

UNIVERSITY OF THE WESTERN CAPE

FACULTY OF LAW

**THE EFFECT OF THE PARTIAL CODIFICATION OF THE COMMON LAW
DUTIES OF DIRECTORS IN THE COMPANIES ACT 71 OF 2008 ON THE
LIABILITY OF DIRECTORS.**

**Research paper submitted in partial fulfilment of the requirements for the LLM
Degree, University of the Western Cape**




**UNIVERSITY *of the*
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Key Words

Common law, Business Judgement Rule; Directors' Duties; Directors' Liabilities; Partial Codification; Companies Act; Duty of Care, Skill and Diligence

Chapter 1

1.1 Introduction and background to study

The global financial crisis resulted in a corporate collapse in different parts of the world.¹ The global financial crisis was caused by poor governance.² Consequently many countries, including South Africa, began to place more emphasis on good governance. The framework and guidelines for the development of good governance in South African company law was published by the Department of Trade and Industry (hereafter DTI) in a document referred to as *The South African Company Law for the 21st Century: Guidelines for Corporate Law Reform* (hereafter the DTI Policy Document) published by the DTI. The DTI Policy Document recognised the need for a *regulatory framework within which enterprises operate to promote growth, employment, innovation, stability, good governance, confidence and international competitiveness*.³ In order to further develop governance, the effectiveness of directors' standards as well as the liability of directors was also said to have developed.⁴

¹ Mupangavanhu B M *Directors' Standards Of Care, Skill, Diligence, And The Business Judgment Rule In View Of South Africa's Companies Act 71 Of 2008: Future Implications For Corporate Governance* (Unpublished PHD, University of Cape Town, 2016) 1.

² Leach J *The Correct Understanding of the Business Judgment Rule in Section 76(4) of the Companies Act 71 of 2008: Avoiding the American Mistakes* (Unpublished LLM Thesis, University of Cape Town, 2014) 3.

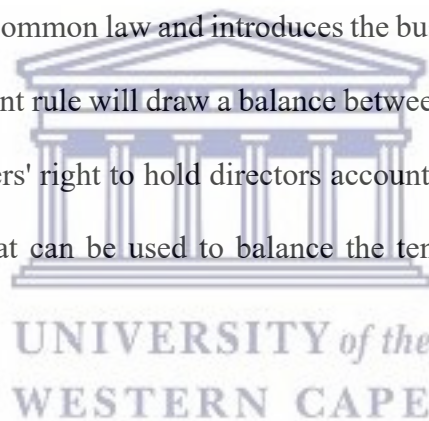
³ South African Company Law, for the 21st Century: Guidelines for Corporate Law Reform by the DTI in 2004: GN 1183 GG 26493 23-06-2004.

⁴ Ahern D 'Codification of Company Law: Taking Stock of Companies Act 2006' (2014) 35 *Statutory Law Review* 236; Tod M A 'Cost-beneficial Analysis of the Business Judgement Rule: A Critique in Light of the Financial Meltdown' (2010-2011) (74) *Albany Law Review* 2; Ahern D 'Codification of Company Law: Taking Stock of Companies Act 2006' (2014) 35 *Statutory Law Review* 237.

Prior to the development of South African corporate law, liability of directors was to a large extent governed by the common law and the King Codes, despite the existence of the Companies Act 61 of 1973 (as amended).⁵ As of the 1st of May 2011, corporate law in South Africa appears to have dramatically changed the duties and liabilities of directors.⁶ The 1st of May 2011 marked the implementation of Companies Act 71 of 2008 (hereafter the Act).

The Act is written in plain language in an attempt to make it more accessible and align it with international trends.⁷ The Act has also theoretically changed the roles and duties of directors as well as the liability that they may face⁸ in that it potentially changes the existing common law and alters policies and philosophies of corporate law in general.⁹

The Act partially codifies the common law and introduces the business judgement rule to South Africa.¹⁰ The business judgment rule will draw a balance between the directors' ability to steer a company and the shareholders' right to hold directors accountable for their decisions.¹¹ It is perceived as a mechanism that can be used to balance the tension between these opposing rights.¹²



⁵ Leach J *The Correct Understanding of the Business Judgment Rule in Section 76(4) of the Companies Act 71 of 2008: Avoiding the American Mistakes* (Unpublished LLM Thesis, University of Cape Town, 2014) 3.

⁶ 'The most significant changes to the changes to South Africa's company law brought about by the Companies Act, 2008' accessed at <http://www.bowman.co.za/FileBrowser/ContentDocuments/NewCompanies-Act-Brochure.pdf> (accessed 01 July 2017).

⁷ Ahern D 'Codification of Company Law: Taking Stock of Companies Act 2006' (2014) 35 *Statutory Law Review* 237.

⁸ Shoeman N 'How the Companies Act Impacts of Directors' accessed at <http://www.schoemanlaw.co.za/wp-content/uploads/2013/07/How-the-Companies-Act-impacts-on-directors.pdf> (accessed 20 March 2016).

⁹ Cassiem et al *Contemporary Company Law* 2ed (2012) 507.

¹⁰ Leach J *The Correct Understanding of the Business Judgment Rule in Section 76(4) of the Companies Act 71 of 2008: Avoiding the American Mistakes* (Unpublished LLM Thesis, University of Cape Town, 2014) 6.

¹¹ Lee A 'Business Judgement Rule: Should South African Corporate Law follow the King Report's Recommendation?' (2005) I *University of Botswana Law Journal* 54.

¹² Lee A 'Business Judgement Rule: Should South African Corporate Law follow the King Report's Recommendation?' (2005) I *University of Botswana Law Journal* 53.

1.2 Problem statement

Directors are considered to serve as the central hub of the conduct of a company.¹³ They act as the central hub because they are deemed to be responsible for making decisions and directing the company in a particular course.¹⁴ Directors have accordingly been at the core of many business scandals and failures in recent years.¹⁵ One such example is the Citibank scandal in which Citibank and 16 others were accused of rigging the price of South Africa's currency.¹⁶ The Commission found that Citibank and its competitors manipulated prices of bids and offers through agreements in order to bypass the system and create illegal bids and offers at particular times for over a decade.¹⁷

As a result, the Act in theory, recognises the integral role that directors play within the controlling of a company and has since partially codified the common law principles.¹⁸ The partial codification of the common law duties of directors as contained in the Act has brought about significant change to company law in South Africa. The partial codification is evident in section 76(3) (a), (b) and (c) of the Act. The aforementioned sections of the Act will be considered together with the business judgment rule (as stipulated in section 76(4) of the Act) in order to determine the potential effect on the liability of directors.

¹³ Leach J *The Correct Understanding of the Business Judgment Rule in Section 76(4) of the Companies Act 71 of 2008: Avoiding the American Mistakes* (Unpublished LLM Thesis, University of Cape Town, 2014) 3.

¹⁴ Tod M A 'Cost-beneficial Analysis of the Business Judgement Rule: A Critique in Light of the Financial Meltdown' (2010-2011) (74) *Albany Law Review* 2.

¹⁵ Woolley C and Costas T 'Directors Liability and Environmental Law' (2005) 13 *Juta Business Law* 2; Muller H and Mathe B 'How can internal audit be better aligned as a partner for achieving success in the boardroom' Internal Audit Corporate Report 2013 11.

¹⁶ Shaban ARA "South African rand rigging scandal: Citibank agrees to \$5.3m settlement" available at <http://www.africanews.com/2017/02/20/south-african-rand-rigging-scandal-citibank-na-agrees-to-53m-settlement/> accessed on 05 August 2018.

¹⁷ Shaban ARA "South African rand rigging scandal: Citibank agrees to \$5.3m settlement" available at <http://www.africanews.com/2017/02/20/south-african-rand-rigging-scandal-citibank-na-agrees-to-53m-settlement/> accessed on 05 August 2018.

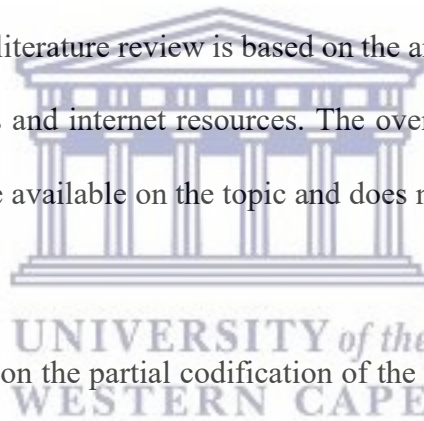
¹⁸ Cassiem et al *Contemporary Company Law* 2ed (2012) 507.

1.3 Research Question and Objectives

The purpose of this research paper is to determine the effect of partial codification of the common law duties on the personal liability of directors. The research paper will provide an outline of the definition of a director in terms of both the common law and the Act itself. Ascertaining the definition of a director will assist in narrowing the scope of the study. The common law duties will then be studied in order to determine which of these duties were partially codified by the Act. Thereafter the business judgement rule will be analysed to determine the extent of its application to the personal liability of directors.

1.4 Literature Review

The overall assessment of the literature review is based on the analysis of legislation, common law, case law, books, journals and internet resources. The overview provided below is not a complete view of the literature available on the topic and does not purport to be an exhaustive view of the subject matter.



The research paper will focus on the partial codification of the common law duties in the Act as well as the potential effect that partial codification may have on the liability of directors. In order to establish the impact of partial codification on the liability of directors, a number of articles will be considered. The writings of Muswaka¹⁹ and Jones²⁰ will be used as the authority in this study as far as it relates to the business judgement rule in the South African context. The

¹⁹ Muswaka L 'Shielding Directors against Liability Imputations: The Business Judgment Rule and Good Corporate Governance' (2013) 3 *International Journal of Humanities and Social Science* and Muswaka L 'Directors' Duties and the Business Judgement Rule in South African Company Law: An Analysis' (2013) 3 *International Journal of Humanities and Social Science*.

²⁰ Jones E 'Directors' Duties: Negligence and the Business Judgement Rule' (2007) 19 *South African Mercantile Law Journal* 333.

writings of Muswaka and Jones can be viewed as leading authority on the aspects which will be discussed in the research paper.

