

**THE APPLICATION AND INTERPRETATION OF PRINCIPLES OF
CORPORATE GOVERNANCE IN THE STATE OWNED ENTITIES (ESKOM) IN
SOUTH AFRICA**

by

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DECLARATION

I, Mr. **Tshepo Milford Ramatabana** declare that this mini-dissertation submitted to the University of Limpopo (Turfloop Campus) for the degree of Masters of Laws (LLM) in Development and Management Law has not been previously submitted by me for a degree at this university or any other university, that it is my own work in design and in execution, and that all material contained herein has been duly acknowledged.

Tshepo Milford Ramatabana

Date

ABSTRACT

Good corporate governance is essentially about effective, responsible leadership. This is characterized by the ethical values of responsibility, accountability, fairness and transparency, which values underpin good corporate governance. After the promulgation of the Kings Code, amendment of the Companies Act and the promulgation of the Public Financial Management Act, it has been shown that most of the leadership and board of directors in state owned entities have not been following the guidelines and principles provided in these legislations and that's why most of them are in disarray. It is, therefore, the objective of this research to help restore the integrity and confidence in state owned entities and the need to a draw the line between personal interest and that of the company. An appropriate approach will be to conduct training or a workshop, whereby appointed persons can be reminded of how to discharge their rights and duties before they are instated into a particular post.

DEDICATION

I great fully acknowledge the following people, without their input this dissertation would not have come to fruition. I am very grateful to Adv. Nevondwe, under whose supervision the research was conducted, for his support and guidance in directing the completion of this work. His willingness to discuss the issues relating to this research was very helpful.

This mini-dissertation is dedicated to my family and friends in that they should not give up on achieving their goals because if they give up they won't achieve them only to find out they were only left with one step to achieve them, and mostly to my daughter Refilwe Grace Ramatabana in that she should follow her dreams and never be discouraged.

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LIST OF ABBREVIATIONS

ADR -Alternative Dispute Resolution

CEO -Chief Executive Officer

CGF -Corporate Governance Framework

CIO -Chief Executive Officer

CLR- Company Law Review

IoDSA- Institute of Directors of South Africa

IT- Information Technology

JSE -Johannesburg Stock Exchange

NGO -Non-Governmental Organisation

OECD- Organisation of Economic Corporation and Development

SOE -State owned Entity

SOX- Sarbanes-Oxley Act of 2002.

UK -United Kingdom

USA- United State of America

LIST OF INTERNATIONAL INSTRUMENTS

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The Greenbury Committee Report 1995

The Hampel Committee Report 1998

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1. Companies Act 61 of 1973
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21. *In Bray v Ford* [1896] AC 44 at 51-2.
22. *Industrial Development Consultants Ltd v Cooley* [1972] 2 All ER 162.
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31. *Re Smith & Fawcett Ltd* [1942] Ch 304 at 306.
32. *Robinson v Randfontein Estates Gold Mining Co Ltd* [1921] AD 168.
33. *S v Shaban* 1965 (4) SA 646 (W).
34. *Shuttleworth v Cox Bros & Co (Maidenhead) Ltd* [1927] 2 KB 9 at 23.
35. *Sibex Construction (SA) (Pty) Ltd v Injectasteel CC* 1988 (2) SA 54 (T) at 66D.
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38. *Transcash Swd (Pty) Ltd v Smith* 1994 (2) SA 295 (C)
39. *Volvo (Southern Africa) (Pty) Ltd v Yssel* 2009 (6) SA 531 (SCA)

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CHAPTER ONE

1. Historical background to the study.

In 1992, as South Africa was embarking on the path to democracy, the former President Nelson Mandela saw the need of a new system of governance and approached Mervyns King to spearhead the creation of this new system.¹ Mervyns King, a veteran corporate lawyer and a former Supreme Court judge.² Rationale for the King commission formed the King committee in 1994, at the instances of the Institute of Directors in Southern Africa, published the Kings report on corporate governance, which contained a Code of Corporate Practices and Conduct. Another King Report was issued in 2002 (King II).³ In King II the seven characteristics of good governance were listed. They are:

