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**Declaration**

I, Luthfiya Essop, hereby declare that the work on which this thesis is based is my original work (except where acknowledgements indicate otherwise) and that neither the whole work nor any part of it has been, is being, or is to be submitted for another degree in this or any other University.

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## Abstract

This paper aims to expose the common law directors' duties of care and skill encapsulated under the South African commercial law. Thereafter an in depth analysis of the newly introduced statutory duty of care, skill and diligence contained in section 76(3)(c) of the South African Companies Act 2008, which replaced the Companies Act 61 of 1973. Lastly the focus will shift to the origin and application of the business judgment rule which was previously unknown to our legislature and freshly introduced under the provisions of section 76(4) of the Companies Act 2008. A historic overview will commence in introducing the common law duties of care and skill, there after moving to the judiciaries in which South Africa followed in moulding the partial codification of directors duties of care, skill and diligence encompassed in the Companies Act 2008. An evaluation to the newly hybrid stringent test adopted in our statute as opposed to the common law lenient view shall also be exposed. The forth chapter will focus on the "safe-harbour" which is provided for in the business judgment rule which focuses on more than just shielding directors who act in good faith with the requisites encompassed under the provisions of section 76. A synopsis will also be carried out to the American based business judgment rule which our South African law has adopted as well as the critique and reviewing factors of the South African modelled business judgment rule. After outlining the crux of each chapter a condensed summary into the topic at hand will be explained.

## **CHAPTER 1**

### **1.1 THE TITLE**

“A focus on directors’ duties of care, skill and diligence in terms of the common law and the Companies Act 71 of 2008.”

### **1.2 THE TOPIC**

The topic which will be researched and exposed orbits around an overview of the duties of a director, namely that of care, skill and diligence in terms of the common law and statute with particular reference to the Companies Act 71 of 2008. An exposition of the newly introduced business judgment rule formulated under the provisions of section 76(4) shall also be focussed on, observing the requisites necessary in order for a director who acts in good faith to be afforded the protection of the rule.

### **1.3 THE RESEARCH DESIGN AND METHODOLOGY**

The research methodology for this dissertation is desk-based and the information in respect of directors’ duties of care, skill and diligence as well as the business judgment rule will be distilled from case law, statutes, journal articles, textbooks and numerous internet data bases such as: Juta; Lexis Nexis; Hein online; SAFLII; Sabinet and Butterworths Company Law Cases (BCLC).

A qualitative approach will be administered in this research to entail exploring the crux of the common law and statutory law duties of care, skill and diligence together with the consequences of failing to carrying out such duties. A topic ancillary to the duties of care, skill and diligence, namely that of the business judgment rule will also be explored.

Particular reference shall be made to the South African Commercial law; particularly the Companies Act 71 of 2008 and the common law. In citing the Companies Act 2008, priority will be attached to the directors’ duties of care, skill and diligence as well as the business judgment rule, its critiques and pros and cons.

## 1.4 SCOPE OF THE DISSERTATION

1.4.1 This dissertation addresses the South African Commercial Law with reference to the duty of care, skill and diligence in both, common law and statute, the arguments for and against its codification and lastly the business judgment rule with an overview of the jurisdiction that our law followed in enacting the business judgment rule into the Companies Act 71 of 2008.

1.4.2 Even though the courts still have regard to the common law including ascending year's case law regarding directors' duties of care and skill, there are recommendations and changes to the current legislation which will be focussed at including the criticisms which arise as a result of the partial codification of directors' duties of care, skill and diligence encompassed in the Companies Act 71 of 2008.

1.4.3 The general principle is that directors are liable for damages which emanate from their negligence in the performance of their duties of care and skill. As a consequence of being in the position as director the directors have a duty to exercise and perform such duties with care, skill and diligence, ultimately for the best interest of the company. The South African judiciary has adopted a very benevolent attitude towards directors' duties of care, skill and diligence which has moved from the more lenient traditional approach which existed in the common law to a more stringent approach of the statutory law. Both these approaches shall be addressed in this dissertation.

1.4.4 A controversial issue, which South Africa adopted from the American judiciary, namely the business judgement rule will be investigated. The main focus is whether it would be necessary or desirable that directors do not incur personal liability for mistakes or errors which led the company to suffer losses and damages as a result of their disastrous decisions despite acting in good faith. The reasoning for South Africa adopting the rule as well as the extensive criticisms which has tagged along with the rule shall also be discussed.

1.4.5 A conclusion following the above enquiries will be discussed in the last Chapter.

## 1.5. INTRODUCTION

The concept of duties of a director does not only represent something being learnt such as academics or achieving a degree, but rather has to be looked at with its focus on the ever

changing commercial landscape present in South Africa<sup>1</sup>. There are many problems which exist and arise when a director is appointed to such a post and the main issue which seems consistent throughout the years is that a director tends to act for their own selfish benefit or interests which consequently impacts negatively on the company and its eventual downfall.

It is obvious that a company cannot operate or function without human involvement and as such directors are appointed who use their diverse skills and strategies to execute and act on behalf of a company and in such performance should act in and uphold the best interests of the company<sup>2</sup>.

Most of South Africa's company directors do not know what an appointment of a director actually entails and this area of law is currently in a very steep and slow development phase<sup>3</sup>. The reason why I chose this topic is to not only provide the reader with information to the duties of care and skill of a director but to also expand my knowledge and understanding to this subject as there are many aspects in this area with potholes which I intend on filling. Most people are not aware of what is expected of a director and if such duties are not carried out the consequences which result from their negligence or *mala fide* (bad faith) conduct could be disastrous to the company, society and most importantly the employees of the company.

I am of the opinion director's often overlook the liability which may result from their negligence, usually from misunderstanding a company's limited liability which clouds a directors' mind into thinking that he would be exempt from liability despite being blissfully ignorant to the decisions made for and on behalf of the company. In the past directors had no direction as to what their duties and performance to the company entailed. Recently the partial codification introduced in the 2008 Companies Act resolves this issue by making the law much clearer and somewhat guideline approach to help directors perform optimally for the success and profitability of the company<sup>4</sup>.

In this dissertation I intend on providing an in depth exposition on the duties of a director particularly to their care, skill and diligence which will be rooted from the common law perspective making its way to the statutory findings in terms of the Companies Act 71 of

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<sup>1</sup> *FHI Cassim et al. Contemporary Company Law. 2ed. (2012) 555*

<sup>2</sup> *Ibid*

<sup>3</sup> *V Finch. 'Company Directors: Who Cares about Skill and Care'? (1992) 55 Modern LR 179 at 179.*

<sup>4</sup> See note 1 above.

2008. An analysis on the protection afforded to a director from liability from mere errors and mistakes taken in good faith shall also be discussed with a detailed discussion on the business judgment rule, its origin and application.

### 1.5.1 The common law

There are many sources from which the duties of a director are extracted, however prior to the Companies Act 71 of 2008 the rights and duties of directors were rooted and sourced from the agreements which were concluded with the company, the company's memorandum and articles of association, the former Companies Act 63 of 1971 and the common law.<sup>5</sup>

As in other jurisdictions, it is trite and noteworthy that directors who breach their common law duties and obligations to act with the expected standard of care and skill may be liable for damages and incur delictual liability.<sup>6</sup> At common law the courts exercised judicial restraint when they assessed the directors' powers and functions in running the company.<sup>7</sup> South African law regarding directors' duties of care and skill has been heavily influenced by English law and as such South African law has initially adopted a lenient attitude towards directors' duties of care and skill.<sup>8</sup>

The common law is a point of retreat when it comes to an analysis of directors' duties. It is apparent that the provisions or principles set down in the common law are subject to change as a result of current sources such as statutes and case law which will consequently impact of the traditional common law approach<sup>9</sup>. Traditionally both the duties to act with honesty and with care and skill were not seen as *sui generis* (unique) duties of directors, and as such the partially codified Companies Act 71 of 2008 addresses the uniqueness of the fiduciary and non-fiduciary duties of directors<sup>10</sup>.

Historically the common law made little demands on directors to exercise care and skill, and the directors were at liberty to manage the companies with disregard, incompetent conduct and with no demand to ensure that such duties were carried out with the reasonable efficiency

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<sup>5</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>6</sup> *Ibid* at 509

<sup>7</sup> See note 3 above

<sup>8</sup> JJ, Du Plessis "A comparative analysis of directors' duty of care, skill and diligence in South Africa and in Australia" (2010) *Acta Juridica* 236.

<sup>9</sup> See note 5 above

<sup>10</sup> *Ibid* at 509

and expected care and skill.<sup>11</sup> At common law all that was expected of a director in the midst and performance of carrying out his office was to exercise care and skill in a manner similar to a director with his or her knowledge, skill and experience, having no regard to any other factors.<sup>12</sup>

The common law plays a crucial role in the governance of directors' duties and responsibilities as directors act as agents for the company in carrying out their obligations which ultimately should be in furthering the best interests of the company. Directors' duties are disparate and inexhaustible and as a result of this the provisions of the Companies Act 71 of 2008, aim to accommodate and transform the expectation of directors' duties with the ever changing commercial terrain.

#### 1.5.2 The statutory provisions relating to the duty of care, skill and diligence- Section 76(3)(c).

The universal principle which exists in the performance of directors' duties of care and skill is that directors are liable for the damages and losses which emanate from their negligence in the performance of their duties.<sup>13</sup> A good example of this principle is expressed in the Australian case of *Daniels v Anderson*<sup>14</sup>, which has had a considerable influence on South African law. The court held that the modern law of negligence should be used to ascertain whether a director was in breach of his or her fiduciary duties. The court further held that the use of a more objective approach to the director's duties to exercise care and skill should be founded<sup>15</sup>. This case conveys a change in the attitude of the South African judiciary in attaining an abrupt end to the perception that directors' duties of care, skill and diligence should be assessed solely subjectively.<sup>16</sup>

It is critical that directors exercise their duties with care and skill and as such the concepts of "care" and "skill" are to be differentiated. "Skill" is described as the technical area or competence of a director, whereas "care" describes the manner in which the skill is applied<sup>17</sup>.

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<sup>11</sup> M Bekink "A Historical Overview of the Director's Duty of Care and Skill: From the Nineteenth Century to the Companies Bill of 2007" (2008) 20 Merc LJ 95-97.

<sup>12</sup> FHI Cassim et al. *Contemporary Company Law*. 2ed. (2012) 555.

<sup>13</sup> Cassim, 505; [1989] BCLC 498 (Ch)

<sup>14</sup> *ACSR 607 CA (NSW) at 664-665*.

<sup>15</sup> *Ibid*

<sup>16</sup> *ibid*

<sup>17</sup> See note 13 above

Skill differs from person to person but care is assessed objectively<sup>18</sup>. A point of importance which carries irony is that a director's incompetence can actually protect him or her from liability<sup>19</sup>. The degree of care, skill and diligence depend mainly on the experience and skill set of that particular director. The lower the skill set or the less experience a director has, the lower the standard of care which will be expected from the director<sup>20</sup>.

An example which elucidates the above is expressed as follows: - "Tim is appointed as a director of a company, if for any particular reason Tim does not possess the expected experience, skill or business acumen, the subjective test will subsequently be applied. If Tim is capable of only conducting a sub standard amount of skill and expertise while being in a position as a director of company, then it is only that substandard or low amount of skill and care that is attached to Tim in holding him liable for breach of his duty of care and skill<sup>21</sup>".

As illustrated above if the director lacks the relevant business acumen and is unskilled then a low standard of care and skill will be expected of him or her. As a result of this if the director possesses a low skill set and business acumen such a director will consequently be protected from liability as a result of his or her substandard performance in holding the position as director<sup>22</sup>.

The Companies Act 71 of 2008<sup>23</sup> reconstructs and modernises the directors' duties of care and skill, as it imposes a less subjective and more demanding and rigorous standard for directors than that of the common law. The provisions of statute accommodates for a hybrid standard containing both subjective and objective elements while its initiation to statute reflect the modern commercial concerns, attitude and principles in incorporating successful management of companies as well as introducing the importance of corporate governance.<sup>24</sup>

The Act has partially codified the directors' duty to exercise care, skill and diligence and as such embraces both objective and subjective elements<sup>25</sup>. As part of the partial codification a

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<sup>18</sup> Cilliers, Benade et al *Korporatiewe reg Tweede uitgawe* (1992) 142.

<sup>19</sup> FHI Cassim "Fraudulent or reckless trading and s 424 of the Companies Act of 1973" (1981) 98 *SALJ* 162.

<sup>20</sup> *Ibid*

<sup>21</sup> See note 6 above.

<sup>22</sup> *ibid*

<sup>23</sup> *Companies Act 71 of 2008*.

<sup>24</sup> FHI Cassim et al. *Contemporary Company Law. 2ed* (2012) 558.

<sup>25</sup> McLennan. "Duties of Care and Skill of Company Directors and their Liability for Negligence" (1996) 8 *SA Merc LJ* 101.

two legged test has been introduced in section 76(3)(c) of the 2008 Act<sup>26</sup>. The first leg is contained in subsection (i) which is has an objective meaning, conveying the notion that all directors should meet a threshold to avoid liability while subsection (ii) comprises of a subjective test which requires quantifying the experience, skill, care and business acumen of that particular director<sup>27</sup>.

The purpose of the partial codification is ultimately to provide clarity and clearer guidelines for directors when it comes to director's liability with regard to a breach of his or her fiduciary duty and the duty of care, skill and diligence<sup>28</sup>. It further focuses on couching directors' ignorance, addressing the scope of their duties and as such making it more accessible and removing the vagueness which existed while making the law more accessible<sup>29</sup>.

