

**FIDUCIARY DUTIES OF A NOMINEE DIRECTOR**

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**Submitted in partial fulfilment of the requirements for the degree of Masters of  
Laws (Corporate Law)**

In the

**FACULTY OF LAW**

At the

**UNIVERSITY OF PRETORIA**

**SEPTEMBER 2016**

**SUPERVISOR: PROF PA DELPORT**

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## CHAPTER 1

### 1.1 INTRODUCTION

In terms of the law a director of a company, when acting in that capacity, is required to exercise the powers and perform the functions of director in good faith and for a proper purpose; and in the best interests of the company.<sup>1</sup> It is a well-established principle that the director's duty is to observe the utmost good faith towards the company, and in discharging that duty he is required to exercise an independent judgement and to take decisions according to the best interests of the company as his principal.<sup>2</sup> This fiduciary duty to exercise an independent judgement is challenging to nominee directors.<sup>3</sup> There is wide spread established practice of appointing nominee directors by the companies. This practice of appointing nominee directors to represent the interests of the nominators is legally recognised and accepted globally. It was held in the case of *Boulting v Association of Cinematograph Television & Allied Techicians*<sup>4</sup> that:

“Or take a nominee director, that is, a director of a company who is nominated by a large shareholder to represent his interests. There is nothing wrong in it. It is done every day. Nothing wrong, that is, so long as the director is left free to exercise his best judgment in the interests of the company which he serves. But if he is put upon terms that he is bound to act in the affairs of the company in accordance with the directions of his patron, it is beyond doubt unlawful.”

This practice of appointing nominee directors is highly practised by institutional investors and even encouraged by their respective laws. For instance, in terms of section 7A of the Pension Fund Act every fund is required to have a board consisting of at least four board members, at least 50% of whom the members of the fund shall have the right to elect.<sup>5</sup> I will dedicate a chapter below on the appointment of nominee trustees and their fiduciary duties. This is of vital importance because a

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<sup>1</sup> Section 76(3) (a) and (b) of the Companies Act 71 of 2008.

<sup>2</sup> *Fisheries Development Corporation of SA v AWJ Investments (Pty) Ltd* 1980 (4) SA 156 (W) 163.

<sup>3</sup> *Kuwait Asia Bank EC v National Mutual Life Nominees Ltd* [1991] 1 AC 187 (PC).

<sup>4</sup> 1963 2 QB 606 , *Cassim at al* Contemporary Company Law (2011) 530d

<sup>5</sup> Act 24 of 1956, see also Section 6 (3) of Government Employees Pension Law, Proclamation 21 of 1996 which stipulates that members and pensioners of the Fund shall be entitled to representation on the Board, which representation shall collectively be equal in number to the representation by the employer as prescribed.

trustee has the same status as that of a director of a company. The role of the directors of companies and the legal principles applicable thereto has been held to apply *mutatis mutandis* to the trustees of a pension fund.<sup>6</sup> The nominee director/trustee is nominated by his constituency to represent its interests and at the same time he is required to exercise his best judgment in the interests of the company which he serves. It now becomes necessary to investigate whether this practice of appointing nominee directors does not coincide with the directors' duty to exercise an independent judgement.

## 1.2 THE CONCEPT OF A NOMINEE DIRECTOR

A nominee director is a director who is appointed by a shareholder, creditor or interest group and who has a continuing loyalty to the nominator or other interest in the company. Thus, the nominee director is expected to represent the interests of the nominator and it is beyond disputes that this puts such a director on a collision course with the duties he owes as a director to his company. The manner in which the nominee director is appointed entails that he/she is expected to represent the interests of the nominator. This director is basically serving the two masters. What happens when the interests of the nominator coincide with those of the company? Clearly when the interests of the company conflict with those of the nominator there would be manifest conflict of interests that puts the nominee director in an invidious position. To add salt to the wound, the nominee director obviously has a duty to report to the nominator mainly on the developments that may affect the interests of the nominator. Nominee directors are in most cases under the impression that they are even obliged to consult with their constituencies on certain positions to be taken by their companies. The reality is that if they do not interact with their constituencies they are often "recalled".

This further poses a legal question of whether a nominee director can be removed from the board for refusing to be influenced by the nominator. This question will be fully investigated in this dissertation. The courts have ruled that there is nothing

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<sup>6</sup> *PPWAWU National Provident Fund v Chemical Energy Paper Printing Wood and Allied Workers Union* 2007 ZAGPHC 146 para 27

inherently dishonest or improper about the practice of appointing nominee directors as it is a commercial reality. In many situations, the nominee directors are employees of the nominators and they are expected to report to their employers. The practice of appointing nominee directors might be seen as promoting puppet directors. Nominee directors in practice do take instructions from their constituencies and they cannot differ or seen to be differing with them. Therefore, this duty to exercise an independent judgement by nominee directors might seem to be a fiction.

The director of a company is required by the law to exercise an independent and unfettered discretion.<sup>7</sup> This means that a director must consider the affairs of the company in an objective manner without being influenced. As stated above, the duty to exercise independent judgement is the fiduciary duty of directors that best illustrate the overarching duty to act *bona fide*, as directors are required to act *bona fide* and in the interest of the company. In the case of *Fisheries Development Corporation of SA Ltd v Jorgensen*<sup>8</sup> the court held that:

“the director's duty is to observe the utmost good faith towards the company, and in discharging that duty he is required to exercise an independent judgment and to take decisions according to the best interests of the company”

The duty requires that whatever decision or action that is taken by the director his or her unfettered discretion must be applied. It further entails that directors must refuse to be the so called “puppet directors”. These are the directors who have been placed on the boards with the intention that they will blindly follow the instructions of their controller. It is said that a puppet director will not escape liability for breach of a fiduciary duty by laying the blame on the person who put him or her in office and pulled strings.<sup>9</sup>

### 1.3 PURPOSE OF THE STUDY

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<sup>7</sup> *Kregor v Hollins* (1913) 109 LT 225; *S v Shaban* 1965 (4) SA 646 (W).

<sup>8</sup> 1980 4 SA 156 (W) 163 D-F.

<sup>9</sup> *S v Hepker* 1973 (1) SA 472 (W) 484.

In the dissertation we will further investigate whether there is any need for introducing express statutory provisions to regulate nominee directors in South African law. Australian, New Zealand and English law will be used as a point of reference for a comparative examination of the following more specific issues:

- the ways in which other jurisdictions have defined the concept of a ‘nominee director’ and interpreted and applied that definition;
- duties, liabilities and other consequences that attach to nominee directors, their theoretical basis and their location within the broader legal framework; and;
- the extent to which existing rules and principles of South African law already provide to the nominee directors.

It is said that a more flexible approach to the duty of a nominee director to exercise an independent judgement has been adopted in those jurisdictions. The planned study is a literature review and study of books, journal articles, legislation and case law. It shall involve a critical analysis of the relevant South African literature and case law. A comparative study with other jurisdictions will also be undertaken, in particular the jurisdictions to which South Africa looks for guidance, such as England, Australia and New Zealand have had ample challenges regarding the same subject.

## 1.4 CONCLUSION

The general legal principle remains that once the nominee director becomes a member of the board of directors of a company, he or she is subject to the duty to serve the interests of the company rather than the interests of his or her nominator.<sup>10</sup> Whether this is a fact of fiction will be discussed in this dissertation. For the benefit of better understanding of the topic under discussion, fiduciary duties of directors under common law and under a new Companies Act<sup>11</sup> will be first discussed. We will then move to the fundamental question of to whom do the nominee directors owe their fiduciary duties. Over the years there has been much debate in corporate law as to whom the board of directors, as the managing body of the company, is accountable.

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<sup>10</sup> *Fisheries Development Corporation of SA v AWJ Investments (Pty) Ltd* 1980 (4) SA 156 (W) 163.