- a) Discipline (a commitment by the company management to adhere to behaviour that is universally accepted),
- b) Transparency (the ease with which an outsider is able to make meaningful analysis of a company's accounts),
- c) Independence (the extent to which mechanisms have been put in place to minimise or avoid potential conflicts of interests),
- d) Accountability (individuals in a company should be accountable for the actions they take),
- e) Responsibility (this pertains to behaviour that allows for corrective action and or for penalising mismanagement),
- f) Fairness (the systems that exist in a company must be balanced in taking into account all those that have an interest in the company and its future),
- g) Social responsibility (a well-managed company will be aware of social issues and respond thereto).

The above characteristics in King II Report will be examined further with special emphasis in case law.

¹ <http://www.irmagazine.com/articles/case-studies/16371/audience-mervyn-king/> ,(visited on 15 March 2016).

² Neil Stewart, An audience with the GRI's Mervyn King, published seminar, available at <http://www.insideinvestorrelations.com/articles/case-studies/16371/audience-mervyn-king/> (visited on 15 MARCH 2016).

³ *Ibid.*

King II contains a Code of Corporate Practices and Conduct. This Code is applicable to all companies listed on the Johannesburg Stock Exchange (JSE) Limited, banks, financial and insurance entities as defined in the applicable legislation, public sector enterprises and agencies. All other enterprises should also give due consideration to the provisions of the Code.⁴ It is important to note that the provisions in the Code were only recommendations but compliance is compulsory. The Code should not be regarded as a set of detailed rules on directors' conduct. The Code operates on a "comply or explain" basis. If the enterprises listed above do not comply with the Code they need to explain their reasons.⁵ The next section provides some of the most important recommendations on corporate governance. Boards of directors, directors, auditors and the company secretary are focused on.⁶

The King report on governance for South Africa 2009 (King III Report) and the King Code of governance for South Africa 2009 (the code), which came into effect on 1 March 2010, which has replaced the King II Report and code of corporate practices and conduct.⁷ The King III Report was prompted by changes in international governance trends and the changes and reformed implemented by the companies act,⁸ (hereafter the Act). One of the very purposes of the Act, as embodied in section 7(b), is to encourage transparency and high standards of corporate governance as appropriate, given the significant role of enterprises within the social and economic life of the nation. This purpose encourages an interaction between the King III Report and the Act.⁹

The King III Report sets out a number of key corporate governance principles, which must be read together with the code, which sets out best practice recommendations on how to carry out each principle.¹⁰ The code regulates directors and their conduct not only with a view to complying with the minimum statutory standard, but also to seek to adhere to the

⁴ Sebola Kgabo Reginald, Principles of corporate governance with specific reference to the case of *South African Broadcasting corporation (Ltd) v Mpofu* [2009] 4 ALL SA169 (GSJ).

⁵ *Ibid.*

⁶ *Ibid.*

⁷ *Ibid.*

⁸ 71 of 2008.

⁹ See Mervyn King op cit n 2 at 447.

¹⁰ *Op cit note 4, page 2.*

best available practice that may be relevant to the company in its particular circumstance.¹¹

2. The statement of the research problem.

In the year 2015, evidence emerged where there was an extensive meddling in Eskom's day to day operations by its chairman, who has been placing orders and making contractual commitments on Eskom's behalf, as well as involving himself in managerial decisions in quite inappropriate ways. And though there is now a new and even more inexperienced board, the past four years have seen extensive second-guessing by directors of managerial decisions. In Eskom it is important to integrate the technological and business aspects to support the decision making process, however it has failed to follow the said business aspects that have to develop and transform it. The challenges facing industries such as Eskom is the balance between the technological and financial aspects of the business.

