

A critical analysis of the fiduciary duties of directors and evaluation of the development of these duties in terms of the common law and statutory law.

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Abstract

Corporate law is based on the premise that directors are fiduciaries of their companies. This is an unbending duty which has to be adhered to at all cost by individuals appointed as directors of a company. Previously the director's duties were governed by the common law which often relied on the interpretation of the courts on a case by case basis. Therefore the courts would often arrive at different conclusions based on a similar set of facts. The advent of the 2008 Companies Act (Act 71 of 2008)¹ brought about a major evolution in South African company law by partially codifying the fiduciary duties of the directors. Understanding fiduciary duties of a director is of significant importance in the modern democracy based on the fact that directors engage on the international spectrum. Company directors have discretionary power which may be abused if they are not familiar with the fiduciary duties.

This study seeks to comprehend fully the fiduciary duties of a director of a company. These are the duty to act bona fide, the duty to act for a proper purpose, the duty to avoid conflicts of interest and the duty not to use a corporate opportunity and information for personal profit. This task will be undertaken both in terms of the common law as well as statute (Companies Act 2008 Act). The study will delineate the fundamental consequences of partial codification of these duties and set out the current legal position of the common law which operates in tandem with the statute. In addition, it will deal with whether the common law provisions are still applicable side by side with the statutes.

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

¹ Act 71 of 2008.

CHAPTER ONE

1.1 Introduction

Section 66(1) of the 2008 Companies Act² states that the business and affairs of the company must be managed by or under the direction of its board of directors, which has the authority to exercise all the powers and perform any of the functions of the company, except to the extent that the Act or the company's Memorandum of Incorporation provides otherwise. A company is a juristic person and it functions through human agency. It acts through its members in general meetings, and through its directors and employees.³ The day to day running of a company is the responsibility of the board of directors. This chapter will examine the meaning of the word 'fiduciary' and when a fiduciary relationship comes into existence. It will also examine the characteristics of a fiduciary relationship, the meaning of the term 'director', and to whom the fiduciary duties are owed.

1.2 Who is a director?

At times, the word 'directors' had caused confusion as it is generally used not only to indicate the plural of an individual director but also the board of directors as a whole.⁴ The directors, individually and as a board, are often referred to in company law sources as the trustee.⁵ As the director and the board of directors can in no way be regarded as owners of the company assets, their description as "trustee" is wholly inappropriate in South African law.⁶ The term 'director' has been defined in law. The 2008 Companies Act defines a director as:

"A member of the board of a company, as contemplated in section 66, or an alternate director of a company and includes any person occupying the position of a director or alternate director, by whatever name designated."⁷

² Act 71 of 2008; s66.

³ FHI Cassim *Contemporary Company Law* (2012) 411.

⁴ HS Cilliers *Corporate Law*. (1992) 112.

⁵ Cilliers (see note 4; 112).

⁶ Cilliers (see note 4; 112).

⁷ Act 71 of 2008; s66.

The Act defines “board” as meaning the board of directors of a company.⁸ Thus “board” or “board of directors” means the directors of the company acting collectively.⁹ Where the board acts within the scope of their powers, its acts are the acts of the company itself and not merely the acts of an agent or representative. The precise nature of the legal relationship between the company and a director is still a controversial question and several views have been expressed on this issue.¹⁰ Inter alia, directors have been described as agents of the company, and as managing partners.¹¹ Previously, a director did not enjoy original powers to act and, like an agent, his or her power to act arose from, and was limited by, the powers conferred on him or her. For instance, a director, like an agent, acts for the benefit of some other person, that is, the company, and not for his or her own benefit. When they contract on behalf of the company, they do not incur liability, unless they act outside their powers, or expressly or impliedly assume liability.¹² But s 66(1) of the Act now confers original powers and duties on directors.¹³

The primary function of the board of directors is to take top-level decisions regarding the management and strategy of the company.¹⁴ The board of directors is often called upon to take business risks and chances in the endeavor to earn profits for the company.¹⁵ These decisions are then executed by the company’s managers and employees.¹⁶ The King III Report confirms that it is for the board of directors to act as the focal point and custodian of corporate governance.¹⁷ The court in *South African Broadcasting Corporation Ltd v Mpofu*¹⁸ stressed that good corporate governance (particularly in state-owned enterprises) is ultimately about effective leadership. The court further held that an organization depends on its board of directors to provide it with direction.¹⁹ The board should ensure that the company is and is seen to be, a responsible corporate citizen and should provide effective leadership based on an ethical foundation.²⁰ The board of directors is responsible for the strategic and control of

⁸ Act 71 of 2008; s1.

⁹ Act 71 of 2008; s1.

¹⁰ Cassim (see note 3; 412).

¹¹ Cassim (see note 3; 412).

¹² Act 71 of 2008; s66 (1).

¹³ Cassim (see note 3; 412).

¹⁴ Cassim (see note 3; 412).

¹⁵ RL Beuthin. *Beuthin’s Basic Company Law* 3ed (2000) 218.

¹⁶ Beuthin (see note 15; 218).

¹⁷ Cassim (see note 3; 480).

¹⁸ (2009) 4 All SA 169 (GSJ) para 60.

¹⁹ *South African Broadcasting Corporation Ltd v Mpofu* 2009 (4) All SA 169 (GSJ).

²⁰ *South African Broadcasting Corporation Ltd v Mpofu* supra.

the company. It should strive to achieve the appropriate balance between its various stakeholder groupings, and is urged to take into account, as far as possible, the legitimate interests and expectations of its stakeholders when making decisions in the best interests of the company.²¹ Therefore, both the directors individually and the board stand quite clearly in a fiduciary relationship towards the company in everything that they do. When a director acts in his capacity as a director he must do so in good faith and for the benefit of the company as a whole.²² In other words, a director has an affirmative duty to safeguard and protect the affairs of the company.²³

Ryan indicated that a director is not an employee of the company and that he or she is not under a duty to carry out the instructions of another person.²⁴ A director's duty obliges him to exercise an independent judgment on what is in the best interests of the company and to act accordingly. He or she holds the position not in terms of a contract of employment with the company but by virtue of having been elected by the shareholders meeting.²⁵ As a result, unless he or she has a service contract with the company, the position carries no security of tenure and the shareholder's meeting can pass a resolution to oust him or her from office at any time.²⁶ However, there is no restriction under the Act, that a director cannot be an employee of the company. In *Lee v Lee's Air Farming*²⁷, it was held that a director may however work as an employee in a different capacity. A director who has entered into a service contract with the company will, in his capacity as an employee, be subjected to contractual duties involving the carrying out of instructions, but when such a person is acting qua director, he is required to bring an independent judgment on what is in the best interests of the company, and to act accordingly.²⁸

If the powers referred to above have been vested in the directors, they alone may exercise them, and the shareholders will have no power to interfere or control them in the exercise of that power, or to perform any of the functions entrusted to the directors, provided that they are in fact acting within the scope of the powers which have been conferred upon.²⁹ In the

²¹ Principle 8.3 of the *King III Report*.

²² Beuthin (see note 15; 218).

²³ *Howard v Herrigel* supra at 45.

²⁴ C Ryan *Company Directors: Liabilities, Rights and Duties*. (1987) 8.

²⁵ Beuthin (see note 15; 205).

²⁶ Cassim (see note 3; 426).

²⁷ 1961 AC 12.

²⁸ Cassim (see note 3; 426).

²⁹ Beuthin (see note 15; 218).

same way the directors have no power to interfere with the shareholders in the exercise by them of such powers as may have been vested in the company in general meeting.³⁰

A question maybe asked whether a *de facto* director falls within the definition of director. A *De facto* director is:

“A person who assumes to act as a director. He is held out as a director of the company, and claims and purports to be a director, although never actually or validly appointed as such. To establish that a person was a de facto director of a company it is necessary to plead and prove that he undertook functions in relation to the company which could properly be discharged only by a director. It is not sufficient to show that he was concerned in the management of the company’s affairs or undertook tasks in relation to its business which can properly be performed by a manager below board level.”³¹

The words ‘occupying the position of a director’ in the definition of a director in s 1 makes it clear that a *de facto* director constitutes a director for the purposes of the Act. Accordingly, a director may not escape his or her duties by virtue that he or she has not been formally or validly appointed as a director. A *de facto* director is subject to the fiduciary duties and other duties of a director.³²

The court in *Gemma Ltd v Davies*³³ held that it is necessary for the person alleged to be a *de facto* director to have participated in directing the affairs of the company on an equal footing with the other directors and not in a subordinate role. Cassim submits that a *de facto* director and a shadow director are often confused and must be distinguished from each other.³⁴ A *de facto* director acts openly as if he is a director of the company whilst a ‘shadow director’ is a third party who secretly exerts influence on the board of directors in breach of their fiduciary duties.³⁵ Cassim further submits that in English law a ‘shadow director’ is a person in accordance with whose directions or instructions the directors of the company are accustomed to act.³⁶ As the name implies a shadow director lurks in the shadow, sheltering

³⁰ Beuthin (see note 15; 219).

³¹ *Holland v Revenue & Customs* (2010) UKSC 51, para 20.

³² Cassim (see note 3; 409).

³³ (2008) BCC para 40.

³⁴ Cassim (see note 3; 409).

³⁵ L Coetzee and J van Tonder ‘The Fiduciary Relationship between a company and its directors’ (2014) 35 *Obiter* 300.

³⁶ Cassim (see note 3; 409).

behind others who he or she claims are the only directors of the company to the exclusion of him or her.³⁷ He is not held out as a director by the company, but exercises power from the shadows.³⁸ The court in *Re Hydrodam (Corby) Ltd*³⁹ stated that the concepts of a *de facto* and a shadow director do not overlap but are alternatives, and in most cases are mutually exclusive.⁴⁰ This is owed from the fact that a *de facto* director is one who claims to act and purports to act as a director, although not validly appointed. A shadow director does not claim or purport to act as a director, but in fact claims not to be a director.⁴¹ In *Secretary of State for Trade and Industry v Deverell*⁴² the court held that a shadow director acts as a superior who instructs or directs the directors. It is not necessary to show that directors adopted a subservient role, surrendered their discretion or were under any compulsion to obey the directions or instructions, although a relationship of dominance and subservience may be evidence of a shadow directorship.⁴³

There is no distinction drawn between executive, non-executive and independent directors, but an important distinction is made between these types of directors in practice, and in the King III Report and the Code.⁴⁴ An executive director is a director who is also an officer employed by the company.⁴⁵ He or she is involved in the day to day management of the company and is the full-time salaried employ of the company.⁴⁶ This implies that there is an existence of a service contract between the company and director.⁴⁷ He has a service contract with the company and is thus an employee of the company.⁴⁸ In *Howard v Herrigel*⁴⁹ the court held that-

*“it is unhelpful and even misleading to classify company directors as ‘executive’ or ‘non-executive’ for purposes of ascertaining their duties to the company or when any specific or affirmative action is required of them.”*⁵⁰

³⁷ Cassim (see note 3; 409).

³⁸ Cassim (see note 3; 409).

³⁹ *Re Hydrodam (Corby) Ltd* [1994] 2 BCLC para 163.

⁴⁰ Cassim (see note 3; 410).

⁴¹ Cassim (see note 3; 410).

⁴² (2000) 2 All ER 365 para 374-376.

⁴³ *Secretary of State for Trade and Industry v Deverell* supra para 376.

⁴⁴ Cassim (see note 3; 411).

⁴⁵ MS Blackman...et al *Commentary on the Companies Act* (2008) 8-13.

⁴⁶ Blackman (see note 45; 8-13).

⁴⁷ Blackman (see note 45; 8-13).

⁴⁸ Coetzee and van Tonder (see note 35; 300).

⁴⁹ 1991 (2) SA 660 (A) at 678.

⁵⁰ *Howard v Herrigel* supra para 678.

No such distinction is to be found in any statute. At common law, once a person accepts appointment as a director, that person becomes a fiduciary in relation to the company and obliged to display the utmost faith towards the company and in his dealings on its behalf.⁵¹ Cassim submits that section 1 of the Act contains an open-ended, non-exhaustive definition of a director, which is both tautologous and unhelpful.⁵²

The court in *Fisheries Development Corporation of SA Ltd v Jorgensen; Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd*⁵³ stated that non-executive directors are not bound to give continuous attention to the affairs of the company. Their duties are of an intermittent nature to be performed at periodical board meetings, and at any other meetings which may require their attention.⁵⁴ He or she does not have a contract with the company outside of board meetings and holds the position by virtue of having been elected by the general meeting and not by virtue of an agreement with the company.⁵⁵ Cassim argues that one of the concerns articulated in relation to the non-executive directors is that since non-executive directors are only part-time directors of the company they are likely to have other interests apart from the company, and their capacity to monitor the activities may be limited. Furthermore, they will necessarily have to rely on the executive directors for information about the company in carrying out their function.⁵⁶ Thus non-executive directors may also lack detailed knowledge of the company's business and affairs.⁵⁷ Fiduciary duties extend to non-executive directors.⁵⁸ Executive and non-executive directors have the same fiduciary duties in law.⁵⁹

Ryan states that there are several reasons for appointing non-executive directors.⁶⁰ First, such directors may have knowledge, expertise or experience which may be used in the company's best interests.⁶¹ Second, whether or not they possess any special skill such directors tend to take a more global view of things. In this sense they balance the executive directors who tend to see things from the management point of view and often get bogged down by the technical

⁵¹ *Howard v Herrigel* supra para 678.

⁵² Cassim (see note 3; 509).

⁵³ 1980 (4) SA 156 (W) para 165.

⁵⁴ *Fisheries Development Corporation of SA Ltd v Jorgensen* supra, para 165.

⁵⁵ *Fisheries Development Corporation of SA Ltd v Jorgensen* supra, para 165.

⁵⁶ Cassim (see note 3; 478).

⁵⁷ Cassim (see note 3; 423)

⁵⁸ MA Fouche *Legal Principles of Contracts and Commercial Law*. (2004) 317.

⁵⁹ *Howard v Herrigel* supra, para 678.

⁶⁰ Ryan (see note 24; 12).

⁶¹ Ryan (see note 24; 12).

detail and problems of loyalty to their company.⁶² Third, a non-executive director may be appointed in the hope that his title, name or status in society is such that the company's reputation, sales and credit rating may be favorably enhanced.⁶³ Lastly, a non-executive director may be appointed not out of choice (on the part of the directors) but because the holder of a large number of the company's shares wants a representative on the board often with a watching brief rather than with any intention that he should take an active role.⁶⁴

1.3 Qualification to serve as a director or prescribed officer

The first directors of a company are the incorporators of the company, and such persons serve as directors of the company until the minimum number of required directors (in terms of section 67(1) of the Act or the Memorandum of Incorporation) has been appointed or elected.⁶⁵ The Act does not prescribe minimum qualifications for a director, such as those relating to the education and training of directors, but instead imposes criteria that disqualify a person from being a director. This is derived from the fact that imposing minimum qualifications is regarded as an internal company policy issue.⁶⁶ Cassim distinguishes between a person being ineligible and disqualified to be a company director. Disqualification is not absolute and a court has discretion to permit a disqualified person to accept an appointment as a director. An ineligible person is absolutely prohibited from being a director.⁶⁷

Section 69 of the Companies Act provides that a person is ineligible for appointment as director or prescribed officer, if that person is a juristic person; an unemancipated minor or persons under a similar legal disability; any persons who do not satisfy any minimum qualification set out in the Memorandum of Incorporation in terms of s 69(6)(b); any persons disqualified in terms of any additional grounds of ineligibility (or disqualification) set out in the Memorandum of Incorporation in terms of s 69(6)(a). A director of a company must be a natural person. A company, a close corporation or a trust is a juristic person and may not be appointed as a director.

⁶² Ryan (see note 24; 12).

⁶³ Ryan (see note 24; 12).

⁶⁴ Ryan (see note 24; 12).

⁶⁵ Cassim (see note 3; 423).

⁶⁶ Cassim (see note 3; 431).

⁶⁷ Cassim (see note 3; 431).

1.4 Grounds of disqualification

A person is disqualified from being a director or prescribed officer, if the person:⁶⁸

- Has been prohibited to be a director by the court of law.
- Has been declared by the court to be delinquent in terms of s 162 of the Act or in terms of s 47 of the Close Corporations Act 69 of 1984.
- Is an unrehabilitated insolvent.
- Is prohibited in terms of any public regulation to be a director of the company.
- Has been removed from an office of trust, on grounds of misconduct involving dishonestly and
- Is a person who has been convicted in South Africa or elsewhere, and imprisoned without the option of a fine, or fined more than R1 000 for theft, fraud, forgery, perjury or other offences as specified in s 69(8)(b)(iv) of the Act.

