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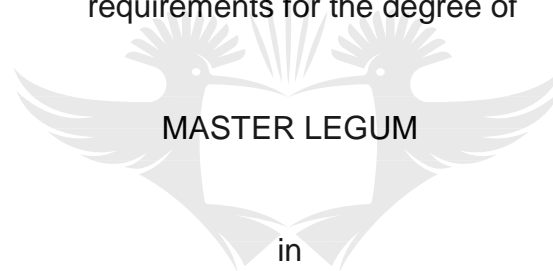
A CRITICAL ANALYSIS OF A DIRECTOR'S LIABILITY TO SHAREHOLDERS
ARISING IN TERMS OF A DIRECTOR'S DUTY OF CARE, SKILL AND
DILIGENCE

by

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Chapter 1: Introduction

1.1 *Research background*

The common law prescribes that directors have a duty of care and skill. Section 76(3)(c) of the Companies Act 71 of 2008 (the “Act”) has partially codified this duty and provides that directors of a company must exercise the powers and perform the functions of a director with the degree of care, skill and diligence that may reasonably be expected of a person: i) carrying out the same functions in relation to the company as those carried out by that director; and ii) having the general knowledge, skill and experience of that director. The failure by a director to properly exercise his duties is regulated by section 77 of the Act which sets out the liability of directors and prescribed officers and provides various circumstances in which a director will be held liable to a company. Specifically, section 77(2)(b)(i) of the Act provides that a director may be held liable to the company for any loss, damages or costs sustained by the company as a result of a director’s breach of the duty of care, skill and diligence. However, section 77 of the Act does not provide for the liability of directors to shareholders.

1.2 *Research question*

To what extent does a director’s duty of care, skill and diligence protect shareholders’ interests in the company?

1.3 *Research aims*

The recent developments regarding Steinhoff in South Africa and the alleged fraud or misconduct and/or negligence on the part of management and/or directors at Steinhoff, have resulted in a significant decrease in the Steinhoff JSE share price from approximately R46 in December 2017 to R1.65 on 31 December 2018. Many shareholders including but not limited to average citizens in South Africa and South African government employees have suffered an unprecedented decrease in their retirement fund values, due to the relevant retirement funds being invested in Steinhoff, on behalf of such retirement funds’ members. The collapse in the share price which has affected many South Africans necessitates an analysis on what

recourse, if any, these South African shareholders have against the directors who breach their duty of care, skill and diligence, when rendering their directorial duties and functions.

The aims of this research are to:

- i) Critically analyse the partial codification of a director's duty of care, skill and diligence set out in section 76(3)(c) of the Act and the effect thereof on application of the common law duty of care and skill;
- ii) Analyse the effect that the business judgment rule set out in section 76(4)(a) of the Act has on the application of a director's duty of care, skill and diligence; and
- iii) Determine whether shareholders have any recourse against directors who breach the duty of care, skill and diligence.

1.4 *Structure of mini dissertation*

The most appropriate manner of analysing the research question is to consider each element of the research aims on a chapter by chapter basis. Chapter 2 sets out an overview of a director's duty of care, skill and diligence and determines the persons who are directors of a company. Chapter 2 further addresses whether there is a distinction between executive and non-executive directors for purposes of the duty of care, skill and diligence and briefly discusses the partial codification of the duty of care, skill and diligence. Chapter 3 analyses the business judgement rule and briefly discusses its USA origins and the scope and application of the business judgment rule in South Africa. Furthermore, it discusses the effect of the business judgment rule on balancing shareholders' interests of profit maximisation, with the director's freedom to manage the company. The analysis of the business judgement rule aims to determine whether the business judgment rule can be used as a safe harbour against liability for a director who fails to properly exercise the duty of care, skill and diligence. Chapter 4 deals with the protection afforded to shareholders arising from a breach of a director's duty of care, skill and diligence in South Africa. Chapter 5 sets out the conclusions obtained in this work, in response to the research question.

Chapter 2: An overview of the development of a director's duty of care, skill and diligence

2.1 Introduction

Corporate governance in South Africa is regulated by the common law, the Act, the King IV Report on Corporate Governance for South Africa 2016 ("King IV"), the Johannesburg Stock Exchange Listings Requirements as well as other applicable legislation and regulations.¹ This research will briefly consider the common law, the Act and King IV in relation to a director's duty of care, skill and diligence. However, before we analyse a director's duty of care, skill and diligence, it is necessary to determine who are the directors of a company.

2.2 Directors

A director is defined in section 1 of the Act as any member of the board of a company, an alternate director, and includes any person occupying the position of a director or alternate director. This definition of "director" is a broad definition which *inter alia* includes *de facto* and *de jure* directors, executive and non-executive directors, nominee directors, shadow directors and *ex officio* directors.² In addition, for purposes of section 76 of the Act, which regulates the standards of a director's conduct, a director also includes prescribed officers and members of a board committee or members of the audit committee of a company. Accordingly, a director is not restricted to persons who are officially appointed as directors. Therefore, persons who have not been appointed as directors, for whatever reason, may also be regarded as directors for purposes of imposing fiduciary and statutory duties and liability on them.³ Now that we have ascertained who the directors of a company are, and before we can analyse a director's duty of care, skill and diligence, it is appropriate to determine the meaning of the words, "care", "skill" and "diligence".

2.3 Care, skill and diligence

"Skill" is defined in the Oxford Dictionary as the ability to do something well and thus with regard to directors, skill refers to the knowledge and experience that a particular

¹ Wiese *Corporate Governance in South Africa with International Comparisons* (2017) 15.

² FHI Cassim, MF Cassim, R Cassim, Jooste, Shev and Yeats *Contemporary Company Law* (2012) 510.

³ Cassim *et al* (n 2) 510.

director brings to his office and encompasses the technical competence of a director.⁴ “Care” is defined as the serious attention or consideration applied to doing something correctly or to avoid damage or risk, thus “care” in respect of directors can be regarded as the manner in which the skill is applied.⁵ While the exercise of care can be assessed objectively, skill varies from person to person as it is “that special competence which is the result of aptitude developed by special training and experience”.⁶

“Diligence” is defined in the Oxford Dictionary as careful or persistent work or effort, thus with regards to directors, “diligence” means properly attending to one’s duties as a director, which includes but is not limited to dedicating attention to the business of the company, the proper supervision and general monitoring of corporate affairs and policies, and regularly attending board meetings.⁷ It should be noted that section 76(3)(c) of the Act introduces a diligence element to the common-law duty of care and skill, and Cassim⁸ believes that the wording of this section indicates that “care” is different from diligence.⁹ However, Du Plessis¹⁰ believes that care and diligence should be viewed as one cumulative standard rather than trying to distinguish between care and diligence. This research agrees with Du Plessis’s point of view as both care and diligence relate to the manner in which skill is applied.

2.4 *The common law on the duty of care and skill*

The common law generally applies when a particular matter is not regulated by legislation.¹¹ Whilst the South African common law is mainly based on Roman-Dutch law, some English law has influenced the common law, by way of precedent.¹² The

⁴ Cassim *et al* (n 2) 556; <https://en.oxforddictionaries.com/definition/skill> (02-10-2018) and Van Tonder “An analysis of the Director’s decision-making function through the lens of the business-judgment rule” 2016 *Obiter* 562 570.

⁵ <https://en.oxforddictionaries.com/definition/care> (02-10-2018) and Van Tonder (n 4) 570.

⁶ Cassim *et al* (n 2) 556 and Cilliers, Benade, Henning, Du Plessis, Delpont, De Koker and Pretorius *Corporate Law* (2000) 147.

⁷ Van Tonder (n 4) 570 and <https://en.oxforddictionaries.com/definition/diligence> (02-10-2018).

⁸ Cassim *et al* (n 2) 559.

⁹ Van Tonder (n 4) 572.

¹⁰ Du Plessis “A comparative analysis of directors’ duty of care, skill and diligence in South Africa and in Australia” 2010 *Acta Juridica* 263 268. Du Plessis states without providing substantiation that “[a]s far as general noteworthy aspects are concerned, first, it should be noted that the word ‘diligence’, hardly ever used by South African commentators or South African courts, are included in section 76(3)(c). There is little doubt that this has been derived from Australian legislation s 180(1) of the Australian Corporations Act 2001”.

¹¹ Kleyn and Viljoen *Beginner’s Guide for Law Students* (2010) 80.

¹² Kleyn and Viljoen (n 11) 80.

English law doctrine of judicial precedent is based on the principle that the law which was applied to a particular matter should be applied to all similar matters.¹³ Accordingly, prior court decisions create binding precedents which must be followed.¹⁴

The South African common law on companies is largely based on English law and dictates that a fiduciary duty comes into existence when a person is in control of the assets of another person.¹⁵ According to the common law, the duties of directors are the fiduciary duties of good faith, honesty and loyalty.¹⁶ Directors fiduciary duties impose a primarily negative obligation on such directors to not do anything which conflicts with the interests of the company.¹⁷ Directors are also required to exercise due care and skill when performing their fiduciary duties.¹⁸ A director's duty to exercise due care and skill, is thus not a fiduciary duty, but rather regulates the performance of such director's fiduciary duties.¹⁹ However, it should be noted that the standard against which the degree of such care and skill should be measured is unclear.²⁰ The common-law duty of care and skill is premised on delictual or *Aquilian* liability for negligence.²¹ This duty has been conveyed by the courts in primarily subjective terms, dependant on the skill, experience and ability of a particular director. This has had the result that a low standard of care has been required of directors.²² Delictual liability of directors for breach of the duty of care, skill and diligence will be dealt with in more detail in Chapter 4.

¹³ Kleyn and Viljoen (n 11) 81.

¹⁴ Wiese (n 1) 15 and Kleyn and Viljoen (n 11) 81.

¹⁵ Wiese (n 1) 15; *Fisheries Development Corporation of South Africa Ltd v Jorgensen and Another: Fisheries Development Corporation of SA Ltd v AWJ investments (Pty) Ltd* 1980 4 SA 156 (W) 165 and Jones "Director's duties: negligence and business judgment rule" 2007 SA Merc LJ 333-334.

¹⁶ Cassim *et al* (n 2) 507.