<sup>11</sup> Act 71 of 2008.

I will argue and demonstrate that although the nominee directors are nominated by their constituencies to the board, they owe their fiduciary duties only to the company and not to their constituencies. But however, it will be highlighted that the company's best interests is a general term and, if interpreted liberally, may extend beyond shareholder profit maximisation to embrace socially responsible board decisions which, indirectly, will benefit the company and its stakeholders. There are various theories which were developed over time which extend the directors fiduciary duties to the other stakeholders. The question of the exact moment of their appointment to the board will also be entertained. This is imperative because their appointment is preceded by the nomination from their respective constituencies. This is obviously and indirectly dealing with the issue of the commencement of the application of fiduciary duties.



## CHAPTER 2

### 2.1 FIDUCIARY DUTIES OF DIRECTORS

A fiduciary relationship exists where a person is in control of the assets of another.<sup>12</sup> It is a special relationship based on trust and confidence and it arises when a fiduciary has the power to control or represent another who is at the fiduciary's mercy. It is a relationship of trust between the company and the director, with the director undertaking to act on behalf of the company, and therefore subsequently the director is placed under the duty to act in the best interests of the company.<sup>13</sup> Fiduciary relationships arise when one party (the 'fiduciary') acts on behalf of another party (the 'beneficiary') while exercising discretion with respect to critical resources belonging to the beneficiary. In this relationship, beneficiaries– or dependant parties – rely upon the fiduciary to manage some aspect of their personal or economic affairs over which the fiduciary has control and responsibility.<sup>14</sup>

It is submitted that the duties of directors are to be found in common law, Companies Act<sup>15</sup>, other statutes and company's own constitution (MOI)<sup>16</sup>. However, common law is the point of departure when it comes to an analysis of directors' duties. This is so because whilst some of the directors' common law duties are stated in the new Companies Act, one must bear in mind that the provisions in the Act are subject to, and not in substitution for, any duties of a director under the common law.<sup>17</sup> The courts may still have regard to the common law, including past case law when interpreting the provisions of the Act, and it has been made clear that the reform of company law in South Africa does not seek to discard the foundation laid down for company law over the century, but to introduce new legislation, where necessary, that is suitable and apt for the unique constitutional and culturally diversified South African economy.

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<sup>12</sup> *Volvo (SA) (Pty) Ltd v Yssel* [2008] 3 All SA 488 (W).

<sup>13</sup> *Bristol and West Building Society v Mothew* [1998] Ch.1.

<sup>14</sup> D.G. Smith, "The Critical Resource Theory of Fiduciary Duty" (2002) 55 Vand. L. Rev. 1399 at 1483.

<sup>15</sup> Act 71 Of 2008.

<sup>16</sup> Natasha Bouwman "An Appraisal of the Modification of the Director's Duty of Care and Skill" *SA Mercantile law journal* 21 (2009) 509.

<sup>17</sup> Section 76(6) of Companies Act.

The common law duties of directors are the fiduciary duties of good faith, honesty and loyalty<sup>18</sup>. And in terms of the new Companies Act a director of a company, when acting in that capacity, is required to exercise the powers and perform the functions of director in good faith and for a proper purpose; and in the best interests of the company.<sup>19</sup> In addition, directors have the duty to exercise reasonable care and skill, which is not a fiduciary duty. It is said that at common law the duty to act in good faith and in the best interests of the company is the paramount and overarching fiduciary duty of directors from which all other fiduciary duties flow. Those duties are categorised as follows:

- the duty to avoid conflict of interests;
- the duty to act within powers;
- the duty to maintain an unfettered discretion;
- the duty not to exercise powers for an improper purpose; and
- the duty to act with care and skill.

I will therefore briefly discuss these common law and statutory fiduciary duties of directors one by one below before entering into the main subject of discussion.

### **2.1.1 THE DUTY TO ACT IN GOOD FAITH**

At both common law and Companies Act the directors have a fiduciary duty to exercise their powers in good faith and in the best interests of the company.<sup>20</sup> In terms of this duty the directors are required to exercise the powers conferred upon them *bona fide* in what they consider, not what a court may consider is in the best interests of the company. This duty requires the directors to have reasonable grounds for holding a specific belief and for acting in accordance with that belief. A director's duty is thus to act in what he or she in good faith honestly considers to be

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<sup>18</sup> Cassim at al Contemporary Company Law (2011).

<sup>19</sup> Section 76(3) (a) and (b) of the Companies Act 71 of 2008.

<sup>20</sup> *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd and Others* 2014 5 SA 179 (WCC), *Da Silva v CH Chemicals (Pty) Ltd* 2008 (6) SA 620 (SCA) 627.

in the best interests of the company. This duty was according to me better explained as follows:

“The duty of good faith stands for the principle that directors and officers of a corporation in making all decisions in their capacities as corporate fiduciaries, must act with a conscious regard for their responsibilities as fiduciaries. A violation of the duty of good faith may include an intentional derelict in the usual duties of a director or officer, intentionally acting for a purpose other than the benefit of the corporation, or intentionally violating the law. Though there is no private shareholder right of action for a violation of the duty of good faith, its violation may also raise a claim under the duty of loyalty.”<sup>21</sup>

There are many better explanations of this fiduciary duty. This duty was further explained as follows:

“The duty of good faith in corporate law is supported by four normative justifications: First, the traditional duties of care and loyalty do not cover all types of improper managerial conduct. The standard of conduct under the duty of care essentially requires a manager, when not acting in his own self-interest, to perform his duties in a manner that he reasonably believes to be in the best interests of the corporation, with a view towards maximizing corporate profit and shareholder gain. The standard of conduct under the duty of loyalty essentially requires a manager to act fairly when he acts in his own pecuniary self-interest or in the pecuniary interest of an associate or a family member. Given the ambit of these standards, certain important kinds of managerial misconduct fall outside the spheres of those duties. Most of these types of misconduct, however, fall within the duty of good faith.

Second, various rules limit a manager's accountability under the duties of care and loyalty. These include the business judgment rule; rules that make harm or unfairness to the corporation, or profit to the manager, elements of a breach of those duties; and rules that allow "disinterested" directors who are friends and colleagues of a self-interested director to insulate that director from liability for self-interested transactions. These accountability-limiting rules should be and are inapplicable to conduct that violates the duty of good faith.

Third, the duties of care and loyalty characteristically (although not invariably) function as platforms for *liability* rules. In contrast, the duty of good faith characteristically (although again, not invariably) functions as a *condition* to the application of rules that do not in themselves impose liability, such as rules concerning indemnification. This difference in characteristic function makes it desirable to treat good faith separately from care and loyalty.

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<sup>21</sup> [https://www.law.cornell.edu/wex/duty\\_of\\_good\\_faith](https://www.law.cornell.edu/wex/duty_of_good_faith).

Fourth, the duty of good faith provides the courts with a principled basis for articulating new specific fiduciary obligations that come to be seen as appropriate in response to changes in social and business norms, and in the general understanding of efficiency and other policy considerations, but that cannot be easily accommodated within the duties of care and loyalty.<sup>22</sup>

If a director reasonably believes that he is acting in the best interests of the company then he/she will be acting in good faith.

## 2.1.2 THE DUTY TO AVOID CONFLICT OF INTERESTS

A director of a company, when acting in that capacity, is required to exercise the powers and perform the functions of director in the best interests of the company.<sup>23</sup>

This duty requires the director to act in the best interests of the company, not in the interests of that director. What this duty entails is that a director must not place himself in a position in which that director has, or may have, a personal interest or a duty to another which conflicts, or may conflict, with the interests of the company or with that director's duties to the company.<sup>24</sup> A director cannot prefer his own interests to those of the company. *Cilliers and Benade*<sup>25</sup> put it nicely in this way:

"A person in a fiduciary position, such as a director, has a legal duty to prevent a conflict arising between his own interests and those of the party whom he serves. It follows, therefore, that a director may obtain no other advantage from his office than that to which he is entitled by way of director's remuneration".