The research paper will also provide insight into the application of the business judgment rule (with relevance to the partial codification as contained in the Act). A comparative study will thereafter be presented which will draw a distinction between the business judgement rule as it applies in America and its potential application in South Africa. The study will be narrowed to include the following:

The Companies Act

The research paper will make considerable reference to section 76(3) (a), (b) and (c) of the Act. These sections of the Act partially codify the common law duties of a director(s). The study also refers to section 76 (4) of the Act. Section 76(4) introduces the business judgement rule to South African corporate law and it outlines the requirements of the rule. These sections, of the Act, will be analysed as far as they apply to the imputation of liability on directors. Section 76 (3) (a), (b) and (c) and section 76 (4) introduces a new component to South African corporate law.

The Duty of Care, Skill and Diligence

The standard of care, skill and diligence in South African law is derived from the English common law, and it has now been codified in the Act.²¹ The opinions of Bouwman²² and Muswaka²³ differ in respect of the applications of this duty as far as it applies to the business

²¹ Lee A 'Business Judgement Rule: Should South African Corporate Law follow the King Report's Recommendation?' (2005) 1 *University of Botswana Law Journal* 50.

²² Bouwman N 'An appraisal of the Modification of a Director's Duty of Care and Skill (2009) 21 *South African Mercantile Law Journal* 509.

²³ Muswaka L 'Shielding Directors against Liability Imputations: The Business Judgment Rule and Good Corporate Governance' (2013) 3 *International Journal of Humanities and Social Science* 27.

judgement rule. Research indicates that Muswaka is of the opinion that the duty of care, skill and diligence is separate but complementary to the business judgement rule. While Bouwman, on the other hand, is of the opinion that the business judgement rule causes confusion to the duty of care, skill and diligence.²⁴ The study will make a distinction between the application of the common law duty of care, skill and diligence and the statutory definitions. The distinction will be made in an attempt to clear away the confusion in the application of this duty as far as it extends to the business judgement rule. Understanding this duty can help to determine the impact of partial codification of the common law duties on the liability of directors.

The Business Judgement Rule

The business judgment rule is an American common law regulation which limits a director's liability in cases where the directors are accused of contravening the duty of care and skill when making business decisions.²⁵ The business judgment rule therefore has the potential to afford directors immunity from liability to the company for loss incurred in a corporate transaction.²⁶ The rule will find application provided that the director acts within his or her authority; while the decision concerned should demonstrate that the transaction was concluded with due diligence, on an informed basis, in the best interest of the company and in good faith.²⁷ In theory, the Act has in many respects increased the scope of the liability of directors while the

²⁴ Bouwman N 'An appraisal of the Modification of a Director's Duty of Care and Skill (2009) 21 *South African Mercantile Law Journal* 509.

²⁵ Lee A 'Business Judgement Rule: Should South African Corporate Law follow the King Report's Recommendation?' (2005) 1 *University of Botswana Law Journal* 50.

²⁶ Muswaka L 'Shielding Directors against Liability Imputations: The Business Judgment Rule and Good Corporate Governance' (2013) 3 *International Journal of Humanities and Social Science* 27.

²⁷ Muswaka L 'Shielding Directors against Liability Imputations: The Business Judgment Rule and Good Corporate Governance' (2013) 3 *International Journal of Humanities and Social Science* 25.

introduction of the business judgment rule has the potential to limit a directors' liability.²⁸ The overall impact will be assessed by way of a comparative study.

The Delaware case of *Aronson v Lewis*²⁹ will be used to illustrate the American application of the rule. *Aronson v Lewis* was selected because it is deemed to be the leading statement on the business judgement rule in the Delaware courts.³⁰ Thereafter the case of *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd*³¹ will be analysed in order to illustrate the South African perspective on the business judgement rule. A further analysis will be done into the statutory application of the business judgement rule by virtue of section 76 (4) (a) of the Act.

The partial codification is evident in section 76(3) (a), (b) and (c) of the Act. The aforementioned sections of the Act will be considered together with the business judgment rule (as stipulated in section 76(4) of the Act) in order to determine the potential effect on the liability of directors.

1.5 Limitation of the study

This research paper will focus on the effect that partial codification of the common law duties of a director has on the liability of a director in terms of the Act. The standard of a directors' conduct (in terms of the Act) also finds application to prescribed officers, a person who is a member of a committee of a company's board and the audit committee of a company, irrespective of whether or not the person is also a member of the company's board. The common law duties on the other hand are only applicable to directors. This research paper will

²⁸ Leach J *The Correct Understanding of the Business Judgment Rule in Section 76(4) of the Companies Act 71 of 2008: Avoiding the American Mistakes* (Unpublished LLM Thesis, University of Cape Town, 2014) 4.

²⁹ *Aronson v Lewis* 473 A.2d 805, 812 (Del. 1984).

³⁰ Leach J *The Correct Understanding of the Business Judgment Rule in Section 76(4) of the Companies Act 71 of 2008: Avoiding the American Mistakes* (Unpublished LLM Thesis, University of Cape Town, 2014) 17.

³¹ *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd and Others* 2014 (5) SA 179 (WCC).

focus on the duties and liabilities as they apply to directors only. The research will not include the effect of partial codification on prescribed officers, a person who is a member of a committee of a company's board and the audit committee of a company.

1.6 Research methodology

Given the purpose of this research paper, an analytical research methodology is appropriate. The main sources consist of legislation, case law, journal articles, textbooks, reports and internet sources.

In addition, a comparative study will be set out in order to illustrate the adoption of the business judgement rule in South Africa. The business judgement rule as it applies to American corporate law will be analysed against the South African incorporation of the rule. The American perspective of the rule will be used in this comparative study because the business judgement rule originated in America.³²



1.7 Chapter outline

Overview of the remaining chapters of this study:

Chapter 2:

Chapter two of this study will provide an overview of the common law duties that are partially codified³³ by the Act. The chapter will also attempt to determine the impact that partial codification will have on the common law duties. In addition, section 76 of the act will be considered with reference to the duties of directors that were partially codified in the Act. This

³² Jones E 'Directors' Duties: Negligence and the Business Judgement Rule' (2007) 19 *South African Mercantile Law Journal* 326.

³³ "an orderly and authoritative statement of the leading rules of law on a given subject, whether the rules are found in statutes or in common law" see Delpont et al 2015:290(3); Davis et al. 2012 110-111; Cilliers et al. 2000 139; Pretorius et al. 1999:278; Cassim et al. 2012(a) 507; Cassim et al. 2012(b) 284; Stein & Everingham 2011 18; Blackman et al. 2002:8-29.

chapter will further examine the ways in which the partial codification impacts on the liability of a director.

Chapter 3:

In this chapter, reference is made to the business judgement rule. A comparative study will be conducted, which will examine the American application of business judgement rule and then compare it with the South African application of the rule. The comparative study will be conducted by reviewing the American and South African applications of the rule and will be set out in a manner that will ascertain the potential impact that the business judgment rule will have on the ability to hold directors accountable.

Chapter 4:

In this chapter, a conclusion will be drawn based on the research obtained for the study as well as applicable recommendations.



Chapter 2

AN OVERVIEW OF THE COMMON LAW DUTIES THAT ARE PARTIALLY CODIFIED BY THE 2008 COMPANIES ACT

2.1 Introduction

Until the implementation of the 2008 Companies Act, South African company law did not have codified rules relating to the duties and liabilities of directors.³⁴ The governance of duties and liabilities of directors was largely left to the common law.³⁵ The legislature has since recognised a need for a mechanism that would consolidate these duties and liabilities and thereby encourage their enforcement.³⁶ The mechanism used was the enactment of the Companies Act 71 of 2008 (the Act).³⁷ The Act has modified the position of company law in South Africa. The modification is found in the partial codification of the duties, obligations and the accountability of directors.³⁸

This chapter will examine the manner in which partial codification impacts on the personal liability of a director of a company. It will be done by examining the duties as they appear in common law and as they appear in the Act. The difference between the common law duties and partially codified duties will be identified. An analysis will thereafter be prepared in order to determine the impact that partial codification may have had on the liability of directors.

³⁴ South African Company Law for the 21st Century, Guidelines for Corporate Law Reform, Government Notice 1183 of 2004 17.

³⁵ Grove A P *Company Directors: Fiduciary Duties and the Duty of Care and Skill* (Unpublished LLM Thesis, University of Pretoria, 2012) 11.

³⁶ South African Company Law for the 21st Century, Guidelines for Corporate Law Reform, Government Notice 1183 of 2004 17.

³⁷ South African Company Law for the 21st Century, Guidelines for Corporate Law Reform, Government Notice 1183 of 2004 17.

³⁸ South African Company Law for the 21st Century, Guidelines for Corporate Law Reform, Government Notice 1183 of 2004 17.

2.2 Common law duties of directors

Prior to the 2008 Companies Act, the duties of directors were primarily derived from the memorandum and articles of association of a company, the former Companies Act 61 of 1973 and the common law.³⁹ The 2008 act has since amended that position. The Act now provides a framework from which directors can conduct company affairs in line with common law responsibilities.⁴⁰ A substantial amendment, brought about by the 2008 Act, was the partial codification of the common law duties of directors. The common law position will however continue to find application in cases where the 2008 act is silent.⁴¹

Whereas South Africa has a mixed legal system, the common law of companies is English law that is said to be derived from custom and judicial precedent. The common law duties that a director owes to a company, are divided into fiduciary duties and the duty of care, skill and diligence.⁴²

2.2.1 Fiduciary Duties

The term *fiduciary* merely outlines the general principles and describes the conduct that is acceptable and required.⁴³ There is no comprehensive definition of what a fiduciary duty is or a closed list of what a fiduciary relationship entails.⁴⁴

³⁹ Bouwman N 'An Appraisal of the Modification of the Director's Duty of Care and Skill' (2009) 21 South African Mercantile Law Journal 509.

⁴⁰ Ahern D 'Directors' Duties, dry ink and the accessibility agenda' (2012) 128 (January) *Law Quarterly Review* 114.

⁴¹ Coetzee L and Van Tonder J 'Advantages and disadvantages of partial codification of directors' duties in the South African Companies Act 71 of 2008' (2016) 41 (2) *Journal for Judicial Science* 9.

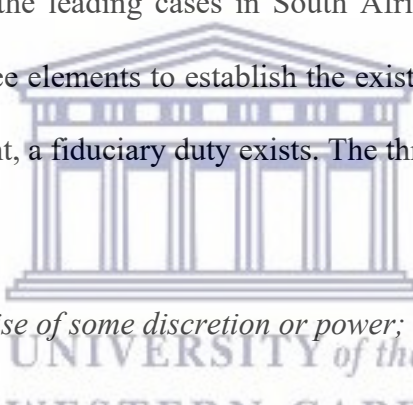
⁴² Du Plessis J J 'A comparative analysis of directors' duties of care, skill and diligence in South Africa and Australia' (2010) *Acta Juridica* 271.