The offences specified in s 69(8) (b) (iv) are:

- An offence involving fraud, misrepresentation or dishonesty;
- An offence in connection with promotion, formation or management of a company; and
- An offence under the Companies Act, the Insolvency Act 24 of 1936, the Close Corporation Act 69 of 1984, the Competition Act 89 of 1998, the Financial Intelligence Centre Act 38 of 2001, the Securities Services Act 36 of 2004 or Chapter 2 of the Prevention and Combating of Corrupt Activities Act 12 of 2004.

In *Magna Alloys & Research (Pty) Ltd v Ellis*⁶⁹ the court held that these provisions are not designed to punish the individual but to protect the public and to prevent the corporate structure from being used to the financial detriment of investors, shareholders, creditors and persons dealing with the company. In its operation it is calculated to act as a safeguard against the corporate structure being used by individuals in a manner which is contrary to proper commercial standards.⁷⁰

⁶⁸ Act 71 of 2008; s 69(8).

⁶⁹ 1975 1 ACLR 203 SC (NSW) 205.

⁷⁰ *Magna Alloys & Research (Pty) Ltd v Ellis* supra.

1.5 The fiduciary relationship

Fiduciary is derived from Latin *fiduciarius*, meaning ‘(holding) in trust’; from *fides*, meaning ‘faith’, and *fiducia*, meaning ‘trust’ this clearly shows that the basis of a fiduciary relationship rests on the concepts of honesty, utmost trust⁷¹ and the central notion of loyalty.⁷² A director stands in a fiduciary relationship to his company with the result that he has the duty to act in good faith towards his company to exercise his powers as director for the benefit of the company and to avoid a conflict between his own interests and those of the company.⁷³ A director cannot be relieved of this duty in the articles, in a contract or in any other way, any act amounting to evasion of this duty is seen in the same light as a breach of the duty itself.⁷⁴

In the case of *Hodgkinson v Simms*⁷⁵ the court recognized the fact that many contracts give rise to fiduciary relationships and specifically recognized the existence of this in relation to contracts of agency and stated that: ‘*the paradigm example of this class of contract is the agency agreement, in which the allocation of rights and responsibilities in the contract itself give rise to fiduciary expectations.*’⁷⁶ In *Phillips v Fieldstone Africa (Pty) Ltd*⁷⁷ the court said that ‘there is no magic in the term fiduciary duty’. The existence of such a duty and its nature and extent are questions of fact to be adduced from a thorough consideration of the substance of the relationship and any relevant circumstances which affect the operation of that relationship.⁷⁸ This was also confirmed in *Randfontein Estates Gold Mining Co, Ltd v Robinson*⁷⁹ where the court held that whether a fiduciary relationship exists depends on the circumstances. The above passage shows clearly that it is not easy to define this concept but one has to consider relevant facts when trying to ascertain whether a fiduciary duty existed in a particular case and cases must be decided on a case by case basis.⁸⁰ Cassim submits that the content of the duty varies and depends on the nature of the relationship between the parties.⁸¹

⁷¹ K Dharmaratne ‘A consideration of whether directors should stand in a fiduciary relationship with the company’s related and inter-related companies’ 1 Available at <http://www.cgblaw.co.za/fiduciary-relationship.pdf>.

⁷² Dharmaratne (see note 71; 1).

⁷³ Dharmaratne (see note 71; 1).

⁷⁴ Dharmaratne (see note 71; 1).

⁷⁵ (1994) 3 SCR 377 (SCC), referred with approval in *Phillips v Fieldstone Africa (Pty) Ltd & Another* 2004 (3) SA 465 (SCA) 477.

⁷⁶ 2004 (3) SA 465 (SCA) para 27.

⁷⁷ *Phillips v Fieldstone Africa (Pty) Ltd* supra, para 27.

⁷⁸ *Phillips v Fieldstone Africa (Pty) Ltd* supra, para 27.

⁷⁹ 1921 AD 168 at 197-98.

⁸⁰ Cassim (see note 3; 431).

⁸¹ Cilliers (see note 4; 135).

There are numerous characteristics which can be imputed to the existence of a fiduciary relationship such as discretion, influence, and vulnerability but most importantly loyalty⁸² and trust.⁸³ The meaning of the word fiduciary is based on the concepts of honesty, good faith, confidence, reliance and utmost trust.⁸⁴ These concepts are centralized around the notion of loyalty.⁸⁵

Even though the concept of ‘fiduciary duty’ has no precise definition, it is said that such duty arises ‘where, as a result of one person’s relationship to another, the former is bound to exercise rights and powers in good faith and for the benefit of the latter’.⁸⁶ A fiduciary is defined as

*‘a person in a position of trust or occupying a position of power and confidence with respect to another, such that he is obliged by various rules of law to act solely in the interest of the other, whose rights he has to protect’.*⁸⁷

In *Bristol and West Building Society v Mothew*⁸⁸ the court stated that a fiduciary is someone who undertakes to act for or on behalf of another in circumstances that give rise to a relationship of trust and confidence between the parties.

From the above discussion, it can be adduced that in a fiduciary relationship, one party is at the mercy of another party’s discretion. In *Hospital Products Ltd v United States Surgical Corporation*⁸⁹ the court held that

‘a fiduciary relationship may arise because on the facts a person has been appointed to act for the benefit of another whose appointment carries powers that could be exercised to the detriment of another’.

A fiduciary has a special opportunity to exercise power or discretion to the detriment of another, who is vulnerable to abuse by the fiduciary. In *Frame v Smith*⁹⁰ the court held that

⁸² *Bristol and West Building Society v Mothew* (1998) Ch. 1 18.

⁸³ Cilliers (see note 4; 141).

⁸⁴ *Volvo (Southern Africa) (Pty) Ltd v Yssel* (2009) 4 All SA 497 (SCA) para 17.

⁸⁵ JS McLennan ‘Directors Fiduciary duties and the 2008 Companies Bill 2009’ (2009) 1 TSAR 184.

⁸⁶ P Hood ‘What is so special about being a fiduciary?’ (2003) 308 4 *Edinburgh Law Review* 30.

⁸⁷ *The Oxford Companion to Law*. 1980

⁸⁸ (1998) Ch. 1 para 18.

⁸⁹ (1984) 156 CLR 41 para 96-7 (HC of A), referred to with approval in *Volvo (Southern Africa) (Pty) Ltd v Yssel* 2009 (4) ALL SA 497 (SCA).

⁹⁰ (1987) 2 S.C.R. para 99.

the relationships in which a fiduciary obligation has been imposed seem to possess three general characteristics namely:

- The fiduciary has scope for the exercise of some discretion or power;
- The fiduciary can unilaterally exercise that power or discretion so as to affect the beneficiary's legal or practical interests; and
- The beneficiary is peculiarly vulnerable to or at the mercy of the fiduciary holding the discretion or power.

There are various professions which may have a fiduciary relationship and the following is not a closed list but includes trustees, agents, partners, directors and attorneys.⁹¹ In *English v Dedham Vale Properties Ltd*⁹² Slate J ruled that the classes of fiduciary relationships are never closed but open-ended. The fiduciary duties are based firmly on loyalty, good faith and avoidance of conflicts of interest and duty.⁹³ Geach submits that the 2008 Companies Act does not introduce anything new in section 76 regarding a director's fiduciary duty.⁹⁴ In *Cyberscene Ltd and Others v i-Kiosk Internet and Information (Pty) Ltd*⁹⁵ it was confirmed that a director stands in the fiduciary relationship to the company of which he or she is a director, even if he or she is a non-executive director. The general rule is that a director is a fiduciary and has an overarching duty to act in good faith and for the benefit of the company.⁹⁶

In *Parker v McKenna*⁹⁷ this basic duty of loyalty was held to be unbending, inflexible and must be applied austere by the court. These duties are based on the general principle that a person standing in a fiduciary relationship to another commits a breach of trust if he acts for his own benefit or to the prejudice of the other. It follows that the cause of action for a breach of a fiduciary duty does not derive from delict or contract, but is unique (*sui generis*). The remedy for breach is restitution to the company of the loss suffered by the company or the benefit gained by the director.⁹⁸ Furthermore, in *Howard v Herrigel and Another NNO*⁹⁹, it

⁹¹ Cassim (see note 1, 512).

⁹² (1978) 1 WLR 93 HC.

⁹³ Cassim (see note 3; 509).

⁹⁴ W Geach 'Statutory, Common Law and other duties of directors' *Paper for CIS Corporate Governance Conference on 10 to 11 September 2009*; 10.

⁹⁵ 2000 (3) SA 806 (C).

⁹⁶ Cassim (see note 3, 510).

⁹⁷ (1874) LR 10 Ch. App 96 para 124-5.

⁹⁸ Cassim (see note 3, 510).

⁹⁹ 1991 (2) SA 660 (A).

was stated that it is a long-established principle of South African law that such a fiduciary duty exists and that the breach thereof is remediable by means of an interdict. In broad terms a fiduciary is a person who has the responsibility or is required by law to act in the best interest of another,¹⁰⁰ and therefore by handling a company's affairs the directors of such a company owes a fiduciary duty to that company. In *Robinson v Randfontein Estates Gold Mining Co Ltd*¹⁰¹ a director of the plaintiff company had purchased property in his own name when his duty was to acquire the property for his company under the company's name. The director then continued to sell the property to the company at an increased price. The court held that the company was able to hold the director liable for the profit he made as there was a breach of fiduciary duty.

1.6 To whom do the directors owe their fiduciary duties?

Upon the formation of a company it is a legal entity that exists separately from its management and shareholders.¹⁰² The general rule is that directors' duties are owed to the company and not to individual shareholders, nor to the company's creditors.¹⁰³ Directors do not owe a fiduciary duty to the company's individual shareholders,¹⁰⁴ nor to its creditors while the company is a going concern,¹⁰⁵ its employees,¹⁰⁶ nor to its holding company, neither to its subsidiary company (at least where the subsidiary has an independent board of directors), nor where the company is a member of a group of companies, or to the group as a whole.¹⁰⁷ The court in *Re Smith & Fawcett*¹⁰⁸ held that the fundamental and paramount or overarching duty of company directors is to act bona fide in what they consider not what the court may consider to be in the interests of the company as a whole, and not for a collateral purpose. This was confirmed by the court in *Cohen v Segal*¹⁰⁹ the court held that the director of a company occupies a fiduciary position towards the company and must act for the benefit of a company with no ulterior motives. The fundamental goal of the directors of a company is

¹⁰⁰ M Blackman, R Jooste et al *Commentary on the Companies Act Vol 2* (2008) 208.

¹⁰¹ 1921 AD 168 page 177.

¹⁰² Cilliers (see note 4; 139).

¹⁰³ P Loose *The Company Director* 9 ed. (2007) 238.

¹⁰⁴ JT Pretorius et al *Hahlo's South African Company Law through the Cases: A Source Book*. (1999) 278; Blackman (see note 45; 8-51).

¹⁰⁵ Pretorius (see note 104; 278).

¹⁰⁶ Cassim (see note 3; 516).

¹⁰⁷ Blackman (supra note 45; 8-51).

¹⁰⁸ (1942) Ch. 304 (CA) at 306.

¹⁰⁹ 1970(3) SA 702 (W) at 706.

the success of the company and the collective best interests of the shareholders of the company. The fiduciary relationship between a director and his company arises from the purpose for which the director's office and powers are entrusted to him, namely, for the benefit of the company.¹¹⁰ The broad duty owed by a director to his company is for him to act in good faith, in the best interests of the company.¹¹¹

In *Bristol and West Building Society v Mothew*¹¹², Millet LJ had this to say-

*'The distinguishing obligation of a fiduciary is the obligation of loyalty. The principal is entitled to the single-minded loyalty of his fiduciary. This core liability has several facets. A fiduciary must act in good faith; he must not make a profit out of his trust; he must not place himself in a position where his duty and his interest may conflict; he may not act for his own benefit or the benefit of a third person without the informed consent of his principal. This is not intended to be an exhaustive list, but it is sufficient to indicate the nature of fiduciary obligations. They are the defining characteristics of the fiduciary.'*¹¹³

In *Howard v Herrigel*¹¹⁴ the court held that as soon as the person assumes an appointment as a director, he becomes a fiduciary in relation to the company and is obliged to display the utmost good faith towards the company and in his dealings on its behalf. In *Percival v Wright*,¹¹⁵ the court held that directors of a company are not trustees for individual shareholders and may purchase their shares without disclosing pending negotiations for the sale of the company.¹¹⁶ However, if a director discloses certain information to shareholders, he has a duty not to mislead the shareholders with respect to that information.¹¹⁷ The milestone decision of *Foss v Harbottle*¹¹⁸ embodies the rule that where any wrong has been done to the company, e.g. breach by a director of his duty to the company, then the company (i.e. the majority in general meeting) is the appropriate body to decide whether or not any action should be taken against the wrongdoer.¹¹⁹ In effect it is the majority of members who

¹¹⁰M Havenga 'Directors fiduciary duties under our future company law regime'. (1997) 9 SA Merc LJ 311.

¹¹¹ Cassim (see note 3; 312).

¹¹² (1988) Ch. 1 supra para 18.

¹¹³ *Bristol and West Building Society v Mothew* supra, para 18.

¹¹⁴ 1991 (2) SA 660 (A) at 58.

¹¹⁵ (1902) 2 Ch. 421.

¹¹⁶ *Percival v Wright* supra at 374.

¹¹⁷ *Percival v Wright* supra at 425-26.

¹¹⁸ 1843 67 ER 189.

¹¹⁹ Ryan (see note 24; 200).

ratify the wrongdoer's transgression.¹²⁰ Therefore a claim may not be brought by a shareholder to make good a loss in the value of his shares where that loss merely reflects the loss suffered by the company. This is referred as the proper plaintiff rule. However the court in *Briess v Woolley*¹²¹ stated that where a director has acted for a shareholder he will, qua agent owe the shareholder a fiduciary duty for all agents owe their principal such a duty. This was also confirmed in *George Fischer (GB) Ltd v Multi-Construction Ltd*¹²² that where the company had no cause of action but the shareholder did, the shareholder could recover even if the loss was the diminution in the value of his shareholding.

1.7 Does a director owe a fiduciary duty to a subsidiary?

As a general principle each company in a group is regarded as a separate legal entity, unless the court pierces the corporate veil or it is done by the legislature.¹²³ In terms of the common law a director of a holding company does not owe any fiduciary duties to its subsidiary.¹²⁴ Similarly a director of a subsidiary only owes fiduciary duties to the subsidiary alone and does not owe fiduciary duties to the holding company.¹²⁵ A director of a company only owes his fiduciary duties to the company on whose board he serves and not to other companies even if they belong to the same group.¹²⁶ However, due to the power exercisable by a holding company over a subsidiary,¹²⁷ the 2008 Act attempts to alleviate the severity of the common law principle by imposing a duty on directors not to use the position of director nor information obtained as directors to gain an advantage for the director nor for another person other than the company or a wholly owned subsidiary of the company nor to knowingly cause harm to the company or a subsidiary of the company.¹²⁸ The inclusion of a wholly-owned subsidiary and a subsidiary in the standards of directors' conduct provision represents an

¹²⁰ Ryan (see note 24; 200).

¹²¹ (1954) AC 333 (HL) at 176-178.

¹²² (1995) BCC 310.

¹²³ Cassim (see note 3; 516).

¹²⁴ *Adams v Cape Industries plc* [1991] 1 All ER (CA) at 929.

¹²⁵ *Bell v Lever Bros Ltd* [1931] All ER Rep 1; *Scottish Co-operative Wholesale Society Ltd v Meyer* [1958] 3 All ER (HL) 66; para 87-88.

¹²⁶ Cilliers (supra note 4; 141).

¹²⁷ *Robinson v Randfontein Estates Gold Mining Co Ltd* supra at 197-198.

¹²⁸ Act 71 of 2008; s76 (2) (a).

extension of the common-law principles.¹²⁹ The duty extends the ambit beyond that of the company of which the person is a director.¹³⁰

1.8 Do directors owe a duty to employees and the company's creditors or society in general?

The general rule is that directors owe their fiduciary duty to the company of which he or she is a director.¹³¹ The court in *Charterbridge Corp Ltd v Lloyds Bank Ltd*¹³² held that directors do not owe a fiduciary duty to the company's creditors except where the company is insolvent or nearly insolvent. Another matter that deserves to be considered is whether company directors owe a duty to the company employees. It was decided in the case of *Hutton v West Cork Railway Company*¹³³ that directors owe their duties only to the company and not to the company's employees or society in general. There has been development towards the imposition of a fiduciary duty towards the shareholders in the United Kingdom and United States of America but this is not yet evident in South African law.¹³⁴

However, this broader underlying philosophy that directors owe their duties only to the company and for the ultimate benefit of the shareholders and not to the company's employees or society in general is outdated. In support of this view the court in *Hutton v West Cork Railway Company*¹³⁵, Bowen LJ observed that, 'the law does not say that there are to be no cakes and ale, but there are to be no cakes and ale except such as required for the benefit of the company.' This view advances the notion that a company and its directors are permitted to provide gratuitous benefits to advance the interests of the company. Ryan submits that modern corporate government is based on the idea that directors can have regard to wider range of interests, including the interests of employees, customers, suppliers, creditors, the protection of the environment and the community at large.¹³⁶ Sealy argues that 'a fundamental change has taken place in the concept of the company. The company is no

¹²⁹ Cassim (supra note 3; 551).

