

**LIABILITIES OF DIRECTORS, THE BUSINESS JUDGMENT TEST,
REMEDIES, THE NEW ENFORCEMENT REGIME
AND INCREASED STAKEHOLDER RIGHTS**

RENEé YVETTE CARRINGTON
BA LLB
STUDENT NUMBER 589562

WRIGHT, ROSE-INNES INC.
31 Arterial Road West
Oriel, Bedfordview
P O Box 2503, Bedfordview, 2008
Docex 11, Bedfordview
TEL: 011-615-8828

LIABILITIES OF DIRECTORS, THE BUSINESS JUDGMENT TEST, REMEDIES, THE NEW ENFORCEMENT REGIME AND INCREASED STAKEHOLDER RIGHTS

1. INTRODUCTION

The New Companies Act adopts the enlightened shareholder value model. This model like the classic model puts the interests of shareholders first but holds that the interests of all stakeholders, including employees, suppliers and creditors as well as the environment and the community at large must be considered.¹ The enlightened shareholder model has been adopted by the New Companies Act as it has by most Western Countries including the United Kingdom in its 2005 Companies Act.

It is common cause that the Act has partially codified the common law fiduciary duties of directors. According to Stein² 'The most important of which requires that directors act in the best interests of the company'. The Act does not legislate on the specifics as to what a director's duty to act in the company's best interest means. This will be left to our Courts to develop a body of common law. Along with the adoption of the enlightened shareholder value model, the new Act includes significant new rights and remedies given to various stakeholders.³

Although not specifically included in Section 76 of the Act directors have to realize and comply with the constitution and the bill of rights to the extent that companies are required to do so. Section 7(a) of the Act reads as follows:

'The purposes of this Act are to –

(a) *promote compliance with the Bill of Rights as provided for in the Constitution, in the application of company law'.*

In addition refer to Section 7(b)(iii) which reads *'The purposes of the Act are to –*

(b) *promote the development of the South African economy by-*

¹ Carl Stein: 'New Companies Act Unlocked', October 2011

² Ibid Stein

³ Ibid Stein

(iii) *encouraging transparency and high standards of corporate governance as appropriate, given the significant role of enterprises within the social and economic life of the nation;*⁵

Section 5(1) of the Act reads as follows:

'General interpretation of Act:

(1) *This Act must be interpreted and applied in a manner that gives effect to the purposes set out in Section 7.*

It will be interesting to see how our Courts manage to interpret the provisions of Section 7 and Section 5 as stated hereinabove in dealing with its interpretations of Section 76 and the enforcement of the Act.

Stein⁴ states the following 'The Act also gives significantly greater rights and remedies to stakeholders including minority shareholders and thus encourages stakeholders activism. Two of the most striking – even alarming in some instances – aspects of the Act are:

- the number of remedies it provides, in particular the number of remedies it provides to minority shareholders, employees and directors; and
- the number of methods by which its remedies may be enforced.'

Stein is of the opinion that the Act goes further than the Company legislation of other Western Countries including the USA and UK and fears that this could lead to increased litigation and a fair amount of 'remedy shopping'⁵.

The new Act partially codifies the duties of directors under the common law. Codified duties will prevail over any conflicting common law duties however, if there is no such conflict the common law remains applicable. It is argued by Stein⁶ that the codified duties of directors are more lenient than those of the common law in certain respects.

⁴ Carl Stein: 'New Companies Act Unlocked', October 2011

⁵ Ibid Stein

⁶ Carl Stein: 'New Companies Act Unlocked', October 2011

Directors who do not properly discharge their duties face greater financial and personal risk under the Act in view of new remedies available to shareholders and other stakeholders. As a counter balance to the increased remedies available against directors, as well as the fact that they are easier to implement, new defences have been given to directors in terms of the Act which include Section 76(4)(a) (The Business Judgment Test) and Section 77(9) which permits a Court to relieve a director from personal liability (other than liability arising from wilful misconduct or wilful breach of trust) if the Court finds that –

- '(a) the director is or may be liable, but has acted honestly and reasonably; or*
- (b) having regard to all the circumstances of the case including those connected with the appointment of a director it would be fair to excuse the director'.*

Section 77(9)(a) brings into the interpretation of the Act an equity jurisdiction for Judges. Section 77(10) also permits a director who has reason to apprehend that a claim may be made alleging that the director is liable, other than for wilful conduct or wilful breach of trust, to apply to Court for relief, and the Court may grant relief to the director on the same grounds as if the matter had come before the Court in terms of subsection 77(9).

2. DUTIES AND LIABILITIES OF DIRECTORS

Stein identifies in broad terms the common law duties of the directors as follows:

- Duty to exercise care, skill and diligence;
- The duty to act in the best interests of the company;
- The duty to act within their powers and for proper purpose;
- The duty to exercise independent judgment;
- The duty to avoid conflict of interest;
- The corporate opportunity and no profit rules.⁷

The purpose of this research paper is not to provide a summary of what the common law is in respect of these duties but to some degree examine what has been codified in the new Act⁸.

⁷ Ibid Stein

⁸ Companies Act 71 of 2008

A director of a company, within a group of companies, owes a fiduciary duty to the company that the director serves and not the holding company, its subsidiaries or any other company within the group of companies. There is no duty to 'the group' as a group of companies does not have a legal personality of its own. A director of a subsidiary company may not be compelled by its holding company to perform his/her duties in any manner directed by the holding company or act in a certain manner in the interests of the group. The director has to comply with his duties and the best interests of the subsidiary to whom he/she is employed. The fiduciary relationship cannot be compromised by the parent company.⁹

This however does not mean that directors are not obliged to take care and to ensure that inter group transactions are not detrimental to any individual entity within the group. Each transaction has to be judged on its own merits according to the interest of the particular company at that particular point in time. Stein submits that the test of whether or not a particular director believed in good faith that he was acting in the best interests of the subsidiary is usually a subjective one.¹⁰

