

# COMMON LAW DUTIES AND SECTION 76 OF THE COMPANIES ACT, 71 OF 2008 COMPARED

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## **COMMON LAW DUTIES AND SECTION 76 OF THE COMPANIES ACT, 2008 COMPARED**

Recently, the South African legislature partially codified the common law duties of directors with the *Companies Act, 71 of 2008* (hereafter referred to as 'the 2008 Companies Act') coming to effect on the 1<sup>st</sup> of May 2011. Wherein Chapter 2 is dedicated to the formation, administration and dissolution of companies, 'Part F' thereof elaborately provides for governance of companies, section 76 requiring directors' and other company's office bearers' duties to meet the standards of directors' conduct. All of these in accordance with the principles of common law as indicated in section 77 subsection (2) (a); where non-compliance will attract legislated liability as provided for in section 77 of the 2008 Companies Act. While the standards of directors' conduct remain within the bounds of common law, this dissertation is to compare the prescripts of common law duties and provision of section 76 of the 2008 Companies Act in order to deduce what impact this codification will have on South Africa's corporate law? and what the realities of its enforcement are.

Prior to codification the court system played a tremendous role in adjudicating issues surrounding disputes arising in areas of pronouncing on the roles that directors play in the management of companies. These roles originated from the English common law, meaning that South Africa adopted the English law pertaining to companies and this model still remains. Although, it is known that English law does not have rigid authority in South Africa's jurisdiction, it is equally widely known that English decisions play a considerable persuasive role in South African courts. Since time immemorial the courts in England, South Africa and elsewhere profoundly recognized directors' common law duties, which comprised of fiduciary duties and the duty of care and skill. However, developments surrounding this have eventually led to codifying these duties in a few foreign jurisdictions and now also in South Africa. The question is should we follow common law or the Companies Act?

Unalienable legal personality is a core notion that underlies the working of a company as a commercial entity. From incorporation to deregistration, the company possesses all qualities attached to a legal person with the rules that govern its proper functioning rooted in common law. The question pertinent to this dissertation is to compare the well established principles of common law to the partially codified provisions in the 2008 Companies Act, and to establish if this should take precedence in litigation? The findings in this regard consist of a combination of the principles of common law stated verbatim and the alignment to the idea of America's Business Judgment Rule. Although the 2008 Companies Act provides for liability for non-compliance, considerable of fears arise that directors committing breach may be getting off scot free due to the indemnity possibilities provided by the Act. In conclusion, it is hereby submitted that the business judgment rule model is not compatible to South Africa's corporate law. Hence the recommendation in conclusion that caution must be exercised in following the codified provisions of the Act.

# **COMMON LAW DUTIES AND SECTION 76 OF THE COMPANIES ACT, 71 OF 2008 COMPARED**

## **Chapter 1**

### **1.0 INTRODUCTION**

#### **1.0.1 Background to the Study**

Recently, the South African Legislature partially codified the common law duties of directors with the *Companies Act, 71 of 2008* (hereafter referred to as ‘the 2008 Companies Act’) which came into effect on 1<sup>st</sup> May 2011. Chapter 2 of the 2008 Companies Act is dedicated to the formation, administration and dissolution of companies. ‘Part F’ thereof elaborately provides for governance of companies, and section 76 contained therein requires directors and other company office bearers to meet the standards of directors’ conduct as prescribed therein. All of these duties are in accordance with the principles of common law as indicated in section 77 subsection (2) (a) where non-compliance will attract legislated liabilities as provided for in section 77 of the 2008 Companies Act. While the standards of directors’ conduct remains within the bounds of common law, what impact will this codification have on South Africa’s corporate law? And what are the realities of its enforcement?

Prior to codification, the court system played a tremendous role in adjudicating issues surrounding disputes arising in areas of pronouncing on the roles that directors play in the management of companies. These roles originated from the English common law, meaning that South Africa adopted the English law pertaining to companies and this model still remains. Although, it is known that English law does not have rigid authority in South Africa’s jurisdiction, it is equally widely known that English decisions play a considerable persuasive role in South African courts. Since time immemorial the courts in England, South Africa and elsewhere profoundly recognized directors’ common law duties, which comprised of fiduciary duties and the duty of care and skill. However, developments surrounding this have eventually led to

codifying these duties in a few foreign jurisdictions and now also in South Africa. The question is should we follow common law or the Companies Act?

## 1.0.2 Research Question

Unalienable legal personality is a core notion that underlies the working of a company as a commercial entity. From incorporation to deregistration, the company remains and possesses all qualities attached to a legal person and the rules that govern its proper functioning are rooted in common law. The question is whether the common law duties of directors could be exclusively regulated by the provisions in sections 76 and 77 of the *Companies Act, 71 of 2008*?

## 1.1 Literature Survey

The debate surrounding codification of directors' common law duties have been ongoing for a considerably long period in history. This move originated with the United States of America, where the business judgment rule now thrives. This, firstly as a trend in America, have now seen a number of countries incorporate into their Companies Act a codified version of directors' duties. By the coming into operation on 11 of May 2011 of the 2008 Companies Act, South Africa codified the common law duties of directors. When duties of directors were based within the common law domain, the debate surrounding codification attracted diverse opinions ranging from the courts as the main custodians of common law, to writers and other role players. This dissertation is mainly based on the wealth of court decisions and opinions emanating from writers on the challenges and opportunities that may be derived from codification. Hence the title: *Common Law Duties and Section 76 of the Companies Act, 2008 Compared*.

1.1.1 The following works and sources are examined and evaluated for their contribution to the debate surrounding the well known and effective common law adjudication of directors' duties, in comparison to codified directors' duties in the 2008 Companies Act, in order to weigh the effects that this Act may have on common law.

1.1.2 For the historical foundation of common law duties, vast court decisions, mostly in the English common law jurisdiction, which forms part and parcel of South African law, are evaluated for their relevance and effectiveness in today's company law. When one court states that a director is not required to give continuous attention to the affairs of his company, another state that the director is required to ensure that he acquaints himself with the business of his company. Other contending issues are the degree at which directors' levels of ability are to be measured. Three cases formed the foundation in relation to this topic, namely *Robinson v Randfontein Estate Gold Mining Co. Ltd* (1921 AD 168), *In re City Equitable Fire Insurance Co. Ltd* ([1925] Ch 407) and *Fisheries Development Corporation of SA Ltd v Jorgensen* (1980 (4) SA 156 (W)). The standards laid down at common law in these cases resonate through this dissertation to compare common law to the Companies Act.

1.1.3 In order to establish the impact of codification of common law duties, a good number of articles are consulted for opinions on the debate around codification. Noteworthy are works of two academics, namely: E Jones 'Directors' Duties' with the submission that the duty of care and skill is already a very tenuous and risky foundation on which to found a legal claim against a director, as is witnessed by the paucity of decisions finding directors in breach of this duty (E Jones '*Directors' Duties: Negligence and the Business Judgment Rule*' 2007 19 SA Merc LJ 326). On the other hand is D Botha and R Jooste 'Critiquing King's Report' submitted that only rarely do shareholders resort to relying on the breach of this duty as a ground of argument, and it is rarer still for them to succeed on that ground, with the opinion that the adoption of a means of further limiting this duty would effectively lower the standard of care expected of directors (D Botha & R Jooste (1997 14 SALJ 65).

In addition to the above, immense journals and articles on related topics in domestic and the jurisdictions of Australia, England, New Zealand and the USA shall be synthesised to elaborate on standing common law provisions

and to evaluate how the codified duties will fare with the general administration of companies and the liability for non-compliance. Amongst the wide sources but a few relevant to this dissertation are: John H Farrar '*The Duty of Care of Company Directors in Australia and New Zealand*' (1996) 7 *Canterbury LR* 228), Havenga MK '*The Business Judgment Rule – Should We Follow the Australian Example?*' 2000 *SA Merc LJ* 25. Since the dissertation is literature based, the works of authors, such as Ciliers and Benade et al. *Corporate Law* 3<sup>rd</sup> ed. Juta 2000 and Pretorius, Delpont, Havenga & Vermaas *Hahlo's South African Company Law Through The Cases* (1999), *Companies Act, 71 of 2008*; as amended by the *Companies Amendment Act 3 of 2011 shall largely be dwelt on.*

## 1.2 Proposed Method

The qualitative research methodology, in its subjective and comparative nature will enable reflection on the nature of directors' duties within various jurisdictions which will be explored and analysed against the impact of codification, in order to explain why and how this fits with common law. The qualitative method have the advantage of a wide source of opinions, though with a monotonous discussion line, this could be disadvantageous. A balance will however be struck by the ample time spent on literature collection and comparison. The Libraries of the University of Pretoria and the University of South Africa will be the major sources of materials.

## 1.3 Definition of Terms

Common law duties as the backbone of directors' duties entail directors' duties imposed by the general principles of common law other than the company's constitution and legislation, which is divided into the directors' fiduciary duties towards the company, which requires directors to exercise their powers *bona fide* for the benefit of the company, and the duty of care and skill. The fiduciary duty and the duty of care and skill are two different broad divisions under the directors' common law duties. Hence the need to emphasise the importance of keeping these two concepts separate and to explore the danger that codification may further cause the

already misconceived notion of classifying the two duties into the one concept of Americas' 'Business Judgment Rule'. All of these shall in turn be briefly defined as applicable to this dissertation.

#### 1.4 **Significance of Study**

The partial codification of the common law duties of directors is not the first of its kind. Other jurisdictions to which South Africa looks for guidance, such as Australia, New Zealand and England have had ample challenges from the same exercise. When it had been the opinion of a number of renowned writers that there is a need for South Africa to tread on the path of codification, there is sizeable opposition to the idea. Hence the need to examine the challenges that codification poses and the opportunities it presents with regards to the vast common law background that this area of company law is founded upon.

