

DIRECTOR'S DUTY TO COMPLY

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Chapter 1 – Introduction

In this dissertation, I aim to illustrate the duties of company directors to ensure that their companies comply with applicable legislation. I will look at it from a company law perspective and also from a compliance best practice perspective. This dissertation will provide an overview of director duties in modern day corporate law where it is applicable, compared with an overview of the best practice requirements and because of the convoluted nature of both the topics; I will highlight the most important and most relevant aspects in order to draw conclusions.

When a person contravenes legislation, the consequence of the contravention is usually as clear as the content of the piece of legislation that is contravened. When a person is caught exceeding the speed limit for example, that person would be held liable for the ensuing penalty. This is similar for corporations in that if a corporation is guilty of an offence as a result of contravening applicable legislation, such a corporation will be liable to pay the fines associated with the contravention. The underlying question of this dissertation however concerns the duty of the directors or other persons as the ‘directing minds’ of the corporation to ensure that the corporation does not contravene applicable legislation since a corporation (the juristic person) is wholly dependent on its ‘directing minds’ to steer business activities and to ensure that applicable rules are followed.

On the 30th of January 2014, the Regional Court of Limpopo sentenced the director of Blue Platinum Ventures Pty Ltd, one Matome Samuel Maponya, to 5 years imprisonment of which all 5 years are suspended on the conditions that i) Mr. Maponya ensures that the company does not contravene section 24F(1) of the National

Environmental Management Act (NEMA)¹ – which contravention meant the accusation in the first place – and ii) that Mr. Maponya in his personal capacity ensure that the damage done to the environment at the relevant areas are repaired and any risks to the environment mitigated.²

The defendant, Mr. Maponya wasn't found guilty by the court as popular news articles read, but instead entered a plea of guilty and was charged with contravening section 24F(1) of NEMA.

Section 24F(1) of NEMA reads as follows:

Notwithstanding any other Act, no person may—

(a) commence an activity listed or specified in terms of section 24(2)(a) or (b) unless the competent authority or the Minister responsible for mineral resources, as the case may be, has granted an environmental authorisation for the activity; or

(b) commence and continue an activity listed in terms of section 24 (2) (d) unless it is done in terms of an applicable norm or standard.

In the particular matter, Blue Platinum Ventures Pty Ltd commenced with clay brick manufacturing on 5 different stretches of land without approval to do so and as a result, contravened section 24F(1) of the National Environmental Management Act.

A company is a separate legal person who can sue or be sued (in the civil sense) and can also be held liable for fines (in the criminal sense)³. Section 34(7) of the National

¹ Act 108 of 1998

² S v Blue Platinum Ventures - Unreported case number RN126/2013 in the Magistrates Court for the Regional Division of Limpopo Province held at Lenyenye – sentencing report – *available from www.cef.co.za*

³ See ex Salomon v Salomon & Co Ltd 1897 AC 22 and Dadoo Ltd v Krugersdorp Municipal Council 1920 AD 530 at 550 where Innes CJ stated “a registered company is a legal persona distinct from the members who compose it”.

Environmental Management Act however states that a director of a firm can be guilty of an offence and held liable if that director failed to take all reasonable steps that were necessary under the circumstances to prevent the commission of the offence. It is on this premise that Mr. Maponya as the director of Blue Platinum Ventures Pty Ltd was accused of crimes against the environment and eventually sentenced.

In this case, the liability of the director as a result of the company's non-compliance is clearly extracted from the National Environmental Management Act. It should be pointed out that liability was not (in this particular case) as a result of the director breaching his duties toward the company, although a case for breach could possibly also be made on the facts. The reason for my inclusion of this case is to point out a trend in public opinion regarding who should fit the bill for contraventions of the law by juristic persons. Apart from the requirements of the Companies Act⁴ (hereinafter referred to as "the Act") and best practice in the area of corporate governance which is discussed in more detail in chapter 2 and chapter 3 below respectively, the following examples also support the view that public opinion require that corporations comply with legislation and has shifted its view from corporate liability to holding the malicious or negligent 'directing mind' liable instead –

- The National Treasury Department of South Africa published new set of 'Treasury Regulations' on the 30th of November 2012⁵ in which the term 'compliance'⁶ is mentioned no less than 14 times;

⁴ The Companies Act, Act 71 of 2008

⁵ Government Gazette no 35939 published on 30 November 2012. National Treasury is mandated by the Public Finance Management Act, 1 of 1999 to issue regulations in terms of the Act, which is referred to as 'Treasury Regulations'.

⁶ The term 'compliance' in this context refers specifically to the 'Accounting Officer' or Accounting Authority' and the responsibility of such a person(s) to ensure that the Department, Constitutional Institution or Public Entity comply with all applicable legislation and also have the correct risk management controls in place.

- The 2013 Financial Service Laws General Amendment Act⁷ added section 7F to the Pension Funds Act⁸ which reads as follows – *“Liability of board member – (1) In any proceedings against a board member in terms of this Act, other than for wilful misconduct or wilful breach of trust, the court may relieve the board member from any liability, either wholly or partly, on terms that the court considers just, if it appears to the court that (a) the board member has acted independently, honestly and reasonably; or (b) having regard to all the circumstances of the case, including those connected with the appointment of the board member, it would be fair to excuse the board member.* In other words, a board member will be liable if he either acted with intent, or if his negligence was not reasonably excusable, given that he acted independently and honestly, or, his negligence was excusable in the light of fairness. Although the meaning words such as ‘fair’ will have to be determined, the Act clearly moves more toward holding members of the board personally liable for pension fund related contraventions; and
- Section 34(7) of NEMA as discussed above.

The duty of company directors to comply with applicable legislation is particularly onerous in the South African context. South Africa is one of the most highly regulated countries in the developing world with highly technical Acts such as the Competition Act,⁹ Financial Markets Act,¹⁰ Companies Act and Financial Advisory and Intermediary Services Act¹¹ to name a few. If the issue of a director’s duty to ensure compliance with all applicable laws and regulations is seen in the light of the plethora of possibly

⁷ 45 of 2013.

⁸ 24 of 1956.

⁹ Act 89 of 1998.

¹⁰ Act 19 of 2012.

¹¹ Act 37 of 2002.

applicable active legislation in South Africa, it should serve a director well to inform him/herself with the risks involved and take appropriate steps.