Section 76 applies to directors, including alternate directors, prescribed officers and any person who is a member of a committee or board of a company or the audit committee of a board, irrespective of whether or not the person is also a member of the company's board¹¹. Section 76(2) contains what is referred to as negative duties and according to Stein¹² codifies two common law fiduciary prohibitions. Section 76(2) reads as follows:

- (2) *A director of a company must –*
- (a) *not use the position of director, or any information obtained while acting in the capacity of a director –*
 - (i) *to gain an advantage for the director, or for another person other than the company or a wholly-owned subsidiary of the company; or*
 - (ii) *to knowingly cause harm to the company or a subsidiary of the company; and*

⁹ Ibid Stein

¹⁰ Ibid Stein

¹¹ Section 76(1)(a) and (b) of the Act

¹² Ibid Stein

- (b) *communicate to the board at the earliest practicable opportunity any information that comes to the director's attention, unless the director –*
 - (i) *reasonably believes that the information is –*
 - (aa) *immaterial to the company; or*
 - (bb) *generally available to the public, or known to the other directors; or*
 - (i) *is bound not to disclose that information by a legal or ethical obligation of confidentiality.*

Of importance in the new Section 76(2) is reference to a subsidiary which essentially expands the scope of the common law duty as a director generally does not owe a common law fiduciary duty to a subsidiary whether wholly owned or not.

In accordance with the provisions of Section 162(5)(c) a director may be declared delinquent if he/she took personal advantage of information or an opportunity contrary to Section 76(2) or intentionally or by gross negligence inflicted harm upon the company or a subsidiary of the company contrary to Section 76(2)(a).

Section 76(2)(b) enshrines the duty to disclose information material to the company. The reference in Section 76(2)(b) to the expressions 'reasonably believes' and 'ethical obligation' may prove to be significant defences for recalcitrant directors in the opinion of Stein¹³. The section seems to be restrictive in the sense that it only applies to matters of a financial, monetary or economic nature. Conflicts of interest could arise for other reasons unrelated to these matters. The intention of this section seems to constitute a partial codification of the common law duty relating to conflicts of interest.

Section 75(3)(a) and (b) refers to a person who is the only director of a company but does not hold all the beneficial interests of all the issued securities of that company.

Section 75(4) reads as follows

'At any time, a director may disclose any personal financial interest in advance, by delivering to the board, or shareholders in the case of a company contemplated in subsection (3), a notice in writing setting out the nature and extent of that interest, to

¹³Carl Stein: 'New Companies Act Unlocked', October 2011

be used generally for the purposes of this section until changed or withdrawn by further notice from that director'.

Again this relates to Section 75(3) alone where the person is the only director of a company but does not hold all the beneficial interests.

Section 75(5) reads

'If a director of a company, other than a company contemplated in subsection (2) (b) or (3), has a personal financial interest in respect of a matter to be considered at a meeting of the board, or knows what a related person has a personal financial interest in the matter, the director –

- (i) must disclose the interest and its general nature before the matter is considered at the meeting;*
- (ii) must disclose to the meeting any material information relating to the matter, and known to the director;*
- (iii) may disclose any observations or pertinent insights relating to the matter if requested to do so by the other directors;*
- (iv) if present at the meeting, must leave the meeting immediately after making any disclosure contemplated in paragraph (b) or (c);*
- (v) must not take part in the consideration of the matter, except to the extent contemplated in paragraphs (b) and (c);*
- (vi) while absent from the meeting in terms of this subsection-*
 - (i) is to be regarded as being present at the meeting for the purpose of determining whether sufficient directors are present to constitute the meeting; and*
 - (ii) is not to be regarded as being present at the meeting for the purpose of determining whether a resolution has sufficient support to be adopted; and*
- (vii) must not execute any document on behalf of the company in relation to the matter unless specifically requested or directed to do so by the board'.*

The definition of 'material' in the definition section of the Act will be important in terms of interpreting the provisions of Section 75 as well as the definitions of personal financial interest which reads as follows

'personal financial interest when used with respect to any person –

- (a) *means a direct material interest of that person of a financial, monetary or economic nature, or to which a monetary value may be attributed; but*
- (b) *does not include any interest held by a person in a unit trust or collective investment scheme in terms of the Collective Investment Scheme Act 2002 (Act 45 of 2002), unless that person has direct control over the investment decisions of that fund or investment;*

Section 75(5) relates to matters which a board has not yet considered. It is for this reason that the section contains the mechanism whereby once the disclosure is made of the material information and the director has disclosed its observations and pertinent insights relating to the particular personal financial interest, the director is obliged to leave the meeting immediately after having done so and may not take any further part in the consideration of the matter. Clearly a director who has a personal financial interest cannot participate in any voting on the matter at a board meeting. There are no exceptions to this prohibition.¹⁴

Section 75(6) reads

'If a director of a company acquires a personal financial interest in an agreement or other matter in which the company has a material interest, or knows that a related person has acquired a personal financial interest in the matter, after the agreement or other matter has been approved by the company, the director must promptly disclose to the board, or to the shareholders in the case of a company contemplated in subsection (3), the nature and extent of that interest, and the material circumstances relating to the director or related person's acquisition of that interest'.

This section clearly relates to matters which have already been approved by the company. The section does not indicate what the consequences are of this disclosure. Clearly it is meant to cover corporate opportunity and no profit rules. The common law rule as decided in the case of **(Da Silva and others versus CH Chemical (Pty) Limited 2008 (6) SA 620 SCA)** is clear.

'It is a well established rule of company law that directors ... may not make a secret profit or otherwise place themselves in a position where their fiduciary duties conflict with their personal interest (Robinson versus Randfontein Estates Gold Mining Company Limited 1921 AD 168 Act 177). A consequence of the rule is that a

¹⁴ Carl Stein: 'New Companies Act Unlocked', October 2011

director is in certain circumstances obliged to acquire an economic opportunity for the company if it is acquired at all. Such an opportunity is set to be a 'corporate opportunity' or one which is the 'property' of the company. If it is acquired by the director, not for the company but for himself, the law will refuse to give effect to the directors intention and will treat the acquisition as having been made for the company. The opportunity may then be claimed by the company from the delinquent director. Where such a claim is no longer possible the company may in the alternative claim any profits which the director may have made as a result of the breach or damages in respect of any loss it may have suffered thereby'.