### 1.5.3. The business judgment rule.

The business judgment rule has been introduced into the Companies Act to try and soften the duty of care, skill and diligence which was codified by the Companies Act 71 of 2008<sup>30</sup>. Section 76(4) is the relevant section which has introduced the business judgment rule into South African law. The business judgment rule has followed the developments made in the American terrain. The provision of the rule entails the discretion which is to be used by courts in holding directors accountable for business decisions which produced poor results.<sup>31</sup> Such restraint is cautioned by a director making a decision in a *bona fide* manner (good faith), with care and on an informed basis. Subject to a director conducting himself or herself in good faith without any foolish disregard seen as negligence, the provisions of the rule shall apply. The elements of the business judgment rule in the American context are voiced as follows: "a business decision; disinterestedness; due care; good faith; and no abuse of discretion or waste of corporation assets."<sup>32</sup> The purpose of the rule ultimately is to encourage risk taking; persuading competent persons to undertake the office of the director,

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<sup>26</sup> The Companies Act 71 of 2008

<sup>27</sup> *Dorchester Finance Co Ltd v Stebbing* 1989 BCLC 498

<sup>28</sup> Irene-Marie Esser and Johan Coetzee 2004 (12) *Juta Business Law Journal* 26

<sup>29</sup> *FHI Cassim et al Contemporary Company Law*. 2ed. (2012) 462

<sup>30</sup> *FHI Cassim et al Contemporary Company Law*. 2ed. (2012) 563

<sup>31</sup> S Kennedy-Good "The Business Judgment Rule (Part 1)" (2006) *Obiter* 62-64.

<sup>32</sup> D Botha and R Jooste "A Critique of the Recommendations in the King Report Regarding a Director's Duty of Care and Skill" (1997) *SALJ* 65-73

the prevention of judicial review; avoiding shareholders involvement in the management of the company; and placing mechanisms in place to manage the director's behaviour<sup>33</sup>.

The business judgment rule affords directors with a defence in respect of the business decisions made by them which are challenged by shareholders, stakeholders and interested parties through litigative processes who state that the directors have acted without the due standard of care and skill with complete disregard and incompetence<sup>34</sup>. The business judgment rule has become a controversial issue which has experienced vast critique. The issue addressed by many commentators is whether it would be necessary or desirable to introduce the business judgment rule into our law in order to protect directors who in good faith from incurring personal liability for the losses which the company incurred as a result of their business decisions<sup>35</sup>. Further a point of critique is whether it was wise for South Africa to follow a judiciary such as America considering the view that the two laws are completely different from each other<sup>36</sup>.

The business judgment rule is a tool in judicial review and the rule essentially serves as a "safe harbour" from liability in cases where a director has made an informed decision, in good faith and on a rational and reasonable basis<sup>37</sup>. A director will therefore not be liable if he or she acted with due care and diligence in making a decision even if the business decision led to unfortunate results. For the business judgment rule to be applicable, a requirement is that the director must not have acted in their selfish interests, must have made an informed decision in an informed manner and must have rationally believed that their decision was in the best interests of the company<sup>38</sup>.

According to Havenga<sup>39</sup>, the business judgment rule was developed "because of a desire to protect honest directors and officers from the risks inherent in hindsight review of their unsuccessful decisions, and because of a desire to refrain from stifling innovation and venturesome business activity"<sup>40</sup>.

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<sup>33</sup> Lee (2003) *Columbia Law Review* 945.

<sup>34</sup> Matsimela (2011) *Company Law Hub Journal of Student Research Vol 1 Article 5*

<sup>35</sup> Kennedy-Good (2006) *Obiter* 63.

<sup>36</sup> *Ibid*

<sup>37</sup> See note 33 above.

<sup>38</sup> *Ibid* at 939

<sup>39</sup> Havenga (2000) *SA Merc LJ* 28; American Law Institute *Principles of Corporate Governance and Structure: Restatement and Recommendations* (1982).

<sup>40</sup> *Ibid*

Chapter 4 below dealing with the business judgment rule will seek to address the purpose of the business judgment rule, its relationship with the duty of care, skill and diligence, its origin, application and the statutory codification that exists in South African law and the criticisms which has been a controversial issue amongst commentators.

## CHAPTER 2

### GENERAL AND THE COMMON LAW

#### 2.1 INTRODUCTION

Companies appoint directors to carry out the day to day dealings and functions required of a company. A company director apart from owing the company a fiduciary duty also owes the company a duty to act with care and skill<sup>41</sup>. Prior to the 2008 Act, the duties of directors' were derived from many sources such as the agreements concluded by companies, companies memorandum and articles of association, the preceding Companies Act 61 of 1973 and most importantly the common law<sup>42</sup>.

The common law is a point of departure when it comes to analysing the duties of a director with particular reference the duties of care, skill and diligence which was rooted and heavily influenced by English precedent from the late 18th and early 19<sup>th</sup> century where the foundations of such duties were laid down<sup>43</sup>. An exposition into the traditional principles of the common law is paramount in gaining a proper understanding of the statutory provisions of the Act, particularly to the non-fiduciary duties of care, skill and diligence<sup>44</sup>.

A principle followed by innumerable English precedents which has been accepted in the early centuries couches the view that directors are not liable for a breach of their duty of care, skill and diligence if they merely acted negligently<sup>45</sup>. An extract from the case of *Lagunas Nitrate Company v Lagunas Syndicate*<sup>46</sup> makes particular reference to this principle of negligence and held that the amount of care to be taken is difficult to pin point; but it is noteworthy that directors are not liable for all the mistakes which they make, however if they had taken more care and precaution in carrying out their duties there is a possibility that the directors might have avoided such errors and mistakes which reasonably could have been avoided<sup>47</sup>.

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<sup>41</sup> Kanamugire and Chimuka, 2014 "The Directors' Duty to Exercise Care and Skill in Contemporary South African Company Law and the Business Judgment Rule" Vol 5 no 20, pg 1

<sup>42</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>43</sup> J. Du Plessis "A comparative analysis of directors' duty of care, skill and diligence in South Africa and in Australia: Corporate governance, mergers and takeovers: Part II." (2010) *Acta Judica* 263.

<sup>44</sup> M F Cassim "Contemporary Company Law" 2ed. (2012) 554

<sup>45</sup> J Du Plessis "A Comparative Analysis of Directors' Duty of Care, Skill and Diligence in South Africa and in Australia" 2010 at 5

<sup>46</sup> [1899] 2 Ch 392.

<sup>47</sup> *Ibid*

Despite the common law evolving and advancing in accordance with various commentaries and authoritative sources, there is still an issue which at hand, not only in South Africa but in many other jurisdictions and such issue is the practical difficulties in endorsing an appropriate and acceptable standard of care and skill expected of the directors of a company<sup>48</sup>. As a consequence of this uncertainty a “dark cloud” is in existence as to the extent, degree or standard to which a director should exercise their powers and duties in conducting the affairs and holding office in a company<sup>49</sup>.

The issue which hovers as the arduous “dark cloud” is that a director is obliged to act with the required and expected degree and standard of care, skill and diligence but to what extent is a director expected to carry out such duties. Further the content of the appropriate standard required and how such standard is to be measured is a controversial issue and remains an unclear one which dampens our law<sup>50</sup>. In the past the courts adopted the view that shareholders or stakeholders were responsible for the appointment of directors who made the decisions on behalf of the company without the proper care and skill. Such responsibility rooted from the fact that the shareholders had appointed the directors to such a position by their vote or choice, and if a foolish and incompetent director was appointed the shareholders was ultimately to blame<sup>51</sup>.

Traditionally the common law duties of a director were divided into two, firstly being the duty to act in good faith, honesty and loyalty, commonly known as the fiduciary duties and secondly the duty to act with care, skill and diligence known as the non-fiduciary duties<sup>52</sup>. It is of significance to note and distinguish these two duties as the fiduciary duties are *sui generis* (unique) in nature while the non-fiduciary duties link to delictual or acqilian liability<sup>53</sup>.

As stated above directors’ duties are diverse, constantly evolving with the economic landscape which is prevalent in South Africa. The Companies Act 71 of 2008 sets a more demanding and taxing standard which has tightened and upgraded the common law

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<sup>48</sup> See note 33 at 555

<sup>49</sup> See note 34: Du Plessis at 263.

<sup>50</sup> See note 31 at 501

<sup>51</sup> See note 33 at 555

<sup>52</sup> *Du Plessis v Phelps* 1995 (4) SA 165 (C).

<sup>53</sup> See note 33 at 555

provisions which expected a degree of skill and care from directors traditionally which was of an exceptionally low standard<sup>54</sup>.

## 2.2 THE STANDARD OF CARE AND SKILL TO BE EXERCISED BY A DIRECTOR OF A COMPANY IN TERMS OF THE COMMON LAW:

### 2.2.1. Quantifying the appropriate standard of care and skill in terms of the common law

The common law remains very much alive in the statutory provisions of director's duties of care and skill; however its relevance, application and use has departed and evolved from the common law approach due to the constant change in the commercial environment existent in South Africa. It is important to set out and understand the traditional common law approach which was adopted in South Africa, and as such will be explained in this chapter.

It is paramount that directors manage the affairs and decisions of a company as a reasonable prudent person would manage their own affairs<sup>55</sup>. The courts did not enforce the duty of care in the same manner in which the fiduciary duties were strenuously enforced<sup>56</sup>. It is important to note that the common law's relaxed approach was originally rooted from two principles.<sup>57</sup> The first principle was that shareholders were ultimately liable for and responsible for the competence of the persons appointed by them to manage the affairs of the company, and secondly; early directors were mostly appointed for the sake of title and reputation and did not possess any particular skill or business acumen which would be beneficial to the company<sup>58</sup>. The repercussions of a director failing to act with the expected standard of care and skill are linked to the law of delict and negligence<sup>59</sup>. It must be recognised that even though South African law followed the same steps as in English precedent, a distinction exists which is quite apparent. In South African law, fault and wrongfulness are distinct concepts and both must be present to hold a director accountable for negligent conduct in delict, this was illustrated in the case of *Trustees, Two Oceans Aquarium Trust v Kantey &*

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<sup>54</sup> See note 49 above

<sup>55</sup> MM Botha "The role and duties of directors in promotion of Corporate Governance :A South African perspective"(2009) 3 *Obiter* 702 at 706

<sup>56</sup> FHI Cassim 'Fraudulent or Reckless trading and s.424 of the Companies Act of 1973' (1981) 98 *SALJ* 162.

<sup>57</sup> Havenga (2000) *SA Merc LJ* 28; American Law Institute *Principles of Corporate Governance and Structure: Restatement and Recommendations* (1982) at 26-27.

<sup>58</sup> *Ibid* at 26 to 27

<sup>59</sup> *Ex Parte Lebowa Developments Corporation Ltd* 1989 (3) SA 71 (T);

*Templar*<sup>60</sup>. The South African taking is very distinct from English law, as wrongfulness is not a clearly defined requirement that must be present for liability of a director.

Authorities such as Cilliers and Benade are of the opinion that the standards according to which the degree of care and skill are to be quantified are by no means clear<sup>61</sup> and the reasoning behind this statement is that while it is to a certain extent possible to establish “care” objectively, “skill” varies from person to person. A remarkable analogy to this point is clearly expressed by these authors who state the following; “It is not a requirement that the directors of a steel company be accomplished metallurgists; people of other professions and walks of life such as a farmer, a lawyer, a medical practitioner and a pensioner may equally be directors without their lack of knowledge of steel which may disqualify them as a result of their lack of skill. It is a requirement of directors that they apply the skill and business acumen which they do possess to the advantage of the company.”<sup>62</sup> From the said analogy it is evident that a director need not be a particular professionally skilled person and anyone may hold the position as a director, what is important is, in holding such a position the director’s conduct themselves with a standard of care and skill reasonably expected.

In the early centuries in certain instances serious misconduct did not necessarily amount to gross misconduct and the common law courts expected gross negligence to be found to hold a director liable before a director could be held liable for breach of the duty of care and skill<sup>63</sup>. At common law a director was required, in the performance of his or her duties, to exercise the care and skill that may be expected of a person with his or her knowledge and experience. In the case of *Re Brazilian Rubber Plantations & Estates Ltd*<sup>64</sup> the directors were unsuccessfully sued for losses as a result of their disastrous business decisions in the rubber plantations in Brazil. The directors based their decision to invest in rubber plantations on a fraudulent report on rubber plantations. The court held that a director is to act with reasonable care, having regard to his knowledge and experience and is not bound to have any special qualifications<sup>65</sup>. It was further held that a director will not be liable for the losses or damages caused as a result of mere errors of judgment.

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<sup>60</sup> 2006 (3) SA 138 (SCA).

<sup>61</sup> H S Cilliers, M L Benade, J J Henning, J Du Plessis, P A Delpont, L De Koker and JT Pretorius *Cilliers & Benade: Corporate Law* 3<sup>rd</sup> ed (2000) at 147-148.

<sup>62</sup> *Ibid* at 147-148

<sup>63</sup> See note 48 supra

<sup>64</sup> [1911] Ch 425 (CA) 437

<sup>65</sup> *Ibid*

In the *Re Brazilian Rubber Plantation & Estates Ltd*<sup>66</sup> case there is regard to a contention of these directors being favoured as a result of their inexperience and incompetence. In this case it is evident that even though the directors were made aware and were in possession of the fraudulent and false reports in respect of the rubber plantation, they still made consequential and disastrous decisions which led to damage and loss of the company<sup>67</sup>. Even though the directors of the said company were sued they were held not to be liable, as court stated that the duty of a director to exercise care must be one that is reasonably expected of such a director taking into account both that specific directors experience as well as his knowledge<sup>68</sup>.

As founded in this case the court was of the view that a director does not need to have any special skill, expertise and qualification and he may continue with the management and affairs of the company without having any knowledge in respect of what a rubber business entails. What is important is that the director is to conduct himself reasonably and rationally in good faith for the benefit of the company<sup>69</sup>.

