

COMPANY DIRECTORS: FIDUCIARY DUTIES AND THE DUTY OF CARE AND SKILL

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CHAPTER 1

General and the Common law

1.1 Introduction

The duties of a company director represent a subject that is not merely academic in nature, but one that is of vital importance in our ever changing commercial world. More and more people are appointed as company directors every day and often they do not know or understand the implications of what they have agreed to.

The basic problem is a very old one. People generally tend to act in their own self-interest. Virtues are generally speaking not absolute. When virtues (for example charitable giving or volunteering) get more expensive, more arduous, or less enjoyable, people will do less of them.

Companies, by their very nature, are incapable of acting without the facilitation of humans. Companies need humans to devise strategy and to execute on the said strategy. In acting in this manner humans are required to act in the best interest of the company and not in their own best interests – *contra naturam suam*.

Furthermore, having the noblest of intentions to act in the best interest of the company is, on its own, unfortunately not good enough. Once you are assigned to devise strategy for a company and to execute on the said strategy, individuals so entrusted must also have the necessary skill and expertise to be able to do the work properly. It is unfortunately a truism that generally speaking humans tend to overestimate their own skills and abilities, especially if they lack the awareness that experience brings of what can go wrong. The problem is exacerbated when one take into consideration that the rights and liabilities flowing from the actions of the individual vests in the company and not to the individual acting on its behalf. It reminds one of the black humour of Ambrose Bierce in his *Devil's Dictionary* where he defines a company as follows: "Corporation: An ingenious device for obtaining individual profit without individual responsibility." It is therefore fully understandable that the legal and moral position of a company director has attracted the attention of

parliamentarians, judges, lawyers, academics, ethicists, social scientists and lay people.

I believe that 90% of the company directors in South Africa do not fully understand the duties that are imposed on them as directors. This is exacerbated by the fact that this area of law that is currently in a very steep developmental phase. The new Companies Act, 71 of 2008 (hereinafter referred to as the “new Act”) has introduced some new-fangled and arduous provisions as far as directors are concerned. On a daily basis people purchase shelf companies, appoint themselves as directors and proceed with their business ventures, blissfully ignorant of what is required from them by law – oblivious of what can happen to them, if they don’t comply.

The reason why I chose this topic is not only to provide information to others, but also to expand my own understanding of this subject. I am of the opinion that director liability is often overlooked when causes of action have to be formulated against companies and/or their members. The reason for this, I believe, is that most people (and legal representatives for that matter) do not have a clear understanding of what is expected of a director in law and when, for what reason and to which extent a director can be held liable.

In this document I will firstly provide an exposition of the different duties of directors from a common law perspective. Thereafter I will compare the common law to the new Act. I will also discuss a director’s liability with specific reference to the options now available, should a claimant wish to institute legal proceedings against a director for a breach of his or her fiduciary duties or duty of care and skill.

1.2 General and the common law

Prior to the new Act, the rights and duties of directors were derived primarily from agreements concluded with the company, the memorandum and articles of association, the former companies Act, Act 61 of 1973 and the common law.¹

¹ Natasha Bouwman “An Appraisal of the Modification of the Director’s Duty of Care and Skill” *SA Mercantile law journal* 21 (2009) 509.

Directors' duties are diverse and plentiful. It is therefore impossible to lay down hard and fast rules which will regulate every comprehensible situation. Each particular instance must be judged on its own merits. The common law plays a crucial role in the governance of directors' duties and liabilities (common law duties of directors are a set of obligations owed by the directors to the company they serve). Directors effectively act as agents for the company in carrying out their obligations. Their duties however extend further, as they also need to protect the company's interests.²

The common law is the point of departure when it comes to an analysis of directors' duties. All the other sources of the law (for example statutes, judgments) have an impact on the common law. Traditionally the common law duties of a director of a company could be divided into the duty to act in good faith, with honesty and loyalty (this is known as a director's "fiduciary duties") and the duty of care, skill and diligence. The first mentioned duties are distinct from the second set and are often mistaken for the same thing, the main difference being that fiduciary duties are *sui generis* (unique) in nature. The duties of care, skill and diligence, are based on delictual or Aquilian liability for negligence.³

1.3 Fiduciary duties

According to the Chambers *Dictionary of the English Language* (12th edition) the word "fiduciary" is defined as:

"Adjective - of the nature of a trust; depending on public confidence; held in trust.

Noun - a person who holds anything in trust; a person who depends on salvation on faith alone, without adherence to the moral law, an antinomian (obs theol)"

² Steyn and Everingham *The New Companies Act Unlocked* 2011 240.

³ A claimant must therefore prove all the elements of a delict to succeed with a claim. See *Ex parte Lebowa Development Corporation Ltd* 1989 (3) SA 71 (T); *Du Plessis NO v Phelps* 1995 (4) SA 165 (C).

The basis of a fiduciary relationship lies in the fact that there must be a legal relationship of trust and confidence. A fiduciary⁴ acts on behalf of and in the interests of another person.⁵ It has been held in *English v Dedham Vale Properties Ltd*⁶ that classes of fiduciary duties are never closed. This has the effect that it will never be possible to have a *numerus clausus* of fiduciary duties. When it comes to determining whether a fiduciary duty exists or not, alternatively what the extent of the fiduciary duty is, one needs to apply the facts in each particular case to the general principles. Particular circumstances also need to be taken into account. It is therefore evident that some uncertainty will remain with regard to the exact parameters and boundaries of a director's fiduciary duties. This results in fiduciary duties never being fixed or static. Fiduciary duties are continuously evolving and they need to adapt to ever changing situations and environments. The underlying general principles however are largely settled.

The question arises as to who can act as a fiduciary? Fiduciaries may include trustees, agents, partners, directors and attorneys. The degree of a particular person's duty varies, dependent on the relationship between the parties. Non-executive directors can also be held liable in terms of the common law.⁷

Since the 18th and 19th centuries the fiduciary duties of directors have developed mainly in English law, based on the analogy of the English trust law,⁸ the reason being that a director, like a trustee, manages the business of another person i.e. the company. A simple definition of a director is that a director be defined as: "...a member of a board conducting the affairs of a company...".⁹ In the South African trust law, unlike English law, a trust is not a separate legal entity. The trust's assets therefore vest in the trustees and not in the trust itself. A company, however, is a legal persona and the assets of a company belong to the company and not to its directors or shareholders. A director however is expected to take commercial risks on behalf of the company. Directors are not expected to cautiously preserve the

⁴ From the Latin "fiducarius" meaning holding in trust.

⁵ Cassim et al *Contemporary Company law (2011)* 465.

⁶ [1978] WLR 93 (ChD) 110; Cassim, 465.

⁷ *Howard v Herrigel NO 1991 (2) SA 660.*

⁸ Cassim, 466.

⁹ Vivian Marr et al *The Chambers Dictionary 12 Edition 2011.*

company's assets in the same way a trustee is obliged to preserve trust assets. In *Daniels t/as Deloitte Haskins & Sells v AWA Ltd* the court stated that “while the duty of a trustee is to exercise a degree of restraint and conservatism in investment judgments, the duty of a director may be to display entrepreneurial flair and accept commercial risks to produce sufficient return on the capital invested”. It can therefore be said that a relationship between a director and a company is *sui generis* and that a director has trustee-like duties.¹⁰ It can therefore be stated that the general principle is that “a person standing in a fiduciary duty to another commits a breach of trust if he acts for his own benefit or to the prejudice of another”.¹¹

The common law fiduciary duties of company directors are the duties of good faith, honesty and loyalty. As stated earlier, the duty to exercise reasonable care and skill is not a fiduciary duty. However, where a director acts in breach of a fiduciary duty it might also be possible that he acts in breach of his duty of care and skill or have committed fraud.¹² The opposite is can also be true for example where a director fails to comply with a legal “rule” he may be in breach of his fiduciary duties.¹³ Fiduciary duties have as their aim the raising of the standards of a director's behaviour in the corporate environment. Fiduciary duties are imposed upon directors for the protection of the company and its shareholders and a breach thereof results in liability for the director.¹⁴

Fiduciary duties can generally be divided into the duty to act *bona fide* and the duty to avoid a conflict of interest.¹⁵ A breach of any of the aforementioned duties results in liability for the director. The amount the director is liable for is dependent on the benefit that accrued to the director and/or the loss to the company. It is also important to note that the absence and/or presence of the one does not necessarily impact on the other. For example: If the company did not suffer a loss, but a director received an unwarranted benefit as a result of his/her breach of fiduciary duties,

¹⁰ Cassim, 466-467.

¹¹ HS Cilliers & Benade et al *Corporate Law 3 ed (2000)* 242.

¹² *R v Milne & Erleigh* (7) 1951 (1) SA 791 (A) at 828 to 830; *S v Ressel* 1968 (4) SA 224 (A).

¹³ *Bester NO v Wright; Bester NO v Mouton; Bester NO v Van Greunen* [2011] 2 All SA 75 (WCC).

¹⁴ Cassim, 461.

¹⁵ Piet Delpont *The New Companies Act Manual Student Edition (2011)* 90.

liability for the director will still exist.¹⁶ For a director to act *bona fide* he needs to act honestly.¹⁷ This duty to act honestly is a subjective duty. Apart from a director's subjective duty there are also objective duties.

It is important to note that objective duties will apply irrespective of the fact that the director alleges that he acted in a *bona fide* manner and therefore honestly. In other words, a director cannot be excused for failing to comply with an objective duty as a result of the fact that he acted honestly. The fact that he acted *bona fide* is irrelevant and he might still be held liable for a breach of his objective duty. The objective duties are therefore not subservient to the duty of honesty. Objective standards may include the following:

- The duty of a director to act in the best interest of the company. In the matter of *Treasure Trove Diamond v Hyman*¹⁸ the court held that where shares were issued for the purpose of obtaining control, and not for the purpose of acquiring capital, the directors did not act *bona fide* and in the best interest of the company.
- The duty of a director to not exceed his or her powers. This means that a director must not act illegally, dishonestly, *ultra vires* the company for example by paying dividends out of capital¹⁹ or by acting beyond his or her powers.²⁰
- A director must use his/her powers for a proper purpose. In this instance the *Treasure Trove* matter referred to above once again finds application. The test is twofold. Firstly one has to ascertain for what specific purpose the power was conferred and secondly whether the power was exercised for that purpose.²¹ In *Howard Smith v Ampel Petroleum Ltd*²² it was held that a

¹⁶ *Symington v Pretoria-Oos Privaat Hospitaal Bedryfs (Pty) Ltd* (2005) 4 All SA 403 (SCA).

