

The Evolution of the Directors' Duty of Care, Skill and Diligence: A Comparative Look at Common Law and Statute

By

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Dedication

I dedicate this study to my family, starting with my wonderful son Wandisokuhle Menelisi Gumbi, who inspires me to be the best person I can be daily.

I am most appreciative to my parents Jabulile Angeline and Cleriton Bhekithemba Gumbi (late) for all the contribution they have made in my life.

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Lastly, I wish to acknowledge all my friends and colleagues who assisted me throughout the process, through an exchange of ideas or moral support.

Declaration

I, Nosihle Pearl Gumbi do hereby declare that unless specifically indicated to the contrary in this text, this dissertation is my own original work and has not been submitted to any other university in full or partial fulfilment of the academic requirements of any other degree or other qualification.

Signed at Pietermaritzburg on this 11th Day of JANUARY 2016

Signature: 

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CHAPTER 1

1. Introduction

1.1 The title

The Evolution of the Directors' Duty of Care, Skill and Diligence: A Comparative Look at Common Law and Statute.

1.2 The Topic

The area of law that is involved in this research paper is Corporate Law and the component to be investigated is that of director's duties in particular that of care, skill and diligence.

The duties are duties which a director is enjoined to follow when carrying out his/her mandate as a director. This paper looks at the duty at common law and in statute and compares the two sources of law under which the duty exists.

1.3 The research design and methodology applied

The research methodology employed in this paper is desk-top based.

The research is based primarily in caselaw and statute. Secondary literature includes legal journals articles, textbooks and other dissertation papers.

1.4 Structure of dissertation

This dissertation is divided into 6 Chapters including this one. Chapter 2 involves a look into the common law with regards to the duty of care, skill and diligence which helps to establish an understanding, among other things, of the nature of this duty.

Chapter 3 looks at the statutory duty of care, skill and diligence and takes a look at the road traversed prior to the codification of this duty in the Companies Act 71 of 2008. It also considers a comparison of the road travelled in South African company law and other jurisdictions in the codification of the duty of care, skill and diligence.

Chapter 4 considers the question of the plaintiff who may be affected by the breach of the duty of care, skill and diligence by a director and also considers the remedies that may be available to such Plaintiff.

Chapter 5 looks at the business judgment rule, from its origins and development to its incorporation into South African company law. This is with the hope that the reader is left with a clear understanding of the business judgment rule and its significance.

Chapter 6 is then the ultimate conclusion which incorporates a recapturing of the important principles discovered in the chapters preceding it.

CHAPTER 2

The Duty of Care, Skill and Diligence at Common-Law

2.1. Introduction:

The corporate governance structure of companies is mainly comprised of shareholders, the directors and management. Shareholders¹ typically own the shares in the company and they appoint the directors.

A director² is vested with the management of the company³. Directors, as a result of this management “power”, are yoked with various duties which are a ‘legal consequence of holding the office of director’⁴ and these duties include the age-old fiduciary duties and other non-fiduciary duties. The subject of this paper is the duty of care, skill and diligence. The court in the *Fisheries Development Corporation of SA Ltd v Jorgensen & Another; Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd and others*⁵ (the *Fisheries Development Corporation v Jorgensen*) pointed out that there was a relative scarcity of cases dealing with this aspect of company law in South Africa at the time, the essential principles of South African company law are the same as in English company law and that the English cases can therefore provide guidance. The situation with regards to scarcity of cases in South Africa dealing with this duty has not changed considerably and foreign law still provides a useful guide.⁶

The duty comprises three elements namely care, skill and diligence which are similar to each other but they hold different meanings.

¹ Section 1 of the Companies Act 71 of 2008 reads, “subject to section 57(1), means the holder of a share issued by a company and who is entered as such in the certificated or uncertificated securities register, as the case may be.”

² Section 1 of the Companies Act 71 of 2008 provides defines a director as follows, “ A director means a member of the board of a company, as contemplated in Section 66 , or any alternate director of a company and includes any person occupying the position of a director or alternate director, by whatever name designated. ”

³ Section 66(1) of the Companies Act 71 of 2008 provides the following, “the business and affairs of the company must be managed by or under the direction of its board, which has the authority to exercise all of the powers and perform any of the functions of the company, except to the extent that this Act or the company’s Memorandum of Incorporation provide otherwise”; See also S Kennedy-Good , L Coetzee , “The Business Judgment Rule(Part 1)” *Obiter* (2006) 62 @63

⁴ See note 3: Kennedy-Good S, Coetzee L *ibid*

⁵ [1980] 4 All SA 525(W) at 534

⁶ See section 5(2) of the Companies Act 71 of 2008 which provides, “to the extent appropriate, a court interpreting or applying this Act may consider foreign company law”. See also JJ Du Plessis “ A comparative analysis of directors’ duty of care, skill and diligence in South Africa and in Australia” (2010) *Acta Juridica* 263-289

Care:

The *Oxford English Dictionary* defines care as special attention or effort made to avoid damage, risk or error. Cassim⁷ describes care as the manner in which skill is applied and it thus may be objectively assessed.

Skill

A clear definition of the term skill has not been found with regards to the materials used in this paper however the *Oxford English dictionary* defines skill as the ability to do something well, and the alternative being a particular ability. It is noteworthy that in the codified duty in South Africa and England, the element of skill is present however in the Australia it is not. It has been suggested⁸ in Australia that reference to 'skill' should be made in dealing with the duty of care and diligence and one such suggestion can be quoted below:

'In the exercise of his powers and the discharge of his duties, a director shall at all times exercise the degree of care, skill and diligence that a reasonable man who had such training and experience as the director has would exercise as a director of the company, provided that the degree of care, skill and diligence that the director is required to exercise shall not be less than which would be exercised by a person of reasonable competence and experience.'⁹

Diligence

Du Plessis submits that the term diligence has hardly been used in South Africa by the courts or the legal commentators in relation to the duty of care and diligence prior to its use in section 76(3) (c) of the Companies Act 71 of 2008.¹⁰ She notes further the inclusion of the term diligence in relation to the duty of care and skill in section 76(3) (c) in the Companies Act, 2008 is likely to be based on its inclusion in section 180(1) of the Australian Corporations Act 2001.¹¹ The *Oxford English Dictionary* defines the term diligent as an adjective which means showing care and effort in a task or duty.

The historic sources of a director's duties prior to the Companies Act, 2008 were the Companies Act, 1973; common law and the company's memorandum and articles of association. As stated above that in South Africa company law the courts realised

⁷ FHI Cassim et al 'Contemporary Company Law' Second Edition (2012) JUTA at page 556; See also *Daniels (formerly practising as Deloitte Haskins & Sells) v Anderson* (1996) 15 ASCR 607 (NSW);(1995) 37 NSWLR 438

⁸ See note 6: Du Plessis at page 268

⁹ RBS Macfarlane 'Directors' Duties after the National Safety Council case: Duty of Care' (1992) 3 *Australian Bar Review* 269 at 274

¹⁰ See note 6: Du Plessis at page 268

¹¹ *Ibid*

that the duty of care, skill and diligence is not richly discussed by South Africa courts, and that other jurisdictions provide guidance. The English jurisdiction was considered very valuable also in this paper one will look at the Australian jurisdiction.

At common law Cassim indicates that directors, as above defined, are held liable for negligence in the performance of their duties. The question that then remains is whether the extent of liability is the same with regards to the different categories of directors' particularly executive and non-executive directors.

It is also interesting to consider whether, with the advent of the enactment of the Companies Act, the standard by which directors are measured with regards to the duty of care, skill and diligence at common law, remains the same or is modified.

In this chapter, one also considers the position of the common law after the enactment of the Companies Act, 2008. In other words one considers whether there is a complete codification of the duty of care, skill and diligence in South Africa, comparing same with other jurisdictions. Another point which is considered in this chapter is the journey of the duty of care, skill and diligence leading up to its codification.

The issue of whether or not directors may be able to delegate some or all of their duties to other persons is considered from the perspective of common law leading up to the Companies Act, 2008.

2.2 The nature of the duty of care, skill and diligence: Fiduciary or Aquilian

2.2.1 Fiduciary duties

Fiduciary duties are based on "loyalty, good faith and avoidance of conflicts of interest and duty"¹² The fiduciary duties are owed generally by directors to the company¹³. At common law there is no distinction with regards to this duty in so far as the type of director is concerned. Executive and non-executive directors do not have different fiduciary duties in law.¹⁴

In the case of *Bristol and West Building Society v Mothew*¹⁵, the court at page 711 said the following:

"The distinguishing obligation of a fiduciary duty 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 profit out of his trust; he must not act for his

¹² See note 7: Cassim at page 509

¹³ In terms of the new statutory fiduciary duties provisions, these duties may be owed by persons who are not directors but who play a role in the corporate governance.

¹⁴ See note 7: Cassim at page 511

¹⁵ [1996] 4 All ER 698(CA) 711; See also Note 7: Cassim at page 514

own benefit or for 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 defining characteristics of the fiduciary.”

This case was dealing with the concept of fiduciary duties where an attorney who was alleged to have acted negligently was accused to be in breach of his fiduciary duties. The court also went as far as differentiating between fiduciary duties and the duty of care; however the difference between the two is discussed further below. From the statement quoted above one may be able to identify the following examples of fiduciary duties: to act in good faith; no profit out of his trust, must not act for his own benefit (also known as the corporate opportunity rule).

2.2.1.1 *The duty to act in good faith in the best interests of the company*

The director must always do what she in good faith believes to be in the best interest of the company. From this it is apparent that there must be such a belief and it must be an honest belief at that, thus rendering the enquiry into whether there was such a belief a subjective one.¹⁶ This principle, that what the individual director holds in good faith to be in the best interests of the company is considered and not what the court holds to be such, was laid down in the English case of *Re Smith & Fawcett Ltd*¹⁷. This principle is based on the rationale that directors, unlike the courts, have more knowledge, time and expertise to consider and evaluate what constitutes the best interests of the company.¹⁸

The subjectivity of the test has some objective limits in that if there are no reasonable grounds upon which the director basis his subjective belief, he would have breached this duty.¹⁹

2.2.1.2 *The duty to act for a proper purpose*

This duty is not apparent in the above extract from *Bristol and West Building Society v Mothew*²⁰; however it is closely linked to the good faith element of the fiduciary duties. It is a saving grace that the director exercised her powers in good faith, in the best interests of the company, the purpose for the exercise of such powers also needs to be one that is “proper”. The consideration for this duty invokes an objective test as opposed to a subjective test which is used to assess the presence of good faith. This is because good faith involves honesty which can only be assessed subjectively, and a proper purpose on the other hand may be assessed objectively.