#### 1.5 **Assumption of Study**

The study from the outset is to compare the common law duties of company directors as to the realities of partial codification of these duties in South Africa, in such a way as to discover what impact the 2008 Companies Act will have on common law to make for better regulation of directors' conduct towards the company they serve. Hence, the outcome of this study will be of great benefit to researchers and practitioners within public and private sectors, as well as other legal scholars.



## Chapter 2

### 2.0 FIDUCIARY DUTIES OF DIRECTORS

The point of departure to establish the extent of directors duties at common law, should be rooted in the core notion of separate juristic personality of a company and the sanctity of a separate corporate personality. Such distinctive recognition of rights and duties in relation to the company and those that serves it, should create a measurable accordance of rights to the company as a separate legal entity, such that the standard of duties imposed by law in general, should to a large extent be universal in its imposition and application. Hence the establishment of what fiduciary duties are and in what form it applies to company law in general and the directors that serve in the company specifically.

The reason for imposing duties on directors is for the sole preservation of the separateness that exists between the company and the directors serving it. The importance of imposition of special and technically crafted duties on directors is to guide the relationship that exist between the company and its directors, as there are times when a director may occupy more than one office<sup>1</sup> in a particular company. In this case, should there be no contract or any form of binding testament between the company and the director, then the basic principles of common law duties will arise. This can be summed up as it was decided in the case of *Re Brazilian Rubber Plantations and Estates Ltd*,<sup>2</sup> that:

‘... directors must diligently attend to the affairs of the company and in performance of their duties display the reasonable care.. an ordinary man might be expected to take in a similar circumstances on his own behalf.’

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<sup>1</sup> There are times where complex situation arise, where a director performs various functions in relation to the company he serves; in cases where such director is an employee, a shareholder, or trustee. In *Greaves v Barnard* 2007 (2) SA 593 (c), a director in addition to being an employee and a shareholder of his company; entered into an agreement between himself and other coordinator shareholders to the effect that they would treat the company as a quasi-partnership. The view of the Cape Court is that ‘irrespective of the complexity that gives rise to the situation of relationship with a director, the company’s interest is paramount’. (at 598)

<sup>2</sup> [1911] 1 Ch 425 (Ch D) at 437.

At this stage, what is important to mention is the magnitude of the impact of the actions of the directors' skills and diligence on the entire company, either for its survival or demise? Hence, the alertness as to adequate measures to ensure directors compliance with their duties at common law. However, common law for time immemorial had considerable impact on duties of directors, subjecting them to fiduciary<sup>3</sup> duties which required them to exercise their powers *bona fide* and for the benefit of the company, and to display reasonable care and skill in carrying out their office. These and other considerations constituting common law duties shall be discussed in this chapter, while the duty to avoid a conflict of interest, as an analogous part of common law duties, shall also be discussed, together with related topics thereto.

### 2.0.1 Fiduciary Duty to Act *Bona Fide*

The duty to act *bona fide* flows from the fiduciary duties placed on directors. To start with, the question should be asked as to who is a "director"? For what reason and to what extent should the conduct of such director be *bona fide* in relation to his duties as a director? The answer to this could be illustrated by the dictum of BOSHOFF J in *Cohen v Segal*<sup>4</sup>, where the meaning of director<sup>5</sup> in relation to his fiduciary duty to act

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<sup>3</sup> The magnitude and the extent of the importance of *fiduciary* duty is well illustrated by **Hiemstra J** in *S v Hepker* (1973 (1) SA 472 (W) at 484: "The proposition of law underlying all these charges is that directors are not allowed knowingly to bind their companies to transactions which are unprofitable to the company and are intended to the directors' own ends. That is so even when they hold all the shares and even when all the members of the board agree with full knowledge of the facts. The basis of this proposition is that the company is a person in law and that the directors stand in a *fiduciary* relationship towards it. This position is not artificial; it is very real because the company's fate always affects others besides the directors.' Although, *In re City Equitable Fire Insurance Co. Ltd* ([1925] Ch 407) is often referred to as containing the roots of the common law duty of care, *fiduciary* duty entails a much wider concept than that. It was submitted by Naude *Maatskappydirekteur* at 188 that any wrongdoing by a person in his capacity as a director acting *mala fide* towards his company can never be ratified. Which in other words means that *mala fide* action of others may in the same circumstances accordingly be ratified. Not only this, but also critical is the fiduciary duty, in the sense that actions resulting in a resolution to ratify which in turn results in directors receiving a benefit at the expense of the company, are generally invalid. HS Cilliers and ML Benade et al *Corporate Law*.139 stated that a director stands in a fiduciary relationship to his company, and at fn 17 explained that: 'a person usually comes into a fiduciary relationship when he controls the assets of another or holds the power to act on behalf of another.'

<sup>4</sup> *Cohen v Segal* 1970 (3) 702 (W).

<sup>5</sup> **Boshof J**: at 706 'the directors of a limited company are the creatures of statute and occupy a position

*bona fide* is defined. In the words of the honourable Judge, it could be inferred that the legal status of directors correlates with the duty to act *bona fide*.

The extent of this duty can be illustrated through a wide common law prescription, which is dominantly rooted in case law and which for a variety of reasons overlaps in its application. While directors are at common law expected to perform their duties *bona fide*<sup>6</sup> that is, this is qualified in the sense that such duties will only be performed for the benefit and in the interest of the company. Encapsulated in the duty to act *bona fide* are the following duties: to act in the best interest of the company, not to exceed powers, to use power for a proper purpose, to exercise independent discretion and the duty to avoid a conflict of interest. All of these and notions connected thereto, shall further be expatiated.

## 2.0.2 Duty to Act in the Interest of the Company

By its very nature the office of a director, demands that a director has a variety of interests, in the sense that, for a director to function appropriately he or she must possess substantial interest in the company in a number of quarters. This in most instances are actually constituted in company's memorandum of incorporation (formerly, the articles of association). This is so as indicated above, in situations

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peculiar to themselves. It has often been said that they are really commercial men managing a trading concern for themselves and all other shareholders in it. They occupy a fiduciary position towards the company and must exercise their powers *bona fide* solely for the benefit of the company as a whole and not for an ulterior motive. They may not advance their own interests at the expense of the company. Directors are from time to time spoken of as agents, trustees or managing partners of a company, but such expressions are not used as exhaustive of the powers and responsibilities of those persons, but only as indicating useful points of view from which they may for the moment and for the particular purpose be considered, point of view at which, for the moment, they seem to be falling within the category of the suggested kind. It is not meant that they belong to the category, but that is useful for the purpose of the moment to observe that they fall *pro tanto*, within the principles which govern that particular class.'

<sup>6</sup> *Treasure Trove Diamond Ltd. v Hyman* 1928 (AD) 464. at 497 ...'where wide powers are conferred on directors by the articles of association of a company in respect of the issue of shares, as in the present case, those powers are primarily given to them for the purpose of enabling them to raise capital for the purpose of the company, and the directors as occupying a fiduciary position towards the company must exercise those powers *bona fide* solely for the benefit of the company as a whole, and not for an ulterior object.'... This in essence is the same view of the court in *Cohen v Segal* which in other words is the confirmation of the common law position on the standard of directors' duties to be rendered *bona fide*.

where a director occupies a number of positions, or where some sort of contract exists with the company, whether as an employee or otherwise and by the very logic that where a shareholder director promotes the interest of the company, the interest of such director will also automatically be met. This is the reason why interference with discretionary powers of directors by the court is kept to the minimum. In *Mills v Mills*<sup>7</sup> it was required that:

...'before the exercise of a discretionary power by directors will be interfered with by the court, it must be proved by the complaining party that they have acted from an improper motive or arbitrarily and capriciously'...

Hence the rule laid down by the Australian High Court per LATHAM CJ in *Mills v Mills*<sup>8</sup>:

'It is urged that the rule laid down by the case is that directors must act always and solely in the interest of the company and never in their own interest. It is clear that, if it is established that the director did not act *bona fide* in the interest of the company, the court in a properly constituted action will set aside their resolution. Thus, if directors issue shares only for the purpose of conserving their own power, the resolution creating the shares will be set aside or an injunction will be granted to prevent the holding of a proposed meeting.'

Ordinarily, it will be assumed that any action of a director is taken in the best interest of the company he serves. The mere fact of holding office as a director creates the obligation in common law for a director to carry out his duties *bona fide*, for the interest and benefit of the company and not for his own ulterior motives. This means that a director will be entitled to the remuneration he earns from the company. Hence the decision in *Robinson v Randfontein Estates Gold Mining Co Ltd*<sup>9</sup> to curtail the conflict of interest of directors and to halt competition with the company they serve. The court in *Robinson* found that the director in question inappropriately and secretly

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<sup>7</sup> *Mills v Mills* (1938) 60 CLR 150.

<sup>8</sup> *Mills v Mills* (1938) 60 CLR 150. At 162-163. A decision which had since been copied and followed by South African courts on several occasions.

<sup>9</sup> *Robinson v Randfontein Estates Gold Mining Co Ltd*. 1921 AD 168.

benefited from the company from the purchase price paid and appropriately recovered the excess in difference of the purchase price from the director and same ordered to be repaid to the appellant company by the director who made profit out of his office as a director at the expense of his company.