¹⁷ *Da Silva v CH Chemicals (Pty) Ltd* (2008) (6) SA 620 (SCA).

¹⁸ 1928 AD 464.

¹⁹ *In re Exchange Banking Company Flitcroft's case* (1882) 21 ChD 519.

²⁰ JT Pretorius et al *Hahlo's South African Company law through the cases Sixth Edition* (1999) 279; *Cullerne v London and suburban General Permanent Building Society* (1890) 25 QBD 485.

²¹ *Piet Delpont* 91; *Punt v Symons & Co Ltd* [1903] 2 Ch 506; *Piercy v S Mills & Co Ltd* [1920] 1 Ch 77.

director's duty to use his or her powers for a proper purpose actually also serves as a test to determine if the act was for the benefit of the company. The duty is therefore not separate duty in a sense.

- A director must exercise an independent and unfettered discretion.²³ This means that a director must not agree to act as a “puppet” for another.²⁴ A director must consider the affairs of the company in an objective manner. This is especially important when *nominee*²⁵ directors come into the equation. In the matter of *Fisheries Development Corporation of SA v Jorgensen; Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd*²⁶ the court held that even though nominee directors represent the interests of persons who nominated them, they are obliged to serve the interest of the company to the exclusion of the interest of their nominators. They may not serve two masters as this gives rise to conflicting loyalties. It is therefore clear that once the nominee becomes the member of the board of directors of a company, he or she is compelled to serve the interests of the company.²⁷

Apart from the standards set out above a director also needs to avoid a conflict of interest. This requires that a director is prohibited from making “secret” or “non-disclosed” profits. The rule is uncompromising and is relentlessly enforced by the courts.²⁸ The test to be applied is whether the director received any benefit as a result of his position.²⁹ It has also been held that a contract between a company and its director inherently constitutes a conflict of interest and as a result such contracts are voidable at the instance of the company, should the company not approve the agreement after the facts are fully disclosed.³⁰

²² [1974] 1 All ER 1126 (PC).

²³ *S v Shaban* 1965 (4) SA 646 (W).

²⁴ *Novick v Comair Holdings Ltd* 1979 (2) SA 116 (W); *Fulham Football Club Ltd v Cabra Estates plc* [1994] 1 BCLC 363 (Ch and CA); *Howard v Herrigal NO* 1991 (2) SA 660.

²⁵ A nominee director is a lawfully elected director appointed by a creditor, financier or significant shareholder. It is expected of the nominee to represent the interests of the nominator.

²⁶ 1980 (4) SA 156 (W) 163.

²⁷ See also *Kuwait Asia Bank EC v National Mutual Life Nominees Ltd* (1991) 1 AC 187 (PC); *Scottish Co-operative Wholesale Society Ltd v Meyer* [1958] 2 All ER 66 (HL).

²⁸ *Parker v Mckenna* (1874) LR 10 Ch 96 at 124.

²⁹ *Phillips v Fieldstone Africa (Pty) Ltd* (2004) 1 All SA 150 (SCA).

³⁰ See *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168.

It is not the purpose of this chapter to exhaustively deal with the common law fiduciary duties of directors. The topic is vast and clouded with a lot of controversy and uncertainty. As already stated the exact contours and limits of fiduciary duties are uncertain and it has been held that the ambit of the duty can change from time to time.³¹ The existence of a fiduciary duty, its nature and scope are questions of fact to be adduced from a thorough deliberation of the substance of the relationship in question and any applicable circumstances which affect the operation of that relationship.³² There is therefore no magical formula to be deduced from the term “fiduciary duty”. The term merely outlines the general principles and describes the conduct that is acceptable and required.

In the premises no closed list of what fiduciary relationships might entail or a comprehensive definition of who a fiduciary is, exist.³³ However, one needs to bear in mind that the basis of a fiduciary relationship is a relationship founded on trust and confidence. It can be said that a fiduciary is someone who acts on behalf of and in the interest of another person.³⁴ A fiduciary relationship typically exists where one party is vulnerable or at the mercy of another’s discretion.³⁵

In conclusion it appears that there are three elements to a fiduciary relationship, namely that a fiduciary has some discretion or power, a fiduciary is able to unilaterally exercise that power or discretion so as to affect the beneficiary’s legal or practical interest and that the beneficiary is vulnerable and at the mercy of the fiduciary.³⁶ The general principal is that a director stands in a position of trust towards a company and the company’s shareholders as a whole, and as a result a director has a duty to act in good faith and for the benefit of his/her company.³⁷ The

³¹ See *Bellairs v Hodnett* (1978)(1) SA 1109 (A) at 1128 A-1134 D.

³² *Phillips v Fieldstone Africa* supra at 477H.

³³ *Volvo (Southern Africa) (Pty) Ltd v Yssel* 2009(6) SA 531 (SCA).

³⁴ MS Blackman et al *Commentary on the Companies Act* vol 2 (2002) at 8 – 31; *In re Equitable fire Insurance Co Ltd* [1925] 1 Ch 407 (CA) at 427-429.

³⁵ *Hospital Products Limited v United States Surgical Corporation* (1984) 156 CLR at 96-7 (HC of A), referred to with approval in *Volvo Southern Africa (Pty) Ltd v Yssel* 2009 (6) SA 531 (SCA); Cassim, 466 note 24.

³⁶ Cassim, 466.

³⁷ *Cohen v Segal* 1970(3) SA 702 (W) 706.

question now arises as to whether the fiduciary duties of a director have changed under the new Act.

A director's fiduciary duties and the duty of care and skill have now partially been codified in the new Act. The 1973 Companies Act³⁸ contained statutory duties in addition to the fiduciary duties of care and skill. The duties of directors were then mostly regulated by means of the common law and codes of best practice for example the *King Report on Corporate Governance*.

1.4 The duty of care, skill and diligence

The general principle is that directors are liable for damages which emanate from their negligence in the performance of their duties.³⁹ As a result they need to exercise their duties and functions with care and skill. It is important to note that the concepts of "care" and "skill" have different meanings. Skill may refer to the technical area of competence of a director, whereas care describes the manner in which the skill is applied.⁴⁰ It is possible to assess care more objectively, but skill varies from person to person.⁴¹

In contrast to the rigorous enforcement of the fiduciary duties of good faith, honesty and the avoidance of conflicting interests, the courts have implemented a very benevolent attitude towards the positive duty of a director to exercise reasonable care, skill and diligence in the performance of his or her duties. The reason for this was firstly based on the assumption that shareholders are responsible for the managers appointed by them,⁴² and secondly that, in the earlier days, there were fewer companies and directors were mostly appointed on a part time basis mainly for their title and reputation and not for their business expertise or skill.⁴³ As a result

³⁸ Act 61 of 1973.

³⁹ Cassim, 505; *Dorchester Finance Co Ltd v Stebbing* [1989] BCLC 498 (Ch)

⁴⁰ Cassim, 506.

⁴¹ Cilliers, Benade et al *Korporatiewe reg Tweede uitgawe* (1992) 142.

⁴² See *Turquand v Marshall* (1868-69) LR Ch App 376 where court stated that it was unfortunate for the company if the shareholders chose unwise directors. See also *Re Elgindata Ltd* [1991] BCLC 959 (Ch).

⁴³ Michele Havenga "The Business Judgment Rule – Should we follow the Australian Example" (2000) 12 SA *Merc LJ* 25 at 34.

nothing less than gross or culpable negligence would lead to a finding that a director was in breach of his duties.⁴⁴

As previously discussed, liability for breach of these duties will be delictual in nature. Therefore to succeed with a claim all the elements of a delict will have to be proved. The duties of care, skill and diligence have been formulated by the courts in largely subjective terms. The degree of care, skill and diligence depend largely on the experience and skillset of that particular director. The less experience a director has, or the lower the skillset, the lower the standard of care expected from him or her. It is paradoxical that a director's incompetence can actually protect him or her from liability.⁴⁵

It should be noted in this regard that directors do not require specialised training.⁴⁶ They are not required to be members of a professional body. Almost anybody can become a director of a company. There is no objectively set standard or skillset required.

In *Re City Equitable Fire Insurance Co Ltd*⁴⁷ the liquidator of the company endeavoured to hold certain directors of the company liable for their failure to detect fraudulent behavior on the part of their managing director. The court found that the other directors were negligent. Those directors were however protected from liability by a provision in the constitution of the company. The court in its judgment laid down three basic legal principles. These principles were followed without critical examination in the matter of *Fisheries Development Corporation v Jorgenson*.⁴⁸ They are the following:

⁴⁴ See *Re Denham & Co* (1884) LR Ch D 752 where court failed to find director in breach of his duty of care after having found him negligent in the performance of his duties by virtue of the fact that he failed to execute same for four years.

⁴⁵ See FHI Cassim "Fraudulent or reckless trading and s 424 of the Companies Act of 1973" (1981) 98 *SALJ* 162.

⁴⁶ Cassim, 506; Andrew Hicks "Directors" Liability for management errors (1994) 110 *LQR* 390; Vanessa Finch "Company Directors: Who cares about Skill and Care?" (1992) 55 *MLR* 179.

⁴⁷ [1925] Ch 407.

⁴⁸ 1980 (4) SA 156 (W) 165.

- A director need not exhibit in the performance of his duties a greater degree of care and skill than may reasonably be expected from a person of *his or her* knowledge and experience. It is clear that the aforementioned is a subjective standard and not the standard of a reasonable director. Directors are not liable for mere errors of judgment.⁴⁹
- A director does not have to continuously give attention to the affairs of a company. In this regard one should distinguish between executive and non-executive directors. Non-executive directors do not have to give unremitting attention to the affairs of the company. Traditionally their duties differ from that of executive directors and they are more often than not only expected to contribute at periodical directors' or other meetings. A non-executive director should however call such meetings if he has reasonable grounds for believing such to be necessary.⁵⁰
- Thirdly, a director is justified in trusting an official to perform certain duties honestly when the duties were entrusted to that official. A director is for example entitled to rely on the company's accountant, auditor or attorney or other such person's to perform their functions properly and honestly.

