al contemporary Company Law 2 ed (2012) *512*.

with control and management of an asset.[193] You might then be mistaken for thinking that shareholders, as owners of a company, are owed fiduciary duties by directors, given that directors are entrusted by shareholders to run the day-to-day affairs of a company, and have wide discretion to control and direct its finances and assets.

The underlying themes involved in a fiduciary relationship is said to be those of vulnerability on behalf of a beneficiary and an obligation on behalf of the fiduciary. Put differently, a fiduciary relationship exists where one party reasonably places his trust and reliance in another party to act in a loyal manner which is in the former's best interests. According to Hood, the relationship involves an obligation of loyalty.[194] This can be either express or implied by the fiduciary to another party which requires the fiduciary to undertake, either expressly or impliedly, to perform a task for and on behalf of the principal in such a manner that, in carrying out the task, the fiduciary places his principal's interests first. Consequently, the principal reasonably expects that the former will not have a conflict of interest or make a secret profit from his position which could affect the latter's interests (directly or indirectly) and that the fiduciary will act in good faith.[195] *Bristol and West Building Society v Mothe,* Millet J stated:

> [t]he distinguishing obligation of a fiduciary is the obligation of loyalty. The principal is entitled to the single-minded loyalty of his fiduciary. This core liability has several facets. A fiduciary must act in good faith; he must not make a profit out of his trust; he must not place himself in a position where his duty and his interest may conflict; he may not act for his own benefit or the benefit of a third person without the informed consent of his principal. This is not intended to be an exhaustive list, but it is sufficient to indicate the nature of fiduciary obligations. They are the defining characteristics of the fiduciary.[196]

The critical feature of fiduciary relationships is that a fiduciary undertakes to act for or on behalf of, or in the interests of another[197] which requires him to act selflessly and with undivided loyalty in the interests of the other person. The obligation to act selflessly is what distinguishes a person who owes fiduciary obligations from a person who owes mere

[193] Cooter R & Freedman B 'The Fiduciary Relationship: Its Economic Character and Legal Consequences' (1991) 66 *New York Law Review* 1045 1046.
[194] Hood P 'What Is So Special About Being a Fiduciary?' (2000) 4 *Edinburgh Law Review* 332-333.
[195] Cooter R & Freedman B 'The Fiduciary Relationship: Its Economic Character and Legal Consequences' (1991) 66 *New York Law Review* 1045 1046.
[196] *Bristol and West Building Society v Mothew* [1998] Ch. 1 (24 July 1996).
[197] *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41.

contractual duties.[198] A contractual relationship is not an indispensable feature of a fiduciary relationship.[199] The fiduciary obligation, as a legal principle, originated in English law and the doctrine of fiduciary relationship is thus, one of equity, the rule being that a person must not take advantage of this relationship to benefit him or herself.[200] Cassim sums up the fiduciary relationship as follows:

> [t]here appears to be three elements to a fiduciary relationship, namely:
>
> *(a)* a fiduciary has some discretion or power,
> *(b)* a fiduciary is able to unilaterally exercise that power or discretion so as to affect the beneficiary's legal or practical interests, and
> *(c)* the beneficiary is vulnerable to or at the mercy of the fiduciary.[201]

Similarly, to Cassim, according to Oakley, whether a relationship can be classified as fiduciary depends on whether it meets the characteristics of a fiduciary relationship. The following characteristics of a fiduciary relationship have been identified by Oakley, namely, the existence of an undertaking by the alleged fiduciary on behalf of the other party to the relationship; reliance placed on the alleged fiduciary by the other party to the relationship; the property of the other party is under the control of the alleged fiduciary; and vulnerability of the other party to the alleged fiduciary in that some power or discretion is vested in the latter which is capable of being used to affect the legal or practical interests of the former.[202] None of these characteristics are, however, of universal application, but each of them has, at one time or another, been held to be sufficient for the imposition of fiduciary obligations.[203]

A number of duties apply to the fiduciary relationship and they are aimed at ensuring that a fiduciary does not abuse the fiduciary relationship of trust and confidence.[204] Even though the concept 'fiduciary duty' has escaped a precise definition, it is said that such duty arises 'where, as a result of one person's relationship to another, the former is bound to exercise

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[198] Rahman L 'Defining the Concept 'Fiduciary Duty' in the South African Law of Trusts' (published LLM thesis, University of the Western Cape, 2006) 11.
[199] Cassim F et al 'The Legal Concept of a Company' in Cassim et al contemporary Company Law 2 ed (2012) *513*.
[200] Rahman L 'Defining the Concept 'Fiduciary Duty' in the South African Law of Trusts' (published LLM thesis, University of the Western Cape, 2006) 11.
[201] Cassim F et al 'The Legal Concept of a Company' in Cassim et al contemporary Company Law 2 ed (2012) *513*.
[202] Oakley AJ *Parker and Mellows: The Modern Law of Trusts* (2003) 8 ed.
[203] Oakley AJ *Parker and Mellows: The Modern Law of Trusts* (2003) 8 ed.
[204] Cassim F et al 'The Legal Concept of a Company' in Cassim et al contemporary Company Law 2 ed (2012) *513*.

rights and powers in good faith and for the benefit of the latter'.[205] Fiduciary duties can be imposed in two ways. It can be imposed under the general law which falls within the traditional category of fiduciary relationships, or it may arise outside the traditional categories, because of an undertaking by one person to another.[206]

The duties which flow from a fiduciary relationship are: a fiduciary cannot profit from his position, except for the arrangements concerning remuneration; and a fiduciary may not place himself in a situation where his interest conflicts with the duty he owes towards a beneficiary. At common law, the duty to act in good faith and in the best interest of the company is the paramount and overarching fiduciary duty of directors from which all other fiduciary duties flow.[207] These duties have been codified in the Companies Act 2008.[208] A failure on the part of the Fiduciary to discharge his fiduciary duty constitutes a breach of trust, for which a fiduciary will be personally liable to make good the loss suffered by the trust.

The directors of companies are legally recognised to be serving as fiduciaries for the company of which they are directors. In 2001, English case law confirmed the principle that in general, directors do not, solely by virtue of their office as directors, owe fiduciary duties to the shareholders, collectively or individually.[209] The directors 'direct and control the affairs and assets of the company; they do not direct or control the affairs or assets of the members [*shareholders*]'.[210] Section 66(1) of the Companies Act 2008 confirms a similar understanding that in South African law the board of directors is mandated to be stewards of the business and affairs of the company. The directors have the mandate to run the company. In South African law, the established view is that the relationship between a director and a company is best seen as being *sui generis*. It is simply a distinct and independent category of fiduciary relationship.[211] Despite common references in various legal scholars' writings, directors are not in fact fiduciaries for the shareholders of the company; they serve the company as a whole, not just the shareholders. Now, directors may interpret their duties as to serve the company as an instruction to maximise shareholder value, with the implicit claim

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[205] Rahman L 'Defining the Concept 'Fiduciary Duty' in the South African Law of Trusts' (published LLM thesis, University of the Western Cape, 2006).
[206] Rahman L 'Defining the Concept 'Fiduciary Duty' in the South African Law of Trusts' (published LLM thesis, University of the Western Cape, 2006) 10.
[207] Cassim F et al 'The Legal Concept of a Company' in Cassim et al contemporary Company Law 2 ed (2012) *523*.
[208] S76(3)(a) and (b) of the Companies Act 71 of 2008.
[209] *Peskin v Anderson [2001] 1 BCLC 372* 29.
[210] *Sharp & others v Blank & Others* [2015] EWHC 3220 9.2.
[211] Cassim F et al 'The Legal Concept of a Company' in Cassim et al contemporary Company Law 2 ed (2012) *514*.

that doing so serves the company best. This is, however, a discretionary interpretation, not a legally mandated one.[212] As per Handley JA in *Brunninghausen*,[213] if the directors owed fiduciary duties to shareholders they would be exposed to harassing actions by minority shareholders, and to a multiplicity of actions, with each shareholder having his or her own personal claim.[214]

In *Sharp v Blank* and others, the plaintiffs' alleged that the directors owed them fiduciary duties, including a duty to act in good faith, for a proper purpose and in their best interests, and had failed to discharge those duties. The High Court said that directors did not owe shareholders fiduciary duties unless there was some 'special factual relationship' between them, over and above the usual director/shareholder relationship. In essence this means that the fiduciary duties are generally owed to the company and not to the company's shareholders in the absence of a special relationship.[215] This special factual relationship as an exception to the general principle as confirmed in *Sharp*, could be established from the facts of the case.[216] The question arises whether the current position remains the same under the Companies Act 2008. This is considered in 2.5.2 below.

2.5.2 The meaning of the phrase 'in the best interests of the company'

As a company is incorporated to pursue the objectives stated in its MOI, it is clear that the directors must act in pursuit of those objectives but it is also necessary to ask in whose interest the company pursues its objectives. In South African company law directors are required to perform their duties and exercise their powers in the best interest of the 'company'.[217] The common-law principle that a director must act in the best interests of the company is codified in section 76(3)(*b*) of the Companies Act 2008, which states that a director of a company, when acting in that capacity, must exercise the powers and perform the functions of director 'in the best interest of the company'. The term 'the best interests of the company' may still require some unpacking through interpretation to give a meaning which reflects and represents the developments in law, including the spirit, objects and

[212] Mitnick B 'Fiduciary Relationships' available at *http://www.pitt.edu/~mitnick/MESM10/FiduciaryRelationships.pdf* (accessed 22 October 2019).
[213] *Brunninghausen v Glavanics* (1999) 32 ACSR 294 40.
[214] *Brunninghausen v Glavanics* (1999) 32 ACSR 294 40.
[215] *Sharp & others v Blank & Others* [2015] EWHC 3220.
[216] Mupangavanhu (2019) 117.
[217] S76(3)(b) of the Companies Act 71 of 2008.

purposes of the Companies Act 2008.[218] This part of the Study will address the lack of clarity regarding the phrase 'the best interests of the company' and will attempt to interpret the phrase in a manner that gives effect to the objectives[219] of the Companies Act 2008.

Traditionally, directors have been required to manage the business of the company in the interest of its shareholders and to maximise profits for the benefit of shareholders.[220] Our law views a company as a separate person and its assets are not to be confused with those of shareholders. Yet, there is potential for conflict when one considers the common law interpretation of 'the best interests of the company' which is not properly aligned to the Companies Act 2008.[221] At present, in an attempt to interpret the phrase 'the best interest of the company', in accordance with the developments made in corporate law, including giving effect to the spirit, objects and purpose of the Companies Act 2008, we look at three corporate governance theories namely; the shareholder-centric approach, the stakeholder approach and the enlightened shareholder-value approach. The shareholder-centric approach places the interest of shareholders at the forefront and provides that directors are entitled to consider the interests of other stakeholders only to the extent that it would be in the interest of the shareholders to do so.[222] In contrast, the stakeholder approach provides that a company owes a responsibility to a wider group of stakeholders, other than just shareholders.[223]The directors are required to consider the interest of all stakeholders in the company on an equal footing.[224] Both approaches, however, are not without fault. The shareholder-centric approach is considered a very narrow vision because its main aim is to gain profits for shareholders, it ignores stakeholders and there is a possible risk since managers and directors may abuse their delegations, and it costs more to monitor directors.[225] Similarly, shortcomings have been found in respect of the Stakeholders approach; for example, there is no clear hierarchy of

[218] Mupangavanhu BM *Directors' standards of care, skill, diligence, and the business judgment rule in view of south Africa's companies act 71 of 2008: Future implications for corporate governance* (published LLD thesis, University of Cape Town, 2016) 24.
[219] S7 of the Companies Act 71 of 2008.
[220] Cassim F et al 'The Legal Concept of a Company' in Cassim et al contemporary Company Law 2 ed (2012) *514*.
[221] Mupangavanhu BM *Directors' standards of care, skill, diligence, and the business judgment rule in view of south Africa's companies act 71 of 2008: Future implications for corporate governance* (published LLD thesis, University of Cape Town, 2016) 54.
[222] Wiese T *Corporate Governance in South Africa, with International Comparisons* 2 ed (2017).
[223] CorplawBlog '*Shareholder & Stakeholder Theories Of Corporate Governance*' (accessed 21 February 2019).
[224] CorplawBlog '*Shareholder & Stakeholder Theories Of Corporate Governance*' (accessed 21 February 2019).
[225] Mudawi O & Timan E 'Does the Concept of Enlightened Shareholder Value Succeed in Bridging the Gap between the Shareholders and Stakeholders Value Theories?' (2018) 8 *Business and Economic Research.*

stakeholders' interests, there is no 'one goal' to achieve and it seems to demand less accountability from directors.[226]

The shortcomings identified in respect of the shareholder-centric and stakeholder approaches has led to a new approach being developed, namely the enlightened shareholder-value approach. It seems that this is the approach currently adopted in South African Corporate law.[227] In essence this approach provides that the interests of stakeholders, other than shareholders, are subordinate to shareholder interests, however, these interests may be taken into account when it is in the interest of the company itself to do so.[228] Thus this approach is still grounded within the shareholder-centric approach, but is considered to eschew a shift from a pure shareholder primacy.[229] It emphasises economic efficiency and maximum returns on shareholder investments while simultaneously considering some stakeholder interests as long as this results in wealth maximisation for shareholders.[230] The enlightened shareholder value approach is more enlightened than the shareholder-centric approach in the sense that directors are encouraged to take into account interests other than those of shareholders, in decision-making.[231] In the event of a clash between the interests of shareholders and stakeholders, the interests of shareholders must prevail.[232] Whether the enlightened shareholder value approach in practice results in a paradigm shift that removes it far from pure shareholder value remains unclear, and this opens the enlightened shareholder value approach to criticisms. It has been argued that the enlightened shareholder value approach still requires directors to treat shareholders' interests as paramount and only considers material interests where this advances shareholders' interests.[233]

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[226] Mudawi O & Timan E 'Does the Concept of Enlightened Shareholder Value Succeed in Bridging the Gap between the Shareholders and Stakeholders Value Theories?' (2018) 8 *Business and Economic Research.*
[227] Cassim F et al *Contemporary Company Law* 2 ed (2012) 20.
[228] Boatright J 'What's Wrong—and What's Right— with Stakeholder Management' (2006) *21 Journal of Private Enterprise*.
[229] Mupangavanhu BM Directors' standards of care, skill, diligence, and the business judgment rule in view of south Africa's companies act 71 of 2008: Future implications for corporate governance (published LLD thesis, University of Cape Town, 2016) 52.
[230] Mupangavanhu BM Directors' standards of care, skill, diligence, and the business judgment rule in view of south Africa's companies act 71 of 2008: Future implications for corporate governance (published LLD thesis, University of Cape Town, 2016) 52.
[231] Mupangavanhu BM *Directors' standards of care, skill, diligence, and the business judgment rule in view of south Africa's companies act 71 of 2008: Future implications for corporate governance* (published LLD thesis, University of Cape Town, 2016) 53.
[232] Boatright J 'What's Wrong—and What's Right— with Stakeholder Management' (2006) *21 Journal of Private Enterprise*.
[233] Mupangavanhu *BM Directors' standards of care, skill, diligence, and the business judgment rule in view of south Africa's companies act 71 of 2008: Future implications for corporate governance* (published LLD thesis, University of Cape Town, 2016) 53.

The meaning of 'best interests of the company' has led to a lot of debate since the new Companies Act 2008 does not provide a meaning of this term for the purposes of section 76(3)(*b*).[234] The problematic part of this otherwise lucid provision is the meaning of the word 'company'. The term 'company' is not defined for the purposes of section 76(3)(*b*).[235] As a result, it follows that that the common law meaning attributed to this term must apply to section 76(3)(*b*). It is therefore widely accepted that the concept of 'company' in the context of 'best interests of the company' generally refers to the interests of the shareholders, in their capacity as shareholders, as a general body.[236] The interests of the 'company' are not confined simply to the present body of shareholders, they include the interests of future shareholders.[237] The reference to future shareholders emphasises the need for directors to take into account long-term considerations.[238] 'The best interests of the company' in this context thus does not refer to the legal entity itself. In *South African Fabrics v Millman*[239] the court found that the company's interests in the context of this duty are only those of its shareholders and the company itself as a commercial entity.[240] It may, however, be argued that the court should have expanded the definition of 'interests of the company' even more to include other stakeholders such customers and employees, because they too play an essential role to the survival of the company. The common law interpretation of 'the best interests of the company' as applied in *South African Fabrics v Millman* is too narrow to the extent that it fails to meet the standards of our contemporary law thereby excluding the rights and interests of other stakeholders. Our company law has developed since the case was decided and therefore such an interpretation is no longer suitable.