In determining whether a director is in breach of this duty the criteria is that it should be assessed whether a reasonable person would when considering the relevant facts and circumstances of the case think that there was a real possibility of breach.<sup>26</sup> It is said that the directors *bona fide* or lack thereof is irrelevant in determining whether or not this duty has been breached.

It is said that there are two separate and independent but closely related legal principles that apply here: (a) a duty to avoid a conflict of personal interests (the no-

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<sup>22</sup> Melvin A. Eisenberg *The Duty of Good Faith in Corporate Law*, Delaware journal of corporate law Vol 31.

<sup>23</sup> Section 73(3)(b) of the Companies Act 71 of 2008.

<sup>24</sup> *Robinson v Randfontein Estate Gold Mining Co Ltd* 1921 AD 168 at 178-9.

<sup>25</sup> Cilliers and Benade at al Corporate Law P 141.

<sup>26</sup> M Havenga "director's exploitation of corporate opportunities and the Companies Act 71 of 2008 (2013) 2 TSAR 257-268.

conflict rule)' and (b) a duty not to make a profit from the fiduciary's position as a director (known as the no-profit rule).<sup>27</sup>

According to the no-profit rule directors are not allowed to retain profit made by them in their capacity as directors while performing their duties as directors. Where a director makes any profits by reason of his office, he is liable to account to the company for such profit. The leading case of this no profit rule is *Regal (Hastings) Ltd v Gulliver*<sup>28</sup> where it was held that the rule requiring directors to account for the profits they have made while standing in a fiduciary relationship does not depend on fraud, or absence of *bona fide*, or upon such questions or considerations as whether the profit would or should otherwise have gone to the company. The court held that the liability arises, from the mere fact that the profit was made. Once proof is adduced that a director made profit contrary to his fiduciary duty, all of the above-mentioned considerations become irrelevant. In its own words the court said that:

"The rule of equity which insists on those, who by use of a fiduciary position make a profit, being liable to account for that profit, in no way depends on fraud, or absence of bona fides; or upon such questions or considerations as whether the profit would or should otherwise have gone to the plaintiff, or whether the profiteer was under a duty to obtain the source of the profit for the plaintiff, or whether he took a risk or acted as he did for the benefit of the plaintiff, or whether the plaintiff has in fact been damaged or benefited by his action. The liability arises from the mere fact of a profit having, in the stated circumstances, been made. The profiteer, however honest and well-intentioned, cannot escape the risk of being called upon to account."

The principle is that the fiduciary is required to account for the profit made by him by such breach. *Phillips v Fieldstone Africa (Pty) Ltd*<sup>29</sup> reaffirmed the legal principles laid in *Regal (Hasting)* case as strict rules that allow little room for exception. The court ruled in this case that once a breach of fiduciary duty has occurred, it is of no relevance that the company has suffered loss or damage, or that the profit was not made at the expense of the company; nor is it relevant that the company could not have made use of the opportunity or the information.

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<sup>27</sup> Cassim *et al* Contemporary Company Law (2011) P535.

<sup>28</sup> [1942] 1 All ER 378.

<sup>29</sup> [2004] (3) SA 465 (SCA).

According to no conflict rule, it is a rule of universal application, that no one, having [fiduciary] duties to discharge, shall be allowed to enter into engagements in which he has, or can have, a personal interest conflicting, or which possibly may conflict, with the interests of those whom is bound to protect. So strictly is this principle adhered to, that no question is allowed to be raised as to the fairness or unfairness of a contract so entered into.<sup>30</sup> The phrase ‘possibly may conflict’ was interpreted as requiring that

the reasonable man looking at the relevant facts and circumstances of the particular case would think that there was a real sensible possibility of conflict; not that you could imagine some situation arising which might, in some conceivable possibility in events not contemplated as real sensible possibilities by any reasonable person, result in a conflict.<sup>31</sup> The above mention rules are the ones that are used by courts to determine if there is a breach of fiduciary duty to avoid conflict of interests by the directors.

Another rule that is also developed in this regard is the so called corporate opportunity rule. A corporate opportunity is seen in law as a corporate asset of the company, which can take the form of a corporeal and/or incorporeal asset. Corporate opportunity rule is the common law rule which is relevant where a director misappropriates and exploits for himself, an economic opportunity of the company. Such an opportunity is said to be a ‘corporate opportunity’ or one which is the ‘property’ of the company. In the case of *Da Silva v DH Chemicals* the courts unequivocally stated that:

“It is a well-established rule of company law that directors have a fiduciary duty to exercise their powers in good faith and in the best interests of the company. They may not make a secret profit or otherwise place themselves in a position where their fiduciary duties conflict with their personal interests (*Robinson v Randfontein Estates Gold Mining Co Ltd* **1921 AD 168** at 177). A consequence of the rule is that a director is in certain circumstances obliged to acquire an economic opportunity for the company, if it is acquired at all. Such an opportunity is said to be a ‘corporate opportunity’ or one which is the ‘property’ of the company. If it is acquired by the director, not for the company but for himself, the law will refuse to give effect to the director’s intention and will treat the acquisition as having been made for the company. The opportunity may then be claimed by the company from the delinquent director. Where such a claim is no longer possible, the company may in the alternative claim any profits which the director may have made as a result of the breach or damages in respect of

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<sup>30</sup> *Aberdeen Railway Co v Blaikie Brothers* (1894) 1 Macq 461 at 471.

<sup>31</sup> *Boardman and Another v Phipps* [1967] 2 A.C. 46, at [124B–124D].

any loss it may have suffered thereby (See Blackman, Jooste and Everingham, *Commentary on the Companies Act* Vol 2 p 8-161 to 8-162)".<sup>32</sup>

In terms of this rule a director is under a duty to acquire an opportunity for the company in the following instances: (i) when he has been given, expressly or impliedly, a mandate to acquire an opportunity for the company; (ii) when the company is reliant upon him to acquire opportunities for it; and (iii) is continuously under a duty to not appropriate any contract, information or other opportunity rightly belonging to the company. This involves actively pursuing activities that fall within the affected company's existing, or prospective, business undertakings, or which are related to the operations of the company within its scope of business. It is said that where a conflict of interests between the company and an opportunity taken exists, liability will ensue and result in the transaction being disregarded as that of the director and treated as if the transaction was concluded by the company. Alternatively, the director will have to expel any profits made from the unjustified transaction. It is said that corporate opportunity rule applies not only to corporate property or assets, but also to corporate confidential information. The corporate opportunity rule forms part of a director's fiduciary duties of fidelity and loyalty to the company. Engaging in the aforementioned conduct will result in a breach of fiduciary duties whereby a director will have no scope to limit his liability for such a breach and will be personally liable to the affected company.

### **2.1.3 THE DUTY TO ACT WITHIN POWERS**

In terms of this duty the powers granted to directors can only be used for the purposes for which they were granted. What this duty entails is that when a director enters into transactions on behalf of the company he should not enter into transactions that fall beyond the capacity of the company. The founding documents of a company, in particular the Memorandum of Incorporation, will play a vital role in determining the scope and ambit of the company's powers.<sup>33</sup> They should not enter into ultra vires transactions on behalf of the company or transactions that are illegal. A director has a fiduciary duty to observe limitations of the powers of the company as

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<sup>32</sup> *Da Silva v CH Chemicals (Pty) Ltd* 2008 (6) SA 620 (SCA) 627 para 18).