Both South African and English law have accepted the view that directors do not need any specific qualifications to hold office.⁵¹ For example, a farmer, attorney or medical practitioner can all serve on a board of directors of for instance a steel factory without having any knowledge of the fabrication of steel. English law has however adopted a more stringent view on the duty of care of directors. This was not adopted in South African company law. In contrast, the US Model Business Corporation Act 1984 states that the members of a board or a committee "shall discharge their duties with the care *that a person in a like position* would reasonably believe appropriate under similar circumstances".⁵² This entails an objective test, but

⁴⁹ Cassim, 507.

⁵⁰ *Fisheries case supra* at 165-166 *per* Margo J.

⁵¹ See Andrew Hicks note 46 *supra*.

⁵² Cassim, 507.

it also takes surrounding circumstances into account.⁵³ A director's liability in the US for failure to exercise reasonable care and skill depends on the business judgment rule which will be discussed later. Similar to the US, Canada's Business Corporations Act (specifically section 117) adopts an objective approach in providing that "a director shall exercise that degree of care, diligence and skill which a reasonably prudent person would exercise in comparable circumstances".

As previously discussed the lenient traditional approach was in need of revision. In *Daniels t/as Deloitte Haskins & Sells v AWA Ltd*⁵⁴ the court stated that it is no longer appropriate to evaluate a director's conduct with outdated subjective tests applied in outdated precedents. The court suggested that a more objective test should apply. This is a clear example of a court's inherent power to develop common law if required. The common law is not codified. It is a living and organic system constantly under legislative and judicial review.⁵⁵

In *Re D'Jan of London Ltd*⁵⁶ the court applied a new test. Both subjective and objective elements were to be taken into account. It is interesting to note that the wording of the test formulated in *Re D'Jan of London Ltd* corresponds greatly with the test contained in the new Act.⁵⁷

In South African law, the Banks Amendment, Act 19 of 2003 and specifically s 40(c) and (d) thereof also paved the way towards a more objective approach when it comes to judging directors' duties of care and skill. The new Companies Act of 2008 continues this development.⁵⁸

In the next chapter I will discuss the provisions of the new Act that are applicable to the fiduciary duties of directors and the directors' duty of care and skill.

⁵³ For a general discussion see JS McLennan 1982 SALJ at 397 – 400; S J Naudé "Die Regsposisie van die Maatskappydirekteur (1970) 157 – 166.

⁵⁴ (1995) 37 NSWLR 438.

⁵⁵ K O'Regan "The best of Both Worlds? Some reflections on the interaction between the Common Law and the Bill of Rights in our new Constitution" *Potchefstroomse Elektroniese Regsblad 2* (1999).

⁵⁶ [1993] BCC 646 (Ch D (Companies Court)).

⁵⁷ Natasha Bouwman op cit note 1 at 512.

⁵⁸ Cassim, 508; See also Johan Coetzee "Codifying director's duties – a lively debate ahead" *Without Prejudice* April 2007, 4 – 5.

CHAPTER 2

2.1 Section 76 of the New Companies Act, Act 71 of 2008

For the first time in South Africa's Corporate Law history, the fiduciary duties of directors and the duty to exercise reasonable care and skill have been statutorily defined by means of section 76(3) of the new Act. As is the case with all legislation, the basic canon of construction applies, namely that a statute should be construed in "conformity with existing law and that the legislature does not intend to alter the existing law more than necessary".⁵⁹ It is important to note that this section does not exclude the common law, which means that the common law duties that are not expressly amended by the section will still apply.⁶⁰ Duties not in conflict with the specific section will also apply.⁶¹ Some foreign jurisdictions choose to exclude the common law *in toto*.⁶²

The purpose of a partial codification is the fact that it will provide clearer guidelines for directors when it comes to a director's liability with regard to a breach of his or her

⁵⁹ See *Van Heerden NNO v Queen's Hotel (Pty) Ltd* 1973 (2) SA 14 (RA); *Casserly v Stubbs* 1916 TPD 310-312; See also section 158(a)

⁶⁰ S 77(2).

⁶¹ Delpont et al *Henochsberg on the Companies Act, 71 of 2008 Volume 1 First Edition* (December, 2011) 285.

⁶² Miranda Feinstein "A Practical guide to the new Companies Act – directors' duties and responsibilities" *De Rebus* 499, July 2012, 43.

fiduciary duties and/or duty of care and skill.⁶³ A code, if drafted properly, can provide for legal certainty. It can also save time and money. Generally it would be much easier to ascertain the applicable law. This aids compliance. The section in effect couches a director's ignorance and also makes the law more easily accessible. Directors would also be in a position to be able to identify the scope of their duties more clearly.

In a survey done by the UK Institute of Directors, results showed that a great percentage of directors do not even know the scope of their fiduciary duties and to whom these duties are owed.⁶⁴ Partial codification also prevents an opportunity to resolve conflicting judgments on these duties. The fact that the common law principles relating to directors' duties remain preserved will have the result that the common law and the partially codified statutory duties will co-exist. Partial codification of director's duties in South Africa follows the trends set in Australia, New Zealand, Ghana, Malaysia, Singapore, the UK and other common-law jurisdictions.⁶⁵ The statutory partial codification will now also bring South Africa in line with the aforementioned approaches.

As stated above partial codification has a number of benefits. The benefits of partial codification are *inter alia* the following:

- clearer and more efficient guidelines;
- saving money, time and effort in finding and complying with the law; and
- enabling directors to clearly identify the scope of their duties.

There are also some negatives, the main concern being a lack of flexibility. The fact that the common law will still apply, might ensure that directors' duties remain flexible and open for further development, if the facts and changes in business practices warrant further development. It is however extremely important that the relationship

⁶³ I Esser "Recognition of Various Stakeholders Interests in Company Management" (LLD thesis UNISA (2008)); Irene-Marie Esser and Johan Coetzee 2004 (12) *Juta Business Law Journal* 26

⁶⁴ Cassim, 462.

⁶⁵ Cassim, 462.

between the statutory duties and the common law be clear, and that no uncertainty and/or confusion exists in this regard.

The relevant portions of section 76 read as follows:

“76. Standards of a director’s conduct –

(1) In this section, “**director**” includes an alternate director, and –

- a) a prescribed officer; or
- b) a person who is a member of a committee of a board of a company, or of the audit committee of a company,
irrespective of whether or not the person is also a member of the company’s board.

(2) A director of a company must –

- a) not use the position of director, or any information obtained while acting in the capacity of 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 subsections (4) and (5), a director of a company, when acting in that capacity, must exercise the powers and perform the functions of director –

- a) in good faith and for a proper purpose;
- b) in the best interests of the company;
- 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;
- ii) having the general knowledge, skill and experience of that director.”

2.1.1 Section 76(1)

What is evident from section 76(1) is that it is not only a director in terms of this section who can be liable for a breach of his/her fiduciary and/or other duties, but that a prescribed officer or a person who is a member of a committee of a board of a company or the audit committee of the company may also be held liable. A definition of “director” in section 1 of the new Act reads as follows:

“**director**” means a member of the board of a company, as contemplated in section 66, or an alternate director of a company and includes any person occupying the position of a director or alternate director, by whatever name designated.“

The definition of prescribed officer reads as follows:

“**prescribed officer**” means the person who, within a company, performs any function that has been designated by the Minister in terms of section 66(10).”

The 2008 Act left the definition of “prescribed officer” to be determined by Regulation. The Companies Regulations 2011 defines a “prescribed officer” as:

“**38. Prescribed officers of companies.** See s. 66(10) – (1) Despite not being a director of a particular company, a person is a “prescribed officer” of the company for all purposes of the Act if that person –

- (a) exercises general executive control over and management of the whole, or a significant portion, of the business and activities of the company; or
- (b) regularly participates to a material degree in the exercise of general executive control over and management of the whole or a significant portion, of the business and activities of the company.”

(2) This regulation applies to a person contemplated in sub-regulation (1) irrespective of any particular title given by the company to –

- (a) an office held by the person in the company;
- (b) a function performed by the person for the company.”

The aforementioned definitions are broad enough to include executive and non-executive directors, *de facto* and *de jure* directors, alternate directors, nominee directors and *ex officio*⁶⁶ directors.⁶⁷ It appears that the definition is also wide enough to include “shadow” directors.

A “shadow” director is in most instances a retired director who stills assists the board, although he is no longer a formally appointed director. The first formal reference to a “shadow director” in English law was the Companies (Particulars as to Directors) Act 1917. The aforementioned act protracted the term “director” to include “any person in accordance with whose directions or instructions the directors of a company are accustomed to act”.⁶⁸ The common law position with regard to the application of fiduciary duties and liability to those who act as shadow directors is not certain.⁶⁹ There are some Australian authorities that treat shadow directors as fiduciaries.⁷⁰ The Australian Corporations Act 2001 however includes shadow directors in its definition of “director”. Prior to the new Act, there was no formal recognition of the shadow director concept in South African company law.⁷¹ In the past our courts have accepted that there are exceptional cases where fiduciary duties can be imposed on a non-director who exercises near-absolute control of a company.⁷² The aforementioned is in line with the view of the English courts.⁷³ Section 76 read with the definition of prescribed officer seems to specifically impose

⁶⁶ An *ex officio* director is someone who holds office as a director as a result of holding some other office, title or designation or similar status specified in the company’s Memorandum of Incorporation – see section 66(4)(a)(ii) read with section 66(5)(b)(ii).

⁶⁷ The fiduciary duties are not limited to director’s only, but also extends to managers or senior employees of the Company. See in this regard Laskin J in *Canadian Aero Service Limited v O’Malley* (1973) 40 DLR (3d) 371 (SCC) 381; *Philips v Fieldstone Africa (Pty) Ltd* op cit note 29.

⁶⁸ Section 3 of the Companies (Particulars as to Directors) Act 1917.