### 2.0.3 Duty Not to Exceed Powers

The notion that a company is a separate legal entity with full legal capacity could give rise to the question as to the manner in which the company could perform legitimate legal functions. In this light, it is clear that a company will by necessity have to act and exercise its powers through its agents<sup>10</sup> and organs<sup>11</sup>. It then follows by rules of logic that any conferral of authority upon an agent to exercise the company's powers on its behalf, is subject to the capacity of the company. Hence, a company cannot confer powers unto an agent if it lacked such powers itself. Therefore, both the agent and the organ of a company must discharge their duties within the capacity as per object of the company and within the powers specifically conferred on them.

A director cannot be relieved of his fiduciary duties in the articles, in a contract or in any other way<sup>12</sup>. The duty not to exceed powers as important as it is, may lead a director to be called upon to make good any transaction entered into, which is beyond the capacity of the company. This duty in all consideration is well managed

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<sup>10</sup> HS Cilliers and ML Benade *et al.* Corporate Law at 84 classified 'agents' of a company to comprise of: the General Meeting of Shareholders, the Board of Directors, Committee of Directors, Managing Director, the Secretary, employees of companies and specially 'appointed agents'.

<sup>11</sup> HS Cilliers and ML Benade *et al.* Corporate Law at 84 describes an 'organ' of a company to be the company itself. Whereby if those that constitute and function as such acts, it will be deemed to be the company that acts, which organ is usually derived from the ranks of: the General Meeting of Shareholders, the Board of Directors, and in certain instances the Managing Director.

<sup>12</sup> HS Cilliers and ML Benade *et al.* Corporate Law at 139-140. In support of the academics opinion is the judgment of **Conradie J** in *Barlows Manufacturing Co Ltd & Others v RN Barrie (Pty) Ltd & Others* 1990 (4) SA 608 (C) at 601I-611A; that: 'a director owes a *fiduciary* duty to his company. He cannot, while he is a director, divest himself of that duty. It is something which is inextricably tied to the office. In the exercise of this duty the director may delegate some or even all of his powers of controlling the company but he cannot without violating what I regard as a fundamental principle of company law, delegate his duty and hence his power to control the controller. He may delegate but he may not abdicate. The board must retain ultimate control.'

by way of the principle laid down in *Turquand*<sup>13</sup>: The rule suggests the placement of bounds of duty on directors to be amongst other things, dependent on certain internal requirements, for example, prior approval by the general meeting or some other company resolutions. The fact that an outsider may not be held responsible for non-compliance with these requirements cast a firm duty on the director to act within the bounds of powers conferred on him.

#### 2.0.4 Duty to Use Power for a Proper Purpose

There are certain modes of conduct of directors which on the face of it might not seem to have a noticeable detrimental effect on the company itself as a separate juristic entity, but when scrutinized through case law have been found to amount to a breach of directors' fiduciary duty, where the director did not exercise his power for their true purpose. Failure by a director to exercise his power for the purpose for which they were conferred, could cause major financial destabilisation as illustrated in *Howard Smith Ltd v Ampol Petroleum*<sup>14</sup>. The underlying principles in *Howard* as illustrated by *Darvall v North Sydney Brick & Tile co. Ltd*<sup>15</sup>, is that:

'the purpose of the prohibition is to protect the proper interest of a company's creditors and shareholders by ensuring that those who acquire shares in a company do so from their own resources and not from those of the company itself.'

In light of the above, the duty to use power for a proper purpose enjoins the board of directors to use its powers, not to perpetrate frustration of the majority shareholders in allotting unnecessary shares, as this shall not amount to a proper purpose, but for a mere destabilisation of the existing majority in the company. In line with this are the varieties of cases where the courts disallowed issue of shares or allotment thereof

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<sup>13</sup> *Royal British Bank v Turquand* (1856) 6E & B 327; 119 ER 886.

<sup>14</sup> *Howard Smith Ltd v Ampol Petroleum* (1974) 1 All ER 1126 (PC) 'while it was contended in this case with a measure of justification that the company was in need of further share capital, the court held that shares had been issued for the substantial purpose of diluting the shareholding of two major shareholders who held the majority shares and had been trying to take over full control of the company.'

<sup>15</sup> *Darvall v North Sydney Brick & Tile Co. Ltd.* (1988) 15 ACLR 230 CA (NSW) 257.

where it was of the view that such directors' action could not amount to the exercise of their power for its proper purpose. The nature and extent of a directors' obligation to use powers for proper purposes can actually lead to a director being exempted from his fiduciary duties. In *Bramford v Bramford*<sup>16</sup>, the English Court of Appeal confirmed the view that the general meeting of members can condone by ordinary resolution a breach in good faith of a director's fiduciary duty. The resolution to condone such breach shall be valid in as much as the breach is committed *bona fide* within proper exercise of the director's power.

### 2.0.5 Duty to Exercise Independent Discretion

The duty to exercise independent discretion is the fiduciary duty of directors that best illustrates or qualifies the overarching 'duty to act *bona fide*', as directors are required to act *bona fide* and in the best interest of the company. What on the face of it, may look like the director failing in his duty to act *bona fide*, but when carefully considered reflect the satisfaction of the interest of the company and thereby whatever decision or action is taken, shall be valid in as much as the decision is made with an unfettered discretion and one which best satisfies the interest of the company. Exercise of independent discretion by directors in actions taken on behalf of their company had the support of the court in directors contracting<sup>17</sup> and thereafter rescind from such contract, if at any time, the directors discover the action taken to be in the best interest of the particular company<sup>18</sup>.

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<sup>16</sup> [1969] 1 All ER 969 (CA).

<sup>17</sup> *Coronation Syndicate Ltd v Lilienfeld and New Fortuna Co Ltd* (1903 TS 489).

<sup>18</sup> In *Coronation Syndicate*, fn. 17 supra; **Solomom J** remarked as follows: 'But the directors are in a fiduciary position, and it is their duty to do what they consider will best serve the interests of shareholders. If therefore, they have bound themselves by contract to do a certain thing, and thereafter have *bona fide* come to the conclusion that it is not in the interest of the shareholders that they should carry out their undertaking, I do not think that the court would be justified in interfering with their discretion and compelling them to do what they honestly believe would be detrimental to the interests of the shareholders'. This view are analogous to the decision in *Fisheries Development Corporation of SA Ltd v Jorgensen* (1980 (4) SA 156 (W)). In as much as the actions of the directors, whatever those actions might be will translate to the best interest of the company, such would nevertheless be valid.



## 2.1 Duty to Avoid Conflict of Interests

Since the decision in *Robinson*<sup>19</sup>, strict limitation had been placed on the derivation of profit by directors from the companies in which they stand in a fiduciary position. This is basically to curtail the possible conflict of interest between the director and his company. While profit earned this way are referred to as secret profit<sup>20</sup>, recovery of such are inevitable irrespective of the manner in which the benefit is earned; even where the company had suffered no loss. The strict liability here is simply determined by evaluation of the position in which such director stands to his company, should the director stand in a fiduciary relationship to his company, he may never be exempted from competing with his company.

Conflict of interest takes diverse forms<sup>21</sup> and the common law rules that prohibit it through case law had dealt with them all in a similar manner. It is a general rule that whenever a director enters into a contract with his company, though this is deemed to contain traits of conflicts of interests, such contracts are never void, but voidable at the instance of the company. In other words, the contract is not automatically invalid, but the acceptance or the validation of it shall rest upon the company to make through its appropriately constituted organ. Where a director serves more than one company, the rule becomes stricter. However, there are exceptions to this rule, which are sometimes legislation based and their comparison to common law will be evaluated in later chapters.

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<sup>19</sup> *Robinson v Randfontein Estate Gold Mining Co Ltd* 1921 AD 168 at 177-178 Honorable **INNES CJ** emphatically stated that “where one man stands in a position of confidence involving a duty to protect the interest of that other, he is not allowed to make a secret profit at the other’s expense or place himself in apposition where his interests conflict with his duty. The principle underlies an extensive field of legal relationship. A guardian to his ward, a solicitor to his client, and agent to his principal afford examples of persons occupying such a position.”

<sup>20</sup> The phrase or notion of secret profit originated from two separate case, where one simply refer to this as secret profit, the other termed it a rule. HS Cilliers and ML Benade et al. Corporate Law at 142.

<sup>21</sup> The diverse nature of directors breach of fiduciary duties by way of conflict of interest may result from acquisition of secret profit, unauthorized use of confidential information, unlawful competition with his company, diversion of company’s interest to that of others. To answer question regarding the lifespan of this duty, **Goldstone J** as he then was, in *Sibex Construction (SA) (Pty) Ltd v Injectaseal CC* (1988) 2 SA 54 (T) indicated that a director remains under a *fiduciary* obligation even after his or her resignation from office.



The duty to avoid conflicts of interest of the director with his company arises by virtue of the office of director. JS McLennan, an academic<sup>22</sup> made the submission that supports this notion and the principles of ‘conflict of interest’, that:

“It is eminently more satisfactory to apply the no power without responsibility principle, and simply to say that if a person is in fact in a position of trust – be he agent, mandatory, director or whatever – he cannot escape the duty that inevitably attaches to the trust.”

The view of the court in *Howard v Herrigel*<sup>23</sup> is that the classification or the title conferred on a director such as executive or non-executive is irrelevant. Liability will arise in so far as he or she is in full-time employ of the company. A further test for liability per LORD PORTER in *Regal (Hastings)*<sup>24</sup> is that the profit should have been acquired by the director on the grounds of his occupation of office and by LORD RUSSELL that the profit should also have been made in the execution of the directors’ office.