What also makes compliance a difficult topic is the fact that when compliance with laws and regulations are considered in the context of a corporation, the following question invariably surfaces – should directors of a company ensure compliance with laws and regulations even when the cost of compliance outweighs the risk of liability in the event of non-compliance? As the CEO of a large international banking conglomerate notoriously pointed out – he has a duty toward his shareholders to undertake business practices in such a way that ensures maximum profit, even if it means paying a fine or two (paraphrased). This attitude towards compliance, although entertained in practice, should not be endured by the legislature for obvious reasons. We have to assume that parliament, as the head of the legislature, takes into account the effect that legislation will have on the country and that parliament will not pass legislation that has an overbearing and unreasonably adverse effect on the economy (although this is only an assumption in law). Mandisi Mpahlwa, the then Minister of Trade and Industry stated the following in the ‘Guidelines for Corporate Law Reform’ published in the Government Gazette no 26493 in May 2004:

In realizing this vision [an economy that can sustainably meet the needs of all citizens] a key role for government is to ensure that the regulatory framework within which enterprises operate promotes growth, employment, innovation, stability, good governance, confidence and international competitiveness. Regulation should be consistent, effective, predictable, transparent, fair and understandable. It should provide flexibility and promote adaptability to an environment with fast changing technologies, economic opportunities and social circumstances. The regulatory scheme should not create artificial preferences and distortions, where these are unnecessary and it should attempt, where practically possible, to balance the competing interests of economic actors and of society at large (my parenthesis added).

A company director's duties – whatever they may be – are conceptually tied to the authority of a director as more fully discussed in chapter 2 below. In the context of South Africa's brand new Company Law regime after the inception of the 2008 Companies Act, the topic of director duties will likely increase in popularity because of the increase in the authority that directors have *vis a vis* the company. Section 66 of the Act states that the business and affairs of the company 'must' be managed by or under the direction of its board, which has the authority to exercise all of the powers and perform any of the functions of the company, except to the extent that this Act or the company's Memorandum of Incorporation provides otherwise. According to Delport this is different from the previous Companies Act, 1973, where the directors were mere functionaries (organs or agents) of the company and implies that a director now has original authority.¹² The movement from the board's authority to manage the business of the company¹³ to the board's authority to manage the business and affairs¹⁴ of the company according to Delport means that a board will even have the authority to wind-up the company on the basis of the inclusion of the word 'affairs'.¹⁵ If this is the case and the board's authority has so significantly been increased, the duties of directors should also then see a significant expansion. For the purpose of this dissertation, if a director has the power of 'life and death' over the company, then such a director should be accountable for the use of that power and should by implication exercise the power in a manner that is compliant with applicable laws and regulations.

In this dissertation I will consider the duties of directors as it applies to or correspond with a director's duty to ensure that the company complies with applicable legislation, which is handled in the second chapter. In the third chapter, I will expound on the best practice principles of corporate governance regarding a director's duty to ensure that a

¹² Delport et al *Henocheberg on the Companies Act, 71 of 2008* (Updated May, 2014) at 251.

¹³ Under the 1973 Companies Act.

¹⁴ Under the 2008 Companies Act.

¹⁵ Delport *supra* at 252.

company complies with applicable legislation and also the possible effect thereof. In the fourth chapter, I will have a closer look at one particular court decision that impacts the application of best practice principles of corporate governance and how, if followed, it will increase the level of duties owed by directors. In the fifth chapter, I will consider the application of the business judgment rule specifically in the context of a director's duty to ensure that the company complies with applicable legislation.

Chapter 2 – Duties of Directors

2.1 Introduction

Much has been said about the history of director duties, the partial codification of director duties by the Act and the consequences thereof (specifically that the common law of director duties still applies as long as its consistent with what the Act prescribes).¹⁶ For the purposes of this dissertation, I will focus on director duties as regulated after the promulgation of the new Companies Act and refer to the common law where necessary to provide weight and explanation to specific parts of the requirements of the Act relating to director duties. This dissertation will also only focus on those duties that relates to or is relatable with the duty of directors to ensure that the company to comply with applicable legislation.

2.2 Fiduciary duties and the duty to act with care and skill

In this chapter, both fiduciary duties and the duty to act with care and skill will be handled together for practical reasons. I will however draw the necessary distinction and provide the relevant critique.

Before jumping into the topic of fiduciary duties, it is first imperative to understand a proper context of fiduciary duties. In other words, who, in terms of the common law, owes fiduciary duties toward a company?

¹⁶ See for example Delpont *supra* at 288 & 289 and Cassim et al *Contemporary Company law* (2012) [2nd ed] 507.

Fiduciary duties, as we find it in the South-African context, is largely derived from English law.¹⁷ Fiduciary duties were developed in the English law based on the analogy of Trust law where the trustee manages the estate of a person on behalf of his or her beneficiaries and therefore is faced with similar conflicts of interest than what we find in the corporate context.¹⁸ In the context of a corporation, some dissimilarity however exists. A trustee is tasked to merely look after the assets under his or her control on behalf of the beneficiaries. A director of a corporation however has a very different and more dynamic role. In *Daniels ta Deloitte Haskins & Sells v AWA Ltd*¹⁹ the court said:

“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 a sufficient return on the capital invested”

In the South-African context, fiduciary duties were developed on this basis with reference to the English law. According to AJ Heher in *Phillips v Fieldstone Africa (Pty) Ltd*²⁰:

*“There is no magic in the term “fiduciary duty”. The existence of such a duty and its nature and extent are questions of fact to be adduced from a thorough consideration of the substance of the relationship and any relevant circumstances which affect the operation of that relationship (cf *Bellairs v Hodnett and another* 1978 (1) SA 1109 (A) at 1130F). While agency is not a necessary element of the existence of a fiduciary relationship (*Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168 at 180), that agency exists will almost always provide an indication of such a relationship”*

The South African common law therefore placed the requirements of fiduciary duties on directors of companies since they are the agents acting on behalf of the company.

¹⁷ See for example Cassim *supra* at 463.

¹⁸ See Cassim *supra* at 513.

¹⁹ 1995 37 NSWLR 438 at 494

²⁰ 2004 (3) SA 465 [SCA] at 477H

The new Companies Act²¹ however increases the scope of the application of director's duties (and by extension, also that of fiduciary duties) and determines as follows:

"...(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"

The term "prescribed officer" is a new term in South African law and according to Idensohn²², one with "far-reaching legal implications". It is not part of the scope of this dissertation to handle with the implications of the term "prescribed officer" however would be of value to see how the Act defines the term "prescribed officer". According to the Act, a prescribed officer is defined as a person who, within a company, performs any function that has been designated by the Minister by Regulation²³. According to the Companies Regulations of 2011, the term "prescribed officer" is defined as:

"(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; or

(b) a function performed by the person for the company."

²¹ Section 76.

²² Kathy Idensohn "The meaning of 'prescribed officers' under the Companies Act 71 of 2008" (2012) 11 *SALJ* 129 at 717.

²³ Section 1 of the Act.

The above definition clearly indicates that the Act goes much further than common law with respect to the type of person in a company who owes fiduciary duties to the company. As an example, and looking at the above definition of a “prescribed officer” one could argue that a company secretary could fall into the category as a “prescribed officer” of a company. The role of the company secretary has seen a great increase in importance and authority that such a person holds.²⁴ In the English case of *Panorama Developments (Guildford) Ltd v Fidelis Furnishing Fabrics Ltd*²⁵ the court made the following statement with regards to company secretaries:

“A company secretary is a much more important person nowadays than he was in 1887. He is an officer of the company with extensive duties and responsibilities. This appears not only in the modern Companies Acts, but also by the role which he plays in the day-to-day business of companies. He is no longer a mere clerk. He regularly makes representations on behalf of the company and enters into contracts on its behalf which come within the day-to-day running of the company’s business. So much so that he may be regarded as held out as having authority to do such things on behalf of the company. He is certainly entitled to sign contracts connected with the administrative side of a company’s affairs, such as employing staff, and ordering cars, and so forth. All such matters now come within the ostensible authority of a company’s secretary”²⁶

Similarly, many more examples can be argued from the above definition, however I mention a company secretary specifically for reasons relevant to this dissertation, which will be expanded on more in chapter 6 below.

