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### **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.<sup>107</sup> The business judgement rule offers immunity to directors against allegations of a breach of the duty of care, skill and diligence.<sup>108</sup> The rule entails that courts should exercise caution in holding directors liable for bona fide business decisions which result in damage or

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

<sup>108</sup>Muswaka 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.<sup>109</sup> 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.<sup>110</sup> 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.<sup>111</sup>

The rule originated in American corporate jurisprudence and is entrenched into the application of its corporate law.<sup>112</sup> The rule gained recognition in American corporate law because it recognized the concept of human fallibility.<sup>113</sup> In recognising the concept of human fallibility, the business judgement rule, potentially provides directors with a shield against imputations of liability.<sup>114</sup> 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.<sup>115</sup> Therefore the business judgement rule enables directors to engage in ‘risky’

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 (Unpublished LLM Thesis, University of Pretoria, 2012) 5.

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 (Unpublished LLM Thesis, University of Pretoria, 2012) 5.

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

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

<sup>113</sup> 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.

<sup>114</sup> 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.

<sup>115</sup> 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,<sup>116</sup> promoting innovation and venturesome business activity,<sup>117</sup> without the constant fear of liability.<sup>118</sup>

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 19<sup>th</sup> century.<sup>119</sup> 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.

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

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

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

<sup>119</sup> 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.<sup>120</sup> 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.<sup>121</sup>

#### 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

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

<sup>121</sup> 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.<sup>122</sup>

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.<sup>123</sup> 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.<sup>124</sup>

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).<sup>125</sup> The standard is deemed to be decreased because the requirement of reasonableness need not be established.<sup>126</sup> 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.<sup>127</sup> Therefore the application prescribed in the approach of the ALI potentially negates the standard prescribed by the duty of care, skill (and diligence).

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

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

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

<sup>125</sup> 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.

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

<sup>127</sup> 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.*<sup>128</sup> 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.<sup>129</sup> 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.<sup>130</sup> The case of *Aronson v Lewis*<sup>131</sup> 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

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

<sup>129</sup> 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).

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

<sup>131</sup> *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.<sup>132</sup>

In the case of *Arson v Lewis*,<sup>133</sup> 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

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<sup>132</sup> 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.

<sup>133</sup> *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.<sup>134</sup>

### **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.<sup>135</sup> 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*

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<sup>134</sup> 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.

<sup>135</sup> 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.<sup>136</sup> However, section 76(4) should be interpreted in a manner which enhances the entire standard of review.<sup>137</sup> A rational belief may be interpreted to be one that no reasonable person in the position of the director can conclude or hold.<sup>138</sup> The rule may then be relied upon by directors as a shield against the imputations of liability<sup>139</sup> to disprove allegations that they acted in breach of their duties.<sup>140</sup> A major difference between the American and South African versions of the business judgement rule is exclusion of the ‘good faith’ requirement.<sup>141</sup> The American

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<sup>136</sup> 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.

<sup>137</sup> 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.

<sup>138</sup> 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.

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

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

<sup>141</sup> 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.<sup>142</sup>

In the recent case of *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd*,<sup>143</sup> 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.<sup>144</sup> 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.<sup>145</sup>

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<sup>142</sup> 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.

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

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

<sup>145</sup> *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.<sup>146</sup> 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).<sup>147</sup> 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.<sup>148</sup> 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.<sup>149</sup> South African courts are now required to consider the foreign judicial decisions (predominantly the American) as guidance when applying the business judgement rule.<sup>150</sup> 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

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

<sup>147</sup> 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.

<sup>148</sup> 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.

<sup>149</sup> 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.

<sup>150</sup> 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.<sup>151</sup>

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.<sup>152</sup> 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.<sup>153</sup> 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.

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<sup>151</sup> 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.

<sup>152</sup> 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.

<sup>153</sup> 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.<sup>154</sup> 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.<sup>155</sup> 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.<sup>156</sup> The claim for disgorgement of profits will arise immediately when the profit is made as a result of the breach of these fiduciary duties.<sup>157</sup> 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

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

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

<sup>156</sup> "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.

<sup>157</sup> "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.<sup>158</sup> The test to determine compliance with section 76 (3) (c) (of Companies 2008 Act) is a subjective-objective test.<sup>159</sup> 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 experience<sup>160</sup>. 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.<sup>161</sup>

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 negligence<sup>162</sup>) to a more stringent approach.<sup>163</sup> The skill requirement encourages a higher standard of care that is

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<sup>158</sup> “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.

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

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

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

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

<sup>163</sup> 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.<sup>164</sup>

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.<sup>165</sup> A breach of this duty will result in a claim in delict and is limited to compensation for delictual damages.<sup>166</sup> 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.

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<sup>164</sup> 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.

<sup>165</sup> "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.

<sup>166</sup> "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.



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.<sup>168</sup> 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.

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<sup>168</sup> '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.