As stated above, at common law and for the purposes of section 76(3)(*b*) of the Companies Act 2008, a director is required to act in the best interests of the 'company', by which is meant under the common law, the collective interests of present and future shareholders. Section 76(3)(*b*) is cast in mandatory terms.[241] The clear implication of the common law and statutory principle is that the interests of other stakeholders, other than shareholders, have

[234] The term 'company' is defined in section 1 of the New Act as a 'juristic person incorporated in terms of the Act'. This definition is of little relevance in the particular context of s76(3)(b) of the Companies Act 71 of 2008.
[235] The term 'company' is defined in section 1 of the Companies Act 71 of 2008 as 'a juristic person incorporated in terms of the Act'. This definition is of little relevance in the particular context of s6(3)(b).
[236] Blackman MS, Jooste RD & Everingham GK et al op cit note 15 at 8-67.
[237] Cassim F et al Contemporary Company Law 2 ed (2012) 516.
[238] Cassim F et al Contemporary Company Law 2 ed (2012) 516.
[239] *Fabrics v Millman* 1972 4 SA 592 (A).
[240] *Fabrics v Millman* 1972 4 SA 592 (A).
[241] Cassim F et al Contemporary Company Law 2 ed (2012) 517.

received no formal, legal recognition under the Companies Act 2008.[242] The common law and statutory positions imply that the duties of directors are focused on maximising shareholder wealth.

Although section 76(3)(*b*) of the Companies Act 2008 requires directors to perform their duties in the best interest of the company which ultimately refers to the interest of the collective body of shareholders and makes no reference to the interest of other stakeholders, modern responsible corporate behaviour requires directors to consider their interests when it is in the interest of the company itself. This approach is favoured due to the fact that by taking into account the interests of all stakeholders, the interests of the company are thereby enhanced, which in effect ensures the best interests of the shareholders are served. It has been argued that this is the best method to ensure sustainability and secure generally prosperity and welfare.[243] The emergence of the enlightened shareholder-value approach constitutes an important development in corporate governance. In essence, this approach provides that the responsibility is owed to all stakeholders because ultimately it is about the interest of the company. In owing the responsibility to all stakeholders, the company's interest will best be served and ultimately it will be in the best interest of the shareholders in any event.

The DTI Policy Document 2004[244] appears to suggest an approach which, though difficult to classify, may provide an answer to the proper interpretation of the 'best interests of the company' properly aligned to the Act.[245] The policy document appears to suggest a rejection of the traditional common law understanding of the best interests of the company.[246] According to the policy document, if company law is to remain consistent with the Constitution and consequential legislation, the interests of the shareholders should be balanced with those of stakeholders.[247] The policy document does not seem to be limited to the enlightened shareholder value approach. The policy document does not advocate a consideration of stakeholders' interests only if this ultimately promotes shareholder interests.

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[242] Cassim F et al Contemporary Company Law 2 ed (2012) 517.
[243] Mudawi O & Timan E 'Does the Concept of Enlightened Shareholder Value Succeed in Bridging the Gap between the Shareholders and Stakeholders Value Theories?' (2018) 8.
[244] 'A Co-operative Development Policy for South Africa' (2004) Available at http://www.thedti.gov.za/economic_empowerment/docs/coops/legis_policy/Co_operativespolicy.pdf. (accessed 27 November 2019).
[245] Mupangavanhu BM *Directors' standards of care, skill, diligence, and the business judgment rule in view of south Africa's companies act 71 of 2008: Future implications for corporate governance* (published LLD thesis, University of Cape Town, 2016) 54.
[246] Mupangavanhu BM Directors' standards of care, skill, diligence, and the business judgment rule in view of South Africa's companies act 71 of 2008: Future implications for corporate governance (published LLD thesis, University of Cape Town, 2016) 54.
[247] See DTI Policy Document 2004 24-27.

The DTI Policy Document 2004 goes even further to provide that directors in certain situations may have a specific duty to promote the stakeholders' interests as ends in themselves.[248] The DTI document suggests that the company's pursuit of economic objectives should thus be constrained by social and environmental imperatives as demanded by relevant constitutional values and legislative enactments.[249]

Furthermore, section 5(1) of the Companies Act 2008 changes the traditional understanding of the duty to act in the best interests of the company and brings its application within the scope of the Bill of Rights.[250] The phrase 'best interest of the company' should be interpreted in a manner that gives effect to the purposes of the Companies Act 2008 provided for in section 7 of the Companies Act 2008. In light of section 5(1) of the Companies Act 2008 the 'best interests of the company' can no longer be interpreted to only mean the collective interests of the present and future shareholders to the exclusion of other key stakeholders' interests. A purposive approach proposed by section 5(1) should lead to an interpretation of section 76(3)(*b*) that takes into account interests of stakeholders such as employees, creditors, the environment, customers etc. Given a purposive interpretation, 'best interest of the company' means that directors owe the duty to act in the best interest of the company to the company as a legal entity, and not to any individual, or group of shareholders, not even if the majority shareholder appointed the director. This interpretation of 'best interest of the company' will ensure that the interests of all stakeholders, including shareholders are balanced. In *Sharp and Others v Blank and Others*[251], the court held that directors as a matter of principle, owe duties to the company as the principal.[252] Thus directors are expected to act in the best interests of the company as a principal.[253]

Therefore in light of the above, it can be said that the Companies Act 2008 makes it mandatory for all types of directors to perform their functions 'in the best interests of the company.'[254]The exact meaning of the phrase 'in the best interests of the company' may be

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[248] See DTI Policy Document 2004 24- 27.

[249] Mupangavanhu BM *Directors' standards of care, skill, diligence, and the business judgment rule in view of south Africa's companies act 71 of 2008: Future implications for corporate governance* (published LLD thesis, University of Cape Town, 2016) 55.

[250] Nomadwayi B *The Directors' Fiduciary Duty to Act in the Best Interests of the Company: The Possible Developments of Common Law by Statute and How They Affect Human Rights* (published LLM thesis, University of Kwazulu-Natal, 2018).

[251] *Sharp and Others v Blank and Others* [2015] EWHC 3220 (Ch).

[252] *Sharp and Others v Blank and Others* [2015] EWHC 3220 (Ch) 9.1, also see *Peskin v Anderson* [2001] 1 BCLC 372 33.

[253] S76(3) of the Companies Act 71 of 2008.

[254] S76(3) (b) of the Companies Act 71 of 2008.

subject to different interpretations.[255] Nonetheless, it can never be interpreted to only include the shareholders of a company and to exclude acting in a manner that benefits the company ahead of any other competing interest.[256] It should in essence refer to the best interests of a company as a commercial entity and/or a separate legal person. For this reason, when a company board makes decisions, it should be motivated by what is in the best interests of the company as a commercial entity. Similarly, when a company suffers losses as a consequence of the board's decisions, the interests affected primarily are the interests of a company as a separate legal person. Thus the rule in *Foss v Harbottle* applies –namely that the proper plaintiff to sue for the company's loss in such circumstances is the company itself – and not the individual shareholders or even the collective group of shareholders that could have suffered consequential loss/reflective loss.[257]

2.6 CONCLUSION

This chapter has laid down a conceptual framework for an interrogation of a shareholder's personal claim against directors for causing a diminution in share price. Importantly, chapter 2 defined key concepts central to this thesis. The chapter points out that while the *King Reports*[258] draws a distinction between executive and non-executive directors, and while in practice the distinction remains, the Companies Act 2008 makes no distinction between directors. In the Companies Act 2008, the term 'director' has been broadened extensively to include executive and non-executive directors, prescribed officers and *ex officio* directors. Thus, for purposes of the Companies Act 2008, all directors are required to comply with the relevant provisions of the Act, and meet the required standard of conduct when performing their functions and duties.

Several theories on the nature of the company have been explored to address the controversy revolving around the question whether the directors owe the fiduciary duties exclusively to the company or whether the shareholders are also owed fiduciary duties by the directors. Two related key questions needed to be answered through the examination of the theories on the

[255] Mupangavanhu BM *Directors' standards of care, skill, diligence, and the business judgment rule in view of south Africa's companies act 71 of 2008: Future implications for corporate governance* (published LLD thesis, University of Cape Town, 2016) 25.
[256] Mupangavanhu BM *Directors' standards of care, skill, diligence, and the business judgment rule in view of south Africa's companies act 71 of 2008: Future implications for corporate governance* (published LLD thesis, University of Cape Town, 2016) 25.
[257] S76(3) of the Companies Act 71 of 2008.
[258] *King II Report* at 54.

nature of a company, the legal status of the company as well as the legal status of a company director. The first question is in whose interests should directors manage the companies? The second question is to whom are the directors' fiduciary duties owed? It has been argued that at common law directors owe their duties to the shareholders as a collective.[259] The theories of the corporation, however, provide the context within which to address this issue. Through a discussion of various theories of the corporation, scholars have interrogated the question whether directors owe duties as fiduciaries, to the company alone, or whether there is any scope to argue that they also owe these duties to prominent stakeholders like shareholders.[260] Like most academic scholars, Havenga argues that this *sui generis* obligation, referring to the fiduciary duties owed by directors, is owed to the company as a separate entity.[261] This view is correct and was confirmed in *Sharp and Others v Blank and Others*[262], in which the court held that directors as a matter of principle, owe duties to the company as the principal.[263] Thus directors are expected to act in the best interests of the company as a principal.[264] It is the common law interpretation of the 'best interests of the company' that may result in the view that the best interests refers to the interests of the shareholders collectively, both current and future shareholders. The traditional view and that view expressed in *Sharp v Blank* are not to be confused. They are related yet they are two separate company law principles with different implications.

It has been established that the fiduciary duties are generally owed to the company and not to the company's shareholders in the absence of a special relationship. A crucial implication of the principle that directors owe their fiduciary duties to the company is that, since the duties are owed to the company only, the company alone is entitled to enforce these duties against negligent or fraudulent directors. The general principle is that directors do not owe shareholders fiduciary duties either collectively or individually. This is, in essence, the application of the enduring principle established in the seminal English case of *Salomon v A Salomon & Co Ltd*, that a company is distinct from its members. For this reason, chapter 3

[259] West A 'The ethics of corporate governance: A (South) African perspective' 2003 51 *International Journal of Law and Management* 10-13.
[260] See a discussion of cases such as *Sharp and Others v Blank and Others* [2015] EWHC 3220 (Ch) (12 November 2015); *Perceval v Wright* [1902] 2 Ch 421; *Peskin v Anderson* [2001] 1 BCLC 372 at 29; *Foss v Harbottle* (1843) 2 Hare 461; *Itzikowitz v Absa Bank Limited* (20729/2014) [2016] ZASCA 43 (31 March 2016) inter alia.
[261] Havenga M *Fiduciary duties of company directors with specific regard to corporate opportunities* (Published LLD Thesis, University of South Africa, 1995) 11.
[262] *Sharp and Others v Blank and Others* [2015] EWHC 3220 (Ch).
[263] *Sharp and Others v Blank and Others* [2015] EWHC 3220 (Ch) 9.1; also see *Peskin v Anderson* [2001] 1 BCLC 372 33.
[264] S76(3) of the Companies Act 71 of 2008.

will critically analyse whether a shareholder has a personal claim against a director for the diminution in share price caused by the fraudulent or negligent director despite fiduciary duties being owed solely to the company and not the shareholder. Put differently, whether the shareholder can rely on a breach of a legal duty owed to the company in order to recover from a diminution in the value of his/her shares.

CHAPTER 3: A COMPARATIVE ANALYSIS OF UK AND SOUTH AFRICAN APPROACHES TO DIMINUTION IN SHARE VALUE CLAIMS

3.1 INTRODUCTION

If a company is harmed by the negligent or fraudulent behaviour of a company director, shareholders may suffer economic consequences in the form of a reduction in the value of their shares.[265] A loss, such as diminution in share value is said to be "reflective" of the company's own loss[266] and therefore the company itself, as opposed to its shareholders, has the sole right to recover company losses.[267] The no-reflective loss principle, addresses the position where a shareholder seeks to claim for loss he or she has suffered in that capacity, when the company has a claim for the same loss.[268] The basic rule in this regard is that a direct claim by the shareholder is not allowed; the company should claim damages.[269] Consequently, only a company against whom a wrong is said to have been committed can bring proceedings in respect of that wrong.[270] This general rule established by *Foss v. Harbottle*[271] and premised on the fundamental principle that a company is a distinct legal person,[272] prevents a shareholder bringing a claim to recover a loss, such as diminution in share value, as such a loss is merely reflective of a loss suffered by the company.[273]

In this chapter a comparative study is undertaken in determining the question: who suffers loss when a company's stock value depreciates on a stock market? From the recent SA case of *Itzikowitz*, the SCA appears to have utilised English law in trying to establish an answer to a similar question. In 2016, the SCA in *Itzikowitz* attempted to clarify the contours between

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[265] De jong B 'Shareholders' claims for reflective loss: a comparative legal analysis' (2013) 14 *European Business Organization Law Review* 1.

[266] Reynolds J 'UK Reflective Loss Rule Impedes Shareholder Recovery' available at https://www.arnoldporter.com/en/perspectives/publications/2018/07/uk-reflective-loss-rule (accessed 9 September 2019).

[267] Winstanley A 'How to Overcome the Concept of Reflective Loss' available at https://pannonecorporate.com/how-to-overcome-the-concept-of-reflective-loss/ (accessed 9 September 2019).

[268] Foxton D & Yihan G *The No Reflective Loss Principle in England, Singapore and elsewhere* Paper presented at the Singapore Academy of Law on 9 January 2019.

[269] De jong B 'Shareholders' claims for reflective loss: a comparative legal analysis' (2013) 14 *European Business Organization Law Review* 1.

[270] Reynolds J 'UK Reflective Loss Rule Impedes Shareholder Recovery' available at https://www.arnoldporter.com/en/perspectives/publications/2018/07/uk-reflective-loss-rule (accessed 9 September 2019).

[271] *Foss v Harbottle* (1843) 67 ER 189.

[272] See part 2.4 of chapter 2 for a discussion of the separate legal personality of a company.

[273] Reynolds J 'UK Reflective Loss Rule Impedes Shareholder Recovery' available at https://www.arnoldporter.com/en/perspectives/publications/2018/07/uk-reflective-loss-rule (accessed 9 September 2019).

delicts committed against a company and those committed against a shareholder. By relying on English case law principles, the SCA showed that the case law position in South Africa in this regard, is similar to the English common-law position. A shareholder, the court ruled, 'cannot recover a sum equal to the diminution in the market value of his shares, or equal to the likely diminution in dividend, because such a ''loss'' is merely a reflection of the loss suffered by the company'.[274] South African law reflects the position in English law: such a loss is not a shareholder's loss.[275] Consequently, a shareholder does not have a cause of action to recover personal damages simply because a company, in which he or she holds shares, has suffered damages.[276] Only a company may sue for a loss, especially where it suffers the loss as a consequence of a breach of duty owed to it, for example, by a fiduciary.[277] Yet, despite this clarification of the position by the SCA, in 2018 there were still legal proceedings being instituted where shareholders sought to recover pure economic losses through a personal claim against former and current directors.