¹⁷ Bekink "A historical overview of the director's duty of care and skill from the nineteenth century to the Companies Bill of 2007" 2008 SA Merc LJ 95 at 95.

¹⁸ Cassim *et al* (n 2) 507.

¹⁹ Cassim *et al* (n 2) 507 and 555.

²⁰ Cassim *et al* (n 2) 507; Cilliers *et al* (n 6) 147 and Bekink (n 17) 95.

²¹ *Ex Parte Lebowa Development Corporation Ltd* 1989 4 All SA 492 (T) 524; Cassim *et al* (n 2) 555 and Maharaj *A discussion on the duty of care, skill and diligence to be exercised by a director in light of the Companies Act 71 of 2008, as well as the common law and an overview of the business judgment rule: A company law perspective* (2015 UKZN thesis) 14.

²² Cassim *et al* (n 2) 554.

In the English case of *Re City Equitable Fire Insurance*,²³ the court set out the following three principles relating to a director's duty of care and skill:

- i) A director is not required to exhibit greater skills than may reasonably be expected from a person with his or her skills and knowledge;
- ii) A director is not required to give continuous attention to the affairs of a company; and
- iii) A director may trust the officials of a company, provided that such trust is reasonable.²⁴

The first principle set out above implies that if a director is unskilled or lacks the relevant business acumen, then a low standard of care and skill will be attached to such director. However, if a director is skilled or has the relevant business knowledge, then a high standard of care and skill will apply to such director. This is indicative of a subjective standard and not that of reasonable director. The second principle above may have been historically applicable to non-executive directors who may have not been required, by their terms of engagement or contracts to attend all board meetings.²⁵ However, the second principle is no longer indicative of what is currently expected of non-executive directors.²⁶

The South African case of *Fisheries Development Corporation of SA Ltd v Jorgensen & Another; Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd*²⁷ adopted the three principles set out in the *Re City Equitable Fire Insurance*²⁸ case and remains the principal case on the applicable standards of care, skill and diligence in South Africa.²⁹ The implementation of the abovementioned three English law principles in South Africa had the effect that a

²³ 1925 Ch 407.

²⁴ (n 23) 408.

²⁵ Cassim *et al* (n 2) 557.

²⁶ Cassim *et al* (n 2) 557.

²⁷ (n 15) 165-166.

²⁸ (n 23) 408.

²⁹ Mupangavanhu *Directors Standards of Care, Skill, Diligence and the Business Judgment Rule in view of South Africa's Companies Act 71 of 2008: Future Implications for Corporate Governance* (2016 thesis UCT) 110.

subjective test applied in terms of the common law to determine whether a director properly exercised his duty of care, skill and diligence.³⁰

The *Fisherries* case also described the duty of care, skill and diligence through drawing a distinction between executive and non-executive directors. This case stated that the duties of a non-executive director are of an intermittent nature and that a non-executive director is not required to have any special business acumen, experience or knowledge in the company. This indicates that the application of the duty of care, skill and diligence differs between executive and non-executive directors.³¹ The court in *Howard v Heriggel and Another*³² confirmed that directors have a duty to exercise the utmost good faith towards the company, and to utilise reasonable care and skill in doing so.³³ However, the court in *Howard* disagreed with the view stated in the *Fisherries* case regarding executive and non-executive directors.³⁴ The court in the *Howard* case stated that it was misleading to classify company directors as executive or non-executive, for purposes of determining their duties towards the company.³⁵ This research disagrees with the court in *Howard* as executive and non-executive directors have differing roles in a company and executive directors inherently have a more succinct and comprehensive understanding of the company's affairs. This is because executive directors are actively involved in the daily management of the company. Therefore, executive directors would have to exercise a greater standard of care and skill in rendering their duties than non-executive directors whose decisions would have to be made based on the information at their disposal, such as in board papers and other submissions, together with their specific skills, knowledge and experience. Before we consider a director's duty of care, skill and diligence in terms of the Act, it is appropriate to understand how the director's duty of care, skill and diligence was regulated by the old Companies Act 61 of 1973. This will provide insight into the historic regulation and development of a director's duty of care, skill and diligence, prior to implementation of the current Act.

³⁰ (n 15) 165; Mupangavanhu (n 29) 111 and Cassidy "Models for reform: The directors duty of care in a modern commercial world" 2009 *Stell LR* 373 384.

³¹ (n 15) 165.

³² 1991 2 All SA 113 (A).

³³ (n 32) 126.

³⁴ (n 32) 130.

³⁵ (n 32) 130.

2.5 *The Companies Act 61 of 1973 on the duty of care and skill*

Prior to the Act, the Companies Act 61 of 1973 (“old Act”) together with the common law regulated company law in South Africa until 1 May 2011. Directors’ duties were not codified in terms of the old Act and the common law applied in this regard. The old Act imposed civil and criminal sanctions for certain contraventions and directors could thus be held criminally and civilly liable to the company, in some instances.³⁶ The Act differs from the old Act in that it moves away from the criminal liability of directors to the personal liability of directors, for losses incurred by the company, due to misconduct on the part of such director.³⁷

2.6 *The Companies Act 71 of 2008 on the duty of care, skill and diligence*

A director’s duty of care, skill and diligence is dealt with in section 76(3) of the Act, which states as follows:

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

...

(c) with the degree of care, skill and diligence that may reasonably be expected of a person –

- (i) carrying out the same functions in relation to the company as those carried out by the director; and
- (ii) having the general knowledge, skill and experience of that director.”

Section 76(3)(c) of the Act imposes a dual or hybrid test that is partially objective and partially subjective on directors.³⁸ The first leg of the test in section 76(3)(c)(i) imposes a duty on a director to exercise the degree of care, skill and diligence that may reasonably be expected of a person carrying out the same functions as the director. It bears noting that the applicable standard here, is that of a reasonable person, however, the use of the words “carrying out the same functions ... as those carried out by that director” links the reasonable person in the first leg of the test to a

³⁶ s 424(1) and s 424(3).

³⁷ s 77 and Wiese (n 1) 80.

³⁸ Cassim *et al* (n 2) 559; Bouwman “An appraisal of the modification of the director’s duty of care, skill and diligence” 2009 *SA Merc LJ* 509 513 and Bekink (n 17) 111.

reasonable director.³⁹ The applicable standard in the first leg of the test, is therefore that of a reasonable director, and the first leg of the test is thus, an objective test.⁴⁰

The second leg of the test set out in section 76(3)(c)(ii) is subjective in that it requires that the knowledge, skill and experience of the relevant director to also be considered.⁴¹ Therefore, if a director has any specialist skill or has more knowledge or experience, his conduct will be measured against this higher subjective test.⁴² However, if a director does not have a high quality of skills, experience or knowledge, a lower level of care and skill will be required from such director, provided that he exercised the minimum reasonable level of care and skill, when exercising his director's duties.⁴³ Cassidy⁴⁴ believes that the second leg of the test in section 76(3)(c)(ii) of the Act undermines the objectivity of the skill test, by stipulating that a director is only required to meet the standard of a person having the skill and experience of that director. Cassidy is of the view that this transformation of the objective standard of skill into a subjective standard of skill, is inappropriate in the modern commercial world.

The use of words "carrying out the same functions ... as those carried out by that director" in section 76(3)(c)(i) of the Act implies that although all directors are required to comply with section 76(3)(c), there is a distinction between executive and non-executive directors, and that a different standard of care and skill may be sought from non-executive directors.⁴⁵ Bekink⁴⁶ believes that the executive or non-executive nature of a particular directorship will be taken into account when assessing a director's conduct. This research agrees with Bekink in this regard, as non-executive directors who are not directly involved in the day to day running of a company will not have the same degree of knowledge and inherent understanding of the business as executive directors who are actively involved in the daily affairs of a company. Therefore, it is submitted that non-executive directors who only have board papers and submissions at their disposal, should exercise a lower standard of care, skill and

³⁹ Bekink (n 17) 111; Van Tonder (n 4) 568 and Du Plessis (n 10) 269.

⁴⁰ Van Tonder (n 4) 568 and Du Plessis (n 10) 269.

⁴¹ Bouwman (n 38) 513-514; Cassim *et al* (n 2) 559 and Wiese (n 1) 76.

⁴² Cassim *et al* (n 2) 559; Wiese (n 1) 76 and Van Tonder (n 4) 568.

⁴³ Cassim *et al* (n 2) 559; Wiese (n 1) 76 and Van Tonder (n 4) 568.

⁴⁴ Cassidy (n 28) 385-386.

⁴⁵ Cassim *et al* (n 2) 559.

⁴⁶ Cassim *et al* (n 2) 559 and Bekink (n 17) 112.

diligence in rendering their duties than executive directors. This lower standard of care, skill and diligence will be based on the information at such non-executive director's disposal together with his particular skills set, knowledge and experience. On the other hand, the degree of care, skill and diligence required of executive directors should be greater than that of non-executive directors, as executive directors would have a better understanding of, and more detailed information on the inner workings of the company.

In addition to incorporating a diligence element into the common-law duty, section 76(3)(c) has the effect of increasing the common-law standard of care and skill that is required from a director.⁴⁷ The result of this, is that an inexperienced director must as a minimum requirement, exercise the degree of care, skill and diligence of a reasonable director. However, an experienced or highly qualified director's performance will be gauged against a higher standard.⁴⁸

Therefore, if a director is a qualified financial professional, for example, a chartered accountant who has served as a director for many years, and should irregularities be found in the financial records of a company, such director will not be able to rely on the reasonable director test. This is because a higher degree of care, skill and diligence with regards to financial matters will be expected from this director. Thus, the reasonable director test could not be successfully utilised by such director as a justification for failing to properly examine a company's financial records.

However, the situation would be different if the director in question is, for example, a human resources practitioner by profession and/or is a fairly inexperienced director with minimal finance related experience. In this case, and provided that such director did not by any action, display prior knowledge of the financial irregularities or any malfeasance in this regard, such director may be able to rely on the reasonable director test as justification for failing to recognise that there were problems with the financial records. Since this human resources practitioner director would not have had the skilled knowledge and experience to ascertain that there were problems with the financial records of the company, he would be judged against a lower standard of

⁴⁷ Bouwman (n 38) 513-514; Cassim *et al* (n 2) 559 and Van Tonder (n 4) 569.