In addition to the aforesaid the Da Silva case indicated that the director was liable to the company even if he resigned before the exploitation of the opportunity and that it did not matter that the company did not avail itself to the opportunity itself.

In the recent case of ***Dorbyl versus Foster 2011 20 GSJ 6.6.1 Moshidi J***¹⁵ considered an action against an employee (Defendant) relating to the disgorgement of secret profits in breach of a fiduciary duty on the part of a Defendant. The judgment date in this matter was 28 July 2011. The subject of the matter related to unfair labour practices and grievance procedures however, in this matter Moshidi J found that the Defendant was to pay to its erstwhile employer sums in excess of R40 million arising from his breach of fiduciary duty. The Court held that it was common cause that the Defendant, as a paid executive director of the Plaintiff, received secret profits, without the knowledge of the Plaintiff, in breach of his duty of trust. It being common cause that the Defendant was, at the time, in a fiduciary position, the secret profits had to be returned to the Plaintiff. In addition to the aforesaid the Court upheld the Plaintiff's contention that in view of the Defendant's breach of his fiduciary duties, he forfeited the right to benefit under the management participation scheme. In this claim too, the Court ordered the Defendant to pay the amount claimed¹⁶. The Defendant in the matter was a duly appointed director of the Plaintiff. He held the position of a group executive director. The Conditions of Defendant's contract of employment also prohibited the offending conduct which came under the scrutiny of the Court. Moshidi J said at paragraph 23

¹⁵ Dorbyl Ltd vs Vorster 2011 JOL 27671 GSJ 6.6.1

¹⁶ Dorbyl Ltd versus Foster 2011 JOL 27671 GSJ reported in Butterworths Case number 06/15260 award date 28 July 2011 South Gauteng Johannesburg

*'What is of crucial importance in this matter, and also not in dispute, is that the Defendant failed to disclose his interest in the various transactions for the disposal of the entities as required by Section 234 and 235 of the Companies Act 61 of 1973 (now enshrined in the provisions of Section 75 of the new Act). In the particulars for trial, the Defendant contended that the benefits he received were remuneration for consultancy services rendered by him to the purchasers of the disposed entities. However, he did not contend that he in fact received the written permission from the Plaintiff to perform work for reward outside the services of the group as envisaged in the Plaintiff's general conditions of employment ... [25]. In the context of the present matter it is common cause that the Defendant, as a paid executive director of the Plaintiff, received the secret profits, in the form of joining fees, share allocation and the proceeds of the resale of the shares, without the knowledge of the Plaintiff in breach of his duty of trust. The Plaintiff only came to know of the secret profits in September 2005. The profits must be returned to the Plaintiff. It was common cause that the Defendant was, at the time, in a fiduciary position'. In this judgment reference was also made to the matter of **Phillips versus Fieldstone Africa (Pty) Limited trading as another 2004 (3) SA 465 (SCA)**'.*

In the **Phillips versus Fieldstone Africa**¹⁷ matter the following portion of the judgment is pertinent *'The fundamental question is not whether the Appellant appropriated an opportunity belonging to the Respondent, but whether he stood in a fiduciary relationship to them when the opportunity became available to him, if he did, it 'belongs to the Respondent'.*

3. LIABILITIES OF DIRECTORS (S77)

Section 77 of the Act codifies the common law liabilities of directors in terms of Section 77(2). Section 77(3) outlines the various statutory liabilities of directors.¹⁸

Section 77(2) reads as follows

'A director of a company may be held liable –

- (a) in accordance with the principles of the common law relating to breach of a fiduciary duty, 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 75, 76(2) or 76(3) (a) or (b); or*

¹⁷ Fieldstone Africa (Pty) Ltd t/a Another 2004 (3) SA 465 (SCA)

¹⁸ Carl Stein: 'New Companies Act Unlocked', October 2011

- (b) *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 –*
- (i) *a duty contemplated in section 76 (3) (c);*
 - (ii) *any provision of this Act not otherwise mentioned in this section; or*
 - (iii) *any provision of the company's Memorandum of Incorporation'.*

Essentially Section 77(2)(a) relates to the breach of fiduciary duty i.e. the duty to disclose conflicts of financial interests, the corporate opportunity rule, knowingly causing harm to the company or failure to disclose material information or duties to act in good faith and for proper purpose and in the best interests of the company.

Section 77(2)(b) essentially relates to delictual claims arising from a director's failure to exercise care, skill and diligence and then in broad terms any provision of the Act not otherwise mentioned in Section 77 or any provisions of the company's Memorandum of Incorporation.

Section 77(3) of the Act reads as follows:

'A director of a company is liable for any loss, damages or costs sustained by the company as a direct or indirect consequence of the director having -

- (a) *acted in the name of the company, signed anything on behalf of the company, or purported to bind the company or authorise the taking of any action by or on behalf of the company, despite knowing that the director lacked the authority to do so;*
- (b) *acquiesced in the carrying on of the company's business despite knowing that it was being conducted in a manner prohibited by section 22(1);*
- (c) *been a party to an act or omission by the company despite knowing that the act or omission was calculated to defraud a creditor, employee or shareholder of the company, or had another fraudulent purpose;*
- (d) *signed, consented to, or authorised, the publication of –*
 - (i) *any financial statements that were false or misleading in a material respect; or*
 - (ii) *a prospectus, or a written statement contemplated in section 101, that contained –*
 - (aa) *an 'untrue statement' as defined and described in section 95; or*

- (bb) *a statement to the effect that a person had consented to be a director of the company, when no such consent had been given,*

[item (bb) substituted by s. 49 (a) of Act 3 of 2011]

Despite knowing that the statement was false, misleading or untrue, as the case may be, but the provisions of section 104 (3), read with the changes required by the context, apply to limit the liability of a director in terms of this paragraph; or

[Para. (d) amended by s. 49 (a) of Act 3 of 2011’.