### 2.1.1 Secret Profit Rule

The ‘Secret Profit Rule’<sup>25</sup> flows from the duty to avoid conflict of interests with one’s company. As it had always been dealt with under common law, the proceeds, (secret profit) had never in any form been released or granted to the directors who oppress their company. A good way to further show the essence of this rule is found in the majority judgement in *Cook v Deeks*<sup>26</sup>, where LORD BUCKMASTER LC stated that:

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<sup>22</sup> JS McLennan “*Directors Duties and Misapplication of Company Funds*” (1982) 99 SALJ 394 at 403

<sup>23</sup> *Howard v Herrigel* 1991 (2) SA660 (A)

<sup>24</sup> *Regal (Hastings) v Gulliver* [1942] 1 All ER 378

<sup>25</sup> “Secret Profit” was coined or originated from the judgment of **INNES CJ** in *Robinson v Randfontein Estates Gold Mining Co. Ltd.* (1921 AD 168), though a much later judgment than *Cook v Deeks* [1916] 1 AC 554 (PC), where this notion of conflict of interest of directors with their company was identified as a rule, which rule is an inalienable one that fundamentally attaches to the relationship between a company and its directors. While Lord Buckmaster illustrated the rule of relationship between a company and a director, INNES CJ emphasized the bearing of making secret profit at the expense of the company. Hence, the origin of the rule known as ‘Secret Profit Rule’.

<sup>26</sup> *Cook v Deeks* [1916] 1 AC 554 (PC)

'It is quite right to point out the importance of avoiding the establishment of rules as to directors' duties which would impose upon them burdens so heavy and responsibilities so great that men of good position would hesitate to accept the office. But on the other hand, men who assume the complete control of a company's business must remember that they are not at liberty to sacrifice the interests which they are bound to protect, and, while ostensibly acting for the company, divert in their own favour business which should properly belong to the company they represent.'<sup>27</sup>

The majority in *Cook v Deeks*<sup>28</sup> found the three defendants that constitute three quarter of the shareholding of Toronto Construction Co. guilty of a distinct breach of duty by way of securing a contract meant for their company for themselves individually, hence the recovery of the proceeds or benefit (secret profit) and the award to their original company, Toronto Construction Co.

### 2.1.2 Corporate Opportunities

The fundamental principles that underlies the acceptance of duties that attach to the office of director dictate that such director is placed in a fiduciary relationship to his company, which honourable INNES CJ described as a relationship likened to that existing between a guardian and his ward. In the words of LORD BUCKMASTER, '*men who assume the complete control of a company's business must remember that they are not at liberty to sacrifice the interests they are bound to protect*'. All of these simply, in my own evaluation, translate to the fundamental company law principles that rule in the corporate or company law domain and specifically within duties cast on a company director as a fiduciary to render his services *bona fide* and in the best interest of the company.

Opportunities will always arise at the time when one is managing the affairs of others, most especially, a company as it does in *Industrial Development Consultant Ltd v*

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<sup>27</sup> Lord Hackmaster LC at para. 563.

<sup>28</sup> Supra fn. 26

*Cooley*<sup>29</sup> where a director was preferred to the company he was currently managing director of. He jumped at the opportunity, but his “ill-health” excuse did not prevent the court from holding him liable to account to his company for all benefits accruing under the contract with the *Eastern Gas Board*. At 173 ROSKILL J states as follows:

‘There being the fiduciary relationship I have described it seems to me plain that it was his duty once he got the information to pass it to his employers and not guard it for his own personal purposes and profit. He put himself into the position when his duty and his interests conflicted.’

### 2.1.3 Contracts between Company and Directors

A contract between a company and directors is usually weighed on the disclosure and non-disclosure scale. The disclosure of information regarding the declaration of directors’ interests in certain businesses with their company is to a large extent regulated in the Companies Act. With the 2008 Companies Act this has changed considerably. A case in South Africa that gives insight and a clear illustration of whether a director’s fiduciary duties were breached by way of non-disclosure of a director’s interest in a particular contract with his company, is that of *Novick*, where it was stated that:

‘in addition to an audible utterance of disclosure, tacit assent to and adoption of assertions as to a director’s interest in a contract may be construed as proper disclosure’<sup>30</sup>

Hence, in the 2008 Companies Act, adequate disclosure by way of an appropriate resolution of the company in general meeting will be acceptable.

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<sup>29</sup> [1972] 2 All ER 162.

<sup>30</sup> *Novic v Comair Holdings Ltd* 1979 (2) SA 116 (W) at 138.

## Chapter 3

### 3.0 PARTIAL CODIFICATION OF FIDUCIARY DUTIES

Partial codification of fiduciary duties with the coming into effect of South Africa's Companies Act<sup>31</sup>, 71 of 2008, will without doubt have profound and wide reaching consequences for companies, company law, and a number of related ventures that work closely within general trade and commerce here in South Africa and their interactions globally. While traces of consequences and liability for breach of fiduciary duties exist in South Africa's previous<sup>32</sup> Companies Act, the current company legislation in South Africa, the Companies Act, 71 of 2008<sup>33</sup> (hereafter as 'the 2008 Act') codified the standard of directors' conduct. Generally and under common law, only a director of a company is considered to be in a fiduciary relationship with his company, however, with the 2008 Act, a number of company officials are bound under legislated fiduciary duties to which non compliance or breaches will attract legislated sanctions.

#### **TERMINOLOGY**

Section 76 subsection (1) of the 2008 Act stated that "**director**" includes a '*prescribed officer*', an '*alternate director*', a '*committee member of a board*' and a '*member of the audit committee*'. Although the 2008 Act did not necessarily define all of the above terms and phrases, but the indicated terms under terminology, while the defined terms are quoted from the 2008 Act, others

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<sup>31</sup> The Companies Act, 71 of 2008: While this is referred to as 'South Africa's Companies Act, there is very little departure from its predecessors in the manner in which it addresses and the sources from which it draws. The very first source which enabled the incorporation of companies, this the Cape Joint Stock Companies Limited Liability Act 23 of 1861, which is in all form and shape a replica of the English Joint Stock Companies Act of 1844 and later the adoption of English Companies (Consolidation) Act of 1908. We see sections which seem to have followed other jurisdictions, amongst other things the codification of directors' duties as well as provision calling for reforms in several areas of company law.

<sup>32</sup> Companies Act, 61 of 1973 did not in any form codify the common law, though it imposed duties on directors, and provided for liability for non-compliance to what can be referred to as common law duties are legislated on. Companies Act in South Africa before and up to the Companies Act, 61 of 1973 were largely modeled after English Companies Act.

<sup>33</sup> Companies Act, 71 of 2008 specifically in Section 76 codified the common law duties of directors as well as the sanctions for non-compliance.

are hereby illustrated as understood, and as shall be used for purposes of this chapter and the rest of the dissertation.

**“Prescribed Officer”** means the holder of an office within a company, that has been designated by the Minister in terms of section 66(11);

**“Alternate Director”** means a person elected or appointed to serve, as the occasion requires, as a member of the board of a company as substitute for a particular elected or appointed director of that company;

**“Board”** means the board of directors of a company;

The person who is a ‘*member of a committee of a board of company*’ which section 76 (1)(b) equate to being a ‘*director*’ is not specifically defined or explained in the 2008 Companies Act, but the “*board*” and “*alternate director*” are just one and the same person occupying the same position of authority.

**“Audit Committee”** This is not defined in the 2008 Act. What or who constitutes an ‘audit committee’ and how this is equated to a director shall by analysis of the partial codification of directors’ fiduciary duties be worked out in this chapter.

Under common law, the beneficiary of fiduciary duties is usually the company which the director serves. It will be the task of this chapter to identify who the beneficiaries of the legislated fiduciary duties are, the need for codification of these duties and what impact the codified duties will have on South Africa’s company law in particular and in the realms of commerce in general. An evaluation of the codification shall be weighed against jurisdictions whose examples South Africa followed. Other legislation, which most probably prompted the codification, shall be purveyed by the courts’ approach based on the foundational common law principles.

### 3.1 Journey to Codification of Fiduciary Duties

The call for codification of directors’ fiduciary duties now in the 2008 Companies Act predates<sup>34</sup>

<sup>34</sup>

The call for codification of directors’ duties was no doubt prompted by various quarters, amongst which is the Constitutional Assembly at the ushering in of a constitutional and non-racial democracy in South

the Constitution<sup>35</sup> of South Africa. Factors, events and efforts calling for the codification of directors' duties have noticeable roots in the notion of corporate governance,<sup>36</sup> which JJ du Plessis an academic argued<sup>37</sup> to contain matters such as directors' duties, financial accounting and the protection of the interests of various stakeholders. In the journey to codification, Professor Michele Havenga a very vocal academic<sup>38</sup> for the idea of codification, who believes that the common law duties will only be ascertainable if fiduciary duties are stated in general terms in the Companies Act, recommending that Australia and New Zealand jurisdictions will provide useful guidelines. Her call for codification is of paramount importance and affect to the final codification of fiduciary duties in South Africa.

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Africa. From the Interim Constitution, we now have the final 1996 Constitution of South Africa. This provided under chapter two in section 8(2) that a provision of the Bill binds a natural and juristic person if, and to the extent that, it is applicable, taking into account the nature of the right and the nature of the duty imposed by the right. In subsection (3) it grants the court the right when applying a provision of the Bill to a natural or a juristic person, to apply, or if necessary to develop, the common law to the extent that legislation does not give effect to that right, and to develop rules of the common law to limit the right, provided that the limitation is in accordance with the limitation provision in the Bill of Rights. This is evidence that the concern for codification of directors' common law duties were well in the vision of those that formed the Constitutional Assembly in 1992. By the decision of *Salomon v Salomon & Co. Ltd* [1897] AC 22 where **Lord Halsbury** at par 51 stated that: "Once the company is legally incorporated it must be treated like any other independent person with its rights and liabilities appropriate to itself..." ,Hence, the equating of rights in the Bill of Rights to both natural and juristic persons.