<sup>33</sup> *S v De Jager* 1965 2 SA 616 (A).

well as the limits of his own authority to act on behalf of the company.<sup>34</sup> Under normal circumstances a director serves as an agent of the company and an agent can only bind his principal contractually to a third party if he acted within the scope of the authority conferred upon him by his principal.<sup>35</sup> If directors exceed the powers conferred on them by the company they will be liable to the company for breach of their fiduciary duty. And it is said that this liability for a breach of fiduciary duty arises irrespective of the bona fides of the director in question or any fault on his or her part.<sup>36</sup> This ultra vires principle was abolished by section 36 of the old Act<sup>37</sup> but I will not dwell into this discussion as it is not relevant for the purposes of this dissertation. In determining whether or not a director violated this duty his knowledge of whether he had authority to act is very important. The directors would be found to have acted in breach of this duty where they entered into transactions knowing that they lacked authority to act on behalf of the company.<sup>38</sup>

#### **2.1.4 THE DUTY NOT TO EXERCISE POWERS FOR AN IMPROPER PURPOSE**

Directors of the company are by the law required to exercise their powers for a proper purpose. This means that they should exercise their powers only for the purpose for which they are conferred.<sup>39</sup> This is the duty not to exercise powers for an unauthorised or collateral purpose. Directors should thus use their powers for the company's benefit and not for their own gain and should act within the confines of the company's Memorandum of Incorporation and all relevant legislation. Difficulties arise where the director, while acting in good faith, is serving a purpose that is not regarded by the law as proper. Section 76(3)(a) requires that the directors must also exercise their powers for a proper purpose. It is said that section 76(3)(a) is a declaratory of the common law and effects no change in this aspect of the common law fiduciary duties of directors.<sup>40</sup>

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<sup>34</sup> Celliers and Benade 144.

<sup>35</sup> *Ashbury Railway Carriage and Iron Co v Riche* 1875 LR 7 HL 653.

<sup>36</sup> Cassim et al Contemporary Company Law (2011) P533.

<sup>37</sup> Section 36 of Companies Act 61 of 1973.

<sup>38</sup> *R v Jona* 1961 2 SA 301 (W).

<sup>39</sup> Cilliers et al, *Corporate Law*, (2000) 141-142.

<sup>40</sup> Cassim et al P 525.



One of the leading cases in this regard is the case of *Howard Smith Ltd v Ampol Petroleum Ltd*.<sup>41</sup> The case concerned the power of the directors to issue new shares. It was alleged that the directors had issued a large number of new shares purely to deprive a particular shareholder of his voting majority. The Privy Council held that the board had acted for an improper purpose although they had acted honestly and not in their self-interest. It also happened in the case of *Hogg v Cramphorn Ltd*<sup>42</sup> where directors fearing a takeover bid and their subsequent removal from the board of directors they allotted shares to their supporters. The court held that although the directors acted under the belief that it would be in the company's interests to preserve their board positions they had acted for an improper cause and thus declared the allotment of the shares to be voidable.

The principle is therefore that in exercising their powers, the directors must exercise their powers only for the purpose for which they are conferred. Where a director exceeds the power conferred on him his actions can only be validated through ratification by shareholders.<sup>43</sup> It is not necessary to prove that the director was dishonest or that the director knew that he was pursuing a collateral purpose. The court is required to follow the four step approach and must identify the particular power that is being challenged; identify the proper purpose for which the power was given to the directors; identify the substantial purpose for which the power was in fact exercised; and decide whether the purpose was proper.<sup>44</sup>

### 2.1.5 THE DUTY TO ACT WITH CARE AND SKILL

The paramount duty of a director is to observe the utmost good faith towards the company and to undertake all actions and decisions to the benefit of the company. In discharging that duty, a director must act with the necessary care and skill. The duty of care and skill requires a director to manage the affairs of the company as a reasonable prudent person would manage his own affairs. The duty of care, skill and diligence is not a fiduciary duty but based on delictual or Aquilian liability for

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<sup>41</sup>[1974] AC 832.

<sup>42</sup> 1967] Ch. 254.

<sup>43</sup> Section 20 of the Companies Act.

<sup>44</sup> *Extrasure Travel Insurances Ltd v Scattergood* [2003]1 BCLC598 (ChD) 619. See also Cassim at al P527-528

negligence. In the case of *Du Plessis NO v Phelps*<sup>45</sup> Friedman J explained the position as follows:

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

Directors are expected to exercise only that degree or level of care and skill that they are capable of.<sup>46</sup> A director will have acted negligently in his duty of care if he failed to do something which a reasonable person would have done under the same instances, or did something that the reasonable person would not have done under the same circumstances.<sup>47</sup> This entails that if the director is an expert, the reasonable person will be placed in the same category namely that of the reasonable expert.

Section 76 of Companies Act also provides for a director's duty to act with the necessary degree of skill and care expected of a reasonable person. The director's actions must have been in the interests of the company, and must have taken diligent steps to understand the subject matter and he must not have a personal financial interest in the subject matter. Where a director does not act reasonably he is liable, in accordance with the principles of the common law relating to breach of fiduciary duty, for any loss, damages or costs sustained by the company as a consequence of any such breach.<sup>48</sup>

A director may, however, in terms of the business judgment rule, be excused from liability for breach of the duties of care, skill and diligence and the duty to act in the best interests of the company. The excuse is granted if the director took reasonably diligent steps to become informed about the matter, has no material financial interest in the matter or had properly disclosed such interest, and made a decision rationally in the belief that it was in the best interests of the company.<sup>49</sup>

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<sup>45</sup> (1995 (4) SA 165 (C) at 170).

<sup>46</sup> Cassim et al P555.

<sup>47</sup> Havenga M, Breach of Directors 'Fiduciary Duties: Liability on What Basis? (1996) 8 *South African Mercantile Law Journal* 366.

<sup>48</sup> Section 77 of the Companies Act 71 of 2008.

<sup>49</sup> Section 77(9) of the Companies Act.

## 2.1.6 CONCLUSION

As stated above, the common law duties of directors are the fiduciary duties of good faith, honesty and loyalty. It is said that all other fiduciary duties flow from them. What is critical important is that anyone assuming the role of a director should be aware of all the rights and duties of the directors as required by both common law and the legislation. In many cases you will find that most directors 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. They only become aware of their duties after they are already appointed as directors during the course of induction and training.

Now that we discussed all common law and statutory duties of the directors, I will dwell into the discussion on the other paramount duty that I left deliberately and is the director's duty to exercise an independent judgement. This duty is very important for the purposes of the topic of this dissertation and as a result, I dedicated the following chapter on it. As stated above, the general legal principle remains that once the nominee director becomes a member of the board of directors of a company, he or she is subject to the duty to serve the interests of the company rather than the interests of his or her nominator. He is required to exercise an independent judgement and whether this is a fact of fiction will be discussed in this dissertation.

## CHAPTER 3

### 3.1 DUTY TO EXERCISE AN INDEPENDENT JUDGEMENT

In terms of the law, a director must not allow his judgement to be interfered with and must objectively apply his mind to the business of the company. In the exercise of their powers and in deciding what is in the best interests of the company, the directors must exercise an independent and unfettered discretion.<sup>50</sup> This is, in a nutshell, what the duty to exercise an independent judgement entails. The director is in law required to manage the affairs of the company in an unbiased and objective manner. The board of the company is not constituted to rubber stamp the wishes of shareholders; it is also not obliged to act in accordance with such wishes. Instead, the board should be in a position to manage the affairs of the company in a manner that advances the interests of the company. In *Fisheries Development Corporation of SA Ltd v Jorgensen*<sup>51</sup> the court held that the director's duty is to observe the utmost good faith towards the company, and in discharging that duty he is required to exercise an independent judgment and to take decisions according to the best interests of the company as his principal.