Section 77(3)(d)(ii) is referred to in Sections 104(2) and 104(4). Section 104 relates to the liability for untrue statements in any prospectus. This clause outlines the liability to compensate persons who acquired securities on the faith of the prospectus for any loss or damage the person may have sustained as a result of any untrue statement in the prospectus, or in any report or memorandum appearing on the face of, issued with, or incorporated by reference in, the prospectus. These liabilities will vest with any person referred to in Section 104(1)(a), (b), (c) or (d) for example the promoter or any person who authorised the issue of the prospectus or made the offer to the public. The liability contemplated in Section 104(1) is in addition to the liability of a director as set out in Section 77(3)(d)(ii) (Section 104(2)).

An essential element of Section 77 is the reference to the definition of ‘knowing’, ‘knowingly’ or ‘knows’ as per Section 1 which reads:

‘knowing’, ‘knowingly’ or ‘knows’, when used with respect to a person, and in relation to a particular matter, means that the person either –

- (a) *had actual knowledge of the matter; or*

[Para. (a) substituted by s. 1 (1) (q) of Act 3 of 2011.]

- (b) *was in a position in which the person reasonably ought to have –*

- (i) *had actual knowledge;*
- (ii) *investigated the matter to an extent that would have provided the person with actual knowledge; or*
- (iii) *taken other measurements which, if taken, would reasonably be expected to have provided the person with actual knowledge of the matter’.*

Section 77(3)(e) is effectively a consolidation of various other sections in the Act namely Section 38(3), s 41(5), s 42(4), s44(6), s45(7), s46(6) and s 48(7).

Section 77(3)(e) reads as follows:

- (e) *been present at a meeting, or participated in the making of a decision in terms of section 74, and failed to vote against –*
 - (i) *the issuing of any unauthorised shares, despite knowing that those shares had not been authorised in accordance with section 36;*
 - (ii) *the issuing of any authorised securities, despite knowing that the issue of those securities was inconsistent with section 41;*
 - (iii) *the granting of options to any person contemplated in section 42(4), despite knowing that any shares –*
 - (aa) *for which the options could be exercised; or*
 - (bb) *into which any securities could be converted, had not been authorised in terms of section 36;*
 - (iv) *the provision of financial assistance to any person contemplated in section 44 for the acquisition of securities of the company, despite knowing that the provision of financial assistance was inconsistent with section 44 of the company's Memorandum of Incorporation.*

[Sub-para. (iv) substituted by s. 49 (b) (i) of Act 3 of 2011.]

- (v) *the provision of financial assistance to a director for a purpose contemplated in section 45, despite knowing that the provision of financial assistance was inconsistent with that section or the company's Memorandum of Incorporation;*

[Sub-para. (v) substituted by s. 49 (b) (i) of Act 3 of 2011.]

- (vi) *a resolution approving a distribution, despite knowing that the distribution was contrary to section 46, subject to subsection (4);*
- (vii) *the acquisition by the company of any of its shares, or the shares of its holding company, despite knowing that the acquisition was contrary to section 46 or 48; or*
- (viii) *an allotment by the company, despite knowing that the allotment was contrary to any provision of Chapter 4.*

[Sub-para. (vii) substituted by s. 49 (b) (ii) of Act 3 of 2011.]

Criminal liability does not attach to any contraventions of these sections and once again the definition of 'knowing', 'knowingly' or 'knows' in Section 1 is relevant.

Section 77(4) constitutes an additional requirement before a director may be held personally liable. The section stipulates that liability is joint and several with any other person who is or may be held liable for the same act.

Section 77(7) provides for a prescription period during which no proceedings for the recovery of any loss, damages or costs for which a person is or may be held liable in terms of this section, may be commenced more than three years after the actual remission that gave rise to that liability. Stein believes that this is more favourable than Section 12 of the Prescription Act which provides that '*prescription of the debt begins to run as soon as the debt is due and that a debt does not become due until the creditor has knowledge of the debtor's identity and of the facts from which the debt arises*¹⁹ .

Section 77(8) reads '*In addition to the liability set out elsewhere in this section, any person who would be so liable is jointly and severally liable with all other such persons –*

- (a) *to pay the costs of all parties in the Court in a proceeding contemplated in this section unless the proceedings are abandoned, or exculpate that person; and*
- (b) *to restore the company any amount improperly paid by the company as a consequence of the impugned act, and not recoverable in terms of this Act*'.

Section 218(2) contains a very general and broad confirmation that '*any person who contravenes any provision of this Act is liable to any other person for any loss or damage suffered by that person as a result of that contravention*'. The clause does not specifically refer to directors but can encompass directors.

Section 218 goes further and indicates that the provisions of Section 218 does not affect the right to any remedy that a person may otherwise have. We deal further with remedies and the new enforcement regime later in this document.

4. BUSINESS JUDGMENT TEST AND REMEDIES FOR DIRECTORS

Section 76(4) contains the counter balance in respect of the increased personal liability facing directors in terms of the provision of the new Companies Act.

¹⁹ Ibid Stein

Section 76(4)(a) is the statutory version of the business judgment test which originated in the USA.

Section 76(4)(a) reads in respect of any particular matter arising in the exercise of the powers or the performance of the functions of a director, a particular director of a company will have satisfied the obligations of exercising his or her powers and functions as a director in the best interests of the company and with a degree of care, skill and diligence reasonably expected of a person (as specified in s 76(3)(b) and (c)) if –

- (i) *'the director has taken reasonably diligent steps to become informed about the matter;*
- (ii) *either –*
 - (aa) *the director had no material personal financial interest in the subject matter of the decision, and had no reasonable basis to know that any related person had a personal financial interest in the matter; or*
 - (bb) *the director complied with the requirements of section 75 (Disclosure of personal financial interest) with respect to any interest contemplated in subparagraph (aa); and*
- (iii) *the director made a decision, or supported the decision of a committee or the board, with regard to that matter, and the director had a rational basis for believing, and did believe, that the decision was in the best interest of the company;'*

Essentially a director is deemed to have discharged all his duties as set out in Section 76(3) (b) and (c) if the director:

- (a) *'had taken reasonably diligent tests to become informed about the matter (an objective test);'*²⁰
- (b) *either had no material personal interest in the subject matter (as defined in Section 1) of the decision and had no reasonable basis to know that any related person had a personal financial interest in the matter or disclosed such personal financial interest to the board or shareholders in compliance with Section 75;'*²¹

²⁰ Ibid Stein
²¹ Ibid Stein

- (c) *made a decision or supported the decision of a committee or the board, with regards to that matter. The director is therefore required to actually take a decision,*²²
- (d) *had a rational basis for believing and did believe that the decision was in the best interest of the company*²³

Stein is of the opinion that this amounts to a defence against a claim that a director has breached his duty of care and skill and effectively lowers the standard of care and skill required of a director at common law from 'reasonableness' to 'rationality'- a significant difference especially when read with Section 76(5).