⁶⁹ Kathy Idensohn “The Regulation of Shadow director’s” *SA Merc Law Journal* 22 (2011): 326.

⁷⁰ *Australian Securities Commission v AS Nominees Ltd* (1995) 13 ACLC 1, 596

⁷¹ Despite the absence of express recognition, there are statutory provisions in relation to wrongful trading and director disqualification for example section 424 of the former Companies Act which applied to “any persons who is knowingly a party to the carrying of the company’s business either recklessly or fraudulently”.

⁷² See *Robinson v Randfontein Estates Gold Mining Co Ltd* op cit note 30.

⁷³ See in general *Ultraframe (UK) Ltd v Fielding* [2005] EWHC 1638 (Ch) and *Triodos Bank v Dobbs* [2004] EWHC 845 (Ch)

fiduciary duties upon shadow directors. The definition of a prescribed officer provided for in the Companies regulations are akin to a definition of a shadow director.⁷⁴

Section 76(1) specifically provides that prescribed officers or committee members need to comply with the fiduciary duties of directors, irrespective of whether they are members of the company's board. They too can be held liable.⁷⁵ The rationale for this approach probably lies therein that the audit committee, for example, plays a very important role when it comes to the oversight responsibilities of corporate boards.⁷⁶ This however has the implication that certain individuals with non-decision making powers will have onerous duties to comply with, notwithstanding the fact that they will most probably and as a result of their non-decision making powers, not be compensated as is the case with directors. The risks faced by these persons are therefore far greater than the rewards they can reap. One will thus have to think carefully before committing to serve on the board of a company, especially if one is not tasked with the day to day management thereof. To deal with every individual on the board in the exact same manner irrespective of the person's level of seniority and influence would be imprudent.⁷⁷

2.1.2 Section 76(2)

Section 76(2)(a) underpins the directors' duty of loyalty and fidelity to the company and the duty not to make a profit for themselves out of their positions as directors.⁷⁸ It is important to note that this section also applies to a wholly-owned subsidiary and a subsidiary. A benefit may not be gained for a party other than the company or a *wholly-owned* subsidiary of the company, nor may damage be caused to the company or a *subsidiary* of the company. It therefore seems as if directors now owe fiduciary duties to subsidiary companies of holding companies. In terms of common law, fiduciary duties are owed only to holding companies and not to subsidiaries.⁷⁹ This has the effect that each company in a group of companies needs to be dealt

⁷⁴ See definition of "prescribed officer" *supra*.

⁷⁵ See note 67 *supra*.

⁷⁶ Cassim, 465.

⁷⁷ Lise Conradie "More indulgent approach to director's duties" *Without Prejudice*, October 2008, 14 – 15

⁷⁸ Siyabonga Shandu "Conflict of interest lessons from the UK" *Without Prejudice*, March 2012, 14 - 15

⁷⁹ *Adams v Cape Industries plc* 1990 Ch 433 (CA)

with separately and be regarded as a separate legal entity, unless the corporate veil is pierced or legislation directs otherwise. Where the directors of a holding and subsidiary company are the same, separate duties in respect of each of the companies will still remain.⁸⁰ It can be argued that section 76(2) is an overriding duty to avoid conflicting interests as developed in terms of the common law.⁸¹ The common law is in any event applicable, unless expressly excluded by the new Act.⁸² As a result we will discuss the common law duty not to misappropriate corporate opportunities, the secret profit rule and the duty not to compete with the company next.

Corporate opportunity rule:

A director has a duty to acquire some economic opportunities for the company. These opportunities can either consist of property or rights and are known as “corporate opportunities”. If a director acquires such an opportunity for himself or herself, the acquisition is to be treated as being made on behalf of the company, and the company has a right to claim the opportunity back from the director.⁸³ Should the claim no longer be possible (for example where the director has already sold the opportunity to a third party), the company may claim any profit made by the director as a result of a breach of his duty or damages.⁸⁴ A corporate opportunity includes information which comes to a director’s knowledge which he may not turn to his personal advantage if it should have been conveyed to the company.⁸⁵ The question arises whether a *former* director can be held accountable for the appropriation of corporate opportunities which occur after his resignation from the company. Once a director has resigned he no longer holds a position from which his fiduciary duty originates. The *prima facie* rule to avoid a conflict of interest would then cease to exist. Leading authorities however suggest that a former director will in certain circumstances continue to owe fiduciary obligations to the company, and that it

⁸⁰ *Scottish Co-operative Wholesale Society v Meyer* 1959 AC 324 (HL).

⁸¹ Delpport, 286.

⁸² Delpport, 287

⁸³ *African Claim & Land Co v Langermann* 1905 TS 494 at 505; *Magnus Diamond Mining Syndicate v Macdonald and Hawthorne* 1909 ORC 65;

⁸⁴ Delpport, 287; *Industrial Development Consultants v Cooley* [1972] 2 All ER 162 (Birmingham Assizes)

⁸⁵ *Cranleigh Precision Engineering Ltd v Bryant* [1946] 3 All ER 289 (QB)

would therefore be suitable to hold him liable for the misappropriation of corporate opportunities which occur after his resignation.⁸⁶ A director can therefore not divest himself of this duty by merely resigning.⁸⁷ Examples include cases such as where a director resigns to personally take up a business opportunity the company was pursuing; where he pursues an opportunity a company is unable to take (excluding opportunities where the board has rejected the said opportunities) and where his position with the company helped or led him to the opportunity he acquired after resignation. However, that does not mean that a director is prohibited from making use of a corporate opportunity where a wish to acquire such opportunity was not the reason for his resignation.⁸⁸

In the matter of *Da Silva v C H Chemicals (Pty) Ltd*⁸⁹ it was held that a director may take steps to set up a competing business during his notice period, provided he does not avert opportunities to himself personally and that he does not compete with the company while he remains a director.⁹⁰

Secret Profit Rule:

A director also has a duty to account to the company for all profits acquired by him by reason of his office. These profits refer to those acquired by a director during the course and execution of the duties of his office.⁹¹ The only exception to this rule is if the profits are obtained with the full knowledge or consent of the company. The term “profits” not only refers to money, but covers every gain or advantage by the director. In the *Robinson* case⁹² it was made clear by Soloman JA that the company’s claim by virtue of this remedy is not a damages claim. Therefore, the fact that no damages

⁸⁶ Rehana Cassim “Post Resignation Duties of Directors: The Application of the Fiduciary duty not to Misappropriate Corporate Opportunities” 125 *SA Law Journal* (2008): 731

⁸⁷ *Magnus Diamond Mining Syndicate v Macdonald and Hawthorne* op cit note 81 at 81 - 82. *Sibex Construction SA (Pty) Ltd v Injectaseal CC* 1988 (2) SA 54 (T) at 56 – 66; *Spieth v Nagel* [1997] 3 All SA 316 (W) at 322 – 324.

⁸⁸ *Island Export Finance Limited v Umunna* [1986] BCLC 460 (QB)

⁸⁹ 2008 (6) SA 620 (SCA)

⁹⁰ See also David Matlala “Companies – Fiduciary duties of directors” *De Rebus* 30:477, 45

⁹¹ Delport, 289; *Parker v McKenna* (1874) LR 10 Ch App 96 at 118; *Transvaal Cold Storage v Palmer* 1904 TS 4 at 33 – 34;

⁹² *Robinson v Randfontein Mining Estates Gold Mining Co Ltd* op cit note 30, at 159

were suffered by the company was of no consequence. A director's liability arises when a profit has been received.⁹³

Duty to avoid a conflict of interest:

A director may also not compete with the company. Such conduct is precluded if it would place him or her in a situation of conflict of interest.⁹⁴ Whether the competition involves a breach of this duty depends on the facts. There needs to be a real conflict of interest.⁹⁵ It has furthermore also been stated in *Phillips v Fieldstone Africa (Pty) Ltd*⁹⁶ that the rule is a strict one and that there is little room for exceptions. The rule might also even extend to a real possibility of conflicts and not only to actual conflicts.⁹⁷ In the matter of *Sibex Construction (SA) (Pty) Ltd v Injectaseal CC*⁹⁸ the court stated that:

"An examination of the case law in this court and in the courts of other jurisdictions on the fiduciary duties of directors and senior officers shows the pervasiveness of a strict ethic in this area of law. Persons in positions of trust may be less tempted to place themselves in a position where duty conflicts with interest if the court recognized and enforced the strict ethic of this rule".

This inflexible principle was also confirmed the *Aberdeen-case*.⁹⁹

The abovementioned common law principles need to be considered in the application and interpretation of section 76(2).

2.1.3 Section 76(3)(a), (b) and (c)

As stated above, subsections 76(3)(a), (b) and (c) state that a director of a company, when acting in that capacity, must exercise the powers and perform the functions of a director –

⁹³ *Parker case supra* at 118; *Regal-case supra* at 144 – 145; 386;

⁹⁴ See *Keech v Sanford* (1726) Sel. Cas. Ch. 61.

⁹⁵ *Atlas Organic Fertilizers (Pty) Ltd v Pikkewyn Ghwano (Pty) Ltd* 1981(2) SA 173 (T) 179 – 189;

⁹⁶ [2004] 1 All SA 150 (SCA) 160 – 161;

⁹⁷ *Aberdeen Railway Co v Blaikie Bros* (1854) 1 Macq 474

⁹⁸ 1988 (2) SA 54 (T) at 66D.

⁹⁹ *Supra*.

- 1) in good faith and for a proper purpose;¹⁰⁰
- 2) in the best interests of the company;¹⁰¹
- 3) with the degree of care, skill and diligence that may reasonably be expected of a person;
- 4) carrying out the same functions in relation to the company as those carried out by that director;¹⁰²
- 5) having the general knowledge, skill and experience of that director.¹⁰³

Section 76(3)(a) and (b) are in line with the common law duty to act *bona fide* and in the best interest of the company. Section 76(3)(c) deals with the duty of care, skill and diligence. As previously stated, there is not an exhaustive and comprehensive list and/or code of fiduciary duties, but it is necessary to read the provisions of this section in conjunction with the common law.

Section 76(3)(a) couples the duty of good faith with the duty to exercise his/her powers for a proper purpose.