¹⁶ See Note 7: Cassim at page 524

¹⁷ [1967] Ch 254 at 268; See also Note 7: Cassim at page 524

¹⁸ See Note 7: Cassim at page 524

¹⁹ See note 7: Cassim at 524-525

²⁰ See Note 15 supra

The meaning of what a proper purpose is may be found in the English case of *Hogg v Cramphorn Ltd*²¹ a case which involved the issue of shares in a family concern in a bid to prevent a takeover by someone perceived to be "inexperienced and unsuitable"²². The directors considered it in the best interests of the company not to allow such an incapable person from taking over the company, and perhaps was an act in good faith in the best interests of the company. However the court found that the issue of shares was done not for purposes of raising capital but for manipulating shareholding and that this was not a proper purpose. This is not to say that at all times the issue of shares should be only for the purposes of raising capital in order for it to be a valid purpose.²³

2.2.1.3 The non-profit rule

This duty falls within the ambit of fiduciary duties dealing with the conflict of interest. The principle that when a director performs her duties she must not place herself in a situation where her personal interests conflict with the official duty is one of the most important fiduciary duties.²⁴ Cassim states "the duty to avoid a conflict of interest is one of the most important fiduciary duties of directors".²⁵

The requirement that a director must not make a personal gain out of their directorship is one that is upheld regardless of whether the company did not suffer a loss as a result of the gain. This was the case in the matter of *Regal (Hastings) Ltd v Gulliver*²⁶ where the directors made a gain which they would not have made had they not been directors (they would not have known about the gain to make) even though it was not at the expense of the company. In the South African case of *Phillips v Fieldstone Africa (Pty) Ltd* 2004 (3) SA 465 it was held that this rule allows little room for exception.²⁷

2.2.1.4. The corporate opportunity rule

This rule was stated by the Supreme Court of Appeal in the case of *Da Silva v CH Chemicals (Pty) Ltd* 2008(6) SA 620 (SCA) at 627 as follows:

²¹ *Hogg v Cramphorn Ltd* [1967] Ch. 254

²² See note 7: Cassim at 526

²³ *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821 (PC) at 835, [1974] 1 All ER 1126 at 1131

²⁴ *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168 at 178-179

²⁵ See note 7: Cassim at 534

²⁶ [1942] 1 All ER 378 (HL)

²⁷ See note 7: Cassim at 537

"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."²⁸

The essence of this rule is that a director should not usurp any opportunity that comes to her by virtue of her being a director of the company.

2.2.2 The duty of care, skill and diligence: nature and content:

Friedman JP in the case of *Du Plessis No v Phelps*²⁹ states that liability for the breach of the common law duty to take reasonable care in management of the company's affairs lies in the principle of *Lex Aquilia* which is the principle of fault, be it *dolus or culpa*. This is in contrast to the breach of fiduciary duties, as the learned Judge pointed out, which do not necessarily include fault. Also in *Fisheries Development Corporation v Jorgensen* the court, in finding that the conduct complained of was not a breach of the duty of care, stated that it did not amount to negligence, negligence being part of the *lex aquilia*.³⁰ Ipp J. in *Permanent Building Society v Wheeler* (1994) 14 ASCR 109 at 157 remarks:

"It is essential to bear in mind that the existence of a fiduciary relationship does not mean that every duty owed by a fiduciary to the beneficiary is a breach of fiduciary duty. In particular, a trustee's duty to exercise reasonable care, though equitable, is not specifically a fiduciary duty".

Also Lord Browne-Wilkinson in *Henderson v Merrett Syndicates Ltd* [1994] 3 WLR 761 at 799 states:

"The liability of a fiduciary for the negligent transact of his duties is not a separate head of liability but the paradigm of the general duty to act with care imposed by the law on those who take it upon themselves to act or advise others. Although the historical development of the rules of law and equity have, in the past, caused different labels to be stuck on different manifestations of the duty, in truth the duty of care on bailees carriers, trustees, directors, agents and others is the same duty: it arises from the circumstances in which the defendants were acting, not from their status or description.

The Australian courts³¹ in the same year as the *Du Plessis No v Phelps*³² also stated that the liability for a breach of this duty lies in the law of Torts and that it was not

²⁸ See note 7: Cassim at 538; *Da Silva v CH Chemicals (Pty) Ltd* 2008(6) SA 620 (SCA) at 627

²⁹ 1995(4) SA 165 (C) at 170; See also Note 7: Cassim at page 555 "The duty of care, skill and diligence, which is not a fiduciary duty but is based on delictual or Aquilian liability for negligence".

³⁰ See Note 5 *supra* at page 534

³¹ See Note 7: *Daniels v Anderson* at 668, "We are of the opinion that a director owes to the company a duty to take reasonable care in the performance of the office. As the law of negligence has developed, no satisfactory policy ground survives for excluding directors from the general requirement that they exercise reasonable care in the performance of their office. A director's fiduciary obligations do not preclude the common law duty of care."

³² See note 29 *supra*

based in equity (fiduciary duties).³³ This clearly indicates that the duty of care, skill and diligence is not a fiduciary duty.

Greg Golding in his article³⁴ summarises the content of the duty as containing the following propositions:

- “There is a core irreducible requirement that a director or officer be involved in the management of the company and guide and monitor the activities of the company tested by what a reasonable person of ordinary prudence would do;
- From that core irreducible requirement any additional skills and expertise that a director or officer has should be factored in and the role that the director or officer performs in the governance structure must also be assessed;
- A director must acquire an understanding of the business of the company and become familiar with the fundamentals of the business of the company.
- A director must remain informed about activities of the company and monitor those activities.
- A director must maintain familiarity with the financial status of the company and must have the ability to read and understand the financial statements of the company.”

Essentially this means that in executing the duty of care, a director is expected to be involved (not be aloof) in the business of the company, this may be tested objectively and any additional skills they may possess should be put into good use in management.

2.3 The objectivity or subjectivity of the standard used to measure at common-law

The question that arises is how a director is measured in determining whether or not they fell short of their duty of care, skill and diligence in other words what is the standard that is employed.

The courts, as some legal writers have opined³⁵, have traditionally adopted a lenient approach to the standard of this duty. It appears that the view adopted by the Courts

³³ See note 6: JJ Du Plessis at 272

³⁴ G Golding “Tightening the screws on directors: care, delegation and reliance” (2012) UNSW Law Journal Volume 35(1) 266 at 270-271

³⁵ N Bouwman “An appraisal of the modification of the director’s duty of care and skill” (2009) 21 (4) SA *Mercantile Law Journal* 510; See also Note 7 : Cassim at 554

has been that shareholders appoint directors, if directors that have been appointed are incapable, the shareholders will suffer at their own hands.³⁶ This low standard of measuring directors could be traced to *Turquand v Marshall*³⁷ and other earlier cases which include *Lagunas Nitrate Co v Lagunas Syndicate* [1899] 2 Ch 392 (CA). Short of the presence of gross negligence, the proposition seemingly prevalent was that a director would not be liable for mere errors of judgment.³⁸ A commentary by the Australian Courts regarding the possible rationale for the English courts adopting such a low standard is found in *Daniels v Anderson*³⁹ where it was commented as follows:

‘The nature and extent of directors’ liability for their acts and omission developed as the body corporate evolved from the unincorporated joint stock company regulated by a deed of settlement and was influenced by the partnership theory of corporation whereunder shareholders were ultimately responsible for unwise appointment of directors.’

Other cases which were decided around the same period, such as the ones that are discussed below, also reflected the low standard of care required from directors. These cases reflected that at common law, a director was required to exercise the care and skill that may be expected from a person with her knowledge and experience.⁴⁰ In *Re Brazilian Rubber Plantations and Estates Ltd*⁴¹ directors relied on a report in committing the company to an agreement to purchase a plantation in Brazil without questioning it. The report was a false and fraudulent account of the output of the rubber plantations.⁴² When the company was being wound up, the liquidator attempted to have the directors liable for their negligence. The court held that a director is expected to act with as much care as can be reasonably expected from such director. There isn’t any expertise expected from such a person with regards to the business of the company however should he have such expertise or skill then it would be expected that the company should benefit from such skill.⁴³ A director cannot be held liable for mere errors of judgment. The test laid down in this case is a subjective test. The court in applying these principles to the facts stated essentially that the directors did not in fact need to be even familiar with the rubber business for them to hold the office as directors; they were simply unskilled and inexperienced.⁴⁴ Since there was no benchmark for skill or expertise in order to

³⁶ See note 7: Cassim at 555; See also note 7: *Daniels* case

³⁷ (1869) LR 4 Ch App 376 at 386 ‘...however ridiculous and absurd their conduct might seem, it was the misfortune of the company that they chose such unwise directors, but as long as they kept within the powers of their deed, the Court could not interfere with the discretion exercised by them.’; *Barnes v Andrew* 298 F. 614 at 618 (1924) “True, he was not very well-suited by experience for the job he had undertaken, but I cannot hold him on that account. After all, it is the same corporation that chose him which now seeks to charge him.”