⁴³ Grove A P *Company Directors: Fiduciary Duties and the Duty of Care and Skill* (Unpublished LLM Thesis, University of Pretoria, 2012) 11.

⁴⁴ Havenga M. Breach of Directors' Fiduciary Duties? Liability on What Basis (1996) 8 South African Mercantile Law Journal 366.

In the case of *Bellairs v Hodnett and Another*,⁴⁵ the fiduciary duty was described as “the existence of such a duty and its nature and extent are questions of fact to be adduced from a thorough consideration of the substance of the relationship and any relevant circumstances which affect the operation of that relationship”. Therefore, the relationship between a company and its directors, gives rise to fiduciary duties.⁴⁶ These duties are based on a relationship of trust and require directors to exercise powers and perform functions in good faith and in the best interests of the company.⁴⁷ The fiduciary duties are non-negotiable and cannot be waived in any manner or form.⁴⁸

In the case of *Robinson v Randfontein Estates Gold Mining Co Ltd*⁴⁹ (hereafter *Robinson v Randfontein Estates*), one of the leading cases in South Africa which deals with fiduciary duties, the court identified three elements to establish the existence of a fiduciary duty. Once these three elements are present, a fiduciary duty exists. The three elements established by the case are, namely:⁵⁰

- 
- (a) *Scope for the exercise of some discretion or power;*
 - (b) *That power or discretion can be used unilaterally so as to affect the beneficiary's legal or practical interests; and*
 - (c) *A peculiar vulnerability to the exercise of that discretion or power.*

⁴⁵ *Bellairs v Hodnett and Another* 1978 (1) SA 1109 (A) at 1130F.

⁴⁶ Geach W “Statutory, Common Law and other Duties of Directors” Paper for CIS Corporate Governance Conference on 10 to 11 September 2009 10.

⁴⁷ Bouwman N ‘An Appraisal of the Modification of the Director’s Duty of Care and Skill’ (2009) 21 *South African Mercantile Law Journal* 509.

⁴⁸ Duties of directors under the new companies act – business as usual available at <https://www.ensafrika.com/news/duties-of-directors-under-the-new-companies-act-business-as-usual?Id=381&STitle=corporate%20commercial%20ENSight> accessed on 23 April 2017.

⁴⁹ *Robinson v Randfontein Estates Gold Mining Co Ltd* 1925 Appellate Division 173.

⁵⁰ *Robinson v Randfontein Estates Gold Mining Co Ltd* 1925 Appellate Division 173.

The definition as provided in *Bellairs v Hodnett and Another* as well as *Robison v Randfontein Estates G M Co Ltd* indicates that the relationship between a company and its directors exhibits these three elements. In application, directors have discretion to act on behalf of a company, directors can unilaterally exercise that discretion to affect the company's interests and in so doing the company is at the mercy of its directors. Therefore, the relationship between a company and its directors is a fiduciary relationship.

A fiduciary relationship gives rise to fiduciary duties.⁵¹ These fiduciary duties are based on a relationship of trust. It requires directors to exercise powers and perform functions in good faith and in the best interests of the company.⁵² The fiduciary duties are non-negotiable and cannot be waived in any manner or form.⁵³

2.2.1.1 Breach of fiduciary duty

The case of *Robinson v Randfontein Estates* deals with the common law breach of a fiduciary duty. In this case the director of the plaintiff company had purchased property under circumstances in which it was his duty to have acquired the property not for himself but for the company. The director thereafter resold the property to the plaintiff company at a profit. In reaching its decision, the court stated that:⁵⁴

‘Where one man stands to another in a position of confidence involving a duty to protect the interests of that other, he is not allowed to make a secret profit at the other’s expense or place himself in a position where his interests conflict with his duty. The principle

⁵¹ Geach W “Statutory, Common Law and other Duties of Directors” Paper for CIS Corporate Governance Conference on 10 to 11 September 2009 10.

⁵² Bouwman N ‘An Appraisal of the Modification of the Director’s Duty of Care and Skill’ (2009) 21 *South African Mercantile Law Journal* 509.

⁵³ Duties of directors under the new companies act – business as usual available at <https://www.ensafrica.com/news/duties-of-directors-under-the-new-companies-act-business-as-usual?Id=381&STitle=corporate%20commercial%20ENSight> accessed on 23 April 2017.

⁵⁴ *Robinson v Randfontein Estates Gold Mining Co Ltd* 1925 Appellate Division 173.

underlies an extensive field of legal relationship. A guardian to his ward, a solicitor to his client, an agent to his principal, afford examples of persons occupying such a position. As was pointed out in *The Aberdeen Railway Company v Blaikie Bros.* (1 Macqueen 474), the doctrine is to be found in the civil law (Digest 18.1. 34.7), and must of necessity form part of every civilised system of jurisprudence’.

The court found in favour of the plaintiff company. That plaintiff company was entitled to claim the profit made by the sale of the property to the company from the director.

Breach of a fiduciary duty is *sui generis* and does not result from contract or delict.⁵⁵ It is determined *sui generis* and potentially leads to a wide risk of liability.⁵⁶ A breach of a fiduciary duty occurs when a director acts for his own benefit or in a manner that prejudices the company.⁵⁷ The remedy for breach of a fiduciary duty is restitution to the company for loss suffered by the company or the benefit received by the director as a result of the breach.⁵⁸

2.2.2 The duty of care and skill

The duty of care and skill can be described as a standard that is reasonably expected of a director when carrying out functions while holding office as a director.⁵⁹ The case of *Fisheries Development Corporation of SA Ltd v Jorgensen*⁶⁰ has been the leading case in matters relating to the duty of care and skill. The *Fisheries Development Corporation of SA Ltd v Jorgensen*

⁵⁵ Bouwman N ‘An Appraisal of the Modification of the Director’s Duty of Care and Skill’ (2009) 21 *South African Mercantile Law Journal* 510.

⁵⁶ Havenga M. Breach of Directors’ Fiduciary Duties? Liability on What Basis (1996) 8 *South African Mercantile Law Journal* 369.

⁵⁷ Bouwman N ‘An Appraisal of the Modification of the Director’s Duty of Care and Skill’ (2009) 21 *South African Mercantile Law Journal* 510.

⁵⁸ Bouwman N ‘An Appraisal of the Modification of the Director’s Duty of Care and Skill’ (2009) 21 *South African Mercantile Law Journal* 510.

⁵⁹ Bouwman N ‘An Appraisal of the Modification of the Director’s Duty of Care and Skill’ (2009) 21 *South African Mercantile Law Journal* 510.

⁶⁰ *Fisheries Development Corporation of South Africa v AWJ Investments (Pty) Ltd* 1980 (4) SA 156 (W).

followed the English law precedent in *In Re Brazilian Rubber Plantations and Estates Limited*⁶¹ and *In Re City Equitable Fire Insurance Company Limited*⁶².

The judgement in *Fisheries Development Corporation of SA Ltd v Jorgensen* identified principles that assist in determining the standard by which directors are required to act. The principles identified by the *Fisheries Development Corporation* case are listed below:⁶³

“(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 and on any particular obligations assumed by or assigned to him.

(b) A director is not required to have special business acumen or expertise, or singular ability or intelligence or even experience in the business of the company. He is, however, expected to exercise the care which can reasonably be expected of a person with his knowledge and experience. A director is not liable for mere errors of judgment.

(c) In respect of all duties that may properly be left to some other official, a director is, in the absence of specific 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 questioning such. Obviously, a director exercising reasonable care would not accept information and advice blindly. He would accept it, and he would be entitled to rely on it, but he would give it due consideration and exercise his own judgment accordingly.”

The principles identified in *Fisheries Development Corporation of SA Ltd v Jorgensen* amount to a dominantly subjective test. The test indicates that a directors' conduct will only be judged

⁶¹ *In Re Brazilian Rubber Plantations and Estates Limited* 1911 1 Ch 425.

⁶² *In Re City Equitable Fire Insurance Company Limited* 1925 Ch 407.

⁶³ Du Plessis J J 'A comparative analysis of directors' duties of care, skill and diligence in South Africa and Australia' (2010) *Acta Juridica* 264.

against the actions that are reasonably expected of a person with his knowledge and experience. A low standard of care and skill is required of directors performing their functions.⁶⁴ Director was not expected to maintain involvement in company affairs or possess any skill or ensure diligent attendance to their duties.⁶⁵ Therefore liability will only ensue in cases of gross negligence.⁶⁶

2.2.2.1 Breach of the duty of care, skill and diligence

The duty of care and skill is based on delictual or aquilian liability for negligence.⁶⁷ As stated above, the test adopted, to determine breach of the common law duty of care, skill and diligence, in South African common law was a dominantly subjective test. Once a director is said to have acted negligently, liability will be determined on a delictual or aquilian basis.

2.3 Partial codification contained in the 2008 Companies Act

The common law fiduciary duties and the duty of care and skill⁶⁸ are now found in the 2008 Companies Act. The duties are contained in section 76 (3) of the Act. Section 76 (3) states:⁶⁹

‘...a director of a company, when acting in that capacity, must exercise the powers and perform the functions of a director;

a) in good faith and for a proper purpose;

⁶⁴ Shoeman N. ‘How the Companies Act Impacts on Director?’ in Without Prejudice Vol 13 (Issue 6) (2013) 10 -13.

⁶⁵ Mupangavanhu B M *Directors’ Standards Of Care, Skill, Diligence, And The Business Judgment Rule In View Of South Africa’s Companies Act 71 Of 2008: Future Implications For Corporate Governance* (Unpublished PHD, University of Cape Town, 2016) 1.

⁶⁶ Shoeman N. ‘How the Companies Act Impacts on Director?’ in Without Prejudice Vol 13 (Issue 6) (2013) 10 -13.

⁶⁷ Ex parte Lebowa Development Corporation Ltd 1989 (3) SA 71 (T); Du Plessis NO v Phelps 1995 (4) SA 165 (C).

⁶⁸ The act makes reference to the duty of care, skill and diligence which can be equated to the common law duty of care and skill; see also Shoeman N. ‘How the Companies Act Impacts on Director?’ in Without Prejudice Vol 13 (Issue 6) (2013) 10 -13.