Criticism has been levied against various provisions which increase the exposure of directors to personal liability in terms of the new Act. The fear was that these provisions would persuade persons from accepting appointments as directors or a desire to continue to act as directors especially non-executive directors because the risk of personal liability is greater than the remuneration earned for rendering services as a director.

The rationale for the business judgment test is that all businesses have to take some financial risk and that directors should be encouraged to take carefully considered reasonable risks and should not have to worry about being held personally liable for doing so.²⁴ The case of ***Shuttleworth versus Cox Brothers and Company (Maiden Head) Limited 1927 2 KB 9 (CA) at 23 -24*** outlines the common law business judgment test.

'When persons, honestly endeavouring to decide what will be for the benefit of the company and to act accordingly, decide upon a particular course, then, provided there are grounds on which reasonable men could come to the same decision, it does not matter whether the Court would or would not come to the same decision or a different decision. It is not the business of the Court to manage the affairs of the company. That is for the shareholders and directors. The absence of any reasonable ground for deciding that a certain course of action is conducive to the benefit of the company may be a ground for finding lack of good faith or for finding that the shareholders, with the best motives, have not considered the matters which

²² Ibid Stein

²³ Ibid Stein

²⁴ Ibid Stein

they ought to have considered. On either of these findings their decision may be set aside. But I should be sorry to see that the Court go beyond this and take upon itself the management of concerns which others may understand far better than the Court does'.

Clearly the test cannot apply in circumstances where there has been *mala fides* or failure to act for a proper purpose as envisaged in Section 76(3)(a). South African Courts will be compelled to look to precedents such as the business judgment test outlined in ***Shuttleworth versus Cox Brothers*** hereinabove and numerous other cases. The Act specifically envisages in Section 5(2) that, to the extent appropriate a Court interpreting or applying this Act may consider foreign company law. Our Courts will have little option but to do so given the novelty of these provisions. Mr. Malokane in his article the Introduction of Business Judgment Rule by the new Companies Act²⁵ describes the business judgment rule developed in the United States of America as the duty of care in that it relates to one aspect of this duty namely the decision making. Malokane indicates that a Court will refuse to review the actions of a company's board of directors in managing the company unless there is some allegation of conduct that violates the director's duty of care, loyalty, or good faith or the decisions of the director's lack a rational basis. The rule creates presumption in favour of the board of directors freeing the members from possible liability for decisions that result in harm to the company.²⁶

A director or prescribed officer who makes a business judgment is taken to have satisfied the duty of care and diligence in respect of the judgment if the provisions of Section 76(4) (a) and (b)²⁷ are complied with.

Malokane²⁸ writes that there existed a need to ignore the long accepted business judgment rule developed by our Courts based upon the fundamental principles of the law of delict. The rationale for the business judgment rule is to encourage and protect informed business judgments, regardless of whether subsequent events prove those judgments right or wrong. The judgment rule prevents the Courts from asking the question '*Did the board breach its duty of care?*'

²⁵ Mmoledi Malokane Newtons Inc. Pretoria De Rebus June 2010

²⁶ Ibid De Rebus June 2010 Introduction of Business Judgment Rule by the new Companies Act

²⁷ Ibid Malokane De Rebus June 2010

²⁸ Ibid Malokane De Rebus June 2010

Malokane²⁹ confirms that the Court has recognised (in the case of ***Fisheries Development Corporation versus Jorgenson at 166 b***) that ‘A director is not liable for mere errors of judgment’ and therefore recognised that directors must be allowed to make judgments and business decisions in a spirit of enterprise untrammelled by the concerns of conservative investments, trustees and that risk may be taken in the hope of commensurate rewards. The introduction of the business judgment rule is necessary to protect directors from risk inherent in hindsight reviews of their business decisions. In the matter of ***Stanziale versus Nachtomi (in re Tower Air Inc)***.³⁰ The Appellate Court reversed the Lower Court’s dismissal of claims against directors and officers of Tower Air for their part in the decline of the airline. Charles Stanziale was appointed as the Chapter 11 Trustee of Tower Air Inc. and commenced action against Tower Air’s directors and officers seeking monetary and punitive damages on a total of seven counts for breach of fiduciary duty, gross negligence and mismanagement, and corporate waste that contributed to the need to liquidate the company. In April 2004 the US District Court for the district of Delaware dismissed all seven counts asserted by Stanziale holding that the allegations were insufficient to overcome the presumptions provided in Delaware’s business judgment rule. The District Court held that if self-interest is not sufficiently alleged, ‘to overcome the presumption of the business judgment rule, Plaintiffs must allege with particularity facts which establish that the contested decision was not the product of valid business judgment’. The Court held that Stanziale failed to comprehend that the business judgment rule applied and that Stanziale was required to rebut the presumption of the rule with well pleaded facts not conclusory allegations. This case outlines the importance of pleadings being sufficient to overcome the business judgment rule. In other words a complaint would be dismissed if an affirmative defence such as the business judgment rule went unanswered in the face of the complaint³¹.