⁴⁸ Bouwman (n 38) 513-514; Cassim *et al* (n 2) 559 and Van Tonder (n 4) 569.

care, skill and diligence than the director who is a qualified chartered accountant by profession. The director's duty of care and skill has been partially codified in section 76(3)(c) of the Act and it important to understand the implications of partial codification, in order to obtain a holistic view of the application of this duty.

2.7 *The partial codification of the duty of care, skill and diligence in the Act*

Section 158(a) of the Act provides that the courts "must develop the common law as necessary to improve the realisation and enjoyment of rights established by this Act" when determining a matter brought before it or making an order contemplated by the Act. This indicates that the intention of section 76(3)(c) of the Act is not to replace the common-law duty of care and skill, but rather to operate in tandem with the common law and to allow courts to further develop the common law in this regard, to the extent not in conflict with section 76(3)(c) of the Act.⁴⁹ Section 76(3)(c)⁵⁰ of the Act thus effectively amounts to a partial codification of a director's common-law duty to exercise care and skill.⁵¹ The purpose of developing the common law when applying section 76(3)(c), is to improve the application and implementation of the duties imposed by the Act.⁵²

Bouwman⁵³ is of the view that the partial codification of the duty of care and skill that co-exists with common-law decisions strikes the perfect balance as it informs directors and other stakeholders of the content of the duty of care and skill in a clear manner, thereby lessening the confusion stemming from the common law, whilst at the same time, maintaining the common-law principles which are valuable when determining complex cases. Havenga,⁵⁴ on the other hand, is of the view that the provisions of the Act may over regulate a director's duties and result in confusion rather than clarification. McLennan⁵⁵ is of the view that the partial codification of the

⁴⁹ Coetzee and Van Tonder "Advantages and dis-advantages of partial codification of directors' duties in the South African Companies Act 71 of 2008" 2016 *Journal for Juridical Science* 1 2-5.

⁵⁰ Section 76(3) provides that subject to subsections (4) and (5), a director of a company, when acting in that capacity, must exercise the powers and perform the functions of a director with the degree of care, skill and diligence that may reasonably be expected of a person (i) carrying out the same functions in relation to the company as those carried out by that director; and (ii) having the general knowledge, skill and experience of that director.

⁵¹ Coetzee and Van Tonder (n 49) 2 and Bouwman (n 38) 533.

⁵² Coetzee and Van Tonder (n 49) 9.

⁵³ Bouwman (n 38) 533.

⁵⁴ Havenga "Regulating directors' duties and South African company law reform" 2005 *Obiter* 609.

⁵⁵ McLennan "Directors' fiduciary duties and the 2008 Companies Bill" 2009 *TSAR* 184 186.

director's duty of care and skill in section 76(3)(c) of the Act is advantageous as it provides clarity on the overlap between a director's fiduciary duty and the duty of care and skill. Du Plessis⁵⁶ believes that section 76(3)(c) of the Act strikes the right balance between accountability and freedom of action, and that the inclusion of the director's duty of care, skill and diligence into the Act is advantageous. This is because if the standards of care, skill and diligence of directors are set too high, this would serve as a barrier to people accepting directorships.⁵⁷ Cassim⁵⁸ believes that the inclusion of fiduciary duties and the duty of care, skill and diligence in the Act is advantageous since it "tightens up and upgrades the director's duty of care and skill", as it reflects the standards which are required from directors in the current economic environment.⁵⁹ However, Cassim⁶⁰ submits that the disadvantage of partial codification is that the preservation of this duty and the extensive body of case law relating to this duty will result in more complexity since the duty will be derived from two sources instead of from just one source.

It is clear from the above that various authors have differing opinions on the advantages and disadvantages of the partial codification of the director's duty of care, skill and diligence. Notwithstanding the potential complexities that may result due to the existing case law on this matter, this research submits the partial codification of the director's duty of care and skill and the inclusion of the diligence element into this duty is more advantageous than disadvantageous. This is because partial codification enhances the duty and provides clarity on the overlap between a director's duty of care, skill and diligence and a director's fiduciary duties. The partial codification enhances the duty by allowing for the development of the common law in the statutory interpretation and application of the director's duty of care, skill and diligence. In addition, the partial codification is reflective of the current standards required from directors. Now that we have established the purpose of the partial codification of the duty, is it necessary to determine to the extent to which a director's duty of care, skill and diligence is also regulated by King IV.

⁵⁶ Du Plessis (n 10) 287-289.

⁵⁷ Du Plessis (n 10) 287-289.

⁵⁸ Cassim et al (n 2) 558 and Coetzee and van Tonder (n 49) 5.

⁵⁹ Cassim et al (n 2) 558 and Coetzee and van Tonder (n 49) 5.

⁶⁰ Cassim et al (n 2) 20.

2.8 *The King IV Report on Corporate Governance for South Africa 2016 and a director's duty of care, skill and diligence*

King IV sets out voluntary principles and recommended practices for corporate governance. King IV provides that the board of directors, as the governing body of a company is responsible for the corporate governance of a company.⁶¹ Should King IV conflict with any legislation, then such legislation will prevail. However, the Johannesburg Stock Exchange (“JSE”) Listings Requirements has made certain aspects of King IV binding on companies with a primary listing on the JSE. Therefore, although the King IV principles and practices are not binding on directors, a court will take account of all relevant circumstances when deciding on the appropriate standard of conduct required by directors.⁶² For purposes of this research, it relevant to note that King IV provides that the board of directors must act with due care, skill and diligence and must take reasonably diligent steps to become informed about matters for decision.⁶³ Now that we have ascertained that King IV also requires directors to exercise their duties with care, skill and diligence, it is appropriate to determine the application of the duty of care, skill and diligence in the United Kingdom (“UK”). This is because the South African common law on companies is largely based on English law and because of the similarities between South African and UK company law.

2.9 *The UK approach to the duty of care, skill and diligence*

Subsequent to the *Re City Equitable Fire Insurance* case, a UK court in *Norman v Theodore Goddard*⁶⁴ stated that section 214⁶⁵ of the UK Insolvency Act 1986, reflected the correct position on the common-law duty of care and skill, which position was subsequently incorporated as section 174 of the UK Companies Act of 2006 (“UK Companies Act”), which provides as follows:

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

⁶¹ Part 3 35.

⁶² King IV 35 and Wiese (n 1) 80.

⁶³ Part 5.1 43.

⁶⁴ 1991 BCLC 1028 (ChD) 1029.

⁶⁵ Section 214(4) states that for the purposes of subsections (2) and (3), the facts which a director of a company ought to know or ascertain, the conclusions which he ought to reach and the steps which he ought to take are those which would be known or ascertained, or reached or taken, by a reasonably diligent person having both (a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as are carried out by that director in relation to the company; and (b) the general knowledge, skill and experience that that director has.

- (2) This means the care, skill and diligence that would be exercised by a reasonably diligent person with—
 - (a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company, and
 - (b) the general knowledge, skill and experience that the director has.”

It is apparent from the above that the statutory duty of care, skill and diligence provisions in section 174 of the UK Companies Act and section 76(3)(c) in the South African Act are very similar, and that both Acts incorporate objective and subjective tests.⁶⁶ Section 170(3) of the UK Companies Act provides that the UK Companies Act codifies and replaces the common-law duty of care, skill and diligence. However, section 170(4) of the UK Companies Act states that the duty must be interpreted and applied in the same manner as the common-law duty and that regard must be had to the UK common-law duties when interpreting the statutory duties. Whilst at first glance, sections 170(3) and 170(4) of the UK Companies Act appear to contradict each other, this research agrees with Mupangavanhu’s⁶⁷ view that section 170(4) of the UK Companies Act should be read to mean that the UK common law should be instructive in the interpretation of the duties in section 174. This approach nullifies the potential confusion created between sections 170(3) and 170(4) of the UK Companies Act and is thus the most appropriate interpretation. Therefore, although section 174 of the UK Companies Act codifies and replaces the common-law duty of care, skill and diligence, regard will be had to the UK common law to interpret the duty of care, skill and diligence.⁶⁸ This is similar to the position in South Africa where the Act partially codifies the duty of care, skill and diligence, but allows for the development of the South African common law in the interpretation and application of the statutory duty of care, skill and diligence.

Similar to the position in South Africa, the words “carrying out the functions carried out by a director” in section 174(2)(a) of the UK Companies Act implies that although all directors are required to carry out their functions with care, skill and diligence, there is a distinction between executive and non-executive directors, and that a lower standard of care, skill and diligence may be sought from non-executive

⁶⁶ McLennan (n 55) 186 and Bouwman (n 38) 516.

⁶⁷ Mupangavanhu (n 29) 73-75.

⁶⁸ Omar “In the wake of the Companies Act 2006: An assessment of the potential impact of reforms to company law” 2009 *International company and commercial law review (ICCLR)* 44 47-48 and Bouwman (n 38) 517.

directors, who are not involved in the daily operations of a company and thus not privy to the same information as an executive director.⁶⁹ It is clear from the foregoing that the duty of care, skill and diligence has a similar interpretation and application in both South Africa and the UK.⁷⁰

2.10 Conclusion

It is necessary to understand the ambit of a director's duty of care, skill and diligence in order to ascertain the extent to which this duty protects shareholders' interests in a company against loss. This chapter sets out a brief overview of the duty of care, skill and diligence applicable to directors in South Africa. Whilst both the common law and the Act prescribe binding duties of care and skill for directors, the Act imposes an additional diligence element for directors as well as imposing objective and subjective standards on the duty of care, skill and diligence of directors. It is also apparent that differing standards of care, skill and diligence are required by executive and non-executive directors. Whether or not a director exercised his duties with the requisite degree of care, skill and diligence will be determined on a case by case basis, with regard to the particular facts at hand, and the applicability of the business judgment rule. The business judgment rule may in certain circumstances be used as a safe harbour against liability for a director who fails to properly carry his out duties and is thus discussed in Chapter 3.

⁶⁹ Stevens "The legal nature of the duty of care and skill: contract or delict" 2017 *PELJ* 1 11.

⁷⁰ Bouwman (n 38) 516.