¹³⁰ PA Delpont et al *Henochnberg on the Companies Act 71 of 2008* (2011) 290; and PA Delpont *The New Companies Act Manual* (2011) 97.

¹³¹ Coetzee and van Tonder (see note 35; 300).

¹³² (1970) Ch. 62.

¹³³ (1883) 23 Ch. D 654 (Court of Appeal).

¹³⁴ Coetzee and van Tonder (see note 35; 300).

¹³⁵ (1883) 23 Ch. D 654 (Court of Appeal).

¹³⁶ Ryan (see note 24; 200).

longer regarded as an instrument of profit maximization for the sole benefits of its shareholders.¹³⁷ It is generally recognized that the company as an economic unit consists of combination of several interests, namely those of its shareholders as providers of capital, employees as providers of labour, creditors and of the public as such. The concept of the company as an instrument of economic capitalism has thus developed into one of the enterprise as an instrument of a new social order. The modern concept of enterprise is founded on the theory of social responsibility.¹³⁸

1.9 Conclusion

To conclude this chapter, it can be argued that a director of a company has a duty of trust relationship with the company, and he should not breach his contractual duty held in trust. A director does not owe any fiduciary duty to the company's shareholders but owes this duty only to the company. The general principle is that a director stands in a position of trust towards a company and the company's shareholders as a whole, and as a result a director has a duty to act in good faith and for the benefit of his/her company.¹³⁹ It was argued that there are different types of directors and that there is no distinction between executive, non-executive and independent directors but an important distinction is made between them in practice. Furthermore, the fiduciary duty of a director of a company is synonymous with the fiduciary duty owed to the beneficiary due to the fact that both requires fiduciaries to act bona fide to the company or beneficiary respectively.¹⁴⁰

¹³⁷ Pretorius (see note 104; 330).

¹³⁸ Pretorius (see note 104; 330).

¹³⁹ *Cohen v Segal* 1970 (3) SA 702 (W) 706.

¹⁴⁰ Pretorius (see note 104; 330).

CHAPTER TWO

This chapter will focus on the common law fiduciary duties of directors. These are the duty to act in good faith and in the best interests of the company, the duty to act for a proper purpose, duty to exercise an independent business judgment and the duty to avoid conflict of interest. This will be done by detailing the content of the aforementioned duties of directors in regard to the directors of companies.

2.1 Introduction

It has been established that directors need to observe two principal duties. The first duty is a fiduciary duty, and the second duty is a duty of care and skill. The effect of these duties is not to impose any positive obligations upon the ordinary director to act at all, but only to set the parameters within which he must stay should he in fact decide to act.¹⁴¹ The typical fiduciary duties of directors are the duty of good faith and loyalty, and the duty to act in the best interests of the company.¹⁴² These duties were derived from 18th and 19th century English company law which was judicially created and developed through continuous interpretation and application in case law.¹⁴³ Director's duty of care and skill is another duty for the director which is not a fiduciary duty but a completely separate branch on its own, which in essence comprises the duty to not act negligently in the carrying out of their duties.¹⁴⁴ Their object is to raise the standard of corporate or directorial behavior. Firstly, I will discuss the common law director's duty to act in good faith and in the best interests of the company.

¹⁴¹ Beuthin (see 15; 223).

¹⁴² Cassim (see note 3; 20).

¹⁴³ DTI *South African Company Law for the 21st Century Guidelines for Corporate Law Reform* (2004); 12.

¹⁴⁴ Cassim (see note 3; 156).

2.2 Common law perspective of the duty to act in good faith and in the best interests of the company

Dine argues that there is one fundamental duty, the duty to act in good faith for the benefit of the company and that conduct which is in breach of the other duties which we have identified is conduct which causes the director to be likely to be in breach of that fundamental duty.¹⁴⁵ A breach of a fiduciary duty can be ratified unless it is a breach of the fundamental duty to act in good faith and in the interests of the company.¹⁴⁶ The common law duty to act in good faith and in the best interests of the company is the paramount and overarching fiduciary duty of directors from which all other fiduciary duties are derived.¹⁴⁷ Good faith is defined as “a state of mind consisting in (1) honesty of belief or purpose, (2) faithfulness to one’s duty or obligation, (3) observance of reasonable commercial standards of fair dealing in a given trade or business, or (4) absence of intent to defraud or to seek unconscionable advantage” and is alternatively known as “bona fides.”¹⁴⁸ Generally, good faith is an honest, faithful, sincere, and reasonable belief that one is doing the right thing.¹⁴⁹ This duty is commonly described as one of absolute loyalty/honesty¹⁵⁰ and utmost good faith to the company.¹⁵¹ This is a subjective duty as the courts will not interfere with a director’s decision, where they honestly believe that decision was for the benefit of the company as a whole as Lord Greene MR stated in *Re Smith & Fawcett Ltd.*¹⁵² The general rule is that the interests of the company are the interests of the shareholders as a general body. Furthermore, directors should treat the company as a going concern and consider the interests of both present and future shareholders. Directors may not exercise their powers for the benefit of the company as a legal or commercial entity distinct from the shareholders, and they may not favour one section of shareholders over another.¹⁵³

Buckley J in *Hogg v Cramphorn Ltd*¹⁵⁴ found that this means that directors would be in breach of their duty to the company if they acted either:

¹⁴⁵ J Dine *Company Law*. 3 ed. (1998); 189-198.

¹⁴⁶ Scottish Law Commission *Company directors: regulating conflict of interests and formulating a statement of duties*. (Discussion paper No 105). (2004) 237.

¹⁴⁷ Cassim (see note 3; 523).

¹⁴⁸ BC Black *Black’s Law Dictionary* 8 Ed (2008) 713.

¹⁴⁹ *Black’s Law Dictionary* (see note 148; 713).

¹⁵⁰ *Black’s Law Dictionary* (see note 148; 713).

¹⁵¹ Loose (see note 103; 246).

¹⁵² [1942] Ch. 304 - 306.

¹⁵³ *RE Smith and Fawcett Ltd* supra at 304-306.

¹⁵⁴ [1967] Ch. 254 at 268.

- 1) not bona fide in the interests of the company (in other words, a subjective test¹⁵⁵); or
- 2) for some improper purpose (in other words an objective test) even if they themselves believed reasonably that they were acting bona fide in the interests of the company.¹⁵⁶

The court in *Darvall v North Sydney Brick & Tile Co Ltd*¹⁵⁷ found that directors of a company have more knowledge, time and expertise at their disposal to evaluate the best interests of the company than judges. The courts will not presume to act as a kind of supervisory board over directors' decisions that are honestly arrived at within the powers of their management.¹⁵⁸ The court in *Hogg v Cramphorn Ltd*¹⁵⁹ stated that it was not for the courts to review the merits of a decision that the directors arrived at honestly.

A director's duty is thus to act in what he or she in a good faith honesty considers to be in the best interests of the company. Ryan argued that a director should take account of the interests of shareholders and also, now, of the company's employees.¹⁶⁰ But the interests of customers, creditors, the community at large, and his personal interests and those of the family are not relevant considerations unless the proposed action is intended to benefit the company.¹⁶¹ As has been stated above that this duty is subjective and its breach requires subjective awareness of wrongdoing.¹⁶²

However there are limits to the subjective test in that the absence of a reasonable ground for believing that the director is acting in the interests of the company may be the basis for finding lack of good faith.¹⁶³ The court in *Shuttleworth v Cox*¹⁶⁴ stressed that the best interests of the company are not assessed by the court itself; instead, the test is whether a reasonable man would have regarded the act of the directors to be in the best interests of the company.¹⁶⁵ This was also emphasized in *Teck Corp Ltd v Millar*¹⁶⁶ where it was stated that there must be reasonable grounds for the directors' belief that they were acting in the best interests of the

¹⁵⁵ *Hogg v Cramphorn Ltd* supra at 268.

¹⁵⁶ *Hogg v Cramphorn Ltd* supra at 268.

¹⁵⁷ (1989) 15 ACLR 230 SC (NSW).

¹⁵⁸ *Howard v Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821 at 832; [1974] 1 All ER 1126 at 1131h.

¹⁵⁹ *Hogg v Cramphorn Ltd* supra at 268.

¹⁶⁰ Ryan (see note 24; 122).

¹⁶¹ Ryan (see note 24; 122).

¹⁶² Ryan (see note 24; 122).

¹⁶³ Cassim (see note 3; 524); Scrutton LJ in *Shuttleworth v Cox Brothers & Co (Maidenhead) Ltd* [1927] 2 KB 9 para 23; [1926] All ER Rep 498 (CA); *Getthing v Kilner* [1972] 1 WLR 337 para 342.

¹⁶⁴ [1927] 2 KB 9 para 23.

¹⁶⁵ *Shuttleworth v Cox Brothers & Co (Maidenhead) Ltd* supra, para 23-24.

¹⁶⁶ (1972) 33 DLR (3d) 288 (BCSC).

company. It was also held in *Extrasure Travel Insurances Ltd v Scattergood*¹⁶⁷ that there must be reasonable grounds for the believing that the directors were acting in the interests of the company.

The court in *Charterbridge Corporation Ltd v Lloyd's Bank*¹⁶⁸ formulated the test that the relevant inquiry is: whether an intelligent and honest person in the position of the director could in the whole of the circumstances have reasonably believed that he or she was acting in the best interest of the company.¹⁶⁹

For instance, where a director of a gown manufacturing company who was in poor health entered into a new service agreement which made provision for a generous pension for his widow in the event of his death, that service agreement was held not to have been entered into bona fide in the interests of the company.¹⁷⁰ This principle was confirmed in *Neptune (Vehicle Washing Equipment) Ltd v Fitzgerald No 2*¹⁷¹ where the court held that apart from any issue of self-dealing, the sole director of a company had not acted in the interests of the company by arranging for the company to make gratuitous or redundancy payments to him on the termination of his service contract with the company. The company director was held to have acted in his own interests, rather than in the company's interests.¹⁷²

The director's duty to act in good faith and for the best interest of the company was well established in *Re Smith v Fawcett Ltd*¹⁷³, wherein the company's articles of association gave the board of directors an '*absolute and uncontrolled discretion to refuse to register any transfer of shares*'. When one director passed away the other surviving directors refused to register a transfer of his shares into the name of the executors. The court held that in terms of the articles of association of the company, the only limitation on the directors' powers was that they had to act in a manner that they believed to be in the best interest of the company.¹⁷⁴ Therefore, the court could not establish any evidence sufficient enough to justify mala fides, or bad faith and therefore refused to set aside the decision of the board of directors.¹⁷⁵

¹⁶⁷ [2003] 1 BCLC 598 (ChD) at 619.

¹⁶⁸ [1970] Ch. 62; para 74.

¹⁶⁹ *Charterbridge Corporation Ltd v Lloyd's Bank* supra; para 74.

¹⁷⁰ [1967] 1 All ER 427.

¹⁷¹ [1995] 1 BCLC 352 (ChD).

¹⁷² *Neptune (Vehicle Washing Equipment) Ltd v Fitzgerald No 2* supra at 159.

¹⁷³ *Re Smith v Fawcett Ltd* supra at 306.

¹⁷⁴ *Re Smith v Fawcett Ltd* supra at 306.

¹⁷⁵ *Re Smith v Fawcett Ltd* supra at 306.

The rationale behind the decision in *Re Smith*¹⁷⁶ case is that a court would not set aside the decision of the board, even if the decision in question does not seem to be the most logical or a fair decision that could have been reached by the board. The court will only set aside a decision taken by the board if it is clear that there is presence of mala fides, by virtue of the fact that the directors did not act in good faith and in the best interest of the company when making that decision in question.¹⁷⁷

2.3 Common law perspective of the duty to act for proper purpose

It is generally accepted that the duty to act bona fide in the interests of the company and the duty to act for proper purposes are two distinct duties.¹⁷⁸ At common law, “proper purpose” means that directors must exercise their powers for the objective purpose for which the power was given to them and not for a collateral or ulterior purpose.¹⁷⁹ Directors are required to exercise their powers and perform their functions in good faith and for a proper purpose, with the overarching promotional purpose being the best interests of the company. This is a fundamental duty which qualifies the exercising of any of the powers which the directors in fact have.¹⁸⁰ In *Darvall v North Sydney Brick & Tile Co Ltd*¹⁸¹ the company was in the process of avoiding a hostile take-over bid to acquire the company for much less than the book value of the company, calculated on the basis of land owned by the company. Furthermore, the company set a scheme in motion to sell the land to subsidiary for development purposes, by means of which the subsidiary as a partner would challenge the hostile bid to acquire control of the company. The court considered whether the partnership or joint venture agreement was for a proper purpose. In this regard, three different opinions were expressed in the law. Mahoney J focused on the belief of the director that the scheme was in the best interest of the company, whilst Clarke JA distinguished the factual circumstances from the Hogg and Whitehouse cases, since no allotment of shares was made

¹⁷⁶ *Re Smith v Fawcett Ltd* supra at 307.

¹⁷⁷ *RE Smith v Fawcett Ltd* supra at 307.

¹⁷⁸ *M C Ling* ‘Rethinking directors duties: An analysis of the proper purpose doctrine’ (2002) 14 *Sing. Ac. L.J.* 387.

¹⁷⁹ *Ling* (see note 178; 387.)

¹⁸⁰ *Visser Citrus (Pty) Ltd v Goede Hoop Citrus (Pty) Ltd* 2014 (5) SA 179 (WCC) para 80.

¹⁸¹ (1989) 15 ACLR 230 SC (NSW).

and lastly Kirby J concluded that honesty when deciding on the proper purpose of the scheme should be an objective inquiry:¹⁸²

It would be to ignore the many blunt reminders of their obligation to conduct a thoroughgoing investigation. It would be to sustain a passive conception of the duty of a fiduciary which has no place in company board rooms. Higher standards of vigilance and honesty are required there in dealing with other people's moneys.

Furthermore, the court stated that it is an abuse of power for directors to exercise their powers for a purpose other than the purpose for which the power was conferred on them. The existence of subjective good faith is insufficient to save the purported exercise of power, if the power was exercised for a collateral purpose.¹⁸³ The duty to act for proper purposes is important because it is a flexible and useful tool which enables the court to review the directors' decisions.¹⁸⁴

In *Hogg v Cramphorn Ltd*¹⁸⁵ the board of directors issued additional shares in an attempt to avoid a hostile take-over. Although the directors honestly believed that the allotment was in the best interest of the company, the court nevertheless held that an objective inquiry should be employed when considering the reason for additional allotment.¹⁸⁶ The court held that the majority of shareholders were acting oppressively towards the minority of shareholders and/or that powers of directors interfered with the shareholder rights as stipulated in the company's constitution.¹⁸⁷ Buckley J found that the manipulation of the voting position could not therefore be found to be within the bounds of acting for a proper purpose. Finally, the court held that the issuing of shares could be ratified by the members at a general meeting. The court emphasized that it was unconstitutional for the directors to exercise their fiduciary powers to issue shares of the company in order to defeat a takeover bid, or for the purpose of destroying an existing majority or to create a new majority.¹⁸⁸

¹⁸² (1989) 15 ACLR 230 SC (NSW) at 288.

¹⁸³ *Extrasure Travel Insurances Ltd v Scattergood* [2003] 1 BCLC 598 (ChD) at 613.

¹⁸⁴ SLJ Lee 'Making a case for the duty to act for proper purposes' (2014) *Singapore Journal of Legal Studies* 79-97 at 80.

¹⁸⁵ *Hogg v Cramphorn Ltd* supra at 269.

¹⁸⁶ *Hogg v Cramphorn Ltd* supra at 265.

¹⁸⁷ *Hogg v Cramphorn Ltd* supra at 266-267.

¹⁸⁸ *Hogg v Cramphorn Ltd* supra at 143.