Prior to the statutory provisions the duty of care and skill were encapsulated by the principles found in the common law. In South Africa the test for negligence was a primarily objective one based on the “reasonable person” test, formulated by courts in largely subjective terms, which depended on skill, experience and the ability of a particular director<sup>70</sup>. The repercussion was that a low threshold standard of care was expected of directors under the common law which required a director to only exercise the degree of care and skill that the individual director was capable of<sup>71</sup>. Under the above test formulated a director may have even acted with complete contempt and absurd foolishness, yet still not be found liable as a result of the director’s incompetence, inexperience and ignorance which protected the director from liability<sup>72</sup>. Directors were expected to only exercise the degree or level of skill and care that they were capable of, so the more incompetent and ignorant a director was the lower the standard of care which was expected.

Throughout the common law duty of care and skill the courts were constantly handicapped by prescribing a single set of standard for all directors. It is not easy to set such an objective test

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<sup>66</sup> See note 52 above

<sup>67</sup> *Ibid* at 147-148

<sup>68</sup> R.C. Williams “*Concise corporate and partnership law.*” 3<sup>rd</sup> ed. (2013) 179.

<sup>69</sup> *Contemporary Company Law* (supra) 556.

<sup>70</sup> *Supra* at 555.

<sup>71</sup> *Ibid* at 555

<sup>72</sup> See note 44 above

for directors as there are many circumstances to be considered such as the different types of companies, the different roles required from each director, companies further vary in size, form and function<sup>73</sup>. If an objective standard or test was applied after considering the above statement then the functioning of a company will be greatly disadvantaged as an objective test will lead to unsuccessful results and is not feasible in such a situation where our country consists of vast diversity.<sup>74</sup>

As explored above it is quite apparent that there are practical difficulties which arise for courts or legislature to prescribe a single standard or requisite for directors in respect of carrying out their duties of care, skill and diligence. As such, a subjective test is superiorly prescribed rather than an objective test due to fact that an appointed director may not be a professional individual and there is no set test according to which the care and skill to which a director portrays is to be quantified, therefore there is no objective test which has been laid down<sup>75</sup>.

Considering the above Williams agrees with the undoubted common law test which places a subjectively moderate or lenient burden on directors in the performance of their duties of care, skill and diligence while holding such a position<sup>76</sup>. Williams supports the subjectively low test by making the following inferences:-

1. A director of a company is compared to that of an employee of a company. What is to be considered is that a director does not enter into a contract with a company as an employee does. Further in respect of an employee the skills, expertise and expectations which an employee possesses are known for the performance of his or her duties<sup>77</sup>. On the other hand the skills and expertise of a director are unknown as an employee and director do not have the same obligations; hence such is the result for attaching a seemingly lenient burden on directors.
2. The next point focuses on the requisites for a non-executive director compared to that of an executive director. An executive director is tasked with the daily dealings expected of a director who is continuously involved in the functioning of the

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<sup>73</sup> *Contemporary Company Law* at 555

<sup>74</sup> *Ibid* at 555

<sup>75</sup> *Ibid* at 555

<sup>76</sup> See note 58 :Williams at 182

<sup>77</sup> *Ibid* at 182

company, while non-executive directors are only expected to be present at board meetings<sup>78</sup>. As a result of the different expectations and obligations required of these two directors there is a different standard of care and skill required of these two directors. This point is of irrelevance in the statutory provisions, after the introduction of the case of *Howard v Herrigal*<sup>79</sup> which held that it is unhelpful to distinguish between executive and non-executive directors as the duties and determination of duties refer to all directors. Williams is in support with the argument in the said case.

3. Lastly with reference to the case of *Dovey v Cory*<sup>80</sup> the court stated that “the business of life could not go on if people could not trust those who are put in a position of trust for the express purpose of attending to the details of management”. A similar principle was laid down in the case of *Fisheries Development Corporation of SA Ltd v Jorgensen Ltd*<sup>81</sup> where the following paragraph was extracted; “in respect of all the duties that may properly be left to some official, a director is in the absence of grounds for suspicion, justified in trusting that official to perform such duties honestly and is entitled to accept and rely on the judgment, information and advice of the manager unless there are proper reasons for querying such.”

As per the above cases it is evident that directors may delegate certain of their functions, duties and tasks to certain officials or employees who are experts in certain fields of the company if the director does not have any reason for distrusting or doubting such official or employees honesty<sup>82</sup>.

Even though the above inferences depict the low standard of care and skill which was required of a director in terms of the common law, the statutory provisions of the Companies Act 2008 aim to attach a more demanding standard of care and skill than the common law as the common law standard of care and skill was subject to wide spread critique by many authoritative sources and commentators.

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<sup>78</sup> See note 63 at 557

<sup>79</sup> 1991 (2) SA 660 (A) 678D.

<sup>80</sup> 1901 AC 477 (HL) 485-6.

<sup>81</sup> 1980 (4) SA 156 (W)

<sup>82</sup> *Supra* note 70

In the case of *Re Brazilian Rubber Plantations & Estates Ltd*<sup>83</sup> which was discussed *supra*, the principle exposed in this case is that a director's duty of care and skill is to act with the level of care that is reasonably expected of that particular director, which is based upon his own knowledge and experience. Under this test it is noted that the more experience and knowledge a particular director has, the higher the threshold of reasonableness becomes. This case is the leading authority based on the facets found in the statutory provisions.

The most salient decision which forms the common law development of the duty of care and skill is founded in the case of *Re City Equitable Fire Insurance Co Ltd*<sup>84</sup> which confirmed the subjective test laid down in the case of *Re Brazilian Rubber Plantations & Estates Ltd*<sup>85</sup>. These cases will be dealt with in detail in the following chapter below.

The decisions made by a director and their duties, even though are distinct from each other are at the same time complementary in nature, an inference of this can be drawn if a director fails to monitor the company affairs and decides to carry out his duties with complete disregard and incompetence, then consequently such a director would have breached his duty of care, skill and diligence and ultimately have incurred delictual liability.<sup>86</sup> A similar inference is drawn where a director appoints an unskilled, inexperienced and fraudulent person to carry out the duties of the company in a situation where the director is temporarily unavailable or away from the company. Such conduct will definitely amount to an abuse of directors' powers and duties of care, skill and diligence and tantamount to negligence or breach of directors' duties.<sup>87</sup>

With reference to the above statements, Cassim infers that while directors are in the performance of their duties, should such duties be conducted with negligence, carelessness or incompetence, the director will be liable to the company as a consequence of their negligent conduct and will further be liable for any loss or damage which may have resulted due to their negligent and careless conduct<sup>88</sup>.

Despite the prevalent differentiation existent from the common law to the Companies Act 2008, the one principle which remains constant through the time line of South African

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<sup>83</sup> See note 50 *supra*

<sup>84</sup> *Re City Equitable Fire Insurance Co Ltd* [1925] Ch 407

<sup>85</sup> See note 50 *supra*

<sup>86</sup> See note 51 above at 148.

<sup>87</sup> *Ibid* at 148

<sup>88</sup> *Contemporary company law* at 554

Commercial law is that it is not a requirement for a director to have any special qualification, skill, expertise or business acumen in the performance of holding a position as director and such requirements may never be known as each company is unique from one another and the directors appointed have their own unique duties which are expected and to be carried out by them<sup>89</sup>. Hence laying a stringent test of what exactly the duties of a director should entail will fail hopelessly in our law, considering the diverse nation which we are born from and the diverse commercial industry which exists.

### 2.2.2 Moving towards a more stringent hybrid approach as opposed to the common law lenient (subjective) approach which existed in the past.

Notwithstanding the fact that our law is powerless in precisely pointing out the set requirements which are expected of a director in the performance of his or her duties of care, skill and diligence and the controversy hovering over this topic, there are many sources which attempt in resolving the existent controversy which subsequently resulted in the South African Companies Act 2008 following the partial codification approach of the directors' duties of care, skill and diligence. An indication of our law moving away from the lenient common law approach, stepping into a more reformed stringent approach is evident from sources which will be dealt with in this paragraph.

The most common source is extracted from our current corporate statute, firstly being that of the partially codified section 76 of the Companies Act 71 of 2008<sup>90</sup>. Section 76 relates to the conduct of a company director and that such conduct and performance should ultimately aim at influencing the profitability, success and best interests of the company. Secondly section 43 of the South Africa Close Corporations Act<sup>91</sup>, which states that a person of a corporation is to act with a standard and degree of care and skill that is reasonably expected of a person with his knowledge and experience or a person in the same shoes as that director<sup>92</sup>. Thirdly a statute adopting a more rigorous approach is evident from findings of section 60(1) of the Banks Act 1990<sup>93</sup>, which state that directors owe the banks a fiduciary duty and the duty of care and skill. This section further makes reference to a director possessing expertise, skill and knowledge to a person in a similar appointment as him.

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<sup>89</sup> *Ibid* at 554

<sup>90</sup> The Companies Act 71 of 2008

<sup>91</sup> The Close Corporations Act 69 of 1984

<sup>92</sup> See note 32 above at pg 3.

<sup>93</sup> The Banks Act 94 of 1990

Fourthly a source to be highlighted in respect of our law adopting a more stringent approach is the King Report<sup>94</sup> which has provided certain guidelines in which directors should adapt to and follow in conducting their duties. An extract from the King Reports states the following:- “In line with modern trends worldwide, should not only exhibit the degree of skill and care that may be reasonably expected from persons of their skill and experience, but should also exercise both the care and skill 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 sufficient understanding of the company’s business and the effects of the economy so as to discharge their duties properly, including where necessary rely on expert advice.”<sup>95</sup>

Lastly reference should be made to a more recent statute, the Bank Amendment Act 2003<sup>96</sup>, section 40 (c) and (d) which shadowed other jurisdictions while incorporating a more stringent approach which states that a director should act in a *bona fide* (good faith) manner for the best interest of the company, possess the required knowledge and skill of a prudent person and should carry out their duties in a manner in which a reasonable person of a similar situation would do so<sup>97</sup>.

South African corporate law, in particular the duty of care and skill was heavily reliant on the findings of English law and as such our common law was moulded from the findings elucidated from the common law of England. The English law thereafter adopted and formulated a more rigorous and stringent test to which a director should carry out their duty of care and skill. This test comprised of a dual subjective and objective test which was once again followed by South Africa<sup>98</sup>.

The first case which took on the stance of adopting a more stringent dual test in English law was the case of *In Re D’Jan of London Ltd*<sup>99</sup>, a case in which the court correctly stated that the test that should be used in respect of quantifying the standard of directors care, skill and diligence should include both subjective and objective elements which will confer a more rigorous approach. This case changed the ruling from the more lenient subjective approach as

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<sup>94</sup> The institute of directors: *The King Report II chapter 4 paragraph 2*, 1994

<sup>95</sup> See note 32 above at pg 4

<sup>96</sup> The Banks Amendment Act 2003

<sup>97</sup> See note 78 at 557

<sup>98</sup> See note 78 at 557

<sup>99</sup> 1993 BCC 646 (Ch D (Companies Court)).

evident from the case of *In Re Denham & Co*<sup>100</sup>, a case in which a director was taken to court for not performing his duties and functions with the requisite care and skill for over a period of four years. The court followed the lenient common law approach and found that a director will only be liable for breaching his duties of care and skill if he had acted with serious or gross negligence and that the director in this matter, even though had not performed his duties for four years had not acted with serious or gross negligence and was not found liable.

A case which is significant to the stringent approach followed by a different jurisdiction is the Australian case of *Deloitte Haskins & Sells v Anderson*<sup>101</sup>, where the court stated that it is no longer appropriate for the courts to judge directors' conduct based on the subjective test which were applied in outdated precedents. Considering the ruling of the above case it is evident that courts are moving away from the lenient subjective approach and are incorporating an objective approach which makes the test for measuring directors' conduct much more stringent while increasing liability for breach of directors' duty to act with the expected degree of care and skill.

Despite the stringent change having been founded in countries such as England and Australia which is evident from above, the stringent approach was also followed by jurisdictions like the United States and Canada. In the United States the US Model Corporation Act 1984<sup>102</sup>, conferred an objective standard which is to be followed by the directors of the company. Such standard entails looking at the circumstances, nature, extent and responsibilities of the duties which are imposed on a particular director. The director is to act with the reasonable standard of care and skill which a person of his calibre would reasonably believe is to be carried out<sup>103</sup>. A similar inference is drawn from the Canada Business Corporation Act 1985<sup>104</sup> which also concurs to the objective standard which is to be used by directors in the course and scope of their duties. According to the Business Corporation of Canada a director is to carry out their duties and powers in a manner in which a reasonable director who is of a similar situation and circumstance would do so<sup>105</sup>.

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<sup>100</sup> 1884 LR 25 Ch D 752.

<sup>101</sup> (1996) 16 ASCR 607 (NSW); (1995)37 NAWLR 438

<sup>102</sup> US Model Corporation Act 1984

<sup>103</sup> See note 78 at 558

<sup>104</sup> Canada Business Corporation Act 1985

<sup>105</sup> See note 78 at 558

As discussed above it is safe to say that South Africa has closely followed the findings encompassed in the above jurisdiction with an attempt to eradicate the lenient approach of the common law which attached very little liability to the negligence of directors which left huge craters and scope for unscrupulous conduct. The partial codification of the Companies Act 71 of 2008 sets a more demanding standard of care and skill which is not limited nor a closed list, but rather ensures that a fair and equitable approach is used to assess the standard of a director to that of a person who is of a similar calibre in a similar situation<sup>106</sup>. Our law does however slightly differ from other jurisdictions as it follows both, a dual subjective and objective test which is appropriate given the diverse commercial standing which exists in our country.

Our law with its stringent approach further aims to incorporate the best practices of corporate governance, while focusing on the evolving commercial factors and management of companies.<sup>107</sup> As a result of the change and focus to which the statutory provisions of the act is ultimately aimed at, the common law becomes inadequate and out dated with the modern times, however its use and reference is constantly utilised for the benefit of improving our statutory findings into improved legislation with a greater impact on the ever changing commercial world which we live in.