⁶⁹ Section 76 (3) of Act 71 of 2008.

- b) *in the best interests of the company; and*
- c) *with the degree, care, skill and diligence that may reasonably be expected of a person-*
- I. *carrying out the same function in relation to the company as those carried out by the director;*
 - II. *Having the general knowledge, skill and experience of that director.'*

Because the common law fiduciary duties and the duty of care, skill and diligence are contained in the 2008 Companies Act, it is said to be partially codified. These partially codified duties (amongst other statutory duties) prescribed by the 2008 Companies Act are mandatory. Therefore, these duties must be adhered to and cannot be negated, limited or restricted in any manner of form. The adherence requirement is found in section 78(2)⁷⁰ of the Act. Section 78(2) states that any provision of an agreement, memorandum of incorporation, rules of a company or resolution adopted by a company (whether express or implied), is void to the extent that it directly or indirectly purports to relieve directors of their duties.

The impact on the personal liability of directors will be considered in the remainder of this chapter.

⁷⁰ This section finds application to the duties envisaged under the section 75, 76 as well as the liability contemplated by section 77.

2.4 How the partial codification of these duties impacts on the personal liability of directors

The impact of partial codification of these, now mandatory duties, contemplated in section 76 (fiduciary duties and the duty of care, skill and diligence) will now be discussed. The discussion will focus on the impact that it has on directors' personal liability.

2.4.1 Fiduciary Duties

Fiduciary duties placed on directors are contemplated in section 76 (3) (a) and (b)⁷¹. Liability for breach of these duties is imposed by section 77 of the 2008 Companies Act. Section 77 implies that a breach of these fiduciary duties will give rise to a claim for damages as well as a claim for a disgorgement of profits.⁷² The claim for disgorgement of profits will arise immediately when the profit is made as a result of the breach of these fiduciary duties.⁷³ The liability provision imposed by section 77, clearly stipulates that directors' may be held personally liable for the loss.

The case of *Blue Farm Fashion Limited v Rapitrade 6 (Pty) Ltd and others*⁷⁴ (hereafter *Blue Farm Fashion Limited v Rapitrade*), the court determined if a contravention of section 77(3) (b) can be a basis to confer personal liability on a director in favour of a third party creditor of the company. The court assumed the correctness of the factual averments made in the pleading

⁷¹ Of the Companies Act 71 of 2008.

⁷² "Act Three: Section 76(3) and the duty of good faith and care" available at <http://www.mondaq.com/southafrica/x/214918/Directors+Officers/The+Standard+of+Directors+Conduct> accessed on 07 February 2017.

⁷³ "Act Three: Section 76(3) and the duty of good faith and care" available at <http://www.mondaq.com/southafrica/x/214918/Directors+Officers/The+Standard+of+Directors+Conduct> accessed on 07 February 2017.

⁷⁴ *Blue Farm Fashion Limited v Rapitrade 6 (Pty) Ltd and others* (2016) ZAWHC.

and therefore only interpreted the objects of section 77(3) (b). It used a narrow approach⁷⁵ to interpret section 77(3) (b) to mean:⁷⁶

‘...directors of a company are liable for loss, damages or costs sustained by the company as a direct or indirect consequence of the director having acquiesced in the carrying on of the company’s business despite knowing that such conduct is prohibited by Section 22(1).’

The court quoted the following excerpt from *Natal Joint Municipal Pension Fund v Endumeni Municipality*⁷⁷ 2012 (4) SA 593 (SCA) at paragraph 18:

‘Interpretation is the process of attributing meaning to the words used in a document ... having regard to the context provided by reading the particular provision or provisions in the light of the document as a whole and the circumstances attendant upon its coming into existence. ... Where more than one meaning is possible each possibility must be weighed in the light of all these factors. ... A sensible meaning is to be preferred to one that leads to insensible or unbusinesslike results or undermines the apparent purpose of the document.’

By applying this reasoning, the court held that an interpretation, which favours holding directors personally liable in terms of section 77(3), leads to a sensible and business-like result.⁷⁸ The court thereby confirmed, in its judgement, that a director of a company may be

⁷⁵ A literal meaning is taken in interpretation unless it results in great absurdity, inconvenience, or inconsistency, and then it modifies the meaning, within the context of the statute, just as far as is necessary to avoid the absurdity see *Blue Farm Fashion Limited v Rapitrade 6 (Pty) Ltd* and others (2016) ZAWHC para 29.

⁷⁶ *Blue Farm Fashion Limited v Rapitrade 6 (Pty) Ltd* and others (2016) ZAWHC para 31.

⁷⁷ *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 (4) SA 593 (SCA)

⁷⁸ Myburg E “Holding delinquent directors personally liable” available at <http://www.derebus.org.za/holding-delinquent-directors-personally-liable/> accessed on 07 September 2018.

held personally liable for damages sustained by a third party creditor where the director in question acted in such a way so as to acquiesce in the carrying on of the company's business despite knowing that it was being conducted in a reckless manner, with gross negligence, with intent to defraud any person, or for any fraudulent purpose.⁷⁹ The statutory clause in question is not limited in its applicability, as contended by the directors in the case, to a claim by the company against its directors.⁸⁰ The Court confirmed that section 77(3) (b) of the Act can be the basis to found personal liability of a director in favour of a creditor of a company.⁸¹

The case of *Robinson v Randfontein Estates* as well as *Blue Farm Fashion Limited v Rapitrade* courts established the existence of a fiduciary duty and thereafter found that the director had failed to meet its fiduciary obligation. In the case of *Robinson v Randfontein Estates*, the breach resulted in the director being liable to the plaintiff company for profit made by the sale of the property to the company. While in the case of *Blue Farm Fashion Limited v Rapitrade*, the court confirmed that a director of a company may be held personally liable to a third party creditor for the damages sustained.⁸² Therefore partial codification results in a change to the common law position, because a director may now be held personally liable to a third party creditor. The claim against the director is no longer limited to the company that suffered loss (or damages) but is extended to third party creditors.⁸³

⁷⁹ Available at <https://www.fwbattorneys.co.za/personal-liability-of-directors-under-companies-act/> accessed on 07 September 2018.

⁸⁰ Available at <https://www.fwbattorneys.co.za/personal-liability-of-directors-under-companies-act/> accessed on 07 September 2018.

⁸¹ Available at <https://www.fwbattorneys.co.za/personal-liability-of-directors-under-companies-act/> accessed on 07 September 2018.

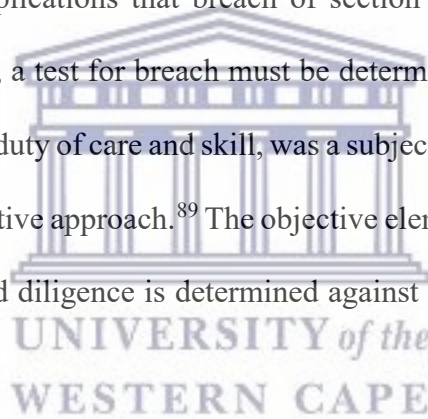
⁸² Myburg E "Holding delinquent directors personally liable" available at <http://www.derebus.org.za/holding-delinquent-directors-personally-liable/> accessed on 07 September 2018.

⁸³ Myburg E "Holding delinquent directors personally liable" available at <http://www.derebus.org.za/holding-delinquent-directors-personally-liable/> accessed on 07 September 2018.

2.4.2 The duty of care, skill and diligence

The duty of care, skill and diligence owed by a director to the company is contemplated in section 76(3) (c) of the Act.⁸⁴ The Act also contains a provision for breach. The provision for breach is found in section 77(2) (b). According to section 77(2) (b), breach will result in a claim in delict⁸⁵ and is limited to compensation for delictual damages.⁸⁶ In addition, section 77(2) (b) limits the remedies available for a contravention of section 76(3) (c) to those that exist in common law.⁸⁷

In order to determine the implications that breach of section 76(3) (c) would have on the personal liability of a director, a test for breach must be determined. As stated above, the test for breach of the common law duty of care and skill, was a subjective test.⁸⁸ Partial codification, introduces an objective-subjective approach.⁸⁹ The objective element indicates that compliance with the duty of care, skill and diligence is determined against the conduct that is reasonably



⁸⁴ “Act Three: Section 76(3) and the duty of good faith and care” available at <http://www.mondaq.com/southafrica/x/214918/Directors+Officers/The+Standard+of+Directors+Conduct> accessed on 07 February 2017.

⁸⁵ The elements of a delict; conduct, wrongfulness, fault causation and damages is to be proved.

⁸⁶ “Act Three: Section 76(3) and the duty of good faith and care” available at <http://www.mondaq.com/southafrica/x/214918/Directors+Officers/The+Standard+of+Directors+Conduct> accessed on 07 February 2017.

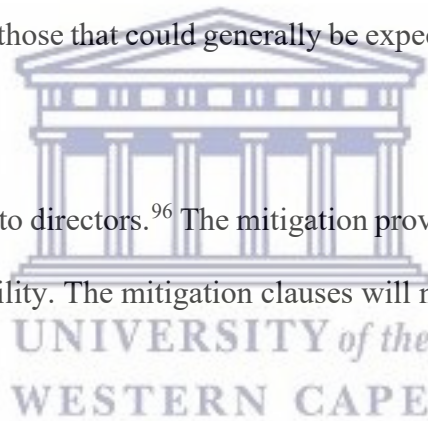
⁸⁷ The companies Act 71 of 2008.

⁸⁸ Shoeman N. ‘How the Companies Act Impacts on Director?’ in Without Prejudice Vol 13 (Issue 6) (2013) 10 -13; *Fisheries Development Corporation of South Africa v AWJ Investments (Pty) Ltd* 1980 (4) SA 156 (W); *In Re Brazilian Rubber Plantations and Estates Limited* 1911 1 Ch 425 and *In Re City Equitable Fire Insurance Company Limited* 1925 Ch 407.