<sup>35</sup> The *Constitution of the Republic of South Africa*, 1996. The non-racial democratic order in South Africa was ushered in at the beginning of 1993, which saw the drafted 'interim' Constitution of 1993 and the final Constitution, which is in force up to date. *Constitution of the Republic of South Africa*, 1996 came into operation on 4<sup>th</sup> February 1997 (hereinafter referred to as 'the 1996 Constitution of South Africa').

<sup>36</sup> The idea and understanding of corporate governance evolved from the Cadbury Report; Report of the Committee on the Financial Aspect of Corporate Governance, 1992 in the United Kingdom. The report defined in essence 'Corporate Governance' as 'the system by which companies are directed and controlled'. at paragraph 2.1 This definition can in other words be said to refer to all aspects of control and management of companies. The Cadbury report further had bearing on relationship between a company and its management, the board, shareholders and other stakeholders. It provides the structure through which objectives of the company are set; and welfare of shareholders amongst others is in particular emphasized strongly.

<sup>37</sup> JJ du Plessis, commenting on the whole idea of corporate governance in 1994, this even before the 1996 Constitution of South Africa come into force, ('Corporate Governance and the Cadbury Report' 1994 Vol. 6 *SA Merc. LJ* 81) emphasised the interrelationship between the various elaborate investigations of Corporate Governance in England, as in the Cadbury Report (1992), and comparing that to the South Africa 'King's Report' on corporate governance as published by the Institute of Directors in Southern Africa in November 1994.

<sup>38</sup> Professor Michele Havenga could be said to be among those at the forefront of the call for the codification of fiduciary duties. In 1997, just before the 1996 Constitution of South Africa could settle in, Havenga in her inaugural lecture at the University of South Africa based it on codification of directors' duties as follows: '*Directors' Fiduciary Duties Under Our Future Company-Law Regime*' (1997)9 *SA Merc LJ* 310. Between the period 1997 and 2008, Professor Michele Havenga had relentlessly written on the need to codify fiduciary duties in South Africa.

The efforts to codify fiduciary duties arise from diverse quotas. Quite a number have their reservations<sup>39</sup> about the idea of codification. The idea of codification is very popular with the Institute of Directors in Southern Africa which recommended through its King's Report in 1994 and 2002 that the Standing Advisory Committee on Company Law investigate the necessity and importance of the Business Judgment Rule<sup>40</sup> for South Africa. It is understandable that this move is based on foreign jurisdiction, for example the resultant effect of the business judgment rule, which had been found<sup>41</sup> to be comparable to majority of state statute in America. This is not far from the situations in South Africa, where the King's Report and calls by others have influenced the codification of directors' duties. As in America, there are comparable<sup>42</sup> statutes to section 76 and the common law has well defined models for enforcement.

### 3.2 Essence of Section 76 of the Companies Act, 2008

The equivalent of section 76 in the 2008 Act has never in the history of South African company law appeared in the Companies Act<sup>43</sup> in any form. However, section 76 subsection (2) and subsection (3) partially codified directors' fiduciary duties and those of care, skill and diligence as follows:

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<sup>39</sup> Most South African legal authors are against the idea of codification of directors' duties at common law. The division among these writers stem from the broad division that existed Historically, namely the Traditionalist view and the Modernist view. It can be said that those who are against codification align themselves to the Traditionalist view, which holds that the common law is adequate for the enforcement of directors' duties. Whilest, those that support codification are of the Modernist view. HS Cilliers and ML Benade illustrate the differences of opinion amongst the Traditionalist and Modernist views.

<sup>40</sup> The Business Judgment Rule developed in the United States of America alongside the duty of care and relates to one aspect of this duty, namely in areas of decision making. In 1982 the American Law Institute's *'Principle of Corporate Governance and Structure'* in Para 4.01 provided for the manner or standard according to which a director is expected to perform his duties.

<sup>41</sup> Melvin Eisenberg's article *'The Duty of Care and the Business Judgment Rule in American Corporate Law'* commenting on the American Law Institute's 'Model Act' wrote in the *Company Financial and Insurance LR* (1997) Vol.2 185 at 186, stating that: 'The majority of state statutes are comparable to the Institute's Model Act and comparable standards are found in case law.

<sup>42</sup> The codification of fiduciary duties of directors under section 76 of the 2008 Companies Act in South Africa, are directly comparable to the provisions of the South African Banks Act, 94 of 1990. The efforts by the Legislature in this regard is simply a reproduction based on the rules laid down by the courts at common law.

<sup>43</sup> From the very first Companies Act in the Cape, The Cape Joint Stock Companies Limited Liability Act 23 of 1861, to the last repealed Companies Act, 61 of 1973, the common law duties of directors had never been codified in South Africa. 'Codified' means legislating what is predominantly common law and stating this in legislation, imposing sanctions for non-adherence on those that are its targets.



***'Standards of directors' conduct***

76 (2) *A director of a company must –*

*(a) not use the position of director, or any information obtained while acting in the capacity of a director –*

*(i) to gain an advantage for the director, or for another person other than the company or a wholly-owned subsidiary of the company; or*

*(ii) to knowingly cause harm to the company or a subsidiary of the company; and*

*(b) communicate to the board at the earliest practicable opportunity any information that comes to the director's attention, unless the director -*

*(i) reasonably believes that the information is –*

*(aa) immaterial to the company; or*

*(bb) generally available to the public, or known to the other directors; or*

*(ii) is bound not to disclose that information by a legal or ethical obligation of confidentiality.*

*(3) Subject to subsection (4) and (5), a director of a company, when acting in that capacity, must exercise the powers and perform the functions of directors –*

*(a) in good faith and for a proper purpose;*

*(b) in the best interest of the company; and*

*(c) with the degree of care, skill and diligence that may reasonably be expected of a person –*

*(i) carrying out the same functions in relation to the company as those carried out by that director; and*

*(ii) having the general knowledge, skill and experience of that director.'*

According to section 76 subsection (2), the Act prohibits improper use of information. In subsection (2) paragraph (a) (ii), it could be said that the causing of harm to the company or a subsidiary as in paragraph (a) basically resonates with the directors' common law duties. The duty placed on directors in subsection (2), paragraph (b) is also nothing other than the duties of directors to exercise all their powers for the purpose and benefit of the company. Calling on directors, to render their services in line with the common law demands as exhibited in subsection (2)



paragraph (b) and subparagraph (i) (aa) and (bb), as well as paragraph (ii), could lead a director to a conflict of interest, most especially in the wording of paragraph (b) subparagraph (ii), as there should be no other forces to bind a director not to disclose. Section 77 (2) providing for liabilities for breach of fiduciary duties anchored such liability to be guided by the principles of common law.

Section 76 (3) providing for the manners, in connection with section 76 (4) and (5), in which directors must carry out their fiduciary duties partially codified the common law duties as well. Notwithstanding the partial codification, the common law principles are retained in section 77 (2). Further, the partial codification of the duty of care, skill and diligence in section 76 (3) (c) has no parameter for measuring, which raises the question: in which ways and on what kind of scale could one weigh care or skill? Thus, the submission of Farrar with regard to Australian company law, that the notion of directors rendering their duty with care, skill and diligence is ‘the confused inheritance of English law.’<sup>44</sup> Hence, the quest to establish the impact of the partial codification of directors’ fiduciary duties on common law provisions. Whether the provisions of section 76 (3) actually increases or decreases the duty of care and skill?

### 3.3 Care, Skill and Diligence

Care, Skill and Diligence; these three words posed very frank questions on numerous occasions What is the nature of care or how it can be determined. What specifically entails skill and how can diligence be ascertained? Michele Havenga, An academic<sup>45</sup> is of the view that the duty of care reaches broadly, applying to all decisions directors make and, indeed, to all decisions they should make were they to exercise due care. However, all of these were not specifically defined in the 2008 Companies Act, thus the underlying definitions and principles laid down by common law shall remain. The

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<sup>44</sup> John H Farrar ‘*The Duty of Company Directors in Australia and New Zealand*’ 1996 (7) *Canterbury LR* 288. Farrar’s submission points back to the sources of company law in England which came up with the idea of care, skill and diligence and to which no adequate measuring stick had been prescribed.

<sup>45</sup> MK Havenga ‘*The Business Judgment Rule – Shall we follow the Australian Example?*’ 2000 *SA Merc LJ* at 25.

fact that the provision in section 77 (2) lead to the common law principle to be applicable in relation to a breach of a fiduciary duty, as contemplated in sections 75, 76 (2) or 76 (3) (a) or (b), then, the vast body of court decisions on the interpretation of this duty.

### 3.4 **Companies Act Compared with Common Law**

The very first point to note in comparing the 2008 Companies Act to the common law position is the fiduciary duty placed on a number of officials of a company by the 2008 Companies Act. section 76 (1) states that 'director' includes an alternate director, a prescribed officer and any other person being a member of a committee of a board, or serving as an audit committee member, as well as the general members of the board. However, at common law, only directors, and sometimes accounting officers are bound by fiduciary duties and could actually incur liability for breach of such duties. Hence, all the office holders mentioned in section 76 (1) (a) and (b), shall be equated to a person holding the office of director, or rather as carrying out their duties, as shall be expected of directors of companies and as such shall incur liability, that could equally be imposed on a director for breach of fiduciary duties.