In a similar case of *Howard Smith Ltd v Ampol Petroleum Ltd*¹⁸⁹ where the board of directors awarded further shares to Howard Smith whom they preferred in order to dilute the majority shareholding of Ampol Petroleum and assist in assuring the take-over bid by Howard Smith. The court found that it was unconstitutional for the directors to use their fiduciary power for the sole purpose of destroying the existing majority or creating a new majority. The court also noted that this would apply even if the directors believed in good faith that they were acting in the best interest of the company and they were not going to receive any personal benefit or advantage for themselves including retaining their position as directors. It was concluded that the principle was clear; no board of directors may interfere with the constitutional right of shareholders to decide the outcome of a take-over bid.¹⁹⁰

Although, the above proposition was favoured by the Australian High Court in *Whitehouse v Carlton Hotel (Pty) Ltd*, the High Court did introduce new changes in the adaptation of the proper purpose doctrine.¹⁹¹ In this case Mr Whitehouse tried to influence the composition of shareholders by allotting additional shares to avoid a future circumstance where his spouse would control the company in the event of his death. This act was done honestly and in the best interest of the company. However, the court used the “but for” test and held that the purpose of this “exercise” was to manipulate the voting power of shareholders, irrespective of whether a valid reason/causation did exist to support the manipulation.¹⁹² In *Punt v Symons & Co Ltd*¹⁹³ the board of directors issued shares to their friends and supporters with the intention of creating a sufficient majority which would result in them being able to pass a special resolution that would allow them to change the constitution of the company so as to deny certain shareholders special rights that were conferred on them by the company’s constitution. Correspondingly, in *Piercy v Mills*¹⁹⁴ the directors of the company issued shares with the intention of creating sufficient majority in order to resist the election of additional directors that would have resulted in the incumbent directors becoming a minority on the board. The court in both cases held that the directors exercised their powers for an improper

¹⁸⁹ [1974] AC 821 at 832.

¹⁹⁰ *Howard Smith* supra at 832.

¹⁹¹ Pretorius (see note 104; 292).

¹⁹² Pretorius (see note 104; 293).

¹⁹³ [1903] 2 Ch. 506.

¹⁹⁴ [1920] 1 Ch. 77.

purpose¹⁹⁵ and that the issuing of shares in order to manipulate the balance of voting power amounts to improper exercise of the power to issue shares.¹⁹⁶

It would clearly be an improper purpose if the directors were to use their power over the company's shares simply in order to benefit themselves, or in order to destroy an existing majority or create a new one.¹⁹⁷ This would be interfering with the constitution of the company – the shareholders in a general meeting which is separate from and set against their own powers.¹⁹⁸ Beuthin argues that if members of the board bona fide believe that they are in fact exercising a power for a proper purpose, the court will be reluctant to interfere, but if the question arises whether something was done for a particular purpose or not, the court will look at the matter objectively to estimate how pressing that purpose was.¹⁹⁹ However, if the court finds out that it was not pressing, it may disbelieve the directors and find in fact that their purpose or their primary purpose was some other purpose which was an improper one.²⁰⁰

The issue by the court of determining from the facts of a particular case the purpose for which a director has exercised his or her power is not an effortless task.²⁰¹ The court in *Mills v Mills*²⁰² held that if there are multiple purposes for the exercise of a power, the court must determine what the substantial or dominant purpose was. If the dominant purpose is found to be improper, the court must regard the exercise of the power as being voidable.

For the exercise of power to be considered as valid, the impermissible purpose must not be causative in the sense that, but for its presence, the power would not have been exercised.²⁰³ On the other hand, if the exercise of the power is found to be proper and in the interests of the company, the fact that an incidental effect of it is to defeat a takeover bid or to enable the directors to maintain themselves in office will not make the exercise of the power improper.²⁰⁴

¹⁹⁵ *Cassim* (see note 3; 527).

¹⁹⁶ *Gaiman v National Association for Mental Health* [1970] 2 All ER 362.

¹⁹⁷ Beuthin (see note 15; 224).

¹⁹⁸ Beuthin (see note 15; 225).

¹⁹⁹ Beuthin (see note 15; 224).

²⁰⁰ Beuthin (see note 15; 224).

²⁰¹ *Cassim* (see note 3; 527).

²⁰² (1938) 60 CLR 150 at 185 (HC of A).

²⁰³ *Cassim* (see note 3; 527).

²⁰⁴ *Cassim* (see note 3; 527).

In *Extrasure Travel Insurances Ltd v Scattergood*²⁰⁵ the court stated that the law relating to proper purpose is clear. It is not necessary to prove that a director was dishonest or that the director knew that he or she was pursuing a collateral purpose. The court developed a four step- test which has to be applied in order to determine conduct relating to proper purpose. The test indicates that a court must:

- identify the particular power that is being challenged;
- identify the proper purpose for which the power was given to the directors;
- identify the substantial purpose for which the power was in fact exercised; and
- decide whether the purpose was proper.

Du Plessis on the other hand proposed another test that should be followed by South African courts in cases where there were permissible and impermissible purposes, whether the actions of the directors should or should not be set aside.²⁰⁶ The first step in the test is to determine what the purpose for which the power was conferred to the directors of the company.²⁰⁷ The court did take cognizance of the fact that there may be multiple purposes; in such a case the principle or dominant purpose must be identified. Once the purpose of the power has been determined, the second step will be to determine whether, in light of the particular facts of the case, the directors misused the powers conferred upon them.²⁰⁸ This test entails whether the decision was primarily or substantially taken within the purpose for which the power was conferred upon the directors (as determined as in the first step). The court will not set such a decision aside irrespective of the fact that partially or incidentally the power might have been exercised for an improper or impermissible purpose.²⁰⁹ Conversely, if the decision was primarily or substantially taken for an improper or impermissible purpose, the court will set such decision aside irrespective of the fact that partially or incidentally the power might have been exercised for a proper purpose.²¹⁰

Once the court has determined that primarily or substantially the power was misused, it will not help the directors who allege that they had not gained personally or that they had acted honestly: the conduct of the directors under attack will then be set aside because of the breach

²⁰⁵ 2003 1 BCLC 589 (ChD) 619.

²⁰⁶ JJ Du Plessis 'Director's duty to use their powers for proper or permissible purpose' (2004) 16 (3) *SA Merc LJ* 318.

²⁰⁷ Du Plessis (see note 206; 318).

²⁰⁸ Du Plessis (see note 206; 319).

²⁰⁹ Du Plessis (see note 206; 319).

²¹⁰ Du Plessis (see note 206; 319).

of their strict fiduciary duty to exercise their powers for the purpose for which the power was conferred upon them. In this regard, there is no difference between cases where directors made a profit by reason and by virtue of their fiduciary office as directors, and the misuse of powers.²¹¹

In a case where the court must consider whether a particular power has been exercised for its proper purpose, the court will not hear the directors' defence that they have acted in the best interest of the company as a whole in exercising the particular power.²¹² The crucial issue is often not the interest of the company, but the interest of shareholders and what is fair between different classes of shareholders.²¹³

2.4 Common law perspective of the duty to exercise an independent judgment

Directors must in general not fetter their discretion.²¹⁴ This means that they must not enter into an agreement with a third party as to how they will exercise their discretion. To do so would prevent them from exercising an independent judgment at the appropriate time.²¹⁵

Ryan argues that a director must not as a general rule fetter his discretion, for example, by contracting with an outsider to vote in a particular way at board meetings.²¹⁶ He submits that if directors enter into a contract on behalf of the company which they consider to be to the company's benefit they may agree to vote in favour of any necessary subsequent action.²¹⁷ The effect of such a voting agreement, if it were to be binding, is that the directors thereby disable themselves from acting honestly in what they believe to be the best interests of the company.²¹⁸ In an Australian case of *Thorby v Goldberg*²¹⁹ the directors of a company who were also shareholders agreed with potential shareholders, inter alia, to alter the company's articles and provide for the issue and allotment of fresh shares. The court considered the agreement to be valid:

²¹¹ *Regal (Hastings) Ltd v Gulliver* [1942] 1 All ER (HR) at 391 G-H.

²¹² Du Plessis (see note 206; 317-318).

²¹³ Du Plessis (see note 206; 317-318).

²¹⁴ Scottish Law Commission Discussion paper (see note 146; 239).

²¹⁵ Scottish Law Commission Discussion paper (see note 146; 239).

²¹⁶ Ryan (see note 24; 125).

²¹⁷ Ryan (see note 24; 125)

²¹⁸ A Keay 'The duty of directors to exercise an independent judgment' (2008) 29 (10) *The Company Lawyer* 290.

²¹⁹ (1964) 112 CLR 597 at 605-6.

*“there are many kinds of transactions in which the proper time for the exercise of the directors’ discretion is the time of the negotiation of a contract, and not the time at which the contract is to be performed. If at the former time they are bona fide of the opinion that it is in the best interests of the company that the transaction should be entered into and carried into effect, I see no reason in law why they should not bind themselves to do whatever under the transaction is to be done by the board.”*²²⁰

Thorby’s decision was followed in *Fulham Football Club Ltd v Cabra Estates Plc*²²¹, where a football club and its directors undertook in return for substantial payment to vote in a particular way. The court rejected the contention that the board of directors may never make a contract by which they bind themselves to the future exercise of their powers in a particular way, even though the contract as a whole is manifestly for the benefit of the company. The board was in this case binding itself under commercial contract which had conferred benefits on the company and which at the time the board had honestly believed was in the best interests of the company. In this case the court stated:

*“It is trite that directors are under a duty to act bona fide in the interests of their company. However, it does not follow from that proposition that directors can never make a contract by which they bind themselves to the future exercise of their powers in a particular manner, even though the contract taken as a whole is manifestly for the benefit of the company. Such a rule could well prevent companies from entering into contracts which were commercially beneficial to them.”*²²²

It must be stated that a company would not escape contractual obligations that have willingly been undertaken by its directors on the basis of their alleged failure to exercise an independent judgment. Cassim distinguishes between a situation in which the entire board of directors has entered into such an agreement and one in which an individual director has done so.²²³ The former but not the latter may in certain circumstances be beyond reproach, as shown in the *Fulham Football Club* case.²²⁴

The duty to exercise an independent judgment is particularly important to nominee directors. It must be borne in mind that a nominee director is a person appointed by a nominator to

²²⁰ *Thorby v Goldberg* supra at 606.

²²¹ [1994] 1 BCLC 363 (Ch. and CA).

²²² *Fulham Football Club Ltd* supra.

²²³ Cassim (see note 3; 529).

²²⁴ Cassim (see note 3; 529).

represent his or her interests at board meetings.²²⁵ A nominee director is a lawfully elected director and is obliged to act under a duty to his nominator while he owes a fiduciary duty to the company.²²⁶ The court in *Scottish Co-operative Wholesale v Meyer*²²⁷ ruled that there is nothing inherently dishonest or improper about nominee directors. Irrespective of these two separate duties a nominee director is expected to bring an independent and unfettered mind in what he consider being in the best interest of the company. A nominee director may not be a dummy or a puppet. The court in *S v Shaban*²²⁸ cautioned that ‘puppets’ cannot be lawfully employed in our company law system. Puppets refers to a person placed on the board of directors of a company who pretend to have taken part in resolutions of which they know nothing, or persons who pretend to have taken part in the management of a company while having no idea what they have signed.²²⁹ In *S v De Jager*²³⁰ where a director who had formally resigned as a director and had been appointed a puppet director was held to be a director despite his resignation.

In *Fisheries Development Corporation of SA Ltd v Jorgensen*²³¹ with regard to the nominee directors it was held that a director is in that capacity not the servant or agent of the shareholders who votes for or otherwise procures his appointment to the board. The court stated that the director’s duty is to observe the utmost good faith towards the company, and in discharging that duty he is required to exercise an independent judgment and to take decisions according to the best interests of the company.²³² Even though nominee directors may in fact be representing the interests of the persons who nominated them, they are in law obliged to serve the interests of the company to the exclusion of the interests of their nominators.²³³

Therefore, it can be argued that upon being appointed as a nominee director, such a person has to take the interests of his or her nominator into account without breaching his fiduciary duties to the company.²³⁴ This means that nominee directors must not blindly follow the instructions of those who have appointed them; nor, in the event of a conflict of interests,

²²⁵ Cassim (see note 3; 529).

²²⁶ Cassim (see note 3; 529).

²²⁷ [1958] 2 All ER 66 (HL).

²²⁸ 1965 (4) SA 646 (W) 651.

²²⁹ *S v Shaban* supra 210.

²³⁰ 1965 (2) SA 616 (A) at 628.

²³¹ 1980 (4) SA 156 (W) at 163.

²³² *Fisheries Development Corporation of SA Ltd v Jorgensen* supra at 163.

²³³ Du Plessis (see note 206; 309).

²³⁴ Cassim (see note 3; 531).

must they prefer the interests of their nominator above that of a company of which they prefer are directors.²³⁵ A more flexible approach in the exercise of an independent judgment rule by a nominator has been adopted in Australia and New Zealand and it may well influence the courts in South Africa to follow this trend towards a flexible approach rather than a strict rigid approach to nominee directors.²³⁶

2.5 Common law perspective of the duty to avoid conflict of interests

In contrast to the lenient attitude towards the director's performance of their duty of care and skill, the law in this area has always appeared to be extremely strict, so it was thought that a director was forbidden from entering into an arrangement in which there was a possibility that a director's personal interests could conflict with his duty.²³⁷ It is a well-entrenched principle of corporate law that a director has a fiduciary duty not to make a secret profit out of his trust, and generally must not place himself in a position in which his duty and self-interest may conflict.²³⁸ The duty to avoid a conflict of interest is one of the most important fiduciary duties of directors. The common law duty to avoid conflict of interests was influenced by the case of *Keech v Sandford*²³⁹. The directors of a company as fiduciaries are under a fiduciary duty to avoid placing themselves in a position in which their duties to the company conflict with their personal interests.²⁴⁰ In particular this applies to the exploitation of any property, information or opportunity available to the company. It applies whether the company could or could not take advantage of such property, information or opportunity.²⁴¹ As such, they are not allowed to make profit or retain a profit made by them in the course of and by means of their office as directors. This test ensures that the profit made by directors, as it derives from their position as directors are disgorged by them. Ryan argues that the law in this area has always been extremely strict, so it was thought that a director was forbidden from entering into an arrangement in which there was a possibility that the directors' interests

²³⁵ Cassim (see note 3; 531).

²³⁶ Cassim (see note 3; 531).

²³⁷ Ryan (see note 24; 125).

²³⁸ MF Cassim '*Da Silva v CH Chemicals (Pty) Ltd: Fiduciary duties of resigning directors*' (2009) 126 SALJ 61 at 65.

²³⁹ [1967] 2 AC 134n.

²⁴⁰ Cassim (see note 3; 534).

²⁴¹ P Loose (see note 103; 286).

could conflict with his duty.²⁴² The court in *Parker v McKenna*²⁴³ held that this rule is inflexible and must be applied inexorably by a court.²⁴⁴ This fundamental and inflexible legal principle was enunciated in *Aberdeen Railway Co v Blaikie Bros*²⁴⁵ where the court stated:

“It is a rule of universal application that no one having such duties to discharge, shall be allowed to enter into engagements in which he has or can have, a personal interest conflicting, or which possibly may conflict, with the interest of those whom he is bound to protect. So strictly is this principle adhered to, that no question is allowed to be raised as to the fairness or unfairness of a contract so entered into.”

In *Boardman v Phipps*²⁴⁶ the court explained the phrase ‘possibly may conflict’ in the above extract from *Aberdeen Railway Co* to mean that where a reasonable man looking at the relevant facts and circumstances of the particular case would think that there was a real, sensible possibility of conflict. Similarly, the court in *Robinson v Randfontein Estates Gold Mining Co Ltd*²⁴⁷ declared that no one who has a duty to perform shall place himself in a situation where his interests conflict with his duty. The chief objective of the no-profit rule is to preclude directors from misusing or making improper use of their positions as directors for their own personal advantage.²⁴⁸ This broad principle to avoid conflict of interest is subdivided into two separate and independent but closely related categories, namely the corporate opportunity rule and the no-profit rule.²⁴⁹

2.5.1 The corporate opportunity rule

Although there is no settled definition of “corporate opportunity”,²⁵⁰ this expression connotes any economic or business opportunity, whether property or rights, which rightfully belongs to the company or to which the company has some kind of claim.²⁵¹ As a general principle, “a man who stands in a position of trust towards another cannot in matters affected by that

²⁴² C Ryan (see note 23; 125).

²⁴³ (1874) 10 Ch. App 96 at 124-125.

²⁴⁴ (1874) LR 10 Ch. App 96 at 124.

²⁴⁵ (1854) 1 Macq 461.

²⁴⁶ [1967] 2 AC para 46.

²⁴⁷ 1921 AD 168 at 178-9.

²⁴⁸ *Chan v Zacharia* (1984) 154 CLR 178 at 198.

²⁴⁹ Cassim (see note 237; 61).

²⁵⁰ M Havenga ‘Corporate opportunities: A South African update (Part 2’) (1996) 8 SA Merc LJ 42-43.