2.2.1 the duty to act in good faith, in the best interest of the company for a proper purpose

²⁴ Cassim *supra* at 418.

²⁵ (1971) 2 QB 711.

²⁶ at 716-717 as referenced by Cassim *supra* at 418.

Now that we have an understanding of who owes fiduciary duties, we can ask the question: would a director (or any other person to whom fiduciary duties apply) of the company have contravened his or her fiduciary duties if the company does not comply with a prescript of the law (the Companies Act or any other applicable Act)?

According to section 76(3) of the Act:

“(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; and

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

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

(ii) having the general knowledge, skill and experience of that director”

The underlying question for the purpose of this dissertation is: can a director (or any other person to whom fiduciary duties apply) argue that he or she acted in good faith, in the best interest of the company and for a proper purpose even though his or her act or omission caused the company to contravene an applicable Act. According to Delpoort²⁷ this should be answered in the negative.

In *Bester NO and another v Wright and others*²⁸ the directors of a company concluded loan agreements between the company and the different directors of the company with the following clause to the loan agreement “the repayment of the loan and interest thereon will not be made to the company until such time as the Cedar Farm Development project is finalised” which project was never finalised.²⁹

²⁷ Delpoort *supra* at 296.

²⁸ 2011 (2) All SA 75 [WCC].

²⁹ *Supra* at 77.

When these loan agreements were challenged in the Western Cape division of the High Court, AJ Fitzgerald was faced with a similar question as the one above, i.e. does contravention of legislation also purport to a breach in director duties. It was eventually conceded in the papers of the respondents that the loan agreements was invalid since it was in contravention of section 226 of the previous Companies Act³⁰, as complimented by AJ Fitzgerald who argues that the information to the disposal of the respondents as directors of the company implies that they could not have acted in the best interest of the company by concluding the different loan agreements.³¹ The Respondents however argued that the loan agreements (though invalid) had the effect of “extinguishing the liability on the parts of respondents to repay the loans admittedly made to them by the company”.³²

Aside from the above contravention, the loan agreement further also contravened the previous Companies Act, 1973 sections 85 and 87, by providing that the company would purchase 50% of its own shareholding owned by various family trusts which was in turn beneficiating the respondents while the company was at that point factually insolvent.³³

The Judge argued that the respondents had acted in breach of their fiduciary duties by knowingly causing the company to contravene the different sections of the previous Companies Act.³⁴

³⁰ Act 61 of 1973.

³¹ *Supra at 77.*

³² *Supra at 78*

³³ *Supra at 78 & 79*

³⁴ *Supra at 80*

The Bester case is an example of directors clearly being in breach of their fiduciary duties by knowingly causing the company to which they are agents to contravene legislation which turned out not to be in the best interest of the company. The question however remains, will a director (or any other person to whom fiduciary duties apply) be in breach his or her fiduciary duties if the non-compliance with legislation is not as a result of an act (or commission), but rather an omission. Further also, would such a person be in breach of his or her fiduciary duties if the non-compliance with legislation were in the best interest of the company, especially considering that the word “interest” in this context according to Delpport should be defined as only the interest of company itself as a corporate entity and those of its members as such as a body.³⁵ These two questions conceptually pose more difficult and very relevant issues for modern day corporate law and is more appropriately expanded on in chapter 4 below.

Directors are also charged with the duty to act *bona fide*. According to Berger J in the Canadian case of *Teck Corporation Ltd v Millar*³⁶ as referenced by Delpport³⁷:

“I think the Courts should apply the general rule in this way: The directors must act in good faith. Then there must be reasonable grounds for their belief. If they say that they believe there will be substantial damage to the company’s interests, then there must be reasonable grounds for that belief. If there are not, that will justify a finding that the directors were actuated by an improper purpose.”

This implies an *onus* on directors to explain the reason why their particular action or omission was in fact *bona fide*, in the best interest of the company and for a proper purpose.

³⁵ Delpport *Supra* at 296. An example would be where directors of a company delays in ensuring that the company complies with environmental legislation where the cost to comply outweighs the real or perceived cost of non-compliance (refer to chapter 1 and the discussion there on the legitimacy of complying with applicable legislation only when its economical for the company).

³⁶ 1973 (33) DLR (3d) 288 at 315 – 316.

³⁷ *Supra* at 297

The duty act *bona fide*, in the best interest of the company and for a proper purpose is invariably linked to a director's authority. A director acts as an agent of the company and for that purpose is endowed with a rather high level of authority after the incorporation of the Act.³⁸ According to Delpont, when a director exceed his or her authority, the director would be deemed to have not acted with a proper purpose and therefore in breach of his or her fiduciary duties. When a director therefore contravenes any legislation by exceeding the authority that the Act bestows on that director, that director will act in breach of his or her fiduciary duties. This is particularly relevant in instances of directors of State Owned Entities such as Schedule 2, 3B and 3D public entities.³⁹ These entities are governed by what is called the 'accounting authority' (which relates to the board of directors) in terms of the Public Finance Management Act, Act 1 of 1999 and the Public Finance Management Act and Regulations prescribe the authority of the directors. These entities also, in most cases, are regulated by an establishing Act, which regulates the authority of the board of directors (accounting authority).⁴⁰ Therefore a contravention of these different Acts in the manner described would constitute a breach by a director of his or her fiduciary duties.

2.2.2 the duty to act with care, skill and diligence

As cited above, section 76(3)(c) requires of a director to act with care, skill and diligence. The common law requires of a director to exhibit the performance of his or

³⁸ See in this regard Delpont *supra* at p252 where he argues that section 66(1) of the Act – that the business and affairs of the company is managed by or under the direction of the board – means that the board has a very wide authority with regards to companies and could even include the authority to decide over the 'life and death of a company'.

³⁹ Schedules to the Public Finance Management Act, Act 1 of 1999.

⁴⁰ Examples of these include the Development Bank of Southern Africa Act, Act 13 of 1997 and Broadband Infracore Act, Act 33 of 2007.

her duties with a degree of care and skill which the circumstances may reasonably require taking into account that particular director's knowledge and experience.⁴¹

I believe it is important for the purpose of this dissertation to include a quick summary of how the duty of care and skill developed in the South African common law context.