³⁸ M Bekink “An Historical Overview of the Director’s Duty of Care and Skill: From the Nineteenth Century to the Companies Bill of 2007” (2008) 20 SA Merc LJ 95 at 97

³⁹ See note 7: *Daniels v Anderson* at page 657

⁴⁰ See note 7: Cassim at 554

⁴¹ [1911] 1 Ch 425

⁴² See note 7: Cassim at 555

⁴³ See note 41 at page 437

⁴⁴ Ibid at 437-438

qualify as a director, the directors were excused from liability in that they acted in accordance with what someone with their lack of skill would have and the shareholders should be able to deal with consequences of putting unskilled people in directorships.⁴⁵

In *Re City Equitable Fire Insurance Co Ltd*⁴⁶, which is considered to be the leading case on the common law duty of care in so far as the legal principles are concerned⁴⁷, a liquidator sought to make directors liable for making poor investment investments, loans and payments. This was after there was a shortage of funds mainly attributable to fraud on the part of the managing director who employed a method of buying treasury bonds before the end of the accounting period and selling same after the audit. This had the effect of allowing another company's debt, wherein this managing director had an interest, to be reduced. The liquidator was of the view that the directors failed to discover this fraud by leaving everything to the managing director and thereby breached their duty of care. This claim by the liquidator was unsuccessful mainly because the company's articles exempted directors from liability for damage caused non-wilfully and also because of the principles that there is no skills benchmark for one to be a director and a director need not pay continuous attention to the affairs of the company. From a reading of this case, the duty may be summarised into four propositions⁴⁸.

- a) "A director must exercise a degree of skill and diligence as would amount to the reasonable care that an ordinary man might be expected to take in the circumstances on his own behalf."⁴⁹
- b) "A director need not show a greater degree of skill 'than may reasonably be expected from a person of his knowledge and experience'." The director's specific qualifications and experience are considered and there is no minimum objective standard. In the case of *Re Denham & Co*,⁵⁰ the court held that a director had not breached his duty of care due to the consideration that given his knowledge and experience he could not have been expected understand the significance of the information which was contained in the financial statements.
- c) "A director is not bound to give continuous attention to the affairs of the company". There is thus no duty for a director to attend all board meetings or to be accountable for the decisions that have been taken in his absence. However if a director does attend a meeting, he is expected to pay attention to the proceedings.

⁴⁵ Ibid

⁴⁶ *Re City Equitable Fire Insurance Co Ltd* [1925] Ch 407

⁴⁷ See Note 38: Bekink at 98

⁴⁸ JF Corkery "Directors' powers and duties" (1987).*Law Book Gallery*. Book 2.at page 133 (http://epublications.bond.edu.au/law_books/2/ last accessed 17 December 2015); See also note 7: Cassim at 557 where he proposes that there are 3 propositions which were accepted into our law in terms of *Fisheries Development Corporation v Jorgensen*; See also Note 6: Du Plessis at 264.

⁴⁹ See note 48 above: Corkery at 133

⁵⁰ (1884) 25 Ch D 752

- d) "A director can rely on other officers or experts." Romer J in *re City Equitable Fire Insurance Co Ltd*⁵¹ stated:

In respect of all duties that, having regard to the exigencies of business, and the articles of association, may properly be left to some other official, a director is, in the absence of grounds for suspicion, justified in trusting that official to perform such duties honestly.

In relation to the preceding proposition (d), Romer J at the same page as the above cited passage cited a passage from *Re National Bank of Wales* which provided a justification as to why the directors should be able to rely on experts and the like:

'Business cannot be carried on upon principles of distrust. Men in responsible positions must be trusted by those above them, as well as by those below them, until there is reason to distrust them. We agree that care and prudence do not involve distrust; but for a director acting honestly himself to be held legally liable for negligence, in trusting the officers under him not to conceal from him what they ought to report to him, appears to us to be laying too heavy a burden on honest business men.'⁵²

The above quotation simply means that denying directors the ability to rely on others placed in responsible positions would be placing an unnecessary burden to know everything.

These propositions were affirmed in South African Company law in the *Fisheries Development Corporation v Jorgensen*⁵³ where there were 3 propositions put forth and which are summarised by *Bekink*⁵⁴:

- a) 'The extent of a director's duty of care and skill depends to a considerable degree on the nature of the company's business.' There is a difference between what is expected of an executive director and what is expected of a non-executive director.
- b) 'A director is not required to have any special business acumen or expertise.'
- c) 'In respect of all duties that may be left to some official, a director is, in the absence of suspicion, justified in trusting that official to perform such duties honestly.'

These propositions basically reinforce the idea that there is no business expertise for directors; unlike in fiduciary duties there is a differentiation between an executive and a non-executive director, more being expected from the former. It also reinforces the principle that delegation of duties by directors is permitted.

⁵¹ See note 46 above at 429

⁵² Later reported as *Dovey v Cory*: [1901] AC 477 as cited at note 46 supra at page 429

⁵³ See note 5 above

⁵⁴ See Note 38: *Bekink* at page 100

The reasons it appears that courts adopted a lenient approach to the directors' duty of care, skill and diligence include the following: 'taking up the position as non-executive director on a part-time basis was seen as 'an appropriate diversion for gentlemen but should not be coupled with onerous obligations, directors are not specialists, like lawyers and doctors; directors are expected to take risks and they are dealing with uncertainties, which would be compromised if too high standards of care were expected of directors; courts are ill-equipped to second guess directors' business decisions'⁵⁵. Basically it appears that in the period around which the above cases were decided, being a director, particularly a non-executive director, as Du Plessis points out⁵⁶, was a position of prestige more than anything. The persons so appointed usually did not actually have that much knowledge or experience and it was considered that burdening such 'gentlemen' with onerous duties would discourage the assumption of positions. The proposition from *Fisheries Development Corporation v Jorgensen*⁵⁷ that there was a difference between executive and non-executive directors also changed in South Africa when *Goldstone JA* in the case of *Howard v Herringel and Another NNO*⁵⁸ (at 678A-D) when he pointed out that this distinction is misleading. He went on to state that this distinction did not exist in any statute nor in common law "whether the inquiry be one in relation to negligence, reckless conduct or fraud, the legal rules are the same for all directors."⁵⁹

The departure from the lenient approach in England came about it seems, in the early 1990s with the case *Re D'Jan of London Ltd* (1994) 1 BCLC 561 (Ch) for example, where the court applied a test that combined both subjective and objective elements based on section 214 (4) of the Insolvency Act, 1986⁶⁰. In this case, an application form to change insurance policy was incorrectly filled by the insurance broker and Mr D'Jan signed the form without checking it. This mistake allowed the insurance company to decline paying out on the cover when there was fire damage to the company's stock. The company was in the process of liquidation when the mistake was discovered by Mr D'Jan and the liquidators sought to hold him liable and tried to recover the losses from him. It has been noted by *Bouwman*⁶¹ that the wording of the test applied in *Re D'Jan of London* is similar to the wording of the test

⁵⁵ See note 6: Du Plessis at page 274

⁵⁶ Ibid

⁵⁷ See note 5 above.

⁵⁸ 1991(2) SA 660

⁵⁹ Ibid

⁶⁰ See Note 38: Bekink at page 99; See also Note 35: Bouwman at page 512; Section 214 reads; "... a reasonably diligent person having both- (a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as are carried out by that director in relation to the company, and (b) the general knowledge, skill and experience that that director has."

⁶¹ See note 35: Bouwman at page 512

as contained in the South Africa Companies' Bill 2007 and later the Companies Act, 2008.⁶²

The departure from the traditionally lenient approach in South African company law, as in England, also came around the 1990s. In the *Philotex (Pty) Ltd & Others v Snyman & Others* 1998 (2) SA 138 (SCA) it was held that a director's conduct would be held against that of a notional reasonable director (objective), however such a director having the same knowledge as the director being measured (subjective). As can be noted, this case was dealing with recklessness which was being determined for purposes of finding out whether the directors of the company in question were liable under section 424(1) of the Companies Act 61 of 1973. In that case former concurrent creditors of the company Wolnit Ltd instituted an action against the persons who were directors of the company at the material time who had allegedly recklessly carried on business of Wolnit Ltd from 1 July 1987. These directors had failed to discuss and take appropriate action following reports from auditors that there were severe cash-flow problems. The directors opted to branch out into other markets on behalf of the company instead of realising assets of the company and paying off the creditors when there was still a chance. This essentially resulted in the company trading for three years despite it being factually and commercially insolvent. The creditors' claims were dismissed by the Transvaal Provincial Division on the grounds that the creditors did not prove recklessness on the part of the directors. On appeal to the Supreme Court of Appeal, the creditors proved on a balance of probabilities that the business had been carried out recklessly during 1989. The directors were held liable for debts incurred during the period when the company traded recklessly under section 424(1) of the Companies Act, 1963

2.4 Common law delegation of director's duties:

The English courts have recognised the fact that directors cannot be expected to perform all the duties personally and that they may sometimes rely on employees of the company to do them and to keep them informed.⁶³ In the case of *Dovey v Cory* the court stated:

"The business of life could not go on if people could not trust those who are put into a position of trust for the express purpose of attending to the details of management."⁶⁴

In the case of *Re City Equitable Fire Insurance Co Ltd* the court may be quoted as follows:

"In respect of all duties that, having regard to the exigencies of business, and the articles of association, may properly be left to some official, a directors is, in the absence of grounds for suspicion, justified in trusting that official to perform such duties honestly."⁶⁵

⁶² See note 1 above: full citation

⁶³ See note 38: Bekink at page 104

⁶⁴ See note 52 above as cited by G Golding note 34 supra at page 275

The principle in the latter mentioned case was incorporated into South African common-law in the *Fisheries Development Corporation* case the court said the following:

"In respect of all duties that may properly be left to some official, a director is in the absence of grounds for suspicion, justified in trusting that official to perform such duties honestly. He is entitled to accept and rely on the judgment, information and advice of the management unless there are proper reasons for querying such."⁶⁵

In *Re Barings plc (No 5)* ([2000] 1 BCLC (CA) 523) the court made emphasis to the fact that the power of delegation does not absolve a director from her duty to perform her supervisory duties.⁶⁷ Cassim⁶⁸ makes the point that total abrogation of duties is impermissible and that though the tasks may be delegated, the supervisory duty of a director may not be delegated.