In the recent case in the Court of Chancery (in re the **Goldman Sachs Group Inc. Shareholders Litigation, C.A5215 – VCG (October 12, 2011)**) held in the Court (Vice Chancellor Galsscock) of Chancery of the State of Delaware the memorandum opinion as submitted by the Court indicates the difficulty that complainants face in proving and in particular reiterated the following ‘*Within the boundary of fiduciary duty, however, these corporate actors are free to pursue corporate opportunities in*

²⁹ Ibid Malokane De Rebus June 2010

³⁰ Stanziale versus Nachtomi 2005 WL 181 3272 04-3633 (3D Circuit.August 3 2005)

³¹ Turnaround Management Association Article by Wendle H Adare Junior Partner Stroock and Stroock and Lavan LLP

any way that, in the exercise of their business judgment on behalf of the corporation, they see fit. It is broad freedom to pursue opportunity on behalf of the corporation, in the myriad of ways that may be revealed to creative human minds, that has made the corporate structure a supremely effective engine for the production of wealth. Exercising that freedom is precisely what directors and officers are elected by the shareholders to do. So long as such individuals act within the boundaries of their fiduciary duties, Judges are ill suited by training (and should be disinclined by temperament) to second guess the business decisions of those chosen by the stockholders to fulfil precisely that function'.

In this case the Plaintiff had brought the action derivatively on behalf of Goldman 'to redress the breaches of fiduciary duties and other violations of law by the Defendants'. Essentially the complaint was against the Goldman directors who had consistently based compensation for the firm's management on a percentage of net revenue and that because of this, Goldman's employees had a motivation to grow net revenue at any cost and without regard to risk. The allegation was that under this compensation structure Goldman's employees attempted to maximise short term profits thus increasing their bonuses at the expense of stockholders interests.

The judgment is instructive, particularly insofar as it deals with the allegations against individual directors and their conduct and exhibits the great difficulty and lengths parties will have to go to in order to succeed against directors in rebutting the defence of the business judgment test. 'Vice Chancellor Glasscock states at 34 B *'Having determined that the Plaintiffs have not pled particularised factual allegations that raise reasonable doubt as to the majority of the Director Defendants disinterestedness and independence, I must now apply the second prong of Aranson and determine whether the Plaintiffs had pled particularised facts that raise a reasonable doubt that Goldman's compensation scheme was otherwise the product of a valid exercise of business judgment. To successfully plead demands futility under the second prong of Aranson,³² the Plaintiffs must allege particularised facts sufficient to raise 1) a reason to doubt that the action was taken honestly and in good faith or 2) a reason to doubt that the board was adequately informed in making the decision'.*

³² Aranson 473 A.2D at 814

Further, at 43 the Vice Chancellor states the following *'At most, the Plaintiff's allegations suggest that there were other metrics not considered by the board that might have produced better results. The business judgment rule, however only requires the board to reasonably inform itself, it does not require perfection or the consideration of every conceivable alternative. The factual allegations pled by the Plaintiffs, therefore do not raise a reasonable doubt that the board was informed when it approved Goldman's compensation scheme'*.

In reaching his conclusion Vice Chancellor Glasscock cited numerous instructive cases such as ***The City Group case 964 May.2D; The Claremark case 698 A2D and others***. The conclusion of Vice Chancellor Glasscock reads as follows

'At 65 to 67 the Delaware General Corporation law affords directors and officers broad discretion to exercise their judgment in the fulfilment of their obligations to the corporation. Consequently, Delaware's case law imposes fiduciary duties on directors and officers to ensure their loyalty and care toward the corporation. When an individual reaches these duties, it is the proper function of this Court to step in and enforce those fiduciary obligations.

*Here, the Plaintiffs allege that the Director Defendants violated fiduciary duties in setting compensation levels and failing to oversee the risks created thereby. The facts pled in support of these allegations however, if true, support only a conclusion that the directors made poor business decisions. Through the business judgment rule, Delaware law encourages corporate fiduciaries to attempt to increase stockholder wealth by engaging in those risks that in their business judgment, are in the best interest of the corporation 'without the debilitating fear that they will be held personally liable if the company experiences losses' (**City Group** 19 to 64 A2D at 139). The Plaintiffs failed to allege facts sufficient to demonstrate that the directors were unable to properly exercise this judgment in deciding whether to bring these claims'.*

Section 76(4)(b) and Section 76(5) are largely a codification of the common law in relation to reliance by directors on the actions and information of others in discharging their duties.³³

³³ Ibid Stein

Section 76(4)(b) reads

'(b) is entitled to rely on –

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

Section 76(5) reads:

'(5) To the extent contemplated in subsection (4) (b), a director is entitled to rely on –

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

5. INCREASED RIGHTS AND REMEDIES FOR STAKEHOLDERS

The new Act recognises the economic necessity to create and foster investor confidence in South African companies. The Act accordingly introduces some significant new rights and remedies for minority shareholders. The Act also gives other stakeholders, particularly employees, rights and remedies they never had before.³⁴ The Act has introduced the following six new remedies:

³⁴ Ibid Stein

1. Section 20(9) (for the piercing of the corporate veil remedy reads as follows:

'If on application by an interested person or in any proceedings in which a company is involved, a Court finds that the incorporation of the company, any use of the company, or any act by or on behalf of the company, constitutes an unconscionable abuse of the juristic personality of the company as a separate entity, the court may –

- (a) declare that the company is to be deemed not to be a juristic person in respect of any right, obligation or liability of the company or of a shareholder of the company or, in the case of a non-profit company, a member of the company, or of another person specified in the declaration; and*
- (b) make any further order the court considers appropriate to give effect to a declaration contemplated in paragraph (a).*

[Sub-s. (9) added by s. 13 (d) of Act 3 of 2011.]

2. Section 159 in respect of the protection of whistle blowers who disclose irregularities or contraventions.
3. Section 161 in terms of which a shareholder has a general right to apply to Court for a declaratory order as to that shareholder's rights and to obtain an appropriate remedy.³⁵
4. Section 162 in terms of which directors may be declared delinquent or placed under probation.
5. Section 164 the appraisal remedy.
6. Section 165 relating to derivative actions in terms of which stakeholders may commence or pursue legal action against anyone in the name company.