When the duty of directors to act with care and skill was first heard in cases such as the *Turquand-case*⁴², *Overend-case*⁴³, *Cardiff Savings Banks-case*⁴⁴ and the *National Bank of Wales-case*⁴⁵ the courts was very hesitant to hold a director liable for mere errors of judgment and where gross negligence was not present⁴⁶. *Bekink*⁴⁷ summarizes it as follows with reference to the *Overend-case*⁴⁸:

"For a director to have been sufficiently negligent, he would have had to have been cognisant of circumstances of such character, so plain, so manifest, and so simple of appreciation, that no men with an ordinary degree of prudence, acting on their behalf would have acted accordingly"

These decisions was mostly followed and placed high judicial flexibility on what the courts required from a director with respect to care and skill as it relates to the director's qualifications and experience as well as the court's reluctance to interfere with the management of companies⁴⁹.

⁴¹ See *In Re Equitable Fire Insurance Co Ltd* 1925 (1) Ch 407 CA at 427–429 and *Fisheries Development Corporation of SA Ltd v Jorgensen* 1980 (4) SA 156 W at 165–166.

⁴² *Turquand v Marshall* 1869 LR 4 App 376 (Ch D).

⁴³ *Overend & Gurney Co v Gibb* 1872 LR 5 HL 480 (HL).

⁴⁴ *Re Cardiff Saving Banks* 1892 2 Ch 100 (Ch D).

⁴⁵ *Re National Bank of Wales Ltd* 1899 2 Ch 629 (CA).

⁴⁶ Mildred Bekink "An historical overview of the director's duty of care and skill: from the nineteenth century to the Companies Bill of 2007" (2008) 20 SA Merc 95 at 97.

⁴⁷ Mildred Bekink *Supra* at 97.

⁴⁸ *Supra* at 487.

⁴⁹ See *Re Equitable Fire Insurance Co Ltd* 1925 1 Ch 407 (CA).

In the South African perspective, the common law duty of care and skill was summarised in *Fisheries Development Corporation of SA Ltd v Jorgensen & Another*; *Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd & Others* by Margo J (while citing the above English common law cases) as follows⁵⁰:

“Nor is he (a director) required to have special business acumen or expertise, or singular ability or intelligence, or even experience in the business of the company” and “He is nevertheless expected to exercise the care which can reasonably be expected of a person with his knowledge and experience” and “A director is not liable for mere errors of judgment” (my parenthesis added).

At this point, the courts relied mostly on the subjective test and excused those directors who, because of their lack of knowledge or a particular skill, caused damage to the company resulting from ill-informed decisions. Therefore, the lower the skills a particular director has, the more he might be excused for not delivering an appropriate standard of care. Cassim criticized this situation and calls it paradoxical for a director’s incompetence to come to his rescue when he or she is sued for liability under his or her duty of care and skill.⁵¹

In England, this *lacuna* in the law was addressed by the companies court in the *Re D’Jan of London Ltd*⁵² case in 1993 when the court applied a test similar to what the English Insolvency Act at that point required with both objective and subjective elements.⁵³ The wording of the test developed in the *D’Jan of London Ltd* case correspond word for word with the test proposed in the 2007 Companies Bill.⁵⁴

⁵⁰ 1980 (4) SA 156 (W) at 156

⁵¹ Cassim *supra* at 555.

⁵² 1993 BCC 646 Ch D (Companies Court).

⁵³ Section 214(4) of the Insolvency Act 1986 (c. 45) as referenced by Natasha Bouwman “An Appraisal of the Modification of the Director’s Duty of Care and Skill” SA Mercantile law journal 21 (2009) at 512.

⁵⁴ See Natasha Bouwman *supra* at 512.

In the South-African context, this issue was first addressed in the banking sector after the fourth amendment of the Banks Act⁵⁵ promulgated in 2003 which included section 40(b) of the amendment Act substituting the wording now found in section 60(1A) of the Act and reads as follows:

*“each director, chief executive officer and executive officer of a bank owes a duty towards the bank to—
(c) possess and maintain the knowledge and skill that may reasonably be expected of a person holding a similar appointment and carrying out similar functions as are carried out by the director, chief executive officer or executive officer of that bank”*

In the Banks Act therefore, a more objective approach was developed requiring directors and other persons to ‘possess and maintain the knowledge and skill...’ This implies a positive duty on directors to ensure that they are and stay updated on the skill and knowledge required for their function.

Section 76(3)(c) of the Act now states that a director must exercise powers and perform functions:

*“(c) with the degree of care, skill and diligence that may reasonably be expected of a person—
(i) carrying out the same functions in relation to the company as those carried out by that director; and
(ii) having the general knowledge, skill and experience of that director”*

According to Delpont⁵⁶ the objective test envisioned by subsection (i) sets the objective standard while the subjective test envisioned by subsection (ii) sets the subjective minimum raised from the objective standard taking into account the particular director’s general knowledge, skill and experience.

⁵⁵ Act 94 of 1990 and amendment Act 19 of 2003.

⁵⁶ *Supra at 295*

The question now arise: is a director required to know of and do something about each and every section of legislation that applies to his or her organisation? Can a director be held liable if the corporation fails to comply with applicable legislation based on his or her fiduciary duty to act in good faith, in the best interest of the company for a proper purpose or alternatively, based on his or her duty to act with care, skill and diligence? Surely in the South-African perspective we cannot expect such a high standard from company directors, especially taking into account the legion of Acts and Regulations that is active in South-Africa? To be able to answer this question, we need to assess what best practice in the form of the third King report on corporate governance requires from South-African directors. This is discussed in the next chapter.

Chapter 3: Compliance requirements of King III

3.1 the third King report on corporate governance: introduction

The first King report on corporate governance was published in 29 November 1994 by the institute of directors chaired by Mervyn King and aimed to introduce a 'best practice' for corporate governance practices in South-Africa following the governance scandals reported all over the world.⁵⁷

In March 2002 a second report on corporate governance was published commonly referred to as King II, which expanded on King I. It is critical for the purpose of this dissertation to mention that neither King I nor King II was law and functioned on the principle of 'comply or explain'.⁵⁸ King II only applied to public companies listed on the Johannesburg Stock Exchange as well as companies such as banks and financial/insurance companies.⁵⁹ King III was introduced on 1 September 2009 and as explained in the report itself, was necessitated by i) the new Companies Act (which at that point was enacted, but not yet promulgated) and ii) 'changes in the international governance trends'.⁶⁰ King III again is not law, but functions on the principle of 'apply or explain' as adopted from the Netherlands Code of Good Corporate Governance, again as explained by the third King Report. The reason for moving away from a 'comply or explain basis' is rooted in the hope that a regime of 'apply or explain' will offer a more dynamic approach to corporate governance requiring application of the mind when the

⁵⁷ See in general Cassim *supra* at 473; Natasha Bouwman "An Appraisal of the Modification of the Director's Duty of Care and Skill" SA Mercantile law journal 21 (2009) at 518.

⁵⁸ See in general Delpont *supra* at 298 and Natasha Bouwman *supra* at 518.

⁵⁹ 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) at page 449.

⁶⁰ The King Report on Corporate Governance for South Africa (Institute of Directors in Southern Africa) September 2009.

principles are considered on a company level.⁶¹ King III became effective from 1 March 2010 and applies to all companies.