²⁵¹ Havenga (see note 249; 43).

position, advance his own interests (e.g. by making a profit) at that other's expense."²⁵² For instance, a director cannot acquire a property that constitutes a corporate opportunity and resell it to the company at a profit. The law does not give effect to his or her intention; it treats the acquisition as one made in the interests of the company.²⁵³ Clearly a director acts in breach of his fiduciary duty to the company where he sabotages the company's contractual opportunities for his own advantage, or where he uses confidential information to advance the interest of a rival concern or his own business to the prejudice of those of the employer company.²⁵⁴ In very broad terms, a director has a duty not to misappropriate corporate opportunities.²⁵⁵ Blackman in *LAWSA*²⁵⁶ stated that there are at least three situations in which the duty attaches to a director. These are:²⁵⁷

- (i) If the director has been expressly or impliedly given a specific mandate either to acquire a particular opportunity for the company or to inform the company as to it's suitability.
- (ii) If he alone, or together with other directors, is given expressly or impliedly a general mandate to acquire opportunities for the company, or to pass on information to it about opportunities, or if he in fact controls the company or those in power to manage its affairs.
- (iii) If he usurps an opportunity which the company is actively pursuing or an opportunity which at least in so far as its directors are concerned can be said to belong to the company.

Since the opportunity belongs to the company, it is a breach of fiduciary duty for directors to divert the opportunity for themselves.²⁵⁸ Only recently, the court in *Da Silva v CH Chemicals (Pty) Ltd*²⁵⁹ regarded the corporate opportunity rule as an aspect of the no-profit rule or the rule against secret profits.²⁶⁰ The court also approved the corporate opportunity rule by stating that:

²⁵² *Robinson v Randfontein Estates Gold Mining Co Ltd* supra; para 179.

²⁵³ *Robinson v Randfontein Estates Gold Mining Co Ltd* supra; para 180.

²⁵⁴ T Achada 'Don't take what isn't yours' (2002) 10 *JBL* 176.

²⁵⁵ *Robinson v Randfontein Estates Gold Mining Co Ltd* supra para 200.

²⁵⁶ M Blackman 'Duties of Directors' and Officers' *LAWSA* Vol. 4(2) 1996 First Reissue para 135 at 224.

²⁵⁷ M Blackman 'Duties of Directors' and Officers' *LAWSA* Vol. 4 (2) 1996 First Reissue para 135 at 224.

²⁵⁸ Cassim (see note 3; 538).

²⁵⁹ 2008 (6) SA 620 (SCA) 627 para 18.

²⁶⁰ Blackman (see note 45 at 8-164).

“A consequence of the rule is that a director is in certain circumstances obliged to acquire an economic opportunity for the company if it is acquired at all. Such an opportunity is said to be a ‘corporate opportunity’ or one which is the ‘property’ of the company.”²⁶¹

It was also pointed out that a corporate opportunity is one that the company was actively pursuing or one that can be said to fall within the company’s ‘existing or prospective business activities’, or that is related to the operations of the company within the scope of its business or that falls within its line of business.²⁶² The court in *Da Silva* held that it does not matter whether the opportunity would not have been taken up by the company - the opportunity would remain a corporate opportunity.²⁶³ The court in *Canadian Aero Services Ltd v O’ Malley*²⁶⁴ held that directors or senior officers may not usurp or divert for themselves, or for another person or another company with which they are associated, a maturing business opportunity which their company is actively pursuing. The court also developed factors (non-exhaustive list) that have to be taken into account in determining the breach of the corporate rule, or the duty to avoid a conflict of interest from which the former is derived. These factors:

- position held by the defendant,
- nature of the corporate opportunity,
- its ripeness,
- the circumstances in which it was obtained, and
- the director’s position in relation to it.²⁶⁵

The courts have made rulings in regard to the corporate opportunity rule in the following illustrative cases. In *Cook v Deeks*²⁶⁶ three of the four directors who had equal share in the railway construction company, decided to appropriate for themselves a new, lucrative construction contract that was expected to be offered to the T Co by the Canadian Pacific Railway Co, which had previous dealings with T Co. Further, the contract involved a continuation of a railway line that had already been laid by T Co.²⁶⁷ By virtue of their

²⁶¹ *Da Silva v CH Chemicals Ltd* supra; para 19.

²⁶² *Da Silva v CH Chemicals Ltd* supra note para 19.

²⁶³ Cassim (see note 3; 538).

²⁶⁴ (1973) 40 DLR (3rd) 371 (SCC).

²⁶⁵ *Canadian Aero Services Ltd v O’ Malley* supra.

²⁶⁶ [1969] 1 AC 554 (PC).

²⁶⁷ *Cook v Deeks* supra at 197

majority shareholding in the company, the three directors passed a resolution which favoured the appropriation of the contract for themselves. The court held that the benefit of the contract belonged to T Co and the resolution was declared *void ab initio*.²⁶⁸ The case of *Cooks v Deeks*²⁶⁹ also illustrates that the distinction between the no-profit rule and the corporate opportunity rule is that the no-profit rule requires the consent of a majority of the shareholders for the director to retain the profit made by him or her. On the other hand the corporate opportunity rule requires the unanimous approval of the shareholders for a director to take the opportunity for him or herself.²⁷⁰

In *Robinson v Randfontein Estates Gold Mining Co Ltd*²⁷¹, Robinson, a director and chairperson of the board of directors of the plaintiff company, had purchased a farm for himself through an agent when the company could not reach finality with the sellers. He then sold the farm to the company at a massive profit.²⁷² The court ruled that the company was entitled to claim the profit made by Robinson on the basis that, where a man stands in a position of confidence in relation to another, involving a duty to protect the interests of that other, he is not permitted to make a secret profit at the expense of the other or to place himself in a position where his interests conflict with his duty.²⁷³

In *Industrial Development Consultants Ltd v Cooley*²⁷⁴ the defendant, an architect and managing director of the plaintiff company had entered into negotiations with Eastern Gas Board to secure a lucrative project pending to design a depot.²⁷⁵ The Eastern Gas Board was not willing to enter into any dealings with the plaintiff company, but only directly with the defendant. The defendant then told the board of IDC group that he was unwell and requested that he be allowed to resign from his job on early notice.²⁷⁶ The board acquiesced and accepted his resignation. He then undertook the design work for the Gas Board on his own account. Roskill J found that the defendant had placed himself in a position in which his duty to the company had conflicted with his personal interests. He had one capacity at the time and that was as managing director of the plaintiff company.²⁷⁷ Cassim argues that the basis of this

²⁶⁸ *Cook v Deeks* supra at 563.

²⁶⁹ *Cook v Deeks* supra at 563.

²⁷⁰ *Cook v Deeks* supra at 563.

²⁷¹ 1921 AD 168.

²⁷² *Robinson v Randfontein Estates Gold Mining Co Ltd* supra at 167.

²⁷³ *Robinson v Randfontein Estates Gold Mining Co Ltd* supra at 177-178.

²⁷⁴ [1975] 2 All ER 162.

²⁷⁵ *Industrial Development Consultants Ltd v Cooley* supra at 10.

²⁷⁶ *Industrial Development Consultants Ltd v Cooley* supra at 20.

²⁷⁷ *Industrial Development Consultants Ltd v Cooley* supra at 175.

decision was the no-conflict rule and the fact that the defendant had used for himself information that had come to him in his capacity as a managing director.²⁷⁸ But it is cogently arguable that the case concerned a corporate opportunity that belonged to the company, on the basis that the board of the company had not made any decision to abandon the possibility of obtaining the contract from the Eastern Gas Board.²⁷⁹

A more strict approach was adopted in *Bhullar v Bhullar*²⁸⁰, which approved of and followed *Cooley* case. The court strongly reaffirmed that the no-profit and the no-conflict rule remain universal and inflexible.²⁸¹

In *Da Silva v CH Chemicals (Pty) Ltd*²⁸² Resinex, a company engaged in the distribution of chemical and plastic products, wished to enter the South African market and was contemplating either entering into a joint venture with the respondent, CH Chemical (CHC) or alternatively, establishing its own business in South Africa in competition with CHC.²⁸³ The first appellant, Da Silva, the managing director of CHC, had handled its negotiations with Resinex. Resinex subsequently informed Da Silva that it had decided against collaborating with CHC and would instead enter the South African market on its own by setting up two South African subsidiaries.²⁸⁴ Da Silva was offered a position as a managing director of these subsidiaries and he did not inform CHC of the offer at that stage but continued to negotiate with Resinex on behalf of CHC.²⁸⁵ Eventually Da Silva accepted the offer made by Resinex, they entered into an agreement under which Da Silva was to establish the two South African subsidiaries of Resinex (a holding company and the other, a trading company).²⁸⁶ During his notice period with CHC, Da Silva acquired two shelf companies which subsequently became the two subsidiaries of Resinex.²⁸⁷ During his notice period, Da Silva also purchased and then sold on behalf of the trading subsidiary of Resinex three containers of LLDPE, a plastic product (the LLDPE transaction).²⁸⁸ When this was apparent to the CHC they sought to institute action against Da Silva for breach of his fiduciary duty to

²⁷⁸ Cassim (see note 3; 542).

²⁷⁹ Cassim (see note 3; 542).

²⁸⁰ [2003] 2 BCLC 241 (CA) para 31.

²⁸¹ *Bhullar v Bhullar* supra para 31.

²⁸² 2008 (6) SA 620 (SCA) para 31.

²⁸³ *Da Silva v CH Chemicals (Pty) Ltd* supra, para 6.

²⁸⁴ *Da Silva v CH Chemicals (Pty) Ltd* supra, para 10.

²⁸⁵ *Da Silva v CH Chemicals (Pty) Ltd* supra, para 10.

²⁸⁶ *Da Silva v CH Chemicals (Pty) Ltd* supra, para 11.

²⁸⁷ *Da Silva v CH Chemicals (Pty) Ltd* supra, para 13.

²⁸⁸ *Da Silva v CH Chemicals (Pty) Ltd* supra, para 13.

avoid conflict of interests for which it sought disgorgement of profits and damages. The Supreme Court of Appeal held that directors may not make secret profit or otherwise place themselves in a position where their fiduciary duties conflict with their personal interests. Such opportunity is said to be a ‘corporate opportunity’ or one which is the property of the company. If it is acquired by the director, not for the company but for himself or herself, the law will refuse to give effect to the director’s intention and will treat the acquisition as having been made for the company.²⁸⁹ It was not a breach of fiduciary duty for a managing director serving his notice period merely to incorporate a company that, in future, would compete with his existing employer or to obtain premises for the future companies (as Da Silva had done). These actions amounted to preparatory steps taken to enable the director to obtain alternative employment.²⁹⁰ However, by purchasing and selling the containers of LLDPE on behalf of the Resinex subsidiaries, while still serving his notice period with CHC, Da Silva had clearly breached his fiduciary duty to CHC. This was due to the fact that the transaction involved the purchase and sale of plastic products which fell within the scope of the business of CHC.²⁹¹ The court found that it was not a breach of fiduciary duty for a managing director serving his notice period to incorporate a company that, in future, would compete with his existing employer.²⁹² However, by purchasing and selling the containers of LLDPE on behalf of the Resinex subsidiaries, while still serving his notice period with CHC, Da Silva had clearly violated his fiduciary duty to CHC. This was because any transaction involving the purchase and sale of plastic products fell within the scope of the business of CHC.²⁹³ The court also examined whether Da Silva had breached his fiduciary duty to CHC by agreeing to set up the subsidiaries of Resinex in South Africa, and to be appointed as their managing director, had exploited an opportunity belonging to CHC to establish some form of collaboration with Resinex in South Africa.²⁹⁴ The court concluded that Da Silva had not breached his fiduciary duty to CHC insofar as the Resinex transaction was concerned. It reasoned that Resinex had decided to extend its operation to South Africa, and had two choices: either to enter the market in competition with CHC or to do so in collaboration with CHC – it was one or the other.²⁹⁵

²⁸⁹ *Da Silva v CH Chemicals (Pty) Ltd* supra; para 18.

²⁹⁰ *Da Silva v CH Chemicals (Pty) Ltd* supra; para 54 and 55.

²⁹¹ *Da Silva v CH Chemicals (Pty) Ltd* supra; para 55.

²⁹² *Da Silva v CH Chemicals (Pty) Ltd* supra; para 54-55.

²⁹³ *Da Silva v CH Chemicals (Pty) Ltd* supra; para 55.

²⁹⁴ *Da Silva v CH Chemicals (Pty) Ltd* supra; para 29 and 37.

²⁹⁵ *Da Silva v CH Chemicals (Pty) Ltd* supra; para 51-52.

Cassim questioned the decision of the court on the Resinex transaction which is open to criticism on three grounds.²⁹⁶ Firstly, the court's analysis of the corporate opportunity doctrine is debatable. Secondly, the court concluded its analysis after interrogating the corporate opportunity rule, but failed to consider the no-profit rule. Lastly, the court did not take account of the broader rule that a director may not place himself in a position of conflict of interest.

2.5.2 No profit rule

The other element of the duty to avoid conflict of interest is the no profit rule. This rule stipulates that directors may not retain any profit made by them in their capacity as directors while performing their duties as directors.²⁹⁷ It is argued that profits made by them by reason of, and in the course of his or her office as directors must be disgorged, unless the majority of shareholders in general meeting have consented to the director making profit.²⁹⁸ The no profit rule is justified as a prophylactic rule,²⁹⁹ meaning that liability arises regardless of whether the company itself could have the opportunity and regardless of whether the director acted in good faith.³⁰⁰ It should be noted that 'profit' is not confined to money, but includes every gain or advantage by a scoundrel directors.³⁰¹

The strict application of the no-profit rule is best illustrated by *Regal (Hastings) Ltd v Gulliver*.³⁰² Regal owned a cinema in Hastings. They took out leases on two more cinemas, through a new subsidiary, to make the whole lot an attractive sale package. However, the landlord first wanted them to give personal guarantees. They did not want to do that. Instead the landlord said they could up share capital to £5,000.³⁰³ Regal itself put in £2,000, but could not afford more (though it could have got a loan). Four directors each put in £500, the Chairman, Mr Gulliver, got outside subscribers to put in £500 and the board asked the company solicitor, Mr Garten, to put in the last £500.³⁰⁴ They sold the business and made a

²⁹⁶ MF Cassim (see note 237; 65).

²⁹⁷ Cassim (see note 3; 536).

²⁹⁸ Blackman ((see note 45; 8-142).

²⁹⁹ LDP Gower and Davies *Principles of Modern Company Law* 8 ed (2008) 562.

³⁰⁰ Blackman 144-148.

³⁰¹ RC Beuthin & SM Luiz *Beuthin's Basic Company Law* 3 Ed (2000) 202.

³⁰² [1942] 1 All ER 378 (HL)

³⁰³ *Regal (Hastings) Ltd v Gulliver* supra at 6.

³⁰⁴ *Regal (Hastings) Ltd v Gulliver* supra at 6.

profit of nearly £3 per share. But then the buyers brought an action against the directors, saying that this profit was in breach of their fiduciary duty to the company.³⁰⁵ They had not gained fully informed consent from the shareholders. The House of Lords, reversing the High Court and the Court of Appeal, held that the defendants had made their profits “by reason of the fact that they were directors of Regal and in the course of the execution of that office.”³⁰⁶ They therefore had to account for their profits to the company. Ironically, the company’s attorney and the outsider who had also purchased shares were able to keep the profits made by them on the sale of their shares since they owed no fiduciary duty to the company.³⁰⁷

The no-profit and no-conflict rule were also affirmed by the court in *Phillips v Fieldstone Africa (Pty) Ltd*³⁰⁸ as a strict rule that allows little room for exception.³⁰⁹ The court in *Aberdeen Railway Co v Blaikie Bros*³¹⁰ held that the rule extends not only to actual conflicts of interest, but also to situations in which there is a real sensible possibility of conflict. In *Phillips v Fieldstone*³¹¹ the court stated that once a breach of fiduciary duty is found, it is of no relevance that the company has suffered no loss or damage or that the profit was not made at the expense of the company; nor is it relevant that the company could not have made use of the opportunity or information. In *Canadian Aero Service Ltd v O’Malley*³¹² the court stated that:

“An examination of the case law in this court and in the courts of other like jurisdiction on the fiduciary duties of directors and senior officers shows the pervasiveness of a strict ethic in this area of the law. In my opinion, this ethic disqualifies a director or senior officer from usurping for himself or diverting to another person or company with whom or with which he is associated a maturing business opportunity which his company is actively pursuing; he is also precluded from so acting even after his resignation where the resignation may fairly be said to have been prompted or influenced by a wish to acquire for himself the opportunity

³⁰⁵ *Regal (Hastings) Ltd v Gulliver* supra at 8.

³⁰⁶ *Regal (Hastings) Ltd v Gulliver* supra at 9.

³⁰⁷ *Regal (Hastings) Ltd v Gulliver* supra at 11.

³⁰⁸ 2004 (3) SA 465 (SCA) 479 para 31.

³⁰⁹ *Phillips v Fieldstone Africa (Pty) Ltd* supra at 31.