Chapter 3: An analysis of the business judgement rule

3.1 Introduction

The origins of the business judgment rule stem from the United States of America (“USA”) and it thus necessary to determine the ambit scope and purpose of the business judgment rule in the USA. In the USA, the test applied by the courts for determining the reasonableness of a director’s decision incorporates a protective rule, known as the business judgment rule.⁷¹ The crux of the business judgment rule is that businesses must take risks to grow, and that directors should thus be supported in taking prudently thought out and reasonable risks, without fear of being held personally liable for doing so.⁷² The rule essentially prevents a court from interfering with the benefit of hindsight, in the honest and reasonable business decisions of the directors of a company.⁷³ It should be noted that the business judgement rule has also been adopted by statute into in South Africa law by way of section 76(4) of the Act.

There are three preconditions or requirements for the operation of the business judgment rule in the USA, namely that:

- i) There must be a business judgment or business decision;
- ii) The director must not be interested in the decision; and
- iii) The duty to be informed must have been satisfied.⁷⁴

When the aforementioned three preconditions for the operation of the business judgment rule are met, liability will only be imputed to directors, in rare cases where the decision is completely unfathomable.⁷⁵ In the Delaware case of *Smith v Van Gorkum*⁷⁶ where the business judgment rule was applied, the court found that the directors were grossly negligent as they had hastily approved a merger without adequately informing themselves about the value of the company’s business.⁷⁷ The directors thus breached the duty of care owed to the company’s shareholders and could therefore not rely on the protection afforded by the business judgment rule.

⁷¹ Wiese (n 1) 77 and Van Tonder (n 4) 573.

⁷² Bouwman (n 38) 523 and Cassim *et al* (n 2) 563

⁷³ Cassim *et al* (n 2) 563 and Cassidy (n 30) 400.

⁷⁴ Cassidy (n 30) 402 and Mupangavanhu (n 29) 153.

⁷⁵ Cassidy (n 30) 402 and Bouwman (n 38) 525.

⁷⁶ 488 A.2nd 858 (Del.Spr 1985).

⁷⁷ (n 76) 873-874.

The business judgement rule in the USA functions as both a procedural rule and a substantive rule of law.⁷⁸ It is procedural in that it creates a presumption that an informed decision was made in good faith, in the honest belief that the decision was made in the best interests of the company.⁷⁹ The rule is substantive in that it requires a court to defer to a business judgment or business decision made by the directors, provided that such decision was not completely irrational.⁸⁰

In the case of *Cede & Co. v Technicolor Inc*,⁸¹ the court stated that the person who alleges that a director failed to meet the requirements of the business judgment rule bears the burden of rebutting the business judgment rule's presumption. Should the presumption not be successfully rebutted, then the business judgment rule will protect directors from the decisions that they make and the courts will not second guess these decisions. However, if the business judgment rule is successfully rebutted, then the burden of proof will shift to the directors, who will have to prove that the entire decision-making process was fair and in accordance with the business judgement rule requirements. Should the directors not be able to successfully defend their actions, then a substantial review of the business decision in question will be undertaken.⁸²

Since we have established USA foundation and of application of the business judgement rule, we have a basis for assessing the inclusion of a business judgement rule into South African statute, by way of section 76(4) of the Act. However, before we analyse the South African business judgement rule, it is necessary to understand the common-law delegation and reliance principles as the South African business judgment rule makes provision for delegation and reliance by the directors of a company.

3.2 *Common-law delegation and reliance*

According to the common law, directors are permitted to delegate their responsibilities and rely on the advice of third parties, without the necessity to

⁷⁸ *Cede & Co v Technicolor Inc* 634 A 2nd 345 (Del.Spr 1993) 361.

⁷⁹ Van Tonder (n 4) 579-580.

⁸⁰ Van Tonder (n 4) 579-580.

⁸¹ (n 78) 361.

⁸² (n 78) 361 and Mupangavanhu (n 29) 154-155.

supervise such third parties.⁸³ The South African case of *Fisheries Development Corporation*⁸⁴ adopted the principles set out in the *Re City Equitable Fire Insurance*⁸⁵ case whereby a director is allowed to rely on another “in the absence of grounds of suspicion” and to assume that the third party to whom responsibilities have been delegated, is honestly and properly performing their duties.⁸⁶ Cassidy⁸⁷ believes that this common-law approach allows directors to pass off their responsibilities to another person, without taking the reasonableness of such delegation of responsibility into account, as no heed is paid to the competence or trustworthiness of the person receiving the delegation. This research does not agree with this view, because although directors are allowed to delegate responsibilities, they cannot relinquish their responsibilities and have a duty to supervise and monitor the discharge of the delegated responsibilities.⁸⁸ Understanding the common-law delegation and reliance principles are relevant for purposes of this research, because part of the business judgment rule in essence, contains delegation and reliance principles, as are discussed further below.

3.3 *The Companies Act and the business judgment rule*

Section 76(4) of the Act sets out the statutory South African business judgment rule and unlike the case in the USA, section 76(4) does not require that the business judgement or business decision must have been made for a proper purpose.⁸⁹ However section 76(4)(a) of the Act creates a presumption that a director will have complied with the duty to act in the company’s best interests⁹⁰ and will have exercised the duty of care, skill and diligence, if three prescribed requirements for the application of the business judgment rule are met.⁹¹ The first requirement is that the decision of the director must be an informed decision. The second requirement is that the director must have no personal financial interest in the decision, he should not be self-dealing, or if applicable, he must make the necessary disclosure in accordance with section 75 of the Act. The third requirement is that the director must

⁸³ Cassidy (n 30) 394.

⁸⁴ n 15 above.

⁸⁵ n 23 above.

⁸⁶ Cassidy (n 30) 402 and (n 23) 429.

⁸⁷ Cassidy (n 30) 402.

⁸⁸ *Re Barings plc* (no 5) 1999 1 BCLC 433 (ChD) 434 and *Cassim et al* (n 2) 561.

⁸⁹ *Cassim et al* (n 2) 564 and *Bouwman* (n 38) 529.

⁹⁰ s 76(3)(b).

⁹¹ Cassidy (n 30) 398.

have a rational basis for believing and must in fact, have believed that the decision was in the best interests of the company.⁹²

The first principle on making informed decisions will be discussed first. Save where the particular circumstances allow a reasonable director to conclude that he is adequately informed about the matter at hand, the standard of care requires a director to take steps to become informed about the particular circumstances and background facts, prior to taking any action in such matter.⁹³ The process of becoming informed would usually entail the review of written materials provided before and after a meeting as well as participation in deliberations on the matter, prior to a vote on the matter at hand.⁹⁴ However, there is no specifically mandated way to become informed and there are various manners and mechanisms, by which a director may become informed about a matter.⁹⁵ A director must however exercise his reasonable discretion to determine how to become informed as well as how much information he needs in order to become sufficiently informed about the matter at hand.⁹⁶

The second requirement regarding no self-dealing, and the disclosure of personal financial interests is important to determine potential conflicts between a director's personal interests and the interests of the company.⁹⁷ The personal interests that must be disclosed could be that of the director or that of a related party. Should the director or a related party have any personal financial interests in a matter to be considered at a meeting of the board, then such director must disclose the relevant personal interests and its general nature, before such matter is considered at the board meeting.⁹⁸ If the director is present at the board meeting where such matter is to be considered, the director must leave the meeting after making the required disclosure.⁹⁹ In addition, such director may not execute any documents on behalf of the company relating to the matter in which he has personal financial

⁹² Bouwman (n 38) 525; Cassim *et al* (n 2) 564 and Wiese (n 1) 78.

⁹³ Van Tonder (n 4) 580 and Cassim *et al* (n 2) 565.

⁹⁴ Van Tonder (n 4) 580.

⁹⁵ Van Tonder (n 4) 580.

⁹⁶ Van Tonder (n 4) 580.

⁹⁷ Cassim *et al* (n 2) 564.

⁹⁸ s 75(5)(a).

⁹⁹ s 75(5)(d).

interests, unless he is specifically requested or directed to do so by the board of the company.¹⁰⁰

With regard to the third requirement relating to rationality in section 76(4)(a) of the Act, it must be noted that the test of rationality is an objective test and thus section 76(4)(a) will not protect an objectively irrational decision.¹⁰¹ The court in *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd*¹⁰² stated that the rationality requirement in respect of the proper exercise of power by directors, concerns the relationship between the decision and the purpose for which the power was given. If there is a rational connection between the decision and the purpose for which the power was given, the court will not interfere in the decision made by the directors.¹⁰³ The court in *Visser* has followed an approach whereby the reasonableness of a director's decision will not be considered, and the courts will only find a director liable where the director acted irrationally.¹⁰⁴ Wiese¹⁰⁵ is of the view that an approach which requires directors to take objectively reasonable actions or decisions should rather be followed and this research concurs with Wiese in this regard.

The effect of section 76(4)(a) of the Act, is that it protects the informed and rational business decisions of directors.¹⁰⁶ Therefore, if the requirements set out in section 76(4)(a) of the Act are complied with, a director will not be held liable for any honest errors of judgement or any honest and reasonable mistakes that he may have made in managing the affairs of the company.¹⁰⁷ A director will thus be presumed or deemed to have complied with his duties to act in the best interests of the company and to have exercised care, skill and diligence in performing his duties.¹⁰⁸

¹⁰⁰ s 75(5)(g).

¹⁰¹ Cassim *et al* (n 2) 564.

¹⁰² 2014 (5) SA 179 (WCC) 199-200.

¹⁰³ Wiese (n 1) 78.

¹⁰⁴ (n 102) 204.

¹⁰⁵ Wiese (n 1) 78.

¹⁰⁶ Cassim *et al* (n 2) 564; Wiese (n 1) 78 and (n 102) 204.

¹⁰⁷ Cassim *et al* (n 2) 564 and Wiese (n 1) 78.

¹⁰⁸ Cassim *et al* (n 2) 564.