A comparative approach is relevant to this study because both the Companies Act 2008 and the Constitution[278] encourages such an approach when interpreting its provisions. Section 5(2) of the Companies Act 2008, notwithstanding that it has been qualified in various cases, explicitly authorises a court to take cognisance of the principles of foreign company law.[279] For the present chapter I have decided to look at the UK as there have been a number of English case law and literature that has emerged on this subject.[280] UK law has had an enduring influence on South African company law. The UK has been regarded as the "mother country" in respect of the Common law[281] and their principles have been transmitted to SA during its colonisation by the British and have therefore influenced South African law to a large extent today.[282] It is a well-known fact that English company law has influenced South African company law since the passing of the first Southern African companies' legislation, the Cape Joint Stock Companies Limited Liability Act 23 of 1861, during the second half of

[274]Mupangavanhu (2019) 109.
[275] Mupangavanhu (2019) 109.
[276] Mupangavanhu (2019) 109.
[277] Mupangavanhu (2019) 109.
[278] S39(2) of the Constitution of the Republic of South Africa, 1996.
[279] S5(2) of the Companies Act 71 of 2008 provides that 'to the extent appropriate, a court interpreting or applying this Act may consider foreign company law'.
[280] See *Prudential Assurance Co Ltd v Newman Industries Ltd* (No 2) [1982] Ch 204 and *Johnson v Gore Wood & Co (a firm)* [2002] 2 AC 1.
[281] Amos M 'The Common Law and the Civil Law in the British Commonwealth of Nations' (1937) 50 *Harvard Law Review* 8 1249-1274.
[282] Lele P & Siems M 'Shareholder Protection' (2007) CESifo DICE Report 1.

the nineteenth century.[283] Thus the similarities that now exists between English and South African company laws has, accordingly had a profound effect on the adoption by South African courts of English company law jurisprudence. Williams expresses himself as follows in this regard:

> [b]ecause the English legislation has merely been superimposed on the common law (viz the South African common law, which indicates that the Companies Act, 2008 is not to be regarded as a codification of company law), the adoption of it meant simultaneous adoption of the extensive English common law of companies.[284]

In light of the foregoing, the reliance on English principles and case law in this chapter would appear to be fully justified. This chapter begins by considering the position in UK common law. Thereafter, the chapter looks at how the English law position has influenced the position in SA.

3.2 UK POSITION/COMMON LAW POSITION

The issue of a shareholder's personal claim against directors for causing pure economic losses through diminution in share value has been settled in the area of English company law but not without some difficulty. As the English Court of Appeal has stated:

> [w]e have not found these cases easy to reconcile and we must embark upon a lengthy examination of their facts and their reasoning with a view, eventually, to identifying the permutations of duty and damage so that one can see how the principles fit the differing circumstances depending upon whether a duty is owed to the shareholder/holding company or to the company/subsidiary or to both, then which one or whether both suffer damage, and finally whether it is the same duty and the same damage.[285]

[283] Scott J 'An Unsuccessful Long Shot Aimed at Effecting Liability for Causing Pure Economic Loss': *Itzikowitz v ABSA Bank* 2016 4 SA 432 (SCA)' (2017) 80 *Journal of Contemporary Roman-Dutch Law* 483-499.

[284] Scott J 'An Unsuccessful Long Shot Aimed at Effecting Liability for Causing Pure Economic Loss': *Itzikowitz v ABSA Bank* 2016 4 SA 432 (SCA)' (2017) 80 *Journal of Contemporary Roman-Dutch Law* 483-499.

[285] *Johnson v Gore Wood & Co (a firm)* [2002] 2 AC 1.

The English approach is, essentially, to regard pure economic loss as a self-contained category.[286] Within this category, there is a general rule against recovery, but also specific sub-categories of ostensible exceptions.[287] UK corporate law is familiar with the term "reflective loss"[288] and generally follows the no reflective loss principle, but provides for several exceptions. The genesis of the no reflective loss principle may be traced to the English Court of Appeal decision in *Prudential Assurance Co Ltd v Newman Industries Ltd*[289] ("*Prudential Assurance*").[290] The court in *Prudential Assurance*, in dealing with this matter for the first time, was determined to lay down the law in respect of a shareholder's personal claim against a director for causing pure economic loss. Since the decision in *Prudential Assurance*, the scope of the rule has expanded. *Johnson v Gore Wood*[291] reiterated the principle which stemmed from *Prudential Assurance* but also clarified and developed the rule. The decisions of the English courts and the facts leading to it are examined below.[292]

3.2.1 Case discussion on *Prudential Assurance*

The genesis of the no reflective loss principle, at least judicially, may be traced to the English Court of Appeal decision in *Prudential Assurance*, the founding authority on reflective loss. In *Prudential Assurance*,

> [t]he directors had fraudulently misrepresented to the shareholders the value of certain other companies so that they could get the members to approve the purchase of some assets from another company in which the directors were interested. The plaintiff, who was a shareholder, then pursued a personal action based on the claim that the directors' fraud reduced Newman's net profits and thus negatively affected the price of its shares.[293]

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[286] Marshall D 'Liability for Pure Economic Loss Negligently Caused: French and English Law Compared' (1975) 24 *The International and Comparative Law Quarterly* 4 748-790.
[287] De jong B 'Shareholders' claims for reflective loss: a comparative legal analysis' (2013) 14 *European Business Organization Law Review* 1.
[288] It must be noted that the phrase "no reflective loss" principle is used in this thesis as shorthand for the rule disallowing shareholder personal recovery in respect of loss of share value because the company has a claim in respect of the same economic loss.
[289] *Prudential Assurance Co Ltd v Newman Industries Ltd* (No 2) [1982] Ch 204.
[290] Safari N *Reconsidering the role of the derivative claim in the United Kingdom. A comparative study with the United States and New Zealand* (published PHD thesis, University of London, 2018) 9.
[291] *Johnson v Gore Wood & Co (a firm)* [2002] 2 AC 1.
[292] Shapira G '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) 37 *Spring* 1 137-152.
[293] *Prudential Assurance Co Ltd v Newman Industries Ltd* (No 2) [1982] Ch 204.

Overruling the lower court,[294] the Court of Appeal held that the personal claim against the directors was misconceived.[295] The court held that a shareholder could not circumvent the *Foss v Harbottle*[296] principle, the proper plaintiff rule, by bringing a personal claim to recover damages for loss in value of shares merely because the company in which he was interested had suffered damage.[297] The rule in *Foss v Harbottle* decrees that where a wrong is done to a company, only the company may sue for any damage caused to it.[298] This does not mean that the shareholders of the company do not suffer any loss, for any negative impact the wrongdoing may have on the company is likely to also affect the value of its assets, and hence the value of the shares of the company.[299] The shareholders do not, however, by reason of that loss alone, acquire any direct cause of action against the wrongdoer. As the cause of action belongs to the company, it is only right that the company alone is entitled to prosecute in respect of that wrong.[300] In most instances, directors of companies owe their duties to the company and the company alone; the company will therefore be the "proper plaintiff" in a potential case.[301] This is a necessary corollary of the separate legal status of the company.[302] The court further noted that:

> [a] personal action would subvert the rule in *Foss v Harbottle* and that rule is not merely a tiresome procedural obstacle placed in the path of a shareholder by a legalistic judiciary. The rule is the consequence of the fact that a corporation is a separate legal entity. Other consequences are limited liability and limited rights. The company is liable for its contracts and torts; the shareholder has no such liability. The company acquires causes of action for breaches of contract and for torts which damage the company. No cause of action vests in the shareholder.[303]

This aspect of the reasoning can, however, be argued to be wholly orthodox. The court further addressed the issue of what would happen if the director owed a fiduciary duty not

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[294] *Prudential Assurance Co Ltd v Newman Industries Ltd* (No 2) [1981] Ch 257 at 302-303.
[295] *Prudential Assurance Co Ltd v Newman Industries Ltd* (No 2) [1982] Ch 204.
[296] *Foss v Harbottle* (1843) 67 ER 189.
[297] Any action in which a wrong is alleged to have been done to a company, the proper claimant is the company itself. This is known as "the rule in *Foss v Harbottle.*
[298] *Foss v Harbottle* (1843) 67 ER 189.
[299] *Foss v Harbottle* (1843) 67 ER 189.
[300] *Foss v Harbottle* (1843) 67 ER 189.
[301] Cheffins B & Black B European Corporate Governance Institute Law Working Paper 71 *Outside Director Liability Across Countries* (2006).
[302] Pearlie K 'The Shareholder's Personal Claim: Allowing Recovery for Reflective Loss' (2011) 23 *Singapore Academy of Law Journal* 863-889.
[303] *Prudential Assurance Co Ltd v Newman Industries Ltd* (No 2) [1982] Ch 204.

just to the company but also to the shareholder.[304] The court whilst recognising that the directors owed the shareholders a duty, when advising them to approve the transaction, to give such advice in good faith and not fraudulently, and which duty may have been breached, held, the plaintiff nevertheless could not succeed in its personal claim as it had not suffered any personal loss.[305] The court in *Prudential Assurance* therefore ruled that a shareholder may not bring a personal action in respect of a wrong suffered by the company which resulted in a reduction in the net assets of the company, thereby leading to a diminution in the value of the company's shares. The Court held that the shareholder cannot recover reflective losses, explaining that:

> [w]hat a shareholder cannot do is to recover damages merely because the company in which he is interested has suffered damage. He cannot recover a sum equal to the diminution in the market value of his shares, or equal to the likely diminution in dividend, because such a "loss" is merely a reflection of the loss suffered by the company. The shareholder does not suffer any personal loss. His only "loss" is through the company, in the diminution in the value of the net assets of the company…[306]

The reflective loss principle as laid down in *Prudential Assurance* was later considered by the House of Lords in *Johnson v Gore Wood.*

3.2.2 Case discussion on *Johnson v Gore Wood*

Currently, the leading case in the UK in respect of a shareholder's personal claim against directors for causing pure economic losses through diminution in share value is *Johnson v Gore Wood,*[307] where the House of Lords did not allow the shareholder to claim reflective loss, even if the shareholder's cause of action is independent of the company's.[308] In *Johnson v Gore*

> Johnson brought an action against Gore Wood for breach of duty, alleging that he had retained the solicitors to act for him personally as well as for the company in the exercise of the option. The heads of damages included personal

[304]Foxton D & Yihan G *The No Reflective Loss Principle in England, Singapore and elsewhere* Paper presented at the Singapore Academy of Law on 9 January 2019 1.
[305] *Prudential Assurance Co Ltd v Newman Industries Ltd* (No 2) [1982] Ch 204.
[306]*Prudential Assurance Co Ltd v Newman Industries Ltd* (No 2) [1982] Ch 204 222–223.
[307] *Johnson v Gore Wood & Co (a firm)* [2002] 2 AC 1.
[308] De jong B 'Shareholders' claims for reflective loss: a comparative legal analysis' (2013) 14 *European Business Organization Law Review* 1.

> losses of Johnsons largely in relation to liabilities and losses of WWH, and diminution of value of Johnson's shareholding in WWH.[309]

To proceed, Johnson had to show an arguable case. Johnson had to convince the court that, on the facts as pled he had a chance of success. Thus, the trial of preliminary issues concerned:

> (i) Whether the facts pleaded were capable of establishing any relevant duty owed by Gore Wood to Johnson personally, and
>
> (ii) whether any of the heads of damages claimed were irrecoverable company losses or whether they were capable of amounting to personal losses capable in law of being recoverable by Johnson.[310]

The trial judge found in favour of Johnson on both issues. Unhappy with the decision, Gore Wood appealed to the Court of Appeal. The Court of Appeal in dealing with the matter, turned to the decision in *Prudential Assurance,* pointing out that in *Prudential Assurance*[311], the court stated that:

> [A] cannot, as a general rule, bring an action against B to recover damages or secure other relief on behalf of C for an injury done by B to C. C is the proper plaintiff because C is the party injured, and therefore the person in whom the cause of action is vested.[312]

The court in *Johnson v Gore Wood* thus held that:

> [w]here a company suffers loss caused by a breach of duty owed to it, only the company may sue in respect of that loss. No action lies at the suit of a shareholder suing in that capacity and no other to make good a diminution in the value of the shareholder's shareholding where that merely reflects the loss suffered by the company. A claim will not lie by a shareholder to make good a loss which would be made good if the company's assets were replenished through action against the party responsible for the loss, even if the company,

[309] *Johnson v Gore Wood & Co (a firm)* [2002] 2 AC 1.
[310] Shapira G '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) 37 *Spring* 1 137-152.
[311] *Prudential Assurance Co Ltd v Newman Industries Ltd (No 2)* [1982] 1 All ER 354 at 357; [1982] Ch 204 at 210.
[312] *Johnson v Gore Wood & Co (a firm)* [2002] 2 AC 1.

acting through its constitutional organs, has declined or failed to make good that loss.[313]

For a plaintiff to successfully recover damages in a delictual claim for pure economic loss, two things must be established. First, the plaintiff must positively establish wrongfulness.[314] The plaintiff must prove that the defendant's conduct constitutes a breach of some legal duty owed to him or her personally. Secondly, the court, on its own assessment of the facts before it, must be satisfied that such a breach of duty has caused the plaintiff personal loss, separate and distinct from any loss that may have been occasioned to any juristic person in which the plaintiff may be financially interested.[315] At common law, the question arises as to when a shareholder may personally claim delictual damages from a director for pure economic loss resulting from a reduction in shareholding caused by the action of the director. To answer this question, Lord Bingham of Cornhill—in the English case of *Johnson v Gore Wood*, cited by Ponnan JA with approval in *Itzikowitz* distilled three propositions which he said were established by the authorities.[316] The above quoted text[317] constituted the main and exclusionary rule. This was followed by two areas where the rule did not apply.

Firstly, the no reflective loss principle does not apply where the company itself has no cause of action, that is to say when the company has never had a cause of action.[318] Put differently, where a company suffers loss but has no cause of action to sue to recover that loss; the shareholder in the company may sue in respect of it, if the shareholder has a cause of action to do so, even though the loss is a diminution in the value of the shareholding.[319] Secondly, where a company suffers loss caused by a breach of duty to it, and a shareholder suffers a loss separate and distinct from that suffered by the company, caused by breach of a duty independently owed to the shareholder, each may sue to recover the loss caused to it by breach of the duty owed to it but neither may recover loss caused to the other by breach of the duty owed to that other.[320] The terms of this second qualification are of particular interest.

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[313] *Johnson v Gore Wood & Co (a firm)* [2002] 2 AC 1.
[314] Mupangavanhu (2019) 118.
[315] Mupangavanhu (2019) 118.
[316] Foxton D & Yihan G *The No Reflective Loss Principle in England, Singapore and elsewhere* Paper presented at the Singapore Academy of Law on 9 January 2019.
[317] See footnote 313.
[318] Foxton D & Yihan G *The No Reflective Loss Principle in England, Singapore and elsewhere* Paper presented at the Singapore Academy of Law on 9 January 2019.
[319] *Johnson v Gore Wood & Co (a firm)* [2002] 2 AC 1.
[320] The Court of Appeal in *Giles v. Rhind* [2002] EWCA Civ 1428 allowed a shareholder to claim for reflective loss where the defendant (the wrongdoer) disabled the company from pursuing that cause of action. Thus Lord Justice Walker identified an additional exception under UK law.[320] The *Giles v. Rhind* exception allowed for the

This aspect of its application makes it clear that the reflective loss rule is not a rule of law which bars a cause of action, but one which renders certain heads of loss irrecoverable. This point was expressly made by Neuberger LJ in *Gardner v Parker.*[321] Neuberger LJ stated that:

> [i]t is clear from the analysis and discussion in the cases to which I have referred, that the rule against reflective loss is not concerned with barring causes of action as such, but with barring recovery of certain types of loss.[322]

The above three propositions can be summarised as follow:

(1) The first category is where a company suffers loss caused by a breach of duty owed to it. In such a scenario, the company is the person wronged and thus the company is the proper plaintiff to claim damages for its economic loss. Under such circumstances, a shareholder should not be entitled to institute a derivative action, because to allow the shareholder to claim loss for their diminished shareholding value could result in a 'double recovery' by both the shareholder and the company. If the wronged company elects not to sue, or is unable to sue for one reason or the other, this does not convert that wrong into a wrong against the company's shareholders.[323]

(2) The first exception is where a company suffers loss but has no cause of action to sue to recover that loss, the shareholder in the company may sue in respect of it (if the shareholder has a cause of action to do so), even though the loss is a diminution in the value of the shareholding.[324]

(3) The second exception is where a company suffers loss caused by a breach of duty to it, and a shareholder suffers a loss separate and distinct from that suffered by the company caused by breach of a duty independently owed to the shareholder, each may sue to recover the loss caused to it by breach of the duty owed to it but neither may recover loss caused to the other by breach of the duty owed to that other[325]

consideration of the impact of a defendant's conduct in determining a shareholder's standing to assert a claim for reflective loss.

