



**THE INFLUENCE OF SECTION 78 OF THE COMPANIES ACT 71 OF 2008 ON PERSONAL  
LIABILITY INSURANCE TAKEN OUT BY DIRECTORS OF COMPANIES**

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BY

**ELRICA GAYLON VAN STADEN**  
**(STUDENT NUMER: 3146880)**

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**SUPERVISOR: DR YVETTE BASSON**

(Mercantile and Labour Law Department)

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## CHAPTER 1: INTRODUCTION TO STUDY

### 1.1 Background to the research problem

In order to understand the context of the research paper, a brief discussion has to be made as to the important fact that a director has to be appointed in a role to assist with the decision-making in running of a company.<sup>1</sup> A director is an officer of a company that is ordinarily appointed in order to make daily business reporting, decisions and to take business risks on behalf of the company.<sup>2</sup> When taking up a position as a director, duties and responsibilities must be fulfilled. A failure to comply with these duties will result in serious consequences for the company and often for the director himself.<sup>3</sup> Director's fiduciary duties previously developed from our common law and was established through the precedents set by our courts.<sup>4</sup> These duties were partially codified in the Companies Act 71 of 2008.<sup>5</sup> It can be clearly seen that the Companies Act 61 of 1973, only mentions the duties but does not specify directly the types of duties.<sup>6</sup> The standard of conduct expected of directors is provided for in section 76 of the Companies Act 71 of 2008.<sup>7</sup> Furthermore, section 77 contains the liability of directors for any breach of their duties.<sup>8</sup> This raises the point that a director can incur various type of liability for a breach of their duties. The type of liability that can be incur is personal liability and criminal liability.<sup>9</sup>

The exemption from or indemnity against the liability of directors and officers of a company was previously dealt with in Section 247 of the Companies Act 61 of 1973 (herein after the 1973 Act);<sup>10</sup> now in terms of Section 78 of the Companies Act 71 of 2008 (herein after the

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<sup>1</sup> Cassim F, Cassim M & Cassim R 'et al' *Contemporary Company Law 2ed* (2012) 523.

<sup>2</sup> Cassim F, Cassim M & Cassim R 'et al' *Contemporary Company Law 2ed* (2012) 375.

<sup>3</sup> Cassim F, Cassim M & Cassim R 'et al' *Contemporary Company Law 2ed* (2012) 484.

<sup>4</sup> Werksmans Attorneys 'Claims against directors in terms of the Companies Act, 2008' available at <https://www.werksmans.com/legal-updates-and-opinions/claims-against-directors-in-terms-of-the-companies-act-2008/> (accessed 2 July 2019).

<sup>5</sup> Coetzee L, Van Tonder JL 'Advantages and disadvantages or partial codification of directors' duties in South African Companies Act 71 of 2008' *Journal for Juridical Science*: Vol. 41 No. 2 (2016) 2.

<sup>6</sup> Section 76 of the Companies Act 71 of 2008.

<sup>7</sup> Bekink M 'Indemnification and Aspects of Directors' and Officers' Liability Insurance in Terms of Section 78 of the Companies Act 71 of 2008', 23 *S. Afr. Mercantile L.J.* (2011) 88.

<sup>8</sup> Section 77 of the Companies Act 71 of 2008.

<sup>9</sup> Van der Linde K 'The Personal Liability of Directors for Corporate Fault - An Exploration' (2008) 20 *S. Afr. Mercantile L.J.* 439.

<sup>10</sup> Section 247 of the Companies Act 61 of 1973.

2008 Act).<sup>11</sup> Section 247 (1) of the 1973 Act provides that

‘any provision contained in the articles of a company or in any contract with a company, which exempts any director from any liability which by law would otherwise attach to him in respect of any negligence, default, breach of duty or breach of trust of which he may be guilty in relation to the company, or purports to indemnify him against any such liability, is void’.<sup>12</sup>

Furthermore, a company is permitted to take out insurance as “indemnification against any liability of any director or officer towards the company in respect of any negligence, default, breach of duty or trust”.<sup>13</sup> Furthermore, the insurance policy taken by the company protects the company against any damages caused by the wrongful act of the directors and permits the company to pay the insurance premiums of the policy taken.<sup>14</sup> This leaves the fact that the director is not protected by the insurance policy but the company and that the director will remain liable for any damages caused to the company which stems from their negligence, default, breach of duty or breach of trust.<sup>15</sup>

Section 78(2) of the 2008 Act new act provides that

‘any agreement, provision in the Memorandum of Incorporation (MOI) or rules of the company, or resolution which directly or indirectly relieves a director of liability in regard to the duties contemplated in sections 75 and 76 and liability contemplated in section 77 or which serves to negate, limit or restrict any legal consequence arising from the act or omission that constitutes wilful misconduct or wilful breach of trust on the part of the director, is void’.<sup>16</sup>

It is further noted that in terms of indemnification, ‘a company may indemnify a director in

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<sup>11</sup> Section 78 of the Companies Act 71 of 2008.

<sup>12</sup> Section 247 (1) of the Companies Act 61 of 1973.

<sup>13</sup> Cliffe Dekker Hofmeyr ‘Directors’ liability insurance under the new act’ available at <https://www.cliffedekkerhofmeyr.com/en/news/press-releases/2010/directors-liability-insurance.html> (accessed 2 July 2019).

<sup>14</sup> Cassim M. F ‘Obstacles and Barriers to the Derivative Action: Costs Orders under Section 165 of the Companies Act of 2008 (Part 2), 26 *S. Afr. Mercantile L.J.* 228 (2014) 240.

<sup>15</sup> Cliffe Dekker Hofmeyr ‘Directors’ liability insurance under the new act’ available at <https://www.cliffedekkerhofmeyr.com/en/news/press-releases/2010/directors-liability-insurance.html> (accessed 2 July 2019).

<sup>16</sup> Section 78 (2)(a) –(b) of the Companies Act 71 of 2008.

respect of any liability arising other than as contemplated in section 78 (6)'.<sup>17</sup> A company may also purchase insurance to protect a director and the company itself against liability or expenses where the company is allowed to indemnify a director as provided for in section 78 (7).<sup>18</sup>

As per Section 78 (7) of the new act, it provides that a company is able to purchase insurance for both the director or the company to protect against any liability or expenses for which the company is allowed to indemnify a director in line with Section 78 (5) of the new act.<sup>19</sup> The limitations provided for in Section 78 (6) of the new act read with the provisions as per Section 78 (5) stipulates that a company will be able to indemnify a director in terms of any liability arising otherwise than due to certain wilful, fraudulent or reckless misconduct on his part or against any fine forced in respect of any national legislation.<sup>20</sup> When comparing Section 78 (7) of the new act to the old act, a concurrent restriction and expansion of the comparable provisions is noted. In future a company will not be able to purchase insurance protecting itself against the director's liability to the company derived from certain wilful, fraudulent or reckless misconduct. As with the old act, nothing prohibited the director and the company from committing to purchase insurance for protection.

As noted in a very popular case involving the Steinhoff scandal<sup>21</sup> which involved Steinhoff International Holdings NV,<sup>22</sup> executives of the company were under scrutiny for the alleged breach of their financial reporting duties. This case is a perfect example of how alleged accounting fraud conducted by auditors, asset managers and non- executive directors resulted

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<sup>17</sup> Section 78 (5) of the Companies Act 71 of 2008.

<sup>18</sup> Section 78 (7) of the Companies Act 71 of 2008.

<sup>19</sup> Cliffe Dekker Hofmeyr 'Directors' liability insurance under the new act' available at <https://www.cliffedekkerhofmeyr.com/en/news/press-releases/2010/directors-liability-insurance.html> (accessed 2 July 2019).

<sup>20</sup> Cliffe Dekker Hofmeyr 'Directors' liability insurance under the new act' available at <https://www.cliffedekkerhofmeyr.com/en/news/press-releases/2010/directors-liability-insurance.html> (accessed 2 July 2019).

<sup>21</sup> Cronje 'German prosecutors still probing Steinhoff for possible accounts fraud' 07 December 2017, available at <https://www.fin24.com/Companies/Retail/german-prosecutors-still-probing-steinhoff-for-possible-accounts-fraud-20171207> (accessed on 30 June 2019).

<sup>22</sup> *De Bruyn v Steinhoff International Holdings N.V. and Others* (29290/2018) [2020] ZAGPJHC 145 (26 June 2020).



in a breach of their fiduciary duties to act in the best interests of the company,<sup>23</sup> and also negligently failed to act with the necessary duty of care, skill and diligence.<sup>24</sup> This case is important for my research paper as it highlights the disregard for fiduciary duties when failing to act in the best interests of the company when taking up position as director or officer. The journal article ‘D and O insurance for directors and officers - what is this and is it a viable option in South African law?’ is worth referencing as it gives a detail explanation as to what the insurance is that is available as protection to directors .<sup>25</sup>

In terms of the previous Act 1973, no protection was provided for directors to protect themselves against liability and financial risk.<sup>26</sup> Section 247 prohibited a company from indemnifying or insuring its directors or officers in respect of any liability of the directors to the company previously.<sup>27</sup> This shortcoming of protection has since been addressed in terms of section 78 of Act 2008, however, there still remain instances where a company is unable to indemnify or insure its directors.<sup>28</sup> There are still gaps seen within the amount of protection available to directors and officers, as there is no statutory obligation on a company to indemnify or take out insurance for their directors for breach of duty or negligence on their part.<sup>29</sup> Which leaves the director still vulnerable and to be held liable with limited protection available.

## 1.2 Research Question

The main research question is whether the current South African company law and personal

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<sup>23</sup> s76 (3) (b) of the Companies Act 71 of 2008.

<sup>24</sup> s76(3) (c) of the Companies Act 71 of 2008.

<sup>25</sup> Spisto M ‘D and O insurance for directors and officers - what is this and is it a viable option in South African law?’ (1996) CILSA 62 - 70.

<sup>26</sup> Spisto M ‘D and O insurance for directors and officers - what is this and is it a viable option in South African law?’ (1996) CILSA 62.

<sup>27</sup> Cliffe Dekker Hofmeyr ‘Corporate Governance: A Guide for Directors’ available at <https://www.cliffedekkerhofmeyr.com/export/sites/cdh/en/sectors/downloads/Corporate-governance-A-directors-guide.pdf> (accessed 5 February 2019).

Cliffe Dekker Hofmeyr ‘Corporate Governance: A Guide for Directors’ available at <https://www.cliffedekkerhofmeyr.com/export/sites/cdh/en/sectors/downloads/Corporate-governance-A-directors-guide.pdf> (accessed 5 February 2019).

<sup>28</sup> Cliffe Dekker Hofmeyr ‘Corporate Governance: A Guide for Directors’ available at <https://www.cliffedekkerhofmeyr.com/export/sites/cdh/en/sectors/downloads/Corporate-governance-A-directors-guide.pdf> (accessed 5 February 2019).

<sup>29</sup> Mupangavanhu BM *Directors’ Standards of Care, Skill, Diligence and the Business Judgment Rule in view of South Africa’s Companies Act 71 of 2008: Future of Corporate Governance* (published PhD thesis, UCT, 2016) V.

liability insurance framework allows for adequate protection for directors who may act in breach of their duties. In order to answer this question, a look at what personal liability measures are in place and further assess the measures in place.

### 1.3 Literature review

There is an extensive body of work available on the fiduciary duties of directors, including the various types of liability that can be incurred by a director in South Africa. However, research regarding the shortcoming of insurance protection available to directors and the gaps in the existing legislation is limited. This research paper will seek to provide more insight into these gaps.

The research paper will focus on analytical and comparative research drawn from various written works. The sources will comprise of legislation, case law, books, cases, academic articles, journals and internet sources. Primary and secondary sources will be used in this study.

Accompanied with the role of director role comes the necessary duties expected of them in this capacity. A book worth referencing is one of Cassim, who says that, “the duties of directors are derived from two sources, namely the Act and the common law as found in the decisions of the courts”.<sup>30</sup>

As noted in a very popular case involving the Steinhoff scandal<sup>31</sup> which involved Steinhoff International Holdings NV,<sup>32</sup> executives of the company were under scrutiny for the alleged breach of their financial reporting duties. This case is a perfect example of how alleged accounting fraud conducted by auditors, asset managers and non- executive directors resulted in a breach of their fiduciary duties to act in the best interests of the company,<sup>33</sup> and also negligently failed to act with the necessary duty of care, skill and diligence.<sup>34</sup> This case is important for my research paper as it highlights the disregard for fiduciary duties when failing

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<sup>30</sup> Radebe ‘Steinhoff scandal points to major gaps in stopping unethical corporate behaviour’ available at <https://theconversation.com/steinhoff-scandal-points-to-major-gaps-in-stopping-unethical-corporate-behaviour-88905> (accessed 30 June 2019).