In this chapter we will interpret this statement as stated in the case of *Boulting v Association of Cinematograph Television & Allied Technicians*<sup>52</sup>: “Or take a nominee director, that is, a director of a company who is nominated by a large shareholder to represent his interests. There is nothing wrong in it. It is done every day. Nothing wrong, that is, as long as the director is left free to exercise his best judgment in the interests of the company which he serves. But if he is put upon terms that he is bound to act in the affairs of the company in accordance with the directions of his patron, it is beyond doubt unlawful”.

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<sup>50</sup> *S v Shaban* 1965 (4) SA 646 (W).

<sup>51</sup> 1980 4 SA 156 (W) 163D-F.

<sup>52</sup> [1963] 1 ALL ER 716 (CA) 723.

This duty to exercise an independent judgement is seen as an aspect of the director's duty to act *bona fide* in the interests of the company. This explains why it is not explicitly referred to in section 76 of the New Companies Act.<sup>53</sup>

### 3.2 NOMINEE DIRECTOR AND DUTY TO EXERCISE AN INDEPENDENT JUDGEMENT

As stated above, a nominee director is a director appointed to the board of a company to represent the interests of his nominator on that board. This director is normally appointed by a shareholder, a creditor or another stakeholder. A nominee director is even expected to report to his nominator on any developments that may affect the interests of the nominator.<sup>54</sup> This practice of appointing nominee directors is legally recognised. It is self-apparent that it becomes a problem when the interests of the company clash with those of the nominator. This clearly puts such a director on a collision course with the duties he owes as a director to his company, particularly duty to exercise an independent judgement.

This chapter will analyse nominee director's duty to exercise an independent judgement and also provide solution to most of the questions that remains unanswered in this regard. There are those who hold a firm view that the nominee director also owe fiduciary duty to his nominator. Their view is that the law has moved on from an absolutist approach where the director was estopped entirely from considering his nominator's interests to an approach by which the director is at least allowed to take into account such outside interests and follow them at least where there is a congruence between the company's and the appointer's interests. It is referred to as conflict between commercial reality and fiduciary duties owed to the company.

The big question that we seek to answer in this work is to whom the nominee director owe his fiduciary duty. It is beyond disputes that a nominee director is, like other directors of a company a fiduciary. Despite his special interest appointment, a nominee director is a *de jure* director of the company to whose board he has been

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<sup>53</sup> Cassim et al P528.

<sup>54</sup> Cassim et al P530.

appointed. Companies Act defines a director “as 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”.<sup>55</sup> This clearly entails that the nominee director is also subject to the same duties as the remainder of his board. The legal position is therefore that nominee directors do not constitute a separate class of directors.<sup>56</sup> They are fiduciaries like other directors and as such their paramount and overarching duty is to act in good faith and for the benefit of their companies.

Now, in the case of *Fisheries Development Corporation of SA Ltd v Jorgensen; Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd*<sup>57</sup> the basic principle was laid when the court unequivocally stated that a director’s duty is to exercise an independent judgement and to take decisions according to the best interests of the company. Are we then saying that even though nominee directors are in fact representing the interests of the persons who nominated them, they are in law obliged to serve the interests of the company to the exclusion of the interests of their nominators? I am of the view that this question should be answered in affirmative. A nominee director, as a fiduciary must avoid fetters on his discretion and must reach his decision independently. According to Pretorius *et al* “The duties of an alternate, nominee or “puppet” director are no different from those of any other director..... A nominee director must place the interests of the company to which he has been nominated above those of the company by which he has been nominated”.<sup>58</sup> It therefore means that even a prior agreement with the appointer to vote in a certain way regarding certain board decisions will violate fiduciary duty to exercise an independent judgement.

Another important case in this regard is the case of *Public Investment Corporation v Bodigelo*.<sup>59</sup> In this case the respondent, Mr Kagiso Bodigelo (Bodigelo) was employed by the appellant, the Public Investment Corporation Ltd (PIC) until his resignation on 3 August 2007. Bodigelo was appointed by PIC as its nominee

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<sup>55</sup> Section 1 of Companies Act 71 of 2008.

<sup>56</sup> *Kuwait Asia Bank EC v National Mutual Life Nominees Ltd* [1991] 1 AC 187 (PC).

<sup>57</sup> 1980 (4) SA 156 (w) 163.

<sup>58</sup> Pretorius JT et al *Hahlo’s South African Company Law Through Cases* P280.

<sup>59</sup> 128/2013) [2013] ZASCA 156 (22 November 2013).

director and on its behalf to represent PIC on the boards of four companies that PIC had invested in. The companies paid directors' fees and bonuses for the services rendered by non-executive directors such as Bodigelo. These fees and bonuses were paid by the companies directly to PIC on the instructions of PIC. Bodigelo contended that he was entitled to payment of these directors' fees and bonuses. The court ruled that Although it is clear, as decided in *Jorgensen*, that a director appointed as a nominee to represent certain shareholders or interests within a company, is obliged to exercise his or her discretion unfettered by such interests, this does not mean that Bodigelo could not perform his functions as a director in the context of his employment with PIC. A distinction has to be drawn between the unfettered exercise of a nominated director's discretion *qua* director and his adherence to the terms of an employment contract with the entity that nominated him or her as a director, which has no bearing upon the exercise of that discretion. The important principle that is confirmed by this case is that the nominee director is required by law to exercise an independent judgement and to take decisions according to the best interests of the company.

As stated by Cassim et al, for now the legal principle remains that the nominee director must exercise an independent judgement for the benefit of the company. Nominee directors must not blindly follow the judgement or the instructions of those who have appointed them; nor, in the event of conflict of interests, must they prefer the interests of their nominator above that of the company of which they are directors.<sup>60</sup> In New Zealand law, more particularly in the case of *Kuwait Asia Bank*, the Privy Council confirmed that in exercising their duties as directors of a company nominee directors had to ignore the interests and wishes of their appointer. The Privy Council confirmed the position that nominee directors owed their duty only to the company and could not take into account the interests of their appointer. But however, this approach was criticised as strict. It is said that commercially nominee directors are bound to take into account their appointer's wishes but to refuse any legal recognition of this is unworkable.<sup>61</sup> It is said that this is not to say that the nominee director should not ignore the appointer's where there is an actual conflict of interest, but it is unacceptable that the nominee must always disregard the

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<sup>60</sup> Cassim et al P 531

<sup>61</sup> *Dawson International plc v Coats Paton Plc* (No1) [1989] BCLC 233 at 243.

interests of his appointer. The position is therefore that a nominee director can take into account the interests of his nominator so long as he does not prefer that interest over the interest of the company if there is conflict.<sup>62</sup>

The English law also prefer the so called “corporate primacy approach” over the traditional approach. In the case of *Re Neath Rugby Club*<sup>63</sup> a nominee director could, without being in breach of his duties to the company take the interests of his nominator into account, provided that he genuinely considered this to be in the best interests of the company. This was considered as a relaxation of the traditional approach, but it remains clear that even if a director can take into account the interests of his nominator, he must not prefer them over those of the company if there is a conflict of interests.<sup>64</sup> In this jurisdiction their law allow adjustments to the duties to exercise judgement independently through the company’s constitutions.

In South Africa the company cannot provide in its Memorandum of Incorporation that the director may act in accordance with his appointer’s wishes. My view on this one is that the clause concerned in MOI will be illegal and unenforceable. It has been said that the fiduciary duties of directors are mandatory, prescriptive and unalterable, and apply to all companies. It is not permissible for directors to contract out of these duties. I therefore dismiss the opinion of that one way to protect nominee directors is to provide in the company’s founding documents that the director may act in accordance with his appointer’s wishes.<sup>65</sup>

### 3.3 CONCLUSION

I am of the view that South Africa should adopt the English approach on this issue. The reason being that the nominee directors should not face a difficult conflict of that on the one hand, the commercial reality of their position requires them to take into consideration the interests of their nominator, and on the other hand the law requires them to act exclusively in the interests of the company. The position should be that nominee directors can take into account the interests of their nominators so long as

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<sup>62</sup> This is referred to as “corporate primacy approach”.