There is no doubt that directors' duties naturally flow from the provisions of common law, in addition to other sources, such as the company's constitution and the Companies Act. Hence, the liability of a director should be established by common law norms, but this has not always been the case and particularly now that directors common law duties have been partially codified by the 2008 Companies Act. At common law directors' liability will be established by the application of general law or common law and on the other hand by related statute. In comparison with the 2008 Companies Act, there are provisions in section 78 for indemnity against directors action, hence the fear that directors could actually commit breaches or other forms of wrongs and eventually by the provisions of section 78 indemnify themselves against liability for mismanagement.

In 1925<sup>46</sup> the English courts Set the standard and requirements to weigh director's duty of care and skill, which had been followed in South Africa since 1980, where MARGO J summarised and paraphrased the guidance from the English decision in three broad proportions in *Fisheries Development Corporation of SA Ltd v Jorgensen*<sup>47</sup>. Other than the argument surrounding the differentiation of executive and non-executive director, the first formulation by Margo J as in the case of *in re City Equitable*, lesser liability is placed on a non-executive director as compared to a full-time director. This is what common law lay down.

However, the 2008 Companies Act without distinguishing proximity of the official to the company's heart, imposed duties on directors, prescribed officers, alternate director, committee member and the entire board alike. Despite the codification of directors' duties in Australia and England, whose example South Africa followed, it will be difficult to determine now whether the provisions of the Companies Act in sections 76, 77, and 78 will be able to solve all the problems regarding good corporate governance.

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<sup>46</sup> *In re City Equitable Fire Insurance Co. Ltd* [1925] 1 Ch 407. This is a leading case in which a clear understanding of requirements for the performance of a director required to exercise care and skill.

<sup>47</sup> 1980 (4) SA 156 (W). The summary of **Margo J** in this case takes precedence in cases involving directors, common law duties in South Africa.

## Chapter 4

### 4.0 BREACH OF DIRECTORS' STATUTORY FIDUCIARY DUTIES

In order to fully understand what constitutes breach, or how a director could be held liable for breach of his fiduciary and particularly, statutory fiduciary duties, the general understanding of breach from the law of contract has a considerable role to play. Breach could result from a number of non-compliant actions, either in the form of non-compliance with certain prescripts, or the disregard of certain norms, or from other actions amounting in context to a form of breach. In the context of corporate law, breach of directors' statutory fiduciary duties simply results from non-compliance with the provisions dictating duties to the company director, which are now in South Africa partially codified<sup>48</sup> in the 2008 Companies Act. Although, there is no precise definition as to what could result in breach of directors' duties, liabilities for non-compliance with the partially codified duty are enumerated<sup>49</sup>.

Despite the partial codification of directors' common law duties, the previous Companies Act<sup>50</sup> contain to a considerable extent certain directors duties, though these were not duties of directors at common law, but basically in a general sense, what the director owes to the company in essence. By statutory, it could be inferred that the company's constitution is statute as well. Though unique to the particular company, it forms one of the sources through which duties and or obligation arise for the director. Other sources from which binding duties flow is contract that may exist

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<sup>48</sup> Section 76 of the Companies Act, 71 of 2008 provided for the 'Standards of directors' conduct', the provisions in section 76 subsection(2) and (3) reflect what common law recognized as directors' duties. These are inalienable company's rights to which the directors' are bound. The move in America, since about 1989 generally refer to this common law ideology as "Business Judgment Rule" and later in England as "Corporate Governance", which was eventually adopted by the King's Report in South Africa are among the influences that see for the first time the general statement of directors duties in the 2008 Companies Act. Since the Companies Act did not do away with common law (Section 77 (2)... (a) 'in accordance with the principles of common law'...) hence, this means that the legislature's effort in this regard is mere partial codification of directors' common law duties.

<sup>49</sup> Section 77 of the 2008 Companies Act elaborately illustrates under what circumstances a director or prescribed officers and other indicated company officials could be held liable by the company for breach of such directors' common law duties.

<sup>50</sup> There are considerable numbers of sections in the companies Act, 61 of 1973 and prior to this Act dating back to the Cape and the Transval Companies Acts, which dictate certain duties binding directors.

between the company and the director. A director's breach will then result from disregard for the indicated sources of obligation, particularly it should be noted that breach will differ from company to company depending to some extent on the nature of the company's business.

Breaches of directors' statutory fiduciary duties are now well spelt out in the 2008 Companies Act, as provided in section 77 (2) (a). They are in addition to other provision in the previous Companies Acts, which precedes the 2008 Companies Act. For example, sections 221-227 and 234-246 of Act 61 of 1973 required certain things of directors, or prevented them from doing certain things. All of these previously curbed directors' mismanagement of the entity they control, but all are now changed with the partial codification of directors' common law duties and the liability flowing from non-compliance with the provisions of the 2008 Companies Act. Although, the first for South Africa to include the general statement of directors' duties in the Companies Act, the examples of jurisdictions followed, shall be closely monitored.

#### 4.1 **Essence of Section 77 of the Companies Act, 2008**

It is clear that section 77 of the 2008 Companies Act codifies the common law liabilities of directors. This also consolidated most of the other sections of the 2008 Companies Act which render directors and prescribed officers personally liable<sup>51</sup> for losses sustained by the company. Section 77 (1) provides that 'director' includes an alternate director, a prescribed officer, a board committee member and audit committee member irrespective of whether or not the person is also a director. Thus the liability flowing from section 77 includes a number of company officials. Section 77(2) codifies the common law liability of a director as follows:

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<sup>51</sup> Liabilities that will be incurred at common law are closely similar to the provisions in section 77(2) (a) and (b). It is important to note here that the 2008 Companies Act recognized such liability to be in accordance with the principles of common law, relating to delict for any loss, damages or cost sustained by the company as a consequence of any breach by the director, which shall be weighed objectively.

### ***'Liability of directors and prescribed officers***

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

It is evident that the provisions in section 77(3) and particularly sub paragraph (e) are the consolidation of other sources which will result in the liability of directors within their statutory obligations. These are sections 38(3), 42(4), 44(6), 45(7), 46(6) and 48(7). All of these sections provided individually for the liability for any loss, damages or costs sustained by the company as a direct or indirect consequence of the director having been present at a meeting or having participated in the making of a decision in terms of section 74 and failing to vote against any of the resultant decisions taken as listed in (i) to (viii).

## **4.2 Common Law Regulation of Fiduciary Duties**

It is important to always keep in mind the crisp differences between the most often confused subdivisions that exist in the common law duties of directors. Briefly, the common law duties of directors' are divided into fiduciary duties and the duty of care and skill. Although it is commonly known that a director owes duties to the company, hence, that there is no direct fiduciary relationship between directors and creditors<sup>52</sup>

<sup>52</sup>

The basis of the proposition supporting the idea that the directors only owe fiduciary duties towards the company is illustrated in HS Cilliers and ML Bedae et al. *Corporate Law* at 162; these, namely that: the company being a separate entity with its own rights and duties, the creditors should protect

this position needs to be recognised and protected as there could not be an external agent in relation to a company, that could equal the company on its own existence. Yet there are instances and moves<sup>53</sup> that support strong proponents of the recognition of creditors' interest, whereby an English court<sup>54</sup> once decided in support of the protection of a creditors interest.

Presently, as it is in the past in South Africa's corporate law, directors owe fiduciary duties towards the company they serve. The other part of the common law duties, which requires directors to exercise reasonable care and skill in carrying out their duties, is well recognised. These duties as well as their fiduciary duties, are pertinent components of directors' common law duties, which render any law or agreement relieving directors of such duties null and void. Under the common law there are abundant<sup>55</sup> court decisions, both foreign and local, that spell out the standards required of directors in carrying out their duties, whereas the non-compliance with the common law prescripts shall result in such a director being held in breach of his common law duties.

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their interests by bargaining with the company and that in the case of the winding up of the company, various statutory provisions are specifically aimed at the fair treatment of creditors.

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The move supporting the recognition of the interests of creditors and other stakeholders, in an effort to cast fiduciary duties on company directors towards such creditors and stakeholders, developed alongside of corporate governance and those of business judgment rule, which proposes directors duties towards employees, shareholders as well as environmental and consumer concerns. Support for these appears in MK Havenga's view in envisaging reforms to South Africa's company law in her article '*Directors' Fiduciary Duties Under Our Future Company-Law Regime*' (1997) 9 SA Merc LJ 310.

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In 1987 an English court in the case of *Winkworth v Edward Baron Development Co. Ltd* [1987] 1 All ER 114 (HL) held that 'a company owes a duty to its creditors present and future'. This in the reasoning of the court is 'to ensure that the affairs of the company are properly administered and that its property is not dissipated or exploited for the benefits of the directors themselves to the prejudice of the creditors'. This decision was later followed in Australia in the case of *Jeffree v National Companies & Securities Commission* [1989] 15 ACLR 217, when a full bench of Western Australia endorsed the English decision that directors owe duties to creditors, future and present. [1989] 7 ACLC 556. However the move and the foreign courts decision in regard to recognition of creditors interests. There is the other opinion in HS Cilliers and ML Benade et al. *Corporate Law* at 163 that 'only time can tell whether in these cases creditors will be given a direct cause of action against the directors'. It should be noted that there are opinions in the same foreign jurisdictions that reject fiduciary duties between directors and creditors.

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As indicated there are a good number of actions that could result in a breach of directors' fiduciary duties. Very important to note is the duties placed on directors at common law as illustrated in HS Cilliers and ML Benade et al. *Corporate Law* at 141 namely 'that directors (a) should prevent a conflict of interest; (b) may not exceed the limitation of their power; (c) must maintain an unfettered discretion; and (d) should exercise their powers for the purpose for which they were conferred'. Thus the breach of or non-compliance with any of these duties will result in liability on the part of such errant director.