<sup>31</sup> Cronje ‘German prosecutors still probing Steinhoff for possible accounts fraud’ 07 December 2017, available at <https://www.fin24.com/Companies/Retail/german-prosecutors-still-probing-steinhoff-for-possible-accounts-fraud-20171207> (accessed on 30 June 2019).

<sup>32</sup> *De Bruyn v Steinhoff International Holdings N.V. and Others* (29290/2018) [2020] ZAGPJHC 145 (26 June 2020).

<sup>33</sup> s76 (3) (b) of the Companies Act 71 of 2008.

<sup>34</sup> s76(3) (c) of the Companies Act 71 of 2008.

to act in the best interests of the company when taking up position as director or officer. The journal article ‘D and O insurance for directors and officers - what is this and is it a viable option in South African law?’ is worth referencing as it gives a detail explanation as to what the insurance is that is available as protection to directors .<sup>35</sup>

Cassim further states that “a company may purchase and maintain insurance on behalf of a director or prescribed officer of the company during their periods of office to protect the director (or prescribed officer) against liability incurred in his or her capacity as a director or a prescribed officer of the company. This type of insurance is known in other jurisdictions as ‘directors and officer liability insurance (D&O insurance)’”.<sup>36</sup>This statement is important because it highlights the argument I will be making which speaks the fact that a director is not fully protected by the insurance obtained by their company and that the company is also not obligated to take protection on the directors and prescribed officers against liability for which a company is permitted to indemnify its directors.

As previously mentioned, s78 will be the primary legislation that will be discussed. Another article, ‘Indemnification and Aspects of Directors’ Liability Insurance in Terms of Section 78 of the Companies Act 71 of 2008’, will be further analysed. This article focuses on the amendments of s78 and provisions from comparators, which is important to note. In terms of English Law,<sup>37</sup> Section 233 of the English Companies Act 2006 allows a company to purchase and maintain insurance against any liability. This leaves the same accord as South African Companies Act 2008 that a company has the discretion to decide whether to take insurance for the liability of directors. As per Canadian Law,<sup>38</sup> in terms of subsection 124 (6) permits a company to purchase directors liability insurance against any liability incurred by the director which includes coverage in instances were a company itself is unable to indemnify a director. However, this duty is incorporate in Canadian corporate by- laws.<sup>39</sup>

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<sup>35</sup> Spisto M ‘D and O insurance for directors and officers - what is this and is it a viable option in South African law?’ (1996) CILSA 62 - 70.

<sup>36</sup> Cassim F, Cassim M & Cassim R ‘et al’ *Contemporary Company Law 2ed* (2012) 577.

<sup>37</sup> English Companies Act, 1948.

<sup>38</sup> Canadian Business Corporations Act of 1985.

<sup>39</sup> Bekink M ‘Indemnification and Aspects of Directors’ and Officers’ Liability Insurance in Terms of Section 78 of the Companies Act 71 of 2008’, 23 *S. Afr. Mercantile L.J.* 88 (2011) 102.



Other authors<sup>40</sup> are of the view that there is still inadequate protection available to directors and officers, as there is no statutory obligation on a company to indemnify their directors.<sup>41</sup> Furthermore, in the case of *Foss v Harbottle*,<sup>42</sup> ‘a director owes his duties to the company that appoints him. If the duties are breached, the company itself must seek redress of the wrong’.<sup>43</sup> This case is important as it highlights the disregard of protection for directors and officers in South Africa when acting out of obligation and the lack of insurance offered. The issues of directors’ and officers’ liability insurance in this context, has meant that South Africa finds itself in a highly litigious environment. This research study aims to shed light on a relatively unexplored area of the extent to which directors and officers are protected by insurance taken out for them and whether s78 is a simple statutory restatement. This research paper will focus squarely on this and whether an alternative provision to s78 will give directors and officers more security and easy of mind to taken on directorship positions.

#### 1.4 Significance of Research

The topic for the research paper is important for parties who may consider accepting, or are currently appointed as company directors. The question of the scope of their duties and how easily deviating from their duties is current, and central to this paper. It must be noted directors are losing confidence in the protection provided to them in the corporate sphere and are reluctant to take on such positions due to the fact that inadequate protection is able.<sup>44</sup> The insurance available to indemnify them for personal liability is not a statutory obligation imposed upon companies, but rather it is incumbent upon directors themselves to obtain this insurance. Recommendations will be made upon certain part of current legislation to be changed in order to minimize the fear of personal and financial ruin being faced by many directors.

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<sup>40</sup> Mupangavanhu BM *Directors’ Standards of Care, Skill, Diligence and the Business Judgment Rule in view of South Africa’s Companies Act 71 of 2008: Future of Corporate Governance* (published PhD thesis, UCT, 2016) V.

<sup>41</sup> Mupangavanhu BM *Directors’ Standards of Care, Skill, Diligence and the Business Judgment Rule in view of South Africa’s Companies Act 71 of 2008: Future of Corporate Governance* (published PhD thesis, UCT, 2016) V.

<sup>42</sup> *Foss v Harbottle* (1843) 2 Hare 461.

<sup>43</sup> Rowe G, ‘Directors’ and Officers’ Liability Insurance in South Africa’, 3 *Juta’s Bus. L.* 139 (1995).

<sup>44</sup> Bekink M ‘Indemnification and Aspects of Directors’ and Officers’ Liability Insurance in Terms of Section 78 of the Companies Act 71 of 2008’, 23 *S. Afr. Mercantile L.J.* 88 (2011).

## **1.5 Research Methodology**

The research paper will focus on analytical and comparative research drawn from various written works. The sources will comprise of legislation, case law, books, cases, academic articles, journals and internet sources. Primary and secondary sources will be used in this study.

## **1.6 Chapter Outline**

### Chapter 1 Introduction

This chapter will elaborate on the background and the problem statement which will be solved with research conducted. It will briefly review the projected aims, the justification for this study and serve as an outline of the literature review which informs the research.

### Chapter 2 Liability for breach of directors' duties

This chapter will offer a detailed explanation of the fiduciary duties of directors and officers at common law and the interpretation of these duties through past precedent. Furthermore, the various type of liability that individuals can incur upon taking such a position as director will be discussed. Analysis of s78 will be compared to the previous s247 of the 1973 Act in terms of expansion and interpretation purposes. This chapter will further elaborate on the fact that a company may indemnify its directors' were liability arises from their conduct, however there are exceptions to this rule.

### Chapter 3 Insurance for Directors Liability

This chapter will further elaborate on the insurance available to directors and the limitation of the insurance. Furthermore, a look into why director liability insurance is needed. Focus will be given to who is responsible to pay the premiums of the insurance policy obtained and the extend of the protection provided by the insurance taken.

### Chapter 4 International benchmarks compared to South Africa's personal liability insurance

for directors

This chapter will focus on international jurisdictions and how they have handled the issue of personal liability insurance for directors. Chosen countries are England (UK) and Canada. Reasons being that South African company law has inherited English and Canadian principles relating to director duties and contains similar provisions which renders any provision void, which tries and exempt directors from liability due to breach of duties. This chapter will further focus on what South Africa can learn from these countries in terms of companies obtaining insurance to protect themselves and their directors.

## Chapter 5 Conclusions – Summary and Recommendations

The last chapter will summarise the findings of the research paper, followed by concluding observations and provide recommendations for formulating an alternative provision to s78. This provision will be drafted on comparison drawn from comparators mentioned in chapter 4.

## **CHAPTER 2: THE DEVELOPMENT OF DIRECTOR'S DUTIES & THE LIMITATION SET ON INDEMNIFICATION OF LIABILITY**

### **2.1 Introduction**

This chapter will offer a detailed explanation of the fiduciary duties of directors and officers at common law and the interpretation of these duties through past precedent.<sup>45</sup> Analysis of s78 will be compared to the previous s247 of the 1973 Act in terms of expansion and interpretation purposes. Furthermore, the various type of liability that individuals can incur upon taking such a position as director will be discussed. This chapter will further elaborate on the fact that a company may indemnify its directors' were liability arises from their conduct, however there are exceptions to this rule.<sup>46</sup>

### **2.2 Directors fiduciary duties**

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<sup>45</sup> Coetzee L, Van Tonder JL 'Advantages and disadvantages or partial codification of directors duties in South African Companies Act 71 of 2008' *Journal for Juridical Science*: Vol. 41 No. 2 (2016) 1.

<sup>46</sup> Rowe G, 'Directors' and Officers' Liability Insurance in South Africa', 3 *Juta's Bus. L.* 139 (1995) 139.

The fiduciary duties of directors previously originated from the common law.<sup>47</sup> The duties are developed through the standards set by our courts.<sup>48</sup> Directors duties were based previously on case law.<sup>49</sup> Many of the common law duties has been partially codified by the new act.<sup>50</sup> In instances where the new act is unable to deal with a specific duty, the common law will still be used.<sup>51</sup> This was confirmed in the case of *Mthimunye-Bakoro v Petroleum Oil and Gas Corporation of South Africa (SOC) Limited and Another*,<sup>52</sup> where the court admitted that section 75 inferred that the common law can be used as alternative.<sup>53</sup> Furthermore, once the appointment of director takes place, will the fiduciary duties of a director ascend.<sup>54</sup> The duties of directors was to act with utmost good faith, in the best interests of their companies and the need to exercise care, skill and diligence as per the common law.<sup>55</sup> As noted in a very popular case involving the Steinhoff scandal<sup>56</sup> which involved Steinhoff International Holdings NV,<sup>57</sup> executives of the company were under scrutiny for the alleged breach of their financial reporting duties. This case is a perfect example of how the alleged accounting fraud conducted by auditors, asset managers and non- executive directors resulted in a breach of their fiduciary duties to act in the best interests of the company,<sup>58</sup> and also negligently failed to act with the necessary duty of care, skill and diligence.<sup>59</sup> This case is highlights the disregard for fiduciary duties when failing to act in the best interests of the company when taking up position as director or officer. Another consequence that can be noted that occur with the breach of duties

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<sup>47</sup> Coetzee L, Van Tonder JL 'Advantages and disadvantages or partial codification of directors duties in South African Companies Act 71 of 2008' *Journal for Juridical Science*: Vol. 41 No. 2 (2016) 1.

<sup>48</sup> Coetzee L, Van Tonder JL 'Advantages and disadvantages or partial codification of directors duties in South African Companies Act 71 of 2008' *Journal for Juridical Science*: Vol. 41 No. 2 (2016) 1.

<sup>49</sup> Esser I & Du Plessis J.J 'The Stakeholder Debate and Directors' Fiduciary Duties' (2007) 19 *SA Merc LJ* 346.

<sup>50</sup> Coetzee L, Van Tonder JL 'Advantages and disadvantages or partial codification of directors duties in South African Companies Act 71 of 2008' *Journal for Juridical Science*: Vol. 41 No. 2 (2016) 2.

<sup>51</sup> Coetzee L, Van Tonder JL 'Advantages and disadvantages or partial codification of directors duties in South African Companies Act 71 of 2008' *Journal for Juridical Science*: Vol. 41 No. 2 (2016) 1.

<sup>52</sup> *Mthimunye-Bakoro v Petroleum Oil and Gas Corporation of South Africa (SOC) Limited and Another* (12476/2015) [2015] ZAWCHC 113; 2015 (6) SA 338 (WCC) (4 August 2015).

<sup>53</sup> *Mthimunye-Bakoro v Petroleum Oil and Gas Corporation of South Africa (SOC) Limited and Another* (12476/2015) [2015] ZAWCHC 113; 2015 (6) SA 338 (WCC) (4 August 2015) paras. 15-25.

<sup>54</sup> Havenga M 'Corporate Opportunities: A South African Update (Part 2)' (1996) 8 *SA Merc LJ* 233.

<sup>55</sup> Werksmans Attorneys 'Companies Act No. 71 of 2008 Duties and Liabilities of Directors' available at <https://www.werksmans.com/wp-content/uploads/2013/04/Director-duties-and-liabilities-FINAL-updated-electronic.pdf> (accessed 3 March 2019).