[321] *Gardner v Parker* [2004] EWCA Civ 781.

[322] *Gardner v Parker* [2004] EWCA Civ 781 49.

[323] *Itzikowitz v ABSA Bank* 2016 4 SA 432 (SCA) 17.

[324] *Johnson v Gore Wood & Co (a firm)* [2002] 2 AC 1 502.

[325] *Johnson v Gore Wood & Co (a firm)* [2002] 2 AC 1; Also see *Itzikowitz v ABSA Bank* 2016 4 SA 432 (SCA) 11.

Proper categorisation of claims, per the above categories, is crucial if courts are to arrive at a correct decision as to whether the plaintiff has been independently so wronged by the defendant as to entitle it to a delictual claim for pure economic loss.[326]

In *Johnson v Gore Wood*, Lord Bingham summarised the UK position on reflective loss. The case suggests that under UK law the recovery of reflective loss will not be permitted even if the company is not pursuing an independent claim; for instance, because the company chooses not to bring a claim.[327] It is irrelevant that the shareholder has a separate cause of action, as the law prohibits recovery for reflective loss regardless of the existence of a separate cause of action for the shareholder.[328]It is further irrelevant that a court could avoid double recovery by carefully drafting its decision.[329] This rule, in the words of Lord Millett, is "a matter of principle; there is no discretion involved".[330]

It would appear from the *Johnson v Gore Wood* case that it is settled law in the UK that a shareholder would, in general, be precluded from recovering reflective loss through a personal action. Unfortunately, the deceptively simple principle and its exceptions provide a complicated foundation. Although the position seems to be settled by *Johnson v Gore Wood,* the case has spawned a plethora of litigants,[331] hoping to create inroads into the reflective loss principle.[332] Legal scholars have argued that this can be attributed to Lord Bingham's words in *Johnson v Gore Wood* that:

> …the court must respect the principle of company autonomy, ensure that the company's creditors are not prejudiced by the action of individual shareholders and ensure that a party does not recover compensation for a loss which another party has suffered. On the other hand, the court must be astute to ensure that the party who has in fact suffered loss is not arbitrarily denied fair compensation.[333]

[326] Mupangavanhu (2019) 119.
[327]Korzun V 'Shareholder claims for Reflective Loss: How International Investment Law Changes Corporate Law and Governance' (2018) 40: *U. Pa. J. Int'l L 1 192-254.*
[328] Korzun V 'Shareholder claims for Reflective Loss: How International Investment Law Changes Corporate Law and Governance' (2018) 40: *U. Pa. J. Int'l L 1 192-254.*
[329] Korzun V 'Shareholder claims for Reflective Loss: How International Investment Law Changes Corporate Law and Governance' (2018) 40: *U. Pa. J. Int'l L 1 192-254.*
[330] *Johnson v Gore Wood & Co (a firm)* [2002] 2 AC 1.62**.**
[331] *Diamantides v. JP Morgan Chase Bank* [2005] EWCA Civ 1612 (CA); *Pearce v. European Reinsurance and Run-Off Ltd* [2005] EWHC 1493 (Ch); *Perry v. Day* [2004] EWHC 3372 (Ch); *Collins Stewart Ltd v. The Financial Times Ltd* [2004] EWHC 2337 (QB).
[332] Lin S 'Barring Recovery for Diminution in Value of Shares on the Reflective Loss Principle' (2007) 66 *Cambridge Law Journal* 3 537-558.
[333] *Johnson v Gore Wood & Co (a firm)* [2002] 2 AC 1 36B-C.

The last sentence has formed the basis of numerous merits-based attempts to escape the rule against the recovery of reflective loss.[334]

English law is important to foundational principles relevant to the question whether shareholders, who suffer pure economic losses as a consequence of company directors' decisions, can sustain personal claims against such directors. *Johnson v Gore Wood* has clarified and restated the law as laid down in *Prudential Assurance*. Thus by the authority of *Prudential Assurance*, and *Johnson v Gore Wood*, the progenitors of the reflective loss principle, the shareholder cannot recover a sum equal to the diminution in the market value of his shares, or equal to the diminution in dividend, because such a 'loss' is merely a reflection of the loss suffered by the company. The shareholder does not suffer any personal loss. His only 'loss' is through the company.[335] It can be said that *prima facie* the diminution in the value of the plaintiffs' shares was by definition a personal loss and not the company's loss, but that is not the point. The point is that it merely reflected the diminution of the company's assets.[336] It is important that corporate autonomy is accorded due respect, and not be obscured by an over-consideration of policy concerns.[337] In order to ensure this, the courts have allowed recovery only if the right asserted by the shareholder is one that is separate and independent of the company's right.[338]

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[334] Foxton D & Yihan G *The No Reflective Loss Principle in England, Singapore and elsewhere* Paper presented at the Singapore Academy of Law on 9 January 2019.

[335] *Prudential Assurance Co Ltd v Newman Industries Ltd* (No 2) [1982] Ch 204 222–223.

[336] Lin S 'Barring Recovery for Diminution in Value of Shares on the Reflective Loss Principle' (2007) 66 *Cambridge Law Journal* 3 537-558.

[337] Following consideration of the authorities, the court in *Sevilleja Garcia v Marex Financial Ltd* [2018] EWCA Civ 1468 concluded that there were four considerations which justified the rule against reflective loss namely; the need to avoid double recovery by the claimant and the company from the defendant; Causation – if the company chooses not to claim against the wrongdoer, the loss to the claimant is caused by the company's decision and not by the defendant's wrongdoing, the public policy of avoiding conflict of interest; particularly that if the claimant has a separate right to claim it would discourage the company from making settlements, the need to preserve company autonomy and avoid prejudice to minority shareholders or other creditors. (Corsi A & Birney N 'Shareholder claims and the "no reflective loss" rule' available at *https://www.nortonrosefulbright.com/en/knowledge/publications/0688bcea/shareholder-claims-and-the-no-reflective-loss-rule* (accessed 6 September 2019)).

[338] Pearlie K 'The Shareholder's Personal Claim: Allowing Recovery for Reflective Loss' (2011) 23 *Singapore Academy of Law Journal* 863-889.

3.3 SA POSITION AS INFLUENCED BY THE UK

Similarly, to the UK position, South African law adheres strictly to the 'no reflective loss' principle in respect of shareholder claims. In the matter of *Itzikowitz*[339] the SCA provided clarity on the distinction between wrongs committed against a company and those committed against a shareholder; and whether such a shareholder has a right of recourse against the party who committed such wrongs.[340] The SCA in *Itzikowitz*, further confirmed and restated some important principles around the "reflective loss" principle as derived from English common law pertaining to companies. Echoing Lord Bingham[341], the court in *Itzikowitz* stated that the shareholder's loss is merely "reflective" of the company's loss and, if anyone, it is the company which must institute action for that loss.[342] The shareholder can only claim if he has a distinguishable and independent cause of action. The facts in Itzikowitz are quite straightforward:

> [a] bank provided loan facilities to a certain group of companies. Mr Itzikowitz, an indirect shareholder of the companies, stood as surety for the debts under those facilities. When the one company fell hopelessly insolvent the bank pursued the surety for the maximum amount under the deed of suretyship. The surety raised an interesting defence; he argued that given the companies' financial position, the bank was wrong to keep advancing them funds. Their conduct resulted in the companies being hugely over-indebted. This caused loss to the surety in that his shares and loan claims effectively became nil in value.[343] Itzikowitz sought to recover from Absa Bank the amount of the reduction in the value of his shareholding in Compass Projects (Pty) Ltd.[344]

A reduction in market share value claim is a delictual claim for pure economic loss. It is important to note that it is well-established under South African law, that, as opposed to cases of physical harm, conduct causing pure economic loss is not *prima facie* wrongful.[345] The

[339] *Itzikowitz v Absa Bank* Ltd (20729/2014) [2016] ZASCA 43; 2016 (4) SA 432 (SCA).
[340] *Itzikowitz v Absa Bank* Ltd (20729/2014) [2016] ZASCA 43; 2016 (4) SA 432 (SCA).
[341] *Johnson v Gore Wood & Co (a firm)* [2002] 2 AC 1.
[342] *Itzikowitz v Absa Bank* Ltd (20729/2014) [2016] ZASCA 43; 2016 (4) SA 432 (SCA).
[343] Crotty A 'Grim news for Steinhoff shareholders' available at *https://www.businesslive.co.za/fm/money-and-investing/2018-10-18-grim-news-for-steinhoff-shareholders/* (accessed 9 September 2019).
[344] *Itzikowitz v Absa Bank* Ltd (20729/2014) [2016] ZASCA 43; 2016 (4) SA 432 (SCA).
[345] Constitutional Court in *Country Cloud Trading CC v MEC, Department of Infrastructure Development, Gauteng* [2014] ZACC 28; 2015 (1) SA 1 (CC) 23.

SCA confirmed the Constitutional Court's view in a different matter[346] that conduct which caused pure economic loss is not *prima facie* wrongful.[347] The plaintiff must be able to demonstrate that a right or legally recognised interest was infringed. If no wrong was committed against the plaintiff there can be no claim.[348] In approaching this enquiry, the court considered certain fundamental principles of company law, namely the nature of the company as a distinct legal personality, separate to that of its members. As such, the property of a company belongs to that company and not its shareholders.[349] The court cited the English decision of *Johnson v Gore Wood,* in which it was stated that one of the principles underpinning the reflective loss doctrine is that in law a company has a separate legal personality distinct from its shareholders. Consequently, a loss to the company, which causes a fall in the share price, is not a loss to the shareholders and that the shareholders cannot be said to have suffered a loss as a result of a breach of the duties owed to the company, simply as a result of the share price falling.

The court in *Itzikowitz* further held that that the point of departure for this type of enquiry must be to determine in which of the three categories identified in *Johnson v Gore Wood*[350] the claim falls.[351] The court ruled that the claim concerning pure economic loss falls squarely within the ambit of the first category. The court therefore ruled that Itzikowitz is not entitled to sue to recover the diminution in value of his shares in the absence of a breach of a duty owed to him.[352]

More recently Justice Molopa-Sethosa handed down judgment in the North Gauteng High Court, Pretoria in an important exposition of the law in relation to the personal liability of directors for causing pure economic loss.[353] In *Hlumisa Investment Holdings (RF) Limited v Kirkinis*, the North Gauteng High Court dealt with exceptions (brought by defendant directors) to the particulars of claim by plaintiff shareholders who were suing former directors of the African Bank in a developing case (the main action).[354] The plaintiffs in the main action were attempting to recover pure economic loss directly from defendant directors

[346] Constitutional Court in *Country Cloud Trading CC v MEC, Department of Infrastructure Development, Gauteng* [2014] ZACC 28; 2015 (1) SA 1 (CC) 23.
[347] *Itzikowitz v Absa Bank* Ltd (20729/2014) [2016] ZASCA 43; 2016 (4) SA 432 (SCA) *8.*
[348] *Itzikowitz v Absa Bank* Ltd (20729/2014) [2016] ZASCA 43; 2016 (4) SA 432 (SCA).
[349] *Itzikowitz v Absa Bank* Ltd (20729/2014) [2016] ZASCA 43; 2016 (4) SA 432 (SCA).
[350] See part 3.2.2 of chapter 3.
[351] *Itzikowitz v Absa Bank* Ltd (20729/2014) [2016] ZASCA 43; 2016 (4) SA 432 (SCA).
[352] *Itzikowitz v Absa Bank* Ltd (20729/2014) [2016] ZASCA 43; 2016 (4) SA 432 (SCA).
[353] *Hlumisa Investment Holdings (RF) Limited and Another v Kirkinis and Others* (100390/2015) [2018] ZAGPPHC 676; 2019 (4) SA 569 (GP).
[354] *Hlumisa Investment Holdings (RF) Limited & another v Kirkinis & others* (100390/2015) [2018].

as a result of a loss in the value of their shares in African Bank Investment Limited (ABIL).[355] They argued that in terms of section 218(2) of the Companies Act 2008, the defendants were liable to compensate the plaintiffs for the loss suffered as a result of the conduct of the directors which resulted in a diminution in value of their ABIL shares. The excipients (defendant directors in the main action in Hlumisa) argued that the plaintiffs' particulars of claim did not disclose a cause of action against them because the loss the plaintiffs were seeking to recover was not the plaintiff shareholders' loss, but that of the company. The Court's dismissal of attempts by African Bank's BEE shareholders to proceed with legal action against the bank's former CEO, Leon Kirkinis, has confirmed that in South African law shareholders cannot sue for what is referred to as "reflective" losses.[356]

The court cited the decision of *Itzikowitz*, stating that a loss to the company, which causes a fall in the share price, is not a loss to the shareholders and that the shareholders cannot be said to have suffered a loss as a result of a breach of the duties owed to the company, simply as a result of the share price falling.[357] In light of the *Hlumisa* judgment, South African shareholders should be mindful of their lack of capacity to bring a claim for "reflective losses" due to directors breaching the Companies Act 2008, resulting in a decrease in the share price of the company. Shareholders should be mindful that South African courts have held that decreases in the share price of a company are not regarded as losses being incurred by the shareholders, but are rather losses incurred by the company and are merely reflected in the share price.[358]

3.4 CONCLUSION

When a company suffers loss due to a wrongful act perpetrated against the company, the company's shareholders suffer where the value of their shares decreases. While many of the details surrounding whether shareholders can sue in these circumstances are shrouded in obscurity, it is clear that where a company and a shareholder have overlapping claims the shareholder cannot pursue its personal claim if its loss is merely reflective of the company's

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[355] *Hlumisa Investment Holdings (RF) Limited & another v Kirkinis & others* (100390/2015) [2018] 6-7.
[356] Crotty A 'Grim news for Steinhoff shareholders' available at *https://www.businesslive.co.za/fm/money-and-investing/2018-10-18-grim-news-for-steinhoff-shareholders/* (accessed 9 September 2019).
[357] *Hlumisa Investment Holdings (RF) Limited and Another v Kirkinis and Others* (100390/2015) [2018] ZAGPPHC 676; 2019 (4) SA 569 (GP).
[358] *Bell J, Lope R, & Collett M* 'Reflecting on the Concept of "Reflective Losses" in Company Law' available at *https://www.polity.org.za/article/reflecting-on-the-concept-of-reflective-losses-in-company-law-2019-08-15* (accessed 10 September 2019).

loss.[359] In these circumstances the 'no reflective loss' principle is commonly accepted as a practical and fair solution.