### 2.2.3. A comparison between the common law and statutory law duties.

Before the initiation of the Companies Act 71 of 2008<sup>108</sup> there was no codification which occurred in respect of directors' duty of care, skill and diligence as expressed in the common law. South Africa and Australia were both heavily influenced by the finding of English precedent from the 18<sup>th</sup> and 19<sup>th</sup> century<sup>109</sup>. It is evident that South Africa did not previously incorporate the directors' duty of care and skill into legislation; however what is to be noted is that there are certain statutes which could be seen to have expressed such duties.

The first notable act in which this is evidently expressed is in section 43 of the Close Corporations Act 69 of 1984<sup>110</sup>. This section makes reference to a director acting with a standard and degree of care and skill that is reasonably expected of a prudent person with his

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<sup>106</sup> *ibid* at 558

<sup>107</sup> See note 78 at 559

<sup>108</sup> The Companies Act 71 of 2008

<sup>109</sup> See note 34 above at pg 10

<sup>110</sup> The Close Corporation Act 69 of 1984

knowledge and experience. The second notable act is section 60 of the Banks Act 1990<sup>111</sup> which state that directors owe the banks a fiduciary duty and the duty of care and skill. This section further makes reference to a director possessing expertise, skill and knowledge to a person in the similar appointment as him. Currently section 76 makes reference to the standard by which a director should carry out their duty of care skill and diligence<sup>112</sup>. A wise metaphor used by Du Plessis is that the intention of legislature in quantifying the reasonable standard which is expected of a director is to ensure that apples are compared with apples and oranges compared with oranges<sup>113</sup>.

Prior to the statutory findings the traditional approach was that directors possessed limitless powers, however the statutory findings were of the view that the traditional approach mirrored outdated practices as we are now exposed to many factors which impacted on this<sup>114</sup>. Some of these factors included our country's vast exposure to international trade, international financial dealings and international corporate management which required that a higher standard and degree of care and skill to be implemented and carried out by company directors<sup>115</sup>. Even though the common law remains flexible and constantly under construction, the current Companies Act 2008 reflects a futuristic approach as compared to the traditional common law approach<sup>116</sup>.

A traditionalist view of directors' duties is illustrated in the case of *Turquand v Marshall*<sup>117</sup>, were it was found that it was within the scope and powers of a director to lend a "brother" director a loan, and however foolish this act, might have been, as long as this act was within the powers and scope of the director the court could not attach liability nor interfere in this instance. Further it was held to be the misfortune of the company and shareholders to have appointed such an unwise and foolish director<sup>118</sup>. It is quite obvious that this lenient approach was subject to criticisms and needed extensive construction. A director is to act for the best interest of the company and should not act in a way to cause himself or any other person any benefit or advantage. The modernistic approach displayed in the statutory provisions aims to

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<sup>111</sup> The Banks Act 1990

<sup>112</sup> See note 34 at pg 14

<sup>113</sup> *Ibid* at 14

<sup>114</sup> MM Botha, "The role and duties of a director in the promotion of Corporate Governance: A South African perspective" *Obiter*, 2009 pg 709

<sup>115</sup> *Ibid* at 709

<sup>116</sup> *Ibid*

<sup>117</sup> (1869) LR 4 Ch App 376

<sup>118</sup> *Ibid*

eradicate the lenient approach followed by the common law which was infallible and would lead to an economic downfall if was still in existence.

An unchanged common law principle which is still currently applied in our statute is derived from the case of *Regal Hastings Ltd v Gulliver*<sup>119</sup>, were it was held that a director should not abuse his position, obtain personal knowledge of the company for his benefit or for the benefit of any other person, neither should a director ever be placed in a position of competing with the company for his own interests. What is discernible in this case is that a director should act in the best interest of the company and as such this principle is incorporated in our statute<sup>120</sup>.

A reaffirmation of the findings in statute is found in the case of *Greaves v Barnard*<sup>121</sup>, whereby the court reasserted that directors owe a fiduciary duty to the company and should act in the best interests of the company and lastly acknowledge that the company is the ultimate heir of the duties by which a director carries out. As per the findings in this case it is of utmost importance that directors acknowledge that their actions are inevitably in the best interests of the company as their decisions and conduct consequently could lead to be advantageous or disadvantageous to a company at a whole which in adversely results in a company's success or eventual downfall.

Apart from section 76(3)(c)<sup>122</sup> which deals with the statutory duty of care, skill and diligence, there are many other statutory provisions which protects a company or restricts directors from acting with incompetence or without due regard for the company<sup>123</sup>. Some of these provisions are envisaged in section 77(2)(a) of the Companies Act<sup>124</sup> which expresses the view that a director of a company may be held liable in accordance with the principles of the common law should the director not act in the best interest of the company or be in breach of their fiduciary duties. A further section which is of importance is that of section 218(2) of the Companies Act<sup>125</sup> which provides that any person who contravenes any provision of the Act is liable to any other person for any loss or damage suffered by that person as a result of that contravention.

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<sup>119</sup> [1942] 1 ALL ER 378 (HL)

<sup>120</sup> *ibid*

<sup>121</sup> 2007 2 SA 593 (CC)

<sup>122</sup> The Companies Act 71 of 2008

<sup>123</sup> See note 34 at pg 14

<sup>124</sup> The Companies Act 71 of 2008

<sup>125</sup> The Companies Act 71 of 2008.

The previous approach to liability of a director who breaches his duty of care, skill and diligence comprised of many factors<sup>126</sup>. Firstly it was ultimately the shareholders misfortune if they had appointed incompetent and dishonest directors<sup>127</sup>. Secondly the courts could not adjudicate upon the dishonest decisions or conduct of directors as the courts were not aware of the circumstances and factors under which the director had made such a decision<sup>128</sup>. Thirdly due to the diversity which is in existence in South Africa and due to the fact that we are unable to pin point the exact requirements or standard by which a director is to carry out his duties of care, skill and diligence there is no accurate or closed standard, as directors are sourced from different backgrounds, skills, knowledge, experience and business acumen<sup>129</sup>.

Apart from the statutory provisions which may hold directors accountable for their loss or damages, a director may be liable for loss or damage under the common law principles of delict<sup>130</sup>. The statutory provisions further incorporate the idea that the common law must be developed with the aim to improve the rights and obligation which were previously laid down under the common law<sup>131</sup>. For a director to avoid such liability it is paramount that the director conduct himself or herself with the require degree and standard of care and skill. The standard of care and skill to be carried out is not that of a reasonable man test, but rather that of what would reasonably be expected from a person with the same skill, knowledge, experience and business acumen holding such a position<sup>132</sup>.

What is distinct from the above is that there is a reasonable expectation that directors who possess the same skill, knowledge, experience and business acumen which is similar to that of another director should be compared to each other. The standard of care and skill will not be measured objectively. The courts will have to determine the expectations of a director with the same functions and comparable traits, and will have to determine how a director with similar characteristics and business traits would have conducted himself or herself before concluding their decision<sup>133</sup>. Ultimately the test is a dual subjective and objective test.

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<sup>126</sup> *Voli v Inglewood Shire Council* (1963) 110 CLR 74-84 (HC of A);

<sup>127</sup> *Turquand v Marshall* (1869) LR 4 Ch App 376 -386

<sup>128</sup> *Levin v Felt and Thread Ltd* 1951 (2) SA 401(A) 414-415

<sup>129</sup> *Ibid* at 414- 415

<sup>130</sup> Section 77(2)(b)(i) of the Companies Act 71 of 2008

<sup>131</sup> *Ibid*

<sup>132</sup> See note 36 at 269

<sup>133</sup> *Ibid* at 269

### 2.3. CONCLUSION.

As expressed above it is evident that South Africa originally followed different jurisdictions in moulding its law, both the common law and statutory law, however its greatest influence stemmed from early centuries of English law. The point to be emphasised is that the common law was noted for its controversial issues resulting in the statutory provisions which reconstructed the traditional approaches used under the common law into a futuristic approach which is in line with current commercial factors.

Under the Companies Act 2008, directors as prescribed offices of the company are expected to conduct themselves in the performance of their duties for the best interest of the company in the most economic and profitable way. The statutory provisions which incorporated both a subjective and objective approach considered the reality and practical circumstances which directors may be faced with and found an approach which will best be suited to match the diversity present in all companies. The prescribed offices of a company play the role as leaders which inevitably influence their employees which in turn may lead to an increase or decrease of profits, take on major decisions on behalf of the company for the best interest of the company which in turn impacts on the company in an advantageous or disadvantageous way. In a nutshell the decisions which directors take ultimately determine the success or downfall of a company.

A major influence to the statutory developments, even though influenced and rooted by international jurisdictions was actually drawn from certain corporate legislature in South Africa. Particular reference is made to the Banks Amendment Act 19 of 2003<sup>134</sup> and the Close Corporation Act 69 of 1984<sup>135</sup>. The lenient approach of the past was eventually overtaken by a more stringent and rigorous approach which was implemented into the statutory law. As a result of this stringent approach there is now a clearer understanding of the law, less uncertainty and a wider breath of exposure to flexibility within the diverse modernistic commercial field which exists. It can be confidently stated that the provisions found in the current partially codified statute is a first for South Africa in terms of following a new approach other than the common law and will definitely be the beginning of many successful companies and future developments in our company legislature.

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<sup>134</sup> The Banks Amendment Act 19 of 2003

<sup>135</sup> The Close Corporation Act 69 of 1984

As a result of the great responsibilities placed on directors which impact not only the company and all that it stands for but also the director, the employees and society. The statutory provisions aim at providing a practical, clearer and more accessible law and guidelines which in turn may aid a director in following the prescribed standard of care and skill resulting in a profitable and successful company.

As a result of the change which occurred, it is safe to say that this change from the common law to the statutory law was inevitable; as the business environment which exists in our country is dynamic and it is only appropriate that the law is on par with the modernistic commercial era we are challenged with.

## **CHAPTER 3**

### **A STATUTORY LAW APPROACH TO DIRECTORS' DUTIES OF CARE AND SKILL-Section 76(3)(c)**

#### **3.1 INTRODUCTION**

The common law duty of care and skill has stepped its way into statute with particular reference to Section 76(3)(c) of the Companies Act.<sup>136</sup> This newly founded statute places a more onerous and demanding standard of care and skill than that which was traditionally expected of in the common law<sup>137</sup>. The initiation of the statutory duty of care and skill mirrors modernised commercial and business factors while incorporating corporate governance which will in turn reflect the promotion of the best interests of the company to operate in the most profitable and successful manner to include the involvement of international trade.<sup>138</sup>

The common law was modified as a result of extensive judicial scrutiny as to what the appropriate standard of care, skill and diligence a company director is to carry out. It is to be noted that as a result of a director holding such a position the business decisions made will inevitably impact on the company's success and profitability. The extensive scrutiny resulted in the introduction of the partial codification which exists in the statutory provisions relating to the duty of care, skill and diligence.

As expressed in the common law chapter above, this chapter will aim to express the changes which were brought about as a result of the statutory provisions which incorporate a more rigorous standard of care and skill by referring to the relevant and applicable case law, legislation, international laws and critique of the partial codification either reflecting an advantage or disadvantage to the South African corporate landscape. As introductory insight into this chapter it is noteworthy that the test applicable in the statutory provisions of the Companies Act 2008 incorporates a dual hybrid, subjective and objective elements which form the partial codification. A further reason for the statutory provisions incorporating a

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<sup>136</sup> The Companies Act 71 of 2008

<sup>137</sup> See note 32 above at pg 4

<sup>138</sup> *ibid* at pg 4

dual stance is to improve the common law test and not completely disregard the importance and provisions of the traditional common law approach.

Despite the improvement and advancement postulated in the statutory provisions of the act, many commentators once again attack these modernised provisions and place them under scrutiny as to whether real success actually lies in these provisions. This controversial issue and the application of both the common law and statutory law and its difference between the standard of skill and care to be carried out shall be examined in an attempt to seek clarity, including the disadvantages and advantages which already hover around our economic environment.

Even though the common law has not been discarded in totality, its use and application is minimal as the stringent approach incorporated in our current statute overrides the lenient traditional approach which existed in the past, thus attaching greater liability to negligent and careless directors who fail to carry out their duties with the required standard of care, skill and diligence.

### 3.2 THE STATUTORY PROVISIONS RELATING TO THE DUTY OF CARE AND SKILL.

#### 3.2.1 The hybrid stringent approach and existent partial codification.

As the common law closely shadowed different jurisdictions in modifying the directors' duties of care and skill, the same approach was incorporated by the South African statute wherein the United Kingdom as well as other relevant provisions of South African legislature such as the Banks Act<sup>139</sup> and Close Corporations Act<sup>140</sup> where followed. As a result of this the Companies Act 2008 was introduced to include the codified provisions relating to directors duty of care and skill.

The provisions of section 76(3)(c) of the Act state the following -

(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 <sup>141</sup> -:

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<sup>139</sup> The Banks Amendmne Act 19 of 2003

<sup>140</sup> The Close Corporation Act 69 of 1984

<sup>141</sup> The Companies Act 71 of 2008.

(c) with the degree of care, skill and diligence that may be reasonably expected of a person<sup>142</sup> –

(i) carrying out the same function in relation to the company as those carried out by that director;<sup>143</sup> and

(ii) having the general knowledge, skill and experience of that director.<sup>144</sup>

From the above provisions it is quite clear that the statutory duty of care is less subjective and more demanding to the provisions in the traditional common law approach. This stringent approach incorporated in our statute aims to instil modernised commercial and business factors and incorporates the best practices of corporate governance applicable to a director which may eventually lead to a more successful and profitable company<sup>145</sup>. It is noteworthy that the statutory approach is partially codified which preserved both subjective and objective elements.