<sup>56</sup> Cronje 'German prosecutors still probing Steinhoff for possible accounts fraud' 07 December 2017, available at <https://www.fin24.com/Companies/Retail/german-prosecutors-still-probing-steinhoff-for-possible-accounts-fraud-20171207> (accessed on 30 June 2019).

<sup>57</sup> *De Bruyn v Steinhoff International Holdings N.V. and Others* (29290/2018) [2020] ZAGPJHC 145 (26 June 2020).

<sup>58</sup> s76 (3) (b) of the Companies Act 71 of 2008.

<sup>59</sup> s76(3) (c) of the Companies Act 71 of 2008.



is that of reputational ruins for either director or officer.<sup>60</sup> Furthermore, in the case of *Re Smith and Fawcett Ltd*<sup>61</sup>, it was held that the fiduciary duty of a company directors as being to act ‘bona fide – is in the interests of the company and not any collateral goal’.<sup>62</sup>

### **2.3 Nature and extent of Section 247 of the Companies Act 61 of 1973, now Section 78 of the Companies Act 71 of 2008**

The exemption from or indemnity against the liability of directors and officers of a company was previously dealt with in Section 247 of the Companies Act 61 of 1973 (herein after the 1973 Act);<sup>63</sup> now in terms of Section 78 of the Companies Act 71 of 2008 (herein after the 2008 Act).<sup>64</sup> Previously, section 247 of the 1973 Act contained the provisions for the indemnification of directors or officers of a company which permitted a company to indemnify them against all liability and expenses obtained.<sup>65</sup> The section provided the following:

- ‘(1) Subject to the provision of subsection (2), any provision, whether contained in the articles of a company or in any contract with a company, and whether expressed or implied, which purports to exempt any director or officer or auditor of the company from any liability which by law would otherwise attach to him in respect of any negligence, default, breach of duty or breach of trust of which he may be guilty in relation to the company or to indemnify him against any such liability, shall be void: Provided that this subsection shall not be applicable to insurance taken out and kept by the company as indemnification against any liability or any director or officer towards the company in respect of any negligence, default or breach of duty or breach of trust.
- (2) The provisions of subsection (1) shall not be construed as prohibiting a company from indemnifying a director, officer or auditor in respect of any liability incurred by him in defending proceedings, whether civil or criminal, in which judgment is given in his favour or in which he is acquitted or in respect of any proceedings which are abandoned

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<sup>60</sup> AG Directors and Officers Liability Insurance available at <https://www.autoqen.co.za/globalassets/brochures/aa-directors--officers-liability-insurance.pdf> (accessed 2 July 2019).

<sup>61</sup> *Re Smith and Fawcett Ltd* [1942] Ch 304 at 306 (CA) [1942] 1 All ER 542.

<sup>62</sup> Nwafor A.O ‘The Shifting Responsibilities of Company Directors – How Desirable in Modern Times’ (2012) 9 *Macquarie J. Bus. L* 160.

<sup>63</sup> Section 247 of the Companies Act 61 of 1973.

<sup>64</sup> Section 78 of the Companies Act 71 of 2008.

<sup>65</sup> Section 247 of the Companies Act 61 of 1973.

or in connection with any application under section 248 in which relief is granted by the Court'.<sup>66</sup> Furthermore, a company is permitted to take out insurance against any liability of any director or officer towards the company in respect of any negligence, default, breach of duty or trust for indemnification purposes.<sup>67</sup>

It was noted that the Greene Committee<sup>68</sup> was not in accord with the provisions that relieved directors from liability relating to breach of fiduciary duty, breach of trust or liability for negligence.<sup>69</sup> It was of the opinion that the protection of the directors was not justifiable.<sup>70</sup> The Committee provided the following, 'satisfied that such an enactment would not cause any hardship to a conscientious director or make his position more onerous and, [that] there is no foundation whatever for the suggestion that it would discourage many otherwise desirable persons from accepting office. A director who accepts office does not consciously do so upon the footing that he may be as negligent as he pleases without incurring liability. It is only when he has been negligent and the company have suffered a loss, that he is content to take shelter behind the article. It is, moreover, in our opinion fallacious to say that the shareholders must be taken to have agreed that their directors should be placed in this remarkable position. The articles are drafted on the instructions of those concerned in the formation of the company, and it is obviously a matter of great difficulty and delicacy for shareholders to attempt to alter such an article as that under consideration'.<sup>71</sup> Hence, section 247 of Act 1973 confirmed that such provisions is rendered void and guaranteed directors did not disobey their statutory and fiduciary duties and also limit exploitation.<sup>72</sup> Furthermore, during 1998<sup>73</sup> this section was amended in order to allow companies to obtain protection again the liability of its directors and officer for breach of duty, default, breach of duty or trust and negligence in the form of insurance.<sup>74</sup> This amended provision however did not protect the director but only the company

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<sup>66</sup> Section 247 (1) - (2) of the Companies Act 61 of 1973.

<sup>67</sup> Cliffe Dekker Hofmeyer 'Directors' liability insurance under the new act' available at <https://www.cliffedekkerhofmeyr.com/en/news/press-releases/2010/directors-liability-insurance.html> (accessed 2 July 2019).

<sup>68</sup> Company Law Amendment Committee Cmnd 2657 (1925 - 1926) paras 46 -7.

<sup>69</sup> Cassim F, Cassim M & Cassim R 'et al' *Contemporary Company Law 2ed* (2012) 573 – 574.

<sup>70</sup> Company Law Amendment Committee Cmnd 2657 (1925 - 1926) paras 46 - 47.

<sup>71</sup> Company Law Amendment Committee Cmnd 2657 (1925 - 1926) para 46

<sup>72</sup> Cassim F, Cassim M & Cassim R 'et al' *Contemporary Company Law 2ed* (2012) 574.

<sup>73</sup> Section 12 of the Companies Amendment Act 35 of 1998.

<sup>74</sup> Cassim F, Cassim M & Cassim R 'et al' *Contemporary Company Law 2ed* (2012) 574.

how could not be lawfully be indemnified.<sup>75</sup>

Section 78 of the Companies Act 2008 which sets out the provisions concerning to indemnification and directors' liability insurance. The section provides the following:

(1) In this section, "director" includes a former director and an alternate director, and-

(a) a prescribed officer; or

(b) a person who is a member of a committee of a board of a company, or of the audit committee of a company, irrespective of whether or not the person is also a member of the company's board.

(2) Subject to subsections (4) to (6), any provision of an agreement, the Memorandum of Incorporation or rules of a company, or a resolution adopted by a company, whether express or implied, is void to the extent that it directly or indirectly purports to-

(a) relieve a director of- (i) a duty contemplated in section 75 or 76; or (ii) liability contemplated in section 77; or

(b) negate, limit or restrict any legal consequences arising from an act or omission that constitutes wilful misconduct or wilful breach of trust on the part of the director.

(3) Subject to subsection (3A), a company may not directly or indirectly pay any fine that may be imposed on a director of the company, or on a director of a related company, as a consequence of that director having been convicted of an offence, unless the conviction was based on strict liability.

(3A) Subsection (3) does not apply to a private or personal liability company if - (a) a single individual is the sole shareholder and sole director of that company; or (b) two or more related individuals are the only shareholders of that company, and there are no directors of the company other than one or more of those individuals.

(4) Except to the extent that a company's Memorandum of Incorporation provides otherwise, the company-

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<sup>75</sup> Cassim F, Cassim M & Cassim R 'et al' *Contemporary Company Law 2ed* (2012) 574.

(a) may advance expenses to a director to defend litigation in any proceedings arising out of the director's service to the company; and

(b) may directly or indirectly indemnify a director for expenses contemplated in paragraph (a), irrespective of whether it has advanced those expenses, if the proceedings- (i) are abandoned or exculpate the director; or (ii) arise in respect of any liability for which the company may indemnify the director, in terms of subsections (5) and (6).

(5) Except to the extent that the Memorandum of Incorporation of a company provides otherwise, a company may indemnify a director in respect of any liability arising other than as contemplated in subsection (6).

(6) A company may not indemnify a director in respect of-

(a) any liability arising- (i) in terms of section 77(3)(a), (b) or (c); or (ii) from wilful misconduct or wilful breach of trust on the part of the director; or

(b) any fine contemplated in subsection (3).

(7) Except to the extent that the Memorandum of Incorporation of a company provides otherwise, a company may purchase insurance to protect-

(a) a director against any liability or expenses for which the company is permitted to indemnify a director in accordance with subsection (5); or

(b) the company against any contingency including, but not limited to –

(i) any expenses- (aa) that the company is permitted to advance in accordance with subsection (4)(a); or (bb) for which the company is permitted to indemnify a director in accordance with subsection (4)(b); or

(ii) any liability for which the company is permitted to indemnify a director in accordance with subsection (5).

(8) A company is entitled to claim restitution from a director of the company or of a related company for any money paid directly or indirectly by the company to or on behalf of that director in any manner inconsistent with this section.<sup>76</sup>

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<sup>76</sup> Section 78 (1) – (8) of the Companies Act 71 of 2008.



Furthermore, a company may indemnify a director in respect of any liability arising.<sup>77</sup> There are exceptions to the rule, where a company is unable to indemnify a director or officer. The exception applies to liability arising from any wilful misconduct or wilful breach of trust by the director; or a director has been convicted of an offence and as a consequence a fine has been imposed; or a director despite knowing he or she lacked authority (absence of authority) or reckless trading or the purpose to defraud creditors or any other fraudulent tenacity.<sup>78</sup>

In terms of expansion and interpretation purposes the definition of director was previously restricted to include only a member of a board of a company, or an alternate director of a company, any person occupying position of a director or alternate director.<sup>79</sup> The widened definition of director was to include a prescribed officer, a person who is a member of a committee of a board of a company or audit committee of a company.<sup>80</sup> Furthermore, the definition includes former directors with regards to indemnification and directors insurance.<sup>81</sup> The standard of conduct expected of directors is provided for in section 76 of the Companies Act 71 of 2008.<sup>82</sup> Furthermore, section 76 of the new act addresses the standard of conduct required from directors and extends it to include to act honestly, in good faith, in the best interests of and for the benefit of their companies.<sup>83</sup>

## 2.4 Types of directors' liability

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<sup>77</sup> Section 78 (5) of the Companies Act 71 of 2008.

<sup>78</sup> Werksmans Attorneys 'Companies Act No. 71 of 2008 Duties and Liabilities of Directors' available at <https://www.werksmans.com/wp-content/uploads/2013/04/Director-duties-and-liabilities-FINAL-updated-electronic.pdf> (accessed 3 March 2019).

<sup>79</sup> Idensohn K 'The meaning of Prescribed Officers under the Companies Act 71 of 2008' (2012) 129 SALJ 720.

<sup>80</sup> Idensohn K 'The meaning of Prescribed Officers under the Companies Act 71 of 2008' (2012) 129 SALJ 717.

<sup>81</sup> Moore Stephens 'Directors Guide' available at

<https://southafrica.moorestephens.com/MediaLibsAndFiles/media/southafricaweb.moorestephens.com/Guide-s-2018/Moore-Stephens-Directors-Guide-2018.pdf> (accessed 12 May 2019).

<sup>82</sup> Bekink M 'Indemnification and Aspects of Directors' and Officers' Liability Insurance in Terms of Section 78 of the Companies Act 71 of 2008', 23 *S. Afr. Mercantile L.J.* 88 (2011).

<sup>83</sup> Section 76 (3) of the Companies Act 71 of 2008.

Section 77 contains the liability of directors for any breach of their duties.<sup>84</sup> This raises the point that a director can incur various type of liability.<sup>85</sup> The type of liability that can be incur is personal liability and criminal liability.<sup>86</sup> In terms of Personal Civil Liability can be incurred by directors in instances were fraudulent or reckless trading, investor protection, unlawful distributions to shareholders and loans to directors or controlling companies.<sup>87</sup> A director can also incur civil liability where the director was aware of a vacancy in the position of auditor and failed to fill the position within three months.<sup>88</sup> If business is conducted by the company without a certificate to commence business under s172 of the Companies Act, the director can be held liable for all debts and liabilities derived from such activity.<sup>89</sup> Lastly, where the registered name of a company does not reflected correctly on the bill exchange, the director can also be held liable.<sup>90</sup> ‘Personal civil liability is imposed in the interests of creditors, the investing public, tax and social security authorities, and in the public interest.’<sup>91</sup> Even though directors or officers of companies are not normally liable in delict or contract for the responsibilities of their companies, due to their duties may be unprotected to personal liability.<sup>92</sup> There is an expectation that the duties of a director or officer is owed to the company that hires him or her.<sup>93</sup> For breach of any of the duties of the director or officer, the company is obligated to seek redress of the wrongdoing itself, as per the rule in *Foss v Harbottle (1843) 2 Hare 461*.<sup>94</sup>

Furthermore, criminal liability can be imposed upon directors either from their own conduct or

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<sup>84</sup> Section 77 of the Companies Act 71 of 2008.