<sup>63</sup> Also known as *Hawkes v Cuddy* [2009] EWCA Civ 219.

<sup>64</sup> See also *Levin v Clark* [1962] NSW 686.

<sup>65</sup> Solicitor General, HC Official Report, SC D (Company Law Reform Bill), 11 July 2006, col 601.



this interests do not conflict with the interests of the company. By the way, in the common law jurisdictions, including South Africa, the fiduciary duties of directors have since the eighteen and nineteenth centuries been judicially developed, mainly in English law, on a case by case basis.<sup>66</sup> The South Africa Companies Act 46 of 1926 was largely based on the English Companies Act of 1908.<sup>67</sup> In the following chapter we will discuss the fact that company law rules operate within live social and economic conditions and that fiduciary duties could be extended to other stakeholders.

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<sup>66</sup> Cassim et al P507.

<sup>67</sup> Cilliers and Benade P 21.

## CHAPTER 4

### 4.1 DIRECTORS FIDUCIARY DUTIES EXTENDED TO OTHER STAKEHOLDER

The most critical question that deserves unequivocal answer is to whom the directors, including the nominee directors, owe their fiduciary duties to. In the chapters above we came to the conclusion that at common law, directors owe their fiduciary duties to act in the best interests of the company only and not to their constituencies or other stakeholders. The duty to act in the best interests of the company is even codified in Section 76(3) (b) of the Companies Act which stipulates that a director of a company, when acting in that capacity, must exercise the powers and perform the function of a director in the best interests of the company. The directors' fiduciary duty to act in good faith and in the best interests of the company is the paramount and overarching fiduciary duty from which all other fiduciary duties flow.<sup>68</sup> The best interests of the company is translated into the shareholders' interests, with profit maximisation or making as a significant indication of what is best interests.<sup>69</sup> If the directors make decisions aimed at protecting other stakeholders they ran the risk of being personally liable to the company for breach of their fiduciary duties to act in the best interests of the company. As highlighted above, at common law transactions which were not ostensibly beneficial to the company were set aside as being void as against the company.<sup>70</sup>

### 4.2. INTERNATIONAL PERSPECTIVE

There are international legal systems that have now abrogated by statute the rule that as against third parties the transaction may be void if it has insufficient commercial benefit to the company. In those countries, statutes now expressly provide for the directors to consider interests other than the pure financial interests of

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<sup>68</sup> *Supra*.

<sup>69</sup> *Da Silver v CH Chemicals (Pty) Ltd* 2008(6)620 (SC) at para 18.

<sup>70</sup> *Howard Smith Ltd v Ampol Petroleum Ltd supra*.

the shareholders.<sup>71</sup> In the United Kingdom, the Companies Act 2006, requires that directors should consider the impact of their actions on a much wider range of stakeholders. The Act requires a director "to promote the success of the company for the benefit of its members as a whole", but sets out six factors to which a director must have regards in fulfilling the duty to promote success. These are:

- the likely consequences of any decision in the long term
- the interests of the company's employees
- the need to foster the company's business relationships with suppliers, customers and others
- the impact of the company's operations on the community and the environment
- the desirability of the company maintaining a reputation for high standards of business conduct, and
- the need to act fairly as between members of a company.

At the international level, companies are held accountable for human rights violations taking place within their sphere of operation. United Nations Human Rights Council unanimously endorsed the Guiding Principles for Business and Human Rights in 2011 which requires companies to promote human rights and also take into account social issues. In *AP Smith Manufacturing Co v Barlow* the court said that 'modern conditions require that corporations acknowledge and discharge social as well as private responsibilities as members of the communities in which they operate'.<sup>72</sup> The provisions of the International Covenant on Economic, Social and Cultural Rights (ICESCR), which is part of a wide network of international instruments designed to advance the realisation of human rights obligations by corporations, links the "obligation of States under the Charter of the United Nations to promote universal respect for, and observance of, human rights and freedoms".<sup>73</sup> There are so many international articles and instruments that address and dealing with the subject.<sup>74</sup>

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<sup>71</sup> Section 35B of the United Kingdom Companies Act of 1985. See also section 309 of the United Kingdom Companies Act 1985 that requires the directors to "have regard to" the interests of the company's employees.

<sup>72</sup> 98 A2d 581 (NJ 1953) at 586.

<sup>73</sup> 1966

<sup>74</sup> Cynthia A Williams & John M Conley 'Is there an emerging fiduciary duty to consider human rights?' 74 *University of Cincinnati Law Review* (2005). See also Janet E Kerr 'Sustainability meets profitability: The

### 4.3 SOUTH AFRICAN CONTEXT

The basic question to be answered in the South African context is whether the directors' fiduciary duty to act in the best interests can still be narrowly interpreted to mean the company's interests or is there any need for the interests of other stakeholders to be considered. It is said that the company's best interests is a general term and, if interpreted liberally, may extend beyond shareholder profit maximisation to embrace socially responsible board decisions which, indirectly, will benefit the company and its stakeholders. In this chapter we will look at what is the best interests of the company- or what it truly entails within the context of both the common law and South African new Companies Act.<sup>75</sup>

There are various theories which were developed over time which extend the directors fiduciary duties to the other stakeholders. The first one is the enlightened shareholder value approach which holds that directors must have regard to the longer-term interests of shareholders, as opposed to the immediate term and where appropriate, must have regard to the need to ensure productive relationships with all stakeholders. In terms of this theory directors are entitled to take a social decision favouring a stakeholder only if they believed this would also, for the long or short term, be for the shareholders' best interests. If there is a conflict between the interests of shareholders and stakeholders, the shareholders' interests must prevail

Another one is the pluralist approach which holds that companies have a social responsibility to society and that shareholders are just one constituency among many. This approach asserts that directors have a legal duty to balance the interests of shareholders and stakeholders.<sup>76</sup> The pluralist theory is based on the premise that 'co-operative and productive relationships can only be optimized where directors are

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convenient truth of how the business judgment rule protects a board's decision to engage in social entrepreneurship' (2007) 29 *Cardozo Law Review* 623.

<sup>75</sup> Act 71 of 2008.

<sup>76</sup> Cassim et al P495.

permitted (or required) to balance shareholders' interests with those of [other stakeholders] committed to the company.

Another approach which is adopted by King III is the so called stakeholder-inclusive corporate governance approach or "triple bottom line approach".<sup>77</sup> In terms of this approach, the legitimate interests and expectations of stakeholders are considered when making decisions in the best interests of the company. In this regard, the best interests of the company must be interpreted within the parameters of the company as a sustainable enterprise and the company as a responsible corporate citizen. Directors are not only responsible for profit making but must also recognise other stakeholder interests within society.

In properly analysing the South African position, the Constitution of the Republic of South Africa should be the starting point.<sup>78</sup> Traditionally, constitutional rights apply in the public sphere but not in the private sphere. In other words, private persons were not bound by human rights but this position had since changed. Section 8(2) of the Constitution states that a provision of the Bill of Rights binds a natural or a juristic person if, and to the extent that, it is applicable, taking into account the nature of the right and the nature of any duty imposed by the right. This is called direct horizontal application, meaning that the Bill of Rights applies not only to the relations between the State and its citizens, but also to private-law relations between individuals.<sup>79</sup>

And again, section 7 of the Companies Act provides that "The purpose of this Act is to- (a) promote compliance with the Bill of Rights as provided for in the Constitution, in the application of Company law". This was praised as a bold move considering that for many years constitutional law and company law existed as if they were largely separate disciplines with a very limited area of overlap.<sup>80</sup> Companies Act expressly stipulates that in interpreting the Act, it must be interpreted and applied in a manner that gives effect to the purposes set out in section 7 of the Act.<sup>81</sup> This

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<sup>77</sup> Institute of Directors *King Report on Corporate Governance for South Africa 2009* ("King III Report") at principles 7.3 and 7.4

<sup>78</sup> Act 108 of 1996.