The statutory dual objective and subjective standard is hybrid in nature and is not wholly one sided to either being a subjective or objective test. Various factors are considered under the application of this test which will augment the minimum objective standard of the common law to a higher subjective standard<sup>146</sup>. These factors include the size of the company, position and responsibilities of a director and the nature of the circumstances under which the decision was made. The purpose of this incorporation into the test ensures flexibility when there is a factual scenario which needs to be determined<sup>147</sup>.

The statutory provisions of director's duty of care, skill and diligence have assimilated a two legged test for directors. The first leg of the test is set out in subsection (i) of section 76(3)(c)<sup>148</sup> which states that all directors carrying out the same function should meet a requisite threshold as that director to avoid liability for negligent conduct in the performance of their duties<sup>149</sup>. This is the objective leg of the test. The second leg of the test is subjective

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<sup>142</sup> *Ibid.*

<sup>143</sup> *Ibid*

<sup>144</sup> *Ibid.*

<sup>145</sup> See note 32 above pg 4

<sup>146</sup> See note 35 above: *Cassim* at pg 60

<sup>147</sup> *Ibid* at 60

<sup>148</sup> The Companies Act 71 of 2008

<sup>149</sup> S McLennan. "Duties of Care and Skill of Company Directors and their Liability for Negligence" (1996) 8 SA Merc LJ 101.

in nature and found in subsection (ii) of section 76(3)(c)<sup>150</sup>. This leg of the test provides that if a director is found to have a higher standard of knowledge, skill and business acumen that could be reasonably be expected of a person carrying out the same function in relation to a company, then such a director will be liable to a higher standard<sup>151</sup>. The eventual outcome is that the judiciary will have to determine the standard of care, skill, diligence and business acumen that is to be reasonably expected of a director who is carrying out the same functions of a company as the director in question. Subject to what is expected of the court, the court does not stop there. The court has to go further and determine the degree of care, skill and diligence that can be expected from the director in question<sup>152</sup>.

The above standard is the statutory test which is used to determine negligence of director's for failure to conduct themselves with the required degree of care, skill and diligence. It is of importance to note that this test does not supersede or substitute the common law principles<sup>153</sup>. The common law is still in effect and is used by courts to hold a director liable in delict for negligent conduct which results in a company suffering a loss or damage from the directors' failure to conduct themselves with the required standard of care, skill and diligence.<sup>154</sup>

A movement from the common law lenient approach towards the more stringent statutory approach ensures that the more care, skill and knowledge a director possesses, the more onerous his duty becomes as he or she would have a higher threshold to meet<sup>155</sup>. In the same way the less care, knowledge and skill a director possesses the less onerous the duty of care, skill and diligence is and the less likely a director is to be held liable for negligence. According to the provisions of section 76(3)(c) a mandatory duty is owed to the company by the directors<sup>156</sup>. A director is not expected to carry himself with all the required care, skill and knowledge, rather what is expected is only the care which may reasonably be expected of that individual director as compared to a director carrying out similar functions<sup>157</sup>. It should be noted that a director may not act in a manner which is less than that expected of a reasonable

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<sup>150</sup> See note 135 above

<sup>151</sup> See note 136 above

<sup>152</sup> See note 35 above :*Cassim* at pg 559

<sup>153</sup> See note 33 above: *Bouwman* at pg 516

<sup>154</sup> *Ibid* at 516

<sup>155</sup> See note 35 above: *Cassim* pg 560

<sup>156</sup> See note 35 above: *Cassim* pg 559

<sup>157</sup> *Ibid* at 559

person. This establishes whether a director has breached his duty of care, skill and diligence under the statutory provisions<sup>158</sup>.

It is apparent that the duty of diligence is not particularly discussed in isolation or made reference to. Diligence actually implies that a director is to conduct himself or herself in a swift and efficient manner in attending to his or her duties, to be informed about the factual scenarios and issues which are affecting the company, and lastly make himself or herself aware and knowledgeable of the steps to be taken forthwith from the issues by finding solutions in the information which has been supplied to him or her.

The provisions of section 76(4)(b)<sup>159</sup> is relevant to a director conducting himself with the required degree of care, skill and diligence. This section accords directors to rely on information from a professional body or expert. The reliance of information from such a body is accepted if the director reasonably believes that such a person is competent and reliable. Should a director accept the information supplied from a person who is not of a competent or reliable nature, then the director would not have acted reasonably and thus be liable for negligence as a result of breaching his duty of care, skill and diligence<sup>160</sup>.

The provisions of the statute aim to promote a higher threshold of transparency, corporate governance and standards of accountability for directors which are in accordance with the international best practice. A director in performing his duties acts as an agent of the company who is assigned with the responsibility of promoting and protecting the company's best interests<sup>161</sup>. A case in which a director had breached his duty and acted for his own interest rather than for the best interest of the company, was the case of *Da Silva v CH Chemicals (Pty) Ltd*<sup>162</sup>, which was dealt with in the Supreme Court of Appeal. The main factor of this case put simply was that the director had furthered his own interests to the detriment of the company. The court held that a director owes his duties to the company to the exclusion of the company's shareholders and all third parties. If it is found that the conduct of the director was not to further the interests of the company, a director renders

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<sup>158</sup> *Ibid* at 559

<sup>159</sup> The Companies Act 71 of 2008

<sup>160</sup> *Ibid*

<sup>161</sup> See note 138 above

<sup>162</sup> (2009) 1 All SA 216 (SCA)

himself liable to being in breach of his duties as a result of his negligence and ulterior motive<sup>163</sup>.

A case comprising of similar principles and importance, which had gradually moulded the principle that a director has a mandatory duty to exercise care, skill and diligence, was highlighted in the case of *Re City Equitable Fire Insurance Company Limited*<sup>164</sup>, where the court found that a director would be negligent even though that director was entrusted with the responsibility of acting honestly. The court held that a director should exercise such a degree of skill and diligence as would amount to reasonable care which an ordinary man, having that particular director's knowledge and skills, may be expected to take in the same circumstances<sup>165</sup>.

The principle distilled from this case is that in respect of the subjective test, a director will not be liable for mere errors of judgment. He is not required to demonstrate expertise which he does not have in the performance of his duties, and is parallel to the objective test, in that the director is not expected to have any knowledge or to exercise skills which he does not possess<sup>166</sup>. In managing the company's affairs diligently, the director is accordingly commended with the responsibility of devoting a reasonable amount of attention to the company's affairs. Failure to demonstrate proper diligence may result in liability of a director who has acted negligently, fraudulently, dishonestly or with disregard and incompetence.

It is safe to say that the common law principles of South African law has now been expanded by the partial codification of the statutory provisions envisaged in section 76(3)(c) of the Companies Act 2008<sup>167</sup>, which strikes a balance between the required standard of care, skill and diligence which was initially founded under the common law, currently very much alive in the statutory provisions which have not discarded the common law in totality but rather modified the traditional founded principles. Bearing this in mind the principles of good corporate governance which aim to promote and protect the best interest of the company have been initiated and included into our newly founded statute.

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<sup>163</sup> *Ibid*

<sup>164</sup> (1925) Ch 407

<sup>165</sup> *Ibid*

<sup>166</sup> *Ibid*

<sup>167</sup> The Companies Act 71 of 2008

### 3.2.2 Application of the newly founded stringent approach

As expressed above, we are aware that the statutory provisions of the Act provides for a two legged test for a director to conduct himself with the required care, skill and diligence. The first leg of the test is set out in subsection (i) of section 76(3)(c)<sup>168</sup> which states that all directors carrying out the same function should meet a requisite threshold as a director of similar functions and performance to avoid liability for negligent conduct in carrying out their duties of care, skill and diligence<sup>169</sup>. This is the objective leg of the test. The second leg of the test is subjective in nature and found in subsection (ii) of section 76(3)(c)<sup>170</sup>. This leg of the test provides that if a director is found to have a higher standard of knowledge, skill and business acumen then such a director will be liable to a higher standard<sup>171</sup>.

In application of the above test it is noteworthy to differentiate between the use of subsection (i) and (ii) of section 76(3)(c). From the wording of the act it is apparent that subsection (i) applies to the spectrum all directors, but subsection (ii) applies to those directors who possess a higher standard of skill and business acumen. If a director possesses a higher standard of skill then both legs of the test will be applied, however if a director does not possess a high standard of skill or expertise then the first leg of the test shall only be applied.

Subject to the above applications it is important to note that the reasonable person test will be applied along with the two legged test. The reasonable person test determines the standard of care, skill, diligence and business acumen that is to be reasonably expected of a director who is carrying out the same functions as the director in question. In the event of a director not possessing a high standard of business acumen and skill where he ought to have required a higher standard of care and skill as a reasonable director carrying out the same functions as the director in question, then that director would be held liable for negligence as he ought to have known that a higher degree of care and skill was required in that instance.

A further reason for the above mentioned test is to eradicate applying a standard single sided approach. The test which is found in our current statute, which is referred to the stringent or rigorous approach actually accommodates for flexibility as it tends to consider the different circumstances and scenarios with which directors are challenged with and that the test should

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<sup>168</sup> *Ibid*

<sup>169</sup> *Ibid*

<sup>170</sup> *Ibid*

<sup>171</sup> *Ibid*

be applied taking into account the facts and challenges that directors are faced with. Bearing in mind that a sense of flexibility is visible from the test available to directors, it is not to be abused as liability will undoubtedly be attached to those directors who are found to be negligent for their failure to conduct themselves with the required degree of care, skill and diligence.

### 3.2.3 Benefits and the downfall of the partial codification which exists in our statute.

Despite the statutory provisions modifying and advancing the traditional principles of the common law, despite its modification is entrenched in our statute and its use is thus current and applicable. The statutory provisions accordingly place directors in a position whereby they are able to identify the scope and standard of their duties more clearly<sup>172</sup>. It is apparent from a survey which was conducted by the UK Institute of Directors', that a substantially high percentage of directors do not even know what the scope of their fiduciary and non-fiduciary duties entail, to whom such duties are owed and the benefit of their duties and performance<sup>173</sup>.

Before discussing any benefits of the partial codification it is important to distinguish the difference between complete codification and partial codification. Complete codification is unchanging, constant, inflexible and does not allow for any change as expressed in findings of partial codification<sup>174</sup>. Partial codification allows for improvement and advancement of the common law as this was the introduction of our law in South Africa which shadowed the English precedent. The refreshed Companies Act 2008 incorporates partial codification and allows for the common law to be constantly modified and improved<sup>175</sup>. The importance of the partial codification is to set out a requisite standard of director's conduct, limiting their powers in the dealings of the company and lastly increasing accountability, transparency, profitability and independence<sup>176</sup>. The act further attaches liability to a director who breaches or fails to act with the required standard of care, skill and diligence in the performance of their duties.

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<sup>172</sup> *Contemporary Company Law* Chapter 11 pg 473.

<sup>173</sup> South African Company Law for the 21st Century – *Guidelines for Corporate Law Reform* (GG 26493 of 2004-06-23)

<sup>174</sup> See note 157 above chapter 12 pg 507

<sup>175</sup> *Supra* at pg 508

<sup>176</sup> *Ibid* at 508

A further benefit born from the statutory provisions is the partial codification which considers the principles and benefits of both the common law and statute. The fact that the common law principles are preserved with the newly founded statute provides that such provisions co-exist for the eventual benefit of all directors. In South Africa the partial codification of directors' duties followed the trends fashioned in many jurisdictions such as Australia, New Zealand, Ghana, Malaysia, Singapore, and the United Kingdom apart from other common-law jurisdictions<sup>177</sup>. As a result of South Africa shadowing these jurisdictions the partial codification of the statute will align and accord South Africa with the approaches found in different jurisdictions<sup>178</sup>.

The Institute of Directors' in Southern Africa, before the introduction of the new Companies Act 2008, created a report known as the King Report on Corporate Governance<sup>179</sup> which aimed and focussed on the review, improvement and recommendations of corporate governance<sup>180</sup>. In a nutshell corporate governance is about "effective" leadership including the relevant principles and guidelines to which a director should adhere to in the performance of his or her duties<sup>181</sup>. The South African corporate governance regime is a set of principles and guidelines founded from the values to which a director should hold. Such values include accountability, transparency, honesty, selflessness, fairness and most importantly business ethics and values<sup>182</sup>. In the case of *South African Broadcasting Corporation Ltd v Mpofo*<sup>183</sup> the court emphasised that integrity is vital in effective corporate governance which should be based on a code of ethical behaviour and personal integrity which are characteristics of which a company director possesses<sup>184</sup>. It is clearly expressed in this case that a director of a company is required to possess a standard of ethics, values and morals of a high calibre and it can be inferred that such characteristics shall be evident in the success and profitability of a company. Through the time line of South Africa's corporate statutory

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<sup>177</sup> See note 158 above

<sup>178</sup> *Ibid* at 158

<sup>179</sup> M King 'The Synergies and Interaction between King III and the Companies Act 71 of 2008' (2010) *Acta Juridica* 446 at 447;

<sup>180</sup> Linda Muswaka 'Directors' Duties and the Business Judgment Rule in South African Company Law: An Analysis Vol. 3 No. 7; April 2013 at pg 5

<sup>181</sup> *Ibid* at pg 5

<sup>182</sup> See note 162 above at pg 6

<sup>183</sup> [2009] 4 ALL SA 169 (GSJ)

<sup>184</sup> *Supra* at para 64

modifications, the King report on corporate governance simultaneously underwent many changes since its first publication in 1994<sup>185</sup>.