<sup>85</sup> Van der Linde K ‘The Personal Liability of Directors for Corporate Fault - An Exploration’ (2008) 20 S. Afr. *Mercantile L.J.* 439.

<sup>86</sup> Werksmans Attorneys ‘Claims against directors in terms of the Companies Act, 2008’ available at <https://www.werksmans.com/legal-updates-and-opinions/claims-against-directors-in-terms-of-the-companies-act-2008/> (accessed 2 July 2019).

<sup>87</sup> Van der Linde K ‘The Personal Liability of Directors for Corporate Fault - An Exploration’ (2008) 20 S. Afr. *Mercantile L.J.* 442 - 443.

<sup>88</sup> Van der Linde K ‘The Personal Liability of Directors for Corporate Fault - An Exploration’ (2008) 20 S. Afr. *Mercantile L.J.* 448.

<sup>89</sup> Van der Linde K ‘The Personal Liability of Directors for Corporate Fault - An Exploration’ (2008) 20 S. Afr. *Mercantile L.J.* 448.

<sup>90</sup> Van der Linde K ‘The Personal Liability of Directors for Corporate Fault - An Exploration’ (2008) 20 S. Afr. *Mercantile L.J.* 448.

<sup>91</sup> Van der Linde K ‘The Personal Liability of Directors for Corporate Fault - An Exploration’ (2008) 20 S. Afr. *Mercantile L.J.* 460.

<sup>92</sup> Rowe G, ‘Directors’ and Officers’ Liability Insurance in South Africa’, 3 *Juta’s Bus. L.* 139 (1995) 139.

<sup>93</sup> Rowe G, ‘Directors’ and Officers’ Liability Insurance in South Africa’, 3 *Juta’s Bus. L.* 139 (1995) 140.

<sup>94</sup> Rowe G, ‘Directors’ and Officers’ Liability Insurance in South Africa’, 3 *Juta’s Bus. L.* 139 (1995) 140.

breaches by the company.<sup>95</sup> Mostly non – compliance with formalities is the breaches conduct by the company.<sup>96</sup> The director can acquire criminal liability where the director authorised, permitted or was party to the contravention; failure to take reasonable steps to avoid a contravention; knowingly contravened or permitted a contravention; was knowingly a participant to the contravention or issued, signed or permitted the issue or signing of documents.<sup>97</sup> As per section 214 of the new Act, any person in relation to a company, its creditors or employees that commits any act of fraud will be held criminally liable.<sup>98</sup> In addition, a person that holds a position of authority and that knows or ought reasonably to have known or might suspect any other person has conducted fraud must report such knowledge; suspicion or initiated such knowledge must be reported to a police official. This is considered a criminal offence if failing to report in terms of section 34 of the Prevention and Combating of Corrupt Activities Act 12 of 2004.<sup>99</sup> A Statutory obligation is placed on a creditor or fellow director to report their suspicions to the police when they suspect the business of a company has the intent to defraud any person or for any fraudulent tenacity.<sup>100</sup> For that reason, a director can incur not only criminally liable but can be held liable for the losses sustained by a company and its creditors.

Furthermore, a director in terms of Law of Delict can incur personal liability despite performing normal functions on behalf of the company.<sup>101</sup> This type of liability is also known as Delictual Liability.<sup>102</sup> In the case of *Jowell v Bramwell-Jones & Other*,<sup>103</sup> due to the negligent conduct in carrying out the company's contractual obligations to the third party the directors were sued

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<sup>95</sup> Van der Linde K 'The Personal Liability of Directors for Corporate Fault - An Exploration' (2008) 20 S. Afr. *Mercantile L.J.* 449.

<sup>96</sup> Van der Linde K 'The Personal Liability of Directors for Corporate Fault - An Exploration' (2008) 20 S. Afr. *Mercantile L.J.* 449.

<sup>97</sup> Van der Linde K 'The Personal Liability of Directors for Corporate Fault - An Exploration' (2008) 20 S. Afr. *Mercantile L.J.* 449.

<sup>98</sup> Werksmans Attorneys 'Claims against directors in terms of the Companies Act, 2008' available at <https://www.werksmans.com/legal-updates-and-opinions/claims-against-directors-in-terms-of-the-companies-act-2008/> (accessed 2 July 2019).

<sup>99</sup> Section 34 of the Prevention and Combating of Corrupt Activities Act 12 of 2004 ("POCA").

<sup>100</sup> Werksmans Attorneys 'Claims against directors in terms of the Companies Act, 2008' available at <https://www.werksmans.com/legal-updates-and-opinions/claims-against-directors-in-terms-of-the-companies-act-2008/> (accessed 2 July 2019).

<sup>101</sup> Van der Linde K 'The Personal Liability of Directors for Corporate Fault - An Exploration' (2008) 20 S. Afr. *Mercantile L.J.* 450.

<sup>102</sup> Van der Linde K 'The Personal Liability of Directors for Corporate Fault - An Exploration' (2008) 20 S. Afr. *Mercantile L.J.* 450.

<sup>103</sup> *Jowell v Branwell-Jones & Others* 1998 (1) SA 836 (W).

for economic loss.<sup>104</sup> In the case of *Du Plessis NO v Phelps*,<sup>105</sup> it was found that a director can be held liable in delict for damages where the director failed to note their duties of care and skill towards the company.<sup>106</sup> In addition, the element of wrongfulness plays a significant role in terms of South African law.<sup>107</sup> It has been noted that liability will be determined by the presence of duty of care, in the case where a contractual basis is non-existent.<sup>108</sup> Where loss is predictable to a specific person or group of persons, it is an important reducing factor to interpret reliance and a duty of care.<sup>109</sup> Also, where a company commits a delict, a director cannot be held delictually liable due to him or her holding directorship in that company.<sup>110</sup> Furthermore, it is noted that in terms of any liability set out in Section 77, the courts are authorised to relieve directors either partly or wholly.<sup>111</sup>

## 2.5 Extent of Indemnification

A director can be indemnified by a company in respect of any liability arising.<sup>112</sup> However, there are instances where a company may not indemnify a director.<sup>113</sup> A company may not indemnify a director in the following instances for any liability arising out of 'any loss, damages or costs sustained by the company as a direct or indirect consequence of the director having (a) acted in the name of the company, signed anything on behalf of the company, or purported to bind the company or authorise the taking of any action by or on behalf of the company, despite knowing that the director lacked the authority to do so; (b) acquiesced in the carrying on of the company's business despite knowing that it was being conducted in a manner prohibited by section 22(1); (c) been a party to an act or omission by the company despite knowing that the act or omission was calculated to defraud a creditor, employee or shareholder

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<sup>104</sup> Van der Linde K 'The Personal Liability of Directors for Corporate Fault - An Exploration' (2008) 20 *S. Afr. Mercantile L.J.* 451.

<sup>105</sup> *Du Plessis NO v Phelps* 1995 (4) SA 165 (C) 170B-C.

<sup>106</sup> *Du Plessis NO v Phelps* 1995 (4) SA 165 (C) 170.

<sup>107</sup> Van der Linde K 'The Personal Liability of Directors for Corporate Fault - An Exploration' (2008) 20 *S. Afr. Mercantile L.J.* 451.

<sup>108</sup> Van der Linde K 'The Personal Liability of Directors for Corporate Fault - An Exploration' (2008) 20 *S. Afr. Mercantile L.J.* 451.

<sup>109</sup> Van der Linde K 'The Personal Liability of Directors for Corporate Fault - An Exploration' (2008) 20 *S. Afr. Mercantile L.J.* 451.

<sup>110</sup> Havenga M 'Directors' Co-liability for Delicts' (2006) 18 *SA Merc LJ* 235.

<sup>111</sup> Bradstreet R.S 'Implications of the Re – Enacted Discretionary Power to Grant Judicial relief to Directors in Section 77(9) of the Companies Act 2008' (2015) 27 *SA MERC LJ* 148.

<sup>112</sup> Section 78 (5) of the Companies Act 71 of 2008.

<sup>113</sup> Section 78 (6) of the Companies Act 71 of 2008.



of the company, or had another fraudulent purpose;'.<sup>114</sup> Another instance where a director may not be indemnified by a company in terms of liability arising from wilful misconduct or wilful breach of trust on the part of the director.<sup>115</sup> Lastly, a director may not be indemnified by a company for 'any fine that may be imposed on a director of the company, or on a director of a related company, as a consequence of that director having been convicted of an offence, unless the conviction was based on strict liability'.<sup>116</sup>

'Furthermore, it has been stated that no insurance could ever be available to directors or officers of a company against liability for dishonesty'.<sup>117</sup> 'By contrast, if a director is held liable to the company for negligence, not only his legal costs but also his liability remain indemnifiable by the company'.<sup>118</sup> It has to be noted that in South Africa the indemnification of directors is not a compulsion but simply an election by the company.<sup>119</sup>

## 2.6 Concluding Comments

The importance of this chapter is that it has explored that taking a position as either director or officer follows certain duties, responsibilities and personal liability that is required to be fulfilled. These duties remain embedded in common law and case law. It is expected of directors to act in the best interests of the company and with the necessary care, skill and diligence.<sup>120</sup> It has been shown that not only can a director be held personally liable for loss and damaged caused to a company but can also be held criminally liable. Furthermore, the liability of directors can only be indemnified to a certain extent. The following chapter will discuss the type of insurance available to directors and the limitations this type of insurance contains. It shall discuss the reasoning for director's liability insurance to be obtained and who is responsible to pay premiums of the insurance policy. Further will be discussed the extent of protection to which the insurance policy provides to directors.

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<sup>114</sup> Section 78 (6)(a)(i) of the Companies Act 71 of 2008.

<sup>115</sup> Section 78 (6)(a)(ii) of the Companies Act 71 of 2008.

<sup>116</sup> Section 78 (6)(b) of the Companies Act 71 of 2008.

<sup>117</sup> Spisto M 'D and O insurance for directors and officers - what is this and is it a viable option in South African law?' (1996) *CILSA* 62.

<sup>118</sup> Cassim M. F 'Obstacles and Barriers to the Derivative Action: Costs Orders under Section 165 of the Companies Act of 2008' (Part 2), 26 *S. Afr. Mercantile L.J.* 228 (2014) 239.

<sup>119</sup> Cassim M. F 'Obstacles and Barriers to the Derivative Action: Costs Orders under Section 165 of the Companies Act of 2008' (Part 2), 26 *S. Afr. Mercantile L.J.* 228 (2014) 240.

<sup>120</sup> Muswaka L 'Shielding Directors against Liability Imputations: The Business Judgment Rule and Good Corporate Governance' [2013] *SPECJU* 2 25.

## CHAPTER 3: INSURANCE FOR DIRECTORS LIABILITY

### 3.1 Introduction

This chapter will further elaborate on the insurance available to the directors of a company and the type of cover available to the directors.<sup>121</sup> In addition, will be discussed the limitation of the insurance policy. Furthermore, a glimpse into why director liability insurance is needed will be discussed. Focus will be given to who is responsible to pay the premiums of the insurance policy obtained. This chapter will further elaborate on the time period the insurance cover is available for when taking liability insurance and the extend of the protection provided by the insurance taken.<sup>122</sup>

### 3.2 Insurance available to directors

During the periods of office held by directors, a company may purchase and maintain insurance in aid of its directors in his or her capacity as director.<sup>123</sup> This kind of insurance taken by companies is also known as ‘directors and officers liability insurance’.<sup>124</sup> A director is frequently protected by directors’ and officers’ liability insurance.<sup>125</sup> Previously, the exemption from or indemnity against liability of directors and officers of a company was dealt with in Act 1973.<sup>126</sup> In terms of section 78 (7) of the new Act 2008,<sup>127</sup> a company may purchase insurance against any indemnifiable liability or expenses to protect its directors.<sup>128</sup> Insurance may also be purchase to protect the company against contingency, including advanced expenses, indemnifiable expenses or any indemnifiable liability.<sup>129</sup> It is noted that

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<sup>121</sup> Bekink M ‘Indemnification and Aspects of Directors’ and Officers’ Liability Insurance in Terms of Section 78 of the Companies Act 71 of 2008’, 23 *S. Afr. Mercantile L.J.* 88 (2011) 89.