2.5 Conclusion

The duty of care, skill and diligence at common law operated on the basis of a very low standard to measure the conduct of directors which was premised on the assumption that shareholders are responsible for choosing the directors they choose. This situation thereafter changed at common law some years later, which paved the way for an "improved standard" which was introduced by the statutory duty of care, skill and diligence.

⁶⁵ See note 46 at page 429

⁶⁶ See note 5 supra

⁶⁷ See note 38: Bekink at page 104

⁶⁸ See note 7 : Cassim at page 561

CHAPTER 3

The statutory duty and the retention of the common-law

3.1 Introduction

Before delving into the statutory duty as per South African law, one will first compare the statutory duty in some of the countries from which South Africa leans on at times in terms of guidance such as England and Australia.

In England, there were various attempts to codify the duty of care, skill and diligence but it appears that this was finally achieved in the Companies Act 2006 Chapter 46⁶⁹ in section 174 which reads:

'(1) A director of a company must exercise reasonable care, skill and diligence.

(2) This means the care, skill and diligence that would be exercised by a reasonable person with -

(a) the general knowledge, skill and experience that may reasonably be expected of carrying out the functions carried out by the director in relation to the company, and

(b) the general knowledge, skill and experience that the director has.'

The above section comprises a dual approach which combines subjectivity and objectivity, section 174(2) (a) is the objective part of the approach and section 174(2) (b) is the subjective part. The application of the codified duty of care, skill and diligence in England occurs in place of the duty at common-law and thus it is a total or complete codification of the duty.⁷⁰

In Australia, in 1958 there was the Victorian Companies Act and section 107 thereof read as follows:

'107(1) A director shall at all times act honestly and use reasonable diligence in the discharge of the duties of his office.

(2) Any officer of a company shall not make use of any information acquired by virtue of his position as an officer to gain an improper advantage for himself or to cause detriment to the company...

(4) Nothing in this section shall prejudice the operation of any other enactment or rule of law relating to the duty or liability of directors or officers of a company.'

The above section entailed the requirement of reasonable diligence from the director and it was a partial codification of the duty. Thereafter, the Australian Uniform Companies Act of 1961 was enacted and section 124 thereof dealt with the duty of

⁶⁹ See Note 38: Bekink at page 103

⁷⁰ See Note 35: Bouwman at page 517; See also Sections 170(3) and 170 (4) of the Companies Act 2006

care and diligence and subsection (6)⁷¹ thereof indicated that this section was in addition to any other enactment or rule of law which meant that this was a partial codification of the duty of care and diligence.

After the Australian Uniform Companies Act of 1961 there was the Companies Act 1981 (Cth) and section 229(2)⁷² of that Act imposed a duty on company officers to exercise reasonable care and diligence.⁷³ The interpretation of this section marked a turning point in the view of the duty of care and diligence in the case of *AWA Ltd v Daniels* [1992] 10 ACLC 33 (SC, NSW), where an objective standard was adopted. The court in that case stated that the standard needed to be aligned with modern times and expectations of people who occupy the position of a director.⁷⁴ Such a person, unlike in the *Re Brazilian Rubber Plantations and Estates Ltd* is expected to be familiar with the business affairs and they have a duty to keep themselves informed.

*Bekink*⁷⁵ submits that section 229(2) of the Companies Act 1981 (Cth) was re-enacted as section 232(4) of the Corporations Law, 1991 and that it was subsequently re-enacted further as section 180 of the Australian Corporations Act, 2001 which is worded as follows:

- '(1) A director or other officer of a corporation must exercise their powers and discharge their duties' with the degree of care and diligence that a reasonable person would exercise if they:
 - (a) were a director of a corporation in the corporation's circumstances; and
 - (b) occupied the office held by, and had the same responsibilities within the corporation as, the director or officer.'

By virtue of section 185⁷⁶ of the Australian Corporations Act, 2001 the codification of the duty of care and diligence is a partial codification and not a complete or total codification as in England. The wording of this section also postulates a hybrid standard which relates to the duty of care, skill and diligence. Notably the element of 'skill' is not part of the Australian duty of care.

⁷¹ Section 124(6) reads: "This section has effect in addition to and not in derogation from any other enactment or rule of law relating to the duty or liability of a director or officer of a corporation."

⁷² Section 229(2) provides, 'An officer of a corporation shall at all times exercise a reasonable degree of care and diligence in the exercise of his powers and the discharge of his duties.'

⁷³ See note 38: *Bekink* at page 105; See also note 6: *Du Plessis* at 281-282

⁷⁴ See note 38: *Bekink* at page 105

⁷⁵ See note 38: *Bekink* at page 106

⁷⁶ Section 185 reads, 'Sections 180 to 184: (a) have effect in addition to, and not in derogation of, any rule of law relating to the duty or liability of a person because of their office or employment in relation to a corporation; and (b) do not prevent the commencement of civil proceedings for a breach of a duty or in respect of a liability referred to in paragraph (a).'

3.2 Section 76(3) (c) of the Companies' Act 71 of 2008

The duty of care, skill and diligence is contained in Section 76(3) (c) of the Companies Act, 2008 it reads:

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

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

This section deals contains, similarly to the Companies Bill of 2007, a subjective and objective standard with regards to measuring the directors' conduct. The objective element is contained in the first paragraph of section 76(3) (c) and it involves measuring the conduct of the director against the conduct reasonably expected from a person carrying out the same functions as she is carrying out. This like the 2007 Bill seems to be limited to a director in relation to that company, in that when judging X as a director of ABC Company, she will be measured against what is reasonably expected of another who is placed in the same position and tasked to carry out the same functions. It is not too clear whether there is a notional reasonable person in this standard or whether the reasonableness is on the expectation upon such a person and from whose perspective is the expectation measured. Phrased differently, who is the person who reasonably expects a certain standard of conduct, is it the court? If it is the court, will the court then accept that it knows what is expected from persons carrying out functions of a director with the benefit of hindsight? Perhaps this is point that would be clarified, if necessary by the courts in the future.

The subjective element is contained in the second paragraph of section 76 (3) (c)(ii) of the Companies Act, 2008. With regards to this portion of the section, the confusion in the preceding paragraph regarding use of the words 'reasonably expected of a person' is explained by Du Plessis⁷⁷. The explanation is that the use of the words 'a reasonable person' would have not reconciled well with the subjective element introduced in section 76(3) (c) (ii) as opposed to section 76(3) (c) (i). The expectations that would be considered here would be those that one would have from someone with the general knowledge, skill and experience of that director. Though the expectation is still a reasonable one, the test is still not purely objective.

The statutory duty of care, skill and diligence in South Africa is partially codified, in other words, common law obligations and remedies still exist. As much as with any

⁷⁷ See note 6: Du Plessis at page 269

position, there are advantages therefor and disadvantages. Bouwman⁷⁸ lists the following paraphrased advantages for a total codification of the duty:

- Improved legal certainty which will make the law easily accessible to directors. This will enable the directors to know exactly what is expected from them. This, in my view will in turn enhance good corporate governance.
- The law will be also more accessible to others which also go towards enhancing good corporate governance in that the shareholders and stakeholders know what to expect from directors and the directors also will know that this is common knowledge and act accordingly.
- Time and consequently legal fees will be reduced in trying to access the law.

Some disadvantages of a total codification are also listed by Bouwman⁷⁹ and they follow:

- Common law has developed overtime, and a 'perfect codification of a mass of developed common law' is not possible overnight. In developing the common law, various judicial minds have had to pronounce on the matters as and when they arose and having a one cure all approach in statute is not possible (*my interpretation*).
- The statute may oversimplify principles and this oversimplification may not be able to address complex cases.
- Common law allows for continual development and flexibility whereas statute is not that flexible. With the times continually changing, globalisation as well as a 'competitive business environment', rigidity of the law is not ideal.

With regards to the issue of a partial codification, Bouwman⁸⁰ identifies the following advantages:

- Common law may continue to develop in respect of the duty of care, skill and diligence.
- Most of the disadvantages of a complete codification may be avoided such as inflexibility, oversimplification.

The disadvantages of a partial codification that Bouwman (*op cit*) identifies are:

- They are the converse of the advantages of a complete codification such as; legal uncertainty, reduced accessibility (may lead to reduced good corporate governance), no reduction of time and legal fees in attempts to ascertain and 'decipher' the law.

⁷⁸ See note 35: Bouwman at page 521

⁷⁹ See note 35: Bouwman at page 522

⁸⁰ See note 35: Bouwman at page 522-523

In summary, a total codification allows for certainty of the law but does not allow for development of the law due to rigidity. Partial codification allows for development of the law due to its flexibility but it does not allow for legal certainty as with total codification.

3.3. **Statutory Delegation of Directors' Duties**

The relevant sections in the Companies Act of 2008 are sections 76(4) and (5).

Section 76(4) (b) reads as follows:

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

- (b) Is entitled to rely on –
 - (i) the performance of any persons-
 - (aa) referred to in subsection (5); or
 - (bb) to whom the board may reasonably have delegated, formally or informally by course of conduct, the authority or duty to perform one or more of the board's functions that are delegated under applicable law; and
 - (ii) any information, opinions, recommendations, reports or statements, including financial statements and other financial data, prepared or presented by any of the persons specified in subsection (5)

Section 76(5) reads as follows:

"To the extent contemplated in subsection (4) (b), a director is entitled to rely on-

- (a) one or more employees of the company whom the director reasonably believes to be reliable and competent in the functions performed or the information, opinions, reports or statements provided;
- (b) legal counsel, accountants, or other professional persons retained by the company, the board or a committee as to matters involving skills or expertise that the director reasonably believes are matters-
 - (i) within the particular person's professional or expert competence; or
 - (ii) as to which the particular person merits confidence; or
- (c) a committee of the board of which the director is not a member, unless the director has reason to believe that the actions of the committee do not merit confidence

This essentially means that directors may rely on the performance of another (employee, professional or expert) provided that such a person is reliable and competent.⁸¹ The underlying requirement is that there must be a reasonable belief in the reliability and competence on the person that has been assigned to the

⁸¹ See note 7: Cassim at page 562

task.⁸² The director may also rely on a committee of the board provided that they are not a member of such a committee.