As a result of the Companies Act 2008 there was a need for a newly founded King Report on corporate governance. The first founded King Report was introduced in 1994, commonly known as the King I which focussed on the issues which were predominant around corporate governance, which further aimed to create a higher standard of corporate governance in South Africa<sup>186</sup>. The King I was thereafter replaced by the King II which required that all companies including large entities were to be listed on the Johannesburg Stock Exchange (JSE) and were also required to comply with the requirements and expectation of the code. Failure in complying with the requirements of the code attached liability to the perpetrators<sup>187</sup>. Lastly the most recent King Report known as the King III was formally formed after the Companies Act 2008<sup>188</sup>, commonly known as King III, which came into effect in March 2010.

The aim of King III is to promote corporate governance and to reinforce responsibility to the class of people who partake in the management and functioning of a company and is seen as the backbone to corporate governance existent in South Africa incorporating the provisions laid down in statute<sup>189</sup>. The King III was also used as an indicator as to whether a director of a company acted with the appropriate standard of care, skill and diligence which ensured compliance of the Companies Act 2008<sup>190</sup>. The Companies Act focussed on the recourse available for a company where a director is in breach of his or her duty of care, skill and diligence while the King III focussed measuring the appropriate standard of care and skill required of a director which was in line with the newly founded statutory provisions<sup>191</sup>.

The provisions expressed in the King III Report advocate that a director should act with a prescribed set of principles. These principles have four requirements prescribing a director to:-

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<sup>185</sup> *King I* (1994)

<sup>186</sup> Esser & Delpont “ *Duty of care and skill: The king report and the 2008 Companies Act*” 2011 (74) THRHR pg 450

<sup>187</sup> *Ibid* at 450

<sup>188</sup> See note 28 above at pg 451

<sup>189</sup> See note 162 above

<sup>190</sup> *Ibid*

<sup>191</sup> *Ibid*

1. Act with intellectual honesty and independence of mind in the best interests of the company and all its stakeholders, avoiding conflict of interest<sup>192</sup>;
2. have the knowledge and skills required for governing a company effectively<sup>193</sup>;
3. be diligent in performing their duties and devote sufficient time to the company affairs<sup>194</sup>, and lastly;
4. have the courage to take the risks associated with directing and controlling a successful, sustainable enterprise, and also the courage to act with integrity in all board decisions and activities<sup>195</sup>.

It is apparent from above that the principles rooted in the King III and that of corporate governance endorse the appropriate standard to which directors' should conduct themselves in the performance of their duties. It can be said that the provisions laid down in statute and the principles of corporate governance work hand in hand in achieving the same outcome which is to ensure the success of the company and the prescribed standard by which directors are to conduct themselves for the success and growth of the company<sup>196</sup>.

The King code of corporate governance complied with the provisions of legislature to provide certainty as to what required standard of care or what required standard of conduct is expected from a director in the performance of his duties to ensure that the appropriate standard of care, skill and diligence is carried out<sup>197</sup>. A further apparent analysis is that the King III is used as an avid indicator as to whether a director acted with the required care, skill and diligence to ensure compliance of their duties while the Companies Act expresses the recourse available to a company should director's be in breach of their duties and be found negligent for their conduct and performance<sup>198</sup>.

A noteworthy case which of importance in this particular instance is the case of *Stilfontein Minister of Water Affairs and Forestry v Stilfontein Gold Mining Company Ltd*<sup>199</sup> which expressed the view of how our judiciary tests directors' conduct and performance against the King Report considering the relevant provisions of the Companies Act of 2008. Considering

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<sup>192</sup> Institute of directors: *King III at para 15.1* 2002

<sup>193</sup> *Supra* at para 15.3

<sup>194</sup> *Supra* at para 15.4

<sup>195</sup> *Supra* at para 15.5

<sup>196</sup> See note 164 above

<sup>197</sup> See note 162 above pg 7

<sup>198</sup> *Ibid*

<sup>199</sup> 2006 5 SA 333(W)

the main factors of this case, there are two main issues canvassed to be of a cardinal nature. The first is whether the directors of the company had breached their duties owed to the company by all resigning simultaneously and secondly the issue of social responsibility and to whom directors owe their fiduciary duty and duty of care and skill<sup>200</sup>.

With regard to the first issue it was held that the directors had indeed breached their fiduciary duties to act selfless for the ultimate benefit and interests of the company. The directors abandoned their responsibilities and relinquished their obligations which were due to the environment as such directors held positions in a mining company. The court held that the directors could not “*walk away*” from their obligations<sup>201</sup>. It was found that the directors were irresponsible and irrational and had left the company to fend for itself without any directions from the directors. The directors paralysed the company by failing to act in its best interest as they ought to<sup>202</sup>.

As expressed above it is evident that the application and provisions of both the King Report and the Companies Act held the directors accountable and negligent for the loss and damage which the company suffered as a result of their failure to carry out their duties with the reasonable standard of care and skill<sup>203</sup>. It is thus indisputable that the Companies Act and the King Reports work hand in hand for the benefit of the company and economy, increasing productivity and profitability which is a distinct consequence of a successfully managed company<sup>204</sup>.

Apart from the above, the partial codification prevalent in the current statute has a number of benefits. The benefits of partial codification comprise of clearer and more efficient guidelines, saving money, time and effort in finding and complying with the law; and enabling directors to clearly identify the scope of their duties. The benefits are not a closed list and are discussed below in greater detail. The benefits further enable the directors to ascertain the standard by which they should conduct themselves for the best interests of the company.<sup>205</sup>

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<sup>200</sup> *Ibid*

<sup>201</sup> *Ibid*

<sup>202</sup> See note 180 at para 16

<sup>203</sup> See note 168 above pg 5

<sup>204</sup> *Ibid* pg 5

<sup>205</sup> *Ibid* pg 5

Despite the innumerable advantages which were borne alongside the provisions of the new Companies Act, there are still disadvantages which hover around this topic. Be that as it may many commentators have different opinions concerning the advantages and disadvantages with which the partial codification of the newly founded Companies Act carries<sup>206</sup>. The benefits borne of partial codification incorporates the principles of corporate governance which mainly focuses on the best interests of a company<sup>207</sup>. The benefits apart from above comprise of the following:-

- promoting transparency, accountability, independence while considering the best principles of corporate governance<sup>208</sup>,
- creating awareness to the duties of a director and the standard which is required of them<sup>209</sup>,
- creating certainty and clarity in the law as the use of the language in the statute is now more understandable as well as user friendly<sup>210</sup>,
- the number of provisions found in the current Companies Act are reduced and supercede those of the old Companies Act<sup>211</sup>,
- provides for the initiation of simpler procedures and compliance with the provisions of the Act<sup>212</sup>,
- considers the evolving modernised corporate terrain as well as the remedies available for the challenges a company might face<sup>213</sup>,
- creates awareness to prospective directors and the public as to the requirements of the duties and characteristics a director should possess<sup>214</sup>, and;
- focuses on corporate governance by providing that a director should be selfless with its ultimate aim at promoting the company for the best interests of the company itself<sup>215</sup>.

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<sup>206</sup> See note 173 above

<sup>207</sup> *Ibid*

<sup>208</sup> See note 1 above: *Bouwman* at 521

<sup>209</sup> *Ibid* at 521

<sup>210</sup> *Ibid* at 521

<sup>211</sup> *Ibid* at 521

<sup>212</sup> *Ibid* at 521

<sup>213</sup> *Ibid* at 521

<sup>214</sup> *Ibid* at 521

<sup>215</sup> *Ibid* at 521

Subject to the above advantages of the partial codification, commentator Bouwman concurs as per her article<sup>216</sup>, and infers that there is a perfect balance between the partial codification of directors duties of care and skill contrasted between the common law and statute. She further concurs with the fact the law is much more easily accessible and certain without ambiguity and loopholes which directors or shareholders may find with regard to their duties of care and skill and as such the confusion which was predominant in the past has now been eradicated.<sup>217</sup>

Despite the above benefits concurred by Bouwman herself, there is a contrast of opinion which carry heavy critique from commentators such as Bekink<sup>218</sup>, Havenga<sup>219</sup> and Mervin King<sup>220</sup>. To introduce the criticisms of the partial codification emphasis is made on the points made by Bekink. Bekinks synopsis considers both the subjective and objective view. He is of the opinion that the subjective test comprises of a directors general knowledge, skill, experience and business acumen which may conceal the requirements of the objective test. As a consequence of this our judiciary may experience uncertainty and ambiguity when determining what directors' duties entail and what duties are reasonably expected of a director<sup>221</sup>.

Moving on to Havenga's notion, she is of the opinion that since this aspect of law is now part of statute, people will try to evade the provisions of the statute due to cost implications which may be involved. Further the common law has been exposed to many changes, criticisms yet has been applied for many years. Her taking expresses the view that the statutory provisions are very current and are still subject to many criticisms, will still have to be applied and there will still be many challenges and problems which may be experienced in its application<sup>222</sup>. Lastly critique apparent from the notions expressed in King Report II by Mervin King who is of the opinion that the provisions of the statute which has codified the common law is still subject to many potholes despite the statute being drafted for the best interests of the directors and the company.

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<sup>216</sup> See note 1 above: *Bouwman* at pg 517

<sup>217</sup> *Ibid* at pg 516

<sup>218</sup> See note 1 above: *Bouwman* at pg 523

<sup>219</sup> See note 1 above: *Bouwman* at pg 522

<sup>220</sup> See note 1 above: *Bouwman* at pg 519

<sup>221</sup> See note 207 above.

<sup>222</sup> See note 208 above.

One of the main reasons is that directors are always placed in a situation of pressure in conducting themselves with the required degree of care and skill. The stringent approach incorporated in statute may instil fear in directors in respect of liability and ultimately may not be the best approach as directors are now restricted to the requirements of provisions which may restrict the expression of their full potential and capabilities as directors for the best interests of the company<sup>223</sup>.

### 3.3. CONCLUSION.

The construction of the common law traditional approach has evidently led to a more stringent and rigorous approach adopted in our statute. This is not to say that the common law is now discarded, it is very much still in use and applied. Apart from the modification of the common law traditional approach, our statute has incorporated a partial codification towards the duties of care and skill which are required of directors. It is safe to say that not much has been lost from the common law as the statutory provisions contain components of both the subjective and objective tests, while the subjective test was initially evident from the traditional approach<sup>224</sup>.

One of the most notable changes provided for in the statutory provisions dealing with the duty of care, skill and diligence is that of liability. As per the provisions of statute, directors are faced with a more onerous duty to ensure the required standard of care and skill is carried out in the performance of their duties. Apart from the aspect of liability, the 2008 Act now incorporates the provisions of corporate governance which ultimately aim at reaching the best interests of the company by considering the many modernised factors which our economic environment are challenged with.

The findings of section 76(3)(c) provide directors with a sense of direction, in that they are now aware of what is expected of them in carrying out their duties of care, skill and diligence. Apart from directors, prospective directors, the community and stakeholders now have access to the provisions of how directors should conduct themselves selflessly and for the best interests of the company. These groups of people are further informed of the liability attached to directors who contravene their duties of care and skill and how a director may

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<sup>223</sup> See note 209 above.

<sup>224</sup> See note 1 above: *Bouwman* at pg 532

escape liability by the provisions of the business judgment rule which will be discussed in the chapter below.

## CHAPTER 4

### THE BUSINESS JUDGMENT RULE - A DIRECTOR'S SANCTUARY FROM LIABILITY.

#### 4.1 INTRODUCTION

It is paramount to understand the reason why South Africa adopted the business judgment rule. Before an exposition into the business judgment rule it is important to note that as a consequence of our statute adopting a more stringent and rigorous test to which directors' duties of care and skill are to be measured, our statute had to strike a balance between this stringent test by easing the burden of liability to those directors who conducted the company and its decisions in good faith.

A company cannot function without human involvement; as such every decision made by a director is subject to a rational, reasonable, and informed basis for the best interests of the company. The main aim of the business judgment rule is to provide a "safe haven" for directors who carried out their duties in a *bona fide* (good faith) manner even if such decisions led to disastrous results<sup>225</sup>. This does not mean that directors will be protected blindly irrespective of their *mala fide* (bad faith) conduct, this protection is only afforded to those directors who honestly, reasonably and rationally believed such decisions would be for the best interests of the company<sup>226</sup>.

It is significant that the differentiation of negligence and mere errors of judgments are expressed herein. In the application of the business judgment rule it is important that the decisions or conduct of a director amount to mere errors of judgments or mistakes and not negligence<sup>227</sup>. A director is to carry out the performance of their duties with all the reasonable care, skill, diligence and honesty for the best interest of the company. If a director fails to act in such a manner such conduct will be tantamount to negligence and the business judgment rule cannot be applied to conceal such negligent conduct.

From the above paragraphs it is evident that the provisions of statute do not imply that directors are to conduct themselves with all the possible skill and care in the performance of

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<sup>225</sup> *Contemporary Company Law: Cassim* pg 563

<sup>226</sup> *Ibid* at 563

<sup>227</sup> *Contemporary Company Law : Cassim* pg 560

the duties, what is expected of directors is for them to conduct their duties of care and skill in a reasonable manner with a reasonable amount of care and skill. Cassim is correct in his contention that humans are infallible and subject to mistakes and errors<sup>228</sup>, however these mistakes and errors should be such that a reasonable director in such a position would have possibly made, given the facts and circumstances. Directors will not incur liability for mistakes and mere errors provided they exercised the reasonable care and skill necessary, this is the curb of liability which the business judgment rule aims to provide<sup>229</sup>.

Given the introduction of this chapter with emphasis on the business judgment rule, this chapter will focus on the jurisdictions to which South Africa followed in its application of the business judgment rule, the current statute and case law applicable to the business judgment rule and a thorough exposition to the application of the business judgment rule currently applied in South Africa and how it affords protection to directors despite the stringent provisions of statute.