The 'no reflective loss' principle, as already established above, was first laid down in *Prudential Assurance*. In 2002 the House of Lords in *Johnson v Gore Wood*, authoritatively clarified and restated the scope and rationale of the rule barring shareholders from bringing personal actions to recover reflective loss.[360] Thus in the UK, shareholders have in principle no personal recourse against the wrongdoer because their loss is merely 'reflective' of the company's loss; the loss is for the company alone to recover.[361] English courts and scholars have persistently supported this reflective loss principle based on a variety of policy considerations. First, it has been argued that allowing a shareholder to recover reflective loss would result in the risk of double recovery.[362] Closely related to but conceptually distinct from double recovery is the concept of 'double jeopardy'. Proponents of this argument would conclude that it would be unfair and undesirable for the wrongdoer to risk paying double for the same wrong.[363] Further, it is seen as being prejudicial to corporate creditors. Lord Millett in Johnson v Gore Wood stated that 'protection of the interests of the company's creditors requires that it is the company which is allowed to recover to the exclusion of the shareholder'.[364] The reflective loss principle has been defended on the grounds that it reinforces the idea that the company's decision making processes are not to be interfered with.[365] In Lord Bingham's words: 'The court must respect the principle of company autonomy'.[366] SA's corporate law reforms coincided with similar developments in the UK, and benefited immensely from evolving UK best practices as far as pure economic loss claims by shareholders are concerned.[367]

Both countries' systems of corporate law unanimously prohibit shareholder claims for reflective loss, allowing only limited exceptions to the 'no reflective loss' principle. For both systems of law, it is irrelevant whether the shareholder has a separate cause of action, as these legal systems prohibit shareholder claims for reflective loss in either case. In general, it appears that the nature of the loss- reflective loss to shareholders resulting from a direct loss

[359] Ferran E 'Litigation by Shareholders and Reflective Loss' (2001) 60 *Cambridge Law Journal* 2 245-247.
[360] *Johnson v Gore Wood & Co (a firm)* [2002] 2 AC 1 72.
[361] Koh A 'Reconstructing the reflective loss principle' (2016) 16 *Journal of Corporate Law Studies* 373-401.
[362] *Johnson v Gore Wood & Co* [2000] UKHL 65; [2002] 2 A.C. 1 62.
[363] Koh A 'Reconstructing the reflective loss principle' (2016) 16 *Journal of Corporate Law Studies* 10.
[364] *Johnson v Gore Wood & Co* [2000] UKHL 65; [2002] 2 A.C. 1 62.
[365] Koh A 'Reconstructing the reflective loss principle' (2016) 16 *Journal of Corporate Law Studies* 15.
[366] *Johnson v Gore Wood & Co* [2000] UKHL 65; [2002] 2 A.C. 1 65.
[367] Mupangavanhu (2019) 109.

to the company- largely determines the prohibition of the recovery, regardless of a separate cause of action by shareholders.[368] If reflective loss is recoverable, the likely result is an increase in parallel proceedings and inconsistent decisions.[369]

In light of the above, in both the UK and SA, shareholders should take cognisance of their lack of capacity to bring a claim for reflective losses due to directors breaching their duties, resulting in a reduction in the share price of the company. It must be borne in mind that acts of directors which cause loss to the company are likely to also cause harm to shareholders and thus the 'no reflective loss' principle may come into play thereby preventing the shareholder from recovering against directors if his loss is reflective of the loss suffered by the company.[370] Yet, despite the said recent clarification of the position concerning pure economic loss personal claims by shareholders against negligent or fraudulent directors in South African common law,[371] today there are still legal proceedings being instituted where shareholders are seeking to recover pure economic losses through a personal claim against former and current directors. This thesis agrees with the observation made by some South African authorities, namely that the ambiguity in section 218 (2) pertaining to possible remedies for pure economic loss, is part of the cause of the confusion.[372] Chapter 4 will interrogate the appropriateness of section 218 (2) as a shareholder's remedy for pure economic loss.

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[368] Korzun V 'Shareholder claims for Reflective Loss: How International Investment Law Changes Corporate Law and Governance' (2018) 40: *U. Pa. J. Int'l L 1 192-254.*

[369] Lin S 'Barring Recovery for Diminution in Value of Shares on the Reflective Loss Principle' (2007) 66 *Cambridge Law Journal* 3 537-558.

[370] Chokuda C *The Protection of Shareholders' Rights versus Flexibility in the Management of Companies: A Critical Analysis of the Implications of Corporate Law Reform on Corporate Governance in South Africa with specific reference to protection of shareholders* (published PHD thesis, University of Cape Town, 2017).

[371] See *Itzikowitz v Absa Bank* Ltd (20729/2014) [2016] ZASCA 43; 2016 (4) SA 432 (SCA).

[372] For example, see views expressed in Mupangavanhu (2019) 110.

CHAPTER 4: APPROPRIATENESS OF THE SECTION 218(2) GENERAL REMEDY

4.1 INTRODUCTION

When directors are involved in decision-making such as approving misleading financial misstatements, the shareholders often suffer the consequences in the form of a diminution in their share price. The common law in South Africa and the UK holds that in these circumstances a shareholder does not have a cause of action to recover personal damages against a director simply because a company in which he or she holds shares, suffered damages. The SCA in *Itzikowitz* confirmed that this principle still applies in South African law today. Thus it is a principle of company law in South Africa that shareholders have no personal claim for damages in these circumstances; only the company suffering the loss has a claim against the third party causing the loss.[373] Yet, despite the SCA clarifying the contours between delicts committed against a company and those committed against a shareholder, there are still cases in which shareholders seek damages against directors for pure economic losses suffered by him or her.

The new Companies Act 2008 introduced a number of measures imputing general or personal liability of either the company *per se* or its directors.[374] Section 218(2) of the Companies Act 2008 is often used as the legislative basis for the personal liability of directors to shareholders.[375] Failure on directorship level in circumstances involving negligent or fraudulent financial misstatements has on more than one occasion resulted in aggrieved shareholders seeking to recover damages suffered and losses incurred in terms of section 218(2) of the Companies Act 2008.[376] Although section 218(2) creates an avenue through which shareholders may have recourse against company directors for the recovery of damages, it must be borne in mind that acts of directors which cause harm to shareholders are likely to also cause loss to the company and thus the 'no reflective loss' principle may come

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[373] Bracher P 'Claim by Shareholders Against Directors Under Section 218(2) of Companies Act fails' available at https://www.financialinstitutionslegalsnapshot.com/ (accessed 18 September 2019).
[374] *Chemfit Fine Chemicals (Pty) Ltd t.a SA Premix v Maake* (5772/2016) [2017] ZALMPPHC 27 28.
[375] *Chemfit Fine Chemicals (Pty) Ltd t.a SA Premix v Maake* (5772/2016) [2017] ZALMPPHC.
[376] *Hlumisa Investment Holdings (RF) Limited v Kirkinis* (100390/2015) [2018] ZAGPPHC 676; *Itzikowitz v Absa Bank Ltd* (20729/2014) [2016] ZASCA 43.

into play thereby preventing the shareholder from recovering against directors if his loss is reflective of the loss suffered by the company.[377]

In *Blue Farm Fashion Limited v Rapitrade 6 (Pty) Ltd and Others,*[378] the court conceded that there is some ambiguity in section 218(2). Read on its own, section 218(2) could create the impression that if a shareholder suffers pure economic loss as a result of a director's contravention a personal claim against a director for such loss is possible.[379] Some courts appear to have chosen to interpret section 218(2)[380] as allowing claimants e.g. creditors or anyone affected by the directors' contravention of 'any' provision of the Act—to claim personally against the directors for the consequent losses suffered.[381] The weight of the recent High Court decisions appear to lean towards allowing claimants to hold directors personally liable under section 218(2) of the Companies Act 2008—especially in reckless-trading cases.[382] This raises the question of whether a shareholder may bring an action against a director in terms of section 218(2) based on a diminution in the value of his or her shares brought about by a fiduciary's contravention of a provision in the Companies Act 2008, which amounts to a breach of duty owed to a company.

This thesis engages with the inquiry whether shareholders who suffer pure economic losses as a result of company directors' actions or decisions, can sustain personal claims against those directors. To answer this question, it is necessary to critically analyse the section 218(2) remedy. It is for this reason that this chapter investigates many related questions surrounding section 218(2) of the Companies Act 2008. This chapter will contain a brief discussion of the scope and interpretation of section 218(2) of the Companies Act 2008. Section 218(2) will be analysed, by looking at its appropriateness as a remedy for holding directors personally liable for the diminution in share price. Further, in this chapter, I will attempt to distinguish between diminution in share price cases from reckless trading cases. Shareholder litigants appear to have recently successfully pursued remedies for pure economic losses on the basis of section 218(2) with respect to reckless trading cases. This clarity regarding whether

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[377] Chokuda C 'The Protection of Shareholders' Rights versus Flexibility in the Management of Companies: A Critical Analysis of the Implications of Corporate Law Reform on Corporate Governance in South Africa with specific reference to protection of shareholders.' (published PhD thesis, University of Cape Town, 2017).
[378] See *Blue Farm Fashion Limited v Rapitrade 6 (Pty) Ltd and Others* (unreported case no 22288/2014 (WCC) 1 April 2016) 31.
[379] Mupangavanhu (2019) 110.
[380] When relied upon in conjunction with sections 22(1) and 77(3)(*b*) of the Companies Act 71 of 2008.
[381] Mupangavanhu (2019) 110.
[382] *Chemfit Fine Chemicals (Pty) Ltd ta SA Premix v Maake & others* (5772/2016) [2017] ZALMPPHC 27; *Rabinowitz v Van Graan and Others* 2013 (5) SA 315 (GSJ).

shareholders seeking remedies under section 218(2) for pure economic loss suffered have a cause of action to recover personal damages against directors in diminution of share value cases is important for the sake of legal certainty as already argued by other Corporate Law scholars.[383]

4.2 SCOPE AND INTERPRETATION OF SECTION 218(2)

Although section 218(2) of the Companies Act 2008 was in the 2008 Bill the accompanying explanatory memorandum is silent on the subject of its inclusion. Nor was it discussed in the 2004 White Paper "South African Company Law for the 21st Century". As a result, the scope of section 218(2) of the Companies Act 2008 has been debated since the law was enacted.[384] Section 218(2) is a section remarkable for both the its drafting simplicity and at the same time the magnitude of its impact. The drafters' attempted simplicity of the provision as a general remedy now has had an unintended consequence of generating unwanted controversies.[385] Section 218(2) of the Companies Act 2008 is titled 'Civil actions' and provides a remedy for affected parties for loss or damages suffered as a consequence of another person contravening provisions of the Companies Act 2008. Section 218(2) of the Companies Act 2008 provides that:

> Any person who contravenes any provision of this Act is liable to any other person for any loss or damage suffered by that person as a result of that contravention.[386]

The gist of section 218(2) is that it enables persons who allege they have suffered losses to claim back such losses provided that they can link such losses to a contravention of any provision of the Companies Act 2008.

Different adjectives have been used by courts and writers to describe the nature of the type of remedy provided to injured parties by section 218(2).[387] Section 218(2) has been described as

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[383] Mupangavanhu (2019) 112.
[384] Bracher P 'Claim by Shareholders Against Directors Under Section 218(2) of Companies Act fails' available at *https://www.financialinstitutionslegalsnapshot.com/* (accessed 18 September 2019).
[385] Cox I 'South Africa: The Misfit- Section 218(2) of the Companies Act 71 of 2008' available at *http://www.mondaq.com/southafrica/x/194898/Directors+Officers/THE+MISFIT+Section+218+2+Of+The+Companies+Act+71+Of+2008* (accessed 18 September 2019).
[386] S218(2) of the Companies Act 51 of 2008.
[387] Mupangavanhu (2019) 120.

a general section,[388] a general enabling remedy[389] or as Jooste describes it, a provision of general application.[390] Cassim et al views section 218(2) as a remedy providing for a 'wide scope and ambit'[391] and also as a good supplement to the specific liability provisions under section 77 of the Companies Act 2008.[392] Stein, agreeing with Cassim et al, points out that section 218(2) is 'wide enough to include a monetary claim by anyone against a director personally if that director contravened any provision of the Act ...'[393] According to Phatudi J in *Chemfit Fine Chemicals (Pty) Ltd t.a SA Premix v Maake*, properly interpreted, the civil liability made available under Section 218(2) brings about liability *sui generis*.[394]

The deliberate repetition of the word 'any' in section 218(2) stresses the section's extremely wide ambit.[395] The general enabling nature and wide ambit of section 218(2) can be attributed to the fact that section 218(2) is worded widely in respect of individuals who fall within its ambit and as a result has been the reason for the influx of claims by shareholders against directors.[396] Section 218(2) exposes directors to personal liability not only to the company, but also to other persons, including shareholders. In *Chemfit Fine Chemicals (Pty) Ltd t.a SA Premix v Maake*, the court held that properly interpreted, 'the civil liability made available under section 218(2) brings about liability sui generis against "any person" encompassing the directors, shareholders and any creditor to institute a claim against any person who "contravenes" any provision of the Act for any loss or damage incurred on account of the contravention.'[397] Liability in terms of section 218(2) is triggered as soon as there is a contravention of any provision of the Companies Act 2008. In addition, should section 218(2) be relied upon, it will not be necessary for a claimant to prove fraud or gross negligence.[398]

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[388] Bracher P 'Claim by Shareholders Against Directors Under Section 218(2) of Companies Act fails' available at ***https://www.financialinstitutionslegalsnapshot.com/*** (accessed 18 September 2019).
[389] Gerber S 'Reckless Trading and Building Contracts' (2016) 79 *Journal of Contemporary Roman-Dutch Law* 121-129; *Blue Farm Fashion Limited v Rapitrade* 6 (Pty) Ltd and Others (22288/2014) [2016] ZAWCHC 35 (1 April 2016) 12; Delport P & Vorster Q *Henochsberg on the Companies Act 71 of 2008* (2013); *Rabinowitz v Van Graan* (2012/26217) [2013] ZAGPJHC 151; Davis & Geach, *Companies and other Business Structures* 4 ed (Oxford University Press, 2019) 153.
[390] Jooste R 'Financial assistance to directors – the Companies Act 71 of 2008' (2010) *Acta Juridica* 165 180.
[391] Cassim F et al, *Contemporary Company Law* 2 ed (2012) 587.
[392] Cassim F et al, *Contemporary Company Law* 2 ed (2012) 582.
[393] Stein *The New Companies Act Unlocked* (2011) 407.
[394] *Chemfit Fine Chemicals (Pty) Ltd t.a SA Premix v Maake* (5772/2016) [2017] ZALMPPHC 27 30.
[395] Cassim F *Contemporary Company Law* 2 ed (2012) 582.
[396] *Hlumisa Investment Holdings (RF) Limited and Another v Kirkinis and Others* (100390/2015) [2018] ZAGPPHC 676; *Itzikowitz v Absa Bank Limited* (20729/2014) [2016] ZASCA 43.
[397] *Chemfit Fine Chemicals (Pty) Ltd t.a SA Premix v Maake* (5772/2016) [2017] ZALMPPHC 27.
[398] Grove P 'Company Directors: Fiduciary Duties and the Duty of Care and Skill' (published LLM thesis, University of Pretoria, 2012) 40.

Upon considering section 218(2) of the Companies Act 2008, the court in *Hlumisa Investment Holdings (RF) Limited and Another v Kirkinis*, acknowledged that the subsection is worded widely in respect of individuals who fall within its ambit. However, the court said that the subsection should be restricted in its application and applies only to "damage suffered by that person as a result of that contravention".[399] The court said that this restriction requires a particular person to have suffered damage as a result of a particular contravention.[400] What this means is that the person who suffered damage must be someone who is able to invoke a claim for damage as a result of a particular contravention of the Companies Act 2008. Put differently, any person, including a director, must have 'contravened' a provision of the Companies Act 2008 in order to be held personally liable to any other person in terms of section 218(2). I agree with the view that in order not to open the floodgates to frivolous claims based on every possible breach of the Companies Act 2008, the contravention has to be a contravention of a peremptory requirement rather than a mere directory requirement.[401]

In some cases, the courts have been reluctant to completely apply section 218(2) to 'any' contraventions of the Companies Act 2008.[402] Rehana Cassim suggests that section 218(2) imposes strict liability on defendants and applies even if the defendant had innocently contravened the Companies Act 2008, as long as the plaintiff suffered damages or loss as a result of the contravention.[403] However, classifying the *sui generis* kind of liability imposed by section 218(2) as 'strict liability' is controversial and has unfortunate consequences for defendants/respondents. In addition, section 218(2) may lead to interpretive challenges, due to the wording of certain provisions of the Companies Act 2008, concerning whether there has been a contravention of a provision of the Companies Act 2008 by a director entitling a person, other than the company, to bring an action in terms of section 218(2).[404] According to *Chemfit Fine Chemicals (Pty) Ltd t.a SA Premix v Maake*, in order to impute the alleged "contravention" of any provision against the alleged guilty party, the nature of the

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[399] *Hlumisa Investment Holdings (RF) Limited and Another v Kirkinis* (100390/2015) [2018] ZAGPPHC 676 26.

[400] *Hlumisa Investment Holdings (RF) Limited and Another v Kirkinis* (100390/2015) [2018] ZAGPPHC 676 26.

[401] Cremen G 'Paying the Piper' available at https://www.hoganlovells.com/en/publications/paying-the-piper (accessed 9 October 2019).

[402] *Itzikowitz v ABSA Bank* 2016 4 SA 432 (SCA).

[403] Cassim R 'A Critical Analysis of the Removal of Directors by the Board of Directors and the Judiciary under the Companies Act 71 of 2008' (published PhD thesis, University of South Africa, 2018) 253.