³¹⁰ *Aberdeen Railway Co v Blaikie Bros* supra para 124.

³¹¹ *Phillips v Fieldstone Africa (Pty) Ltd* supra para 31.

³¹² (1974) 40 DLR 3d 371 at 309.

sought by the company, or where it was his position with the company rather than a fresh initiative that led him to the opportunity which he later acquired.”³¹³

Furthermore, the court in *Canadian Aero Service Ltd v O’ Malley*³¹⁴ stipulated that in some instances a profit may be disgorged although it was not gained at the expense of the company. This is owed to the fact that directors are fiduciary and should not be allowed to make profit even if it was not open to the company.

It must be submitted that financial inability may be a reason for a company’s failure to acquire a corporate opportunity. Most commonwealth decisions refuse corporate inability, or rejection of the particular opportunity by the company by the company as a defence³¹⁵ for the director to acquire a corporate opportunity. In the United States of America, courts seem to accept that the financial inability of a corporation to take up a corporate opportunity absolves directors from liability for making personal use of opportunity, subject to certain restrictions which are quite broad in scope.³¹⁶ The matter is still unsettled in South Africa. It is submitted that directors should be allowed to acquire the corporate opportunity if the company is financially unable to do so or has genuinely rejected it.

It is also submitted that a director cannot divest himself of his duty by resigning from the company.³¹⁷ In *Magnus Diamond Mining Syndicate v Macdonald and Hawthorne*,³¹⁸ Maasdorp, CJ held that the fact that the defendants resigned their directorships did not affect their position in any way. “That resignation was merely an attempt to divest themselves of the responsibilities and obligations of their office, from which they could not in law free themselves without the consent of the corporation.”³¹⁹ Where a director’s resignation is influenced by a wish to acquire for himself or herself an opportunity, or where his position with the company, rather than a fresh initiative, led him to the opportunity, he remains precluded from taking it.³²⁰ In *Industrial Development Consultant Ltd v Cooley*,³²¹ the defendant was a managing director and resigned from his office in order to benefit from the

³¹³ *Canadian Aero Service Ltd v O’ Malley* supra at 382.

³¹⁴ *Canadian Aero Services Ltd v O’ Malley* supra at 391.

³¹⁵ M Havenga ‘Appropriation of corporate opportunities by directors and employees 2007 TSAR 169 at 175-176.

³¹⁶ Havenga (see note 263; 176).

³¹⁷ Blackman (see note 137; 135); *Canadian Aero Services Ltd v O’ Malley* supra at 382.

³¹⁸ 1909 ORC 65 para 81.

³¹⁹ *Magnus Diamond Mining Syndicate v Macdonald and Hawthorne* supra; para 81.

³²⁰ Blackman (see 137; 225).

³²¹ *Industrial Development Consultant Ltd v Cooley* supra; para 176.

opportunity he had received due to his position. In fact, he misrepresented his state of health and was released from his directorship. He used the opportunity received and acquired employment. The court held that he had to account for the plaintiff company.³²² In *London and Mashonaland Exploitation Co v New Mashonaland Exploitation Co*³²³, the court held that if it is:

*“not appearing from the regulations from company that a director’s services must be rendered to that company and to no other company, he was at liberty to become a director even if a rival company, and it not being established that he was making to the second company any disclosure of information obtained confidentially by him as a director of the company he could not at the instance of that company be restrained in his rival directorate.”*³²⁴

Each individual director is not as such an agent of the company and is, therefore, as a rule, free to transact business in his own account, even in competition with the company of which he is a director. Kanamugire argues that this rule may not be entirely correct since a director who becomes simultaneously a director for a rival company creates a situation which conflicts, or may possibly conflict, with his or her position.³²⁵ In *Cook v Deeks*, Lord Bushmaster held that:

*“men who assumes the complete control of a company’s business must remember that they are not at liberty to sacrifice the interests which they are bound to protect, and while ostensibly acting for the company, divert in their own favour business which should properly belong to the company they represent.”*³²⁶

According to the duty of trust occupied by a director, van Dijkhorst J said: “it is a duty to act for the benefit of the company and not for his own benefit.”³²⁷ It also follows that a director should not engage in activities that compete with his or her company.

³²² *Industrial Development Consultant Ltd v Cooley* supra; para 176.

³²³ 1891 WN 165 (ChD); M Havenga ‘Competing with the company –when does a director breach his or her fiduciary obligations?’ (1995) 7 *SA Merc LJ* 435; 437; M Christie ‘The director’s fiduciary duty not to compete’ (1992) 55 *MLR* 506; 509.

³²⁴ 1891 WN 165 (ChD) at 398.

³²⁵ JC Kanamugire ‘The impact of the Companies Act 71 of 2008 on the Traditional director’s duty to avoid conflict of interest’ 2014 (5) *Mediterranean Journal of the Social Sciences* 9; 80.

³²⁶ *Cook v Deeks* supra at 563.

³²⁷ *Atlas Organic Fertilizers (Pty) Ltd v Pikkenwyn Ghwano (Pty) Ltd and Others* supra at 197.

2.6 Conclusion

This chapter has discussed all common law fiduciary duties of a director of a company. These duties are the duty to act in good faith and in the best interest of the company; duty to act for the proper purpose; duty exercise independent judgment and the duty to avoid conflict of interests. These duties were derived from the 18th and 19th century English company law which was judicially created and developed through continuous interpretation and application in case law.³²⁸ The paramount fiduciary duty of directors is to exercise their powers bona fide in the best interests of the company.³²⁹ To ensure that the director does not breach this fundamental duty, the fiduciary relationship imposes a ring of prophylactic duties around him, which are all aimed at protecting the company to whom the duties are owed.³³⁰

It must be stated that a director must exercise his or her powers in an independent and objective manner. He or she has a duty to do what he or she considers best serve the company's interests. A director must further exercise his or her powers for the purpose for which they were given. Furthermore, a director must exercise judgment in an honest manner as to what is in the company's interests and must act for the benefit of all shareholders and disclose on request to all shareholders and disclose on request to all shareholders, certain information connected with the company.³³¹ A director must account to the company for profits made by reason of his or her directorship. This includes any gain or advantage made by a director while carrying out his or her duties as director. A director may not misappropriate or usurp a business opportunity which the company is pursuing or which the director is obliged to acquire for the company. Therefore, a director has a common law duty to disclose to the company any interest he or she has in a contract with the company. The rule at common law is that, unless the company's article provide otherwise, a director may not, whether directly or indirectly, have an interest in a contract with the company, unless a general meeting of the company approves the contract, following full disclosure.³³²

³²⁸ DTI *Guidelines* (see note 132).

³²⁹ Pretorius *et al* (see note 95; 279).

³³⁰ Blackman *et al* (see note 44; 8-34).

³³¹ M Ramnath 'Interpreting Directors' fiduciary duty to act in the Company's best interest through the prism of the Bill of Rights: Taking other stakeholders into consideration' 2013 (2) *Speculum Juris* 98-115.

³³² *Visser Citrus (Pty) Ltd v Goede Hoop Citrus (Pty) Ltd* supra para 80.

CHAPTER THREE

Previously, director's duties have been governed by the common law. The advent of the 2008 Companies Act has partially codified the directors' duties in terms of the statute. This chapter discusses all the common law fiduciary duties of directors that have been codified and incorporated in the Act.

3.1 Introduction

The reform of company law in South Africa has brought about a number of important changes. These changes include the partial codification of directors' fiduciary duties. The changes have put measures in place to prevent the abuse of power by company directors. As one of the mechanisms, the Companies Act contains the general statement of the minimum duties of directors in a statutory form.³³³ There was a need to align South African company law to be in line with international trends and to reflect and accommodate the changing environment for businesses locally and internationally, whilst maintaining, encouraging and promoting compliance with the Bill of Rights as provided in the Constitution.³³⁴ In an attempt to create certainty, certain duties of directors have been partially codified in the Companies Act.³³⁵

Codification does not entail a rigid fixation of law, but a proposed code with provisions that if used correctly by the courts, can ultimately lead to development of the law, based on the existing principles of South African common law.³³⁶ The aim of partial codification is not to revoke the common law but to ensure that the partial codification is appropriate to the legal, economic and social context of South Africa as a constitutional democracy and open economy.³³⁷ There are nine fundamental fiduciary duties which are acknowledged in Blackman³³⁸, where directors may not:

³³³ T Mongalo 'An overview of company law reform in South Africa: from the guidelines to the Companies Act 2008', in Mongalo (ed) *Modern Company Law for a Competitive Economy* (2010) xiii-xxv.

³³⁴ DTI *Guidelines* (see note 132) and s 7(a) of the 2008 Act.

³³⁵ Geach (see note 94; 8).

³³⁶ J Sauveplanne *Codification and Judge made Law* (1982) 113.

³³⁷ The Department of Trade and Industry' Companies Bill 2007: Notice of intention to introduce a Bill into Parliament' (GG 29630, GN 166 of 2007).

³³⁸ Blackman *et al* (see note 45; 208).

- (i) exceed their power; or (ii) exercise their power for an improper or collateral purpose; or (iii) fetter their discretion; or (iv) place themselves in a position in which their personal interests conflict, or may possibly conflict, with their duties to the company, or (v) deal with the company otherwise than openly and in good faith; or (vi) make a secret profit; or (vii) take certain economic opportunities; or (viii) compete with the company; or (ix) misuse confidential information.'

The relevant section of the 2008 Act in this regard is section 76 which reads as follows:

“76. Standards of directors conduct-

A director of a company must-

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

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

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

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

(i) reasonably believes that the information is-

(aa) immaterial to the company; or

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

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

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

(a) In good faith and for a proper purpose;

(b) In the best interest of the company;

3.2 Statutory duty to act in good faith and in the best interests of the company

The fundamental duty of good faith is now imposed by both the common law as well as the Act. It is a well-established rule of common law that directors have a fiduciary duty to exercise their powers in good faith and in the best interests of the company.³³⁹ The duty of good faith entails the duty to exercise an independent judgment and the duty to act within the limits or authority.³⁴⁰ The test of good faith is subjective and not objective, since the question is whether the director honestly believed that he or she acted in the interests of the company.³⁴¹ The issue is about the director's state of mind.³⁴² The directors' fiduciary duty to act in good faith and in the company's best interest is partially codified in section 76 (3) (a) and (b) of the 2008 Companies Act which states that subject to s 76(4) and (5), a director of a company, when acting in that capacity, must exercise the powers and perform the functions of a director:

- in good faith and for a proper purpose; and
- in the best interests of the company.

Section 76(3) (b) also gives a statutory basis for the common law duty to act in the best interest of the company. This section obligates a director, when acting in that capacity, to exercise his powers and perform his functions in the best interest of the company. In *Visser Sitrus*³⁴³, the court stated that the duty imposed by section 76(3) (b) to act in the best interest of the company is subjective.³⁴⁴ It requires the directors, having taken reasonably diligent steps to become informed, to have subjectively believed that their decision was in the best interest of the company and that this belief must have had a rational basis. According to Rogers J, the test is not an objective one and does not entitle the court, if the board's decision is challenged, to determine what is objectively speaking in the best interests of the company.

The Act does not provide details regarding these duties other than to state that directors of companies are expected to exercise their powers and to perform their powers in good faith and in the best interest of the company. However, the Act does not explain what is meant by good faith. The significant of the above-mentioned omissions is that they leave scope for the

³³⁹ *Da Silva v CH Chemicals* supra para 55.

³⁴⁰ Cassim (see note 3; 524).

³⁴¹ Cassim (see note 3; 524).

³⁴² *Regentcrest plc v Cohen* [2001] 1 BCLC 80 at 104.

³⁴³ *Visser Sitrus (Pty) Ltd v Goede Sitrus (Pty) Ltd* supra para 80.

³⁴⁴ *Visser Sitrus (Pty) Ltd v Goede Sitrus (Pty) Ltd* supra para 80.

application of common law. In other words, common law remains relevant for purposes of determining the meaning and scope of the duty to act in good faith and in the best interests of the company. This is further stated in the DTI guidelines that the motive behind the enactment of the Act was not to unreasonably jettison the body of jurisprudence built up over more than a century.³⁴⁵ It is not the intention of the Act to replace the common-law duties of directors, to the extent that they are not in conflict with the standards of directors conduct provision.³⁴⁶ Accordingly the common law principles relating to the directors' duties are still relevant to determine the content of the duties to the extent that they are not in conflict with the provision.³⁴⁷

A further crucial implication of the principle that directors owe their fiduciary duties to the company is that, since the duties are owed to the company only, the company alone is entitled to enforce these duties against any delinquent directors.³⁴⁸ The Act endorses the common law principle that directors owe their fiduciary duties to the company i.e. the collective body of shareholders, whether present or future shareholders, not individual shareholders;³⁴⁹ or creditors of the company while the company is a going concern.³⁵⁰ Hence the importance of the new derivative action instituted in terms of s 165 on behalf of the company by a shareholder, a director of the company, or any other person with *locus standi*.³⁵¹ This means where the company incurs a loss or damages as a result of a director's breach of fiduciary duty, only the company may sue in respect of that loss.³⁵² A shareholder cannot claim from the delinquent director for a loss he or she may have incurred as a result of a fall in the value of his or her shares caused by the director's breach of fiduciary duty.³⁵³

³⁴⁵ *South African Company Law for the 21st Century – Guidelines for Corporate Law Reform* (GG 26493, 2004) 7.

³⁴⁶ PA Delpont *The New Companies Act Manual* (2011) 90; Delpont et al *Henochsberg on the Companies Act 71 of 2008* 288; D Davis et al *Companies and Other Business Structures in South Africa: Commercial Law* (2011) 111; FM Cassim et al *Contemporary Company Law* (2012) 509; FM Cassim et al *The Law of Business Structures* (2013) 284-285; C Stein and G Everingham *The New Companies Act Unlocked* (2016) 244.

³⁴⁷ Delpont et al *Henochsberg on the Companies Act 71 of 2008* 288.

³⁴⁸ Cassim (see note 3; 516).

³⁴⁹ *Percival v Wright* supra.

³⁵⁰ *Multinational Gas and Petrochemical Co v Multinational Gas and Petrochemical Services Ltd* [1983] 2 All ER 653 (CA).

³⁵¹ Cassim (see note 3; 516)

³⁵² Cassim (see note 3; 516).

³⁵³ *Stein v Blake (No 2)* [1998] 1 All ER 724 (CA); *Johnson v Gore Wood & Co* [2001] 1 BCLC 313 (HL).

Furthermore, section 76(2) has modified the common-law principle that directors of a subsidiary company did not owe any fiduciary duty to the holding company of the subsidiary, or to the group of companies of which the subsidiary formed part.³⁵⁴

An innovation of the Companies Act is to qualify the duty by the introduction of a “business judgment rule” in section 76(4) which serves as a defense or ‘safe harbor’³⁵⁵ for directors against an alleged breach of the fiduciary duty. This rule requires the courts to defer to the directors’ judgment on what is in the ‘best interests of the company’ if their judgment was shown to be honest and reasonable.³⁵⁶ In addition to the business judgment rule, section 77(9) of the Companies Act provides that a court: ‘may relieve the director, either wholly or partly, from any liability set out in this section, on any terms the court considers just if it appears to the courts that-

- (a) the director is or may be liable, but has acted honestly and reasonably; or
- (b) having regards to all the circumstances of the case, including those connected with the appointment of the director, it would be fair to excuse the director.’

3.3 Statutory duty to act for a proper purpose

It is not enough for the directors to exercise their powers in good faith and in the best interests of the company. Section 76(3) requires that the directors must exercise their powers for the proper purpose.³⁵⁷ The Act does not define proper purpose but at common-law it has always been taken to mean that directors must exercise their powers for the objective purpose for which the power was given to them and not for a collateral or ulterior purpose.³⁵⁸ It should be borne in mind that s 76(3) (a) refer to two duties being the good faith and proper purpose but these are separate and distinct, and cumulative with the consequence that even if the directors have subjectively acted honestly in the interests of the company, they could be objectively in breach of their duty to exercise their powers for proper purpose.³⁵⁹

³⁵⁴ *Charterbridge Corporation Ltd v Lloyds Bank Ltd* supra 123.

³⁵⁵ GFK Santow ‘Codification of directors’ duties’ (1999) 73 *Australian Law Journal* 336 at 348.

³⁵⁶ Cassim (see note 3; 563).

³⁵⁷ Cassim (see note 3; 525).

³⁵⁸ Cassim (see note 3; 525).

³⁵⁹ Cassim (see note 3; 525).