Section 76(3)(b) codifies the common-law principle that a director must act in the best interest of the company. The wording of this provision makes it clear that directors owe this duty to the company alone.¹⁰⁴ This will be discussed in more detail in chapter 3.

Section 76(3)(c) tightens up the director's duty of care and skill. If one reads the section you can ascertain that an objective test is to be applied to determine what

¹⁰⁰ Section 76(3)(a)

¹⁰¹ Section 76(3)(b)

¹⁰² Section 76(3)(c)(i)

¹⁰³ Section 76(3)(c)(ii)

¹⁰⁴ Cassim, 467

the reasonable director would have done in a similar situation, as well as a subjective test in which the factors to be taken into account are the knowledge, skill and experience of that specific director. It therefore appears that the duty has two elements with the objective standard being the minimum.¹⁰⁵ In the matter of *Australian Securities Investment Commission v Healy*¹⁰⁶ the court held that a minimum objective of knowledge and skill was required from directors. Directors therefore need to comply with certain minimum requirements. If a director has much greater skill than the bare minimum, he or she will be judged accordingly. However, the objective requirement must also be reasonable and flexible for directors do not form part of a homogeneous group.¹⁰⁷

In the next chapter the provisions of section 76(3)(a), (b) and (c) will be critically compared to the common law.

¹⁰⁵ Delport, 292. See also Section 60 of the Banks Act no. 94 of 1990 and Johan Coetzee “Codifying director’s duties – lively debate ahead” *Without prejudice*, April 2007, 170

¹⁰⁶ [2011] FCA 717

¹⁰⁷ In *Dorchester Finance Co Ltd v Stebbing* two of the three company directors were qualified directors with experience. The two directors signed blank cheques without enquiry. This resulted in the managing director misappropriating company funds. They were held liable for their negligence. A higher standard of care was expected from them for they were professional persons. See also *Re D'Jan of London Limited* [1994] 1 BCLC 561 (Ch).

CHAPTER 3

3.1 The new Act and common law duties – a comparison

We have noted that section 76 is in line with the common law duties to act *bona fide* in the best interest of the company for a proper purpose.¹⁰⁸ I will now discuss the impact section 76(3) of the new Act might have on the fiduciary common law duties and the duty of care and skill of a company director. We will firstly look at a director's fiduciary duties now partially codified by means of section 76(3)(a) and (b) and thereafter the director's duty of care and skill partially codified by section 76(3)(c).

3.1.1 Common law fiduciary duties and section 76(3)(a) and (b) of the new Act

¹⁰⁸ This section is not the only section that deals with director's duties, see also section 75 addressing a conflict of interest, section 77 on liability of director's (discussed in chapter 4) and section 78 on indemnification of insurance.

As we have stated, the common law position has now been partly codified in the new Act.¹⁰⁹ The common law will however still be applicable as long as it is not in conflict or has not been expressly amended by the new Act.¹¹⁰

In *Da Silva and others v C H Chemicals (Pty)*¹¹¹ it was held that “it is a well-established rule of common law that directors have a fiduciary duty to exercise their powers in good faith and in the best interests of the company”. It has also been held that it is not for the courts to review the merits of a decision of the directors honestly arrived at.¹¹² Directors are bound to exercise the powers conferred upon them in a *bona fide* manner in what they consider (and not what the courts may consider) to be in the best interest of the company.¹¹³ Therefore, the primary duty of a director is to act in what he or she honestly considers to be the best interest of the company.¹¹⁴ The test of honesty and good faith is subjective and not objective.¹¹⁵ It also depends on the director’s state of mind.¹¹⁶ However, the absence of a reasonable ground for believing that the director acted in the interest of the company may provide a basis for determining a lack of good faith.¹¹⁷ In *Shuttleworth v Cox Bros & Co (Maidenhead) Limited*¹¹⁸ the court in *obiter* stated that the test to be applied is whether a reasonable man would have regarded the act of the directors to be in the interests of the company.¹¹⁹ Again this introduces an objective element.

A director will be in breach of his duty to act in the best interests of the company should he:¹²⁰

¹⁰⁹ Delport, 258.

¹¹⁰ Section 77(2)

¹¹¹ 2008 (6) SA 620 (SCA)

¹¹² *Re Smith & Fawcett Limited* [1942] Ch 304 & 306; *Hogg v Cramphorn Ltd* [1967] Ch 254 & 268; *Carlen v Drury* [1812]; *Levin v Felt and Tweeds Ltd* 1951 (2) SA 401 (A) at 414 – 415; *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] 1 All ER 1126 (PC) at 1131

¹¹³ *Smith v Fawcett Ltd* [1942] Ch 304 at 306

¹¹⁴ Cassim, 476;

¹¹⁵ *Greenhalgh v Arderne Cinemas Ltd* [1950] 2 All ER 1120 [CA]

¹¹⁶ See *Greenhalgh* matter *supra*.

¹¹⁷ *Scrutton LJ in Shuttleworth v Cox Bros & Co (Maidenhead) Ltd* [1927] 2 KB 9 at 23.

¹¹⁸ *Supra*.

¹¹⁹ Cassim, 476; See also *Tec. Corp. Ltd. v Millar* (1972) 33 DLR [3d] 288 [BCSC]; *Howard Smith* case *supra* at 1133

¹²⁰ For further examples see Delport, 294.

- cause the company to guarantee his personal liability;¹²¹
- discount a bill of exchange in favor of the company for private purposes or his own purposes;¹²²
- misappropriate the proceeds of a company cheque even when he is the only director and member of the company;¹²³
- use the company's confidential information to compete with it in a particular market;¹²⁴
- benefit himself by issuing shares for the purpose of manipulating voting interests;¹²⁵

Directors owe no duty as such to members in their personal capacities.¹²⁶ Not even majority shareholders.¹²⁷

It is however not sufficient for directors to merely exercise their powers for what they believe to be in the best interest of the company.¹²⁸ Section 76(3)(a) states that the directors must also exercise the powers of director for a “proper purpose”. Although “proper purpose” is not defined in the act, its common law meaning dictates that directors must exercise the powers and perform the functions of director for the purpose for which the power was given to them and not for an ulterior purpose. In other words, notwithstanding the duty of honesty and good faith having been complied with, a director also needs to prove that he acted for a proper purpose. Section 76(3)(a) merely declares what is stated in the common law. Some authorities, however, have regarded the duty for a proper purpose as part of the directors' duty of good faith.¹²⁹ By including the “proper purpose” provision in section 76(3)(a), it removes all doubt in this regard and it does confirm that one needs to deal therewith in a separate and distinct manner. The duty to exercise powers for a

¹²¹ *Paddon v Brock Ltd v Nathan* 1906 TS 158 at 162 – 164.

¹²² *Contemporary Refrigeration (Pty) Ltd v Leites* 1967 (2) SA 388 (D) at 391; *International Sales & Agencies Ltd v Marcus* [1982] 3 All ER 551 (QB).

¹²³ *AL Underwood Ltd v Bank of Liverpool* [1924] 1 KB 775 (CA).

¹²⁴ *Sibex Construction v Injectaseal CC* 1988 (2) SA 54 (T).

¹²⁵ *Punt v Symons & Co Ltd* [1903] 2 Ch 506.

¹²⁶ *Percival v Wright* [1902] 2 Ch 421; *Pergamon Press Ltd v Maxwell* [1970] 2 All ER 809 (Ch) at 814

¹²⁷ *Bell v Lever Brothers Ltd* [1932] AC 161 [HL]

¹²⁸ Cassim, 477.

¹²⁹ *Teck Corp Ltd v Millar* (1972) 33 DLR (3d) 288 (BCSC)

“proper purpose” is thus now both a statutory and a common law requirement. The test for “proper purpose” is an objective one.¹³⁰ In *Hogg v Cramphorn Ltd*¹³¹ the board of a company allotted shares that carried special voting rights to the trustees of a trust. The trustees were expected to be the allies of the current directors and it was anticipated that they would cast their votes in support of the directors rather than in support of a potential takeover bidder. Even though the directors believed that the takeover would not be in the best interest of the company, the court ruled that the directors had improperly exercised their powers to issue the shares. The court furthermore stated that it was irrelevant that they had acted in good faith. The power to issue shares is a fiduciary power which in this particular instance was exercised for an improper purpose.

In *Piercy v Mills*¹³² it was held that an issue of shares for the purpose of distorting the balance of voting power is an improper exercise of the power to issue shares. It is also true that in some instances there might be more than one purpose for which the director holds power. In such a case, the court needs to determine what the dominant purpose was. In *Extrasure Travel Insurances Limited v Scattergood*¹³³ it was held that the law pertaining to proper purpose is clear and unambiguous. One does not need to prove that the director was dishonest or that he or she was pursuing an improper purpose. The test to be applied according to the court is fourfold. The court must:

- 1) identify the power that is being challenged;
- 2) identify the proper purpose for which the power was originally given;
- 3) identify the substantial purpose for which the power was exercised;
- 4) decide whether the purpose was proper.

When it therefore comes to section 76(3)(a), the test that needs to be applied in measuring whether a director exercised his powers in good faith is subjective, and

¹³⁰ *Supra*

¹³¹ [1967] Ch 254

¹³² [1920] 1 Ch 77

¹³³ [2003] 1 BCLC 598 [ChD] 619

the test that finds application with regard to deciding whether a director exercised his powers for a proper purpose is objective.

Subsection 76(3)(b) states that a director must exercise the powers and perform the functions of director in the best interests of the company. If regard is had to the wording of this provision, it becomes evident that the directors of a company owe a specific duty to the company and the company alone. The question arises as to what is defined as “the company”. In section 1 of the new Act a company is defined as “a juristic person incorporated in terms of the Act”. This definition does not help define the word “company” for purposes of section 76(3)(b). The common law meaning therefore finds application. At common law the word “company” does not necessarily mean the legal entity itself, but refers to the interests of the collective body of present and future shareholders.¹³⁴ Directors therefore owe a duty to the “company” as a whole, which means the collective body of shareholders, including future shareholders. Stakeholders other than shareholders have received no formal acknowledgment under the new Act. In terms of common law, a director of a subsidiary company does not owe a fiduciary duty to its holding company or to the group of companies of which the subsidiary forms part.¹³⁵ Section 76(2) might have changed this principle.¹³⁶

The question is yet again raised whether a company is to be regarded as a business entity or whether it can be regarded as a part of society at large. The question is whether the purpose of a company is wealth creation or profit maximization. There are two schools of thought on this topic.