⁸⁹ Du Plessis J J ‘A comparative analysis of directors’ duties of care, skill and diligence in South Africa and Australia’ (2010) *Acta Juridica* 269 and Mupangavanhu B M *Directors’ Standards Of Care, Skill, Diligence, And The Business Judgment Rule In View Of South Africa’s Companies Act 71 Of 2008: Future Implications For Corporate Governance* (Unpublished PHD, University of Cape Town, 2016) 131.

to be expected of a person in a similar position and under similar circumstances.⁹⁰ This objective element reflects a minimum degree of degree of care, skill and diligence expected of directors.⁹¹ The skill, knowledge and experience component introduces a subjective element. The subjective element reflects a higher standard than the standard of a reasonable man.⁹² The standard demanded of a director in terms of this test will be dependent on the size, business of the company, nature of the position, the skill and experience of the director.⁹³ A minimum degree of skill, knowledge and experience is not specifically prescribed by the Act (but may be prescribed in the company's memorandum of incorporation).⁹⁴ Therefore, several authors suggest that the converse will apply when the element of skill is not present. When the converse applies, a lower standard will be required from a director who has general knowledge, skill and experience that are lower than those that could generally be expected from a person who carries those functions.⁹⁵

The Act introduces mitigation to directors.⁹⁶ The mitigation provided to directors may have the potential to limit personal liability. The mitigation clauses will now be discussed.



⁹⁰ Du Plessis J J 'A comparative analysis of directors' duties of care, skill and diligence in South Africa and Australia' (2010) *Acta Juridica* 269.

⁹¹ Du Plessis J J 'A comparative analysis of directors' duties of care, skill and diligence in South Africa and Australia' (2010) *Acta Juridica* 269.

⁹² Du Plessis J J 'A comparative analysis of directors' duties of care, skill and diligence in South Africa and Australia' (2010) *Acta Juridica* 269.

⁹³ Du Plessis J J 'A comparative analysis of directors' duties of care, skill and diligence in South Africa and Australia' (2010) *Acta Juridica* 269.

⁹⁴ Shoeman N. 'How the Companies Act Impacts on Director?' in *Without Prejudice* Vol 13 (Issue 6) (2013) 10 -13.

⁹⁵ Mupangavanhu B M *Directors' Standards Of Care, Skill, Diligence, And The Business Judgment Rule In View Of South Africa's Companies Act 71 Of 2008: Future Implications For Corporate Governance* (Unpublished PHD, University of Cape Town, 2016) 131.

⁹⁶ Shoeman N. 'How the Companies Act Impacts on Director?' in *Without Prejudice* Vol 13 (Issue 6) (2013) 10 -13.

2.5 Mitigation of liability

The mitigation of liability clauses can be found in section 76 (4); 78 (5); 77(9). Section 76 (4) is specifically important because it introduces the business judgement rule to South Africa. . Section 76 (4) will be discussed in detail in chapter 3 of this research paper.

Section 78 (5) of the Act grants a company the power to indemnify a director from liability. A company can indemnify a director provided that the directors' conduct did not amount to wilful misconduct or breach of trust on the part of the director; where a fine has been imposed as a consequence of the director having been convicted of an offence and/or where a director acted recklessly, despite knowing that he or she lacked authority, acted in the name of the company, or acted with the intent to defraud creditors, or acted with any other fraudulent purpose.

Section 77 (9) of the 2008 Companies Act also has the potential to bring relief to directors. This section will find application to proceedings against a director, provided that the proceedings do not amount to wilful misconduct or wilful breach of trust.⁹⁷ In order for section 77 (9) to apply, the director should illustrate to the court that he or she acted honestly or reasonably. If the court is satisfied that the conduct is honest and reasonable, it would be fair to absolve the director. A court may elect to absolve directors of liability either wholly or partially.

Section 78 (5) and 77(9) as described above can be used by directors as a means of mitigating their liability. In addition to Section 78 (5) and 77(9), section 76 (4) also provides a defence to

⁹⁷ "Claims against directors in terms of the Companies Act, 2008" available at <http://www.werksmans.com/legal-briefs-view/claims-against-directors-in-terms-of-the-companies-act-2008/> accessed on 27 August 2018.

directors. Section 76 (4) can be used to mitigate the increase in standard required by the duty of care and skill.⁹⁸ Section 76(4) will be discussed at length in the next chapter.

2.6 Conclusion

In terms of the common law, breach of a fiduciary duty was determined sui generis. The remedy for breach of a fiduciary duty is restitution to the company for loss suffered by the company or the benefit received by the director as a result of the breach.⁹⁹ The common law Fiduciary duties are now codified in section 76 (3) (a) and (b)¹⁰⁰ Liability for breach is imposed by section 77 of the Companies Act. Section 77 states that breach will give rise to a claim for damages as well as a claim for a disgorgement of profits.¹⁰¹ The claim for disgorgement of profits will arise immediately when the profit is made as a result of the breach of these fiduciary duties.¹⁰² The liability provision imposed by section 77, clearly stipulates that directors' may be held personally liable for the loss. In the case of *Blue Farm Fashion Limited v Rapitrade* section 77 was applied. The judgement indicates that the creditor can hold the director personally liable, changing the common law position.

At common law, the test used to determine breach of the duty of care, skill and diligence was identified in *Fisheries Development Corporation of SA Ltd v Jorgensen*. This test was adopted from English law. It was a dominantly subjective test. The test indicates that a directors'

⁹⁸ Shoeman N. 'How the Companies Act Impacts on Director?' in *Without Prejudice* Vol 13 (Issue 6) (2013) 10 -13.

⁹⁹ Bouwman N 'An Appraisal of the Modification of the Director's Duty of Care and Skill' (2009) 21 *South African Mercantile Law Journal* 510.

¹⁰⁰ Of the Companies Act 71 of 2008.

¹⁰¹ "Act Three: Section 76(3) and the duty of good faith and care" available at <http://www.mondaq.com/southafrica/x/214918/Directors+Officers/The+Standard+of+Directors+Conduct> accessed on 07 February 2017.

¹⁰² "Act Three: Section 76(3) and the duty of good faith and care" available at <http://www.mondaq.com/southafrica/x/214918/Directors+Officers/The+Standard+of+Directors+Conduct> accessed on 07 February 2017.

conduct will only be judged against the actions that are reasonably expected of a person with his knowledge and experience. A low standard of care and skill is required of directors performing their functions.¹⁰³ The duty of care, skill and diligence is now codified in section 76(3) (c).¹⁰⁴ In terms of section 77(2) (b), breach of this duty will result in a claim in delict and is limited to compensation for delictual damages.¹⁰⁵ Partial codification of the duty of care, skill and diligence results in a move from a dominantly subjective approach to an objective-subjective approach. The dual objective-subjective approach can allow the courts to take into account the circumstances of each company and the context in which a director acts in this capacity. It is possible to interpret s76 (3) (c) as imposing an objectively determinable minimum standard to be expected of any director on a case to case basis.

However, no minimum degree of skill, knowledge and experience is prescribed by the Act (but may be prescribed in the company's memorandum of incorporation).¹⁰⁶ Therefore partial codification does not substantially change the common law duty of care and skill. A director may only presumably be held to higher degree of care, skill (and diligence) when he or she possess skill and experience. When directors are held to this higher degree, the business judgement rule may be used as a defence and may potentially be one of the most important mitigations provided by the Act. This will be discussed in the next chapter.

¹⁰³ Shoeman N. 'How the Companies Act Impacts on Director?' in Without Prejudice Vol 13 (Issue 6) (2013) 10 -13.

¹⁰⁴ "Act Three: Section 76(3) and the duty of good faith and care" available at <http://www.mondaq.com/southafrica/x/214918/Directors+Officers/The+Standard+of+Directors+Conduct> accessed on 07 February 2017.

¹⁰⁵ "Act Three: Section 76(3) and the duty of good faith and care" available at <http://www.mondaq.com/southafrica/x/214918/Directors+Officers/The+Standard+of+Directors+Conduct> accessed on 07 February 2017.

¹⁰⁶ Shoeman N. 'How the Companies Act Impacts on Director?' in Without Prejudice Vol 13 (Issue 6) (2013) 10 -13.

Chapter 3

A COMPARITIVE ANALYSIS OF THE BUSINESS JUDGEMENT RULE AND ITS IMPLICATION ON THE PERSONAL LIABILITY OF DIRECTORS, IN TERMS OF THE 2008 COMPANIES ACT

3.1.Introduction

Chapter 3 of this research paper will examine the use of the business judgement rule when it is utilised as a defence by directors against the imputation of personal liability. The chapter will be set out in the following manner: an explanation of the business judgement rule will first be provided followed by a partial comparative study. The comparative study will be conducted by reviewing the American and South African applications of the rule. The comparative study will be set out in a manner that will ascertain the potential impact that the business judgment rule will have on the ability to hold directors personally liable. The comparative study will be limited to the possible implication on the personal liability of directors, subsequent to the enactment of the 2008 Companies Act.

3.2.A general understanding of the business judgement rule

The business judgement rule is commonly known as a legal principle that has the potential to make directors (of a company) immune from liability for loss incurred through corporate transactions.¹⁰⁷ The business judgement rule offers immunity to directors against allegations of a breach of the duty of care, skill and diligence.¹⁰⁸ The rule entails that courts should exercise caution in holding directors liable for bona fide business decisions which result in damage or

¹⁰⁷ Jones E 'Directors' Duties: Negligence and the Business Judgment Rule' (2007) 19 *South African Mercantile Law Journal* 326.

¹⁰⁸Muswaka L 'Directors' Duties and the Business Judgment Rule in South African Company Law: An Analysis' (2003) 3 *International Journal of Humanities and Social Science* 89.

loss to the company.¹⁰⁹ The effect of the application of the business judgment rule is that a director, who made a decision in good faith, with due care and on an informed basis which he or she reasonably believed to be in the best interest of the company, cannot be held liable in respect of that decision.¹¹⁰ The business judgment could be seen as mechanism used to ensure that the sanctity of managerial freedom is maintained. It could be argued that the rule was used to assist in preventing the imposition of personal liability on directors for the conduct or fault of the company by disregarding the corporate veil.¹¹¹

The rule originated in American corporate jurisprudence and is entrenched into the application of its corporate law.¹¹² The rule gained recognition in American corporate law because it recognized the concept of human fallibility.¹¹³ In recognising the concept of human fallibility, the business judgement rule, potentially provides directors with a shield against imputations of liability.¹¹⁴ The potential shield provided by the business judgement rule encourages: (1) risk taking and allowing directors to voluntarily take risk, (2) enables competent persons to serve as directors; (3) prevents judicial second-guessing; (4) allows directors sufficient freedom to manage the company and (5) allows more effective market mechanisms to manage director behaviour.¹¹⁵ Therefore the business judgement rule enables directors to engage in ‘risky’

¹⁰⁹ Von Durckheim L ‘Does South Africa Need a Statutory Business Judgement Rule? (Unpublished LLM Thesis, University of Pretoria, 2012) 5.