[404] Chokuda C 'The Protection of Shareholders' Rights versus Flexibility in the Management of Companies: A Critical Analysis of the Implications of Corporate Law Reform on Corporate Governance in South Africa with specific reference to protection of shareholders.' (published PhD thesis, University of Cape Town, 2017).

contravention within the ambit of Section 218(2) of the Companies Act 2008 must be considered.[405]

Due to the fact that the subsection does not specify which contravention the person may sue for, the shareholder who sues would have to specify with sufficient particulars which contraventions were attributed to the director(s) and the exact losses or damages.[406] It cannot, however, reasonably be expected of an applicant or a plaintiff to formulate a specific contravention and in turn causally link it meticulously with exactitude the "loss or damage" actually suffered. It would therefore be sufficient, if the applicant could establish that a "loss or damage" has been suffered "as a result of that contravention" contemplated in section 218(2).[407] As emphasised by the court in *Rabinowitz v Van Graan*[408] a director may only be held liable under section 218(2) of the Companies Act 2008 for loss or damage suffered as a result of a contravention of the Companies Act 2008. It follows that section 218(2) of the Companies Act 2008 would not be applicable to a breach of a common law fiduciary duty.[409] *Rabinowitz v Van Graan*, is the first reported decision in which a High Court has set out to make sense of the complexities of the Companies Act 2008 in regard to the various grounds on which the directors of a company can incur personal liability towards other parties, such as shareholders and outsiders, as distinct from incurring liability toward the company.[410]

The word "contravenes" though not defined, and when used judicially, implies violation or conduct repugnant to any provision under the Companies Act 2008 and the regulations made thereunder.[411] "Contravene" here would obviously mean any offence in terms of the Companies Act 2008, but, would also include any noncompliance with a provision of the Companies Act 2008 that may not be an offence.[412] The word "contravention" in section 218(2) is not limited to criminal contraventions; contraventions of the Companies Act 2008

[405] *Chemfit Fine Chemicals (Pty) Ltd t.a SA Premix v Maake* (5772/2016) [2017] ZALMPPHC 27 23.
[406] Delport P & Vorster Q *Henochsberg on the Companies Act 71 of 2008* (2013); *Rabinowitz v Van Graan and Others* 2013 (5) SA 315 (GSJ); *Sanlam Capital Markets* (*Pty*) *Ltd v Mettle Manco* (*Pty*) *Ltd and Others* [2014] 3 All SA 454 (GJ) 41.
[407] *Chemfit Fine Chemicals (Pty) Ltd t.a SA Premix v Maake* (5772/2016) [2017] ZALMPPHC 27 32.
[408] *Rabinowitz v Van Graan* (2012/26217) [2013] ZAGPJHC 151.
[409] Cassim R 'A Critical Analysis of the Removal of Directors by the Board of Directors and the Judiciary under the Companies Act 71 of 2008' (published PhD thesis, University of South Africa, 2018) 253.
[410] *Rabinowitz v Van Graan and Others* 2013 (5) SA 315 (GSJ).
[411] *Chemfit Fine Chemicals (Pty) Ltd SA Premix v Maake* (5772/2016) [2017] ZALMPPHC 27 30.
[412] Henochsberg on the Companies Act 71 of 2008.

which do not result in an offence but which nevertheless cause loss or damages are pursuable under section 218(2). [413]

The far-reaching sentence entrenched under section 218(2) goes beyond the common law and opens up the possibility for claims by other stakeholders, and by shareholders directly.[414] Section 218(2) potentially gives hope where the common law would not have gone far enough: as was the case in *Itzikowitz v Absa Bank Ltd,* where the common law delictual claim faltered due to inability to prove the sometimes very difficult element of wrongfulness in claims for pure economic loss but the claim under section 218(2) read with section 22 of the Companies Act 2008 at least survived the exception stage.[415]

The common law position is much more clear to that of section 218(2) as the common law allows the company only and not shareholders, to sue directors for losses incurred as a result of a director's improper conduct, and one of the well-established principles of statutory interpretation is that a statute does not alter the existing common law more than necessary.[416] A further relevant common-law rule of statutory interpretation is that a statutory provision must be construed in conformity with the common law rather than against it, save where the statute is manifestly intended to alter the common law.[417] If there has to be a departure from this rule, the statute must either expressly state that it is the intention of the legislature to alter the common law, or that there should be no conclusion other than to find that the legislature intended to alter the common law.[418] This is a rebuttable presumption created by the common law. This presumption enhances legal certainty, discourages destabilisation or unsettling of the law and manifests recognition of the status and value of the common law.[419] Nothing in section 218(2) explicitly states that the legislature intended to amend the common-law rule applicable to claims for pure economic loss arising from reflective loss (reduction in share value).[420] Nor can the section be construed to mean that only one conclusion is possible from

[413] *Chemfit Fine Chemicals (Pty) Ltd SA Premix v Maake* (5772/2016) [2017] ZALMPPHC 27 30.
[414] Reddell C *Directors' Liability and Climate Risk: South Africa - Country Paper* (2018) Commonwealth Climate and Law Initiative.
[415] Kleitman Y 'Director Liability' available at *https://withoutprejudice.co.za/article/5043/view* (accessed 2 October 2019).
[416] Bracher P 'Claim by shareholders against directors under section 218(2) of Companies Act fails' available at *https://www.financialinstitutionslegalsnapshot.com/2018/10/claim-by-shareholders-against-directors-under-section-2182-of-companies-act-fails/* (accessed on 29 March 2019).
[417] Mupangavanhu (2019)124.
[418] Mupangavanhu (2019)124.
[419] *Hlumisa Investment Holdings (RF) Limited v Kirkinis* (100390/2015) [2018] ZAGPPHC 676; *Itzikowitz v Absa Bank Ltd* (20729/2014) [2016] ZASCA 43 32.
[420] Mupangavanhu (2019)125.

reading section 218(2); that it evidences a manifest legislative intent to alter the common law.[421]

The Companies Act 2008 provides in section 5 that its provisions should be interpreted in a way which gives effect to its purposes as set out in section 7. It has been argued, correctly so in my view, that section 5(1) shows that the appropriate approach to the interpretation of provisions of the Companies Act 2008 is a purposive or contextual approach.[422] Context includes a consideration of the national context in the sense of background issues, common-law principles that remain relevant, and public policy considerations.[423] To interpret section 218(2) so widely as to make serious inroads into the common-law rules and allow for a remedy for reflective loss is inconsistent with the need to interpret the Companies Act 2008 in a way which promotes 'the spirit, purport and objects' of the Companies Act 2008.[424] Judging from the context of the Companies Act 2008, it cannot be argued that common-law rules dealing with fault, foreseeability, liability, causation, and the proper-plaintiff rule, are in any way altered or discarded by section 218(2).[425]

If section 218(2) is a general remedy as stated by courts and writers, the question that needs to be answered in light of the judgments, is whether it should be interpreted widely or narrowly in different contexts.[426] In *Blue Farm Fashion Limited*, Matame J concluded that the approach to be adopted when interpreting section 218(2) is a narrow approach because of the ambiguity of the section.[427] Matame J explained that a narrow approach is to be adopted where the language is ambiguous, as is the case with section 218(2) of the Companies Act 2008.[428] To interpret section 218(2) too widely, and adopt a wider meaning, would lead to a manifest absurdity which would not have been intended by the legislature.[429] This was confirmed in *Chemfit Fine Chemicals (Pty) Ltd t.a SA Premix v Maake*. In *Chemfit Fine Chemicals (Pty) Ltd t.a SA Premix v Maake*, the court emphasised that the approach to be adopted when interpreting section 218(2) is a narrow approach because of the ambiguity of

[421] Mupangavanhu (2019)126.
[422] S5(1) of the Companies Act 71 of 2008; Mupangavanhu (2019)123.
[423] Mupangavanhu (2019)123.
[424] See s7 of the Companies Act 71 of 2008; Mupangavanhu (2019)125.
[425] Mupangavanhu (2019)125.
[426] Mupangavanhu (2019)123.
[427] *Blue Farm Fashion Limited v Rapitrade 6 (Pty) Ltd and Others* (unreported case no 22288/2014 (WCC) 1 April 2016) 31.
[428] *Blue Farm Fashion Limited v Rapitrade 6 (Pty) Ltd and Others* (unreported case no 22288/2014 (WCC) 1 April 2016) 29.
[429] See *Blue Farm Fashion Limited v Rapitrade 6 (Pty) Ltd and Others* (unreported case no 22288/2014 (WCC) 1 April 2016) 29, as cited in Mupangavanhu (2019)124.

the section.[430] In *Hlumisa Investment Holdings (RF) Limited & Eyomhlaba Investment holding (RF) Limited v Leonidas Kirkinis* the court stated that a too wide of interpretation of section 218(2) would result in a situation where a director of a company is potentially liable to parties who, 'he, or she, has not met, has not heard of, and is entirely unaware of.'[431] I agree with the judges' preferred approach to the interpretation of section 218(2) of the Companies Act 2008.

4.3 APPROPRIATENESS OF THE SECTION 218(2) GENERAL REMEDY – DIMINUTION OF SHARE VALUE CASES AND RECKLESS TRADING CASES DISTINGUISHED

The SCA in *Itzikowitz* did not seize the opportunity to clearly draw the line between the applicability of the section 218(2) remedy to reckless trading cases and cases involving a reduction in shareholding value. It is not clear why the court chose to avoid drawing that distinction. The answer may well be that the court felt that the occasion had not yet arrived to make such a distinction.[432] Despite this omission by the court, drawing a distinction in the applicability of section 218(2) to either reckless trading cases or reduction in shareholding value cases is unavoidable. I agree with the view expressed that for whatever reason the court elected not to clarify this issue, the lack of clarity will continue to encourage litigant shareholders to found claims against directors for a reduction in shareholding value within the wide scope and ambit of section 218(2).[433] It is hoped that the SCA will at some future stage, provide this kind of clarity and draw a line between the applicability of section 218(2) to reckless trading cases, and the non-applicability of the remedy to reduction in shareholding value cases.

4.3.1 Diminution of share value cases

Cases concerning pure economic loss require special attention in corporate law mainly because it imposes a limitation problem. There has never been a universally accepted definition of "pure economic loss",[434] nor any of its many synonyms.[435] Pure economic loss

[430] *Chemfit Fine Chemicals (Pty) Ltd t.a SA Premix v Maake* (5772/2016) [2017] ZALMPPHC 27 39; see also *Blue Farm Fashion Limited v Rapitrade* 6 (Pty) Ltd and Others (22288/2014) [2016] ZAWCHC 35 (1 April 2016).

[431] *Hlumisa Investment Holdings (RF) Limited and Another v Kirkinis* (100390/2015) [2018] ZAGPPHC 676.

[432] Mupangavanhu (2019)122.

[433] Mupangavanhu (2019)122.

[434] Herath A 'Pure Economic Loss' (2017).

[435] Also referred to as commercial loss, financial loss and pecuniary loss.

has been defined to mean financial loss which is sustained by a plaintiff with no accompanying physical harm to his or her person or property.[436] Harms JA, in *Telematrix (Pty) Ltd v Advertising Standards Authority* SA[437], gave a comprehensive definition of the term pure economic loss. He defined pure economic loss to mean 'loss that does not arise directly from damage to the plaintiff's person or property but rather in consequence of the negligent act itself, such as loss of profit, being put to extra expenses or the diminution in the value of property'.[438] South African courts have taken a cautious approach when they have to decide a pure economic loss issue.[439] In *Itzikowitz v Absa Bank Ltd*, Ponnan JA found it necessary to reiterate the cautious approach taken by our courts when they have to decide a pure economic loss issue by quoting from the judgment of the Constitutional Court in *Country Cloud Trading CC v MEC, Department of Infrastructure Development.* In *Country Cloud Trading CC v MEC, Department of Infrastructure Development,* the court focused on the general reluctance of our courts to recognise pure economic loss claims, "especially where it (*sic*) would constitute an extension of the law of delict."[440]

> [s]o our law is generally reluctant to recognise pure economic loss claims, especially where it would constitute an extension of the law of delict. Wrongfulness must be positively established. It has thus far been established in limited categories of cases, like intentional interferences in contractual relations or negligent misstatements, where the plaintiff can show a right or legally recognised interest that the defendant infringed.[441]

It was further argued in *Country Cloud Trading cc v MEC: Department of Infrastructure Development* that 'if claims for pure economic loss are too-freely recognised, there is the risk of liability in an indeterminate amount for an indeterminate time to an indeterminate class'.[442] The decision of the court in *Country Cloud Trading CC v MEC, Department of Infrastructure Development*, seems to lean strongly towards a more restrictive approach to liability for pure economic loss, and is currently the apex of a long line of South African judgments which have been grappling with this notion in our law.[443] Our courts try not to impose indeterminate

[436] *Country Cloud Trading cc v MEC: Department of Infrastructure Development* (751/12) [2013] ZASCA 22.
[437] *Telematrix (Pty) Ltd v Advertising Standards Authority* SA (459/2004) [2005] ZASCA 73.
[438] *Telematrix (Pty) Ltd v Advertising Standards Authority* SA (459/2004) [2005] ZASCA 73 1.
[439] Scott J 'An Unsuccessful Long Shot Aimed at Effecting Liability for Causing Pure Economic Loss: *Itzikowitz v ABSA Bank* 2016 4 SA 432 (SCA)' (2017) 80 J*ournal of Contemporary Roman-Dutch Law.*
[440] Scott J 'An Unsuccessful Long Shot Aimed at Effecting Liability for Causing Pure Economic Loss: *Itzikowitz v ABSA Bank* 2016 4 SA 432 (SCA)' (2017) 80 J*ournal of Contemporary Roman-Dutch Law.*
[441] *Country Cloud Trading cc v MEC: Department of Infrastructure Development* (751/12) [2013] ZASCA.
[442] *Country Cloud Trading cc v MEC: Department of Infrastructure Development* (751/12) [2013] ZASCA 24.
[443] *Country Cloud Trading cc v MEC: Department of Infrastructure Development* (751/12) [2013] ZASCA.

liability for causing pure economic loss as this would result in opening the floodgates of liability.[444]

The appellant in *Itzikowitz* failed to rely on the provisions of section 218(2) of the Companies Act 2008 in an attempt to recover loss suffered as a result of devaluation of its shareholding caused by the actions of the respondent.[445] The court ruled that a shareholder cannot recover a sum equal to a reduction in the market value of his or her shares, or equal to the likely reduction of dividends.[446] Such a loss should be correctly understood in law as merely reflecting the loss suffered by the company. The shareholder does not suffer any personal loss except through the company as reflected in the reduction in the value of the company's net assets.[447]

When Section 218(2) is read in context, particularly where a breach of Section 76(3) is relied upon by a plaintiff to establish the defendant's liability to compensate it for damages under section 218(2), the provisions of Section 77(2) must be considered. Section 77(2) expressly requires a claim for a breach of Section 76(3) to be brought "in accordance with the principles of the common law".[448] The result of the reference to the common law in Section 77(2) is that a reflective loss claim cannot be brought under Section 77(2) because the common law does not permit such a claim. What the plaintiffs' in *Hlumisa's argument* involves is a finding that the Companies Act 2008 allows a reflective loss claim which the common law prohibits if the claim is brought under Section 76(3).[449] At common law there is no assumed or automatic liability to third parties for breach of a statute causing pure economic loss, unless provided otherwise by the statute itself; one has to apply the principles developed in the law of delict around wrongfulness in the context of losses caused by statutory breaches.[450] Judge Brand JA in the Supreme Court of Appeal judgment of *Country Cloud Trading cc v MEC: Department of Infrastructure Development*[451] declared that 'wrongfulness in the context of delictual liability for pure economic loss is ultimately dependent on an evaluation based on considerations of legal and public policy'[452] and that

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[444] Loubser M et al *The Law of Delict in South Africa* 3 ed (2018).
[445] *Itzikowitz v ABSA Bank* 2016 4 SA 432 (SCA) 6.
[446] *Itzikowitz v ABSA Bank* 2016 4 SA 432 (SCA) 12.
[447] *Prudential Assurance Co Ltd v Newman Industries Ltd* (No 2) [1982] Ch 204 222–223.
[448] *Hlumisa Investment Holdings (RF) Limited v Kirkinis* (100390/2015) [2018] ZAGPPHC 676 40.
[449] *Hlumisa Investment Holdings (RF) Limited v Kirkinis* (100390/2015) [2018] ZAGPPHC 676 41.
[450] Kleitman Y 'Director Liability' available at *https://withoutprejudice.co.za/article/5043/view* (accessed 2 October 2019).
[451] *Country Cloud Trading cc v MEC: Department of Infrastructure Development* (751/12) [2013] ZASCA 16.
[452] *Country Cloud Trading cc v MEC: Department of Infrastructure Development* (751/12) [2013] ZASCA 18.