3.2 Director duties as referenced in the King Reports

It is important to note that before the new Companies Act or the 2003 amendment of the Banks Act was enacted and while our common law took a very subjective approach to director's duty of care and skill as explained above in chapter 2, King II considered the international best practice and introduced a mixture of objective and subjective elements to the test that we see currently in the Act as mentioned in chapter 2. King II determined that directors must not only exhibit the degree of care and skill that may be reasonably expected from persons of their skill and experience,⁶² but that directors must also:⁶³

“exercise care and skill that any reasonable person would be expected to show in looking after their own affairs, as well as having regard to their actual knowledge and experience, and qualify themselves on a continuous basis with a sufficient, or at least general, understanding of the company's business and the effect of the economy so as to discharge their duties properly, including where necessary relying on expert evidence”

According to King III, the fiduciary duties of a director and the duty to act with care, skill and diligence hinges not only on compliance with law and states that governance codes and guidelines will be relevant to determine what is regarded as an appropriate standard of conduct for directors.⁶⁴ King III suggest the role it plays in the scope of director duties is to determine the standard of conduct against which the conduct of directors will be measured when a determination is made if they complied with their duties. Natasha Bouwman suggests that King III will 'raise perceptions of what are

⁶¹ King Report on Corporate Governance for South Africa 2009 *supra*.

⁶² See Natasha Bouwman *supra* at 518 & 519.

⁶³ The King Report on Corporate Governance for South Africa (Institute of Directors in Southern Africa) March 2002.

⁶⁴ King Report on Corporate Governance for South Africa 2009 *supra*.

regarded as the appropriate standards of director conduct' and that 'Courts will regard director conduct in line with established corporate governance practices as meeting the required standard of care'.⁶⁵ This is critical to mention for the purpose of chapter 4 below.

3.3 King III, Chapter 6: Compliance with laws, rules, codes and standards

In determining a director's duty to comply with the applicable legislation, it is paramount to mention the duties of the board with regards to compliance as outlined in chapter 6 of King III in order to establish the standard of director conduct relating to his or her duty to ensure that a company complies with applicable legislation. For the purpose of this dissertation, I will go into each of the four principles mentioned in chapter 6 of King III and discuss the implications thereof relevant to this dissertation.

3.3.1 the board should ensure that the company complies with applicable laws and consider adherence to non-binding rules, codes and standards⁶⁶

This is the first principle of compliance and consists *inter alia* of the following sub-principles:

- 1. Companies must comply with all applicable laws.*
- 2. Exceptions permitted in law and shortcomings in the law that present an opportunity for abuse which is contrary to the spirit, intent and purpose of the law, as well as proposed changes expected in legislation and regulation, should be handled in an ethical and responsible manner.*
- 3. Corporate governance is the expression of ethical values and standards. As such, compliance should also be understood to be an ethical imperative for the governance of companies. Consequently, in some countries, as in the United States, the offices of ethics and compliance are combined.*

⁶⁵ *Supra* at 520.

⁶⁶ King Report on Corporate Governance for South Africa 2009 *supra*.

6. The board should consider adherence to applicable non-binding rules, codes and standards if it would constitute good governance and practice. The board should disclose in the integrated report the applicable non-binding rules, codes and standards to which the company adheres on a voluntary basis.

7. The board is responsible for the company's compliance with applicable laws and with those non-binding rules, codes and standards with which the company elected to comply.

One of the important responsibilities of the board is therefore to monitor the company's compliance with all applicable laws, rules, codes and standards.

8. Compliance with applicable laws, rules, codes and standards should be proactively and systematically managed by companies and compliance should be a regular item on the agenda of the board even if this responsibility is delegated to a separate committee or function within the organisational structure.

Sub-principle 6.1 provides an introduction into the standard of conduct required from directors and already it's clear that the standard required is very high and quite onerous. It is respectfully submitted that no one company in South Africa complies with each and every piece of legislation applicable to that specific company.

Sub-principle 6.1.6 for example requires that companies consider compliance with non-binding rules codes and standards, but given the fact that companies in practice already have difficulty ensuring that they comply with binding rules, this requirement is generally ignored in practice.

Sub-principle 6.1.7 makes it clear that it is the board of the company who is responsible for ensuring that a company complies with applicable laws and regulations. Sub-principle 6.1.8 introduces a concept that will form a major part of compliance risk management, i.e. that compliance should be proactively and systematically managed. Currently, for a lot of companies in South Africa, compliance risks are managed mostly in a reactive manner where the board is only made aware of compliance breaches after they occur and the resulting risk is only managed once the non-compliance occurred. This reactive approach to risk management is not very effective for obvious reasons. It

reminds you of the story where the Dutch boy use his best efforts to stop the wall from bursting by putting his fingers in the holes of the wall. Sub-principle 6.1.8 seeks to address that very issue by requiring that companies implement proactive systems to identify all applicable compliance requirements and then design controls to ensure compliance.

3.3.2 the board and each individual director should have a working understanding of the effect of the applicable laws, rules, codes and standards on the company and its business

The second principle of compliance consist of three sub-principles:

11. The board has a duty to take the necessary steps to ensure the identification of the laws, rules, codes and standards applicable to the company.

12. Processes should be in place to ensure that the board is continually informed of relevant laws, rules, codes and standards, including changes to them, as part of their induction and ongoing training and education.

13. Directors should sufficiently familiarise themselves with the general content of applicable laws, rules, codes and standards to be able to adequately discharge their fiduciary duties in the best interests of the company and their duty of care, skill and diligence. Included in this duty is to make use of the rights and protection that the law presents in the best interests of the company.

In principle 6.2, we see a focus on the duty of the board to ensure that the company is informed about the compliance risks that may materialise. Again, the duty of the board is emphasised. In sub-principle 6.2.13 the duty of directors to inform themselves on the content of applicable laws, rules and codes are mentioned in specific relation to their fiduciary duties and duty of care, skill and diligence. This therefore sets the standard of director conduct to one where directors are required to not merely be informed, but to be familiar with the general content of laws applicable to the organisation. This is quite

important when considering the fact that historically, directors have been able to escape liability based on the fact that they weren't informed or expected to be informed about risks facing the company as we saw in chapter 2 above.

3.3.3 Compliance risk should form an integral part of the company's risk management process

The third principle of compliance consist of three sub-principles:

14. Compliance risk can be described as the risk of damage, arising from non-adherence to the law and regulations, to the company's business model, objectives, reputation, going concern, stakeholder relationships or sustainability.

15. The risks of non-compliance should be identified, assessed and responded to through the company's risk management processes. Although a systematic risk management approach to compliance is advised, this does not imply that compliance is optional depending on whether the risk assessment warrants it. Compliance is compulsory in keeping with Principle 6.1, while the risk management framework provides an appropriate system for the management, monitoring and reporting thereof.

16. As part of the broader risk management structure, a compliance function provides assistance to the board and management in complying with applicable laws, rules, codes and standards.