#### 4.2.1 The jurisdiction to which South Africa shadowed in incorporating the business judgment rule.

The business judgment rule has been incorporated into the Companies Act 2008 for the purpose of easing the burden of the partially codified duties of care, skill and diligence<sup>230</sup>. The business judgment rule was formally developed by the American judiciary to essentially aid as a defence for directors who acted in a *bona fide* (good faith) and reasonable manner when making business decisions for and on behalf of the company which resulted in loss or damage to the company<sup>231</sup>. The aim of the rule was to provide a shield of protection to a director who in the performance of his duty of care, skill and diligence made a rational, reasonable and informed decision in a manner which he believed was in the best interest of the company<sup>232</sup>.

The business judgment rule originated in the early 19<sup>th</sup> century in the state of Delaware in America and was used as a tool for judicial review<sup>233</sup>. It is important to note that in American law, similar to South Africa directors owe the company a fiduciary duty to act in the best

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<sup>228</sup> *Ibid* pg 560

<sup>229</sup> *Ibid* pg 560

<sup>230</sup> See note 32 above at pg 5

<sup>231</sup> Kennedy-Good (2006) *Obiter* 64.

<sup>232</sup> *Ibid*

<sup>233</sup> Botha (1997) *SALJ* 73.

interests of the company as well as a duty of care and honesty as opposed to the duty of care, skill and diligence in South Africa<sup>234</sup>. The duty of care and loyalty is quantified against an ordinary reasonably cautious person, while the duty of loyalty involves the notion that a director should not place himself in a situation where there will be a conflict of interest. A director is not to make decisions for his or her benefit but rather focus the benefit solely on the company. In the performance of their duties a director should and not conduct himself in a dishonest, unscrupulous and unfaithful manner<sup>235</sup>.

Apart from the above, the law of Delaware states that a director is to act in good faith and honesty. The meaning of “good faith” was expressed in the case of *In re RJR Nabisco Inc Shareholders Litig*<sup>236</sup>, where Chancellor Allen had provided for the meaning of “bad faith” by stating, “such limited substantive review as the rule contemplates (i.e. is the judgment under review “egregious” or “irrational” or so beyond reason etc) really is a way of inferring bad faith”<sup>237</sup>. The meaning portrayed in this case ultimately links to liability of a director due to negligence, should a director make a decision which is irrational, unscrupulous, dishonest and completely *mala fide* (good faith) then such a director will be subject to judicial review were the judiciary shall attach liability to the director based on the nature of their negligence and the extent of negligence.

Directors who perform their duties with the reasonable care, loyalty and honesty for the best interests of the company, shall be afforded the use and protection of the business judgment rule which serves as a defence or shield, should a third party such as shareholders of the company infer negligence to the conduct of the directors<sup>238</sup>. The rule serves as a “safe harbour” for directors who carry out their duties in the above manner even though the company suffers damages<sup>239</sup>. However should a director breach their duty of care or conduct themselves in an irrational and selfish manner, then the losses or damages suffered by the company can be linked to the unfavourable conduct of the directors who will inevitably be found negligent and liable as a result of their conduct.

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<sup>234</sup> *Ibid*

<sup>235</sup> *Ibid*

<sup>236</sup> 1989 WL 7036 13 (Del. Ch. 1989),

<sup>237</sup> *Ibid*

<sup>238</sup> Lee (2003) *Columbia Law Review* 939.

<sup>239</sup> *Ibid* at 939

#### 4.2.2 The constitution of the business judgment rule according to the American Judiciary.

According to the American Law Institute<sup>240</sup> and the Delaware law dealing with the business judgment rule, there are certain components or elements which need to be fulfilled in order for a director to benefit from the protection encapsulated in the business judgment rule. The elements which a director needs to partake in to benefit from the shield of protection are as follows:-

- A decision is to be made by the director free from selfish interest and for the best interests of the company<sup>241</sup>;
- The director is not to be placed in a position which conflicts with his or her interest or the interests of the company when making such a decision<sup>242</sup>;
- The decision must be made in good faith with honest and profitable intentions for the company<sup>243</sup>, and;
- The decisions must be taken with reasonable and rational care, considering the circumstances of the situation<sup>244</sup>.

If a director fulfils the above requirements and did indeed act in good faith, then the business judgment rule shall act as armour against directors liability for negligence for the losses and damages suffered<sup>245</sup>. Evidently so, if a director makes a decision irrationally without the reasonable care, with selfish intentions or fails to carry out the above elements he or she shall justly be found liable for negligence and the business judgment rule will provide no scope for protection to the director.

The introduction of the term “safe- harbour” was formally initiated by the American judiciary in the American Law Institute<sup>246</sup>. The term “safe-harbour” entrenched the above elements in its application and ultimately provide directors with an antidote free from liability subject to the fulfilment of the above elements<sup>247</sup>.

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<sup>240</sup> American Law Institute, ALI Corporate Governance Project (Philadelphia: American Law Institute (1994)).

<sup>241</sup> *Ibid*

<sup>242</sup> *Ibid*

<sup>243</sup> *Ibid*

<sup>244</sup> *Ibid*

<sup>245</sup> See note 222 above

<sup>246</sup> Branson (2004) *Hong Kong LJ* 306

<sup>247</sup> *Ibid*

Apart from the “safe-harbour” term, the Delaware law provided a further benefit to directors based on that of presumption. The findings on the use of presumption was held in the case of *Aronson v Lewis*<sup>248</sup>, thereafter concurred in the case of *Warshaw v Calhoun*<sup>249</sup> where it was held that “there is a presumption that in making a business decision the directors of the corporation acted on an informed basis, in good faith and in the honest belief that the action or decision taken was in the best interest of the corporation”.

It is apparent from the wording of the above case that the courts will presumably believe that a director of a company acted in good faith, made a rational and reasonable decision, made the decision for the best interest of the company and took the appropriate steps of care and skill in making the decision. Subject to a third party such as a shareholder or an interested party of the company contesting that the decisions were made in good faith, for the best interest of the company, or that the director failed to carry out the required care and skill then the third party shall have to prove to the court that the director did in fact act in *mala fide* (good faith) manner.

The third party or any other interested party of the company is to show the court negligence on part of the director by proving to the court that the decision made by the director was so irrational and unreasonable that a director with his skill, qualifications, experience, business acumen and expertise would have considered various factors and information before making the decision and would not have arrived at the same decision<sup>250</sup>. Should the third party be unsuccessful in proving to the judiciary on a balance of probabilities that the director failed to act with the required care and skill, then the director shall get the benefit of the doubt and thus avoid any liability for negligence.

It is a pre-requisite of the business judgment rule that the decisions made by the director shall be made reasonably and rationally in good faith for the best interests of the company and to avoid decisions that are considered to be made in bad faith<sup>251</sup>. In the American case of *Shuttleworth v Cox Brothers & Co (Maidenland) Ltd*<sup>252</sup>, the court had correctly decided that if a director fails to make a decision with the reasonable and rational care and skill then the decision made shall convey characteristics of bad faith.

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<sup>248</sup> 473 A 2d 805, 812 (Del 1984)

<sup>249</sup> 221 A 2d 487

<sup>250</sup> See note 235 above.

<sup>251</sup> *Contemporary Company Law* : Cassim pg 564

<sup>252</sup> (1927) 2 KB 9 (CA) 23.

A noteworthy case which moulded the South African business judgment rule which was formally decided by the Delaware law in America is the case of *Smith v Gorkum*<sup>253</sup>, a case which was taken on appeal by the shareholders of the company in finding the directors' liable for negligence in respect of their decision to sell the shares of the company without any due regard to the price of the shares which were to be sold. The court *a quo* (court of first appearance) had incorrectly found that the directors may escape liability by the use of the business judgment rule. On appeal the court disagreed and reversed the decision initially made by the court *a quo* (court of first appearance) for the following reasons:-

- The directors failed to inform themselves of the value of the shares of the company to the value of the sale of each share<sup>254</sup>;
- The board did not make an informed and rational decision in respect of the sale of the shares as this decision was done within a short period of time without considering any expert reports or expert advice;
- The shares were not correctly valued by independent experts and the board irrationally accepted the recommendations of the senior management of the company who are not qualified to value such shares<sup>255</sup>, and;
- The board failed to examine the agreement to the sale of the shares, failed to look at the profit which the company may make and most importantly failed to consider the losses and damages that the company could suffer<sup>256</sup>

This case is of cardinal importance as evidently shows that the directors of the company failed to conduct themselves with the required standard of care, skill and diligence which was expected of a director. Even though the facts of the case did not have any relation to self interests or fraud on part of the directors, the decisions made by the directors were so unreasonable and irrational that the company had suffered grave losses. The appeal court correctly decided that the application of the business judgment rule shall not be used in a situation where the directors failed to make a decision rationally, reasonably, in good faith with sound reasons. The directors in this case failed to take the appropriate steps in making a sound business decision which lead to the destruction of the company and their liability for negligence.

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<sup>253</sup> 488 A.2d 858 (Del. 1985).

<sup>254</sup> *Ibid*

<sup>255</sup> *Ibid*

<sup>256</sup> *Ibid*

#### 4.3 THE INTRODUCTION OF THE BUSINESS JUDGMENT RULE IN SOUTH AFRICA.

The business judgment rule has been a controversial issue in South Africa which began from the mid 1990's. The controversy lingers around the aspect of whether it was a bright idea for South Africa to follow the initial business judgment rule formulated by the American law<sup>257</sup>. The main aim of South African law incorporating the business judgment rule is to shield those directors who carry out their duties in good faith and honesty from liability for negligent conduct. Bearing in mind the aim of the business judgment rule, it is evidently true that should a director conduct himself in good faith with the required degree of care and skill, yet still cause a loss or damage to the company as a result of his or her decision he or she shall be subject to the protection of the business judgment rule as a result of acting in good faith and honesty with the required degree of care and skill<sup>258</sup>.

Since the introduction of the King Report on Corporate Governance<sup>259</sup> in 1994 there has been a need for the Companies Act to be amended to include certain limitations which will aim to protect or encourage directors who conduct themselves in good faith to seek entrepreneurial opportunities, take risks, agree to the position of being director and to be innovative for the benefit of the company<sup>260</sup>.

In respect of the most recent King Report on corporate governance, known as the King Report III which was formed after the Companies Act 2008, despite the Report not being legislation it is guidelines which work hand in hand with legislation and the Act<sup>261</sup>. According to King III there are guidelines laid forth for directors in the performance of their duties such as to act with honesty and independence for the best interests of the company, to avoid any situation which may lead to a conflict of interest, to have a standard of care, skill and diligence required for effectively performing for the company, and to encourage risk taking and entrepreneurial activities which will ultimately lead to a successful and profitable company<sup>262</sup>. Should a director conduct himself or herself in such a manner and make a decision which leads to a business error or mistake even though might be disastrous will be

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<sup>257</sup> Kennedy-Good at pg 69

<sup>258</sup> *Ibid*

<sup>259</sup> Kennedy-Good at pg 63

<sup>260</sup> Institute of directors: *Para3.2 of the King Report,2002*

<sup>261</sup> Linda Muswaka " Directors' Duties and the Business Judgment Rule in South African Company Law: An Analysis" 2013 Vol. 3 No. 7 pg 6

<sup>262</sup> *Ibid* at 6

absolved from liability by the use of the business judgment rule. These principles will thus have to be considered by the judiciary who will have the final say as to whether the director is to be found liable for his or her negligence or whether the use and application of the business judgment rule can be used as protection by the director to exonerate him or her from liability<sup>263</sup>.

With regard to South Africa adopting the American common law approach, particular emphasis should be placed on the case of *Foss v Harbottle*<sup>264</sup> which incorporated principles from the American law. The relevance of the findings by the judiciary was of cardinal importance as there are certain requirements which a director needs to fulfil in order to qualify for the protection which the business judgment rule affords. The court further held that the decision made by the director is to be made in good faith, with the required degree of care, skill and diligence for the best interest of the company<sup>265</sup>. The (4) requirements which a director should observe are as follows:-

1. The decision considered and made by the director should be a business related matter<sup>266</sup>;
2. The decision made by the director should have no gain for the director neither shall the director be in any position to benefit from the decision, the decision is to be made for the sole and best interests of the company<sup>267</sup>;
3. In the decision making process an appropriate level of care, skill, diligence and expertise is to be portrayed<sup>268</sup>,and;
4. The director is to act in good faith<sup>269</sup>.

As a consequence of the findings in the above case, it is apparent that the requirements from this case are similar to the requirements of the American based business judgment rule which require that the directors are to perform or conduct themselves in a similar manner. Given the findings of the American legislation which has been in application for almost 160 years<sup>270</sup>, it is safe to say that as a result of the successful application and use of the business judgment

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<sup>263</sup> *Ibid* at 6

<sup>264</sup> (1843) 2 Hare 461, 67 ER 189.

<sup>265</sup> *Ibid*

<sup>266</sup> *Ibid*

<sup>267</sup> *Ibid*

<sup>268</sup> *Ibid*

<sup>269</sup> *Ibid*

<sup>270</sup> *Contemporary Company Law* : Cassim pg 563

rule in America, that South Africa modelled its taking on the business judgment rule and followed similar footsteps as America in introducing the business judgment rule in the 2008 Companies Act<sup>271</sup>.

#### 4.4 CODIFICATION OF THE BUSINESS JUDGMENT RULE- S76(4) OF THE COMPANIES ACT 2008.

The business judgment rule under the 2008 Act was introduced as an attempt to lighten the liability which flows from the stringent and rigorous test applied to directors carrying out their duties of care, skill and diligence<sup>272</sup>.

The provisions of section 76 (4)<sup>273</sup> of the Companies Act is expressed as follows - “In respect of any particular matter arising in the exercise of powers or the performance of functions of a director, a particular director of a company –

**(a)** will have satisfied the obligations of subsections (3) (b) and (c) if -

i) the director has taken reasonably diligent steps to become informed about the matter;

ii) either –

aa) the director had no material personal financial interest in the subject matter of the decision, and had no reasonable basis to know that any related person had a personal financial interest in the matter; or

bb) the director complied with the requirements of section 75 with respect to any interest contemplated in subparagraph (aa); and

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

**(b)** is entitled to rely on –

i) the performance of any persons –

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<sup>271</sup> See note 250 above at pg 5

<sup>272</sup> See note 259 above.