This section is a declaratory of the common law and effects no change in this aspect of the common-law fiduciary duties of directors.³⁶⁰ Cassim argues that section 76(3) (a) removes any doubt relating to the existence of the fiduciary duty to act for a proper purpose as some authorities do regard it as an aspect of the directors' duty of good faith.³⁶¹ Some commentators have seen and considered this duty as an aspect of the duty to act in good faith.³⁶² Therefore the director's duty to exercise powers for a proper purpose is now both a statutory and a common law obligation. It is an abuse of power for directors to exercise their powers for a purpose other than the purpose for which the power was conferred on them. Unlike the duty of good faith, which is subjective, the test for proper purpose is objective.³⁶³

It must be mentioned that section 38(1) of the Act confers on the board of directors the power to issue shares. This fiduciary power must be exercised bona fide for a proper purpose and not for collateral purpose.³⁶⁴ Therefore, where the directors' exercise of their powers is improper and is consequently set aside, the directors will be jointly and severally liable to compensate the company for any loss suffered in consequence of the improper exercise of the power.³⁶⁵ In *Bishopsgate Investment Management Ltd (In liquidation) v Maxwell (No 2)*³⁶⁶ where a director of a company had used the company pension funds to fund his own lifestyle. Hoffmann LJ held that the director was liable for the value of the shares, not even on the basis of any negligence, but merely by misapplying the assets.³⁶⁷

Section 77(2) (a) of the Act also provides that a director will be held liable in accordance with the principles of the common law relating to a breach of a fiduciary duty, for any loss, damages or costs sustained by the company as a consequence of any breach by the director of a duty contemplated in section 76(3) (a) or (b) (i.e. the duty to act in good faith and for a proper purpose).³⁶⁸ Where a director exceeds the power conferred on him his actions can only be validated through ratification by shareholders.³⁶⁹

³⁶⁰ Cassim (see note 3; 525).

³⁶¹ *Teck Corp Ltd v Millar* (1972) 33 DLR (3d) 288 (BCSC).

³⁶² Cassim (see note 3; 525).

³⁶³ *Extrasure Travel Insurances Ltd v Scattergood* supra.

³⁶⁴ Cassim (see note 3; 528).

³⁶⁵ *Re Lands Allotment Co Ltd* (1894) Ch. 616 (CA)

³⁶⁶ [1994] 1 All ER 261 (CA) at 78.

³⁶⁷ *Bishopsgate Investment Management Ltd (In liquidation) v Maxwell (No 2)* at 120.

³⁶⁸ Act 71 of 2008; s76 (3) (a) or (b).

³⁶⁹ Act 71 of 2008; s20.

It is an abuse of power for directors to exercise their powers for a purpose other than the purpose for which the power was conferred on them. The court in *Darvall v North Sydney Brick & Tile Co Ltd*³⁷⁰ held that the existence of subjective good faith is insufficient to save the purported exercise of a power, if the power was exercised for a collateral purpose. Unlike the duty of good faith, which is subjective, the test for proper purpose is objective.³⁷¹ In *Visser Citrus (Pty) Ltd v Goede Hoop Citrus (Pty) Ltd*³⁷², the court tested section 76(3)(a) where the court had to determine inter alia whether the board of directors had exercised the power to refuse to register a transfer of shares for a proper purpose and in good faith.³⁷³ With regards to proper purpose, Rogers J had the following to say:

*“as to proper purpose (s 76(3) (a), the test is objective, in the sense that, once one has ascertained the actual purpose for which the power was exercised, one must determine whether the actual purpose falls within the purpose for which the power was conferred, the latter being a matter of interpretation of the empowering provision in the context of the instrument as a whole. In the context of decisions by directors, there will often be, in my view, a close relationship between the requirements that the power should be exercised for a proper purpose and the requirement that the directors should act in what they consider to be the best interests of company. Put differently, the overarching purpose for which directors must exercise their powers is the purpose of promoting the best interests of the company.”*³⁷⁴

3.4 Statutory duty to exercise an independent judgment

The duty to exercise an independent judgment is seen by some commentators as an aspect of the directors’ duty to act bona fide in the interests of the company. This perhaps explains why this specific common-law duty is not explicitly referred to in section 76, and more specifically, in section 7 (2) and (3). On this basis, the duty to exercise an independent judgment continues to form part of the fiduciary and statutory duties of directors.

³⁷⁰ (1989) 15 ACLR 230 SC (NSW).

³⁷¹ *Hogg v Cramphorn Ltd* supra.

³⁷² 2014 (5) SA 179 (WCC) para 13.

³⁷³ *Visser Citrus (Pty) Ltd v Goede Hoop Citrus (Pty) Ltd* supra, para 14.

³⁷⁴ *Visser Citrus (Pty) Ltd v Goede Hoop Citrus (Pty) Ltd* supra, para 80.

3.5 Statutory duty to act within their powers

This fiduciary duty is not explicitly referred to in section 76 of the Act as a separate and distinct duty.³⁷⁵ Nevertheless it is an aspect of the fiduciary and statutory duty of directors to exercise their powers in good faith for a proper purpose, and in the best interests of the company, as provided in section 76(3) (a) and (b).³⁷⁶ Where a director disregards a constitutional limitation on his or her authority, a number of relevant statutory provisions may be triggered. Section 77(2) (a)³⁷⁷ imposes liability on a director in accordance with the principles of the common law relating to breach of fiduciary duty for any loss, damages or costs sustained by the company as a result of a breach of duty. It follows that, if directors disregard a constitutional limitation on their authority to act on behalf of the company, they may incur liability to the company for any loss, damages or costs sustained by the company as a result of their failure to act within the constitutional limits of their authority. A director may also be held liable in accordance with the principles of the common law relating to delict for any loss, damages or costs sustained by a company as a consequence of any breach by a director of (among other things) any provision of the company's Memorandum of Incorporation.³⁷⁸

Furthermore, section 77(3) (a) imposes liability on a director for any loss, damages or costs sustained by a company as a direct or indirect consequence of the director having done some act in the name of the company, signed anything on behalf of the company, or purported to bind the company or authorize the taking of any action by or on behalf of the company despite knowing that he or she lack the authority to do so.³⁷⁹

Section 20(6) of the Act, also confers a right to each shareholder of the company to claim damages against any incumbent or previous director who "fraudulently or due to gross negligence causes the company to do anything inconsistent with a limit, restriction or qualification unless the fraudulent act or gross negligence has been ratified by a special resolution of the shareholders of the company."³⁸⁰ *R v Byrnes*³⁸¹, is an Australian decision where directors entered into an unauthorized transaction, when they ought to have known that

³⁷⁵ Cassim (see note 3; 533)

³⁷⁶ Cassim (see note 3; 533)

³⁷⁷ Act 71 of 2008; s 77(2) (a).

³⁷⁸ Cassim (see note 3; 533).

³⁷⁹ Cassim (see note 3; 533).

³⁸⁰ Act 71 of 2008; s165; Delport *The New Companies Act Manual* (see note 130; 38-39).

³⁸¹ (1995) 183 CLR 501; *Austin & Ramsay para 9.280 at 475.*

they were not authorized to enter into the transaction. Following this decision, it is the ‘intent’ or ‘purpose’ of the director to gain an advantage or cause detriment to the company that is important. Cassim submits that based on this persuasive authority, there is a strong possibility of the court finding that the director has contravened the statutory duties under section 76(3)(a) or (b) of the Act, if the a director has knowingly entered into an unauthorized transaction on behalf of the company.³⁸²

3.6 Statutory duty to avoid conflict of interest

The duty to avoid conflict of interest is one of the most fundamental fiduciary duties at common law. Cassim describes this duty as “the core duty of a fiduciary”.³⁸³ A director may not place himself in a position in which he has, or can have, a personal interest or a duty to another, conflicting, or which possibly may conflict, with his duties to the company.³⁸⁴ This duty is based on the consideration that, human nature being what it is, there is a danger, in such circumstances, of the person holding a fiduciary position being swayed by interest rather than duty, and thus prejudicing those whom he is bound to protect.³⁸⁵ For this reason, the courts have created an inflexible rule. This duty is specifically provided for in the Companies Act 71 of 2008 which proposes to enhance corporate accountability and to ensure that directors are aware of their duties and responsibilities by partially codifying director’s duties³⁸⁶ and specifically setting a standard of directors’ conduct.³⁸⁷ In terms of the Act, directors must exercise the powers and perform the function of a director honestly and in good faith (*bona fide*) and for a proper purpose.³⁸⁸ Traditionally, the law has divided conflicts of duty and interest into two categories, namely the corporate opportunity rule and the no-profit rule.³⁸⁹

³⁸² Cassim (see note 3; 534).

³⁸³ Cassim (see note 3; 534).

³⁸⁴ Blackman, Jooste & Everingham *Commentary on the Companies Act 2006* vol 2 at p. 8-111; MS Blackman ‘Companies’ in WA Joubert *LAWSA* vol. 4 (2) (1996) 209 para 128.

³⁸⁵ *Beach Petroleum NL v Abbot Tout Russel Kennedy* [1999] 33 ACSR 1 (NSW) 45.

³⁸⁶ D Davies *et al Companies and Other Business Structures in South Africa* (2009) 102-103.

³⁸⁷ Act 71 of 2008; s76.

³⁸⁸ Act 71 of 2008; s76 (3).

³⁸⁹ FC Maleka ‘*Da Silva v CH Chemicals (Pty) Ltd: Fiduciary duties of resigning directors*’ (2009) 126(1) *SALJ* 61-70.

3.6.1 The no-profit rule: section 76(2) (a)

A director of a company must not use his position of a director, or any information obtained while acting in the capacity of a director, to gain an advantage for the director, or for another person other than the company; knowingly to cause harm to the company or a subsidiary of the company.³⁹⁰ In terms of section 1 of the Act the word “knowingly”, as used in section 76(2)(a), means that the person either had actual knowledge of the matter or was in a position in which the person reasonably ought to have had actual knowledge or reasonably ought to have investigated the matter to an extent that would have provided the person with actual knowledge or reasonably ought to have taken other measures which, if taken, would reasonably be expected to have provided the person with actual knowledge of the matter.³⁹¹

The main idea behind the provisions is to limit directors’ power to enter into contracts with companies where conflicts of interests may arise as well as to enhance transparency and independence. The possible danger is that the director may be driven by the desire to give business to companies where they will also benefit at the expense of the company they are working for. As an enforcement measure, the Act provides for liability of directors where they have acted outside the authority vested in them and when their actions were contrary to the provisions of the Act.³⁹²

Directors (and prescribed officers) are likely to contravene section 76(2) (a) (i) even if they have no intention of acting dishonestly. It is inconsistent with the proper discharge of the duties of a director for directors to use their positions as directors or use corporate information to gain a personal advantage for themselves. It is also irrelevant that the company has suffered no loss or that it was not deprived of any opportunity that it might have used for its own advantage.

It must be mentioned that the inclusion of a subsidiary represents a fundamental extension of the common-law principle. At common-law, a director of a holding company does not owe any fiduciary duty to its subsidiary. Each company in a group of companies is as a general rule regarded as a separate legal entity with its own rights and liabilities,³⁹³ unless the court decides to pierce the veil of corporate personality or this is done by the legislature. Section

³⁹⁰ Act 71 of 2008; s76 (2) (a) (i) and (ii).

³⁹¹ P Delpont *The New Companies Act Manual* (2009); 290.

³⁹² Act 71 of 2008; s 77(2).

³⁹³ *Adams v Cape Industries plc* [1990] 1 Ch. 433 (CA).

76(2)(a) (ii) alleviates the severity of the common-law principle by imposing a duty on directors not to misuse their positions as directors or not to use information obtained as directors to knowingly cause harm to a subsidiary of the company.

While section 76(2) (a) may have encapsulated the common-law no-profit rule, it is submitted that section 76 (2) (a) (i) and (ii) is wide enough to apply to both the no-profit rule and the corporate opportunity rule.³⁹⁴ Havenga disagrees with this proposition, he argued that the provision covers corporate situations only partially.³⁹⁵ She argues that neither of the limitation contained in section 76(2) (a) applies to the appropriation of corporate opportunities under the common law rule, and also that the section does not provide for the situation where a former director takes up an opportunity after his resignation from office.³⁹⁶ For section 76(2) (a) (i) and (ii) of the Act to apply, the following requirements must be satisfied.³⁹⁷

- the defendant must be a director, prescribed officer, or an alternate or de facto director or a member of a board committee or of the audit committee;
- the information or advantage obtained (if any) must have come to the director while acting in his or her capacity as such or by reason of his or her position in the company as director;
- the director must have used his or her position as director or information obtained in his or her capacity as a director either to gain an advantage or to knowingly cause harm to the company or its subsidiary;
- such advantage (where applicable) must have been obtained for the director or for some other person (other than the company or its wholly owned subsidiary).³⁹⁸

The court in *Volvo v Yssel*³⁹⁹ held that moneys that are earned secretly in breach of a duty of trust fall to be disgorged by the fiduciary and there is little room for him or her to avoid

³⁹⁴ Cassim (see note 3; 551).

³⁹⁵ M Havenga 'Directors exploitation of corporate opportunities and the Companies Act 71 of 2008' 2013 (2) *TSAR* 257-268 at 265.

³⁹⁶ Havenga (see note 394; 266).

³⁹⁷ *Chew v R* (1992) 173 CLR 626.

³⁹⁸ *Chew v R* supra; para 89.

³⁹⁹ 2009 para 14.

that consequence. The court quoted with approval the dictum in *Phillips v Fieldstone Africa (Pty) Ltd*⁴⁰⁰ that:

*‘the rule is a strict one which allows little room for exceptions. It extends not only to actual conflicts of interest but also to those which are a real sensible possibility. The defences open to a fiduciary who breaches his trust are very limited: only the free consent of the principal after full disclosure will suffice in that a fiduciary who acquires for himself is deemed to have acquired for the trust and once proof of a breach of a fiduciary duty is adduced it is of no relevance that (1) the trust has suffered no loss or damage; (2) the trust could not itself have made use of the information, opportunity etc. or probably would not have done so; (3) the trust, although it could have used the information, opportunity has refused it or would do; (4) there is not privity between the principal and the party with whom the agent or servant is employed to contract business and the money would not have gone into the principal’s hands in the first instance; (5) it was no part of fiduciary’s duty to obtain the benefit for the trust; (6) the fiduciary acted honestly and reasonably.’*⁴⁰¹

3.6.2 The duty to communicate information to the company: section 76(2) (b)

A director of the company must communicate to the board, at the earliest practicable opportunity, any information that comes to the director’s attention; unless the director reasonably believes that the information is immaterial to the company; or generally available to the public; or known to the directors; or is bound not to disclose that information by a legal or ethical obligation of confidentiality.⁴⁰² Cassim argues that section 76(2) (b) is an omnibus provision that requires directors to convey material corporate information to the company.⁴⁰³ Even though the section requires ‘any’ information to be communicated to the company, this is sensibly pruned down by requiring the information:

- to be material to the company; or
- not to be generally available to the public; or
- not to be already known to the directors; or

⁴⁰⁰ *Phillips v Fieldstone Africa (Pty) Ltd* supra para 31.

⁴⁰¹ *Volvo v Yssel* supra; para 14.

⁴⁰² Act 71 of 2008; s76 (2) (b) (i) and (ii).

⁴⁰³ Cassim (see note 3; 553).

- not to be information that is protect from disclose by a legal or ethical duty.⁴⁰⁴

Section 76(2) (b) attempts in effect to impose an ethical standard on directors. Its *raison d'être* is simply that information is the property of the company,⁴⁰⁵ and that, as custodians of corporate information; directors may not misuse it for their own purposes. This is the correct approach, because corporate information is nowadays regarded as one of the company's most valuable commodities. Section 76(2)(b) also encompasses the common-law 'fair-dealing' rule⁴⁰⁶ - a director must disclose, unasked, any information he or she has acquired when acting for the company that is likely to influence the company's decisions and which he or she knows that those acting on behalf of the company do not already possess.⁴⁰⁷

Kanamugire argues that this section codifies the duty not to misuse confidential information that rightfully belongs to the company obtained while a person occupies the position of a director.⁴⁰⁸ It also codifies the duty not to compete with the company, as well as the duty not to take corporate opportunities.⁴⁰⁹ The underlying principle of section 76(2)(a) is the director's duty of loyalty and fidelity and the duty of directors not to misuse confidential information that rightfully belongs to the company obtained while a person occupies the position of a director.⁴¹⁰

A director of a company, when acting in that capacity, must exercise the powers and perform the functions of director in the best interests of the company.⁴¹¹ This obligation will be satisfied, in respect of any particular matter arising in the exercise of the powers or the performance of the functions of director, if – the director has taken reasonably diligent steps to become informed about the matter; either – 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 the director complied with the requirements of section 75 with respect to any interest.⁴¹² This section codifies the director's duty not to take corporate opportunities.

⁴⁰⁴ Cassim (see note 3; 553).

⁴⁰⁵ *Boardman v Phipps* [1966] 3 All ER 721 (HL).

⁴⁰⁶ *Blackman et al* (see note 45 at 8-124).