This principle warrants directors to ensure that the company has a proper system of risk management to ensure that applicable laws are complied with. This takes the standard of director conduct even further and requires that directors who familiarised themselves with applicable laws, should develop a system that actively manages the risks posed by potential non-compliance and, moreover, have appropriate monitoring and reporting structures to manage the identified control environment. Monitoring compliance risks has certain practical implications such as full time compliance officers to execute the monitoring endeavors and which drives the cost of compliance up quite high.

3.3.4 the board should delegate to management the implementation of an effective compliance framework and processes

The fourth principle of compliance consist *inter alia* of the following sub-principles:

17. Management should develop the compliance policy and the board should approve it. Management should be responsible for implementing this policy and reporting to the board regarding compliance with it.

19. A company's procedures and control framework should incorporate compliance with relevant laws, rules, codes and standards and the board should receive assurance on the effectiveness of the procedures and control framework.

21. A compliance culture should be encouraged through leadership, establishing the appropriate structures, education and training, communication, and measurement of key performance indicators relevant to compliance.

24. The compliance function should have adequate resources to discharge its responsibilities.

26. Where the role of in-house legal adviser or counsel is combined with that of compliance officer, company secretary or other similar position, companies should exercise due care that the common law right of privilege is not compromised when the officer acts in a capacity other than legal adviser.

The common law right of privilege is available to a client when approaching a legal adviser for legal advice about a court matter.

This principle and sub-principles go a step further in raising the standard of director conduct by requiring the board to test the effectiveness of the compliance function. The board should therefore not only have systems in place to mitigate the risk of non-compliance, but those systems should be assessed from time to time to ensure that they are indeed effective. Sub-principle 6.4.21 requires a compliance culture to be established with a top down approach starting with the leadership (directors and managerial staff) of the company. This again is a loaded statement. South Africa is certainly not world renowned for the culture of compliance that exists within its four

corners. Compliance works when the board has a mature culture of compliance, which naturally flows down to lower management and employees. If compliance is a mere mechanical process by the board to ‘seem compliant’ for investment reliability purposes without any real desire to comply, the systems and process implemented will be followed mechanically and will likely not be effective.

It however also needs to be mentioned that these requirements are quite onerous and can be very costly for directors to ‘apply’ in their organisations. Botha criticize the King report on this aspect and states that:⁶⁷

If compliance brings fewer benefits and more costs to a corporation, compliance would then cease to be value-maximizing behaviour and should be discouraged, rather than encouraged, by a fully informed market. In fact, a well functioning and efficient market is not likely to enforce a code of corporate practices and conduct unless it is also value maximizing.

The word ‘compliance’ that Botha refers to is used in the context of compliance with the King code, but makes out a good argument and certainly reflects the attitude toward the King code in practice.

For the purpose of this dissertation, it warrants me to mention that King III provides leeway by allowing directors, when pursuing to discharge their fiduciary duties toward the company, to decide not to apply a principle of King III when it is regarded not to be in the best interest of the company. Directors however still need to achieve the overarching principles of fairness, accountability, responsibility and transparency. In the context of compliance with applicable laws, directors will therefore be able to circumvent the onerous procedures prescribed by King III, but should still apply the underlying principles to ensure that their company complies.⁶⁸

⁶⁷ Botha “Confusion in the King Report” SA Merc LJ 1996 (8) at 38.

⁶⁸ King Report on Corporate Governance for South Africa 2009 *supra* as mentioned by Natasha Bouwman *supra* at 520.

The above procedures prescribed in principle 6 and sub-principles can be argued to have an overwhelming focus on implementing processes and systems to ensure that a company does not contravene applicable legislation. Contravening these processes and systems will therefore not result in the liability of a director for the breach of their duties, since at this point, companies have not necessarily contravened any law. The issue of liability will only surface when a company indeed contravenes legislation, but when this happens, the processes and systems implemented by directors may be a crucial determinant of whether or not such directors properly discharged their duties toward the company. At such a point, directors might have to provide an indication of the processes and systems they developed either in line with what King III prescribes, or something else more fitting for their company, to ensure that such a company complies with applicable legislation.

Chapter 4: The role of the Courts in determining the standard of director duties

4.1 Introduction

As explained in chapter 3 above, King III is not law, but represents a governance best practice for corporations to follow. In this Chapter I will look back at the relevant director duties as examined in Chapter 2 above as well as what King III requires. I will further investigate Natasha Bouwman's statement that King III raises perceptions of what are regarded as the appropriate standards of director conduct and that Courts will regard director conduct in line with established corporate governance practices as meeting the required standard of care.⁶⁹ Because of the open ever-evolving nature of director duties, the Courts will have to look at popular modern opinion on what director duties constitute and against what it should be benchmarked. The King Report explains:⁷⁰

"In addition to compliance with legislation, the criteria of good governance, governance codes and guidelines will be relevant to determine what is regarded as an appropriate standard of conduct for directors. The more established certain governance practices become, the more likely a court would regard conduct that conforms with these practices as meeting the required standard of care. Corporate governance practices, codes and guidelines therefore lift the bar of what are regarded as appropriate standards of conduct. Consequently, any failure to meet a recognised standard of governance, albeit not legislated, may render a board or individual director liable at law"

The question therefore remains, how will courts interpret the standard of director duties and to what extent will the courts use the standard set by the King code when determining if a director properly discharged his/her duties?

⁶⁹ *Supra at 570.*

⁷⁰ King Report on Corporate Governance for South Africa 2009 *supra* as mentioned by Delpont and Esser *supra at 450.*

4.2 Minister of Water Affairs and Forestry v Stilfontein Gold Mining Co Ltd⁷¹

During the mining operations of the Stilfontein Gold Mining Co Ltd (Stilfontein), an environmental risk developed where if Stilfontein did not make certain investments to raise the water level and treat it appropriately, it would result in the pollution of underground water resources. The Minister of Water Affairs issued certain directives in accordance with section 19 of the National Water Act No. 36 of 1998 aimed at remedying the effects of pollution caused by the Stilfontein mining operations.⁷² After Stilfontein failed to comply with these directives, the Minister obtained judgment on the 18th of May 2005 to order Stilfontein to comply.⁷³ On the 17th of June 2005 all the directors of Stilfontein decided to resign at once without complying with the court ordered directive to treat the polluted water. The Minister of Water Affairs applied to the Witwatersrand division of the High Court (as it was then known) for an order that the directors are in contempt of court and should be punished accordingly.

The court then had to deal with two issues: the first being if the directors breached their duties by resigning simultaneously, and second the issue of social responsibility and to whom directors owe their duties.⁷⁴ For the purpose of this chapter, I will deal with the second issue and the approach taken by the court in that regard. The underlying question was one that has been debated for the past century: should a company only look out for its own interest (which broadly translates to the interests of the shareholders) the so-called shareholder value approach, or should a company also take into consideration the interest of society as a whole – the so-called pluralistic or stakeholder approach. According to King III, a company should take into account the interest of its shareholders, its employees and the environment, commonly referred to as the triple bottom line.