<sup>273</sup> Section 76(4) of the companies Act 71 of 2008

aa) referred to in subsection (5); or

bb) to whom the board may reasonably have delegated, formally or informally by course of conduct, the authority or duty to perform one or more of the board's functions that are delegable under applicable law; and

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

The aim of the business judgment rule is to encourage risk taking, innovation and entrepreneurial activities by shielding directors from liability for negligence were directors make an informed rational and reasonable business decision in good faith<sup>274</sup>. It is safe to say that the business judgment rule prevents the courts from interfering in a situation where a director has made a business decision in honesty and good faith despite the consequence of the business decision<sup>275</sup>.

In the case of *In re City Equitable Fire Insurance Company Limited*<sup>276</sup> and *Fisheries Development Corporation of SA Ltd v Jorgenson*<sup>277</sup>, both cases dealing with the similar common law principles which stated that a director shall be liable in the performance of their duties of care, skill and diligence if they fail to conduct themselves with the required degree of care and skill which would be reasonably expected of a person with that particular directors knowledge and experience. The provisions of statute express the view that each case will have to be determined in isolation, considering the fact that each company and the directors of the company hold different functions, obligations and responsibilities and are involved in conducting different business initiatives<sup>278</sup>. If the situation is such that the director fails to carry himself out in a rational and reasonable manner as that of a similar director then the director shall be liable for the loss or damage which the company may suffer<sup>279</sup>.

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<sup>274</sup> See note 259 above

<sup>275</sup> *Ibid*

<sup>276</sup> [1925] 1 Ch 407 (CA)

<sup>277</sup> 1918 (4) SA 156 (W)

<sup>278</sup> See note 265 above

<sup>279</sup> See note 266 above

Our statutory business judgment rule has shadowed the rule which has been in application in the American judiciary for 160 over years<sup>280</sup>. Despite following the American footsteps, section 76(4) of the 2008 Act has initiated a partly subjective and objective test. In application the objective test is measured against the reasonable man, which requires a director to carry out the required degree of care, skill and diligence which is reasonable expected of a director carrying out the same functions as that director<sup>281</sup>. The subjective test is thereafter quantified by considering the knowledge, skill and experience of that particular director. If the director has a higher degree of skill, knowledge or experience then that director will be measured against a higher standard as opposed to a director who has a lower degree of skill, knowledge and experience<sup>282</sup>.

A synopsis of the statutory business judgment rule is broken down as follows:-

1. The decision which is made by the director must be an informed and knowledgeable one where the director has become aware of all the facts, circumstances, advantages and disadvantages attached to the particular decisions<sup>283</sup>;
2. Secondly the director must have no interest in the decision which is made, there must be no beneficial gain whatsoever whereby the director or a third party has benefited at the cost of the company. The cardinal rule is that the director is to conduct himself in such a manner which results in the best interests of the company<sup>284</sup>, and ;
3. Lastly the director must have had a rational belief, and actually did believe that the decision which he made was ultimately in the best interest of the company<sup>285</sup>.

Considering the above pointers, it is of paramount importance to note that should a director fulfil these requirements then such a director shall be protected by the use of the statutory provisions relating to the business judgment rule. In essence the business judgment rule is a sanctuary of protection afforded to directors who are honest, trustworthy and who conduct themselves in good faith with the required degree of care, skill and diligence. In the

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<sup>280</sup> See note 259 above

<sup>281</sup> *Contemporary Company Law* : Cassim pg 559

<sup>282</sup> *Ibid* at 559

<sup>283</sup> *Contemporary Company Law* : Cassim pg 565

<sup>284</sup> *Ibid* at 565

<sup>285</sup> *Ibid* at 565

application of the business judgment rule, the judiciary and courts shall not interfere in reviewing or judging the business decisions of the director if such decisions were actually rational, reasonable and in accordance with the act<sup>286</sup>.

Despite the beneficial protection which is afforded by the business judgment rule there are many authors such as Bouwman, Botha, Jooste, Havenga, McLennan, Coetzee and Muswaka who abhorred and disfavoured the provisions of the business judgment rule in the 2008 Act<sup>287</sup>.

With the critique on the business judgment rule, Bouwman states as follows:-“ In a society where corporate scandals are not few; where competent directors are highly sought after; where our courts usually have afforded (and will continue to afford) directors the benefit of the doubt; where court decisions show that South African society does not have a history of succeeding against directors due to breach of their duty of care and skill; and where the 1973 Act currently contains, and the 2008 Act proposes, equivalent provisions to provide defences for directors against liability, it hardly makes sense to extract a principle (that has the effect of providing an extra defence to directors against being found in breach of their duty of care) in isolation from a legal system that does not much resemble ours and to incorporate such a principle into South African company law<sup>288</sup>.”

With particular reference, Bouwman’s scorned view disfavours South Africa shadowing the American judiciary as she is of the opinion that we have very different legal systems, therefore, the success of the American based rule shall not in any way depict the success of the rule implemented in the 2008 Act as both these judiciaries have vast differences in respect on the law of directors and are in no way similar<sup>289</sup>. Further she is of the view that there was no need to implement an “extra” defence as the law clearly provided directors who acted in good faith with the opportunity of proving their innocence without the use of the business judgment rule.

Notwithstanding the above, the King III taking on the business judgment rule hovers around the dark cloud of critique which Bouwman concurs with. The King III report states that “the

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<sup>286</sup> *Ibid* at 565

<sup>287</sup> See note 250 above: Muswaka pg 4

<sup>288</sup> See note 272 *supra*.

<sup>289</sup> See note 1 above : Bouwman at 530

2008 Act has introduced a new defence for the advantage of directors who are purportedly in breach of their duty of care and skill”.<sup>290</sup>

The findings of the King III convey the despair that the business judgment rule implements. According to the report’s statement I am of the opinion that the reports taking on the business judgment rule is seen as a tool in cushioning dishonest directors from liability which is to be attached to the perpetrators’ of the law.

According to McLennan, the notion on directors duties are that the fiduciary duties and the duties of care, skill and diligence are to be examined in isolation. McLennan’s view on the business judgment rule is that the rule “muddles” the aspect as to what the salient duties of directors consist of, as a result of this vagueness, unnecessary uncertainty and confusion is promoted<sup>291</sup>

#### 4.5 CONCLUSION.

It is evident that the business judgment rule has been a controversial issue since its implementation in the Companies Act 2008. Davis’s wise explanation regarding the aim of the business judgment rule is revealed as follows: “The 2008 Act promotes the objective that there should not be an over-regulation of company business. The Act grants directors the legal authority to run companies as they deem fit, provided that they act within the legislative framework. In other words, the Act tries to ensure that it is the board of directors, duly appointed, who run the business rather than regulators and judges, who are never best placed to balance the interests of shareholders, the firm and the larger society within the context of running a business”<sup>292</sup>.

The above extract aims to concur with the application of the business judgment rule in South Africa in providing directors with the opportunity to be innovative, take-risks, make large entrepreneurial decisions and remove the daunting fear that may always linger on their minds as to the liability of their business decisions. Provided a director fulfils all of his duties and

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<sup>290</sup> See note 1 above: Bouwman at 528.

<sup>291</sup> *Ibid* at 528

<sup>292</sup> See note 250 above: Muswaka pg 4

obligations in a reasonable and rational manner with the expected degree of care and skill a director will be afforded the protection envisaged in the business judgment rule<sup>293</sup>.

Even though the origin, purpose and application of the business judgment rule of the American judiciary is expressed and understood the critique, both for and against the introduction of the rule into the South African Companies Act is currently at a constant upheaval. The cardinal criticism against the business judgment rule is that South Africa has followed the footsteps of a country which has no similarities whatsoever to that of South Africa, despite this factor was still implemented into our statute. With regard to those commentators who favour the use and application of the business judgment rule it is apparent that the business judgment rule will protect directors who act in good faith with the expected degree of care, skill and diligence from the errors of judgment and mistakes despite such decisions causing substantial loss or damage. As a cardinal point the rule as explained above grants directors the opportunity to make risky decisions subject to the decisions being reasonable, rational and an informed one. Notwithstanding the above, since the initiation of the stringent and rigorous test which is applied against directors' duties of care, skill and diligence in the performance of their duties, the business judgment rule is used as a tool to soften the burden placed on these directors who may be subjected to a higher amount of responsibility and power if incorrectly used leading to a greater amount of liability for negligence<sup>294</sup>.

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<sup>293</sup> *Contemporary Company Law* : Cassim pg 564

<sup>294</sup> *Contemporary Company Law* : Cassim pg 563

## **CHAPTER 5**

### **THE CONCLUSION**

Peeking into the expositions on the above chapters, it is apparent that a standard can be set in respect of directors and that standard is the critical role in which they play. A director of a company is as crucial as a heart in a human body, without a director the company will not function as a body without a heart. In portraying these vital characteristics it is imperative that directors convey positive leadership skills which in turn results in increased productivity, a greater turnover of income, radiant employees, content customers and lastly as a result of the success of the company a social and environmental responsibility is borne wherein the company is in a position to give back to the society and environment as a whole.

Directors' duties of care, skill and diligence are unique in nature and directors who manage a company on a high management level portray benefits by strongly rooting a successful and profitable company. As a result of the partial codification introduced in the Companies Act 2008, it is imperative to note that the legislature intended to promote a sense of conscience and ethical values on all directors and prospective directors to ensure they conduct themselves in such a manner which is beneficial for the company in the most profitable and successful way possible.

Recapping on the common law's taking on directors' duties of care, skill and diligence it is evident from the above chapters that the traditional view has been a controversial in nature, mainly in respect of the issue of liability. The traditional lenient approach conveyed in the principles of the common law needed to be reconstructed due to the vagueness and uncertainty which hovered around this area. As a result this lenient traditional approach was reconstructed by the partial codification existent in the 2008 Companies Act which seeks to provide a dual hybrid subjective and objective test in attaching liability to directors. As a result of the partial codification the uncertainty of directors' duties, nature and extent of their duties as well as liability for breach of their duties were addressed.

Since the introduction of common law from the late 1800's, South Africa's stance on commercial law has always followed the principles laid down in foreign jurisdictions. This shadow process resulted from the application and success evident in the foreign jurisdictions such as England, Canada, Australia and the United States. Incorporating the principles of

foreign jurisdictions it is safe to say that the provisions of the Companies Act 2008 followed their stance in incorporating so to say a more “stringent” and “rigorous” approach.

This “stringent” and “rigorous” approach in respect of directors duties of care, skill and diligence are encompassed in the provisions of section 76(3)(c)<sup>295</sup>. It is noteworthy to point out that despite the modification of the provisions founded in the common law; the common law has not been discarded in the statutory provisions, rather the statute has modified directors’ duties of care, skill and diligence by adopting a more taxing and burdensome approach. This taxing approach comprises of a mandatory two legged test which roots subjective and objective elements. As per the provisions encapsulated in this section, directors of a company are to be tested against this standard. From the wording of section 76(3)(c) it is apparent that subsection (i) applies to the spectrum all directors, but subsection (ii) applies to those directors who possess a higher standard of skill and business acumen. If a director possesses a higher standard of skill then both legs of the test will be applied, however if a director does not possess a high standard of skill or expertise then the first leg of the test shall only be applied.

From the above synopsis it can be seen that the statute provides a stricter test and as such favoured as opposed to the common law. Despite the critique which is inevitable to any subject, I concur with the view of Bouwman<sup>296</sup> that the provisions of the statute promoting transparency, accountability, independence while considering the best principles of corporate governance, creates awareness to the duties of a director and the standard which is required of them and creates certainty and clarity in the law as the use of the language in the statute is now more understandable.

The duty of care, skill and diligence works hand in hand with the provisions of section 76(4) which comprises of the business judgment rule which places a limit or restriction on how directors may curb out their liability as a result of carrying out their duties in good faith despite concluding with disastrous results.

The crux of the business judgment rule is to provide directors as well as the judiciary with a set of guidelines comprising of a test of reasonability and rationality when attaching liability

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<sup>295</sup> The Companies Act 71 of 2008

<sup>296</sup> See note 1 above: *Bouwman* at 521

to directors' conduct of care, skill and diligence. As expressed in chapter 4, it is evident that the South African based business judgment rule followed the steps of the American judiciary.

Simply, the aim of the business judgment rule is to provide a director who makes an error of judgment in good faith, or has carried out his duties in good faith with the expected standard of care and skill from liability. It has been emphasised by a large number of authorities that the statutory business judgment rule should not have been incorporated in South Africa. Despite the critique the business judgment rule is applied to protect honest directors from liability subject to the fulfilment of the requirements in place for the business judgment rule to be applied. The requirements strongly expects a decision to be made, the decisions to be made without any self dealings to the director or a third party and ultimately for the best interest of the company, and that there must be a rational and reasonable basis for believing that the decisions made by the director was for the best interest of the company.

As a result of the stricter test laid down in the provisions of section 76(3)(c), the business judgment rule aims to lighten the burden placed on directors subject to them acting with the expected degree of care, skill and diligence.

Despite the heavy critique borne through the incorporation of the business judgment rule in statute, its success in application is not reliant on the success of American based business judgment rule but rather on the application and use in South Africa which has an economic terrain completely different from that of the United States. Its success or downfall shall only be known through continuous application and the results which flow from the application of the rule.

The incorporation of the statutory business judgment rule is subject to heavy construction due to the negative commentaries of many authors which the rule carries. Notwithstanding the critique, the eventual success or downfall is dependent on its application and the success which applying the rule might bring. As such the success or downfall of the business judgment rule shall only be known with time, due to its introduction in the recent Companies Act 2008.

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