<sup>122</sup> Jacobs W ‘Liability Insurance in a Nutshell: Simplified Complexities or Complex Simplicities’, 21 *S. Afr. Mercantile L.J.* 202 (2009) 211.

<sup>123</sup> Cassim F, Cassim M & Cassim R ‘et al’ *Contemporary Company Law 2ed* (2012) 577.

<sup>124</sup> Cassim F, Cassim M & Cassim R ‘et al’ *Contemporary Company Law 2ed* (2012) 577.

<sup>125</sup> Cassim M. F ‘Obstacles and Barriers to the Derivative Action: Costs Orders under Section 165 of the Companies Act of 2008’ (Part 2), 26 *S. Afr. Mercantile L.J.* 228 (2014) 240.

<sup>126</sup> Section 247 of the Companies Act 61 of 1973.

<sup>127</sup> Section 78 (7) of the Companies Act 71 of 2008.

<sup>128</sup> Cassim M. F ‘Obstacles and Barriers to the Derivative Action: Costs Orders under Section 165 of the Companies Act of 2008’ (Part 2), 26 *S. Afr. Mercantile L.J.* 228 (2014) 240.

<sup>129</sup> Cassim M. F ‘Obstacles and Barriers to the Derivative Action: Costs Orders under Section 165 of the Companies Act of 2008’ (Part 2), 26 *S. Afr. Mercantile L.J.* 228 (2014) 240.

this section does not allow insurance against all liability, only liability and expenses which is acceptable to indemnify director against.<sup>130</sup>

Furthermore, this type of insurance also provides protection to directors were a company for whatever reason is incapable to fulfil the indemnification payments it has accepted.<sup>131</sup> The insurance policy provides insurance cover only for difficulties that is statutorily acceptable.<sup>132</sup> Insurance cover given by the policy is extended to include cover for damages for an error, a negligent or misleading statement, breach of duty, may not afford protection against liability rising from a fraudulent, dishonest or illegal act or contrary to wilful default or breach of duty owing to the company.<sup>133</sup> Furthermore, the policy is also designed to provide indemnity for the expenditures of legal representation occurring out of criminal prosecution of a director or officer.<sup>134</sup>

There is three main parts of cover that the directors' liability insurance policy makes provision for.<sup>135</sup> Firstly, cover for a director's liability concerning third parties consequently due to a breach of contractual, fiduciary or statutory duties.<sup>136</sup> Secondly, cover for the defence costs incurred by the company or director consequently due to legal proceedings regarding any liability.<sup>137</sup> Lastly, cover for the repayment to the company in terms of indemnity paid beforehand to its directors.<sup>138</sup>

'Obviously, insuring clauses may differ in form and wording, but the typical insuring clause obliges the insurer (1) to pay on behalf of the directors or officers (the insured) of the company any loss arising from any claim first made against the insured, (2) during the period of insurance, (3) by reason of any wrongful act committed in their capacity as director or officer, (4) except for and to the extent that the company has indemnified the director or

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<sup>130</sup> Cassim F, Cassim M & Cassim R 'et al' *Contemporary Company Law 2ed* (2012) 578.

<sup>131</sup> Cassim F, Cassim M & Cassim R 'et al' *Contemporary Company Law 2ed* (2012) 578.

<sup>132</sup> Cassim F, Cassim M & Cassim R 'et al' *Contemporary Company Law 2ed* (2012) 578.

<sup>133</sup> Cassim F, Cassim M & Cassim R 'et al' *Contemporary Company Law 2ed* (2012) 578.

<sup>134</sup> Rowe G, 'Directors' and Officers' Liability Insurance in South Africa', 3 *Juta's Bus. L.* 139 (1995) 139.

<sup>135</sup> Bekink M 'Indemnification and Aspects of Directors' and Officers' Liability Insurance in Terms of Section 78 of the Companies Act 71 of 2008', 23 *S. Afr. Mercantile L.J.* 88 (2011) 89.

<sup>136</sup> Bekink M 'Indemnification and Aspects of Directors' and Officers' Liability Insurance in Terms of Section 78 of the Companies Act 71 of 2008', 23 *S. Afr. Mercantile L.J.* 88 (2011) 89.

<sup>137</sup> Bekink M 'Indemnification and Aspects of Directors' and Officers' Liability Insurance in Terms of Section 78 of the Companies Act 71 of 2008', 23 *S. Afr. Mercantile L.J.* 88 (2011) 89.

<sup>138</sup> Bekink M 'Indemnification and Aspects of Directors' and Officers' Liability Insurance in Terms of Section 78 of the Companies Act 71 of 2008', 23 *S. Afr. Mercantile L.J.* 88 (2011) 89.

officer.<sup>139</sup> It has been observed that the term ‘wrongful act’ has been classified in the policy to mean breach of warranty of authority, misstatement, neglect, error, breach of trust, omission or any other act done or wrongly endeavoured by any director or officer or any actual or alleged breach of duty.<sup>140</sup>

Furthermore, ‘the clause further obliges – or may alternatively further oblige – the insurer, (1) to pay on behalf of the company (the insured) any loss arising from any claim first made against the directors or officers, (2) during the period of insurance, (3) by reason of any wrongful act committed in their capacity as director or officer, (4) but only when and to the extent that the company has indemnified the director or officer pursuant to the law, common or statutory, or the company constitution.’<sup>141</sup>

Moreover, it has been observed that most directors and officers insurance policies contain two sections, which is generally known as Side A and Side B cover.<sup>142</sup> Cover is provided for the single director under Side A, were a contract has been entered into by the director negligently with a third party in aid of the company which the company is not competent to abide by.<sup>143</sup> Cover is provided for the company under Side B to the magnitude that it indemnified its director against claims made towards its director.<sup>144</sup> It has been noted that the company is reimbursed due to expenses acquired consequently of claims against the director under Side B, however the company is not protected.<sup>145</sup> In addition, certain policies offer cover known Side C, otherwise known as, corporate/entity cover.<sup>146</sup> Both directors and

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<sup>139</sup> Bekink M ‘Indemnification and Aspects of Directors’ and Officers’ Liability Insurance in Terms of Section 78 of the Companies Act 71 of 2008’, 23 *S. Afr. Mercantile L.J.* 88 (2011) 89.

<sup>140</sup> Rowe G, ‘Directors’ and Officers’ Liability Insurance in South Africa’, 3 *Juta’s Bus. L.* 139 (1995) 139.

<sup>141</sup> Bekink M ‘Indemnification and Aspects of Directors’ and Officers’ Liability Insurance in Terms of Section 78 of the Companies Act 71 of 2008’, 23 *S. Afr. Mercantile L.J.* 88 (2011) 89.

<sup>142</sup> Bekink M ‘Indemnification and Aspects of Directors’ and Officers’ Liability Insurance in Terms of Section 78 of the Companies Act 71 of 2008’, 23 *S. Afr. Mercantile L.J.* 88 (2011) 90.

<sup>143</sup> Bekink M ‘Indemnification and Aspects of Directors’ and Officers’ Liability Insurance in Terms of Section 78 of the Companies Act 71 of 2008’, 23 *S. Afr. Mercantile L.J.* 88 (2011) 90.

<sup>144</sup> Bekink M ‘Indemnification and Aspects of Directors’ and Officers’ Liability Insurance in Terms of Section 78 of the Companies Act 71 of 2008’, 23 *S. Afr. Mercantile L.J.* 88 (2011) 90.

<sup>145</sup> Bekink M ‘Indemnification and Aspects of Directors’ and Officers’ Liability Insurance in Terms of Section 78 of the Companies Act 71 of 2008’, 23 *S. Afr. Mercantile L.J.* 88 (2011) 90.

<sup>146</sup> Bekink M ‘Indemnification and Aspects of Directors’ and Officers’ Liability Insurance in Terms of Section 78 of the Companies Act 71 of 2008’, 23 *S. Afr. Mercantile L.J.* 88 (2011) 90.



company liability is covered under this type of insurance, were any primary or vicarious liability for the works and defaults of directors is encountered by the company.<sup>147</sup>

### 3.3 Reason for Directors insurance

The positions held by directors and officers of a company is unprotected to personal liability.<sup>148</sup> As a result, personal insurance had to be afforded in order to protect them, hence a policy was created.<sup>149</sup> It was held in the case of *City Equitable Fire Insurance Company Ltd*<sup>150</sup>, by the court that directors cannot and should not be held liable for mere errors of judgment.<sup>151</sup> In addition, in the case of *Terblanche and Others v Damji and Another*<sup>152</sup>, it was stated that ‘in the ordinary course no director is liable for the debts of the company, other than in certain circumstances’.<sup>153</sup> Directors should be able to take planned risks based on business related issues without the fear of being charged.<sup>154</sup>

Due to the actions of directors, the Directors’ and Officers’ liability insurance functions as a way to reduce the damages brought upon companies by directors.<sup>155</sup> The distress of personal and financial loss is eliminated and corporate performance is strongly impacted by the functionality of the Directors’ and Officer’s liability insurance.<sup>156</sup> Furthermore, it is noted that directors’ and officers’ liability insurance is beneficial for the company obtaining the insurance policy.<sup>157</sup> ‘First, D & O insurance cover boosts the likelihood that the company would be compensated, given that directors who are held personally liable to the company may lack sufficient personal funds to compensate the company for its loss.’<sup>158</sup> Secondly, in the

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<sup>147</sup> Bekink M ‘Indemnification and Aspects of Directors’ and Officers’ Liability Insurance in Terms of Section 78 of the Companies Act 71 of 2008’, 23 *S. Afr. Mercantile L.J.* 88 (2011) 90.

<sup>148</sup> Rowe G, ‘Directors’ and Officers’ Liability Insurance in South Africa’, 3 *Juta’s Bus. L.* 139 (1995) 139.

<sup>149</sup> Rowe G, ‘Directors’ and Officers’ Liability Insurance in South Africa’, 3 *Juta’s Bus. L.* 139 (1995) 139.

<sup>150</sup> *Re City Equitable Fire Insurance Company Ltd* 1925 1 Ch 428.

<sup>151</sup> *Re City Equitable Fire Insurance Company Ltd* 1925 1 Ch 428.

<sup>152</sup> *Terblanche and Others v Damji and Another* (7895/2000) [2001] ZAWCHC 3 (11 September 2001).

<sup>153</sup> *Terblanche and Others v Damji and Another* (7895/2000) [2001] ZAWCHC 3 (11 September 2001).

<sup>154</sup> Bekink M ‘Indemnification and Aspects of Directors’ and Officers’ Liability Insurance in Terms of Section 78 of the Companies Act 71 of 2008’, 23 *S. Afr. Mercantile L.J.* 88 (2011) 91.

<sup>155</sup> Bekink M ‘Indemnification and Aspects of Directors’ and Officers’ Liability Insurance in Terms of Section 78 of the Companies Act 71 of 2008’, 23 *S. Afr. Mercantile L.J.* 88 (2011) 90.

<sup>156</sup> Bekink M ‘Indemnification and Aspects of Directors’ and Officers’ Liability Insurance in Terms of Section 78 of the Companies Act 71 of 2008’, 23 *S. Afr. Mercantile L.J.* 88 (2011) 91.

<sup>157</sup> Cassim M. F ‘Obstacles and Barriers to the Derivative Action: Costs Orders under Section 165 of the Companies Act of 2008’ (Part 2), 26 *S. Afr. Mercantile L.J.* 228 (2014) 240.