Aside from being able to rely on the person assigned, a director may also rely on the report, information or recommendation of such a person. The reliance must however be warranted in that if the director knows that the person and or their report cannot be relied upon for their incompetence or dishonesty or the like, such a director cannot escape liability for having relied on another person.⁸³ By reliance, it is not meant that the director must not even acquaint himself with the report.

In the event that the director's reliance on another is warranted, she may escape liability if there is an error that causes loss to the company.

3.4 The Events leading up to the Statutory Duty of Care, Skill and Diligence in South Africa

In South Africa, before the codification of the duty of care, skill and diligence under the Companies Act of 2008 there was section 43 of the Close Corporations Act 69 of 1984, which codified the duty in relation to members of close corporations and it read:

- '(1) A member of a corporation shall be liable to the corporation for loss caused by his failure in the carrying on of the business of the corporation to act with the degree of care and skill that may reasonably be expected from a person of his knowledge and experience.
- (2) Liability referred to in subsection (1) shall not be incurred if the relevant conduct was preceded or followed by the written approval of all the members where such members were or are cognisant of the material facts.'

The standard here appears to be purely objective. Liability could be escaped if there was prior authorisation or ex-post facto ratification by all members of the Close Corporation.

Another move towards the codification of the duty in South Africa appears in section 40(b) of the Banks Amendment Act 19 of 2003 which was amending section 60 of the Banks Act 94 of 1990 and it reads:

'by insertion of the following subsections after subsection (1):

(1A) Each director, chief executive officer or executive officer of a bank owes a duty towards the bank to-

....(c) possess and maintain knowledge and skill that may reasonably be expected of a person holding a similar appointment and carrying out similar functions as are carried out by the director, chief executive officer or executive officer of that bank; and

⁸² Ibid

⁸³ Ibid

(d) exercise such care in the carrying out of his or her functions in relation to that bank as may reasonably be expected of a diligent person who holds the same appointment under similar circumstances. And who possesses both the knowledge and skill mentioned in paragraph (c) and any such additional knowledge and skill as the director, chief executive officer or executive officer in question may have...'

This section shows a hybrid standard which is similar to the current duty of care, skill and diligence in the 2008 Companies Act. Paragraph 1A(c) contains an objective consideration and paragraph 1A (d) contains a subjective consideration.

The road to the codification of the duty of care, skill and diligence for directors in company specific law is preceded by the *King Reports on Corporate Governance for South Africa I and II*. The definition of corporate governance may be that it is a system by which companies are directed and controlled.⁸⁴ It 'involves principles of a degree of confidence necessary for the proper functioning of a market economy'⁸⁵, and the first one was published in 1994. The *King I Report* is not prescribed by law however it and its successors operate by way of self-regulation. *King I Report* recommended the codification of the duty of care, skill and diligence and it appears that this recommendation was met with some criticism from legal authors⁸⁶.

In 2002 the *King II Report* was published and it superseded its predecessor. It also confirmed the duty on both executive and non-executive directors to perform their duties of with care and skill (note that diligence was not part of the wording):

'Directors must exercise care and skill that any reasonable person would be expected to show in looking after their own affairs, as well as having regard to their actual knowledge and experience, and

qualify themselves on a continuous basis with a sufficient, or at least general, understanding of the company's business and the effect of the economy so as to discharge their duties properly, including where necessary relying on expert advice.'⁸⁷

The *King II Report* also suggested that there should be a collective form of accountability in respect of a board of a company, and as one may expect this was met with criticism.⁸⁸ The criticism was due to the fact that this seems to suggest strict liability of the Board which is not part of South African company law.⁸⁹ This report further stated made reference to the business judgment rule and recommended that an investigation be conducted as to whether such a rule was necessary in South Africa law.

In 2007, the Companies Bill (the Bill) was published which seemed to take into cognisance the suggestions made in the *King Reports* preceding it in that it

⁸⁴ See Note 38: Bekink at page 107

⁸⁵ See note 38: Bekink *ibid*

⁸⁶ See note 38: Bekink at page 108-109

⁸⁷ *King Report II* in Chapter 4 at 55 in paragraph 2.3; See note 38: Bekink at page 109; See also note 35: Bouwman at page 519;

⁸⁸ See note 38: Bekink at page 109

⁸⁹ *Ibid*

encompassed a codification of the directors' duties including the duty of care, skill and diligence. This was contained in clause 91(1) (a) of the Bill⁹⁰. The Bill contained a two-pronged test which was both objective and subjective, the objective portion being contained in clause 91(1) (a) (i) and the subjective portion being contained in clause 91(1) (a) (ii). The objective element entailed the comparison of the director's conduct against that of notional 'reasonable diligent director' who has the same general knowledge, skill and experience that can be expected to be held by a person who is a director of that company. My interpretation is that the X as a director of ABC Company will be measured against the notional reasonable person Y who would have the requisites expected reasonably from someone who was a director or who carried out the functions of a director of ABC Company. In other words the attributes of the reasonable person carrying out the functions of a director would not be measured generally against any other director of any other company e.g. pitting a director of a private company with the minimum shareholding and directorship possible versus a director of a huge public company listed on various Stock Exchanges.

The subjective element would be measured in the sense that the director in question would be measured against a reasonable diligent individual who had the general knowledge, skill and experience that such a director had.

The Bill sought to modify South African common law as laid down in *Fisheries Development Corporation v Jorgensen* in that it did not differentiate between executive and non-executive directors with regards to the duty in question. Some principles laid down in *Fisheries Development Corporation v Jorgensen* were incorporated in that the Bill stated that the directors could delegate duties to other professionals and rely on their advice. (Clause 91(3)-(5)). By virtue of clause 91(6) the codification proposed in the Bill was partial codification.

3.5 **Conclusion**

It is evident from the foregoing that the duty of care, skill and diligence has evolved from the time of its development and that it seemingly has not developed at the same pace as fiduciary duties due to a scarcity of cases which dealt with this duty.⁹¹ The development of common law principles is achieved through courts having to deal with the questions of law in various cases.

⁹⁰ 91(1), ' Each director of a company, when acting in that capacity, or as a member of a committee of directors, or when gathering information or similarly preparing to act in either of those capacities, is subject to- (a) a duty to exercise the degree of care, skill and experience that would be exercised by a reasonable diligent individual who had both- (i) the general knowledge, skill and experience that may reasonably be expected of an individual carrying out the same functions as are carried out by that director in relation to the company; and (ii) the general knowledge, skill and experience of that director.'

⁹¹ See Note 5 supra: Cassim at page 534

This seems to indicate that this duty was not a 'favourite' duty to invoke in so far as holding directors' liable for lack of care and this may have been due to the history of the standard by which the directors were measured at common law being, what some considered too low.⁹²

There has not been a complete abandonment of common law with regards to this duty, and the advantages and disadvantages for having partial or complete can be put forward⁹³. It is submitted that perhaps a partial codification of the duty of care, skill and diligence may have been preferable in light of the fact that there is a need for the duty of care, skill and diligence to develop at common law, and a complete codification would have stifled further development due to rigidity⁹⁴.

It is apparent as well that the example which has been followed in South Africa in considering whether to codify partially or completely, is the Australian example.⁹⁵

⁹² See note 35: Bouwman at page 510; See also note 7: Cassim at page

⁹³ See note 35: Bouwman at page 521 to 522; See also note 7: Cassim at page 554

⁹⁴ See note 32: Bouwman at page 522-523

⁹⁵ See note 76 *supra*

CHAPTER 4

Breach of the duty of care, skill and diligence and the available remedies

4.1 Introduction

This chapter explores the question of who has the *locus standi* in bringing an application for the enforcement of the duty of care, skill and diligence. Once the proper plaintiff has been ascertained, it is important to also identify the remedies that may be available in the event of a breach, particularly in light of the protection that a director may have from liability, as discussed in Chapter 5 below.

4.2 To whom and by who is the duty owed?

Section 76(1) provides: In this section, ‘**director**’ includes an alternate director, and –

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

A prescribed officer is defined as ‘a person who, within a company, performs any function that has been designated by the Minister in terms of section 66 (10)’. This indicates that even persons who are not directors as defined in section 1 of the Companies Act, 2008⁹⁶ are burdened with the duty of care, skill and diligence. It appears that if a person is part of corporate governance of the company, they may be included in the definition of director for the purposes of section 76.

With regards to the question of to whom is the duty owed, the answer is that the duty is owed to the company.⁹⁷ The question of who is the proper plaintiff with regards the duties owed by directors to the company, was answered in *Foss v Harbottle*⁹⁸ and the answer is that the wrong is committed against the company and therefor the company is the proper plaintiff. Even if the shareholders’ value of shares may be lessened as a result of the breach, the plaintiff remains the company.⁹⁹

⁹⁶ See Note 6: Du Plessis at page 267

⁹⁷ See Note 7: Cassim at page 584, “a director will be liable in accordance with the principles of common law relating to delict for any loss, damages or costs sustained by the company as a consequence of any breach by the director...”

⁹⁸ (1843) 2 Hare 461, 67 ER 189

⁹⁹ See note 7: Cassim at page 584.

4.3 Remedies available to the person aggrieved by the breach of the duty of care, skill and diligence

4.3.1 Section 77 Liability

With regards to the breach of the statutory duty of care, skill and diligence; a breach leads to liability under section 77(2)(b)(i) of the Companies Act 71 of 2008 which provides that its application is in accordance with the common-law of delict and the liability includes loss, damages or costs sustained by the company as a consequence of the breach.