‘the enquiry is thus: do these policy considerations require that harm causing conduct should be declared wrongful and consequently render the defendant liable for the loss, or do they require that harm should remain where it fell, i.e. with the plaintiff?’[453]

Under South African law the *Aquilian* action is in principle available to claims for damages arising from pure economic loss, therefore in order for a plaintiff to successfully make a case for pure economic loss, the elements of Delict should be proven. The elements of Delict are harm, conduct, causation, fault and wrongfulness.[454] When having to decide a pure economic loss issue, it would appear that the courts attach the utmost importance to the element of wrongfulness. The primary problem of where to draw the line in deciding on liability for pure economic loss (the limitation problem) in most cases is resolved by applying the principles attaching to the determination of wrongfulness, where policy considerations are of crucial importance.[455] In doing so, the court will ordinarily establish whether a legal duty exists and it will be guided by examining several policy factors.[456] There is no general right not to be caused pure economic loss.[457] It therefore follows that conduct causing pure economic loss is not *prima facie* wrongful.[458] In *Itzikowitz v Absa Bank Ltd*, the court commenced its reasoning on the issue of pure economic loss by emphasising, with reference to Harms JA’s judgment in *Steenkamp v Provincial Tender Board, Eastern Cape*[459], the generally-accepted position that conduct causing such loss is not to be regarded as *prima facie* wrongful. Its wrongfulness depends on the existence of a legal duty.[460]

As discussed above, nothing in section 218(2) indicates that the legislature intended to alter the common law and allow shareholder value loss claims to be brought under section 218(2).[461] Thus section 218(2) does not extend to cases where shareholders suffer a loss through a diminution in share price. Indeed, as the Constitutional Court pertinently pointed out in *Country Cloud*:

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[453] *Country Cloud Trading cc v MEC: Department of Infrastructure Development* (751/12) [2013] ZASCA 18.
[454] Loubser M et al *The Law of Delict in South Africa* 3 ed (2018) 25.
[455] Scott J ‘An Unsuccessful Long Shot Aimed at Effecting Liability for Causing Pure Economic Loss: *Itzikowitz v ABSA Bank* 2016 4 SA 432 (SCA)’ (2017) 80 J*ournal of Contemporary Roman-Dutch Law.*
[456] Herath A ‘Pure Economic Loss’ (2017).
[457] *Country Cloud Trading cc v MEC: Department of Infrastructure Development* (751/12) [2013] ZASCA 22.
[458] *Country Cloud Trading cc v MEC: Department of Infrastructure Development* (751/12) [2013] ZASCA 22.
[459] *Steenkamp v Provincial Tender Board, Eastern Cape* 2006 3 SA 151 (SCA) 155F.
[460] Herath A ‘Pure Economic Loss’ (2017).
[461] Bracher P ‘Claim by shareholders against directors under section 218(2) of Companies Act fails’ available at *https://www.financialinstitutionslegalsnapshot.com/2018/10/claim-by-shareholders-against-directors-under-section-2182-of-companies-act-fails/* (accessed on 29 March 2019).

> Until we are satisfied the department *wronged* Country Cloud, its claim does not get off the ground'. Absa's primary contention is, in principle, very simple: It is that damage, if suffered at all, had been suffered by AMU and that the appellant, being no more than in the position of a shareholder thrice removed from that company, could not sue to recover its (AMU's) loss or in the language of *Country Cloud*, that the appellant had not been 'wronged' by Absa.[462]

The court in *Hlumisa Investment Holdings (RF) Limited & Eyomhlaba Investment holding (RF) Limited v Leonidas Kirkinis* took the view that allowing a claim for diminution in share value under section 218(2) of the Companies Act 2008 is, 'an enormous departure from the clearly established legal principles'. The court said that if a departure from the common law position has been intended, then the statute would have said something along the lines of "notwithstanding anything in the common law".[463] The court said that even if the plaintiffs could advance a claim for a breach of section 76(3) under section 218(2), they must show that section 218(2) has altered the common law to allow a reflective loss. The court held that there was nothing to indicate that the legislature intended to alter the common law and allow reflective loss claims to be brought in terms of this section. Justice Molopa-Sethosa said that the Plaintiffs' reliance on section 218(2) to found a reflective loss claim does not establish a claim that can be sustained in law, and does not avoid the exception that the defendants have taken. [464]

4.3.2 Reckless trading cases

The section 218(2) remedy has been successfully applied by litigants chiefly in reckless trading cases involving a breach of the statutory reckless trading provision under section 22(1) of the Companies Act 2008. South African corporate law previously regulated reckless trading in terms of the Companies Act 61 of 1973 ('1973 Act'). Section 424(1) of the 1973 Act allows for the piercing of the corporate veil, and gives the court powers to impose personal liability on directors and anyone who was a party to reckless and fraudulent trading

[462] *Country Cloud Trading cc v MEC: Department of Infrastructure Development* (751/12) [2013] ZASCA 43.
[463] *Hlumisa Investment Holdings (RF) Limited v Kirkinis* (100390/2015) [2018] ZAGPPHC 676; *Itzikowitz v Absa Bank Ltd* (20729/2014) [2016] ZASCA 43.
[464] *Hlumisa Investment Holdings (RF) Limited v Kirkinis* (100390/2015) [2018] ZAGPPHC 676; *Itzikowitz v Absa Bank Ltd* (20729/2014) [2016] ZASCA 43.

of the company.[465] The 1973 Act has, however, been repealed by the Companies Act 2008. Currently reckless trading is regulated by the Companies Act 2008.

In 2008, the Companies Act 2008 was enacted, which has introduced a few statutory prohibitions and otherwise offensive conduct by either the Company or its constituent members or directors.[466] An example of such a prohibition is the provisions of section 22(1)(a) and (b).[467] Sections 22 and 77(3)*(b)* of the Companies Act 2008 were introduced to deal with the issue of reckless and fraudulent trading of companies.[468] The Companies Act 2008 came into force in 2011 and has brought a new interpretation to the issue of reckless and fraudulent trading by a company. The effect of Schedule 5, item 9(1) read with item 9(4) of the Companies Act 2008 is that Chapter 14 of the 1973 Act continues to apply with respect to winding-up and liquidation of solvent or insolvent companies until a date determined by the Minister. Chapter 424(1) of the 1973 Act forms part of Chapter 14 of the 1973 Act thus section 424(1) survives the repeal of the 1973 Act through the retention of chapter 14 of the 1973 Act. Section 424(1) applies to companies whether solvent or not, that are in winding-up and liquidation. If, however, the company is not in winding-up, section 22 of the Companies Act 2008, and not section 424 of Act 1973, will apply.[469]

Section 22(1) of the Companies Act 2008 prohibits a company from carrying on its business recklessly, with gross negligence, with intent to defraud any person or for any fraudulent purpose.[470] In essence, section 22(1) prohibits a company from conducting its affairs in a reckless or fraudulent manner, and section 76(3) provides that the director of a company must exercise the powers and perform the functions of a director in good faith and for proper purpose, in the best interest of the company as the directors manage the company. Section 76(3) also houses an equally important duty of care, skill and diligence. Should the directors allow the company to conduct its affairs in a reckless or fraudulent manner and with the intent to defraud a third party, such directors would be breaching their fiduciary duties as provided in section 76.

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[465] Phungula I 'Lessons to be learned from reckless and fraudulent trading by a company: Section 424(1) of the Companies Act 61 of 1973 and sections 22 and 77(3)(b) of the Companies Act 71 of 2008' (2016) *SA Merc LJ* 238 1.
[466] *Chemfit Fine Chemicals (Pty) Ltd t.a SA Premix v Maake* (5772/2016) [2017] ZALMPPHC 27 23.
[467] *Chemfit Fine Chemicals (Pty) Ltd t.a SA Premix v Maake* (5772/2016) [2017] ZALMPPHC 27 23.
[468] Phungula I 'Lessons to be learned from reckless and fraudulent trading by a company: Section 424(1) of the Companies Act 61 of 1973 and sections 22 and 77(3)(b) of the Companies Act 71 of 2008' (2016) *SA Merc LJ* 238 1.
[469] Cassim F *Contemporary Company Law* 2 ed (2012) 588.
[470] S22(1) of the Companies Act 71 of 2008.

In addition, section 77 creates liability of the director/s relevant to the common law principles relating to breach of fiduciary duties. The liability is for any loss, damage or costs sustained by the company. In this regard the liability of the directors arises in the event of an infringement of the common law principles founded in a breach of fiduciary obligations as a result of which the company incurs "any loss, damages or costs".[471] Section 77(3)(*b*) of the Companies Act 2008 states that a director of a company is liable for any loss, damages or costs sustained by the company as a direct or indirect consequence of the director having 'acquiesced in the carrying of the company's business despite knowing that it was being conducted in a manner prohibited by section 22(1)'.[472] In terms of section 78(6) of the Companies Act 2008, a company may not indemnify a director in respect of any liability arising from section 77(3)(b) of the Companies Act 2008.[473] Reckless trading will consequently result in a company director being held personally liable to the company for loss, damages or costs directly or indirectly sustained by the company.

Section 22(1) of the Companies Act 2008 is the equivalent of portion of section 424(1) of the 1973 Act, but there is one fundamental difference between these two provisions. While section 22(1) prohibits a company from carrying on its business in a certain manner, section 424 contains no such prohibition. Instead section 424(1) deals with the consequences of a company's business being conducted in a reckless or fraudulent manner by subjecting the wrongdoer, usually a director, to personal liability for the company's debts if that person was knowingly a party to the carrying on of the company's business recklessly or fraudulently.[474]

Whilst Section 22(1) establishes a prohibition against reckless trading, it does not, of itself, provide for personal liability of directors. The imposition of personal liability on directors for reckless trading may be regarded as an important precautionary measure against gross mismanagement of the business and affairs of a company. The burden of personal liability in this regard is well placed if one considers that the management of a company's business and affairs is vested with its board of directors.[475]

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[471] *Chemfit Fine Chemicals (Pty) Ltd t.a SA Premix v Maake* (5772/2016) [2017] ZALMPPHC 27 28.2.
[472] S77(3)(b) of the Companies Act 71 of 2008.
[473] S78(6) of the Companies Act 71 of 2008.
[474] Stein C *The New Companies Act Unlocked* (2008) 4.
[475] S66 (1) of the Companies Act 71 of 2008.

4.3.2.1 The simultaneous application of section 22(1) and section 218(2)

Various authors writing on the interpretation of section 218(2) suggest that directors are personally liable under section 218(2) of the Companies Act 2008 if section 22(1) is breached. In this regard Cassim in 'Cotemporary Company Law' states that 'a further important statutory provision that must not be overlooked in this context[476] is section 218(2).[477]

According to Myburgh, section 218(2) serves as the basis on which a director who contravenes the provisions of section 22(1) of the Companies Act 2008, by trading recklessly, with gross negligence, with intent to defraud any person or for any fraudulent purpose, and thereby causes loss or damage to any person, can be held liable for that loss or damage.[478] Furthermore, it appears that some High Courts, such as in Limpopo and the Western Cape,[479] are prepared to allow personal claims against directors under section 218(2) in the context of 'reckless trading' cases.[480] Thus section 218(2) of the Companies Act 2008 can be said to be an important statutory provision in the context of section 22(1) of the Companies Act 2008. The wide scope and ambit of section 218(2) has already been emphasised elsewhere in chapter 4.[481]

In *Rabinowitz v Van Graan*, it was necessary for the court to make a determination whether a third party could hold a director liable for breach of section 22(1), as read with section 218(2) of the Companies Act 2008.[482] *Rabinowitz v Van Graan* indicated that a third party should be able to use section 218(2) to sue a director personally for damages and losses suffered by the third party as a result of the company's reckless or fraudulent trading in contravention of section 22. This is despite the fact that the prohibition in section 22 is placed on the 'company' and not actually on the 'directors'. Naturally legal counsel for any director who is sued under section 218(2) read with section 22 would take cognisance of the fact that section 22 refers to "the company" and not "the directors". This argument has so far been rejected by the courts on the basis that ultimately the company, being an artificial being, acts, and can

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[476] The context being a consideration of fraudulent, reckless and insolvent trading prohibited by s22 of the Companies Act 71 of 2008.
[477] Cassim F *Contemporary Company Law* 2 ed (2012) 582.
[478] Myburgh E 'Holding delinquent directors personally liable' (2017) *De Rebus* 29.
[479] *Chemfit Fine Chemicals (Pty) Ltd ta SA Premix v Maake & others* (5772/2016) [2017] ZALMPPHC 27 (1 September 2017) 42.; *Rabinowitz v Van Graan & others* 2013 (5) SA 315 (GSJ) 22.
[480] Mupangavanhu (2019)112.
[481] See part 4.2 of chapter 4.
[482] *Rabinowitz v Van Graan and Others* 2013 (5) SA 315 (GSJ).

only act, through natural persons such as its directors.[483] In turn, that would allow the third party who has suffered loss to institute action against the directors through Section 218(2) of the Companies Act 2008 that is the enabling provision.[484] Similarly, in *Chemfit Fine Chemicals*, the defendant directors were ordered to pay damages pursuant to the provisions of section 218(2) of the Companies Act 2008 in the amount of R3 126 344.41 in a personal claim in which the directors were held liable for causing the company to trade while insolvent.[485] While shareholders (as third parties) are not allowed to claim for pure economic loss arising from diminution of share value, other third parties such as creditors are allowed to claim in the context of section 22(1) despite the fact that section 22(1) read together with section 77(3) (b) appears to indicate that the company is the proper plaintiff.

In *Rabinowitz v Van Graan & others,* Du Plessis AJ further ruled that 'a third party can hold a director personally liable in terms of the Act for acquiescing in or knowing about conduct that falls within the ambit of section 22(1)'.