¹¹⁰ Von Durckheim L Does South Africa Need a Statutory Business Judgement Rule? (Unpublished LLM Thesis, University of Pretoria, 2012) 5.

¹¹¹ Van Der Linde K ‘The Personal Liability of Directors for Corporate Fault-An Exploration’ (2008) 20 *South African Mercantile Law Journal* 441.

¹¹² Jones E ‘Directors’ Duties: Negligence and the Business Judgment Rule’ (2007) 19 *South African Mercantile Law Journal* 326.

¹¹³ Leach J *The Correct Understanding of the Business Judgment Rule in Section 76(4) of the Companies Act 71 of 2008: Avoiding the American Mistakes* (unpublished LLM thesis, University of Cape Town 2014) 14.

¹¹⁴ Muswaku L ‘Directors’ Duties and the Business Judgment Rule in South African Company Law: An Analysis’ (2013) 3 *International Journal of Humanities and Social Science* 89.

¹¹⁵ Von Durckheim L Does South Africa Need a Statutory Business Judgement Rule? (Unpublished LLM Thesis, University of Pretoria, 2012) 5 see also Nethavhani K *The Business Judgement Rule: Under Erosion of Directors Duty of Care, Skill and Diligence* (Unpublished LLM Thesis, University of Pretoria, 2015) 21.

endeavours which can be of benefit to the company,¹¹⁶ promoting innovation and venturesome business activity,¹¹⁷ without the constant fear of liability.¹¹⁸

A comparative study will now be done. The comparative study will be conducted in a manner that will assist in examining the impact that partial codification has on the personal liability of directors.

3.3.A comparative study of the American and South African approaches to the application of the business judgement rule

The comparative study will first examine the American and South African application of the business judgment rule. The study will consider the application of the business judgement rule in America in an attempt to understand the impact that its partial codification in South Africa (as contained in the 2008 Companies Act) will have on the personal liability of South African directors. The American approach was chosen for this comparison because the business judgement rule has been a cornerstone of the American corporate jurisprudence since the early 19th century.¹¹⁹ South African courts may therefore look to the American application for guidance. In addition, the major similarities between the wordings of the business judgement rule existing in South African and the American corporate law, may make it easier to rely on American precedent.

¹¹⁶ Nethavhani K *The Business Judgement Rule: Under Erosion of Directors Duty of Care, Skill and Diligence* (Unpublished LLM Thesis, University of Pretoria, 2015) 21.

¹¹⁷ Jones E 'Directors' Duties: Negligence and the Business Judgment Rule' (2007) 19 *South African Mercantile Law Journal* 331.

¹¹⁸ Nethavhani K *The Business Judgement Rule: Under Erosion of Directors Duty of Care, Skill and Diligence* (Unpublished LLM Thesis, University of Pretoria, 2015) 21.

¹¹⁹ Leach J *The Correct Understanding of the Business Judgment Rule in Section 76(4) of the Companies Act 71 of 2008: Avoiding the American Mistakes* (Unpublished LLM Thesis, University of Cape Town, 2014) 14.

3.3.1. The application of the business judgment rule in the United States of America

The application of the business judgment rule as applied within the American corporate jurisprudence will now be examined. Research indicates that two formulations of the business judgment rule have been adopted in the United States.¹²⁰ The two approaches adopted in America are the approaches followed by the American Law Institute (herein after referred to as “ALI”) and the approach applied by the Delaware Courts.¹²¹

3.3.1.1. The approach followed by the ALI

The ALI version of the business judgment rule is found in par. 4.01(c) of the ALI Corporate Governance Project. The section states:

“4.01 (c) a director or officer who makes a business judgment in good faith fulfils the [duty of care] if the director or officer:

(1) is not interested in the subject of his business judgment;

(2) is informed with respect to the subject of the business judgment to the extent that the director or officer reasonably believes to be appropriate under the circumstances;

(3) rationally believes the business judgment to be in the best interest of the corporation.”

The application of section 4.01(c) of the ALI Corporate Governance Project contends that a director will escape liability for an alleged breach of the duty of care provided that: (a) the

¹²⁰ Von Durckheim L Does South Africa Need a Statutory Business Judgement Rule? (Unpublished LLM Thesis, University of Pretoria, 2012) 11.

¹²¹ The United States District Court for the District of Delaware is the Federal district court having jurisdiction over the entire state of Delaware. The Delaware court is composed of the Supreme Court, the Court of Chancery, the Superior Court, the Family Court, the Court of Common Pleas, the Justice of the Peace Court, and related judicial agencies. The Court is notable for hearing and trying a large number of patent and other complex commercial disputes.

director made a judgment or decision, (b) as decision maker, the director, was free from conflict of interest, (c) the director exercised reasonable care in making the decision and (d) the director had a rational basis for the decision.¹²²

Once these elements (as stated in a, b, c and d above) are established, the standard required by the duty of care would have also been established and that director will not incur liability for that business decision.¹²³ The practical application of the ALI approach shows that the rule would not serve its function if reasonableness is to be determined because a plenary trial would have to be held.¹²⁴

Therefore, the application of the business judgement rule, as prescribed by the ALI, has the potential to decrease the standard required by the duty of care, skill (and diligence).¹²⁵ The standard is deemed to be decreased because the requirement of reasonableness need not be established.¹²⁶ Once a slight standard of care is established in the decision-making process, a director will have met the burden of proof and escape liability.¹²⁷ Therefore the application prescribed in the approach of the ALI potentially negates the standard prescribed by the duty of care, skill (and diligence).

¹²² Branson D M 'The rule that isn't a rule - The business judgment rule.' (2002) 36 (number 3) *Valparaiso University Law Review* 634.

¹²³ Von Durckheim L Does South Africa Need a Statutory Business Judgement Rule? (Unpublished LLM Thesis, University of Pretoria, 2012) 11.

¹²⁴ Branson D M 'The rule that isn't a rule - The business judgment rule.' (2002) 36 (number 3) *Valparaiso University Law Review* 635.

¹²⁵ Jones E 'Directors' Duties: Negligence and the Business Judgment Rule' (2007) 19 *South African Mercantile Law Journal* 327 and Branson D M 'The rule that isn't a rule - The business judgment rule.' (2002) 36 (number 3) *Valparaiso University Law Review* 634.

¹²⁶ Branson D M 'The rule that isn't a rule - The business judgment rule.' (2002) 36 (number 3) *Valparaiso University Law Review* 634.

¹²⁷ Branson D M 'The rule that isn't a rule - The business judgment rule.' (2002) 36 (number 3) *Valparaiso University Law Review* 635.

The application of the approach explained by the ALI can be seen in the case of *Rosenfield v. Metals Selling Corp.*¹²⁸ The judgement summarised the business judgment rule as a policy of judicial non-interference with business decisions of corporate managers, presuming that they pursue the best interests of their corporations, insulating such managers from second-guessing or liability for their business decisions in the absence of fraud or self-dealing or other misconduct or malfeasance.¹²⁹ The summary of the rule echoes what the application as contended by ALI sought to achieve.

3.3.1.2. The application of the business judgement rule applied by the Delaware Courts

The application of the business judgement rule, as applied by the Delaware Courts, describes the rule as a presumption.¹³⁰ The case of *Aronson v Lewis*¹³¹ describes the presumption in the following manner:

‘The rule is a rebuttable presumption that directors are better equipped than the courts to make business judgments and that the directors acted without self-dealing or personal interest and exercised reasonable diligence and acted with good faith.’

The practical effect of the business judgement rule, as applied by the Delaware Courts, specifies that the shareholder (plaintiff) is required to establish that directors did not comply with the elements of the rule. If shareholders are unable to prove that directors did not comply

¹²⁸ *Rosenfield v. Metals Selling Corp.*, 643 A.2d 1253, 1261 (Conn. 1994).

¹²⁹ See also *Omnibank v. United S. Bank*, 607 So. 2d 76, 85 (Miss. 1992); *Cuker v. Mikalauskas*, 692 A.2d 1042, 1045- 46 (Pa. 1997).

¹³⁰ Jones E ‘Directors’ Duties: Negligence and the Business Judgment Rule’ (2007) 19 *South African Mercantile Law Journal* 329.

¹³¹ *Aronson v Lewis* 473 A 2d 805, 812 (Del 1984).

with the elements, the decisions made by directors, will be respected by the courts and directors will be exonerated from the claim of personal liability.¹³²

In the case of *Arson v Lewis*,¹³³ the Plaintiff (and others) brought a shareholders' derivative action. The derivative action was brought to contest the employment contract and interest free loan granted to a Leo Fink (Fink). Fink was a 47% stockholder of Defendant (Meyers Parking Systems Inc.). The Delaware Court found that the plaintiff failed to raise a reasonable doubt that the directors' actions would be protected under the business judgment rule. The Delaware Court dismissed the derivative action. In dismissing the derivative action, the Delaware Court found application of the business judgment rule. In its finding, the Delaware court, reiterated the important role that the business judgment rule plays in maintaining directors' managerial freedom to make decisions in the best interest of the company. The court maintained that in order to have successfully raised a reasonable doubt, the plaintiff must allege specific facts that cause reasonable doubt that (1) the directors are disinterested and independent and (2) the challenged transaction was otherwise the product of a valid exercise of business judgment.

The Delaware court's application of the rule therefore places a reverse onus of proof when compared to the ALI application of the rule. The two approaches may cause inconsistencies in the application of the rule. These inconsistencies will impact the application of the rule in the South African context because section 5(2) of the 2008 Companies Act empowers our courts to consider foreign company law in appropriate circumstances. Despite such discrepancies consideration of American case law is essential because the business judgment rule is a fairly

¹³² Mupangvanhu B M Directors' Standards Of Care, Skill, Diligence, And The Business Judgment Rule In View Of South Africa's Companies Act 71 Of 2008: Future Implications For Corporate Governance (Unpublished PHD, University of Cape Town, 2016) 178.

