WERKSMANS
ATTORNEYS

DISPUTES

Section 161 of the Companies Act and a shareholder's claim for reflective loss

6 October 2021 *7 min read*

Section 161 of the Companies Act

In terms of the South African common law, a shareholder does not have the right to claim for a reduction in the value of its shares that merely reflects the loss suffered by the company itself as the result of wrongdoing. This "reflective loss principle" was articulated in *Johnson v Gore Wood & Co*[1] where Lord Bingham stated that:

> *"Where 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."*

Lord Bingham did however identify two narrow exceptions, namely:

> *"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."*

And:

> *"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."*

Section 161(1)(b)(ii) of the Companies Act

Section 161(1)(b)(ii) of the Companies Act[2] however provides as follows –

> *"[a] holder of issued securities of a company may apply to a court for... any appropriate order necessary to... rectify any harm done to the securities holder by (aa) the company as a consequence of an act or omission that contravened this Act or the company's Memorandum of Incorporation, rules or applicable debt instrument, or violated any right contemplated in paragraph (a); or (bb) any of its directors to the extent that they are or may be held liable in terms of section 77."*

On the face of it, the court's powers in terms of section 161 are extraordinarily wide: the court can make *any* appropriate order necessary to rectify *any* harm done to the shareholder. The question thus arises whether this power opens the door to a shareholder's claiming for damages by way of reflective loss outside of the above two exceptions. The ordinary meaning of the words in which section 161 is couched would certainly appear broad enough to encompass such a claim.

Henochsberg's commentary on section 161 contemplates that an application in terms of section 161 could include an order for damages where a shareholder suffered diminution of value due to the directors' breach of fiduciary duties. Henochsberg opines that this potential wide interpretation of section 161 *"corresponds with the change in approach signalled in Kalinko v Nisbet 2002 (5) SA 766 (W) 777-778 where the Court indicated that it would be willing to permit an individual shareholder to bring action against the directors for losses that he sustained because of a diminution in the value of his shareholding in the company, due to the fact that the directors did not comply with their fiduciary duties" However, the Court also indicated that his possible action would only be available to the shareholder as long as it would not result in "double recovery" by both the shareholder and the company from the wrongdoers. A similar proviso is not included in s161 (1) (b) (ii) (bb) and it is conceivable that the director liability provided for under s161, separately and in addition to liability in terms of 77, may well result in such a "double recovery" from directors."* (Emphasis added.)

The tentative "change in approach" signalled in *Kalinko* has however not found traction in our jurisprudence. In *Itzikowitz v ABSA Bank Ltd***[3]**, *Kalinko* was criticised and not followed. The SCA found that the possibility of double recovery (i.e. both the shareholder and the company recovering the same loss from the wrongdoer) forms the basis for the reflective loss principle. However, the Court in *Kalinko* had incorrectly elevated the *absence* of any possibility of double recovery to form a new self-standing exception to the reflective loss principle, when the Court ought to have asked a prior question, namely whether the loss suffered by the shareholder was separate and distinct from the loss suffered by the company. The Court in *Kalinko* had thus allowed the enquiry into whether there might be a double recovery to determine whether there was an actionable duty owed to the shareholder.

The applicability of section 161

The applicability of section 161 was however not in issue in *Itzikowitz*. The appellant instead had relied for his reflective loss claim on section 218(2) – "*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.*" *Itzikowitz* accordingly cannot be considered authority on the potential availability of a claim for reflective loss brought in terms of section 161.

In *London & others v Department of Transport, Roads and Public Works, Northern Cape & others***[4]**, the SCA upheld an exception to a delictual claim for reflective loss, noting that the particulars of claim had failed to allege that the shareholders' loss was separate and distinct from that suffered by the company and caused by breach of a legal duty independently owed to shareholders. Once again, section 161 was not relied upon by the plaintiff and therefore not interpreted by the Court.

In *Hlumisa Investment Holdings RF Ltd and Another v Kirkinis and Others***[5]**, the Court once again dealt with a claim for reflective loss brought in terms of section 218(2), and once again upheld the reflective loss rule excluding the claim without having to determine the applicability or correct interpretation of section 161.

There is accordingly no guidance from existing precedent on the question of whether section 161 is wide enough to encompass a claim by a shareholder to recover the diminution in value of its shareholding from the directors whose breaches of fiduciary duties caused such diminution, given that there is no reported case in which a plaintiff has sued for reflective loss in terms of section 161.

Given the firm entrenchment of the reflective loss rule in our jurisprudence, and the emphasis placed on the separate legal personality of the company as the foundation of that rule, it is perhaps likely that a court faced with such a claim would read the wording of section 161 down in order to avoid upholding a claim for reflective loss, so that a diminution in value of shares would be held not to constitute "*any harm done to the securities holder*" in terms of section 161, but would rather be regarded as loss only to the company, notwithstanding the shareholder's actual reflective loss.

The requirements for Rescission Applications restated – find out more.

by Pierre Burger, Director

---

[1] [2001] 1 All ER 481

[2] Act 71 of 2008

[3] 2016 (4) SA 432 (SCA)

[4] (1035/2018) [2019] ZASCA 144 (30 October 2019)

[5] 2020 (5) SA 419 (SCA)



@werksmans