The one school of thought is known as the “pluralist” or “stakeholder” approach and the other the “enlightened shareholder value” approach.

¹³⁴ *Miller v Bain Sub Nom Pantone 485 Ltd* [2002] BCLC 266 (ChD)

¹³⁵ *Charterbridge Corporation Ltd v Lloyds Bank Limited* [1969] 2 All ER 1185

¹³⁶ Section 76(2) states that a director of a company must not use the position of a director or any other information obtained while acting as a director to gain an advantage for the director, or for another person other than the company or a wholly owned *subsidiary* of the company or to knowingly cause harm to the company or a *subsidiary* of the company.

The pluralist approach dictates that shareholders are an important constituency of a company. However, it does not represent the only constituency. It also forms part of the body of company constituencies. In *AP Smith Manufacturing Co v Barlow*¹³⁷ the court stated that "...modern conditions require that corporations acknowledge and discharge social as well as private responsibilities as members of the communities within which they operate..." This approach entails that directors should disregard shareholder interests in favour of stakeholder interests where it would be in the best interest of the company to do so.¹³⁸ Directors should even be willing to sacrifice profits to promote the well-being of other stakeholders.

The "enlightened shareholder value approach" on the other hand states that directors must maximize profits for shareholders, but permits directors to take stakeholder's interests into account provided that it is subservient to the shareholder's interests and profit maximization.

The issues date back to the 1930's when a famous debate arose between Professor A Berle and Professor E Merrick Dodd Jr.¹³⁹ Professor Berle's view was that powers granted to company management are only exercisable to the benefit of shareholders.¹⁴⁰ He was of the opinion that the sole function of a company is to make a profit for shareholders. This is in line with the "enlightened shareholders approach"

Professor Dodd however rejected this view. According to Professor Dodd a company has more objectives than merely profit maximization. He was of the opinion that a company performed a social service as well.¹⁴¹

In the USA and UK it seems as if the matter has become settled. In those jurisdictions it appears that non-shareholder interest may be taken into account but

¹³⁷ 98 A2d 581 (NJ 1953) a 586.

¹³⁸ Rehana Cassim and Femida Cassim "The Reform of Corporate Law in South Africa" (2005) *International Company and Commercial Law Review* 411 at 411-412

¹³⁹ Cassim, 470.

¹⁴⁰ A Berle "Corporate powers as powers in trust" (1931) 44 *Harv LR* 1049.

¹⁴¹ E Merrick Dodd, Jr "For whom are corporate managers trustees?" (1931 – 32) 45 *Harv LR* 1145 at 1147-8.

only if the interests of the company, in other words its shareholders, gain from it.¹⁴² What this in effect means is that profit maximization still remains the main purpose of a company in the long run, and that stakeholder interest may only be taken into consideration if it supports the interest of the company's shareholders. In the event of a conflict of interest, the interest of the shareholders must triumph.

The common-law principles followed by the courts favour the enlightened shareholder value approach. In *Dodge v Ford Motor Company*¹⁴³ the court held that the prime objective of a company is to make a profit for its shareholders. Bowen LJ stated in *Hutton v West Cork Railway Co*¹⁴⁴ that:

“Charity has no business to sit at boards of directors qua charity. There is, however, a kind of charitable dealing which is for the interests of those who practice it, and to that extent and in that garb (I admit not a very philanthropic garb) charity may sit at the board, but for no other purpose The law does not say that there are to be no cakes and ale, but that there are to be no cakes and ale except as are required for the benefit of the company.”

I believe Rehana Cassim summed it up when she stated that:

*“Directors are allowed to have a social conscience only if it is in the interest of the company”.*¹⁴⁵

3.1.2 Section 76(3)(c) of the Act and the duty of care and skill

The common law provides that a director is subject to the duty of care and skill in addition to his or her fiduciary duties.¹⁴⁶ If he fails to display the same care that a reasonable man would display in the conduct of his own affairs or a degree of skill which may reasonably be expected from a man of his knowledge and experience he

¹⁴² Cassim, 471.

¹⁴³ 204 MICH 495; 170 NW 668 (1919)

¹⁴⁴ (1883) 23 ChD 654 [CA] 673; See also Cassim, 472-473

¹⁴⁵ Cassim, 473

¹⁴⁶ Blackman, 8-189, Frederick Dwight “Liability of Corporate Directors” 1970 7 *Yale LJ* 33; MG Lynch “Diligence of directors in Management of Corporations” (1914) 3 *Calif LR* 21.

will be liable to the company for any damage it may have suffered.¹⁴⁷ The standard of care that needs to be exercised is negligence and not gross negligence.¹⁴⁸ Reasonable care is measured objectively and not limited by the director's knowledge and experience".¹⁴⁹ Skill can however not be measured objectively.¹⁵⁰ The absence of an objective skill standard has previously been canvassed. Firstly it has been held that it is the shareholders misfortune if they choose incompetent directors.¹⁵¹ It would secondly be incorrect for courts to phonate upon the justification of directors decisions honestly arrived at.¹⁵² Thirdly, the diversity of companies do not provide for a undeviating standard.¹⁵³ And fourthly, as a result of the fact that those different directors have different backgrounds and training and may be appointed on the basis that they will bring that training and skill to the company, it gives rise to the proposition that a director will not need to display a greater degree of care and skill that may reasonably be expected of a person with that director's ability.¹⁵⁴

Section 76(3)(c) reads as follows:

"(3) subject to subsections "4" and "5", a director of a company, when acting in that capacity, must exercise the powers and perform the functions of director - ...

- (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."

¹⁴⁷ Blackman, 8-189.

¹⁴⁸ *Ex parte Lebowa Development Corporation Ltd* 1989 (3) SA 71 (T) 106 108-109; *Du Plessis NO v Phelps* 1995 (4) SA 154 (C) 170; *Daniels v Anderson* (1995) 16 ACSR 607 668 CA(NSW); *Re City Equitable Fire Insurance Limited* [1925] Ch 407 427-428

¹⁴⁹ *Daniels v Anderson* (1995) 16 ACSR 607 666 68 CA(NSW); *Bishopsgate Investments Management Ltd v Maxwell (No 2)* [1993] BCLC 1282 (CA).

¹⁵⁰ *Voli v Inglewood Shire Council* (1963) 110 CLR 74 84 (HC of A); *ASC v Donovan* (1998) 28 ACSR 589 599 (Fed C of A)

¹⁵¹ *Turquand v Marshall* (1869) LR 4 Ch App 376 386;

¹⁵² *Levin Felt & Tweeds Ltd* 1951 (2) SA 401(A) 414-415; *Harlowe's Nominees Pty Ltd v Woodside (Lakes Entrance) Oil Co NL* (1967) 121 CLR 483 493 (HC of A); *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821 832

¹⁵³ *AWA Ltd v Daniels* (1992) 7 ACSR 759 867 SC (NSW); *Daniels v Anderson* (1995) 16 ACSR 607 664 CA(NSW);

¹⁵⁴ *Lagunas Nitrate Co v Lagunas Syndicate* [1899] 2 Ch 392 435 (CA); *Re Brazilian Rubber Plantations and Estates Ltd* [1911] 1 Ch 425 437 (CA); *Re Equitable Fire Insurance Co Ltd* [1925] Ch 407 428-429; *Fisheries Development Corp of SA Ltd v Jorgensen* (1980) 4) SA 156 (W)

It is clear from the wording of section 76(3)(c) that the objective and subjective elements contained in the common law were preserved. The first part of the test sets out the minimum standard all directors have to meet.¹⁵⁵ The second part sets a standard for directors who have additional experience and skills.¹⁵⁶ Directors therefore have to meet the objective and subjective standards to comply with the section.

A director can be held liable in terms of the common law principles relating to delict for any loss, damages or costs flowing from a breach of the statutory or common law duty of care and skill.¹⁵⁷ The Act further states that a court must, when determining a matter brought before it in terms of the new Act, develop the common law as necessary to improve the realization and enjoyment of rights established under the Act.¹⁵⁸ One can therefore safely say that the new Act does not intend nor does it replace the common-law provisions relating to the duty of care and skill.¹⁵⁹

It needs to be noted that the word “diligence” has hardly ever been used by South African courts. It seems as if this has been derived from section 180(1) of the Australian Corporations Act, 2001.¹⁶⁰ Some commentators are however of the view that the wording of the section suggests that “care” is different from “diligence”.¹⁶¹ It furthermore seems as if section 76(3) links the duty of care, skill and diligence to situations where directors act in their capacities as directors and where they “must exercise the powers and perform the functions of directors”. Directors might argue that for whatever breach they are sued, they did not act in the capacity nor exercised their powers or performed the functions of “director” when the breach occurred.

¹⁵⁵ JS McLennan “Duties of Care and Skill of Company Directors and their liability for negligence” (1996) 8 SA *Merc LJ* 94 at 101;

¹⁵⁶ See discussion of Paul L Davies, Sarah Worthington & Eva Micheler “Gower and Davies’ Principles of Modern Company Law 8th ed (2008) at 490-1).

¹⁵⁷ Section 77(2)(b)(i); *Ex parte Lebowa Development Corporation Ltd* 1989 (3) SA 71 (T) 106.

¹⁵⁸ Section 158(a).

¹⁵⁹ For a discussion on possible implications if courts test directors’ conduct against the *King report* in view of the new Act see Irene-Marie Esser and Piet Delpont “The duty of care, skill and diligence: The *King report* and the 2008 Companies Act” *Journal of Contemporary Roman-Dutch Law* 74 (2011) 449; See also *Stilfontein Minister of Water affairs and Forestry v Stilfontein Gold Mining Co Ltd* 2006 5 SA 333 (W).

¹⁶⁰ Jean J du Plessis “A comparative analyses of directors’ duty of care, skill and diligence in South Africa and in Australia” *Acta Juridica* (2010) 263.