The introduction of class actions introduces a legal procedure to give access to justice to people who would be otherwise unable to find the costs for legal proceedings of their own. Stein³⁶ comments that this could play a crucial role in assisting stakeholders to pursue their remedies under the Act including those against directors. Section 157(1)(c) reads as follows:

³⁵ Ibid Stein

³⁶ Carl Stein the New Companies Act Unlocked

'Section 157 Extended standing to apply for remedies

(1) When, in terms of this Act, an application can be made to, or a matter can be brought before, a court, the Companies Tribunal, the Panel or the Commission, the right to make the application or bring the matter may be exercised by a person –

(c) acting as a member of, or in the interest of, a group or class of affected persons, or an association acting in the interest of its members;'

6. REMEDIES AND ENFORCEMENT

As enumerated hereinabove Chapter 7 introduces a number of new remedies:

For example:

Protection for whistle blowers

Section 159 provides a new remedy to a number of stakeholders of a company, namely a shareholder, director, company secretary, prescribed officer or employee of a company, a registered trade union that represents employees of the company or another representative of that company's employees, a supplier of goods or services to a company or an employee of such company. It is clear that the section is wide and encompasses numerous stakeholders who have not previously had rights in terms of the Company's Act. Any of the aforesaid persons has a qualified privilege in respect of the disclosure and is immune from any civil, criminal or administrative liability for that disclosure (see Section 159(4)(a) and (b)).

Section 159(1) confirms that the protection of whistle blowers is in addition to any other rights that exist for an employee in terms of the Protected Disclosures Act 2000³⁷.

Section 159(3) confirms that the section applies to any disclosure by a person contemplated in subsection 159(4) if the requirement of section 159(3) (a) and (b) are complied with.

Enforcement

³⁷ Act 26 of 2000

The Act establishes a new enforcement regime which largely replaces the criminal law enforcement regime of the 1973 Act.³⁸ The duty to enforce the Act has shifted from the state in the form of the prosecuting authorities to the commission and take-over regulation panel ("TRP"). The take-over regulation panel, enforces those matters which fall under its jurisdictions namely affected transactions and offers, whilst the commission enforces the remaining provisions of the Act as well as fifteen other statutes listed in Schedule 4 of the Act.³⁹ The Commission and the take-over regulation panel enjoy greater powers in the new Act. The new procedure commences with the filing of a complaint with the Commission or the take-over regulation panel. The Commission or the take-over regulation panel may also initiate complaints themselves on request by another regulatory authority or if directed so by the Minister. Complaints are investigated by appointed inspectors to establish the merits of the complaint. The commission or the take-over regulation panel may refer the matter to the National Prosecuting Authorities if it believes an offence has been committed or issue a compliance notice to the offender. A compliance notice may require the cessation or correction of the alleged contravention, restoration of assets to any person or even provide a community service.⁴⁰ The compliance notice remains in force and effect until such time as a compliance certificate is issued. Failure to comply with the compliance notice may render a party liable to an administrative fine imposed by the Commission or the take-over regulation panel or the matter can be referred to the National Prosecuting Authority for prosecution as an offence. This is one of the few offences provided for in the Act.⁴¹

Section 156 of the Act deals with alternative procedures for addressing complaints or securing rights.

Section 156 outlines four alternative procedures which a person referred to in S 157(1) may seek to address a contravention of the Act or enforce any rights of the Act, a company's Memorandum of Incorporation or rules, or a transaction or agreement contemplated in the Act. The four alternative procedures are as follows:

- 'a) *attempting to resolve any dispute with or within a company through alternative dispute resolution in accordance with Part C of this Chapter;*
- b) *applying to the Companies Tribunal for adjudication in respect of any matter for which such an application is permitted in terms of this Act;*

³⁸ Carl Stein the New Companies Act Unlocked

³⁹ Ibid Stein

⁴⁰ Ibid Stein

⁴¹ Ibid Stein

- c) *applying for appropriate relief to the division of the High Court that has jurisdiction of the matter;*
- d) *filing a complaint in accordance with Part D of this Chapter within the time permitted by section 219 with –*
 - (i) *the Panel, if the complaint concerns a matter within its jurisdiction; or*
 - (ii) *the Commission in respect of any matter arising in terms of this Act, other than a matter contemplated in subparagraph (i)'.*

Sections 156 (a), (b) and (d) are new procedures. The High Court however remains the principal forum for the resolution of disputes, interpretation and enforcement of the Act.⁴²

Section 157(1) give locus standi to a range of persons and introduces the class action in Section 157(1)(c).

Section 157(2) gives the Commission or the panel the discretion to:

- '(a) *commence any proceedings in a court in the name of a person who, when filing a complaint with the Commission or Panel, as the case may be, in respect of the matter giving rise to those proceedings, also made a written request that the Commission or Panel do so; or*
- (b) *apply for leave to intervene in any court proceedings arising in terms of this Act, in order to represent any interest that would not otherwise be adequately represented in those proceedings'.*

Section 157(3) makes it clear that nothing in Section 157 creates a right of any person to commence legal proceedings as contemplated in Section 165(1) which constitutes derivative proceedings.

7. CLASS ACTIONS

Section 157(1)(c) enshrines the common law rule that claimants must have a personal and direct interest in the subject matter of the claim.⁴³ Class actions constitute a legal procedure its purpose being to give access to Courts to persons who would otherwise not have been in a financial position to commence proceedings on their own. It is anticipated that this will increase litigation and in turn increase the

⁴² Ibid Stein

⁴³ Patz versus Greene & Co. 1907 TS427

costs of companies in terms of legal costs and indemnity insurance policy premiums for their directors and officers.⁴⁴ The case of the ***Department of Welfare Eastern Cape versus Ngxuza 2001 (4) SA 1184 SCA*** is the locus classicus in terms of the requisites for a class action namely:

1. The class must be so numerous that joinder of all its members is impractical;
2. There must be questions of law and fact common to the class;
3. The claims of the applicant representing the class must be typical of claims of the rest of the class;
4. The applicant through its representative must fairly and adequately protect the interest of the class⁴⁵.

Section 168 Part D (ss 168 – 175) outlines the complaints and compliance procedures. A brief summary of this procedure is already outlined hereinabove.