With regards to the common law of delict and the duty of care, skill and diligence, Kennedy-Good and Coetzee¹⁰⁰ provide a succinct breakdown of the elements involved: The first element requires that there must be conduct which is either an omission or commission; the second requirement is wrongfulness which entails the breach of a legal duty. This element of the wrongfulness is further divided into 2 elements; the first requires an investigation into whether an interest has been infringed, secondly whether the infringement is *contra bonos more*. The third requirement is that of fault which is also further divided into 2 categories, one being intention (dolus) and the other being negligence (culpa) which entails the reasonable man test.¹⁰¹

The fourth element is causation and it is divided into legal causation and factual causation. Factual causation is said to entail the causal link between the conduct and the prejudicial consequence. Legal causation is said to be the enquiry into whether or not there is a sufficiently close connection between the conduct and the consequence. This causation element has the effect of limiting the liability of the person Respondent/ Defendant for the wrongful act.¹⁰²

The fifth element is damage, which means that there must have been a loss, or the "diminution of in the utility ...of a patrimonial or personality interest".¹⁰³

4.3.2 Derivative Action- Section 165 of the Companies Act 71 of 2008

It is important to note that if the company does not proceed against the director for a loss it has suffered, section 165 of the Companies Act 71 of 2008 provides for a statutory derivative action which takes the place of any common-law derivative action. The list of possible persons who can demand the company to commence or

¹⁰⁰ S Kennedy-Good and L Coetzee "The Business Judgement Rule" (Part II) *Obiter* (2006) 277 at page 281-283

¹⁰¹ Ibid

¹⁰² Ibid

¹⁰³ Ibid

continue proceedings, or take related steps to protect the legal interests of the company has been widened and it includes:¹⁰⁴

- A shareholder or person entitled to be a shareholder;
- A director or prescribed officer
- A representative of the company's employees which may be a registered trade union
- A person granted leave by the court to do so.

As stated above, these classes of persons would be taking this derivative action for the losses suffered by the company itself, and not their own damages.

4.3.3 Section 218 of the Companies Act 71 of 2008

It is very crucial to note section 218 of the Companies Act 71 of 2008 which appears to be a statutory exception of the *Foss v Harbottle* general rule of the proper plaintiff. Section 218(2) reads:

"Any person who contrives any provision of this Act is liable to any person for any loss or damage suffered by that person as a result of that contravention."

This is a widened scope for liability for directors in that it entails that a person who has suffered loss due to a breach of the duty of care may be able to hold the director liable. In terms of *Foss v Harbottle* as cited above, only the company could be the plaintiff and the scope increased further with the derivative action being available to more classes of persons. However it submitted that the tests for liability in the common law of delict detailed in paragraph 4.3.1 above, will limit the liability for directors. Another limitation of which the directors may be able to use as a 'safe-harbour' is the business judgment rule which is discussed in detail in Chapter 5 below.

4.4 Conclusion

In summary, the proper plaintiff in the case of a breach of the duty of care, skill and diligence is the company.¹⁰⁵ The scope of the persons who can 'encourage' a company as the proper plaintiff to take action against a defaulting director in the event that the board does not act promptly (derivative action), now includes more classes of persons in addition to shareholders' of the company.¹⁰⁶

¹⁰⁴Section 165(2)

¹⁰⁵ See note 98:*Foss v Harbottle*

¹⁰⁶ See Section 165 of the Companies Act 71 of 2008

Further, though the proper plaintiff is the company, a director's liability it appears it can be to a wider group of persons as well if there are losses suffered by such a person.¹⁰⁷

¹⁰⁷ See Section 218(2) of the Companies Act 71 of 2008

CHAPTER 5

The advent of the business judgment rule and its impact on the duty of care, skill and diligence

5.1 Introduction

The business judgment rule is now contained in section 76(4) of the Companies Act 71 of 2008 and provides a shield for directors against liability for, amongst others, breach of the duty of care, skill and diligence.¹⁰⁸ In this chapter one considers its origin; the rationale for its development i.e. the purpose for which the business judgment rule was developed.

This chapter further considers reception of the business judgment rule into the South African company law. In this regard one will consider the position at common law, statute as well as the precursors to the inclusion of the business judgment rule in statute. The precursors include the reports by the *King Committee*; opinions of the legal writers as well the governments' opinion of same through the Department of Trade and Industry are considered.

It has been said that the business judgment rule is a safe-harbour for directors, the question to be considered is how safe a harbour is the business judgment rule for directors and the extent to which a director's conduct which fails to meet the standard of care, skill and diligence expected, is protected¹⁰⁹. This enquiry entails considering the standard which is used to measure the director's conduct for purposes of measuring their worthiness of protection by the business judgment rule.

5.2 The origins of the business judgment rule

The business judgment rule has its origins in the United States of America as far back as 1829 where the Louisiana Supreme Court formally recognised the rule as a defence that may be used in company law¹¹⁰. It is said that the rule was developed due to a desire to protect honest directors and officers from the risks that are inherent in their offices with the benefit of hindsight once their decisions have been unsuccessful and also because of caution against stifling innovation.¹¹¹ Though the rule is old, and one may expect that there would be certainty regarding same, it appears that a single composite theory which explains its parameters and its

¹⁰⁸ L Muswaka "Directors' Duties and the Business Judgment Rule in South African Company Law: An Analysis" *International Journal of Humanities and Social Sciences* Vol.3 No. 7, April 2013 at page 89 (http://www.ijhssnet.com/journals/Vol_3_No_7_April_2013/10.pdf. Last accessed on 24 November 2015)

¹⁰⁹ See note 7: Cassim at 563

¹¹⁰ Janelyn Pua-Ng 'The Business Judgment Rule Checking the Autocracy in the Boardroom' (2007-2008) *LIJUS Law review* 149 at 155, as cited by Bouwman N 'A New defence for directors' *Without Prejudice* page 12 (http://www.gleason.co.za/fusion/print.php?A&item_id=815 last accessed 23 September 2015)

¹¹¹ See Note 35: Bouwman at page 523;

practical application does not exist.¹¹² According to Arsch¹¹³, the business judgment rule is:

"A corporate transaction that involves no self-dealing by, or other personal interest of, the directors who authorised the transaction will not be enjoined or set aside for the directors' failure to satisfy the standards that govern a director's performance of his or her duties, and directors who authorised the transaction will not be held personally liable for resultant damages unless:

The directors did not exercise due care to ascertain the relevant and available facts before voting to authorise the transaction, or

The directors voted to authorise the transaction even though they did not reasonably believe or could not have reasonably believed the transaction would be for the best interest of the corporation, or

In some other way the directors' authorisation of the transaction was not in good faith."

This rule essentially means that if a director takes a decision which has unfavourable results for the company, but it was an informed one, in good faith and the director believed that it was in the interest of the company to make such a decision, she may not incur liability with the benefit of hindsight.¹¹⁴ The result of the foregoing is that a presumption is created that the decision was in the best interests of the company. If the Plaintiff or Applicant wishes to rebut this presumption they would have to attack the substance of the decision by the director or the procedures followed by the director in reaching their decision.¹¹⁵ To challenge the substance one would have to show that the decision was not rational to such an extent that 'no reasonable business person would have made the decision'.¹¹⁶ With regards to the examination of the merits (substance) an example may be found in the case of *Gimbel v Signal Companies Inc*¹¹⁷. The court in that case had to investigate a decision by the directors to sell a subsidiary company for a value of \$480 million as opposed to the true market value of \$761 million as alleged by an expert. The court considered the process element and chose not to focus on the methodology leading up to the decision but instead focused on the value of the company. The court therefore granted the Plaintiff a preliminary injunction which was being sought to bar the sale based on the merits that the decision to sell the company for almost half its market value was not one a reasonable business person would make.

¹¹² KB Davis Jr. "Once More, the Business Judgment Rule" (2000) *Wisconsin Law Review* 573, at 573

¹¹³ S Arsch "The Business Judgment Rule Revisited" (1979-1980) 8 *Hofstra Law Review* 93 at 111-112

¹¹⁴ See *Aronson v Lewis* 473 A.2d 805,812 (Del. 1985)

¹¹⁵ Aman T.M. "Cost-Benefit Analysis of the Business Judgment Rule: A Critique In Light of the Financial Meltdown" at page 8-9

(https://open.uct.ac.za/bitstream/item/9802/thesis_law_2014_leach_j.pdf?sequence=1 last accessed on 17 December 2015)

¹¹⁶ *Peter v Letsou, Implications of Shareholder Diversification on Corporate Law and Organization: The Case of the Business Judgment Rule*, 77 Chi.-Kent L. Rev. 179, (2001) 179-180, as cited by Aman *supra*

¹¹⁷ 316 A.2d 599 (Del. Ch. 1974)

In order to challenge the process of leading to the decision one would have to show that there was gross negligence by the director in informing herself of all material information reasonably available to her before acting.¹¹⁸

A variety of purposes for the rule can be quoted in order to support the business judgment rule and in summarising his position on the rule, Arschit states the following:¹¹⁹

“The rule functions not to preclude the inquiry but to guide it...this inquiry is made, not for the purpose of ascertaining whether the decision made was correct or one which the court would have made, but to ascertain whether the evidence does or does not establish that the directors exercised due care or believed, on a reasonable basis, that the challenged transaction was in the corporations best interests.”

Bouwman lists 5 purposes for the business judgment rule which are summarised below¹²⁰:

- Firstly, what may be termed as the principal purpose is that the rule encourages directors to be able to take risk which is the core of entrepreneurship;¹²¹
- Secondly it encourages the taking up of appointment as directors by competent people. Aman in his paper explains this point well when explains that if the office of director bestowed upon a person more personal liability without protection, even the competent people may be deterred from assuming office.
- The third purpose is to avoid judges, who are experts in law, second guessing directors' business decisions.
- Fourthly, it would be to avoid the shareholders managing the company (a function for directors) by being overzealous with litigation to interfere with or influence directors' decision.
- The fifth and last purpose is that there are mechanisms already in place in the market which control the directors' conduct. The corporate environment or the business market is a competitive one and in order to remain in the market the directors need to ensure sound management of the corporation or company.¹²²

It appears that in the developmental stages of the business judgment rule; it developed hand in hand with the duty of care. However it has been submitted that the development of the business judgment rule lowered the importance of the duty of care.¹²³ However there has been recent trend in America of moving away from a low

¹¹⁸Brehm v. Eisner 746 A.2d 244 (Del. 2000).