In *Blue Farm Fashion Limited v Rapitrad*, the plaintiff contended in its particulars of claim, that he had instituted a civil action against the directors, and argued that they be personally held liable for a loss or damage because they were knowingly a party to the reckless or fraudulent conduct of the company's business as provided for in Section 77(3)(b) and (c).[486] The absence of an express reliance by the plaintiff on section 218(2) does not result in the particulars of claim disclosing no cause of action.[487] In *Bato Star Fishing*, O'Regan J held that:

> [w]here a litigant relies upon a statutory provision, it is not necessary to specify it, but it must be clear from the facts alleged by the litigant that the section is relevant and operative.[488]

Recent cases reveal that in enforcing personal liability under section 218(2) of the Companies a director can be held personally liable in terms of section 218(2) as read with section 22(1) of the Companies Act 2008 provided that a plaintiff can prove the exact contravention of the

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[483] *Rabinowitz v Van Graan and Others* 2013 (5) SA 315 (GSJ); *Blue Farm Fashion Limited v Rapitrade 6 (Pty) Ltd and* Others (22288/2014) [2016] ZAWCHC 35.
[484] *Blue Farm Fashion Limited v Rapitrade 6 (Pty) Ltd and Others* (22288/2014) [2016] ZAWCHC 35 15.
[485] In other words the directors contravened s 218(2) and became personally liable to creditors for actions inconsistent with s 22(1) of the Act. See *Chemfit Fine Chemicals* 42.
[486] *Blue Farm Fashion Limited v Rapitrade* 6 (Pty) Ltd and Others (22288/2014) [2016] ZAWCHC 35 22.
[487] *Blue Farm Fashion Limited v Rapitrade* 6 (Pty) Ltd and Others (22288/2014) [2016] ZAWCHC 35 22.
[488] *Bato Star Fishing (Pty) Ltd v Minister of Environmental Affairs* 2004 (4) 490 (CC) *at 507 C – D.*

Companies Act 2008 as well as the causation between the loss suffered and the reckless or fraudulent trading.[489]

4.4 CONCLUSION

Company law is not solely based on legislation, but also on common law principles. The common law no reflective loss rule applies to the overlap between personal claims of shareholders and that of the company. The principle may well be extended equally to section 218(2) of the Companies Act 2008. It is implicit from the judgment in *Itzikowitz* that, unlike in reckless trading matters, a third party cannot hold a director personally liable in terms of section 218(2) in order to recover damages equal to the loss in the market value of his or her shares. Section 218(2) is not a backdoor for investors in shares to derive the advantage of personally claiming against directors, which advantage is typically reserved for the company as a principal. The possibility of loss of share value on the stock market is a business risk that shareholders are expected to personally carry, as investors. In this construction, a loss to a company as a result of a fall in its share price value is thus not an actionable loss to a shareholder.

s22(1) read together with s218(2) creates liability for a director as fiduciary, to his/her company, for causing the company to trade under insolvent circumstances. It would appear, judging from the *Rabinowitz, Blue Farm* and *Chemfit* cases that a director will be liable too, to a third party such as a creditor who may be affected by the contravention of s22(1) by the director. Intrinsically connected to section 22(1), is the general civil liability created by the provisions of Section 218(2) which imposes liability once, again, to "any person" who "contravenes" any provisions of the Act.[490] The nature of liability is one for "any loss or damage" suffered by the aggrieved party arising from the contravention.A third party may institute action if he suffers loss or damage as a result of reckless and fraudulent trading as described in section 22.[491] The enforceability of section 218(2) of the Companies Act 2008 has been crystallised in the case of *Rabinowitz v Van Graan*. The court confirmed that a director can be held personally liable in terms of section 218(2) as read with section 22(1) of

[489] 'Personal Liability of Directors: Whither Section 424? – South Africa' available at *https://www.hg.org/legal-articles/personal-liability-of-directors-whither-section-424-south-africa-27066* (accessed 9 October 2019).
[490] *Chemfit Fine Chemicals (Pty) Ltd t.a SA Premix v Maake* (5772/2016) [2017] ZALMPPHC 27 28.5.
[491] Gerber S 'Reckless Trading and Building Contracts' (2016) 79 *Journal of Contemporary Roman-Dutch Law* 121-129.

the Companies Act 2008. The court stated, however, that a plaintiff has to allege and prove the exact contravention of the Companies Act 2008 as well as the causation between the act complained of and the damages suffered.

The full ambit of section 218(2) of the Companies Act 2008 has been ventilated in our courts, what can be said with definite certainty is that stakeholders suffering harm at the hands of reckless directors are not left remediless. It is contraventions of this nature that invariably attracts personal liability of the directors within the meaning and purport of section 218(2) and ancillary provisions. Extending liability under section 218(2) of the Companies Act 2008 to every breach of a statutory duty would open the floodgates to claims the legislature never intended, thus creating the risk of unjust and potentially ruinous claims.

CHAPTER 5: CONCLUSIONS AND RECOMMENDATIONS

5.1 INTRODUCTION

The main objective of this research has been to draw attention to the potential importance or the impact of section 218(2) of the Companies Act 2008. After considering the information put forward, in chapter 2 to 4 above, it is important to consider the main points that have arisen as a result. Thus the main focus of this concluding chapter is to summarise the findings of this research, including the steps followed to reach the conclusions arrived at. The importance of each chapter in contributing towards an attempt to find solution(s) to the key research question and sub-inquiries will be outlined in part 5.2, a part that provides chapter summaries. This is followed by part 5.3 which discusses recommendations to provide a beneficial guide that will resolve certain issues that have been identified.

5.2 SUMMARY OF THE SALIENT FEATURES ACROSS CHAPTERS 1-4

5.2.1 The research focus (the legal problem)

Chapter 1 introduced the key research question, namely whether shareholders can sustain personal claims against directors on the basis of section 218(2) of the Companies Act 2008 for suffering pure economic losses arising from diminution of shareholding value, say through directors' negligent behaviour such as approving misleading financial statements.[492] Although the position seems to be settled in our law, we still have incidences where shareholders are seeking to hold directors personally liable for the diminution in share price. The fact that after *Itzikowitz v Absa Bank Ltd* and other decided cases there are still cases of shareholder personal claims against directors for causing pure economic losses made it a question worth investigating. Shareholders are now relying on section 218(2) of the Companies Act 2008 to hold directors personally liable for the diminution in share price. Thus the study investigated many related questions surrounding section 218(2) of the Companies Act 2008, in light of directors' personal liability and shareholder protection.[493]

[492] See part 1.4 of chapter 1.
[493] See part 1.4.1 of chapter 1.

5.2.2 Appropriateness of a shareholder's personal claim against directors for suffering pure economic losses arising from diminution of shareholding value

Chapter 2 set out a conceptual framework to the overall focus of the study, as a pathway to answering the question whether shareholders can sustain personal claims against directors on the basis of section 218(2) of the Companies Act 2008 for suffering pure economic losses arising from diminution of shareholding value, say through directors' negligent behaviour such as approving misleading financial statements.

This thesis engages with the inquiry whether shareholders who suffer pure economic losses as a result of company directors' actions or decisions, can sustain personal claims against those directors. To answer this question, it was necessary to reflect on the legal nature of a company; the assets of a company vis-à-vis assets of shareholders; the legal nature of a share in South African law; implications of the fiduciary relationship between a director and a company (agency issues) and whether directors owe any fiduciary duties to shareholders.[494]

The thesis briefly examined relevant theories on the nature of the company in an attempt to address the controversy around the question whether the directors owe the fiduciary duties exclusively to the company or whether the shareholders are also owed fiduciary duties by the directors.[495] It has been established that the fiduciary duties are generally owed to the company and not to the company's shareholders in the absence of a special relationship.[496] A crucial implication of the principle that directors owe their fiduciary duties to the company is that, since the duties are owed to the company only, the company alone is entitled to enforce these duties against negligent or fraudulent directors. This principle was illustrated in the landmark decision of *Foss v Harbottle*[497] which became known as the *proper plaintiff rule* and states that where a company has suffered a wrong, the company itself will be the proper plaintiff and only the company itself has the *locus standi* to sue.[498] If a shareholder wishes to seek redress in respect of these corporate wrongs, a derivative action but not a personal action will have to be instituted by him or her. A shareholder cannot personally claim from the fraudulent or negligent director for a loss he or she may have incurred as a result of a

[494] See part 1.6 of Chapter 1.
[495] See part 2.3 of Chapter 2.
[496] See part 2.5 of Chapter 2.
[497] *Foss v Harbottle* (1843) 2 Hare 461.
[498] See *Foss v Harbottle* (1843) 2 Hare 461.

diminution in the value of the company's share capital caused by the director's breach of fiduciary duties.

5.2.3 A Comparative Analysis of UK and South African Approaches to Diminution in Share Value Claims

The comparative study in chapter 3 provided invaluable insights which could enrich South African jurisprudence on shareholders seeking to claim for reflective loss. The international experiences were drawn from the UK. South African law shares a common law inheritance with the UK. As such, law reforms in the UK will continue to provide lessons for SA. The content of the common law 'no reflective loss' principle and UK case law principles have the potential to enrich the interpretation of the remedy provided for under section 218(2) of the Companies Act 2008.[499]

The issue of a shareholder's personal claim against directors for causing pure economic losses through diminution in share value has been settled in English Company law.[500] The English approach is based on the common law 'no reflective loss principle'.[501] The common law no reflective loss principle addresses the position where a shareholder seeks to claim for pure economic loss it has suffered in that capacity, when the company has a claim for the same loss. The no reflective loss principle poses a major obstacle for shareholders who seek to recover pure economic losses that overlap with those losses of the company as the principle prevents claims of shareholders where their loss merely reflects the loss suffered by the company.[502]

The no reflective loss principle emerged in the early 1980s in the case of *Prudential Assurance*, where the English court decided that the personal claim by the shareholder for the diminution in share price should fail as the only loss they had suffered, as a result of a misrepresentation by the directors, was a diminution in the value of their shares. This loss was simply a reflection of the loss that the company itself had suffered as a result of the wrong done to the company.[503] *Johnson v Gore Wood* confirmed unequivocally the English common law position that where a company suffers a loss by breach of duty owed to it, only

[499] See part 3.1 of Chapter 3.
[500] See part 3.2 of Chapter 3.
[501] See part 3.2 of Chapter 3.
[502] See part 3.2 of Chapter 3 of a discussion of the 'reflective loss principle'.
[503] See *Prudential Assurance Co Ltd v Newman Industries Ltd* (No 2) [1982] Ch 204.

the company may sue in respect of that loss.[504] According to *Johnson v Gore Wood*, the rationale for the no reflective loss principle is that it prevents the individual shareholder from recovering at the expense of the company. The shareholder does not suffer any personal loss. His only 'loss' is through the company. The 'loss' suffered by the shareholder can be viewed as reflective of the diminution of the company's assets.[505]

Similar to the position in the UK, South African Company law also adheres strictly to the no reflective loss principle in respect of shareholders seeking to hold directors personally liable for a diminution of the value in share price.[506] The SCA in *Itzikowitz*, confirmed and restated some important principles around the no reflective loss principle as derived from English common law. *Itzikowitz* confirmed that in SA a loss to the company, caused by a fall in the company' share price, is not a loss to the shareholders and that the shareholders cannot be said to have suffered a loss as a result of a breach of the duties owed to the company. If there is anyone that suffers loss under these circumstances, it is the company, which alone has the *locus standi* to institute action for that loss.[507] The shareholder can only claim if he has a distinguishable and independent cause of action.

5.2.4 Shareholder Remedies for Diminution of Shareholding Value

Although it has been established that shareholders as a principle cannot hold directors personally liable for the diminution in share price because they are barred by the common law no reflective loss principle from doing so[508], we still have incidences where shareholders are seeking to hold directors personally liable for the diminution in share price under section 218(2). This raises the question; whether a shareholder may bring an action against a director in terms of section 218(2) for the loss he or she suffered as a result of a diminution in share price despite the common law's no reflective loss principle barring such an action. It is for this reason that chapter 4 investigated the appropriateness of section 218(2) to be relied upon by shareholders when seeking to hold directors personally liable for the diminution in share price.

As established in this thesis, the no reflective loss principle derived from English law applies in SA. Thus the common law holds that only the company has *locus standi* (or is the proper

[504] See *Johnson v Gore Wood & Co (a firm)* [2002] 2 AC 1.
[505] See *Johnson v Gore Wood & Co (a firm)* [2002] 2 AC 1.
[506] See part 3.3 of Chapter 3.
[507] *Itzikowitz v Absa Bank Ltd* (20729/2014) [2016] ZASCA 43; 2016 (4) SA 432 (SCA).
[508] See part 3 of Chapter 3.

plaintiff) to sue directors for breaching their fiduciary obligations towards the company in a manner which causes diminution of the company's assets through for example, a reduction of a company's share price on the stock market. This thesis affirmed one of the principles of statutory interpretation, namely that a statute does not alter the existing common law more than is necessary. It was thus argued and established that there is nothing in section 218(2) of the Companies Act 2008 which indicates that the legislature intended to alter the common law to allow an extension of personal liability under section 218(2) of the Companies Act 2008 for shareholders' suffering of pure economic loss arising from the diminution in the value of share price, blamed on directors' actions on behalf of the company. This is undesirable as it would open the floodgates to shareholders' personal claims against directors, in a manner which the legislature never intended.[509] The no reflective loss principle will not, however, pose an obstacle where the loss suffered by the shareholder and that suffered by the company are distinguishable. In those instances, the shareholder may have a personal claim against a director.[510]

Under Chapter 4 a distinction was drawn between 'diminution in share price' cases and 'reckless trading' cases where section 218(2) read together with section 22(1) of the Companies Act 2008, was successfully applied by litigants to hold directors personally liable for causing third parties pure economic losses.[511] Chapter 4 examined a number of cases such as *Blue Farm Fashion Limited* and *Chemfit Fine Chemicals* for example, where s218(2) read together with s22(1) was applied to hold directors personally liable for causing creditors/third parties losses as a consequence of the directors having led the company to trade under insolvent circumstances.[512] In *Rabinowitz v Van Graan*, the court confirmed that a director can be held personally liable in terms of section 218(2) as read with section 22(1) of the Companies Act 2008. Thus stakeholders suffering harm at the hands of reckless directors are not left remediless as contraventions of this nature invariably attract personal liability under section 218(2) of the Companies Act 2008.[513]

[509] See part 4.2 of Chapter 4.
[510] See part 3.2.2 of Chapter 3.
[511] See part 4.3.2 of Chapter 4.
[512] See parts 4.2 and 4.3 under Chapter 4.
[513] See part 4.3.2 of Chapter 4.

5.3 RECOMMENDATIONS

Ambiguities surrounding the interpretation of section 218(2) have been highlighted in this chapter as also noted throughout Chapter 4.[514] Section 218(2) has been critiqued by various authors; some even go as far as calling it a mistake, calling for the removal of section 218(2) from the Companies Act 2008. The removal of this section is, however, in my opinion unnecessary. Section 218(2) is a necessary provision in our law but which needs to be addressed to prevent frivolous litigation. Simple redrafting or guidelines on its interpretation will potentially help remedy the problem and see fewer applications being brought by shareholders under section 218(2) for a shareholder's loss suffered through a diminution in share price. Recommendations to improve the law will now be made below.

The issue of determining when section 218(2) of the Companies Act 2008 is applicable has now received attention in a growing number of cases in the High Courts. Case law regarding the interpretation of section 218(2) is steadily evolving.[515] The best thing that can be done is to adopt an interpretation that is aligned to and promotes the 'spirit, purposes and objects' of the Companies Act 2008.[516] The general recommendation is that section 218(2) of the Companies Act 2008 is to be given a workable interpretation. The interpretation to be given should be one that is practical, predictable and effective in its operation. It has been argued by Mupangavanhu and others, correctly so in my view, that section 5(1) of the Companies Act 2008 provides for a purposive approach to be adopted when interpreting the provisions of the Companies Act 2008[517]. As such, the context in which a provision is applied must be considered during the process of attaching meaning to that provision.[518]

If section 218(2) is a general remedy as stated by courts and writers, the question that needs to be answered in light of the judgments discussed in this thesis, is whether section 218(2) should be interpreted widely or narrowly in different contexts.[519] As was emphasised in *Blue Farm Fashion Limited*, section 218(2) should be given a narrow interpretation as to adopt a

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[514] See part 4.2 of Chapter 4.
[515] See *Itzikowitz v ABSA Bank* 2016 4 SA 432 (SCA); *Hlumisa Investment Holdings (RF) Limited v Kirkinis* (100390/2015) [2018] ZAGPPHC 676; *Rabinowitz v Van Graan*; *Chemfit Fine Chemicals (Pty) Ltd t.a SA Premix v Maake* (5772/2016) [2017] ZALMPPHC 27.
[516] S5 of the Companies Act 71 of 2008; See part 4.2 of Chapter 4 where the views of Mupangavanhu (2019) 124 and Mantame J in the *Blue Farm Fashion Limited* case para 29 have been cited.
[517] Mupanguvanhu (2019) 123.
[518] Mupanguvanhu (2019) 123.
[519] Mupanguvanhu (2019) 123.

wider interpretation would lead to a manifest absurdity which would not have been intended by the legislature, as already argued by some authorities.[520] Matame J in the *Blue Farm Fashion Limited* case explained that a narrow approach is to be adopted where the language is ambiguous, as is the case with section 218(2) of the Companies Act 2008.[521]

In addition, as a result of poor drafting, one is left with an unclear understanding for what reason and to which extent a director can be held liable under section 218(2) of the Companies Act 2008. By redrafting, one would provide clarity to section 218(2) and ultimately give effect to the purpose of the Companies Act 2008 provided in s7(*b)(iii*) which is to promote the development of the South African economy by encouraging high standards of corporate governance. It is hereby recommended that section 218(2) of the Companies Act 2008 be amended as follows:

218(2)

> '**In accordance with the principles of the common law relating to delict and to breach of a fiduciary duty**, any person who contravenes any provision of this Act is liable to any other person for any loss or damage suffered by that person as a result of that contravention'.

[520] See part 4.2 of Chapter 4 where the views of Mupangavanhu (2019) 124 and Mantame J in the *Blue Farm Fashion Limited* case para 29 have been cited.
[521] *Blue Farm Fashion Limited* case para 29.

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