The common-law principles relating to delegation and reliance have been expanded upon and partially codified in sections 76(4)(b) and 76(5) of the Act.¹⁰⁹ Section 76(4)(b) of the Act provides for a director to become informed and sets out the circumstances in which a director is permitted to rely on the advice of third parties, whilst section 76(5) of the Act lists the persons whom a director may rely upon. Section 76(4)(b)(i)(bb) of the Act acknowledges the board's ability to delegate responsibility and encompasses a reasonable delegation test.¹¹⁰

Furthermore, section 76(4)(b) read together with section 76(5) essentially stipulates that directors may rely on the performance of employees, professional advisers, subject matter experts, or board committees, provided that the director reasonably believes that such persons merit confidence or are reliable and competent.¹¹¹ Should a director comply with the requirements of section 76(4)(b) and 76(5), such director will not be held liable for the actions of persons, upon whom he has placed his reliance. However, a director's reliance on the competence of any person listed in section 76(5) must be reasonable.¹¹² Therefore, if a director knows that the person upon whom he has placed his reliance or to whom he has delegated a task, is dishonest or incompetent, the director's reliance on such person will be unreasonable with the consequence that the director may incur liability for the transgressions of such person.¹¹³ The scope and parameters of the business judgment rule have been set out above, however, it is imperative to determine the impact of the inclusion of business judgment rule principles into South African law.

3.4 *Analysis of statutory business judgment rule in South Africa*

South Africa and the USA have differing legal systems and it is therefore necessary to determine the applicability and usefulness of the inclusion of a business judgment rule with USA origins, into South African company law. Jones¹¹⁴ believes that the fact that the business judgment rule was developed by the USA courts is indicative of its inappropriateness in the South African context. The fact that the business

¹⁰⁹ Mupangavanhu (n 29) 137.

¹¹⁰ Wiese (n 1) 79.

¹¹¹ Wiese (n 1) 79 and Cassim *et al* (n 2) 562.

¹¹² Cassim *et al* (n 2) 562; Wiese (n 1) 79 and Mupangavanhu (n 29) 138.

¹¹³ Cassim *et al* (n 2) 562 and Mupangavanhu (n 29) 138-139.

¹¹⁴ Jones (n 15) 327.

judgment rule blurs the distinction between a director's fiduciary duty to his company and the duty of care skill and diligence, is illustrative of the fact that the USA law on a director's duties differs substantially from the South African legal position.¹¹⁵ Jones¹¹⁶ further believes that the adoption of the business judgement rule in the South African context as a means of limiting a director's duty of care, skill and diligence would effectively lower the standard of care, skill and diligence required from directors. Whilst this research agrees with Jones that the USA and South Africa have differing legal systems and that the business judgement rule may thus not be appropriate in the South African legal context, this research does not believe that the incorporation of the business judgment rule into South African statute, necessarily lowers the standard of care, skill and diligence required from directors. This is because the prescribed South African statutory requirements for the application of the business judgment rule necessitates that the director must make informed decisions, that the directors should not have any personal financial interests the relevant decisions and that the director must have a rational basis for believing that such decisions were in the best interests of the company. In addition, the business judgment rule has the effect of partially codifying the existing common law delegation and reliance principles, which are not new principles in South African law. The codification of the delegation and reliance principles relates to the first requirement of a director to make informed decisions.

Bouwman¹¹⁷ believes that since the criteria used to make a determination of breach of the duty, care and skill and diligence are not easily achieved, it is thus necessary for us to move away from the incorporation of the business judgement rule into South African law. This is because the business judgement rule in essence provides directors with a further defence to aid them against any allegations of a breach of the duty of care, skill and diligence by directors. Furthermore, Bouwman¹¹⁸ is of the view that the inclusion of the business judgement rule into the Act was a misstep by the legislature and that the rule should have in fact been omitted from the Act. This research accepts Bouwman's view that proving a breach of a director's duty of care, skill and diligence is difficult to achieve and that directors do not require any further

¹¹⁵ Jones (n 15) 327.

¹¹⁶ Jones (n 15) 327.

¹¹⁷ Bouwman (n 38) 533-534.

¹¹⁸ Bouwman (n 38) 533-534.

defences, such as the business judgement rule, to aid them to escape liability from breaches of the duty to exercise care, skill and diligence. However, this research believes that the purpose of the business judgment rule is to regulate risk-taking by directors, to *inter alia* maximise corporate profits and thereby shareholder returns, whilst protecting directors against hindsight bias, in a review of their decisions. The business judgement rule would thus serve to protect the decisions made by directors when exercising due care, skill and diligence, despite the fact that in hindsight, such decisions may turn out to have unfavourable results.

Mupangavanhu¹¹⁹ is of the view that the inclusion of a business judgment rule into the Act is a positive development for South African company law. This is because the business judgment rule provides a test or standard of review that is to be applied when reviewing a director's conduct.¹²⁰ For purposes of this research, the standard of conduct that will be reviewed is the director's duty of care, skill and diligence. Mupangavanhu¹²¹ further states that there are no indicators that suggest that the purpose of the business judgment rule is to dilute the effectiveness of a director's duty of care, skill and diligence under the Act and this research concurs with Mupangavanhu. Due to the similarities between South African and UK company law, it is necessary to determine whether the UK Companies Act incorporates a business judgment rule and the rationale for the incorporation or non-incorporation of a business judgment rule into UK law.

3.5 *Non-inclusion of business judgment rule in the UK Companies Act*

The UK Law Reform Commission *inter alia* investigated whether a statutory business judgment rule was necessary in the UK and found that there was no need for a statutory formulation of the business judgment rule in the UK Companies Act of 2006. The Law Reform Commission stated that courts in the UK applied similar reasoning in duty of care decisions to those applied in the USA business judgment rule decisions, in that UK courts were reluctant to review business decisions where

¹¹⁹ Mupangavanhu (n 29) 174.

¹²⁰ Mupangavanhu (n 29) 221.

¹²¹ Mupangavanhu (n 29) 221.

elements of gross negligence or self-interest were absent.¹²² In addition, the UK courts would not find directors liable for mere errors of judgment.¹²³ The court in the case of *Shuttleworth v Cox Brothers & Company (Maidenhead) Limited*¹²⁴ stated that it “is not the business of the court to manage the affairs of the company”, irrespective of whether the court would have come to the same decision or a different decision. The Law Reform Commission thus found nothing to evidence that a statutory business judgment rule would result in higher standards of a director’s behaviour.¹²⁵

3.6 Conclusion

This chapter sets out a brief overview of the business judgment rule and its inclusion into South African law since the business judgment rule is a new concept in South African company law. It was determined that the statutory business judgement rule is directly related to a director’s duty of care, skill and diligence. The application of the statutory business judgment rule in South Africa is not an exact duplication of the USA business judgment rule, however, this could be imputed to the differing legal systems in South Africa and the USA. Although the intention of the business judgement rule is to prevent hindsight bias and to balance shareholders’ interests of profit maximisation with the director’s freedom to manage the company, the business judgement rule should not be used as a loophole for directors to escape liability for failing to properly exercise the requisite duty of care, skill and diligence. After discussing the scope and application of the business judgment rule, it is appropriate to determine the extent of protection that shareholders have against a director who breaches the duty of care, skill and diligence.

¹²² The Law Commission and Scottish Law Commission “Regulating conflicts of interest and formulating a statement of duties” 1999 417- 419.

http://www.lawcom.gov.uk/app/uploads/2015/06/cp153_Company_Directors_Consultation.pdf (21/10/2018).

¹²³ n 122 above.

¹²⁴ 1927 2 KB 9 23-24 and Mupangavanhu (n 29) 76.

¹²⁵ Mupangavanhu (n 29) 75 to 76 and n 122 above.

Chapter 4: Extent of protection of shareholders arising from a breach of a director's duty of care, skill and diligence in South Africa

4.1 Introduction

The Steinhoff saga has been mentioned to be one of the controversies surrounding the topic on the duties of directors in the commercial sphere. This is because it has brought about a lot of speculation on who bears the liability for the losses incurred. The dilemma being whether or not Steinhoff shareholders may hold Steinhoff directors liable for the losses incurred. Therefore, this necessitates a discussion on the Steinhoff saga, what it is and how the liability of a director comes into play when it comes to the duty of skill, care and diligence. A brief summary of the Steinhoff matter is set out below, however, it must be emphasised that the information below is based on data obtained from public sources and may not be entirely accurate.¹²⁶

4.2 Steinhoff facts and allegations

The Steinhoff¹²⁷ board announced on 6 December 2017 that its CEO, Markus Jooste, would step down with immediate effect and the Steinhoff board also announced that its auditors, Deloitte, had flagged information relating to accounting irregularities, which would result in the delay of the release of its audited financial results.¹²⁸ Auditing services firm, PricewaterhouseCoopers, was subsequently appointed by Steinhoff to conduct an independent investigation into its books of account.¹²⁹ Whilst we do not know all the facts, and will not know the extent of the Steinhoff debacle until the auditor's report is available, the information available from various public sources indicates that Steinhoff undertook some creative accounting over a number of years, to misrepresent the company's finances in a more positive light than the actual financial state of affairs.¹³⁰

¹²⁶ Although the information has been obtained from public sources, these public sources nevertheless provide contextual background in order to solve the issues raised by the research question.

¹²⁷ Steinhoff International is a South African retail company of primarily furniture and other retail goods. It is dual listed in South Africa and Germany and it has operations in Africa, Asia, Australia, Europe, New Zealand and the USA.

¹²⁸ Naude, Hamilton, Ungerer, Malan and De Klerk "The Steinhoff saga: Part 1: The making of a corporate giant" *Financial Mail* <https://www.businesslive.co.za/rdm/business/2018-06-15-the-steinhoff-saga-part-one-the-making-of-a-corporate-giant/> (28-06-2018).

¹²⁹ Naude *et al* (n 128).

¹³⁰ Naude *et al* (n 128).