The issuing of a compliance notice is a key provision (see section 171(1)). A compliance notice cannot be issued if the alleged contravention could otherwise be addressed in terms of the Act by an application to a Court or to the tribunal.⁴⁶

Section 171(2) reads as follows:

- '(2) A compliance notice may require the person to whom it is addressed to-*
- (a) cease, correct or reverse any action in contravention of this Act;*
 - (b) take any action required by this Act;*
 - (c) restore assets or their value to a company or any other person;*
 - (d) provide a community service, in the case of a notice issued by the Commission; or*
 - (e) take any other steps reasonably related to the contravention and designed to rectify its effect'.*

A compliance notice remains in force until the Commission or the take-over regulation panel issues a compliance certificate or the compliance notice is set aside by means of review in terms of the provisions of Section 171(5).

⁴⁴ Ibid Stein

⁴⁵ Ibid Stein

⁴⁶ Section 171(1)

Section 171(7) deals with the failure to comply with a compliance notice which includes the following:

1. application to Court for the imposition of an administrative fine; or
2. referral of the matter to the National Prosecuting Authority for prosecution as an offence in terms of Section 214(3),

but the Commission or executive director of the take-over regulation panel may not do both in respect of any particular compliance notice.

Section 214(3) stipulates that it is an offence to fail to satisfy a compliance notice but prosecution cannot follow if the Commission or the take-over regulation panel has applied to Court in terms of Section 171(7)(a).

Administrative fines are outlined in Regulation 163. A Court may impose an administrative fine upon application in terms of Section 171(7) for an amount not exceeding the greater of R1 million⁴⁷ and 10% of the Respondent's turnover for the period during which the company fail to comply with the compliance notice.⁴⁸

Section 175(2) outlines factors that need to be considered when imposing an administrative fine and reads as follows:

'(2) When determining the amount of an appropriate administrative fine, the following factors must be considered:

- (a) the nature, duration, gravity and extent of the contravention;*
- (b) any loss or damage suffered as a result of the contravention;*
- (c) the behaviour of the respondent;*
- (d) the market circumstances in which the contravention took place;*
- (e) the level of profit derived from the contravention;*
- (f) the degree to which the respondent has co-operated with the Commission or Panel, as the case may be, and the court; and*
[Para. (f) substituted by s. 110 of Act 3 of 2011]
- (g) whether the respondent has previously been found in contravention of this Act.*

8. RIGHTS AND REMEDIES OF EMPLOYEES AND TRADE UNIONS (increased stakeholder rights)

⁴⁷ S175(5)

⁴⁸ Section 175(1)

Employees, as stakeholders, have increased rights in terms of the new Act. For example during business rescue proceedings, employees continue to be employed on the same terms and conditions as those before business rescue proceedings began and are preferred unsecured creditors of the company for remuneration which became due and payable to them at any time before business rescue proceedings began. Employees may also participate in all Court proceedings, form committees of employees' representatives and vote with creditors to approve proposed business rescue plans⁴⁹.

Foreign companies must register with the Commission as an external company and therefore become subject to all the provisions of the Act which relate to external companies.

Employees are afforded protection in terms of Section 159, the whistle blowing provisions.

Employees have the right to apply to Court for an order declaring a director delinquent or under probation⁵⁰ and may invoke the provisions of the Act to pierce the corporate veil⁵¹.

Employees have the right to institute derivative proceedings in terms of Section 165 of the Act.

Employees may lodge complaints with the Commission or the take-over regulation panel.⁵²

Trade unions now also have rights and remedies under the new Act which did not exist before. These include the rights to institute derivative actions, lodge complaints with the Commission or the take-over relation panel, applying to Court to declare a director delinquent or under probation, representing employees in business rescue proceedings. Trade unions may institute class action proceedings on behalf of employees.⁵³ Trade unions have the right to restrain a company from doing anything inconsistent with the Act and are entitled to receive written notice of any resolution

⁴⁹ Ibid Stein
⁵⁰ S162 of the Act
⁵¹ S20(9) for example
⁵² Ibid Stein
⁵³ Ibid Stein

providing financial assistance to a director⁵⁴. Trade unions through the Commission must be given access to the company's financial statements for purposes of any business rescue procedures.

9. CONCLUSION

Each topic covered in this research paper merits greater in depth attention and could form a topic on its own. For purposes of this course a more general overview and approach was adopted and is therefore by no means a full and definitive summary of each topic.

.....
R. Y. CARRINGTON

⁵⁴ Ibid Stein

INDEX OF REFERENCES

Carl Stein New Companies Act Unlocked, October 2011

Dorbyl Ltd v Vorster (2011) 20 GSJ 6.6.1

Da Silva and Others v CH Chemicals (Pty) Ltd 2008 (6) SA 620 (SCA)

The Business Judgment Rule Revisited by Wendell H. Adair, Jr., Mary E. McEachern

Court of Chancery Upholds the Business Judgment Rule Again posted on October 12, 2011
by Edward M. McNally

The Goldman Sachs Group Inc. Shareholders Litigation, C.A. 5215-VCG (October 12, 2011)

Fryar Law Firm P.C. – Application of the Texas Business Judgment Rule in Shareholder
Oppression

Obermayer Rebmann Maxwell & Hippel – Determining bad faith using the ‘Business
Judgment Rule’, Published January 31, 2003

Locke Lord Bissell & Liddell – The Business Judgment Rule and Mutual Insurance
Companies – *Hill v. State Farm Mutual Automobile Insurance Company*, October 22, 2008

Business Judgment Rule Protects Directors of Failed California Credit Union, Wednesday,
September 7, 2011 written by Jake Bielema

Matter of Levandusky v One Fifth Ave. Apt. Corp, Court of Appeals of New York, Argued
February 14, 1990, Decided April 5, 1990

Smith v. Van Gorkom 488 A.2d 858 (Del. 1985)

Companies Act Online Site - Australian Securities and Investments Commission v Healey
(2011) FCA 717

Company Law – The “ring fenced” provision by Natasha Bouwman