<sup>158</sup> Cassim M. F ‘Obstacles and Barriers to the Derivative Action: Costs Orders under Section 165 of the Companies Act of 2008’ (Part 2), 26 *S. Afr. Mercantile L.J.* 228 (2014) 241.

light of the vague distinction between a patent lack of care in decision – making and mere commercial misjudgements, directors would be loath to engage in entrepreneurial risk – taking or to serve as directors, without insurance against directorial negligence.<sup>159</sup>

### 3.4 Payment of Premiums

Looking at who is responsible for the payment of the premiums for the personal coverage of directors, this issue remains unaddressed whether a company may pay under Act 1973.<sup>160</sup> Directors are however allowed to pay their personal insurance and indemnification coverage.<sup>161</sup>

There is no specific obligation upon a company to maintain an insurance policy, however section 78 (7) of Act 2008 does permit a company to purchase an insurance policy.<sup>162</sup> It would appear to be possible for a company to pay the premiums as there is no exemption or indemnification from liability by the company in doing so.<sup>163</sup> What remains in doubt is whether companies are keen and enthusiastic to pay on behalf of its directors the premiums of the personal insurance taken.<sup>164</sup> It can be considered to be contained within a directors remuneration package or form a part of the directors conditions of service, that the company will pay the premiums of the insurance cover.<sup>165</sup> Furthermore, it is noted that a company has the authority but has no obligation to offer indemnity for its directors, however the insurer is obliged contractually to the insurance policy.<sup>166</sup>

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<sup>159</sup> Cassim M. F 'Obstacles and Barriers to the Derivative Action: Costs Orders under Section 165 of the Companies Act of 2008' (Part 2), 26 *S. Afr. Mercantile L.J.* 228 (2014) 241.

<sup>160</sup> Bekink M 'Indemnification and Aspects of Directors' and Officers' Liability Insurance in Terms of Section 78 of the Companies Act 71 of 2008', 23 *S. Afr. Mercantile L.J.* 88 (2011) 92.

<sup>161</sup> Bekink M 'Indemnification and Aspects of Directors' and Officers' Liability Insurance in Terms of Section 78 of the Companies Act 71 of 2008', 23 *S. Afr. Mercantile L.J.* 88 (2011) 96.

<sup>162</sup> Cassim F, Cassim M & Cassim R 'et al' *Contemporary Company Law 2ed* (2012) 578.

<sup>163</sup> Bekink M 'Indemnification and Aspects of Directors' and Officers' Liability Insurance in Terms of Section 78 of the Companies Act 71 of 2008', 23 *S. Afr. Mercantile L.J.* 88 (2011) 96.

<sup>164</sup> Bekink M 'Indemnification and Aspects of Directors' and Officers' Liability Insurance in Terms of Section 78 of the Companies Act 71 of 2008', 23 *S. Afr. Mercantile L.J.* 88 (2011) 96.

<sup>165</sup> Bekink M 'Indemnification and Aspects of Directors' and Officers' Liability Insurance in Terms of Section 78 of the Companies Act 71 of 2008', 23 *S. Afr. Mercantile L.J.* 88 (2011) 96.

<sup>166</sup> Cassim M. F 'Obstacles and Barriers to the Derivative Action: Costs Orders under Section 165 of the Companies Act of 2008' (Part 2), 26 *S. Afr. Mercantile L.J.* 228 (2014) 240.

### 3.5 Extent of Protection

It has been found that when looking at the extent to which directors of companies is protected, that many of them find themselves in situations where they have no indemnity or liability insurance.<sup>167</sup> Directors have to take out insurance policies on their own behalf in order to protect themselves.<sup>168</sup> Additionally, cover by liability insurance policies is only accorded for a limited period.<sup>169</sup> The duration of insurance cover could be one year in a liability policy.<sup>170</sup> In addition there are two types of durations of liability cover which is Claims Made and Occurrence Based Liability policies.<sup>171</sup>

Directors of companies is protected against legal costs and expenses, by way of indemnification or insurance, obtained through having the right to use corporate funds for defence proceedings.<sup>172</sup> Furthermore, where a court is of the view that a director acted honestly and reasonably, the court may dismiss the director from liability.<sup>173</sup> In the case of *Re Brazilian Rubber Plantations and Estates Limited*,<sup>174</sup> it was stated that directors cannot be made accountable in damages except where guilty of gross negligence, and they acted honestly.<sup>175</sup> Consequently, the protection of the directors and officers insurance is to a large extent in the interests of a corporation.<sup>176</sup>

### 3.6 Concluding Comments

The importance of this chapter showed that directors liability can be protected by obtaining insurance policy known as Directors' and officers' liability insurance. The insurance taken

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<sup>167</sup> Bekink M 'Indemnification and Aspects of Directors' and Officers' Liability Insurance in Terms of Section 78 of the Companies Act 71 of 2008', 23 *S. Afr. Mercantile L.J.* 88 (2011) 97.

<sup>168</sup> Bekink M 'Indemnification and Aspects of Directors' and Officers' Liability Insurance in Terms of Section 78 of the Companies Act 71 of 2008', 23 *S. Afr. Mercantile L.J.* 88 (2011) 97.

<sup>169</sup> Jacobs W 'Liability Insurance in a Nutshell: Simplified Complexities or Complex Simplicities', 21 *S. Afr. Mercantile L.J.* 202 (2009) 211.

<sup>170</sup> Jacobs W 'Liability Insurance in a Nutshell: Simplified Complexities or Complex Simplicities', 21 *S. Afr. Mercantile L.J.* 202 (2009) 211.

<sup>171</sup> Jacobs W 'Liability Insurance in a Nutshell: Simplified Complexities or Complex Simplicities', 21 *S. Afr. Mercantile L.J.* 202 (2009) 211.

<sup>172</sup> Cassim M. F 'Obstacles and Barriers to the Derivative Action: Costs Orders under Section 165 of the Companies Act of 2008' (Part 2), 26 *S. Afr. Mercantile L.J.* 228 (2014) 238.

<sup>173</sup> Bekink M 'Indemnification and Aspects of Directors' and Officers' Liability Insurance in Terms of Section 78 of the Companies Act 71 of 2008', 23 *S. Afr. Mercantile L.J.* 88 (2011) 96.

<sup>174</sup> *Re Brazilian Rubber Plantations and Estates Limited* (1911) 1 Ch 425 (Ch D).

<sup>175</sup> *Re Brazilian Rubber Plantations and Estates Limited* (1911) 1 Ch 425 (Ch D).

<sup>176</sup> Cassim M. F 'Obstacles and Barriers to the Derivative Action: Costs Orders under Section 165 of the Companies Act of 2008' (Part 2), 26 *S. Afr. Mercantile L.J.* 228 (2014) 240.

can protect either the company or the company's directors. Deeper inside was given as to what insurance cover can be given when obtaining an insurance policy.<sup>177</sup> It has been shown that a company may purchase an insurance policy, however there is no obligation upon a company to maintain an insurance policy. Directors also need to obtain additional cover to protect themselves against liability as shown when taking up position, as they are only protected to a certain extent. The following chapter will discuss the indemnification and insurance processes of chosen comparators and their benchmarks and trends. Further will be discussed what the current position is in South African law and what could be learned from the compared comparators.

## **CHAPTER 4: INTERNATIONAL BENCHMARKS & TRENDS COMPARED TO SOUTH AFRICA'S INDEMNIFICATION AND INSURANCE PROCESSES**

### **4.1. Introduction**

This chapter will further, in terms of section 78, be compared to similar provisions in relevant statutes of the chosen comparators. The chosen comparators will be that of English and Canadian law. It will further be discussed the shortfalls of those countries indemnification and insurance processes for their directors. This chapter will further focus on what South Africa can learn from these countries and the current position of law in South Africa. With the abovementioned, it will form the basis for the alternative provision to section 78, which will be framed in the last chapter.

### **4.2. English Law**

In the England when dealing with corporate law disputes, reference is made to the English Companies Act.<sup>178</sup> The indemnification of directors or company officers from all liability or expenses for which a company is permitted to indemnify a company, is contained in section 205 of the English Companies Act of 1948. This section provides as follows:

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<sup>177</sup> Bekink M 'Indemnification and Aspects of Directors' and Officers' Liability Insurance in Terms of Section 78 of the Companies Act 71 of 2008', 23 *S. Afr. Mercantile L.J.* 88 (2011) 89.

<sup>178</sup> English Companies Act, 1948.



‘Subject as hereinafter provided, any provision, whether contained in the articles of a company or in any contract with a company or otherwise, for exempting any officer of the company or any person (whether an officer of the company or not) employed by the company as auditor from, or indemnifying him against, any liability which by virtue of any rule of law would otherwise attach to him in respect of any negligence, default, breach of duty or breach of trust of which he may be guilty in relation to the company shall be void: Provided that— (a) nothing in this section shall operate to deprive any person of any exemption or right to be indemnified in respect of anything done or omitted to be done by him while any such provision was in force; and (b) notwithstanding anything in this section, a company may, in pursuance of any such provision as aforesaid, indemnify any such officer or auditor against any liability incurred by him in defending any proceedings, whether civil or criminal in which judgment is given in his favour or in which he is acquitted or in connection with any application under section four hundred and forty-eight of this Act in which relief is granted to him by the court.’<sup>179</sup>

Moreover, Section 205 provides that any provisions contained in articles of a company or any contract exempting a director from liability is void.<sup>180</sup> Section 205 is similar to section 247 in that it provides that any provisions that exempt a director from his duties are void, including provisions that exempt a director from liability due to a breach of duty.<sup>181</sup> The English legislation similarly permits the indemnification of directors against liability for negligence to third parties and negligence against the company.<sup>182</sup> Moreover, in terms of English Law, a director is generally exempted from personal liability from his actions.<sup>183</sup> Also, it was held in the case of *Rainham Chemical Works Ltd (in liquidation) & Others v Belvedere Fish Guano Company Ltd*<sup>184</sup>, that a director during his directorship cannot be held liable for misdemeanours performed whilst director of a limited liability company.<sup>185</sup> The English

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<sup>179</sup> Section 205 of the English Companies Act, 1948.

<sup>180</sup> Section 205 of the English Companies Act, 1948.

<sup>181</sup> Section 205 of the English Companies Act, 1948.

<sup>182</sup> Section 232(2) - 234 of the English Companies Act, 2006.

<sup>183</sup> Havenga M ‘Directors’ Co-liability for Delicts’ (2006) 18 SA Merc LJ 230.

<sup>184</sup> *Rainham Chemical Works Ltd (in liquidation) & Others v Belvedere Fish Guano Company Ltd* [1921] 2 AC 465 (HL).

<sup>185</sup> *Rainham Chemical Works Ltd (in liquidation) & Others v Belvedere Fish Guano Company Ltd* [1921] 2 AC 465 (HL).

courts were primarily very lenient in terms of ‘holding directors liable for a breach of their duty of care and skill due to the subjective standard which was used’.<sup>186</sup>

Furthermore, a company is permitted to purchase and maintain insurance against any liability as mentioned in s 232 (2) for a director of the company or of an associated company.<sup>187</sup> The provision that provides for directors insurance stipulates as follow: ‘Section 232(2) (voidness of provisions for indemnifying directors) does not prevent a company from purchasing and maintaining for a director of the company, or of an associated company, insurance against any such liability as is mentioned in that subsection’.<sup>188</sup> In terms of Section 233 (2) of the English Companies Act 2006<sup>189</sup>, it is noted that a stipulation is made that the personal insurance premiums of directors is to be paid by their companies.<sup>190</sup> The premiums for the coverage of directors is permitted to be paid by their companies in terms of English law.<sup>191</sup> Previously, when the Directors and Officers insurance first emerged it was debatable and the validity of such liability insurance was queried, particularly the part where the company had to pay all the premiums.<sup>192</sup>

In addition, in English Law it is an infringement of the principles of separate legal personality and limited liability to enforce liability on directors for wrongful conduct ascending from performing regular work duties.<sup>193</sup> ‘In England a director acting in pursuit of company business can be held liable only on the basis of “assumption of personal responsibility” and reasonable reliance thereon.’<sup>194</sup> In the case of *Williams & Another v Natural Life Health Foods Ltd*<sup>195</sup>, were it was held that a business director was not personally dependable in

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<sup>186</sup> Stevens R ‘The Legal Nature of the Duty of Care and Skill: Contract or Delict?’ *PER/PELJ* 2017 (20) 16.

<sup>187</sup> Section 233 of the English Companies Act, 2006.

<sup>188</sup> Section 233 of the English Companies Act, 2006.

<sup>189</sup> Section 233 (2) of the English Companies Act, 2006, c 46.

<sup>190</sup> Bekink M ‘Indemnification and Aspects of Directors’ and Officers’ Liability Insurance in Terms of Section 78 of the Companies Act 71 of 2008’, 23 *S. Afr. Mercantile L.J.* 88 (2011) 96.