It is alleged that Steinhoff did this by *inter alia* creating off-balance sheet entities, including Champion Capital and Southern View Finance, which entities were not disclosed in Steinhoff's financial statements as related party entities, and utilising these off-balance sheet companies to artificially inflate Steinhoff's earnings.¹³¹ It is also alleged that these off-balance sheet entities are controlled by former Steinhoff executive officers and associates.¹³² According to Viceroy Research Group, Steinhoff used the off-balance sheet entities to inflate its earnings in three ways. Firstly, Steinhoff *inter alia* issued loans to Champion Capital subsidiaries and also booked revenue interest against these Champion Capital subsidiaries, for the purchase of loss-making Steinhoff subsidiaries. However, these revenues will never translate into cash. In addition, these loans were not booked as related party transactions, despite Champion Capital being a related party entity.¹³³ Secondly, Steinhoff moved two loss-making and predatory consumer loan providers to JD Consumer Finance and Capfin, which are off-balance sheet entities.¹³⁴ Thirdly, Steinhoff thereafter negotiated the repurchase of profitable portions of JD and Capfin only (loan administration and debt collection facilities) while allowing losses to be incurred at off-balance sheet, related party entities under Champion Capital. Since the loss-making entities are being round-tripped back to Steinhoff, Viceroy is of the view that "it is possible that Steinhoff are/was 'repaying' Champion's outlays through acquisition premiums (i.e. losses are being capitalised through round-trip transactions with related parties)".¹³⁵

It has also been alleged in public sources that Steinhoff's previous CEO, Markus Jooste, held secret stakes in various companies that Steinhoff did business with and that these transactions and their beneficiaries were not reported to Steinhoff shareholders.¹³⁶ Ultimately, the accounting irregularities and the non-disclosure of related party transactions and conflicts of interest by directors, such as Markus Jooste, has resulted in various parties, including but not limited to South African

¹³¹ <https://viceroyresearch.org/2017/12/06/steinhoffs-skeletons-off-balance-sheet-entities-inflating-earnings-obscuring-losses/> (16-03-2018).

¹³² (n 131) 1.

¹³³ (n 131) 1.

¹³⁴ (n 131) 1.

¹³⁵ (n 131) 1.

¹³⁶ Mckune & Thomson "Steinhoffs secret history and the dirty world of Markus Jooste" *Financial Mail* <https://www.businesslive.co.za/fm/features/cover-story/2018-11-01-steinhoffs-secret-history-and-the-dirty-world-of-markus-jooste/> (10-11-2018).

retirement funds, investing in JSE listed Steinhoff shares, based on the inaccurate financial information available to them. This chapter seeks to ascertain the potential liability of directors to shareholders for a breach of the duty of care, skill and diligence and whether based on the Steinhoff allegations above, one or more Steinhoff directors could be held liable to its shareholders for a breach of the duty of care, skill and diligence which resulted in a drastic diminution in the Steinhoff share price and thus created losses for the shareholders of Steinhoff shares.

4.3 *Liability for breach of the duty of care and skill in terms of the common law*

A person alleging a breach of a fiduciary duty will have to bring an action based on a breach of trust. However, as stated earlier in Chapter 2, the cause of action for a breach of the duty of care and skill in terms of the common law is delict. A delict is the act of a person that causes harm to another in a wrongful and culpable way.¹³⁷ The requirements for delict are: i) an act; ii) wrongfulness; iii) fault; iv) harm; and v) causation, and all five of these requirements must be present in order for the conduct complained of, to constitute a delict.¹³⁸ If any one or more of the five requirements are absent, then there will be no delict, and accordingly, no liability.¹³⁹

The South African law of delict is based on the *actio legis Aquiliae*, the *actio iniuriarum*, and the action for pain and suffering.¹⁴⁰ The *actio iniuriarum* deals with injury to personality, the action for pain and suffering deals with bodily injuries and the *actio legis Aquiliae* deals with patrimonial damages.¹⁴¹ For purposes of this research, the focus will be on the *actio legis Aquiliae* and patrimonial damages. Patrimonial damages or patrimonial loss arises as a result of the “loss or reduction in value of a positive asset in someone’s patrimony or the creation or increase of a negative element of such patrimony”.¹⁴² The court in *Ex Parte Stubbs NO: In re Wit Extension Ltd*¹⁴³ stated that a director who breaches his duty of care and skill, whether intentionally or negligently, is liable for delictual damages to the company.¹⁴⁴ Thus, the cause of action for a breach of the duty of care, skill and diligence is based

¹³⁷ Neethling, Potgieter and Visser *Law of Delict* (2014) 1.

¹³⁸ Neethling *et al* (n 137) 5 and Jones (n 15) 334.

¹³⁹ Neethling *et al* (n 137) 6.

¹⁴⁰ Neethling *et al* (n 137) 9.

¹⁴¹ Cassim *et al* (n 2) 555; Neethling *et al* (n 137) 9 and Jones (n 15) 19.

¹⁴² Neethling *et al* (n 137) 202.

¹⁴³ 1982 3 All SA 340 (W).

¹⁴⁴ (n 143) 346 and Bekink (n 17) 102.

on delict or Aquilian liability for negligence and where a director breaches this duty, delictual damages are recoverable by the company.

Negligence is a characteristic of conduct, thus when a person's conduct falls short of the standard that the law demands from him, such conduct is described as negligent and the person is guilty of acting negligently.¹⁴⁵ The court in *Ex Parte Lebowa Development Corporation*¹⁴⁶ stated that anyone who negligently injures another is personally liable to the victim in terms of the common-law *actio legis Aquiliae* remedy for patrimonial loss resulting from the negligence.¹⁴⁷ The criteria used to determine whether a person has acted carelessly and thus negligently, is the objective standard of the reasonable man or reasonable person test.¹⁴⁸ A person would be found to be negligent if a reasonable person in his position would have acted differently, if the unlawful causing of damage was reasonably foreseeable and preventable.¹⁴⁹

Therefore, fault would arise:

- a) firstly, where a reasonable person in the position of the perpetrator:
 - i) would foresee the reasonable possibility of his conduct injuring another in his person or property and causing him patrimonial loss; and
 - ii) would take reasonable steps to guard against such occurrence; and
- b) secondly where the perpetrator failed to take such steps.¹⁵⁰

In support of the above, the court in *Du Plessis NO v Phelps*¹⁵¹ stated that the liability that results from a director failing to take reasonable care in the management of the company's affairs, is based on the *lex Aquilia* and that the basic requirement of the *lex Aquilia* is fault, which results in loss.¹⁵² The court in *Jowell v Bramwell-Jones*¹⁵³ stated that the Aquilian action is available for claims for damages resulting in pure economic loss and that the wrongdoer's conduct must merely comply with

¹⁴⁵ Boberg *The Law of Delict* (1984) 269.

¹⁴⁶ n 21 above.

¹⁴⁷ (n 21) 524.

¹⁴⁸ n 145 above.

¹⁴⁹ n 145 above.

¹⁵⁰ Neethling *et al* (n 137) 116-118.

¹⁵¹ 1995 2 All SA (C) 469.

¹⁵² (n 151) 473.

¹⁵³ 1998 1 SA 836 (W).

the general delictual requirements in order to found liability for pure economic loss.¹⁵⁴

In light of the *Jowell*¹⁵⁵ case and based on the information available from public sources on Steinhoff, this research believes that it may be possible to hold one or more of the Steinhoff directors delictually liable. Delictual liability of the directors arises from the Steinhoff events, which include negligent conduct in creating and/or utilising off-balance sheet entities to artificially inflate earnings, not disclosing these off-balance sheet entities as related parties in Steinhoff's financial statements and/or not disclosing conflicts of interest which has resulted in the company sustaining losses due to the *inter alia* extreme diminution in the Steinhoff share price. It should be noted that Steinhoff's CFO and CEO are both chartered accountants by profession. Should it be proven that Steinhoff's CFO and CEO signed off on the company's annual financial reports, then this poses a direct attack on their duty of care, skill and diligence. This is due to the fact that these directors have specialist finance related expertise and knowledge and it is within their capacity to exercise a certain degree of care, skill and diligence which may have been omitted in this case. Based on the foregoing, Steinhoff would be able to hold the CEO and CFO liable for delictual damages arising from financial irregularities, based on the *lex Aquilia*. Whether or not any of the other Steinhoff directors will be found to be delictually liable for damages sustained by the company for financial irregularities, will depend on whether these directors had knowledge of or participated in or would reasonably be expected to have knowledge of the financial irregularities and the usage of off-balance sheet entities to artificially inflate Steinhoff's earnings, as well as presence of all the requirements of a delict.¹⁵⁶

4.4 *Directors' liability to shareholders in terms of the old Act*

A brief discussion of the liability provisions in Old Act together with an analysis of the liability provisions of the Act is useful as it indicates the development of a director's liability to shareholders. Section 424(1) of the old Act stated that personal liability can

¹⁵⁴ (n 153) 877 and Neethling *et al* (n 137) 268-269.

¹⁵⁵ (n 153) 877.

¹⁵⁶ The five requirements for a delict are: i) an act, ii) wrongfulness; iii) fault; iv) harm; and v) causation.

be imposed on any person who was knowingly a party, to the carrying on of any business of the company in a way which was reckless, intended to defraud creditors of the company or any other person, or for any fraudulent purpose. In addition, section 424(3) of the old Act imposed criminal liability on persons who knowingly carried out any business of the company recklessly or fraudulently.¹⁵⁷

Based on current information available from public sources, the Steinhoff ex-CEO and CFO's conduct with regards to the creative accounting practices undertaken at Steinhoff, was reckless and fraudulent, as it was undertaken to *inter alia* deceptively inflate company earnings. These directors would thus be guilty of an offence in terms of the Old Act and would be held criminally liable for any reckless and fraudulent conduct, as well as personally liable for the debts or liabilities incurred by Steinhoff due to such reckless and fraudulent conduct by such directors.¹⁵⁸

4.5 *Directors' liability to shareholders in terms of the Act*

Section 20(6) of the Act provides that each shareholder of the company has a claim for damages against any person who intentionally, fraudulently or due to gross negligence causes the company to do anything inconsistent with the Act, or inconsistent with a limitation, restriction or qualification in the MOI¹⁵⁹ of the company or the purposes or activities of the company, or inconsistent with the authority of the directors, unless such actions are ratified by way of a special resolution. In addition, section 77(2)(b)(i) of the Act provides that a director of a company may be held liable in accordance with the principles of the common law relating to delict for any loss, damages or costs sustained by the company as a consequence of any breach by the director of his or her duty to exercise reasonable care, skill and diligence. Therefore, directors will be held liable for delictual damages by the company, where they exercised their duty of care, skill and diligence negligently. It must be noted that this remedy is only available to the company for losses sustained by the company, and is not available to any shareholders for losses sustained by such shareholders. With respect to Steinhoff, the remedy in section 77(2) (b)(i) of the Act for breach of the

¹⁵⁷ 61 of 1973.

¹⁵⁸ s 424(1); s 424(3) and s 424(4).