¹⁶¹ Cassim, 508.

It is furthermore noticeable that the degree of care, skill and diligence expected of directors is not that of a “reasonable person”, but what could “reasonably be expected of a person having the general knowledge, skill and experience of *that* director. The section therefore provides that there is a reasonable expectation that persons acting as directors should act with the “general knowledge, skill and experience” of persons with comparable “general knowledge, skill and experience”.¹⁶² The standard of care, skill and diligence will not be revealed completely objectively, but a court will first have to determine the expectations of directors “carrying out the same functions in relation to the company as those carried out by that director”. Then secondly, the court will also have to come to a finding as to how other directors, with the general knowledge, skill and experience of *that* director would have conducted themselves.

3.1.3 Section 76(4) – The “business judgment rule”:

Section 76(4) states that:

76 (4) - “In respect of any particular matter arising in the exercise of powers or the performance of functions of a director, a particular director of a company –

- (a) will have satisfied the obligations of subsections (3) (b) and (c) if -
 - i) the director has taken reasonably diligent steps to become informed about the matter;
 - ii) either –
 - aa) the director had no material personal financial interest in the subject matter of the decision, and had no reasonable basis to know that any related person had a personal financial interest in the matter; or
 - bb) the director complied with the requirements of section 75 with respect to any interest contemplated in subparagraph (aa); and

¹⁶² Du Plessis, 269.

- iii) the director made a decision, or supported the decision of a committee or the board, with regard to that matter, and the director had a rational basis for believing, and did believe, that the decision was in the best interest of the company; and

- b) is entitled to rely on –
 - i) the performance of any persons –
 - aa) referred to in subsection (5); or
 - bb) to whom the board may reasonably have delegated, formally or informally by course of conduct, the authority or duty to perform one or more of the board's functions that are delegable under applicable law; and

 - ii) any information, opinions, recommendations, reports or statements, including financial statements and other financial data, prepared or presented by any of the persons specified in subsection (5).

The abovementioned section introduces the “business judgment rule” into South African law.¹⁶³ In the matter of *In re City Equitable Fire Insurance Company Limited*¹⁶⁴ it was stated that the general principle with regard to the common law duty of care of skill of a director is that a director shall be liable if he or she fails to perform the duties to the degree which in the circumstances would reasonably have been expected from a person with his or her knowledge and experience. The director will then be liable to the company for any damage that the company might have suffered.¹⁶⁵ An objective (the reasonable man standard) and a partly subjective (the reasonable man compared to the knowledge and experience of that particular director) test is therefore applicable. The position is confirmed in terms of the new section 76(4). A director's liability for his breach of duty depends largely on the type of business the company conducts and the responsibilities and obligations assigned to the specific director.

The business judgment rule has been part of the legal system in the USA for more than 160 years.¹⁶⁶ The purpose of the rule is to prevent the court from interfering in

¹⁶³ Delpont, 297.

¹⁶⁴ [1925] 1 Ch 407 (CA).

¹⁶⁵ See also *Fisheries Development Corporation of SA Ltd v Jorgenson* 1918 (4) SA 156 (W).

¹⁶⁶ See generally S Samuel Arsht “The Business Judgment rule Revisited” 1979 8 *Hofstra* LR 93; Cassim, 513.

the honest and rational business decisions of directors of companies.¹⁶⁷ It also encourages informed and calculated risk taking. Its benefits in the South African context are that it will relieve and counter the now more demanding duty of directors to exercise reasonable care, skill and diligence in the execution of their duties.

In summary it appears that there are three requirements enunciated in section 76(4)(a) for a director to be protected by the business judgment rule. They are the following:

- 1) the director must have made an informed decision;
- 2) there must have been proper disclosure of any material personal financial interest of the director or a related person;
- 3) there has to be a rational basis for believing that the said director acted in the best interest of the company.

The merits and judiciousness of business decisions therefore fall outside of the scope of scrutiny by the courts if there is compliance with the abovementioned three requirements. The courts do not necessarily have the expertise to dissect and review the commercial merits of business decisions made by the directors of a company. In the USA the courts do not attend to review directors on the reliability of business decisions made by them. Therefore, when the business judgment rule applies, the courts will not enforce its own views regarding the merits of a decision by directors.

It is important to note that the business judgment rule has various restrictions that need to be complied with in addition the act. The director needs to make an *informed* decision. If an informed decision was not made, the rule will not apply. On a proper interpretation of section 76(4)(a), it appears that the section is not merely confined to business decisions, for the scope is much wider. If the requirements of section 76(4)(a) are satisfied, the director will not be liable for honest and reasonable

¹⁶⁷ Stephen Kennedy-Good & Lindi Coetzee “The Business Judgment Rule (Part 1)” (2006) 27 *Obiter* 62 at 64.

mistakes. It is important to note that section 76(4) merely refers to subsections 76(3)(b) and (c) and not to 76(4)(a). It is not a requirement for a director to have exercised his powers for a proper purpose as per 76(3)(a).

With regard to the third requirement found in section 76(4)(iii) in that there has to be a rational basis for believing that the director acted in the best interest of the company, the test is objective. An objective irrational decision is therefore not protected. The underlying reason for this is that an irrational decision is suggestive of bad faith. In *Shuttleworth v Cox Brothers & Co (Maidenhead) Ltd*¹⁶⁸ the court stated that the absence of any reasonable ground for deciding that the course of action is for the benefit of the company may be a ground for finding lack of good faith.

If directors therefore have acted honestly and reasonably and the requirements of section 76(4)(a) have been complied with, they will not incur liability for errors in judgment even if the decisions of the board members had catastrophic effects on the company.¹⁶⁹ Fraudulent decisions are obviously not protected.

CHAPTER 4

Directors' liability

Section 77(1) to (10) of the new Act statutorily sets out the liability of directors and prescribed officers of a company. This section also applies to members of the audit committee, a committee of the board, irrespective of whether the persons serving on the committee are directors of the company, as well as alternate directors. We will discuss section 77 more extensively later in this chapter.

¹⁶⁸ [1927] 2 KB 9 (CA) 23.

¹⁶⁹ *Smith v Gorkum* 488 A 2d 858 (Del. Supr. 1985).

There are also other sections in the new Act which deal with liability. Examples are section 218(2) and section 22.¹⁷⁰

Another example of a section that deals with liability is section 20(6) which reads as follows:

“(6) Each shareholder of a company has a claim for damages against any person who intentionally, fraudulently or due to gross negligence causes the company to do anything inconsistent with –

- a) this Act; or
- b) a limitation, restriction or qualification contemplated in this section, unless that action has been ratified by the shareholders in terms of subsection (2).”

This section provides that each shareholder of a company has a claim for damages against any person who *fraudulently* or due to *gross negligence* causes the company to do anything inconsistent with the new Act or a limitation, restriction or qualification in the Memorandum of Incorporation of the company with regard to its purposes, powers or activities. It is important to note that this fraudulent and/or gross negligent conduct may be ratified by a special resolution in as much as the conduct has application to a limitation, restriction or qualification in the Memorandum of Incorporation.¹⁷¹ However, an act that contravenes the provisions of the new Act may not be ratified.¹⁷²

A claim for damages in terms of section 20(6) instituted by a shareholder would be a personal action in the sense that it is brought by the shareholder on behalf of the shareholder. The right evidenced in section 20(6) is a right in addition to a

¹⁷⁰ Section 218(2) affords a remedy to a creditor to institute a civil claim against any person for any loss or damage suffered as a result of that person’s contravention of any section of the new Act. The ambit is extremely wide. See also section 22 which states that a company must not carry on its business recklessly, with intent to defraud or for any fraudulent purpose. Should section 22 be contravened liability can exist either through section 218(2) or section 77(3)(b). Section 22 is very similar to section 424 of the former companies act.

¹⁷¹ S 20(2)

¹⁷² S 20(3)

shareholder's right to institute a statutory derivative action provided for in section 165.¹⁷³

However, it is not necessary for conduct to be fraudulent or to be carried out with gross negligence for a shareholder to institute a claim. The reason for this lies in the provision of section 218(2).¹⁷⁴ It would be incomprehensible for a shareholder to institute an action against a person based on the provisions of section 20(6), for the shareholder would then be burdened with the onus to prove fraud or gross negligence. The test applied when a claim is based on section 218(2) is much lighter. Liability in terms of that section is triggered as soon as there is a contravention of *any* provision of the new Act. Should section 218(2) be relied upon, it will not be necessary for a claimant to prove fraud or gross negligence. The fact that the word "any" is repeated in section 218(2) stresses the section's extremely wide ambit.

The crux of a director's liability can however be found in section 77 of the new Act.

Section 77(2) provides that a director, prescribed officer and member of a committee of the board may be held liable in accordance with the principles of the common law relating to *breach of a fiduciary duty*, for any loss, damages or costs sustained by the company as a consequence of any breach by the director –

- to disclose a personal financial interest (section 75);
- to avoid a conflict of interest (section 76(2));
- to act in good faith and for a proper purpose or in the best interest of the company (section 76(3)(a) and (b)).

It appears as if the liability of a director for any benefit obtained by the said director (irrespective of whether the company suffered damages) is not covered by this

¹⁷³ A derivative action is brought by a shareholder on behalf of a company for the purpose of protecting the legal interests of the company; See Delpont, 584 to 587 for a discussion on the statutory derivative action.

¹⁷⁴ S 218(2) provides that any person who contravenes any provision of the new Act is liable to any other person for any loss or damages suffered by that person as a result of that contravention. See also note 160 *supra*.

section. In the circumstances it is not clear whether the common-law remedies for a benefit will still apply. The wording of section 77(2)(a) expressly excludes the common law liability for a benefit.¹⁷⁵ The section only makes provision for “loss, damages or costs”.

Section 77(2)(b) of the new Act states that should a director breach –

- the duty to act with the required degree of care, skill and diligence (section 76(3)(c));
- any provision of the new Act not otherwise mentioned in this section; or
- any other provision of the company’s Memorandum of Incorporation, the principles of the common law relating to *delict* for any loss, damages or costs shall find application and the director shall be liable in accordance thereof.