<sup>191</sup> Bekink M ‘Indemnification and Aspects of Directors’ and Officers’ Liability Insurance in Terms of Section 78 of the Companies Act 71 of 2008’, 23 *S. Afr. Mercantile L.J.* 88 (2011) 101.

<sup>192</sup> Johnston J.F Jr ‘Corporate Indemnification and Liability Insurance for Directors’ and Officers’ (1977 -1978) 33 *Bus. Law.* 2012.

<sup>193</sup> Van der Linde K ‘The Personal Liability of Directors for Corporate Fault - An Exploration’ (2008) 20 *S. Afr. Mercantile L.J.* 450.

<sup>194</sup> Van der Linde K ‘The Personal Liability of Directors for Corporate Fault - An Exploration’ (2008) 20 *S. Afr. Mercantile L.J.* 450.

<sup>195</sup> *Williams & Another v Natural Life Health Foods Ltd* [1998] 1 WLR 830 (HL).

negligence, unless it can be clearly presented that personal responsibility was voluntarily undertaken by the director.<sup>196</sup>

### 4.3. Canadian Law

In Canada, section 124 (1) similarly seeks to provide indemnification for directors or officers.<sup>197</sup> The section provides as follows:

‘124 (1) A corporation may indemnify a director or officer of the corporation, a former director or officer of the corporation or another individual who acts or acted at the corporation’s request as a director or officer, or an individual acting in a similar capacity, of another entity, against all costs, charges and expenses, including an amount paid to settle an action or satisfy a judgment, reasonably incurred by the individual in respect of any civil, criminal, administrative, investigative or other proceeding in which the individual is involved because of that association with the corporation or other entity’.<sup>198</sup>

Section 124 of the Canadian Business Corporations Act 1985,<sup>199</sup> is similar to South African Law in terms of including both former and alternate directors to whom the provision applies to.<sup>200</sup>

As per Section 136 of the Ontario Business Corporations Act 1990, provides that a corporation is permitted to indemnify a director of that corporation.<sup>201</sup> The personal wealth of

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<sup>196</sup> *Williams & Another v Natural Life Health Foods Ltd* [1998] 1 WLR 830 (HL).

<sup>197</sup> Section 124 (1) of the Canada Business Corporations Act, RSC 1985, c C-44.

<sup>198</sup> Section 124 (1) of the Canada Business Corporations Act, RSC 1985, c C-44.

<sup>199</sup> Canada Business Corporations Act, RSC 1985, c C-44.

<sup>200</sup> Bekink M ‘Indemnification and Aspects of Directors’ and Officers’ Liability Insurance in Terms of Section 78 of the Companies Act 71 of 2008’, 23 *S. Afr. Mercantile L.J.* 88 (2011) 98.

<sup>201</sup> Section 136 of the Ontario Business Corporations Act of 1990.

a corporate director can be protected by the corporation purchasing insurance on his behalf.<sup>202</sup> Similarly, the Directors and Officers insurance policy becomes relevant when a manager is sued in his role as an agent of the company.<sup>203</sup> In spite of the fact that the insurance company only indemnifies the business and the director, upon acting in good faith and in aid of the business, cases of gross negligence or criminal behaviour is not cover.<sup>204</sup> It has been noted that Directors and Officers insurance acts as a corporate governance instrument or monitoring device and decreases the expected cost of bankruptcy.<sup>205</sup>

Moreover, Directors' and Officers' insurance contracts specify that a policy maximum, a premium to be paid and a deductible is contained within.<sup>206</sup> Furthermore, section 124 (5) of the Canada Business Corporations Act 1985 provides for the Right to indemnity for directors.<sup>207</sup> This section provides the following: 'Despite subsection (1), an individual referred to in that subsection is entitled to indemnity from the corporation in respect of all costs, charges and expenses reasonably incurred by the individual in connection with the defence of any civil, criminal, administrative, investigative or other proceeding to which the individual is subject because of the individual's association with the corporation or other entity as described in subsection (1), if the individual seeking indemnity (a) was not judged by the court or other competent authority to have committed any fault or omitted to do anything that the individual ought to have done; and (b) fulfils the conditions set out in subsection (3)'.<sup>208</sup> This right is accessible to any individual taking position as director or officer of a corporation.

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<sup>202</sup> Boyer M.M 'Three Insights from the Canadian D & (and) O Insurance Market: Inertia, Information and Insiders' 14 *Conn. Ins. L.J.* 75 (2007) 76.

<sup>203</sup> Boyer M.M 'Three Insights from the Canadian D & (and) O Insurance Market: Inertia, Information and Insiders' 14 *Conn. Ins. L.J.* 75 (2007) 76.

<sup>204</sup> Boyer M.M 'Three Insights from the Canadian D & (and) O Insurance Market: Inertia, Information and Insiders' 14 *Conn. Ins. L.J.* 75 (2007) 76.

<sup>205</sup> Boyer M.M 'Three Insights from the Canadian D & (and) O Insurance Market: Inertia, Information and Insiders' 14 *Conn. Ins. L.J.* 75 (2007) 78.

<sup>206</sup> Boyer M.M 'Three Insights from the Canadian D & (and) O Insurance Market: Inertia, Information and Insiders' 14 *Conn. Ins. L.J.* 75 (2007) 76.

<sup>207</sup> Section 124 (5) of the Canada Business Corporations Act, RSC 1985, c C-44.

<sup>208</sup> Section 124 (5)(a) -(b) of the Canada Business Corporations Act, RSC 1985, c C-44.



Furthermore, a company may purchase and maintain insurance for the directors or officers against any liability incurred by the individual.<sup>209</sup> Directors liability insurance is permitted to be obtained by corporations in terms of Section 124 (6) of the Canadian Business Corporations Act, 1985.<sup>210</sup> This section provides as follows: ‘A corporation may purchase and maintain insurance for the benefit of an individual referred to in subsection (1) against any liability incurred by the individual (a) in the individual’s capacity as a director or officer of the corporation; or (b) in the individual’s capacity as a director or officer, or similar capacity, of another entity, if the individual acts or acted in that capacity at the corporation’s request’.<sup>211</sup> Evidence has shown that various Canadian businesses has included this obligation into their corporate by-laws and is of eager nature to do so.<sup>212</sup>

The premiums for the coverage of directors is permitted to be paid by their companies in terms of Canadian law.<sup>213</sup> As per Canadian Law, predictably two types of directors’ and officers’ liability insurance coverage can be obtained.<sup>214</sup> Firstly, Corporate Reimbursement Coverage, which is to cover losses to the company ascending from the company’s indemnification of a director.<sup>215</sup> Secondly, Personal Coverage, to cover the liability of a director which is not indemnified by the company and would be personally accountable.<sup>216</sup>

#### **4.4 Current position in South African law and what we can learn**

In terms of South African Law, section 78 (4) does not compel a mandatory statutory duty to indemnify directors, compared to Canadian Law section 125 (5) of the Canada Business Corporations Act 1985.<sup>217</sup> It can be noted that ‘section 78 (4) merely authorises, subject to the

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<sup>209</sup> Section 124 (6) of the Canada Business Corporations Act, RSC 1985, c C-44.

<sup>210</sup> Section 124 (6) of the Canada Business Corporations Act, RSC 1985, c C-44.

<sup>211</sup> Section 124 (6)(a)- (b) of the Canada Business Corporations Act, RSC 1985, c C-44.

<sup>212</sup> Bekink M ‘Indemnification and Aspects of Directors’ and Officers’ Liability Insurance in Terms of Section 78 of the Companies Act 71 of 2008’, 23 *S. Afr. Mercantile L.J.* 88 (2011) 102.

<sup>213</sup> Bekink M ‘Indemnification and Aspects of Directors’ and Officers’ Liability Insurance in Terms of Section 78 of the Companies Act 71 of 2008’, 23 *S. Afr. Mercantile L.J.* 88 (2011) 101.

<sup>214</sup> Daniels R.J & Hutton S.M ‘The Capricious Cushion: The Implications of the Directors’ and Officers’ Insurance Liability Crisis on Canadian Corporate Governance’ 22 *CAN. Bus. L.J.* 182 (1993) 188.

<sup>215</sup> Daniels R.J & Hutton S.M ‘The Capricious Cushion: The Implications of the Directors’ and Officers’ Insurance Liability Crisis on Canadian Corporate Governance’ 22 *CAN. Bus. L.J.* 182 (1993) 188.

<sup>216</sup> Daniels R.J & Hutton S.M ‘The Capricious Cushion: The Implications of the Directors’ and Officers’ Insurance Liability Crisis on Canadian Corporate Governance’ 22 *CAN. Bus. L.J.* 182 (1993) 188.

<sup>217</sup> Cassim F, Cassim M & Cassim R ‘et al’ *Contemporary Company Law 2ed* (2012) 577.

company's Memorandum of Incorporation, a company to indemnify a director for expenses incurred in successfully defending legal proceedings instituted against him or her, or if the legal proceedings have been abandoned.<sup>218</sup> No duty is imposed upon a company to indemnify a director in these circumstances in terms of section 78 (4).<sup>219</sup>

There is a slight discrepancy between English Law and South African Law.<sup>220</sup> English Law makes provision for the indemnification against directors' liability for negligence against a company, whilst South African Law does not ban the indemnification of directors liability for negligence against a company.<sup>221</sup> It has also been noted that South African Law places no compulsion upon companies.<sup>222</sup> A company in South Africa should be allowed obtain insurance policies to cover the aforementioned against liability deriving from the acts or errors of that company.<sup>223</sup> It should be similar to any other liability insurance policy used in the above mentioned countries.

Furthermore, unlike English Law were their courts is of the opinion that it is an infringement of limited liability and separate legal personality for placing liability on directors for conducting normal functions on behalf of the corporations.<sup>224</sup> South African Law is of the view that directors of companies must be held liable for their conduct for the reason of enforcing personal liability for loss ascending from their wrongful conduct.<sup>225</sup> In the case of *Ex Parte Lebowa Development Corporation Ltd*<sup>226</sup>, the court was of the opinion that no director was to be relieved from any liability deriving from fraudulent conduct from the

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<sup>218</sup> Cassim F, Cassim M & Cassim R 'et al' *Contemporary Company Law 2ed* (2012) 577.

<sup>219</sup> Cassim F, Cassim M & Cassim R 'et al' *Contemporary Company Law 2ed* (2012) 577.

<sup>220</sup> Cassim M. F 'Obstacles and Barriers to the Derivative Action: Costs Orders under Section 165 of the Companies Act of 2008' (Part 2), 26 *S. Afr. Mercantile L.J.* 228 (2014) 239.

<sup>221</sup> Cassim M. F 'Obstacles and Barriers to the Derivative Action: Costs Orders under Section 165 of the Companies Act of 2008' (Part 2), 26 *S. Afr. Mercantile L.J.* 228 (2014) 239.

<sup>222</sup> Cassim M. F 'Obstacles and Barriers to the Derivative Action: Costs Orders under Section 165 of the Companies Act of 2008' (Part 2), 26 *S. Afr. Mercantile L.J.* 228 (2014) 240.

<sup>223</sup> Spisto M 'D and O insurance for directors and officers - what is this and is it a viable option in South African law?' (1996) *CILSA* 68.

<sup>224</sup> Van der Linde K 'The Personal Liability of Directors for Corporate Fault - An Exploration' (2008) 20 *S. Afr. Mercantile L.J.* 450.

<sup>225</sup> Van der Linde K 'The Personal Liability of Directors for Corporate Fault - An Exploration' (2008) 20 *S. Afr. Mercantile L.J.* 450.