¹⁵⁹ Memorandum of Incorporation.

duty of care, skill and diligence is only available to the company and not to Steinhoff's shareholders.

In circumstances where a company fails to bring or prosecute any legal proceedings against a director, section 165 of the Act provides for a statutory derivative action which replaces the common-law derivative action, and *inter alia* allows shareholders to commence proceedings or to continue with proceedings or to take related steps to protect the interests of the company. It is important to note that any action taken by shareholders in this regard, will be taken by the shareholders acting on behalf of the company for the company's benefit, and not in the personal capacity of such shareholders nor for the direct benefit of such shareholders.

Section 218(2) of the Act states that any person who contravenes any provision of the Act is liable to any other person, for any loss or damage suffered by such person, as a result of the contravention. Section 218(2) of the Act is a wide provision and thus includes a financial claim by anyone against a director personally, if such director contravened any provision of the Act which has resulted in such person suffering financial loss. It should be noted that the ambit of section 218(2) of the Act is not limited to directors, but rather applies to any person who fails to abide by the provisions of the Act.¹⁶⁰

Since the remedy for a director's liability for breach of the duty of care, skill and diligence in section 77(2)(b)(i) is only available to the company, section 218(2) of the Act must be assessed to determine whether section 218(2) allows a shareholder who has suffered loss or damage as a result of a director's breach of his duty of care, skill and diligence, to also institute action against such director for losses or damages resulting from the director's failure to exercise due care, skill and diligence whilst rendering his duties. This issue was addressed in the *Hlumisa Investment Holdings (RF) Limited & Eyomhlaba Investment Holdings (RF) Limited v Leonidas Kirkinis*¹⁶¹ case, which was an exception application. The plaintiffs in this case were minority shareholders of African Bank and the first to tenth defendants were directors

¹⁶⁰ Davis D, Geach W, Mongalo T, Butler D, Loubser A, Coetzee L and Burdett D *Companies and other Business Structures* (2013) 127.

¹⁶¹ case no 100390/2015 (GNP) (unreported).

of African Bank whilst the eleventh defendant was a professional auditing services firm. The claim against the professional auditing services firm is not relevant for purposes of this research as it does not relate to the duty of care, skill of diligence of directors and is thus not dealt with further herein. The plaintiffs *inter alia* relied on section 76(3) of the Act and claimed that a breach of section 76(3) resulted in a significant loss by African Bank which caused the share price to drop by R27.84. The plaintiffs alleged that the devaluation in their shares constituted loss or damages in accordance with section 218(2) of the Act and that the directors conduct constituted a breach of section 76(3) of the Act.¹⁶² The court stated that in order to succeed with their claim, the plaintiffs would need to show that their reliance on section 218(2) of the Act and a breach of section 76(3) of Act provides the plaintiffs with a claim against the directors and that section 218(2) of the Act has extinguished and altered the common law which does not allow a claim for reflective loss.¹⁶³

The common law principle of reflective loss precludes a shareholder of company from claiming damages or loss (for example, a diminution in the value of such shareholder's shares), that results from circumstances in which the company has suffered damages or loss.¹⁶⁴ This is because a shareholder's loss is merely reflective of the company's loss and thus, it is the company which must institute action for that loss. A shareholder can only institute a claim for such loss, if he has a separate and distinguishable cause of action.¹⁶⁵

The court in *Hlumisa* assessed section 218(2) of the Act and stated that whilst section 218(2) of the Act has a wide application in respect of individuals who fall within its scope, it is limited in its application as it only applies to "damage suffered by a person as result of that contravention".¹⁶⁶ This means that a person who has suffered damage as a result of a particular contravention of the Act, must be a person who is able to claim damages for such contravention of the Act.¹⁶⁷

¹⁶² (n 161) par 9.

¹⁶³ (n 161) par 24.

¹⁶⁴ Kleitman "Reflective loss" 2016 *Without Prejudice* 8.

¹⁶⁵ Kleitman (n 164) 8.

¹⁶⁶ (n 161) par 26.

¹⁶⁷ (n 161) par 26.

Similarly, the court in *Burco Civils v Stolz & Another*,¹⁶⁸ stated that in order to successfully bring a claim based on section 218(2) of the Act, one must demonstrate that a person contravened a provision of the Act and that another person suffered damage. In addition, the court stated that one must demonstrate that the damage suffered was the result of the contravention. Accordingly, there should be proof of a causal link or connection between the contravention of the Act and the damage suffered.¹⁶⁹ Therefore, if a shareholder wishes to institute a claim for damages against a director for failure by the director to exercise proper care, skill and diligence in carrying out his duties in accordance with section 218(2) of the Act, such shareholder must establish a causal link or connection between the director's failure to properly exercise his duties and the loss suffered by such shareholder. Thus, in order for a Steinhoff shareholder to hold Steinhoff's directors liable in terms of the general remedy in section 218(2) of the Act, such shareholder would have to establish a causal link or connection between the director's failure to properly exercise his duty of care, skill and diligence and the loss suffered by such shareholder. Such shareholder will thus have to prove that the failure of a director, for example, the CFO to properly exercise his duty of care, skill and diligence resulted in financial irregularities being committed by Steinhoff. Such shareholder will further have to show that the financial irregularities such as the usage of off-balance sheet entities to artificially inflate Steinhoff's earning, resulted in a diminution in the Steinhoff share price, in order to claim damages in accordance with section 218(2) of the Act.

The court in *Hlumisa Investments* further stated that when section 76(3) of the Act is utilised by a party to found the director's liability to compensate such party for damages in accordance with section 218(2) of the Act, the provisions of section 77(2) of the Act should also be taken into account. The court emphasised that section 77(2) of the Act specifically requires that any claim for a breach of section 76(3) must be brought "in accordance with the principles of the common law". The court stated that the effect of the reference to the common law in section 77(2) is that

¹⁶⁸ case no 26201/15 (GNP) (unreported) par 47.

¹⁶⁹ n 168 above.

a reflective loss claim cannot be brought in terms of section 77(2) of the Act since the common law does not permit reflective loss claims.¹⁷⁰

The court also stated that where special and general remedies are provided in statute, the special remedy must be “followed in preference to the general remedy”. Section 218(2) of the Act provides a general remedy whilst section 77(2) provides a special remedy for a contravention of section 76(3) which relates to a director’s duties to the company, and not to the shareholders.¹⁷¹ Based on the foregoing, the remedy in section 218(2) of the Act is not available in cases where a special remedy, such as section 77(2)(b)(i)¹⁷² of the Act is available. However, shareholders would in any event not be able to utilise the remedy in section 77(2)(b)(i) of the Act to claim damages for a director’s breach of the duty of care, skill and diligence set out in section 76(3)(c) of the Act, as the remedy in section 77(2)(b)(i) of the Act is only available to the company, and not to any shareholders. Thus, with regards to Steinhoff, a Steinhoff shareholder would not be able to rely on the general remedy in section 218(2) of the Act to claim damages from one or more Steinhoff directors, resulting from a failure by such director or directors to properly exercise his or their duty of care, skill and diligence.

In the *Itzikowitz v Absa Bank*¹⁷³ case where a delictual claim was made for pure economic loss, the court considered double recovery and the reflective loss doctrine and stated that one of the key principles of the reflective loss doctrine is that a company has a separate legal personality which is distinguishable from shareholders and therefore, a loss to a company which causes a loss in its share price is not considered to be a loss to a shareholder.¹⁷⁴ The court in *Hlumisa Investments* referred to the *Itzikowitz* case and stated with regards to section 218(2) of the Act, that shareholders will not be deemed to have sustained a loss resulting from a breach of duties owed to the company merely because its share price has fallen as a

¹⁷⁰ (n 161) par 39-41.

¹⁷¹ (n 161) par 78.

¹⁷² This section provides that a director of a company may be held liable in accordance with the principles of the common law relating to delict for any loss, damages or costs sustained by the company as a consequence of any breach by the director of a duty contemplated in section 76(3)(c).

¹⁷³ 2016 4 SA 432 (SCA).

¹⁷⁴ (n 173) 436-443.

result of such breach of duty.¹⁷⁵ This is because there is an insufficient causal link between any loss sustained by a company as a result of a breach of a duty owed to the company and any loss sustained by such company's shareholders, resulting from a fall in the company's share price.¹⁷⁶

The court in *Johnson v Gore Wood & Co*¹⁷⁷ stated that in the situation where a company sustains a loss as a result of a breach of a duty owed to the company, only the company is permitted to sue regarding such loss.¹⁷⁸ The court further stated that in circumstances where both the company and a shareholder suffers a loss as a result of a breach of an independent and distinct duty owed to it/him, respectively, both the company and the shareholder may sue to recoup the loss sustained by it/him, due to the breach of the duty owed to it/him, respectively. However neither party would be permitted to recoup losses sustained by such party resulting from a breach of a duty owed to such other party.¹⁷⁹ Therefore, since directors owe the duty of care, skill and diligence to the company and not to the shareholders, any shareholder who suffers a loss as a result of the negligence of a director in carrying out his duty of care and skill and diligence owed to the company, will not have a delictual remedy for damages against such director.

Similarly, with regards to Steinhoff, unless a Steinhoff shareholder can prove that a loss suffered by him as a result of a breach of a Steinhoff director's duty of care, skill and diligence, is separate and distinct from the loss suffered by the company, such shareholder will have no delictual remedies against the relevant Steinhoff director or directors arising from such director's failure to properly exercise his duty of care, skill and diligence. Based on the foregoing, only the company, Steinhoff, and not its shareholders, will have recourse against the Steinhoff directors for a failure to properly exercise their duty of care, skill and diligence as the duty to exercise care, skill and diligence is a duty that is owed to the company. Since the above has established, that a director cannot be held liable by shareholders for losses, in terms

¹⁷⁵ (n 161) par 50.

¹⁷⁶ (n 161) par 50.

¹⁷⁷ 2001 1 All ER 481 (CA).

¹⁷⁸ (n 177) 498.

¹⁷⁹ (n 177) 498.

of sections 77(2)(b)(i) and 218(2) of Act, it is necessary to determine whether there are any provisions of the Act that exempt a director from liability.