Section 77(3) lists specific actions of directors for which they can be held liable. The subsection in effect provides practical examples of when a director can be held liable to the company for any loss, damage or costs arising as a direct or indirect consequence of that director’s actions. The examples are:

- 1) acting on behalf of the company despite knowing that he lacks authority to do so;¹⁷⁶
- 2) acquiescing to carrying on of the company’s business despite knowing that it is prohibited in terms of section 22.¹⁷⁷
- 3) being a party to an act or omission despite knowing that the act or omission was calculated to defraud a creditor, employee or shareholder of the company;

¹⁷⁵ See *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134 (HL); *Symington v Pretoria-Oos Hospitaal Bedryfs (Edms) Bpk* [2005] 4 All SA 403 (SCA); *Dorbyl v Vorster* 2011 (5)SA 575 (GSJ); Delpont, 301

¹⁷⁶ “Knowing” is very widely defined in s 1 and includes knowledge which he or she reasonably ought to have had or reasonably ought to have investigated to the extent that would have provided him or her with actual knowledge or to have taken measures that would reasonably be expected to have provided him or her with actual knowledge.

¹⁷⁷ Section 22 provides that a company must not carry on its business recklessly, with gross negligence, with intent to defraud any person or for any fraudulent purpose.

- 4) consenting to the publication of financial statements that were false and misleading or a written section 101 statement that contained an “untrue statement” as defined in section 95;
- 5) issuing of any unauthorised shares or options on those shares with the knowledge that those shares had not been authorised under section 36;
- 6) providing financial assistance to any person despite knowing that the financial assistance is in contravention of section 44 or alternatively the company’s Memorandum of Incorporation;
- 7) the provision of financial assistance to a director under section 45 despite knowing that it is in contravention of the act or the company’s Memorandum of Incorporation. This section makes it clear that financial assistance to a related company or the lending company is excluded;¹⁷⁸
- 8) drawing up a resolution approving a distribution despite knowing that the said distribution is not in accordance with section 46;
- 9) the acquisition by a company of any of its shares despite knowing that the said acquisition was contrary to sections 46 or 48;
- 10) an allotment by the company despite knowing that the allotment was contrary to
any provision of Chapter 4.

Subsection 77(3) furthermore states that the liability of a person in terms of the said section is jointly and severally with any other person who is or may be held liable for the same act.

Prescription is also regulated in this section. Section 77(7) specifically states that proceedings to recover any loss, damages or costs for which a person may be held liable in terms of section 77(3) may not be commenced more than three years after the act or omission that gave rise to that liability. In this regard it is submitted that the principles in *Burley Appliances v Grobbelaar* [2003] 3 All SA 505 (C)¹⁷⁹ should apply. In that matter the court held that prescription begins to run “as soon as it appears that any business of a corporation is being carried on recklessly, with gross

¹⁷⁸ Piet Delpport, 100

¹⁷⁹ Delpport, 302

negligence or with intent to defraud any person or for any fraudulent purpose". The aforementioned was subject to the proviso that the debt will not be deemed to be due until such time as the knowledge and identity of the debtor and the facts from which the debt arose, vests within the creditor.

Section 77(9) provides that in any proceedings against a director other than for willful misconduct or willful breach of trust, the court has a discretion to, if it appears to the court that the director is or may be liable, but acted honestly and reasonably and having regard to all the circumstances of the case, and if the court is of the opinion that it would be fair to excuse the director, the court may relieve the person, either wholly or partly, from the liability on any terms as the court considers just. Willful breach of trust and/or willful misconduct means that a director did not act "honestly".¹⁸⁰

In the premises it is evident that the common law principles of liability are therefore still applicable. Should sections 75, 76(2) and 76 (3) (a) and (b) be contravened, liability will exist on the basis of a breach of fiduciary duties. The liability for breach of fiduciary duty is *sui generis* and not delictual in nature.¹⁸¹

Should section 76(3)(c) or any other provision of the new Act or the Memorandum of Incorporation be contravened, liability will exist on the basis of delict.¹⁸²

The quantum of the liability is normally equal to the damages in respect of the loss that occurred to the company as a result of the breach. The causal connection between loss and breach must be alleged and proved.¹⁸³ The general rule is that the company must institute proceedings to enforce the liability.¹⁸⁴ Should the majority of the members for instance ratify or condone the conduct, for example in

¹⁸⁰ Delport, 303; *Ex parte Lebowa Development Corporation Ltd* 1989 (3) SA 71 (T)

¹⁸¹ *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168 at 199, 242

¹⁸² Liability for a breach of the provisions of the Memorandum of Incorporation should actually be based upon a breach of contract and not delict. Section 77(2)(iii) is therefore nonsensical.

¹⁸³ Delport, 304

¹⁸⁴ *Foss v Harbottle* [1843] 2 Hare 461; 67 ER 189; Delport, 304

circumstances amounting to fraud on the minority, any member is entitled to bring a derivative action.¹⁸⁵ The derivative action can be seen as an exception to the rule.

CHAPTER 5

Conclusion

¹⁸⁵ *Cohen v Directors of Rand Collieries Ltd* 1906 TS 197 at 203; *Burland v Earle* [1902] AC 83 (PC); S 165 of new Act

Good leadership is of fundamental importance when it comes to business. A good leader influences his or her employees, which in turn will more often than not result in an increase in productivity and an overall better performance of a company. However, a failure in directorship may ultimately ruin a company with distressed creditors attempting to recover damages and losses. Failed companies lead to failed careers, for both managers and ordinary employees.

We have shown that the common law plays a crucial role in the governance of directors' duties and liabilities. Traditionally the common-law duties of a director of a company were categorised as the fiduciary duties to act in good faith, with honesty and loyalty and the duty of care, skill and diligence. These duties do not only represent legal constructs, for in essence they can be regarded as moral imperatives. In essence what the law is trying to achieve, is to encourage people to be good moral corporate citizens.

We have shown that both the fiduciary duties and the duty of care and skill have now been partly codified in the new Act. Partial codification improves the clarity, simplicity and legal certainty, and thus makes the law more accessible to directors and other people affected by the actions of directors. Time, money and effort will be saved if directors are enabled to extract clear and succinct rules from statute. On the other hand partial codification, in contrast to total codification, does not impede the common-law to expand fiduciary duties and the duty of care and skill where required. It embraces the general principles developed through the years and it sidesteps the problem of having to reduce the living body of common law to a guileless fixed statutory provision. Most importantly, it leaves the common-law principles to regulate matters for which Parliament has not made provision in statute. As a result flexibility is not compromised. The business environment is dynamic in nature. The law regulating it should be able to keep pace.

What is further evident from the new Act is that it extends liability for breach of fiduciary duties and the duty of care and skill to not only directors, but also to prescribed officers and to committees of the board members, irrespective of the fact

that they are not appointed as directors.¹⁸⁶ We have shown that a prescribed officer can be defined as any person who exercises general executive control over the management or business of a company, or who regularly participates to a material degree in the exercise of general executive control. In the light of the aforementioned a shadow director will most probably also be included in the definition of a prescribed officer. This has the effect that a number of people dealing with the day to day management of the company, who are not appointed as directors and who therefore do not receive compensation in the form of directors' remuneration, will be potentially exposed and be liable should they breach any of the fiduciary duties or duty of care and skill as set out above.

The opposite is also true. Non-executive directors who are not involved in the day-to-day management of the company and who merely attend board meetings will from time to time also now have onerous duties to comply with. The reason for this is found in the definition of the concept "director" in section 1 of the new Act.¹⁸⁷ This definition must also be read with the definition of "knowing", "knowingly" or "knows" in section 1 of the Act which places a substantial responsibility on directors (executive and non-executive) to become informed about the company's dealings. All members of the board will now be dealt with in the same manner, irrespective of their seniority or influence. Section 76 is therefore literally a "catch-all" provision.

When it comes to the partially codified fiduciary duties, the test remains subjective in so far as it requires directors to act *bona fide* and in the best interests of the company. This aspect is dependent on the director's state of mind. When a director has to act for a "proper purpose" an objective test is applied and it is irrelevant whether a director acted in good faith.

We have also shown that with regard to section 76(3)(c) and the duty of a director to act with a degree of care, skill and diligence, the common law test was objective. The new Act did not render the test completely objective. The court will also have to

¹⁸⁶ S 76(1) read with Regulation 38 of Companies Regulations, 2011

¹⁸⁷ Director in s 1 "means a member of the board of the company, as contemplated in section 66, or an alternate director of a company and includes any person occupying the position of a director or alternate director, by whatever name designated"

take into account the knowledge, skill and experience of *that* director. A subjective test is therefore also applicable.

Section 77 confirms the common-law position in as much as there is a breach of a fiduciary duty.¹⁸⁸ It furthermore confirms that a director will be held liable based on the basis of delict, should he or she fail to execute his or her duties with the necessary degree of care and skill.¹⁸⁹ Section 77(3) on the other hand specifically lists examples of conduct which directors may be held liable for.

From a practical perspective the new Act is a primary source and it makes the law much more easily accessible and clear. The common law duties however still apply, and one would always be able to revert thereto, should a particular set of facts not fall squarely within ambit of the examples provided for in section 77(3).

A great deal has been said about the new Act which increases the exposure of a director's liability. Apart from the different degrees of care and skill which arise from specialist skills or the involvement of the day-to-day management of the company, there appear to be no legal differences between the duties and liabilities of executive and non-executive directors. Although the codified duties are not more onerous than those enacted by the common law, the financial implications for a failure to discharge those duties effectively vary a lot from the former Act. Directors face a far greater personal financial risk for *inter alia* the following reasons:

- Directors' statutory duties (duties in addition to the common law) have now been increased;
- powerful new remedies are available to stakeholders;
- the new enforcement regime will should prove to be more effective;¹⁹⁰

Directors have significant powers, but with great power come great responsibility. If directors are found wanting in the exercise of their duties, they need to pay the price. Only time will tell whether the legislature has achieved the balance between appropriate monetary sanctions and over-exposure to financial risk.

¹⁸⁸ S 77(2)(a)

¹⁸⁹ S 77(2)(b)

¹⁹⁰ Stein, 255

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