⁷¹ (2006) 5 SA 333 (W).

⁷² Stilfontein case *supra* at par 14.5

⁷³ Stilfontein case *supra* at par 6

⁷⁴ See Delpont and Esser *supra* at 451.

The court in the Stilfontein case therefore examined the conduct of the directors and had to determine if the mass resignation of the directors especially in this context – leaving the corporation ‘rudderless’ when compliance is required from it to prevent disastrous effects on the environment – was a proper exercise of their duties. When making this determination, the court looked to King III for the standard of care that directors should use when the interest of the environment is at stake. This is clear from the following passages:⁷⁵

“Practicing sound corporate governance is essential for the well being of a company and is in the best interests of the growth of this country’s economy especially in attracting new investments. To this end the corporate community within South Africa has widely and almost uniformly accepted the findings and recommendations of the King Committee on Corporate Governance – see King Report on Corporate Governance for South Africa – March 2002”

and:

“The conduct of the second to fifth respondents fly in the face of everything recommended in the code of corporate practices and conduct recommended by the King Committee. In my view the second to fifth respondents acted irresponsibly in merely abandoning the first respondent, a listed company of which they were the directors”

The court referenced the second King report (which was in place at the time of the judgment) as follows:⁷⁶

“A well-managed company will be aware of, and respond to, social issues, placing a high priority on ethical standards. A good corporate citizen is increasingly seen as one that is non-discriminatory, non-exploitative, and responsible with regard to environmental and human rights issues. A company is likely to experience indirect economic benefits such as improved productivity and corporate reputation by taking those factors into consideration.”

⁷⁵ Stilfontein-case *supra* at par 16.7

⁷⁶ Stilfontein-case *supra* at par 16.9

According to Delpont and Esser,⁷⁷ even should the issue of resignation not have been present, but the directors non-the less acted without regard to the environment, the court would still have decided that the directors acted contrary to their duties.

The court therefore clearly used the second King report and the standard of director care suggested therein to make the determination that the directors did not discharge their duties properly by not having regard to the environment.

The Stilfontein-case was decided on the 1973 Companies Act. According to Delpont and Esser,⁷⁸ using the King report to test for breach of duties could have far reaching consequences in the 2008 Companies Act since director duties is partly codified in the 2008 Companies Act and moreover because a person can be held liable in terms of Section 218(2) for non-compliance with the Companies Act. Section 218(2) of the Companies Act states the following:

“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”

This section will allow third parties an action against directors personally.

Section 77 of the Act also makes provision for the company to hold a director liable for any loss, damage or costs sustained by the company as a result of the director’s breach of his or her duties.⁷⁹

Delpont and Esser summaries it as follows:

“Currently it is only the company that can have recourse against the specific director for breach of fiduciary duties and duties of care and skill but, due to section 218(2) of the 2008 Companies Act, this may change. In terms of section 218(2) a person will also have a claim against, for example, the directors,

⁷⁷ See Delpont and Esser *supra* at 452.

⁷⁸ See Delpont and Esser *supra* at 452.

⁷⁹ See Delpont *supra* at 301.

as any person who contravenes any provision of the 2008 Companies Act is liable to any other person (which could also include the company itself) for any loss or damage suffered by that person as a result of that contravention. Directors' duties are codified in the 2008 Companies Act and a director who breaches these duties can therefore be accountable, in addition to the liability in section 77, to the company, even to third parties, as it is surely a contravention of a provision of the 2008 Companies Act. In addition, these statutory duties also extend to certain "management positions" and the prescribed officers"

When we determine the effect of the Stilfontein-case on the aspects of a director's duty to ensure that his/her corporation complies with applicable legislation, the following should be remarked:

- i. When we use King III to test whether a director discharged his or her compliance duties properly, we need to consider the high level/standard of care proposed in King III when it regards compliance with applicable legislation as referred to in Chapter 3. In such a test, directors will be assumed to have 'established structures and processes to discharge their legal responsibilities, and oversee compliance with legislation'. This implies a rather costly exercise when considering the high amount of legislation that will apply to different types of organisations and the process of sifting through all potentially applicable Acts and regulations to get to a list of Acts and regulations that apply to the organisation. The most costly for an organisation however will most likely be the process to ensure that proper systems of risk management is implemented taking into consideration each and every compliance requirement encapsulated in the different pieces of legislation that applies to an organisation. In absolute terms, there is probably no director in any organisation in South Africa that complies with this standard of director duty.
- ii. The second remark prevalent to the above proposed standard of director duties is that should an organisation contravene any piece of legislation, it is not only the organisation internally that can hold its directors liable for not discharging

their duties properly, but a third party will also have a right of recourse against directors. In most cases in practice, third parties who have a decision to either sue the company or the directors for loss suffered, would choose to sue the company because it generally has bigger coffers to raid. In situations where the company doesn't have any money or assets to take a hold of (such as in the event of factual insolvency) the third party will now have the option to sue the directors for the damage suffered as a result of the corporation's non adherence to applicable legislation as provided for in section 218(2) of the Companies Act.

Chapter 5: Possible application of the ‘Business Judgment Rule’

Up to now, it was pointed out that Directors has a duty to ensure that its organisations comply with applicable legislation and that it will likely be expected to apply the suggestions of King III in order to ensure compliance. The logical next question that should be raised is can a director be excused in the event that his/her organisation contravenes applicable legislation in pursuance of business opportunities on the basis of the so-called ‘Business Judgment Rule’?

According to section 76(4) of the Companies Act:

“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”

Section 76(4) incorporates the ‘Business Judgment Rule’, which originated in the United States into South African law.⁸⁰ The purpose of the rule is to protect directors who engage in risky business activities necessary for the advancement of their organisation, which may at times – due to the nature of the risks involved – culminate in adverse

⁸⁰ Kennedy-Good & Coetzee “The Business Judgment Rule (Part I)” (2006) 27 *Obiter* at 64.

effects for the organisation. The rule will protect directors who made a decision in good faith, with care and on an informed basis, which the director reasonably believed was in the best interest of the organisation.⁸¹

Before the rule was incorporated in the Companies Act, it was a suggestion in the second King report for the rule to be incorporated and the reasons therefore included the onerous nature of directors' duties in the South African context. These reasons was severely criticized by Botha and Jooste⁸² who argued that the degree of care and skill required of South African directors were 'lamentably low' in contradiction to what the report noted. Botha and Jooste also argued against the incorporation of the rule in the South African context citing the international trend regarding the rule.⁸³ The incorporation of the rule was mostly criticised prior to its incorporation by academic writers.⁸⁴

The purpose of this dissertation, however, is not to examine the working of the rule in the South African context, but merely to point out that a director will in any event likely not be able to rely on section 76(4) to excuse his non-compliance with applicable legislation. Section 76(4)(a)(i) requires that a director should have taken the reasonably diligent steps to become informed about the matter. The words 'reasonably diligent steps' are not defined and will have to be interpreted by the Court. It has been suggested that if this matter of 'reasonable diligent steps' is considered in the context

⁸¹ Kennedy-Good *supra* at 64.