The submission of Andrew Hicks<sup>56</sup> that ‘there is no general professional standard of expertise required of directors’ will not be able to save a negligent director in the performance of his duties as he will be liable to the company for the damage caused. To sum up on the breach of directors’ common law duties of care and skill, the dictum of ROMER J in *In re City Equitable Fire Insurance Co. Ltd*<sup>57</sup> remains vital and important and might be the solution to the opinion in Cilliers *et al* that: ‘the standards according to which the degree of care and skill is to be measured are by no means clear.’<sup>58</sup>

The honourable judge in *In re City Equitable Fire Insurance Co. Ltd* at paragraph 426-427 stated that:

*... ‘It is indeed impossible to describe the duty of directors in general terms, whether by way of analogy or otherwise. The position of a director of a company carrying on a small retail business is very different from that of a director of a railway company. The duties of a bank director may differ widely from those of an insurance director, and the duties of a director of one insurance company may differ from those of a director of another. In one company, for instance, matters may normally be attended to by the manager or other members of the staff, which in another company are attended to by the directors themselves. The larger the business carried on by the company the more numerous, and the more important, the matters that must of necessity be left to the managers, the accountants and the rest of the staff. The manner in which the work of the company is to be distributed between the board of directors and staff is in truth a business matter to be decided on business lines. ...’*

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<sup>56</sup> Andrew Hicks ‘Directors’ Liability for Management Errors’ (1994) 110 LQR 390. Another opinion widely criticised for promoting directors’ negligent acts is the article by Vanessa Finch ‘Company Directors: Who cares About Care and Skill?’ (1992) 55 MLR 179.

<sup>57</sup> [1925] 1 Ch 407; the entirety of this judgment is often referred to as containing the roots of the common law duty of care.

<sup>58</sup> HS Cilliers and ML Benade *et al. Corporate Law* at 147.



## Chapter 5

### 5.0 BASIS OF LIABILITY FOR BREACH OF FIDUCIARY DUTIES

A director who fails to observe his duty of care and skill will be liable<sup>59</sup> to the company for any loss suffered as a result of such failure. The director's liability will be based either on delict, or if there is a contract between the director and the company, on breach of contract. This position is placed in context in *Du Plessis No v Phelps*<sup>60</sup> where FRIEDMAN J explained the position as follows; at 170:

*'Apart from their statutory duties, directors owe fiduciary duties to the company as well as a common law duty to take reasonable care in the management of the company's affairs. Liability in the event of a director failing to take reasonable care in the management of the company affairs is based on the principles of the lex aquilia. The basic requisite for liability under the lex aquilia is fault, i.e dolus or culpa, which results in loss to the plaintiff.'*

The basis of directors' liability for breach of fiduciary duties may arise from a number of sources, including the ones categorically laid down in section 77 of the 2008 Companies Act, while the basis of liability for breach of statutory duty is of paramount importance at this advent of partially codified common law duties in South Africa. A comparison of this to the common law basis for breach will also be crucial in order to evaluate if the codification lowers or elevates the common law duties. The positive and negative duties placed on directors create the basis which in turn cast a reverse onus on the director to prove due diligence, that is, the director needs to prove that he had taken proper and reasonable steps in the particular instance.

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<sup>59</sup> *Du Plessis No v Phelps* 1995 (4) SA 165 (C). See also, HS Cilliers and ML Benade *Corporate Law* at 148.

<sup>60</sup> *Du Plessis No v Phelps* 1995 (4) SA 165 (C).

### 5.0.1 Nature of Liability (*sui generis*)

It is certain that a director who is slack with the discharge of his duties will be liable to his company. This, as a well established principle at common law, is now dictated by the 2008 Companies Act. However, in order to establish the nature or basis of the liability resulting for the company director, a distinction should briefly be drawn between directors' duties at common law, namely, the 'fiduciary duties' as one component and the duty of 'care and skill' as the other part of the duty. Resultantly, the basis of liability that flows from these two components should by necessary implication be differentiated also. While the basis of liability for breach of directors' duties remains *sui generis*, the basis for liability for breach of duty of care and skill is the *Aquilian* action (*lex aquilia*).

The widely accepted<sup>61</sup> basis of liability for breach of directors' fiduciary duties is and remains *sui generis*. The leading<sup>62</sup> opinion on this suggests that, should the *Aquilian* action not be accepted as the proper basis for directors' liability for breach of their fiduciary duties, then fault would be a general requirement for liability. However, liability without fault is generally recognised in respect of directors' who breached their fiduciary obligation. The case of *Du Plessis No v Phelps* above clearly illustrates the basis and also emphasises the importance in distinguishing, though silent on the basis of liability for breach of fiduciary duty, indicated that the breach of duty of care

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<sup>61</sup> In *Robinson v Randfontein Estates Gold Mining Co. Ltd*, 1921 AD 168 **Innes CJ** referring to the no-profit rule stated at 179 that: 'the test is expressed, for the most part, in terms peculiar to the English Law, but the principle which underlies it is not foreign to our own. For it rests upon the broad doctrine that a man, who stands in a position of trust towards another, cannot, in matters affected by that position, advance his own interests...at that other's expense'. At paragraph 199, the honorable Chief Justice confirmed that 'the action with which we have to do falls under none of the specified classes suggested'. **Solomon JA** in the same judgment at 242 confirmed that 'the action is one *sui generis*'. HS Cilliers and ML Benade et al. *Corporate Law* at 141 indicated that a director of a company is a fiduciary *sui generis*. It is noteworthy that South African common law particularly provides a *sui generis* action for breach of fiduciary duties as obligation can arise from contract, delict or other sources.

<sup>62</sup> M Havenga 'Fiduciary Duties Of Company Directors With Specific Regards to Corporate Opportunities' (Unpublished LLD thesis University of South Africa 1995) at 325-328 (hereafter as *Havenga Corporate Opportunities*). Havenga's submission illustrates a consolidation of the decision in *Cohen No v Segal* 1970 (3) SA 702 (W) at 706G, in regards to company law doctrine of 'proper purpose' and 'secret profit' rules. The strength of this opinion is renewed and reiterated by **Friedman JP** in *Du Plessis No v Phelps* 1995 (4) SA 165 (C) at 171B. All of these confirm the reason why actions for directors' breach of their fiduciary duties cannot always be based on the *Aquilian* action.

is based on the principle of *lex Aquilia*, where the requisite for liability is fault resulting in loss to the company.

In past developments as compared to recent times, there was a considerable argument as to the appropriate actions for negligence, which in South Africa is confined to the law of delict. The arguments surrounding holding a director who breached his duty of care, bound in delict is equally a concern in England and Australia. In *Daniels v Anderson*<sup>63</sup> CLARKE and SHELLER JJA on the issue of holding directors liable at delict made the following comments:

*'In our opinion the concept of negligence which depends ultimately 'upon a general public sentiment of moral wrongdoing for which the offender must pay (Donogue v Stevenson (1932) AC 562 at 580) can adapt to measure appropriately in the given case whether the acts or omissions of an entrepreneur are negligent. Indeed, were a company not involved, an investor, whose property or money had been lost can call the entrepreneur to account for a breach of the duty of care owed in the circumstances to the investor. We are not impressed by this perceived barrier against imposing on directors a duty of care at common law. Nor do we think that the fact that the directors come to the task with different backgrounds in terms of training presents any problem... The law of negligence can accommodate different degrees of duty owed by people with different skills but that does not mean that a director can safely proceed on the basis that ignorance and a failure to ignore are a protection against liability for negligence'.*

In this judgment, CLARKE and SHELLER JJA accepted that directors are expected to take a decisive role within the company. That they must continuously be informed about their company's affairs and that they have a duty to exercise reasonable supervision and control over its affairs. They then concluded that the arguments against directors being under a common law duty to act negligently towards the company were based on historical considerations and are outdated.

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<sup>63</sup> Daniels v Anderson [1995] 37 NSWLR 439, at 576.

## 5.0.2 Liability (Contract or Delict)

The distinction between contract and delict formed the bases, when fiduciary duties do not really look at contract or delict as the foundation for recourse for breach of directors' fiduciary duties. Once a director acted for his own benefit or acted to the prejudice of others, such director commits 'breach of trust' and the action could neither be contractual nor delictual, but *sui generis*. The basis for this notion is well established<sup>64</sup>. Yet there are opinions and calls<sup>65</sup> for the *sui generis* action against company director who breached their fiduciary duties to be a 'strict liability' one, as understood within the existing framework of the law of delict. The call further suggests that strict liability will create greater legal certainty than what is currently the position in the application of the *sui generis* actions.

## 5.0.3 Quantum (Damages and losses)

Although there is some degree of uncertainty<sup>66</sup> about the theoretical basis of a director's fiduciary office, recognised actions at common law have always been applied and appropriately envisaged remedies obtained. The undisputed basis of directors' liability for breach of their fiduciary obligations being *sui generis*, remains and has also been consistently adjudicated by the courts. The *sui generis* nature of such action is recognised in the *Robinson* case, as well as the prescript of the Digest where in 'D 44.7.1Pr' it indicates the existence of liability as 'obligation *ex variis causarum figuris*' meaning obligation arising from 'various other' sources. These sources literally are many and varied. In more recent decisions in South Africa, there are no noticeable modifications to these age old principles.

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<sup>64</sup> Under the common law, courts' decisions in regard to breach of directors' fiduciary duties are succinctly stated in a number of cases; amongst which are *Robinson v Randfontein Estates Gold Mining Co. Ltd* 1921 AD 168 at para 199 by **Innes CJ** and at para 242 by **Solomon JA**, *Cohen No v Segal* 1970 (3) SA 702 (W)

<sup>65</sup> JSA Fourie 'Die Sui Generis Aksie Teen Direkteure Weens Verbreking van Vertrouenspligte' (1995) 3 Stellenbosch LR 408. At 416.