¹³³ *Aronson v. Lewis*, 473 A.2d 805, 1984 Del. LEXIS 305 (Del. Mar. 1, 1984).

new concept to South African corporate law. South African courts are therefore likely to look to American precedent when applying the business judgment rule.¹³⁴

3.3.2. The South African Interpretation of the Business Judgement Rule

The business judgement rule has been codified with the enactment of the 2008 Companies Act.¹³⁵ It is set out in Section 76(4) of the 2008 Companies Act. Section 76(4) of the 2008 Companies Act states:

'In respect of any particular matter arising in the exercise of the powers or the performance of the functions of director, a particular director of a company, will have satisfied the obligations of subsection (3) (b) and (c) if—

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

(ii) either—

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

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

¹³⁴ Kanamugire J C and Chimuka T V 'The Directors' Duty to Exercise Care and Skill in Contemporary South African Company Law and the Business Judgment Rule' (2005) 5 *Mediterranean Journal of Social Sciences* 70.

¹³⁵ Kanamugire J C and Chimuka T V 'The Directors' Duty to Exercise Care and Skill in Contemporary South African Company Law and the Business Judgment Rule' (2005) 5 *Mediterranean Journal of Social Sciences* 76.

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

A director will be exempt from liability provided that: (i) a director has taken reasonably diligent steps to become informed about the matter, (ii) either had no conflict of interest in relation to the matter or (iii) complied with the rules on conflict of interests and had a rational basis for believing and did believe, that his decision was in the best interest of the company. Section 76(4) should be interpreted in a manner in which the subjective element does not undermine the objective elements of the business judgement rule in the subsection.¹³⁶ However, section 76(4) should be interpreted in a manner which enhances the entire standard of review.¹³⁷ A rational belief may be interpreted to be one that no reasonable person in the position of the director can conclude or hold.¹³⁸ The rule may then be relied upon by directors as a shield against the imputations of liability¹³⁹ to disprove allegations that they acted in breach of their duties.¹⁴⁰ A major difference between the American and South African versions of the business judgement rule is exclusion of the ‘good faith’ requirement.¹⁴¹ The American

¹³⁶ Mupangavanhu B M *Directors’ Standards Of Care, Skill, Diligence, And The Business Judgment Rule In View Of South Africa’s Companies Act 71 Of 2008: Future Implications For Corporate Governance* (Unpublished PHD, University of Cape Town, 2016) 178.

¹³⁷ Mupangavanhu B M *Directors’ Standards Of Care, Skill, Diligence, And The Business Judgment Rule In View Of South Africa’s Companies Act 71 Of 2008: Future Implications For Corporate Governance* (Unpublished PHD, University of Cape Town, 2016) 178.

¹³⁸ Mupangavanhu B M *Directors’ Standards Of Care, Skill, Diligence, And The Business Judgment Rule In View Of South Africa’s Companies Act 71 Of 2008: Future Implications For Corporate Governance* (Unpublished PHD, University of Cape Town, 2016) 178.

¹³⁹ Muswaka L ‘Shielding Directors against Liability Imputations: The Business Judgment Rule and Good Corporate Governance’ (2003) 1 *Speculum Juris* 25.

¹⁴⁰ ‘The Business Judgement Test’ available at <http://www.vdma.co.za/business-judgement-test/> accessed on 20 March 2016.

¹⁴¹ Mupangavanhu B M *Directors’ Standards Of Care, Skill, Diligence, And The Business Judgment Rule In View Of South Africa’s Companies Act 71 Of 2008: Future Implications For Corporate Governance* (Unpublished PHD, University of Cape Town, 2016) 178.

application of the rule, places an emphasis on the requirement of good faith while the South African application of the rule tacitly excludes the requirement and makes reference to the duty of care and duty to act in the best interests of the company.¹⁴²

In the recent case of *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd*,¹⁴³ the court applied section 76(4). In the case, the court considered an application concerning the refusal by the board of Goede Hoop Sitrus (Pty) Ltd to approve a transfer by Visser Sitrus (Pty) Ltd to Mouton Sitrus of the shares held by Visser Sitrus (Pty) Ltd in Goede Hoop Sitrus (Pty) Ltd. Visser Sitrus (Pty) Ltd sought to compel Goede Hoop Sitrus (Pty) Ltd to register the transfer by claiming relief in terms of section 163 of the Act.

The court was required to make a decision on the board's refusal to transfer shares from Visser Sitrus (Pty) Ltd to the Mouton Sitrus. When concluding its judgement, the court found that Visser Sitrus (Pty) Ltd had not alleged that the directors failed to take reasonably diligent steps to inform themselves of the facts relevant to the decision taken to refuse transfer of the shares. The directors had in fact been of the bona fide view that the best interests of the company would not be served by consenting to the transfer of the shares in question.¹⁴⁴ The court had no doubt that sufficient information was available for the directors to make a proper assessment. In that the directors had a rational belief that their decision was in the best interests of the company. In the consideration of the action taken by the board to refuse the transfer of shares, the court found that it was in the best interests of the company to refuse the transfer of said shares.¹⁴⁵

¹⁴² Mupangavanhu B M *Directors' Standards Of Care, Skill, Diligence, And The Business Judgment Rule In View Of South Africa's Companies Act 71 Of 2008: Future Implications For Corporate Governance* (Unpublished PHD, University of Cape Town, 2016) 178.

¹⁴³ *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd and Others* 2014 (5) SA 179 (WCC).

¹⁴⁴ *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd and Others* 2014 (5) SA 179 (WCC) para 82.

¹⁴⁵ *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd and Others* 2014 (5) SA 179 (WCC) para 81.

3.4. Conclusion

Research suggests that in application of common law, the courts exercised judicial restraint when assessing directors' compliance with his or her duty of care and skill.¹⁴⁶ Restraint was extended by courts in an attempt to ensure that directors retain managerial freedom and to cater for the skill (or lack thereof) of directors. The enactment of the 2008 Companies Act, has since partially codified a director's duty of care and skill. The partial codification of said duty increases the standard of care, skill (and diligence) expected from a director when that director possesses skill (reasonably expected of a director in a similar position).¹⁴⁷ In these instances a director who fails to observe his or her codified duties of care and skill to the company, can be held liable in delict for damages.¹⁴⁸ In order to limit the effects of the increased standard, the 2008 Companies Act, imported the American business judgment rule as a defence which can be used (by directors) to mitigate the effects of codification.¹⁴⁹ South African courts are now required to consider the foreign judicial decisions (predominantly the American) as guidance when applying the business judgement rule.¹⁵⁰ South African courts are to consider the decisions made in American judiciary because; the business judgement was introduced there and the concept (business judgment rule) is fairly new South Africa. Inconsistency in South Africa's application may arise because American Courts do not have a single method of interpreting the rule. There are two methods that are followed in American corporate

¹⁴⁶ Cassim FHI 'Fraudulent or reckless trading and s424 of the Companies Act of 1973' (1981) 98 *South African Law Journal* 162.

¹⁴⁷ Shoeman N. 'How the Companies Act Impacts on Director?' in *Without Prejudice* Vol 13 (Issue 6) (2013) 10 -13; see also Kanamugire J C and Chimuka T V 'The Directors' Duty to Exercise Care and Skill in Contemporary South African Company Law and the Business Judgment Rule' (2005) 5 *Mediterranean Journal of Social Sciences* 76.

¹⁴⁸ Kanamugire J C and Chimuka T V 'The Directors' Duty to Exercise Care and Skill in Contemporary South African Company Law and the Business Judgment Rule' (2005) 5 *Mediterranean Journal of Social Sciences* 76.

¹⁴⁹ Kanamugire J C and Chimuka T V 'The Directors' Duty to Exercise Care and Skill in Contemporary South African Company Law and the Business Judgment Rule' (2005) 5 *Mediterranean Journal of Social Sciences* 76.

¹⁵⁰ See section 5(2) of the Companies Act 71 of 2008; see also Kanamugire J C and Chimuka T V 'The Directors' Duty to Exercise Care and Skill in Contemporary South African Company Law and the Business Judgment Rule' (2005) 5 *Mediterranean Journal of Social Sciences* 76.

jurisprudence. The two approaches are: the application of the business judgment rule by the ALI and the application of the business judgment by the Delaware Courts.

In short, the ALI application of the rule, requires proof that; 1) a judgment or decision was made; 2) free from disabling conflicts of interest; 3) the decision maker exercised some (not necessarily reasonable) care in informing themselves about the matter decided; 4) they had a rational (not necessarily reasonable) basis for the decision they made. While the Delaware application treats the rule as presumption and places the onus on the shareholder to disprove.

In the next chapter a conclusion will be drawn to determine the impact that the partial codification of the fiduciary duties as well as the duty of care and skill will have on the personal liability of directors. Consideration will be given to the use of both approaches (ALI and Delaware Court) as well as how each of these approaches will impact personal liability.



Chapter 4

Conclusion

The Department of Trade and Industry recognised the need to bring South African company law in line with international corporate law developments. It sought to bring it in line with international trends in order to facilitate easier international trade and efficiency. In so doing, it recognised the need to have a statutory dispensation that contained the duties of directors. As illustrated in Chapter 2 and 3, the fiduciary duties, duty of care and skill as well as the business judgement rule are partially codified in the South African Companies Act 71 Of 2008.¹⁵¹

Partial codification, as contained in the 2008 Companies Act, creates a standard of directors' conduct and is a restatement of the common law fiduciary duties and the duty of care and skill.¹⁵² It is a method of attaining uniformity in South African company law, making it more accessible and has the potential to provide simplicity and legal clarity.¹⁵³ Despite these perceived benefits that partial codification has on South African company law as a whole, a conclusion will now be drawn to decipher the impact that it has on the personal liability of directors. Its impacts will be considered in relation to the fiduciary duty and thereafter to the duty of care and skill when the business judgement rule is used as a defence to liability imputations.

¹⁵¹ Coetzee L and Van Tonder J 'Advantages and disadvantages of partial codification of directors' duties in the South African Companies Act 71 of 2008' (2016) 41 (2) *Journal for Judicial Science* 1; Bouwman N 'An appraisal of the Modification of a Director's Duty of Care and Skill (2009) 21 *South African Mercantile Law Journal* 509.

¹⁵² Coetzee L and Van Tonder J 'Advantages and disadvantages of partial codification of directors' duties in the South African Companies Act 71 of 2008' (2016) 41 (2) *Journal for Judicial Science* 3.

¹⁵³ Coetzee L and Van Tonder J 'Advantages and disadvantages of partial codification of directors' duties in the South African Companies Act 71 of 2008' (2016) 41 (2) *Journal for Judicial Science* 4.