¹¹⁹ See Note 113: Arschit at page 114

¹²⁰ See Note 35: Bouwman at page 523-524

¹²¹ See Note 3: Kennedy-Good S, Coetzee L at page 65

¹²² See Note 3: Kennedy-Good S, Coetzee L at page 66

¹²³ SR Cohn “Demise of the Director’s Duty of Care: Judicial Avoidance of Standards and Sanctions Through the Business Judgment Rule” (1983) 62 Texas Law Review 603;

standard with regards to director duties, this has been noted from the Delaware Court judgments¹²⁴ one of which is *In re Walt Disney Co Derivative Litigation* (825 A 2nd 275 (Del. Ch. 2003)). The facts essentially were that a derivative action had been brought against the current and former directors at Disney for a breach of their duty of care. The board, under the chairmanship of one of the directors who was also CEO, had approved the employment of another gentleman as a COO and President as well as a severance package worth \$140 million. The Delaware Court of Chancery dismissed the claim on the basis that the CEO did not have an interest in the appointment of his close personal friend as COO and President. After the Delaware Supreme Court allowed for the amendment of pleadings by the Plaintiffs, it allowed for certain further facts to be averred. This allowed for the challenge to the directors' entitlement to use the business judgment rule, the court a quo now found that the board had not in fact discharged its duty of care. The factors taken into account by the court included that there was a friendship between the CEO and the COO; the COO's employment had been discussed just by the two of them, when the matter was presented before the full board very little deliberation was undertaken by the board.

RM Jones is of the view that such judgments by the American courts indicate 'a new reluctance to credit defendants' arguments which are premised on the assertion that the directors charged with making the challenged decision were independent.'¹²⁵ This indicates that the directors will no longer get a pass from scrutiny of their decisions based only on their independence.

5.3 Application of the business judgment rule in America

5.3.1 Factors to be considered in applying the business judgment rule

The courts in applying the business judgment rule would make the following considerations: business decision; due care; good faith and the belief by the director that the decision is in the best interests of the company.¹²⁶

5.3.1.1 Business decision

For the purposes of judicial application of the rule, a decision must have been made or taken. For this element, a decision to do something and a conscious decision not to do something are seen as a decision. If there is no decision at all, then the business judgment rule would not find application. There is also a difference in the

¹²⁴ E Jones 'Directors' Duties : Negligence and the Business Judgment Rule' (2007) 19 *SA Merc LJ* 326 at 327-329

¹²⁵ R M Jones "Rethinking Corporate Federalism in the Era of Corporate Reform" (2004) 29 *J of Corporation law* 644 at 661

¹²⁶ See Note 3: Kennedy-Good S, Coetzee L at page 67

application of the business judgment rule depending on the type of the decision that was taken, that is, there is a difference between a routine decision and an extraordinary decision.¹²⁷

5.3.1.2 Due care

This element involves the court enquiring as to the process followed by the directors in making the decision and whether all the information that was relevant to the decision making was considered.¹²⁸

The case of *Smith v Van Gorkom*¹²⁹ is considered a noteworthy case with regards to the element of due care. Van Gorkom, as chairman of the board and chief executive officer (CEO) presented to the board a proposal of a sale of the company despite the senior management of the company having regarded the offer that was presented as being too low. Van Gorkom, in presenting this offer to the board, did not disclose the methodology employed in reaching a figure; neither did the board study the sale agreement. A decision to sell at the offered price was then made by the board. The court concluded that the board had failed to make an informed decision, they were grossly negligent and therefore they could not be saved from liability by the business judgment rule.

5.3.1.3 Good faith and the best interests of the company

Good faith is said to presuppose that there is a rational business purpose for the decision.¹³⁰ If there is no rational business purpose for the decision by the director, it would not matter they exercised due care, such a decision would not be considered as one which is in good faith.¹³¹

The director must not have an interest in the transaction which is being considered, she must have been independent in her judgment. The court will essentially enquire whether or not the director was of 'sound ordinary business judgment'¹³²

With regards to the best interest of the company, the director must have believed that the decision was in the best interests after exercising due care and in good faith. The enquiry into this element is synonymous with the good faith enquiry.¹³³

¹²⁷ *ibid*

¹²⁸ See Note 3: Kennedy-Good S, Coetzee L at page 68

¹²⁹ 488 A. 2d 858 (Del 1985) as cited in Kennedy-Good S, Coetzee L *ibid*

¹³⁰ Veasey 1982 37 *The Business Lawyer* 1251 as cited in Kennedy-Good S, Coetzee L (Part I) at page 69

¹³¹ Kennedy-Good, Coetzee (Part I) *supra* at page 69

¹³² *ibid*

¹³³ *ibid*

5.3.2 The Codification of the Business Judgement Rule in USA

It appears that with regards to a codification of the business judgment rule, its country of origin has made two notable but unsuccessful attempts at doing so. The first attempt was by the Committee on Corporate Laws of the Section of Business Law of the American Bar Association (ABA).¹³⁴ The committee attempted to modify section 35 of the Model Business Corporation Act so that the rule could be reflected as explained by the courts. However no consensus on the formulation of the rule could be reached in this regard as the committee was of the opinion that the matter was too complex and the time too limited to be able to achieve the task.¹³⁵ It is contended by Gervutz¹³⁶ that the reason for the failure to codify is based on the misconception that there is a single composite rule whereas the rule truly has a number of different meanings.

The second American attempt at codification was done by the American Law Institute (ALI) where it sought to prescribe the elements of the rule in section 4.01 and the circumstances of application of the rule.¹³⁷ This attempt received various criticisms which includes that it did not take into account the different corporate structures in America and it did not reflect the law which has been applied by the courts over the years¹³⁸, this may be what some may term oversimplification.

5.4. Reception of the rule in South African company law

5.4.1 Common Law

An English case wherein a business judgment rule statement was made was in the case of *In re Smith and Fawcett Ltd*¹³⁹ where Lord Greene MR stated:

"They must exercise their discretion bona fide in what they consider –not what a court may consider– is in the best interests of the company"

Essentially this statement reveals that it is "not the function of the courts to be the arbiter of commercial decisions."¹⁴⁰ The essence of the *In re Smith and Fawcett Ltd* has been applied by the courts in varied situations in that the decisions of directors have been cautiously looked at with a view to refrain from second guessing them¹⁴¹. The courts do not consider themselves as a supervisory board over the boards'

¹³⁴ See note 3: Kennedy-Good, Coetzee at page 73

¹³⁵ *Ibid*

¹³⁶ Gervutz "Corporation Law" (2000) 278-279 as cited *ibid*

¹³⁷ See note 3: Kennedy-Good, Coetzee at page 73

¹³⁸ *Ibid*

¹³⁹ See note 17: at page 306

¹⁴⁰ JS McLennan "Duties of Care and Skill of Company Directors and their Liability for Negligence" (1996) 8 SA Merc LJ 94 at 95.

¹⁴¹ *Howard v Herrigel* NNO 1991 (2) SA 660 (A); *Ozinsky NO v Lloyd* 1992 (3) SA 396 (C) *Triptomania Twee (Pty) Ltd v Connolly* 2003 (3) SA 558 (C)

decisions which the directors arrived at honestly (the process) within the management powers.¹⁴²

5.4.2 The business judgment rule reception prior to the enactment of the Companies Act, 2008

5.4.2.1. The King Reports on Corporate Governance

As stated above, the King I Report on Corporate Governance¹⁴³ was published in 1994 and it recommended that the duty of care and skill as it stood at common law had too high a bar, and that to encourage entrepreneurship and the assumption of directorship positions, the liability for the breach thereof should be limited by the statute. Thus the report made a recommendation to amend the Companies Act 61 of 1973 to provide for this limitation of liability for directors if they had exercised business judgment in good faith, the decision being an informed one and such director no interest in the transaction.¹⁴⁴ This Report also advocated for collective responsibility of the directors, a point which Kennedy-Good and Coetzee consider false due to the fact that South African law does not provide strict or vicarious liability with regards to directors.¹⁴⁵

The King II Report on Corporate Governance¹⁴⁶ which was published in 2002 recommended that the Standing Advisory Committee on Company Law should investigate whether or not it was desirable and necessary to introduce the business judgment rule in South African law.

5.4.2.2 The Department of Trade and Industry's Guidelines for Corporate Law Reform

Kennedy-Good and Coetzee opine that it is also useful to consider the report that was issued by the Department of Trade and Industry in 2004.¹⁴⁷ The report contended that there needed to be a review of company law as the business environment had changed remarkably since the 1973 and the Companies Act promulgation. The two legal writers note that whilst the same report says that the current (as at 2006) law is ineffective when it comes to enforcing directors duties, it is self-contradictory as it also says that South Africa is not a litigious country and it's

¹⁴² See note 23: *Howard Smith Ltd v Ampol Petroleum* at page 832; See Note 21 *supra*: *Cramphorn v Hogg*

¹⁴³ The Institute of Directors in South Africa 1994 Nov.

¹⁴⁴ See note 100: Kennedy- Good S, Coetzee L at page 287

¹⁴⁵ *Ibid*

¹⁴⁶ The Institute of Directors South Africa 2002 March

¹⁴⁷ See note 100: Kennedy- Good S, Coetzee L at page 289-290

thus not necessary to provide further mechanisms (such as the business judgment rule) that will help directors avoid liability.¹⁴⁸

5.4.2.3. Legal Writers' Opinion on the Business Judgment Rule

Havenga¹⁴⁹ suggested that the South African common law principles were sufficient to impose the duty of care and ensure that directors were not overprotected to the extent that it became difficult to enforce the duty as is the case in America.

In 2006, Kennedy-Good and Coetzee noted fact that the Americans which originated the business judgment rule have tried unsuccessfully to codify it due its complexity. The different meanings that have been given to business judgment rule by US courts and the fact that no legislation had been implemented in any federal state which imposed the rule, indicates that it may not be best to introduce same to South Africa.¹⁵⁰ Kennedy-Good and Coetzee also further take the point that the law of delict in South Africa and the tests involved for wrongfulness, fault and legal causation, already provide sufficient protection for directors and render the importing of the business judgment rule "needless".¹⁵¹

Jones¹⁵² submitted that the breach of the duty of care, skill and diligence is hardly used as a cause of action against directors in South Africa, the then already low standard of this duty would further be lowered if another mechanism to limit its liability was introduced. He further opined that the existing law was sufficient to allow directors to be protected if they acted honestly and reasonably.¹⁵³ To this end he considered section 248 of the Companies Act, 1973.