<sup>79</sup> *Khumalo and Others v Holomisa* 2002 (5) SA 401 (CC). 2002 (8) BCLR 771 (CC).

<sup>80</sup> *Bilchitz* 2008 SALJ 774.

<sup>81</sup> Section 5 of the Companies Act 71 of 2008.

means that courts have to consider the purposes of the Companies Act as expressed in section 7 of the Companies Act. One of those stated purposes is the promotion of compliance with the Bill of Rights. Therefore, whenever a court is interpreting the Companies Act, consideration of the Bill of Rights may be inevitable. Furthermore, section 158 of the Companies Act further supports this idea of purposive interpretation by providing that "... a court must develop the common law as necessary to improve the realisation and enjoyment of rights established by this Act". However, the Companies Act qualify the duty to act in the best interests of the company by the introduction of a "business judgement rule" which is a defence for directors against an alleged breach of the fiduciary duty.<sup>82</sup> This rule requires the courts to defer to the directors' judgement on what is in the best interests of the company if their judgement was shown to be honest and reasonable.

Common law duty to act in the best interests of the company was formulated in a pre-constitutional era where profit maximisation was the primary concern for companies.<sup>83</sup> Duty to act in the best interests of the company only is referred to as the so called "shareholder dominance theory".<sup>84</sup> It is now difficult to ignore the social influence that companies have.

The issue that needs to be clarified here is whether the introduction of the above constitutional provisions represent the total deviation from the traditional common law position of that the directors of the company owe their fiduciary duties only to the company. Put it differently, is social responsibility requirement inconsistent with the fiduciary duties of directors? It is also said that with the mounting evidence of climate change, consumer preferences for socially responsible brands, and trends in transparency and reporting, the traditional paradigm of fiduciary duty is undergoing a transformation.<sup>85</sup> From this discussion, it appears that the scope of the duty is now extended to incorporate the social dimensions. What this entails is that it would be necessary for both shareholder and stakeholder interests to be recognised and

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<sup>82</sup> Section 76(4) of Companies Act 71 of 2008.

<sup>83</sup> Minal Ramnath "Interpreting Directors Fiduciary Duty to Act in the Companies Interests Through the Prism of the Bill of Rights: Taking Other Stakeholders into Consideration" *Speculum Juris* 2013(2) at 101.

<sup>84</sup> Where a company's best interests were associated with those of directors.

<sup>85</sup> [www.forbes.com/.../csr/.../friend-or-foe-fiduciary-duties-meet-socially-responsible-investments](http://www.forbes.com/.../csr/.../friend-or-foe-fiduciary-duties-meet-socially-responsible-investments)

balanced against each other in determining the company's interests. As stated above, the term company's interests is broad to include both shareholder and stakeholder interests.

It is argued that:" while it is true that shareholders own the company due to their financial investments, other stakeholders such as employees have also invested into the company in the form of human capital. They also bear a risk of loss if the company is unsuccessful. The same may be said of other stakeholders like consumers who have faith in the company's products and the community which is interested in the company's operations being safe and not harmful to its environment. Similarly, suppliers that do business with a company may place great emphasis on the reputational risk of having relations with companies that violate human rights. It is clear that despite not being "owners" of the company, various stakeholders still have significant interests in it.....stakeholders may play an active role in policing the management of the company by its directors. In certain cases stakeholders may have a derivative action to force the company to engage in legal proceedings which may include proceedings against its own directors.<sup>86</sup> It is not unusual for key stakeholders (such as employees or suppliers) to appoint directors to a company's board.<sup>86</sup>

It is beyond disputes that the above statement is correct. The scope of the directors' duty to act in company's best interests is as a result extended as its nature and scope cannot be determined unless the impact of the Bill of Rights is recognised.

#### 4.4 CONCLUSION

It is true that Common law duty to act in the best interests of the company was formulated in a pre-constitutional era where profit maximisation was the primary concern for companies. In my view, the common law position that directors owe their fiduciary duties to act in the best interests of the company only and not to their constituencies or other stakeholders is no longer accurate. In a nutshell, the directors must exercise their duties in the interests of both the shareholders and the stakeholders. By so doing, they are acting in the best interests of the company as a whole. The introduction of the above constitutional provisions makes an additional requirement to the duty of directors to act in the best interests of the company. The duty is now broadened to include the interests of other stakeholders. With the

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<sup>86</sup> Minal Ramnath "Interpreting Directors Fiduciary Duty to Act in the Companies Interests Through the Prism of the Bill of Rights: Taking Other Stakeholders into Consideration" *Speculum Juris* 2013(2).

practice of appointing nominee directors this objective shall be easily realised. In the following chapter I will deal with the directors' liability for breach of their fiduciary duties.

## CHAPTER 5

### 5.1 NOMINEE DIRECTORS' LIABILITY FOR BREACH OF FIDUCIARY DUTIES

The next question to be answered, which is critical and inevitable in this work, is what happens when the nominee director violates his fiduciary duties as provided for by both common law and the legislation. As discussed above, the Act defines a director "as 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."<sup>87</sup> This definition is broad enough to include nominee directors as members of the boards. It further means that the nominee directors are also subjected to the same duties and liabilities as other directors.<sup>88</sup> The discussion of directors' liability for breach of their fiduciary duties will also cover the liabilities of nominee directors.

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

It is said that at common law, the director's liability is based either on delict and contract. In the case of *Du Plessis v Phelps*<sup>89</sup> it is said that:

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

A director who does not observe his fiduciary duties is liable to the company in delict for damages; and if in addition there is a contract between the director and his company he is guilty of breach of contract as well.<sup>90</sup>

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<sup>87</sup> Section 1 of Companies Act 71 of 2008.

<sup>88</sup> *Boulting v Association of Cinematograph Television & Allied Technicians* 1963 2 QB 606

<sup>89</sup> 1995 (4) SA 165 (C).

<sup>90</sup> *Cilliers et al* P148



### 5.3 LIABILITY IN TERMS OF NEW COMPANIES ACT

Section 77(1) to (10) of the new Companies Act also statutorily sets out the liability of directors of a company. It is beyond disputes that this section of the Act codifies the common law liabilities of directors. In terms of section 77 of the Act, a director of a company 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)).<sup>91</sup>

It is important to mention that the liability of a director for any benefit obtained by the said director is not covered by this section 77(2) of the Act. The wording of section 77(2) (a) expressly excludes the common law liability for a benefit. The section only makes provision for “loss, damages or costs”. According to Cassim, the ambiguity in section 77(2)(a) in failing to provide explicitly for disgorgement of profits creates unnecessary uncertainty in this regard.<sup>92</sup> It deviates from the original position established by the case law where directors were required to disgorge profits made by them even though the company had suffered no loss and may have benefited from the act of the directors.<sup>93</sup> In terms of section 77(2) (b) a director will be liable in accordance with the principles of the common law relating to delict for any loss, damages or costs sustained by the company as a consequence of any breach by the director of- (i) a duty contemplated in section 76(3)(c); (ii) any provision of this Act not otherwise mentioned in this section; or (iii) any provision of the company’s Memorandum of Incorporation.

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<sup>91</sup> Section 77(2) (a).

<sup>92</sup> Cassim *et al* P583.

<sup>93</sup> *Regal (Hastings) Ltd v Gulliver* [1942] 1 All ER 378.