4.6 Exemptions of directors from liability

Section 77(9) of the Act, states that in proceedings against a director, other than proceedings for wilful misconduct or wilful breach of trust, a court may relieve such director either wholly or partly, on any terms that the court deems just in the two prescribed situations. Firstly, if it appears, that the director is or may be liable, but that he has acted honestly and reasonably; or secondly, that when having regard to all the circumstances of the case, including those connected with the appointment of the director, it would be fair to excuse the director.

Similarly, section 77(10) which also provides that the court may relieve a director from liability, excludes instances of wilful misconduct or wilful breach of trust by the director.¹⁸⁰ Although section 77(9) and section 77(10) of the Act provide mechanisms for condonation of a director's actions, these provisions specifically exclude instances of wilful misconduct or wilful breach of trust of the part of the director. Thus, a director will not be able to rely on section 77(9) nor section 77(10) as a condonation mechanism for failing to exercise due care, skill and diligence in the exercise of his duties, if the failure to exercise due care, skill and diligence will amount to wilful misconduct or wilful breach of trust by such director.¹⁸¹

With regards to Steinhoff, the CFO as well as the ex-CEO are both chartered accountants by profession and thus have specialist finance related expertise and knowledge. The creation and utilisation of off-balance sheet entities to *inter alia* artificially inflate Steinhoff's earnings as well as the failure to disclose such off-balance sheet entities as related party entities in Steinhoff's annual financial statements could thus amount to wilful misconduct and/or wilful breach of trust by these directors. This will be the case if these directors, as is currently alleged in public sources, knowingly and intentionally utilised such off-balance entities and

¹⁸⁰ Cassim *et al* (n 2) 579 and Wiese (n 1) 85.

¹⁸¹ Cassim *et al* (n 2) 579 and Wiese (n 1) 85.

knowingly and intentionally failed to disclose such off-balance sheet entities in Steinhoff's financial statements.

In addition, the failure of the ex-CEO to declare alleged interests in companies that Steinhoff did business with, would definitely amount to a breach of trust and/or wilful misconduct on the part the ex-CEO. It is thus unlikely based on the currently available data, that the condonation mechanisms in sections 77(9) and 77(10) will be available to these Steinhoff directors as it unlikely that these directors were acting honestly and reasonably in relation to the usage of off-balance entities to artificially inflate Steinhoff's earnings. Since the circumstances in which a director will be exempt from liability has been established, it is necessary to determine the circumstances in which a director may be indemnified against liability, by the company.

4.7 *The company's indemnification of directors*

Section 78(5) read with section 78(6) of the Act states that subject to the provisions of the company's MOI, the company may indemnify a director in respect of certain liabilities. However, any indemnification of a director in the following three circumstances, are specifically prohibited by the Act:¹⁸²

- i) against any liability arising from wilful misconduct or wilful breach of trust; or
- ii) any liability arising in terms of section 77(3)(a) to(c); or
- iii) any liability arising out of a fine imposed on a director as a consequence of the director being convicted of an offence, unless the offence was based on strict liability.

In addition, the Act states that subject to any contrary provisions in the MOI, a company may purchase insurance to protect a director against any liability or expenses for which the company is permitted to indemnify a director.¹⁸³ Therefore, whilst a director will not be able to avoid personal liability for a breach of the duty of care, skill and diligence, a director may be able mitigate the effects of such breach on his personal finances, if the company has provided an indemnity to such director

¹⁸² s 78(5) and s 78(6).

¹⁸³ s 78(7).

in relation to exercising his duty of care, skill and diligence or if the company has insurance in place to cover such liabilities arising as a result of the actions or inactions of its directors. With regards to the current information available from public sources on the Steinhoff directors' actions and omissions, it is unlikely that any valid indemnifications are in place to protect such directors against liability arising from a breach of the duty to exercise care, skill and diligence, as the Act specifically prohibits any indemnities in this regard.

4.8 *Conclusion*

This chapter has aimed to determine what protection is available to shareholders who have sustained losses as a result of a breach of the duty of care, skill and diligence by a director. A director failing to properly exercise his duty of care, skill and diligence constitutes a contravention of section 76(3)(c) of the Act. However, this duty is a duty that is owed by a director to the company, and is not a duty that is owed by a director to the shareholders of the company. Section 77(2)(b)(i) of the Act provides that a director of company may be held liable for damages, losses or costs incurred by the company resulting from a breach of this duty, in accordance with the common law principles of delict. Accordingly, the remedy in section 77(2)(b)(i) of the Act is only available to the company for losses sustained by the company.

Whilst section 218(2) of the Act provides that any person who contravenes the Act is liable to any other person for any losses or damages suffered by such person as a result of the contravention, the general remedy in section 218(2) of the Act is not available in cases where a specific remedy, such as the remedy in section 77(2)(b)(i) of the Act, is available. This is because the doctrine of reflective loss precludes a shareholder of company from claiming damages or losses that results from circumstances in which the company has suffered damages or losses. Both a shareholder and the company may independently recoup losses from a director as a result of breach of a separate and distinct duty owed to the company or shareholder, respectively. However, neither the company nor a shareholder would be permitted to recoup losses sustained by the other party or a result of a breach of a duty owed to the other party.

Since the director's duty to exercise care, skill and diligence is not owed to the shareholders, the shareholders would thus not have any claims against any of the directors for a breach of this duty. Shareholders thus have no remedies or protection against a director for a breach by a director of his duty to exercise care, skill and diligence. Accordingly, Steinhoff shareholders have no recourse against any Steinhoff directors who have failed to properly exercise their duty of care, skill and diligence, which has resulted in a diminution of Steinhoff share price and losses to the shareholders of Steinhoff shares.



Chapter 5: Conclusion

The directors of a company include members of the board of a company, any person occupying the position of a director, *de facto* and *de jure* directors, executive and non-executive directors, nominee directors, shadow directors and *ex officio* directors. Furthermore, for purposes of section 76 of the Act, which regulates the standards of a director's conduct, a director also includes alternate directors, prescribed officers and members of a board committee or members of the audit committee of a company

Although, both the common law and the Act prescribe binding duties of care and skill for directors, the Act imposes an additional diligence element for directors. The intention of a partial codification of a director's common-law duty to exercise care and skill is to operate in conjunction with the common law and to develop the common law, and not to override and replace the common-law duty of care and skill. Since South Africa does not have extensive case law on this subject matter, the development of the common law in this regard will be beneficial for purposes of improving the application and implementation of the duty of care, skill and diligence imposed by the Act. The Act imposes objective as well as subjective standards on the duty of care, skill and diligence of directors and differing standards of care, skill and diligence are required from executive and non-executive directors. Ultimately, the question of whether or not a director exercised his duties with the required degree of care, skill and diligence will be determined on a case by case basis, with regard to the particular facts of the matter, the objective reasonable director test, the subjective knowledge, experience and expertise of the particular director and the applicability of the business judgment rule.

A business judgment rule was incorporated into the Act in terms of section 76(4)(a) of the Act. The application of the business judgment rule in the USA was explored in this research due the fact that the business judgment rule originated in the USA. In addition to the statutory South African business judgment rule, the non-incorporation of the business judgment rule into UK company law was explored in this research due to the similarities between South African and UK company law.

The statutory business judgement rule in South Africa is directly related to a director's statutory duty of care, skill and diligence and the statutory business judgment rule creates a presumption that a director will have complied with the duty to act in the company's best interests and will have exercised the duty of care, skill and diligence, if the prescribed requirements are met. The requirements of the business judgement rule are that the director must make informed decisions, that the director should not have any personal financial interests in the relevant decisions and that the director must have a rational basis for believing that such decisions were in the best interests of the company. Accordingly, a director who has complied with the requirements of the statutory business judgment rule will be deemed to have properly exercised his duty of care, skill and diligence.

The intention of the business judgement rule is to prevent hindsight bias, to encourage people to take up directorships in companies without undue fear of repercussions resulting from their business decisions, and to balance shareholders' interests of profit maximisation with the director's freedom to manage the company. However, care must be taken to ensure that the business judgement rule is not used as a loophole for directors to escape liability for failing to properly exercise the requisite duty of care, skill and diligence. There is currently no case law in South Africa regarding the business judgment rule and it has thus not yet been established whether the judicial review of business decisions will be a positive or negative step for corporate South Africa.

Provided that the provisions in section 76(3)(c) of the Act and the business judgement rule are not applicable, a director's failure to exercise due care, skill and diligence in carrying out his duties as a director, is a contravention of the Act. This contravention could result in such director being held liable by the company only, for losses and damages sustained by the company as a result of such director's failure to properly exercise his duty of care, skill and diligence. Accordingly, if the business judgment rule is found to be applicable, a director will not be held liable for the failure to properly exercise his duty of care, skill and diligence.

Section 77(2)(b)(i) of the Act states that a company which has suffered loss or damage as a result of a director's negligence in exercising his duty of care, skill and

diligence may institute action against such director for losses or damages sustained by such company, in accordance with the common law principles of delict. These losses include pure economic losses. However, shareholders who have sustained losses as a result of a director's failure to properly exercise his duty of care, skill and diligence have no recourse against such directors in terms of section 77(2)(b)(i). This is because the duty to exercise care, skill and diligence is a duty that is owed by the directors to the company only, and it is not a duty that is owed by the directors to the shareholders of a company.

Section 218(2) of the Act provides that any person who contravenes the Act is liable to any other person for any losses or damages suffered by such person as a result of the contravention. However, this general remedy is not available in cases where a specific remedy is available, such as the remedy available to the company to recoup losses from the directors for a breach of the duty of care, skill and diligence in terms of section 77(2)(b)(i). This is because the doctrine of reflective loss precludes a shareholder of company from claiming damages or losses that results from circumstances in which the company has suffered losses or damages. Both a shareholder and the company may independently recoup losses from a director as a result of the breach of a separate and distinct duty owed respectively to the company and the shareholder. However, neither the company nor a shareholder would be permitted to recoup losses sustained by the other party or a result of a breach of a duty owed to the other party. Since the duty of a director to exercise care, skill and diligence is a duty that is owed to the company only, a director will have no liability to shareholders for a failure by such director to properly exercise his duty of care, skill and diligence in relation to the affairs of the company. The director's duty to exercise care, skill and diligence thus does not offer any protection to shareholder interests in a company.

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