<sup>226</sup> *Ex Parte Lebowa Development Corporation Ltd* 1989 (3) SA 71 (T).

director side.<sup>227</sup> Thus, can be noted that the English Law doctrine of the assumption of personal responsibility and reasonable reliance thereon, does not form part of the South African law.<sup>228</sup>

As noted in Canadian law, companies can protect its directors by means of taking corporate indemnification plans.<sup>229</sup> These plans provided protection for directors against third – party lawsuits.<sup>230</sup> Another means of protection directors by companies is through the amendment of contracts by limiting the directors’ liability.<sup>231</sup> Furthermore, it is noted that by comparing both these two countries, that English and Canadian Law, allows companies to pay the personal coverage premiums of their directors.<sup>232</sup> However, in terms of South African, the issue remains inaudible. South African law does not specifically mention that companies must maintain the policy taken, by paying the policy premiums.<sup>233</sup>

#### 4.5 Concluding Comments

The importance of this chapter is that it has compared South African law against English and Canadian law. The English and Canadian legislation similarly permits the indemnification of directors against liability for negligence to third parties and negligence against the company which is the same in terms of South African law. The premiums for the coverage of directors is permitted to be paid by their companies in terms of English and Canadian law. However, there is no obligation in terms of South African Law to pay the premiums for coverage of their directors.<sup>234</sup> South African law can consider taking some of the following examples of English and Canadian legislation and incorporating them. This will encourage more directors

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<sup>227</sup> *Ex Parte Lebowa Development Corporation Ltd* 1989 (3) SA 71 (T).

<sup>228</sup> Van der Linde K ‘The Personal Liability of Directors for Corporate Fault - An Exploration’ (2008) 20 *S. Afr. Mercantile L.J.* 451.

<sup>229</sup> Boyer M.M ‘Three Insights from the Canadian D & (and) O Insurance Market: Inertia, Information and Insiders’ 14 *Conn. Ins. L.J.* 75 (2007) 77.

<sup>230</sup> Boyer M.M ‘Three Insights from the Canadian D & (and) O Insurance Market: Inertia, Information and Insiders’ 14 *Conn. Ins. L.J.* 75 (2007) 77.

<sup>231</sup> Boyer M.M ‘Three Insights from the Canadian D & (and) O Insurance Market: Inertia, Information and Insiders’ 14 *Conn. Ins. L.J.* 75 (2007) 77.

<sup>232</sup> Bekink M ‘Indemnification and Aspects of Directors’ and Officers’ Liability Insurance in Terms of Section 78 of the Companies Act 71 of 2008’, 23 *S. Afr. Mercantile L.J.* 88 (2011) 101.

<sup>233</sup> Cassim F, Cassim M & Cassim R ‘et al’ *Contemporary Company Law 2ed* (2012) 578.

<sup>234</sup> Cassim F, Cassim M & Cassim R ‘et al’ *Contemporary Company Law 2ed* (2012) 578.

to take directorship positions without distress and will be beneficial to companies in terms of corporate performance.<sup>235</sup> The final chapter will discuss the findings, observations and will provide recommendations for formulating an alternative provision to Section 78 of the Companies Act, 2008.

## CHAPTER 5: CONCLUSIONS – SUMMARY AND RECOMMENDATIONS

### 5.1. Finding and Recommendations

The last chapter will summarise the findings of the research paper, followed by concluding observations and provide recommendations for formulating an alternative provision to section 78. This provision will be drafted on comparison drawn from comparators mentioned in the previous chapter.

The common law duties of directors have been partially codified by the new Companies Act.<sup>236</sup> The current South African company law has gaps in its legislation, which leaves directors very vulnerable. The personal liability insurance framework is inadequate to protect directors for breach of their duties, whilst acting honestly and in good faith. In the case of *Howard v Herrigel NO and Another*<sup>237</sup>, it was stated that ‘at common law, once a person accepts an appointment as a director, he becomes a fiduciary in relation to the company and is obliged to display the utmost good faith towards the company and in his dealings on its behalf’.<sup>238</sup> It has been noted that these duties are based on the “general principle that a person standing in a fiduciary relationship to another commits a breach of trust if he acts for his own benefit or to the prejudice of the other”.<sup>239</sup> In addition, the primary function of the fiduciary duty of a director is loyalty towards his company.<sup>240</sup> ‘Directors are required to exercise their

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<sup>235</sup> Bekink M ‘Indemnification and Aspects of Directors’ and Officers’ Liability Insurance in Terms of Section 78 of the Companies Act 71 of 2008’, 23 *S. Afr. Mercantile L.J.* 88 (2011) 105.

<sup>236</sup> Mupangavanhu BM ‘Fiduciary Duty and Duty of Care under Companies Act 2008: Does South African Law insist on the two duties being kept separate?’ 2017 (1) *Stell LR* 149.

<sup>237</sup> *Howard v Herrigel NO and Another* (130/89) [1991] ZASCA 7; 1991 (2) SA 660 (AD); [1991] 2 All SA 113 (A) (8 March 1991).

<sup>238</sup> *Howard v Herrigel NO and Another* (130/89) [1991] ZASCA 7; 1991 (2) SA 660 (AD); [1991] 2 All SA 113 (A) (8 March 1991).

<sup>239</sup> Bouwman N ‘An Appraisal of the Modification of the Director’s Duty of Care and Skill’ (2009) 21 *SA Merc LJ* 509 -510.

<sup>240</sup> McLennan J.S ‘Duties of Care and Skill of Company Directors and Their Liability for Negligence’ (1996) 8 *SA Merc LJ* 94.



powers and perform their functions in the best interests of the company'.<sup>241</sup> Furthermore, a director appointed by a corporation based on common law rules pertaining to any losses of delict or damages which the corporation may incur by means of a breach of duty of care and skill and losses due to contravention of provisions mention in the Memorandum of Incorporation (MOI) of the corporation, may be held liable.<sup>242</sup>

The personal liability measures put in place to protect directors leaves a lot of uncertainty. Furthermore, it has been found that there is no obligation upon companies in South Africa to indemnify their directors.<sup>243</sup> In addition, a company is permitted to indemnify itself against losses suffered by wrongful doings by its directors and also to take insurance against the wrongful deeds.<sup>244</sup> It is noted that the company is alone protected by the insurance cover and the director of the company not.<sup>245</sup> It has been shown that companies that has taken out directors and officers liability insurance policies has protected their business interests when insured.<sup>246</sup>

In addition, there is no compulsion upon companies to maintain an insurance policy.<sup>247</sup> Based on the findings and observations found, there is a huge need for the courts in South Africa to revise their current company legislation pertaining to directors liability and insurance. Being protected is a major concern for many applicants considering taking directorship positions in South African companies, therefore the following suggestions and recommendations to follow will be of great worth.

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<sup>241</sup> Van Tonder J.L 'An analysis of the Directors' duty to act in the best interests of the company, through the lens of the business judgment rule' (2015) *Obiter* 712.

<sup>242</sup> Stevens R 'The Legal Nature of the Duty of Care and Skill: Contract or Delict?' *PER/PELJ* 2017 (20) 1.

<sup>243</sup> Cassim M. F 'Obstacles and Barriers to the Derivative Action: Costs Orders under Section 165 of the Companies Act of 2008' (Part 2), 26 *S. Afr. Mercantile L.J.* 228 (2014) 240.

<sup>244</sup> Bekink M 'Indemnification and Aspects of Directors' and Officers' Liability Insurance in Terms of Section 78 of the Companies Act 71 of 2008', 23 *S. Afr. Mercantile L.J.* 88 (2011) 95.

<sup>245</sup> Bekink M 'Indemnification and Aspects of Directors' and Officers' Liability Insurance in Terms of Section 78 of the Companies Act 71 of 2008', 23 *S. Afr. Mercantile L.J.* 88 (2011) 95.

<sup>246</sup> Cassim M. F 'Obstacles and Barriers to the Derivative Action: Costs Orders under Section 165 of the Companies Act of 2008' (Part 2), 26 *S. Afr. Mercantile L.J.* 228 (2014) 240.

<sup>247</sup> Cassim F, Cassim M & Cassim R 'et al' *Contemporary Company Law 2ed* (2012) 578.

## 5.2 Suggestions and Recommendations

Firstly, it is suggested that Section 78 of the Companies Act, which provides for the indemnification and directors' insurance, be reformed. The section proposed, that ought to be amended, is section 78 (7).<sup>248</sup> This section provides as follows:

‘Except to the extent that the Memorandum of Incorporation of a company provides otherwise, a company **may** purchase insurance to protect –

- (a) a director against any liability or expenses for which the company is permitted to indemnify a director in accordance with subsection (5); or
- (b) the company against any contingency including, but not limited to -.’<sup>249</sup>

### **The provision could read as follows, it is suggested:**

‘Except to the extent that the Memorandum of Incorporation of a company provides otherwise, a company **must** purchase insurance to protect –

- (c) a director against any liability or expenses for which the company is permitted to indemnify a director in accordance with subsection (5); or
- (d) the company against any contingency including, but not limited to -.’

By including the word ‘must’ instead of ‘may’ will impose a legal obligation upon many companies in South Africa to obtain insurance to protect their directors. Furthermore, it is a suggestion that can be considered by the South African courts and would be very effective. It is suggested that the South African company laws be revisited and reconsidered, for a better corporate performance from directors also in effect limiting the concern of taking directorships position.

Secondly, it is recommended that a clause is inserted in directors' contracts that indemnification insurance must be obtain and maintained by the company for the director taking position in directorship. This will limit the fear of directors of financial and personal losses faced when taking the position and also the director corporate performance will be of

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<sup>248</sup> Section 78 (7) of the Companies Act 71 of 2008.

<sup>249</sup> Section 78 (7) (a) – (b) of the Companies Act 71 of 2008.

decent standard.<sup>250</sup> Furthermore, it has been noted with the new legislative and governance changes that in South Africa no corporation should be without Directors' and Officers' liability insurance.<sup>251</sup>

Thirdly, it is suggested that both director and company is held liable to pay the personal insurance premiums for a ratio of 50% each (Joined combined contribution to insurance policy premiums) or alternatively like compared comparators legislation, enforce South African companies to make full payment. That way both parties will be held accountable for the payment of personal insurance premiums in the event the director is unable to. It would be suggested to add this as a clause within the director's contract when taking up position within directorship of the company. It has been noted that directors is permitted to pay their personal insurance and indemnification coverage.<sup>252</sup> On the other hand, there is silence upon whether the premiums of insurance are allowed to be paid by companies in aid of their directors.<sup>253</sup> Author Bekink, is likewise of the opinion that the premiums of personal insurance be paid by the directors companies and that it would form part of a directors' conditions of services or alternatively included in the remuneration packages of directors.<sup>254</sup> Lastly, South African courts should circumvent to limit or cap the amount of indemnification and costs orders.<sup>255</sup>

Individuals needs to be aware of the increased obligations and potential exposure to liability when taking up a role as Director or Officer. It is recommended that the above mentioned clause be included in all business contracts. It would be advisable that no person should consider taking up a position as a Director or Officer before ensuring that there is a Directors' and Officers' Liability insurance policy in place. This will manage the risk exposure faced by

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<sup>250</sup> Bekink M 'Indemnification and Aspects of Directors' and Officers' Liability Insurance in Terms of Section 78 of the Companies Act 71 of 2008', 23 *S. Afr. Mercantile L.J.* 88 (2011) 105.

<sup>251</sup> Carciumaru L 'The importance of directors' and officers' liability insurance – in spite of the new Companies Act and King 3' (2012) 33 17.

<sup>252</sup> Bekink M 'Indemnification and Aspects of Directors' and Officers' Liability Insurance in Terms of Section 78 of the Companies Act 71 of 2008', 23 *S. Afr. Mercantile L.J.* 88 (2011) 96.

<sup>253</sup> Bekink M 'Indemnification and Aspects of Directors' and Officers' Liability Insurance in Terms of Section 78 of the Companies Act 71 of 2008', 23 *S. Afr. Mercantile L.J.* 88 (2011) 96.

<sup>254</sup> Bekink M 'Indemnification and Aspects of Directors' and Officers' Liability Insurance in Terms of Section 78 of the Companies Act 71 of 2008', 23 *S. Afr. Mercantile L.J.* 88 (2011) 96.

<sup>255</sup> Cassim M. F 'Obstacles and Barriers to the Derivative Action: Costs Orders under Section 165 of the Companies Act of 2008' (Part 2), 26 *S. Afr. Mercantile L.J.* 228 (2014) 232.

many directors. This will also allow many individuals to take on the position without any fear or concern. All the factors stated above point towards the development of standards through future case law and the successful application of standards. The courts of law have a significant function to play in the formation of South African law. Based on all the recommendations and suggestions made in this research paper and the constantly changing legislation makes it possible for growth in the future.



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### **List of Abbreviations**

MOI	Memorandum of Incorporation
SA Merc LJ	South African Mercantile Law Journal
Per/ PELJ	Potchefstroom Elektroniese Regstydskrif/ Potchefstroom Electronic Law Journal
Ltd	Limited
Stell Ir	Stellenbosch Law Review

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