⁴⁰⁷ Cassim (see note 3; 554)

⁴⁰⁸ Kanamugire (see note 271; 84).

⁴⁰⁹ *Regentcrest plc v Cohen* supra.

⁴¹⁰ Kanamugire (see note 271; 84).

⁴¹¹ Act 71 of 2008; s76 (3) (b).

⁴¹² Act 71 of 2008; s76 (4) (a) (i) and (ii).

It has been established in *Volvo v Yssel*⁴¹³ that moneys that are earned secretly in breach of a duty of trust fall to be disgorged by the fiduciary and there is little room for him or her to avoid that consequence. In *Kukama v Lobelo and Others*⁴¹⁴ is a precedent setting case in which the first order of delinquency against a director was made in terms of section 162 (5)(c) of the Act.⁴¹⁵ In 2010 and 2011 the South African Revenue Service (SARS) made two refunds of approximately R 22 million and R 39 million into the bank account of Diphuka.⁴¹⁶ The amount of R 22 million was a rebate due by SARS to Peolwane but SARS in error paid this amount into the bank account of Diphuka.⁴¹⁷ It transpired that the payment of R 39 million was not due by SARS at all, to either Peolwane or Diphuka. The payment of R 22 million had not been transferred to Peolwane's bank account as it should have been and Lobelo had instead used it for the benefit of other companies that were not subsidiaries of Peolwane.⁴¹⁸ The court held that the conduct of Lobelo in dealings with the affairs of Peolwane did not measure up to the standard required and expected of a director.⁴¹⁹ Further that Lobelo was in breach of s 76(2) (b) of the Act by failing to communicate to Kukama (as a co-director and co-shareholder of Peolwane) the information relating to the payments by SARS into the bank account of Diphuma.⁴²⁰ Therefore, the duty to communicate relevant information to the board of directors is an integral part of the directors' fiduciary duties of loyalty, good faith and the avoidance of a conflict of interest.⁴²¹ Section 76(2) (b) also complements s 76(2) (a) (i) and (ii). The latter prohibits the use of corporate information to gain an advantage or to inflict harm on the company. Then section 76(2) (b) completes this prohibition by positively requiring a director to communicate information to his or her company.

3.7 Conclusion

In this chapter, I have discussed the statutory duties of directors of a company in terms of the Companies Act of 2008. The directors' fiduciary duties are partially codified in the standards

⁴¹³ Supra para 14.

⁴¹⁴ (GSJ) (Unreported case no 38587/2011).

⁴¹⁵ *Kukama v Lobelo and Others* supra; para 3.

⁴¹⁶ *Kukama v Lobelo and Others* supra; para 10.

⁴¹⁷ *Kukama v Lobelo and Others* supra; para 10.

⁴¹⁸ *Kukama v Lobelo and Others* supra; para 10.

⁴¹⁹ *Kukama v Lobelo and others* supra; para 9.

⁴²⁰ *Kukama v Lobelo and Others* supra; para 41.

⁴²¹ *Kukama v Lobelo and Others* supra; para 41.

of directors conduct provision.⁴²²The companies Act 2008 has codified and modified almost all the traditional director's common law duties. The partial codification of the director's duties is one of the important changes brought by the new company law regime. Codification of the director's duties makes the law easily accessible. Studies undertaken by different organizations have shown that many directors do not know what their duties are. This makes it essential for the duties to be codified and encourages good corporate governance.⁴²³ Codification also affords South Africa an opportunity to conform to international best practices.⁴²⁴

The duties of directors are contained in section 76 of the 2008 Companies Act.⁴²⁵ This section deals specifically with the duty to act in good faith and for a proper purpose, the duty to act in the best interest of the company, and the duty of care, skill and diligence. Even though the Act has largely retained common law principle, it has also brought important changes that worth mentioning in relation to the fiduciary duties. The duties of a director are no longer limited to the company that the director serves, but now extend to wholly-owned subsidiaries of that company. The partial codification of the duties of directors will assist companies, in particular their directors, to be more compliant.⁴²⁶ The fact that the codification is partial means that not all common law principles have been incorporated into the Act. Hence, the common law shall continue to apply in this area of law. This was explained by the DTI report that the motive behind enactment of the Act was not to unreasonably jettison the body of jurisprudence built up over more than a century.⁴²⁷ Section 77 also codified common law remedies as it states that where a director has breached his fiduciary duty to act in good faith and for a proper purpose, or the duty to act in the best interest of the company, he shall be held liable in accordance with the principles of common law relating to a breach of duties, for any loss, damages or costs sustained by the company.⁴²⁸

⁴²² Act 71 of 2008; s76).

⁴²³ Kanamugire (see note 271; 87).

⁴²⁴ Davis (see note 291; 116).

⁴²⁵ Act 71 of 2008; s76.

⁴²⁶ JL van Tonder 'An analysis of the directors' duty to act in the best interests of the company, through the lens of the business judgement rule' (2015) 36 *Obiter* 704.

⁴²⁷ *South African Company Law for the 21st Century – Guidelines for Corporate Law Reform* (GG 26493, 4004), 7.

⁴²⁸ Act 71 of 2008; s77.

CHAPTER FOUR: CONCLUDING REMARKS

4.1 Introduction

The fiduciary duties of directors are of fundamental importance to any developed corporate law system. This is largely due to the fact that as a separate legal entity or juristic person which exists apart from its management and shareholders, a company must necessarily act through individuals.⁴²⁹ The functions and responsibilities of corporate directors, who are entrusted with its management, arise by virtue of this nature of a company.⁴³⁰ Company management can only be effective if those who manage are allowed a certain measure of freedom and discretion in the exercise of their function.⁴³¹ Contrarily, effective control of management is vital in the interests of the company itself and its various stakeholders.⁴³²

Company directors are subject to various duties. Their onerous common law fiduciary responsibilities exist in addition to the various statutory duties contained in the Companies Act. A company directorship is generally regarded as one of the most complex fiduciary offices.⁴³³ The fiduciary relationship arises from the purpose for which the director's office and powers are entrusted to her, namely the benefit of the company.⁴³⁴ Therefore it is significant that directors know and understand their duties in order that they do not breach their duties negligently or abuse their discretionary powers.⁴³⁵

It must be submitted that there is an extensive literature on the fiduciary duties of directors but the duties of a company director represent a subject that is not merely academic in nature, but one that is of vital importance in our ever changing commercial world. More and more people are appointed as company directors every day and often they do not know or understand the implications of what they have agreed to. This problem is further exacerbated by partial codification of the directors' duties because the fiduciary are now derived from both the common law and the statute.

⁴²⁹ HS Cilliers et al (see note 4; 3).

⁴³⁰ MS Blackman (see note 45 para 161).

⁴³¹ M Havenga 'Directors' Fiduciary duties under our future Company-Law regime' (1997) 9 *Merc LJ* 310.

⁴³² Havenga (see note 430; 310).

⁴³³ JC Shepherd *The Law of Fiduciaries* (1981) 347-348.

⁴³⁴ Geach (see note 94; 8).

⁴³⁵ Geach (see note 94; 8).

The duties of directors have been a contentious issue in company law jurisprudence. These duties play a role in ensuring the promotion of corporate governance principles.⁴³⁶ The common-law fiduciary duties of directors require them to exercise their powers bona fide and for the benefit of the company.⁴³⁷ In addition, they have the duty to display reasonable care and skill in carrying out their functions: they should act in the best interests of the company, avoid conflicts, not take corporate opportunities or secret profits, not fetter their votes, and use their powers for the purpose conferred and not for a collateral purpose.⁴³⁸

The Companies Act contains provisions dealing with directors' general duties that are comparable to the common-law duties of directors: the Companies Acts provisions pertaining to the duties of directors are a semi- or quasi-codification of their common law duties. Katz is of the view that this codification does not in reality alter the common-law position, it is merely descriptive of the common law.

At common law it is clear that directors owe fiduciary duties to the company of which he is a director. In the parent-subsidary context the common law principle is that the subsidiary company owes no duty to the holding company,⁴³⁹ and the holding company owes no duty to the subsidiary except in specific circumstances where control is exercised.

4.2 Findings of the study

Chapter one (1) of this study explored the definition of a director in regards to both the common law and the Act, and also considered the meaning of the fiduciary in the context of the company law. It was discovered that the definition of the term 'director' is broad enough to accommodate other persons to be associated with the position of a director.⁴⁴⁰ For instance, the words 'occupying the position of a director' in the definition of a director makes it clear that a de facto director constitutes a director for the purposes of the Act.⁴⁴¹ There is no distinction drawn between executive, non-executive and independent directors however an

⁴³⁶ Mongalo (see note 332; 158).

⁴³⁷ Dharmaratne (see note 71; 1).

⁴³⁸ N Bouwman 'An Appraisal of the modification of the director's duty of care and skill' 2009 (21) *SA Merc LJ* 510.

⁴³⁹ Botha *supra* at 242.

⁴⁴⁰ Cassim (see note 3; 409).

⁴⁴¹ Cassim (see note 3; 409).

important distinction is made between these types of directors in practice.⁴⁴² It was revealed that a director of a company owes a fiduciary duty to the company from the day he accepts the position of a director.⁴⁴³ A director of a company owes a fiduciary duty to the company and only the company alone and does not owe a fiduciary duty to the shareholders even if appointed by them.⁴⁴⁴ Furthermore, directors do not owe a fiduciary duty to the company's creditors except where the company is insolvent or nearly insolvent.⁴⁴⁵ Thus, a director of a company has a duty of trust relationship with the company, and he or she should not breach his contractual duty held in trust.

Chapter two discussed all the common law fiduciary duties of director of a company. These are the duty to act in good faith and in the best interests of the company, duty to act for a proper purpose, duty to exercise an independent business judgment and the duty to avoid conflict of interest. The duty to act in good faith and in the best interests of the company is described as the duty of absolute loyalty or honest⁴⁴⁶ and utmost good faith to the company.⁴⁴⁷ This is a subjective duty as the courts will not interfere with a director's decision, where the director honestly believed that the decision he or she took was for the benefit of the company as a whole.⁴⁴⁸ It was discovered that the court will only set aside a decision taken by the board if it is clear that there is presence of mala fides, by virtue of the fact that the directors did not act in good faith and in the best interests of the company when making a decision.⁴⁴⁹ It is apparent that the fiduciary duty that a director of a company must exercise the powers and perform the function of director in good faith and best interests of the company. The director owes the duty to the company itself not to individual shareholders or other stakeholders.⁴⁵⁰

Furthermore, when analyzing the duty to act for the proper purpose, it was revealed that it is an abuse of power for directors to exercise their powers for a purpose other than the purpose for which the power was conferred on them. The duty to act for proper purposes is important because it is a flexible and useful tool which enables the court to review the directors'

⁴⁴² Cassim (see note 3; 409).

⁴⁴³ *Howard v Herrigel* supra at 678.

⁴⁴⁴ Blackman (see note 45; 8-51).

⁴⁴⁵ Pretorius (see note 104; 278).

⁴⁴⁶ *Black's Law Dictionary* (see note 1148, 713).

⁴⁴⁷ Loose (see note 103; 246).

⁴⁴⁸ *Re Smith and Fawcett Ltd* supra note 99 para 304-306.

⁴⁴⁹ *Re Smith and Fawcett Ltd* supra note 99 para 307.

⁴⁵⁰ Pretorius (see note 104; 8-51).

decision.⁴⁵¹ At common law proper purpose is defined as meaning that the powers given to directors must be exercised for the purpose for which they were granted. Many of the cases which dealt with this duty under common law concerned the power of directors to issue new shares of the company. Such power must not be used for an ulterior motive such as entrenching control of the company or thwarting bona fide takeover offers. The courts are not entrusted with this decision. On the other hand, it is the sphere of the courts to determine what actions are not in the beneficiaries' interest, and an action will not be in the beneficiaries' interest if it constitutes a breach of any of the specific duties.⁴⁵² Directors are not entitled to use their powers of issuing shares merely for the purpose of maintaining their control or control of themselves and their friends over the affairs of the company, or merely for the purpose of defeating the wishes of the existing majority of shareholders.⁴⁵³ Furthermore, directors are entitled to consider the reputation, experience and policies of anyone seeking to take over the company. If they decide, on reasonable grounds, that a takeover will cause substantial damage to the company's interests they are entitled to use their powers to protect the company.⁴⁵⁴

It was also revealed that directors must as a general rule not fetter their discretion. This means they should not enter into an agreement with a third party as to how they exercise their discretion. Directors have the job of managing the company and they are given certain powers to enable them to do that. But they must act according to the company's constitution and use those powers in the interests of the company, not to further their narrow interests. For example, their power to issue new shares must be used for the purpose of raising capital for the business. Issuing shares to your cronies just to keep voting control in friendly hands is an abuse of power and a breach of duty.

A director must not use the position of director, or any information obtained as a director, to gain personal advantage or for personal gain, nor advantage for any other person, other than the company itself.⁴⁵⁵

⁴⁵¹ Lee (see note 184; 79-97).

⁴⁵² P Finn *Fiduciary Obligations* (1977) 16.

⁴⁵³ *Piercy v Mills & Co Ltd* [1920] 1 Ch. 77.

⁴⁵⁴ *Hogg v Cramphorn* supra; 317.

⁴⁵⁵ Kanamugire (see note 324; 80).

In *Cyberscene Ltd and Others v i-Kiosk Internet and Information (Pty) Ltd*⁴⁵⁶, the court held that clearly a director acts in breach of his fiduciary duty to the company where he sabotages the company's contractual opportunities for his own advantage, or where he uses confidential information to advance the interests of a rival concern or his own business to the prejudice of those of his company.

Furthermore, directors are not allowed to take corporate opportunities. A man who stands in a position of trust towards another, cannot, in matters affected by that position advance his or her own interests (e.g. by making a profit) at that other's expense.⁴⁵⁷ We discovered that a director cannot acquire a property that constitutes a corporate opportunity and re-sell it to the company at a profit. The law does not give effect to his or her intention; it treats the acquisition as one made in the interests of the company.⁴⁵⁸

Chapter 3 discusses the statutory fiduciary duties of directors of the company. We have shown that the directors' fiduciary duties are partially codified in the standards of directors' conduct provision.⁴⁵⁹ However, it is not the intention of the Act to replace the common-law duties of directors, to the extent that they are not in conflict with the standards of directors' conduct provision.⁴⁶⁰ We have shown that partial codification of the director's duties improves the clarity, simplicity and legal certainty, and thus makes the law more accessible to directors and other people affected by the actions of directors. What is further evident from the Act is that it extends liability for breach of fiduciary duties and the duty of care and skill to not only directors, but also to prescribed officers and to committees of the board members, irrespective of the fact that they are not appointed as directors. Prescribed officer can be defined as any person who exercises general executive control over the management or business of a company, or who regularly participates to material degree in the exercise of general executive control. In the light of the aforementioned a shadow director will most probably also be included in the definition of a prescribed officer.

Section 73(3) expressly states that a director, when acting on behalf of the company, should perform all of his or her functions and powers in good faith, for a proper purpose, in the best interests of the company, and with the requisite degree of care, skill and diligence that may

⁴⁵⁶ 2000 (3) SA 806 (C).

⁴⁵⁷ *Robinson v Randfontein Estates Gold Mining Co Ltd*; para 179.

⁴⁵⁸ *Robinson v Randfontein Estates Gold Mining Co Ltd*; para 180.

⁴⁵⁹ Act 71 of the Companies Act supra note 1; s 76 read with s 77(2).

⁴⁶⁰ Delpert ...et al *Henocheberg on the Companies Act 71 of 2008* (see note 130; 288).

reasonably be expected of a person holding such office, with the same level of knowledge and skill as that director. Furthermore, section 76 (2) places a positive obligation on a director to avoid any conflict of interests with the company.⁴⁶¹ Section 72 (2) (a) may be viewed as a restatement of the common law no profit rule. One material difference is the extension of the fiduciary duty to subsidiaries of the holding company. Directors' fiduciary duties did not extend to subsidiary companies under common law. Section 77 of the Act makes provision for the liability of a director in the event that he/she breaches one or more of his statutory duties owed towards the company.⁴⁶²

4.3 Contributions of the study

This study sought to assist in the interpretation of fiduciary duties since the partial codification in order to apprehend the 2008 Act and outline the current position in relation between the 2008 Act and the common law. Most importantly, the common law principles are reserved to function in tandem with the partial statutory codification.⁴⁶³ This allows directors to reach for answers in the treasure chests of the common law if the statutes cannot provide them with guidance or an answer in a set of complicated factual circumstances that requires a decision based on the application of the principles of fiduciary duties. In addition, the tried and tested common law principles will not be abandoned forever.

⁴⁶¹ Act 71 of the Companies Act supra note 1; s76 (2).

⁴⁶² Act 71 of the Companies Act supra note 1; s77.

⁴⁶³ Bouwman (see note 434; 534).

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