THE SUPREME COURT OF APPEAL
REPUBLIC OF SOUTH AFRICA

MEDIA SUMMARY – JUDGMENT DELIVERED IN THE SUPREME COURT OF APPEAL

***Hlumisa Investment Holdings (RF) Ltd and Another v Kirkinis and Others* (Case no 1423/18) [2020] ZASCA 83 (3 July 2020)**

From: The Registrar, Supreme Court of Appeal

Date: 03 July 2020

Status: Immediate

The following summary is for the benefit of the media in the reporting of this case and does not form part of the judgment of the Supreme Court of Appeal

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Today the Supreme Court of Appeal (SCA) handed down judgment in an appeal against an order of the Gauteng Division of the High Court, Pretoria (Molopa-Sethosa J, sitting as court of first instance). The appeal was dismissed with costs.

The matter concerned, principally, the question whether shareholders have a claim against directors for damages in relation to a diminution in the value of their shares under s 218(2) of the Companies Act 71 of 2008. It also concerned the viability of a shareholder's claim based on a diminution in share value related to alleged misconduct by auditors in auditing the company's financial statements.

The first appellant, Hlumisa Investment Holdings (RF) Ltd, and the second appellant, Eyomhlaba Investment Holdings (RF) Ltd, the first and second plaintiffs in the court a quo, were shareholders in African Bank Investments Limited (ABIL). They owned, respectively, 1.73% and 3.24% of the issued share capital of ABIL. The first to tenth respondents were at all material times directors of ABIL and African Bank Limited (African Bank), a wholly-owned subsidiary of ABIL. The eleventh respondent, Deloitte & Touche (Deloitte), was the auditor of both ABIL and African Bank.

The appellants sued the directors and Deloitte, jointly and severally, for damages allegedly suffered as a result of the diminution in the value of their shares in ABIL, on account of the directors' alleged misconduct in relation to the affairs of both African Bank and ABIL (Claim A) and on account of Deloitte failing to conduct audits in accordance with generally recognised auditing standards (Claim B). In respect of Claim A the appellants submitted that, between 2012 and 2014, the directors had breached

their fiduciary duties in that they failed to exercise their powers in good faith and in the best interests of ABIL and African Bank. This, they alleged, resulted in the business of ABIL and African Bank being carried out recklessly or with gross negligence, in contravention of s 22(1) of the Companies Act. It also caused African Bank and ABIL to suffer significant losses, which, in turn, caused the ABIL share price to drop from R28.15 per share as at April 2013 to R0.31 per share as at August 2014. The alleged misconduct of the directors included, amongst others, the publication of false financial statements in respect of both entities, the authorisation of a loan in contravention of s 45 of the Companies Act, and pursuing reckless and aggressive accounting practices.

The directors excepted to the appellants' particulars of claim on three bases. First, because the loss in respect of which the plaintiffs sought to claim was merely reflective of the loss sustained by ABIL and African Bank, which meant that the claim lacked the necessary averments to sustain a cause of action. Secondly, because the appellants had not alleged that their losses were suffered as a result of the contravention of ss 45, 74, 76(3) or 22(1) of the Companies Act, and s 218(2) only made provision for liability to any person who had suffered loss 'as a result of' a contravention of the Companies Act. And thirdly, in respect of the prospectus which the directors had authorised to be published, and which was alleged to be a misrepresentation, because the appellants had not alleged that they relied on the misrepresentation, nor that they acted on the strength thereof, nor that they suffered loss in consequence.

In respect of Claim B the appellants submitted that, during the period between December 2012 and December 2014, Deloitte reported that African Bank's financial statements fairly represented the Bank's financial position when, according to the appellants, the financial statements did not reveal the true state of affairs at the Bank. It was further alleged that Deloitte knew, or could reasonably have been expected to know, that this would induce investors to act or refrain from acting in a certain way. Deloitte also excepted to the particulars of claim – for one, because the alleged wrong was committed against the company and not against the appellants; and two, because Deloitte owed no legal duty to the appellants in their capacity as individual shareholders. The case of the directors and Deloitte was that the appellants' claims were unsustainable at common law and could also not be brought under s 218(2) of the Companies Act.

The claim was dismissed by Molopa-Sethosa J. It was held that a claim for damages for the alleged breach of s 76(3) was to be brought in terms of s 77(2), which specifically created the liability for such a breach. The high court found that a general provision could not be invoked in the event of a specific provision being available in the same statute. It also confirmed a well-established principle of statutory interpretation, *viz.* that a statute is not intended to alter the common law unless it does so expressly or by necessary implication. It then referred to cases on the principle against reflective loss and concluded that the appellants could not rely on s 218(2) of the Companies Act for their claim. The exceptions by the directors and Deloitte were upheld.

The SCA considered whether the exceptions were correctly upheld. It did so by looking, firstly, at the present position of the rule against claims for reflective loss in South Africa. This involved a careful analysis of the leading authorities both locally and in the United Kingdom, from where the rule originates. The SCA concluded that the rule against claims for reflective loss remains good law, particularly in relation to claims of shareholders based on diminution in share value. The appellants had not been able to prove an independent cause of action, as they had submitted. They were also not successful in showing that their claim fell within one of the recognised exceptions to the rule.

The SCA then considered whether the appellants' claim could nevertheless be allowed under s 218(2) of the Companies Act. After having regard to all of the relevant provisions of the Companies Act, it held that the Legislature had clearly decided where liability should lie for conduct by directors in contravention of certain provisions, and who could recover the resultant loss. Section 218(2) had not abolished the rule against claims for reflective loss expressly, nor did it follow by necessary implication. The SCA concluded that the essential findings of the high court in relation to the directors' exceptions could not be faulted.

In relation to the claim against Deloitte, the SCA found that the appellants had in fact suffered loss only in the third degree. It was African Bank who suffered the primary loss. ABIL's loss was a reflection of that primary loss, which was in turn reflected in the appellants' loss. Couched in delict, the claim against Deloitte had a further hurdle in that conduct causing pure economic loss is not prima facie wrongful. The SCA noted that the question to be addressed on the issue of wrongfulness was whether public and legal policy considerations dictated that the auditors of African Bank be held liable to the shareholders of ABIL for the reflective losses they sustained. On this score it held that the imposition of a legal duty on auditors in a case such as this would raise the spectre of indeterminate liability. Recognition of the appellants' claims would open the door to all others who suffered reflective losses to pursue similar claims. This would, in turn, expose the auditors to 'liability in an indeterminate amount for an indeterminate time to an indeterminate class'. It might also detract from the rights of creditors in the event of insolvency. This disqualified the recognition of a new category of claim.

In the result, the appeal was dismissed with costs, including the costs of two counsel.