<sup>66</sup> On two separate occasions as published in different articles, Havenga indicated that 'uncertainty about the theoretical basis of a director's fiduciary office has the undesirable consequence that doubt arises as to the available remedies for breach of fiduciary duties. These in M Havenga 'Breach of Directors' Fiduciary Duties: Liability on what Basis?' (1996) 8 SA Merc LJ 366, at 367 and M Havenga 'Company Directors – Fiduciary Duties, Corporate Opportunities and Confidential Information' (1989) 1 SA Merc LJ 122, at 131.

In *Phillips v Fieldstone*<sup>67</sup>, the Supreme Court of Appeal distinguished between appropriation of an opportunity and standing in a fiduciary position. On establishing that the Appellant stood in a fiduciary relationship to the Respondents, the court held that the Appellant had breached his duty towards the Respondents. The breach created a conflict of interest between his duty and his self-interest, thus resulting in the dismissal of the appeal. The Appeal court relied on the *Robinson* case as well as other related cases in South Africa and on finding the Appellant accountable to the Respondents, confirmed that an agent is accountable for profits made within the scope of and ambit of his duty.

However in *Symington and Others v Pretoria-Oos Private Hospitaal*<sup>68</sup>, the issue before the court was to establish whether the Respondent's claim was one that was correctly a claim for damages, or whether it was one for the disgorgement of profits. The Supreme Court of Appeal held that the Respondent's claim was incorrectly framed as one of disgorgement of profits as there was no evidence that the Appellants had received any benefit from the sublease. Further that since the relationship between a director and a company is a contractual one, such relationship could be terminated by mutual consent.

The second component of directors' duties at common law, is the requirement that directors exercise care and skill in the carrying out of their duties. This call upon directors as illustrated by ROMER J's decision in *In re City Equitable Fire Insurance Co. Ltd*<sup>69</sup>, though finding the directors in this case liable, they escaped liability for certain provisions in the company's articles. Where at para 429 the honourable judge states that: 'directors are not liable for mere errors of judgment'. However, the basis for liability under the directors' duty of care and skill, is loss or damages suffered resulting from the act of the director, which is wrongful to the company as a result of

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<sup>67</sup> *Phillips v Fieldstone* 2004 1 All SA 150 (SCA).

<sup>68</sup> *Symington and Others v Pretoria-Oos Private Hospitaal Bedryfs (Pty) Ltd* 2005 (4) All SA 403 (SCA).

<sup>69</sup> *In re City Equitable Fire Insurance Co. Ltd* [1925]Ch 407.

the director's negligence, which event is to be measured both objectively and subjectively<sup>70</sup>.

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The objective and subjective measure of directors' negligence emanates from case law. *In re Brazilian Rubber Plantation and Estates Ltd* [1911] Ch 425, **Romer J** said that a director is required to act 'with such care as is reasonably to be expected from him, having regard to his knowledge and experience. ...Such reasonable care must, I think, be measured by the care an ordinary man might be expected to take in the same circumstances on his own behalf' (at 437).

## Chapter 6

### 6.0 CONCLUSION

#### 6.0.1 DIRECTORSHIP AND DUTIES ATTACHED THERETO

The acceptance of the office of director confers wide reaching responsibilities on individuals in such office. It became apparent from the dictum in *Daniels v Anderson* [1995] 13 ACLC 614 at 665 that: “A person who accepts the office of director of a particular company undertakes the responsibility of ensuring that he or she understands the nature of the duty a director is called upon to perform”. This confirms the opinion in Cilliers and Benade et al. *Corporate Law 2000* (at 139) that ‘it is expected of every person who acts as a director of a company to take reasonable steps to acquaint himself with the law governing directors’ responsibilities’. In view of the above and by general examination of common law duties in comparison with the partially codified version thereof in section 76 of the Companies Act, 71 of 2008, now to state the impact, if any at all, that the partial codification of directors common law duties, whether it lowered the standard required, or whether the codification raised the standards of directors’ conduct at common law.

Without derogating from the principles of legal separateness between the company, management and the shareholders, it is required by the 2008 Companies Act that the business and affairs of a company be managed by and under the direction of its board. However, case law had proved that the mere fact that a person is a director of a limited liability company does not by itself render him liable for a delict committed during the period of his directorship (*Rainham Chemical Works Ltd* (in liquidation) & *Others v Belvedere Fish Guano Company Ltd* [1921] 2 AC 465 (HL) at 476. However, should the delict be committed by such director during his term of office, or where he or the employee or other officer committed, authorised, or participated in the act amounting to delict in the performance of his duties for the company, he may incur personal liability in delict. This will create a special relationship with the company as liability is not automatic.

## 6.1 Directors Duties Prior to the 2008 Companies Act

Directors are at common law subjected to fiduciary duties, which required directors to exercise their powers and carry out their office in good faith and for the benefit of the company. In so doing the director must exercise the required degree of care and skill. The postulation found in case law is that ‘a director need not exhibit in the performance of duties a greater degree of skill than may be reasonably expected from a person of his knowledge and experience’ and secondly a director is ‘not bound to give continuous attention to the affairs of his company’. Although this judgment have been read by some to be a lenient approach to directors’ duty of care. Should consideration be given to the facts of *In re City Equitable Fire Insurance Co. Ltd* ([1925] Ch 407) in today circumstance, for directors to be held in breach of duties, gross or culpable negligence will have to be proved.

### 6.1.1 The Banks Act 94 OF 1990

The Banks Act, 94 of 1990 basically aligned itself to the principles of common law in regards to codifying directors’ duties therein, even though the 2008 Companies Act raised the standards illustrated by the Banks Act, the standard in common law of the duties of directors cannot be said to have been raised by the 2008 Companies Act in its entirety. Alignment of the provision of the Banks Act in section 60 to the common law can further be buttressed by the provided sanction for non-compliance in the Companies Act. This, points back to the 1973 Companies Act, as provided for in section 422, which in essence is basically the ideas of common law.

## 6.2 Impact of the 2008 Companies Act

The impact envisaged from the partially codified directors’ duties cannot surpass the notion that the prime function of the fiduciary duty of a director is loyalty to his company. ‘The paramount duty of directors, individually and collectively is to exercise their powers *bona fide* in the best interest of the company’ (*Hahlos South African*



*Company Law through the Cases*) JT Pretorious 8ed by PA Delpont et al (1998) at 278. Should the question arise as to what the company's interest is, or who should decide this? The answer to this is the judgment of Lord GREEN MR in *In re Smith & Fawcett Ltd* [1942] Ch 304 CA at 306 which stated that: '*They (directors) must exercise their discretion bona fide in what they consider is in the interest of the company*'. The inference to be drawn here is that, not what a court may consider as the interest of the company should stand in decisions.

In light of the above, should the common law duties of directors give way to the 2008 Companies Act, or perhaps the idea of strict compliance to the absolute codification of duties, the overlap in fiduciary duty and duty of care and skill will be encouraged as the courts will now more frequently disagree with the wisdom of directors decisions in its efforts to enforce the provisions of the Companies Act. The effect of this analogy can be best described by the dictum of SCUTTON LJ in *Shuttleworth v Cox Brothers & Co (Maidenhead) Ltd* [1927] KB 9 (CA) at 23-24:

*'Now when persons, honestly endeavouring to decide what will be for the benefit of the company and to act accordingly, decide upon a particular course, then, provided there are grounds on which reasonable men could come to the same decision, it does not matter whether the court would or would not come to the same decision or a different decision. It is not the business of the court to manage the affairs of the company. That is for the shareholders and creditors. The absence of any reasonable ground for deciding that a certain course of action is conducive to the benefit of the company may be a ground for finding lack of good faith or for finding that the shareholders, with the best motives, have not considered the matter which they ought to have considered. On either of these findings their decision might be set aside. But I should be sorry to see the court go beyond this and take upon itself the management of concerns which others may understand far better than the court does.'*

This is the reason why the common law should be maintained and retained in its totality as it is enough to regulate the fiduciary duties and the duty of care and skill.

### 6.3 **Business Judgment Rule**

In the partially codified directors' common law duties, section 76 (4) rubs shoulders with the American idea of business judgment rule, following the example in the Australian Corporations Act, 2001. What this means for South Africa is a tremendous curtailment or limitation of interference by a court with the affairs of a company, as in America, where the rule was developed to protect honest and reasonable business decisions of company directors. Eventually, reasonableness is the foundation upon which the tests to evaluate breaches committed have to stand, objective or subjective. The call upon a director to manage the affairs of a company is equally a call upon him to exercise reasonable care in the discharge of his task. Although this reasonableness will have to be matched with the nature of the business, the type or kind of company the director is expected to manage. These are amongst the subjective background issues by which the extent of breach will have to be weighed.

### 6.4 **Recommendation**

It is hereby recommended that great care should be taken in the application of the entirety of sections 76 and 77 of the 2008 Companies Act in relation to advice or litigation involving actions for the breach of common law duties, for the following reasons: firstly, the business judgment rule have a considerable defect in that it does not categorically differentiate between fiduciary duties and the duty of care and skill, secondly, that the English law which remains South Africa's common law source outrightly rejected the business judgment rule, thirdly, that in America, where the business judgment rule was developed, the courts are now changing their sympathetic stance and moving towards more vigorous enforcement of directors' duties, fourthly, for the profound difference in the jurisprudence of the American legal system and South Africa's legal system. The business judgment rule taken as it is in the 2008 Companies Act might lead to directors escaping liability for losses resulting from poor decision-making. However, the safeguard that the principles of common law are retained reduces the call for alarm at this stage.