Bouwman¹⁵⁴ takes the view that the South African society requires competent directors and the courts already give directors the benefit of the doubt. She further notes that there has not been a history of successful suits for breach of the duty of care and skill, the Companies Act, 1973 provides defences for directors against liability. It does not then make sense to wish to extract foreign principles and incorporate them into our law. Further she points out that the *King II* recommendations regarding the business judgment rule should not have been followed since they have been criticised of inadequate research.¹⁵⁵ She further cautions against taking isolated principles from foreign jurisdictions particularly since the rule was developed in a different environment and the recent cases from the

¹⁴⁸ Ibid

¹⁴⁹ M Havenga "The Business Judgment Rule- Should we follow the Australian Example?" [2000] 12 SA Merc LJ 25 at page 36

¹⁵⁰ See note 3: Kennedy-Good, Coetzee at page 74; See also note 95 at page 291

¹⁵¹ See note 3: Kennedy-Good, Coetzee at page 283

¹⁵² See note 124 :E Jones at page 327

¹⁵³ See note 124:E Jones at page 333

¹⁵⁴ See note 35: Bouwman at page 533-534

¹⁵⁵ Ibid

country of origin also indicate that there is a move away from giving the directors too much protection.¹⁵⁶

5.4.3 The Statutory Business Judgment Rule

The business judgement rule is contained in section 76(4) of the Companies Act, 2008 which reads:

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

- (a) will have satisfied the obligations of subsections (3)(b and (c) if-
 - (i) the director has taken reasonably diligent steps to become informed about the matter;
 - (ii) either
 - (aa) the director had no material personal financial interest in the subject matter of the decision, and had no reasonable basis to know that any related person had a personal financial interest in the matter; or
 - (bb) the director complied with the requirements of section 75 with respect to any interest contemplated in subparagraph (aa); and
 - (iii) the director made a decision or supported the decision of the board, with regard to that matter, and the director has a rational basis for believing, and did believe that the decision was in the best interest of the company; and...”

The business judgement rule is contained in section 76(4) (a) and there is reference only to discharging the duties of section 76(3) (b) and (c), namely to act in the best interests of the company as well as the duty of care, skill and diligence respectively. There are some points to note from the wording of the rule in this section such the following. Firstly, it appears that the rule does not relate to the directors' duty to act in good faith and a proper purpose¹⁵⁷ as contained in section 76(3)(a); secondly the rule, with regards to the duty of care, skill and diligence, appears to be limited to the statutory duty of care only¹⁵⁸.

¹⁵⁶ *ibid*

¹⁵⁷ This is unlike the Australian counterpart of the codified business judgment rule which is contained in section 180(2) of the Corporations Act 2001. See D A DeMott “ Directors’ Duty of Care and the Business Judgment Rule: American Precedents and Australian Choices” (1992)4(2) *Bond Law Review* Article 2 133(<http://epublications.bond.ed.au/blr/vol.4/iss2/2> .last accessed 17 December 2015) ; See also note 7: Cassim at page 564

¹⁵⁸ C Stein, G Everingham “The Companies Act Unlocked: A Practical Guide” (2011) 245-6 as cited by J Leach ‘The Correct Understanding of the Business Judgment Rule in Section 76(4) of the Companies Act 71 of 2008: Avoiding the American Mistakes’ UCT Dissertation at page 21 (https://open.uct.ac.za/bitstream/item/9802/thesis_law_2014_leach_j.pdf?sequence=1. Last accessed 24 November 2015)

One would recall that the business judgment rule in its “original formulation” (these terms being used in a very loose fashion); has as one of its elements, the requirement of good faith.¹⁵⁹ The presence of good faith is an element which is perceived to exist if there was a rational business purpose.¹⁶⁰ The rationality in the present statutory rule appears to relate to the basis for believing that the decision was in the best interests of the company. It therefore appears as a departure from the “original formulation” that the statutory business judgment rule expressly excludes the requirement of good faith. The requirement of rationality appears to be included to objectify the belief that the director had with regards the best interests of the company. This means that the belief must be a reasonable belief; however the director is further required to have actually held such as belief.¹⁶¹

The requirements of the statutory business judgment rule can thus be summarised as follows:¹⁶²

- the director must have made an informed decision;
- the director must not have had an interest in the matter, if she did, she must have made the relevant disclosure in terms of section 75;
- there must be a rational basis for believing that the decision was in the best interests of the company and actual belief of same.

5.5 **Conclusion**

It is clear from the foregoing that not every conduct of a director may be shielded by the business judgement rule. Firstly, the business judgment rule as contained in statute appears to limit its application to the statutory duty of care, skill and diligence¹⁶³. This implies that where a breach exists of the duty of care, skill and diligence at common law, the business judgment rule as contained in section 76(4) of the Companies Act, 2008 will not apply.

Secondly, and most importantly, the business judgment rule protects the decisions of honest and rational directors indicating that irrational and dishonest directors may not be harboured by the rule.¹⁶⁴

Thirdly, though the business judgment rule shields honest and rational directors from breach of the statutory duty of care, skill and diligence, section 218 widens the door for liability. This indicates that the limits of liability for any loss suffered by a person

¹⁵⁹ See note 130 *supra*

¹⁶⁰ See note 131 *supra*

¹⁶¹ See wording of the Section 76(4) of the Companies Act, 2008

¹⁶² See note 7: Cassim at 565

¹⁶³ See Note 158 *supra* : C Stein, G Everingham at page 245-6

¹⁶⁴ See Note 108: Muswaka at page 91

who uses that section, may be limited by the ordinary common law principles in delict as indicated above.¹⁶⁵

¹⁶⁵ See note 100 Kennedy-Good, Coetzee at page 281-283

CHAPTER 6

6.1 Conclusion

In this paper one has considered the nature of the duty of care; skill and diligence contrasted it to the fiduciary duties. It is clear that the duty of care, skill and diligence is not part of the fiduciary duties, but is part of *lex aquilia*¹⁶⁶ The common law origins of the duty of care, and the standards used to measure the conduct of directors was also considered. It is apparent that initially the standard used was lenient.¹⁶⁷ The incorporation of the traditionally lenient standard into South African company law occurred through the legal principles that were listed in *Fisheries Development Corporation v Jorgensen*¹⁶⁸ The gradual move away from the traditionally lenient standard at common law, began around the 1990s in South Africa and abroad.

The partial codification of the duty of care, skill and diligence as opposed to a complete codification in terms of section 76(3) (c) of the Companies' Act 71 of 2008 was discussed explored in this paper. The departure from a lenient standard of measuring directors' conduct was solidified by the introduction of a hybrid standard which contained objective¹⁶⁹ and subjective¹⁷⁰ considerations. The codification in other jurisdictions, whether partial or complete, was also considered and it became clear that other jurisdictions have opted to codify the duty completely whereas others have chosen to codify it partially.

The available remedies for a breach of the duty of care, skill and diligence were also considered above in Chapter 4. The business judgment rule, which decreases the liability for directors who breach the duty of care, was also considered. The business judgement rule, which originated in the United States of America around 1829,¹⁷¹ was first recommended for adoption in South Africa in 1994 by the first King Committee.¹⁷² The business judgment rule was eventually codified by its inclusion in section 76(4) (a) of the Companies' Act 71 of 2008.

It would be interesting to note whether there will be an increase in cases where the grounds for seeking remedy against a director would be ones based on the breach of the duty of care, skill and diligence or whether the preferred grounds would continue to be those based on fiduciary duties. Due to the fact that the duty of care, skill and diligence has been partially codified, it is hoped that there will be such an increase of cases so as to enable the development of the law, in order this duty may also have a wealth of judgments. This perhaps may in the future allow, if deemed desirable, an amendment to section 76(3) (c) of the Companies' Act 71 of 2008 which would see a

¹⁶⁶ See note 33 supra

¹⁶⁷ See note 35 supra

¹⁶⁸ See note 5 supra.

¹⁶⁹ Section 76(3)(c)(i)

¹⁷⁰ Section 76(3)(c) (ii)

¹⁷¹ See note 110

¹⁷² See note 144 supra

complete codification of the duty of care, skill and diligence. This is particularly so, since the scope of potential liability has been increased as opposed to the duty at common law, through the introduction of sections like section 218(2). The immediate counter to the increased scope of potential liability is of course the business judgment rule, an almost yin-yang scenario. It would be interesting for a court to consider an application based on a breach of the duty of care, skill and diligence brought in terms of section 218(2) where section 76(4)(a) is raised as a defence.

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Section 107



29 February 2016

Miss Noshihle Pearl Gumbi 200303222

School of Law

Pietermaritzburg Campus

Dear Miss Gumbi

Protocol reference number: HSS/0190/016M

Project title: The Evolution of the Directors' duty of care, skill and diligence: A comparative look at common Law and Statute

Full Approval – No Risk / Exempt Application

In response to your application received on 26 February 2016, the Humanities & Social Sciences Research Ethics Committee has considered the abovementioned application and the protocol have been granted **FULL APPROVAL**.

Any alteration/s to the approved research protocol i.e. Questionnaire/Interview Schedule, Informed Consent Form, Title of the Project, Location of the Study, Research Approach and Methods must be reviewed and approved through the amendment/modification prior to its implementation. In case you have further queries, please quote the above reference number.

PLEASE NOTE: Research data should be securely stored in the discipline/department for a period of 5 years.

The ethical clearance certificate is only valid for a period of 3 years from the date of issue. Thereafter Recertification must be applied for on an annual basis.

I take this opportunity of wishing you everything of the best with your study.

Yours faithfully

.....
Dr Shenuka Singh (Chair)
Humanities & Social Sciences Research Ethics Committee

/pm

Cc Supervisor: Mr D Subramanien

Cc Academic Leader Research: Dr Shannon Bosch

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