Section 77(3) of the Act lists specific actions of directors for which they can be held liable. This section of the Act spell out 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. Those examples are:

- (a) Acting on behalf of the company despite knowing that he lacks authority to do so;
- (b) Acquiescing to carrying on of the company's business despite knowing that it is prohibited in terms of section 22.
- (c) 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;
- (d) 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;
- (e) Issuing of any unauthorised shares or options on those shares with the knowledge that those shares had not been authorised under section 36;
- (f) 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;
- (g) 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.
- (h) Drawing up a resolution approving a distribution despite knowing that the said distribution is not in accordance with section 46;
- (i) The acquisition by a company of any of its shares despite knowing that the said acquisition was contrary to sections 46 or 48;
- (j) an allotment by the company despite knowing that the allotment was contrary to any provision of Chapter 4.

As stated above, section 77 of the Act confirms the common-law position on the breach of a fiduciary duty. It further confirms that a director will be held liable based on the basis of delict, should he fail to execute his duties with the necessary degree of care and skill. Section 77(3) on the other hand specifically lists examples of conduct which directors may be held liable for contravening.

Section 218(2) of the New Companies Act also stipulates that any person who contravenes any provision of this Act is liable to any other person for any loss or damage suffered by that person as a result of that contravention. Another relevant section is section 20(6) which 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. However, 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.<sup>94</sup> It is imperative to mention that in terms of section 20(3) an act that contravenes the provisions of the new Act may not be ratified.

The first reported case on the liability of directors in terms of the above sections of Companies Act is the case of *Rabinowitz v van Graan*.<sup>95</sup> In this particular case at the heart of the litigation were the provisions of section 77(3)(b) of the Act. The Court pointed out that section 77(3)(b) is explicit that the liability of the director is a liability toward the company for any loss that it has suffered as a result of conduct by the director.

#### **5.4 BUSINESS JUDGEMENT RULE**

Business Judgment Rule is a legal principle that protects directors of a company from personal liability to the company for loss incurred in business transactions that are within their authority and power to make when sufficient evidence demonstrates that the transactions were made in good faith. The business judgment rule is provided for in the South African company law as part of the statement on the duty to act in the best interest of the company and the duty to act with care, skill and diligence. In terms of the rule, a director will be protected from allegations of breach of the duty to act in the best interests of the company and with care, skill and diligence in relation to a matter where that director has taken reasonably diligent

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<sup>94</sup> Section 20(2).

<sup>95</sup> 2013 (5) SA 315 (GSJ).

steps to become informed about the matter; either had no conflict of interest in relation to the matter or complied with the rules on conflict of interests; and had a rational basis for believing, and did believe, that his decision was in the best interest of the company.<sup>96</sup> The business judgment rule was originally imported from the USA into Canada and then into SA and has been part of the legal system in the USA for more than 160 years.<sup>97</sup> The purpose of the rule is to prevent the court from interfering in the honest and rational business decisions of directors of companies. 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.

The business judgment rule is found in Section 76(4) of Companies Act which stipulates that:

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

(a) will have satisfied the obligations of subsection (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

(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 interests of the company; and

(b) is entitled to rely on-

(i) the performance by any of the 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)”.

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<sup>96</sup> Linda Muswaka “Directors’ Duties and the Business Judgment Rule in South African Company Law: An Analysis” *International Journal of Humanities and Social Science* Vol. 3 No. 7; April 2013.

<sup>97</sup> S Samuel Arshat “The Business Judgment rule Revisited” 1979 8 *Hofstra* LR 93.

From the above provision of the law, a director will be protected from allegations of breach of the duty to act in the best interests of the company and with care, skill and diligence in relation to a matter where that director has (i) taken reasonably diligent steps to become informed about the matter, (ii) either had no conflict of interest in relation to the matter or complied with the rules on conflict of interests and (iii) had a rational basis for believing, and did believe, that his decision was in the best interest of the company. There are basically three requirements enunciated for a director to be protected by the business judgment rule. They are the following:

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

It is said that the enactment of the business judgment rule is not a fortress for directors as dishonest and irrational directors will still face the sanction of the court for breach of the duty to act in the best interest of the company and the duty to act with care, skill and diligence. In terms of section 77(2)(a), a director may be held liable in accordance with the principles of the common law relating to breach of a fiduciary duty, for any loss or damages sustained by the company as a result of a breach of *inter alia*, the duty to act in the best interest of the company.

## CHAPTER 6

### 6.1 CONCLUSION

It is now clear that in terms of the law the established principle is that the directors owe their fiduciary duties to the companies that they serve even when they are nominee directors. The general legal principle remains that once the nominee director becomes a member of the board of directors of a company, he or she is subject to the duty to serve the interests of the company rather than the interests of his or her nominator. The principle in the case of *Boulting v Association of Cinematograph Television & Allied Technicians*<sup>98</sup> that there is nothing wrong with the practice of appointing nominee directors, so long as the director is left free to exercise his best judgment in the interests of the company which he serves is paramount. But if he is put upon terms that he is bound to act in the affairs of the company in accordance with the directions of his patron, it is beyond doubt unlawful. The courts have ruled that there is nothing inherently dishonest or improper about the practice of appointing nominee directors as it is a commercial reality.

It has been highlighted in this work that at common law the duty to act in good faith and in the best interests of the company is the paramount and overarching fiduciary duty of directors from which all other fiduciary duties flow. Those duties were categorised as the duty to avoid conflict of interests; the duty to act within powers; the duty to maintain an unfettered discretion; the duty not to exercise powers for an improper purpose; and the duty to act with care and skill. Anyone assuming the role of a director should be aware of all the duties of the directors as required by both common law and the legislation as stipulated above. What is important for nominee directors like other directors is that in the exercise of their powers and in deciding what is in the best interests of the company, they must exercise an independent and unfettered discretion. The legal position is that nominee directors do not constitute a separate class of directors. They are fiduciaries like other directors and as such their paramount and overarching duty is

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<sup>98</sup> *Supra*.

to act in good faith and for the benefit of their companies. The position is that nominee directors can take into account the interests of their nominators so long as this interests do not conflict with the interests of the company.<sup>99</sup>

However, it has been demonstrated in this work that the company's best interests is a general term and, if interpreted liberally, may extend beyond shareholder profit maximisation to embrace socially responsible board decisions which, indirectly, will benefit the company and its stakeholders. The scope of the duty is now extended to incorporate the social dimensions. The position now is that is necessary for both shareholder and stakeholder interests to be recognised and balanced against each other in determining the company's interests. It is an established principle that the term "company's interests" is broad to include both shareholder and stakeholder interests. The approach which is adopted by King III of stakeholder-inclusive corporate governance approach or "triple bottom line approach" in terms of which the legitimate interests and expectations of stakeholders are considered when making decisions in the best interests of the company is adopted as a legal principle. In this regard, the best interests of the company must be interpreted within the parameters of the company as a sustainable enterprise and the company as a responsible corporate citizen. Directors are not only responsible for profit making but must also recognise other stakeholder interests within society.

It was also highlighted that the fiduciary duties of directors are derived from our common law, which is created through the precedents set by our courts. While the new Companies Act attempts to codify many of these common law duties, it is a partial codification of the common law. As stated above, section 76(3) of the new Companies Act expressly states that a director, when acting on behalf of the company, should perform all of his/her functions and powers in good faith, for a proper purpose, in the best interests of the company, and with the requisite degree of care, skill and diligence that may reasonably be expected of a person holding such office, with the same level of knowledge and skill as that director. A director who does not observe his fiduciary duties is liable to the company in delict for

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<sup>99</sup> *Levin v Clark* [1962] NSWLR 686.

damages; and if in addition there is a contract between the director and his company he is guilty of breach of contract as well. Section 77 of the new Companies Act makes provision for the liability of a director in the event that he/she breaches one or more of his statutory duties owed towards the company. A breach of the duty under section 76(3)(c) by a director would attract delictual liability, as would a breach of any other provision of the New Act or the company's memorandum of incorporation.



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