⁸² Botha and Jooste "A Critique of the Recommendations in the King Report Regarding a Directors Duty of Care and Skill" 1997 114 SALJ 76.

⁸³ *Supra*.

⁸⁴ See in this regard Natasha Bouwman "An Appraisal of the Modification of the Directors' Duty of Care and Skill" (2009) SA Merc LJ at pages 509 529-531; Jones "Directors' Duties: Negligence and the Business Judgment Rule" (2007) SA Merc LJ at pages 332-333; Kennedy-Good & Coetzee "The Business Judgment Rule (Part II)" (2006) *Obiter* at pages 277-291.

of the *Lex Aquilia*, it can be addressed by asking what public opinion would demand in each individual case.⁸⁵

An important case in this respect from an international point of view is one decided by the Federal Court of Australia in Australian Securities and Investment Commission (ASIC) v Healey⁸⁶ where the court held directors liable for being in breach of their directors duties by not making an informed decision and by not applying themselves diligently with an inquiring mind in order to inform their opinions. Judge Middleton held as follows:⁸⁷

“What each director is expected to do is to take a diligent and intelligent interest in the information available to him or her, to understand that information, and apply an enquiring mind to the responsibilities placed upon him or her... Because of their nature and importance, the directors must understand and focus upon the content of financial statements, and if necessary, make further enquiries if matters revealed in these financial statements call for such enquiries.”

In the context of compliance with applicable legislation, the Court, when considering the best practice, may consider the principles proposed in Chapter 6 of the King Code outlined in Chapter 3 and argued in Chapter 4 and 5 above as what public opinion demands. This is not entirely clear at this stage and will need to be considered by the Courts. What is clear, however, is that a degree of diligence will be expected from directors to be informed regarding the laws that apply to their organisation. When a corporation therefore contravenes legislation, it should be difficult for a director to argue section 76(4) – the fact that he or she ignorantly decided to pursue a business opportunity in the interest of the organisation, that turned out to be in contravention with the law – as a reason why his/her non-compliance should be tolerated especially if the test in *Asic v Healey* above is applied.

⁸⁵ Lindy Muswaka “Shielding Directors against Liability Imputations: The Business Judgment Rule and Good Corporate Governance” (2013) *Speculum Juris* (1) at page 27.

⁸⁶ (2011) FCA 717.

⁸⁷ *Supra* at par 20.

Moreover, the requirements listed in section 76(4)(a) should be seen as conjunctive in nature since it is separated by the word 'and', which implies that if the first requirement (that of an informed decision) is not met, the Business Judgment Rule should not be applied.⁸⁸

⁸⁸ See in this regard Lindy Muswaka *supra* at page 27 where the point is neatly summarised as follows *"Business decisions therefore exist alongside these duties which are entirely separate and distinct, although complementary concept. A separate analysis of whether or not a director has complied with these duties is always necessary. These duties apply whether or not a business judgment has been made. For instance, if the directors fail to monitor the affairs of the company, there could be liability under the duty of care, skill and diligence and the business judgment rule would have no application"*.

Chapter 6: Conclusion

It was argued both on the basis of a director's fiduciary as well as care and skill duties that directors have a duty to ensure that the organisation complies with applicable legislation.

The consequence of this is clear: if a company contravenes legislation, questions will be asked about the steps taken by the directors to ensure that the company complies with the legislation and the adverse effect of non-compliance (such as loss, damage or costs) may well be directed toward the directors personally for breach of their duties not only by the company itself in terms of section 77 of the Companies Act but also by third parties in terms of section 218(2) of the Companies Act.

The exercise of the duties of company directors will likely be compared with what King III requires and in the context of this dissertation, what chapter 6 requires in the light of compliance. The Stilfontein-case gives the impression that King II (applicable at that point) is the benchmark against which directors should exercise their duties.

Directors, in my view, will not be able to make use of the business judgment rule to excuse them when they have not properly exercised their duty to ensure the company complies with applicable legislation, since the business judgment rule is defeated by ignorance.

I will now briefly refer to a situation alluded to earlier in chapter 2 when I discussed the inclusion of the term 'prescribed officer' in the definition of a director for the purposes of section 76 of the Companies Act as well as the argument that this will most likely include the company secretary. According to section 88(2) of the Companies Act:

“A company secretary’s duties include, but are not restricted to—

- (a) providing the directors of the company collectively and individually with guidance as to their duties, responsibilities and powers;
- (b) making the directors aware of any law relevant to or affecting the company;
- (c) reporting to the company’s board any failure on the part of the company or a director to comply with the Memorandum of Incorporation or rules of the company or this Act;
- (d) ensuring that minutes of all shareholders meetings, board meetings and the meetings of any committees of the directors, or of the company’s audit committee, are properly recorded in accordance with this Act;
- (e) certifying in the company’s annual financial statements whether the company has filed required returns and notices in terms of this Act, and whether all such returns and notices appear to be true, correct and up to date;
- (f) ensuring that a copy of the company’s annual financial statements is sent, in accordance with this Act, to every person who is entitled to it; and
- (g) carrying out the functions of a person designated in terms of section 33 (3)”

In the light of the topic discussed in this dissertation – i.e. the duties of ‘directors’ to ensure that their company complies with applicable legislation – the duties of the company secretary listed above may prove to be quite problematic, especially in the light of the argument that the company secretary is also a prescribed officer and therefore owe fiduciary duties as well as the duty to act with care, skill and diligence toward the company in addition to the section 88 duties. Section 88(2)(b) is especially relevant since it requires the company secretary to inform the directors of any law ‘relevant to or affecting the company’. The Act doesn’t provide any guidance on the meaning of the word ‘inform’, but we can assume it goes beyond just identifying the names of the Acts that is relevant to or affecting the company. If one draws from the insights provided in Chapter 4, one could argue that the Courts will use the standard set in King III – i.e. the systems and processes recommended for adoption by companies to be informed about the compliance risks related to applicable legislation – when they interpret the word ‘inform’. A person accepting company secretaryship can

therefore by reason of his or her explicit compliance duties and embodiment of a 'prescribed officer' role for the company be held liable either by the company itself⁸⁹ or by a third party⁹⁰ when the company suffers loss, damage or costs as a result of contravening applicable legislation.

This is one example from the law discussed in this dissertation, but depending on how a company is structured and to whom the duties of compliance are delegated and in what position of trust such a person stand, it could virtually be any person in the company who can be determined to be a prescribed officer as defined. Company directors and officers therefore should ensure that they have a robust and mature system in order to:

- i) Be aware of and understand the consequences of the legislation that applies to the company;
- ii) Have a risk management plan to address the risks of non-compliance; and
- iii) Prioritise the risks in such a manner to enable the delegated officials to monitor the identified risks in an efficient and effective manner taking into account the obscene amount of legislation active in the South African context.

⁸⁹ In terms of section 77 of the Companies Act.

⁹⁰ In terms of section 218(2) of the Companies Act.

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