4.1 Personal liability implications due to the partial codification of fiduciary duties

In terms of the common law, the remedy for breach of a fiduciary duty is restitution to the company for loss suffered by the company or the benefit received by the director as a result of the breach.¹⁵⁴ The 2008 Companies Act partially codifies the fiduciary duty in section 76 (3) and liability for breach of these duties is imposed by section 77 of the Act. Judicial decisions suggest that courts make use of a narrow method of interpretation when interpreting this section.¹⁵⁵ With the use of the narrow method of interpretation, the section means that directors of a company are liable for loss, damages or costs sustained by the company as a direct or indirect consequence of the director having acquiesced in the carrying on of the company's business despite knowing that such conduct is prohibited by Section 22(1) or being party to an act or omission by the company despite knowing that the act or omission was calculated to defraud a company creditor, employee or shareholder, or had another fraudulent purpose. It therefore implies that a breach of these fiduciary duties will give rise to a claim for damages as well as a claim for a disgorgement of profits.¹⁵⁶ The claim for disgorgement of profits will arise immediately when the profit is made as a result of the breach of these fiduciary duties.¹⁵⁷ The liability provision imposed by section 77, clearly stipulates that directors' may be held personally liable for the loss.

Partial codification (of the fiduciary duty) results a change to the common law position because a director may now be held personally liable to a third party creditor for loss and damages

¹⁵⁴ Bouwman N 'An Appraisal of the Modification of the Director's Duty of Care and Skill' (2009) 21 *South African Mercantile Law Journal* 510.

¹⁵⁵ *Blue Farm Fashion Limited v Rapitrade 6 (Pty) Ltd* and others (2016) ZAWHC.

¹⁵⁶ "Act Three: Section 76(3) and the duty of good faith and care" available at <http://www.mondaq.com/southafrica/x/214918/Directors+Officers/The+Standard+of+Directors+Conduct> accessed on 07 February 2017.

¹⁵⁷ "Act Three: Section 76(3) and the duty of good faith and care" available at <http://www.mondaq.com/southafrica/x/214918/Directors+Officers/The+Standard+of+Directors+Conduct> accessed on 07 February 2017.

occasioned as a result of a breach thereof. It is not only the company who has a claim against a director who breached any of the provisions in section 77(2) and (3) of the Companies Act. In addition, the Act leaves room for common law liability.

4.2 Personal liability implications resulting from the partial codification of the duty of care and skill

The duty of care and skill (and diligence) owed by a director to the company is found in section 76 (3) (c) of the Act.¹⁵⁸ The test to determine compliance with section 76 (3) (c) (of Companies 2008 Act) is a subjective-objective test.¹⁵⁹ Compliance with the section is determined against the conduct that is reasonably expected of a director with general knowledge, skill and experience of a director with same general knowledge, skill and experience¹⁶⁰. The degree of care, skill and diligence required is not that of a reasonable person but rather what is reasonably expected of a person with general knowledge, skill and experience against a director with comparable general knowledge, skill and experience.¹⁶¹

The requirement of a prescribed skill results in a move from a lenient approach (the lenient approach resulted in directors only being held liable in instances of gross negligence¹⁶²) to a more stringent approach.¹⁶³ The skill requirement encourages a higher standard of care that is

¹⁵⁸ “Act Three: Section 76(3) and the duty of good faith and care” available at <http://www.mondaq.com/southafrica/x/214918/Directors+Officers/The+Standard+of+Directors+Conduct> accessed on 07 February 2017.

¹⁵⁹ Du Plessis J J ‘A comparative analysis of directors’ duties of care, skill and diligence in South Africa and Australia’ (2010) *Acta Juridica* 269.

¹⁶⁰ Du Plessis J J ‘A comparative analysis of directors’ duties of care, skill and diligence in South Africa and Australia’ (2010) *Acta Juridica* 269.

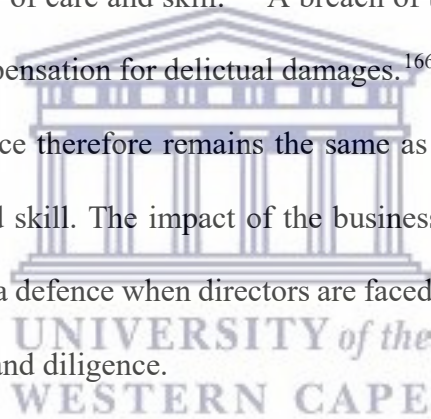
¹⁶¹ Du Plessis J J ‘A comparative analysis of directors’ duties of care, skill and diligence in South Africa and Australia’ (2010) *Acta Juridica* 270.

¹⁶² Bouwman N ‘An Appraisal of the Modification of the Director’s Duty of Care and Skill’ (2009) 21 *South African Mercantile Law Journal* 512.

¹⁶³ Bouwman N ‘An Appraisal of the Modification of the Director’s Duty of Care and Skill’ (2009) 21 *South African Mercantile Law Journal* 512.

to be observed by directors. The skill requirement will however be determined on a case by case basis because the Act does not prescribe a minimum degree of skill. Partial codification results in directors being held to a higher standard of care, skill and diligence when performing functions for the company, as directors of said company if the director under review possesses more skill than that which can generally be expected from a person who carries those functions. In the alternate, a lower standard will be required from a director who has general knowledge, skill and experience that are lower than those that could generally be expected from a person who carries those functions.¹⁶⁴

A breach of said duty is governed by section 77 (2) (b). The section reiterates the common law position for breach of the duty of care and skill.¹⁶⁵ A breach of this duty will result in a claim in delict and is limited to compensation for delictual damages.¹⁶⁶ The remedy for breach of the duty of care, skill and diligence therefore remains the same as the remedy for breach of the common law duty of care and skill. The impact of the business judgement rule will now be considered, when it is used as a defence when directors are faced with a claim for breach of the duty of the duty of care, skill and diligence.



¹⁶⁴ Mupangavanhu B M *Directors' Standards Of Care, Skill, Diligence, And The Business Judgment Rule In View Of South Africa's Companies Act 71 Of 2008: Future Implications For Corporate Governance* (Unpublished PHD, University of Cape Town, 2016) 131.

¹⁶⁵ "Act Three: Section 76(3) and the duty of good faith and care" available at <http://www.mondaq.com/southafrica/x/214918/Directors+Officers/The+Standard+of+Directors+Conduct> accessed on 07 February 2017.

¹⁶⁶ "Act Three: Section 76(3) and the duty of good faith and care" available at <http://www.mondaq.com/southafrica/x/214918/Directors+Officers/The+Standard+of+Directors+Conduct> accessed on 07 February 2017.

4.2.1 Application of the business judgment rule as a defence

The American business judgment rule as a defence which can be used (by directors) to mitigate the effects of codification, when directors have met the skill requirement.¹⁶⁷ South African courts may consider the decisions taken in American judiciary because the business judgment was derived from American corporate law. The two approaches are: the application of the business judgment rule by the ALI and the application of the business judgment by the Delaware Courts.

The ALI application of the rule requires proof that; a) a judgment or decision was made; b) free from disabling conflicts of interest; c) the decision maker exercised some (not necessarily reasonable) care in informing themselves about the matter decided; d) they had a rational (not necessarily reasonable) basis for the decision they made. The Delaware application on the other hand, treats the rule as presumption. The presumption is that directors are better equipped than the courts to make business judgments and that the directors acted without self-dealing or personal interest and exercised reasonable diligence and acted with good faith. The Delaware approach places the onus on the shareholder claiming breach to prove that a director acted in bad faith.

At first glance section 76(4) appears to resemble 4.01(c) of the ALI Corporate Governance Project. The similarities can be found in the wording and application section 76 (4) and 4.01(c) of the ALI Corporate Governance Project. In addition, 76 (4) and 4.01(c) of the ALI Corporate Governance Project does not function as a presumption like the Delaware application (of the business judgement rule). It is therefore more likely that courts will use precedent in which the ALI approach was used. However, when South African courts select an approach to follow, it

¹⁶⁷ Kanamugire J C and Chimuka T V 'The Directors' Duty to Exercise Care and Skill in Contemporary South African Company Law and the Business Judgment Rule' (2005) 5 *Mediterranean Journal of Social Sciences* 76.

should consider that the majority of South African directors are not professionals and do not always enjoy easy access to competent professional advice or the assistance of highly skilled employees.¹⁶⁸ Many South African directors will be unlikely to meet the increase in the standard that must be observed by them by the 2008 Companies Act. The implementation of the ALI approach would lesser standard of care while the Delaware approach to the business judgment rule reverses the onus of proof but does not lessen the care standard. The use of the ALI approach may therefore cater for the lack of skill of many South African directors due to the lessened standard of care that is required when meeting the onus of proof.

Partial codification presents an increase of the standard of care, skill and diligence when the director under review has general knowledge skill and experience that is reasonably expected of a person holding that position. When a director has less skill than that which is reasonably expected, he or she will be held to a lower standard because the act does not prescribe a minimum skill requirement. When a director is found personally liable, the business judgment rule can be used as a defence, provided that the director has taken reasonably diligent steps to become informed about the matter, either had no conflict of interest in relation to the matter or complied with the rules on conflict of interests and had a rational basis for believing and did believe and the decision was in the best interest of the company.

In conclusion, partial codification of the common law fiduciary duties as well as the duty of care and skill brings about a change to the common law position. The changes brought about results in directors being held to a higher standard of care and skill and increases the scope of to whom directors can be held personally liable. The judiciary will however play a substantial role in reinforcing the effects of partial codification.

¹⁶⁸ 'South Africa: The Standard of Directors Conduct - Unpacking Section 76 of the Companies Act 71 Of 2008' available at <http://www.mondaq.com/southafrica/x/214918/Directors+Officers/The+Standard+of+Directors+Conduct> accessed on 13 September 2017.

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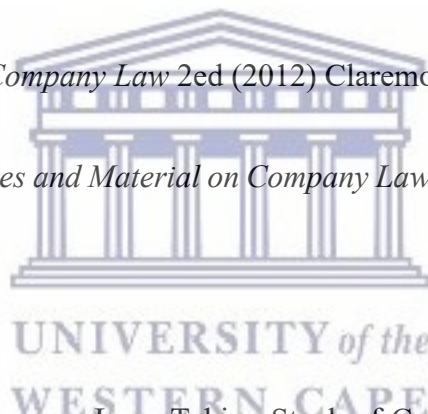
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