Eskom requires the seamless interlocking of several elements: steady and superior operational performance, proactive infrastructural investment, appropriate pricing structures and a level of customer service that sets it apart from its competitors as well as other utilities in the world. Collectively, Eskom has to integrate the technological and the business aspects more effectively and efficiently in a manner that elevates good corporate governance. Eskom needs to ensure continuity of supply to all its customers in the most effective, efficient and cost effective manner while abiding themselves by good corporate governance. Eskom is also subject to the provisions of the Companies Act¹², which grants the control of the corporation to the board, Section 66 of the Companies Act, clearly stipulates that the business and affairs of the Eskom must be managed by or under the direction of the board.

This mini-dissertation seeks to address the question whether the corporate governance reforms in South Africa are sufficient to meet the internationally accepted standards and whether internationally standards are good for South Africa. The study further analyses

¹¹ *Ibid*, *South African Broadcasting Corporation Ltd v Mpofu* (2009) 4 ALL SA 169 (GSJ) Para 29.

¹² 71 of 2008.

codes, the duty of directors and their liabilities versus legislating corporate governance principle in determining the best approach for South Africa.

3. Literature Review.

Corporate governance is concerned with the structures and processes associated with management, decision making and control in organisations.¹³ It relates to the way in which companies are directed and controlled and the principles and practices that are regarded as appropriate conduct by directors and managers.¹⁴ The function of corporate governance practices is essentially nothing other than a performance management system to ascertain or assist directors on whether they have discharged their duties.¹⁵

According to, Sir Adrian Cadbury, UK, and Commission Report: Corporate Governance 1992 said that “Corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals. The governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible the interests of individuals, corporations and society.”¹⁶

Mark Goyder, Director of Tomorrow's Company says “Governance and leadership are the yin and the yang of successful organisations. If you have leadership without governance you risk tyranny, fraud and personal fiefdoms. If you have governance without leadership you risk atrophy, bureaucracy and indifference.”¹⁷

Mervyn King, Chairman: King Report say “Good corporate governance is about 'intellectual honesty' and not just sticking to rules and regulations, capital flowed towards companies that practiced this type of good governance, and it is clear that good corporate governance makes good sense. The name of the game for a company in the 21st Century will be conforming while it performs.”¹⁸

¹³ *Op cit note 4*, page 2.

¹⁴ *Ibid.*

¹⁵ Cassim FHI; *Contemporary Company Law*, 2nd Edition, 2011, Juta, Cape Town, South Africa.

¹⁶ *Op cit note 4*, page 2.

¹⁷ *Ibid.*

¹⁸ *Op cit note 4*, page 2.

“It is essential that the activities of corporate executives are under constant, vigorous and public scrutiny, because those activities are crucial to the economic well-being of society. If anything, developments both locally and internationally during 2001 have emphasised the need to continuously update and upgrade corporate governance standards” by Ann Crotty.¹⁹

While Deloitte and Touche say that “Information technology governance is no longer some stand-alone function, but is an integral part of any organisation’s overall corporate governance. If an (your) organisation cannot survive as a competitive player without IT, then the (your) Board cannot apply acceptable corporate governance without overt IT Governance.”²⁰ “A director is “bound to take such precautions and show such diligence in their office as a prudent man of business would exercise in the management of his own affairs.” by Trustees of the Orange River Land & Asbestos Company v King, 1892.²¹

In *South African broadcasting corporation Ltd v Mpofu*²², the court stressed that integrity is a key principle underpinning good corporate governance, and that it is based on a clear code of ethical behaviour and personal integrity exercised by the board, where communications are shared openly. The legal and regulatory framework for state-owned entities should be developed in order to ensure a level-playing field for state owned entities and the private sector in areas where they compete and with the view to promote good corporate governance practices, following in this regard the (Organisation for Economic Co-operation and Development) OECD Principles²³ of Corporate Governance.

¹⁹ *Ibid.*

²⁰ *Ibid.*

²¹ *Ibid.*

²² [2009] 4 ALL SA 169 (GSJ).

²³ *Op cit note 4*, page 2. Guidelines on corporate governance of state-owned enterprises draft text December 2004; (A. There should be a clear separation between the ownership function and the state’s other roles that may influence the conditions for state-owned enterprises’ activity, particularly in regulation and industrial policy. B. Governments should strive to simplify and streamline the legal form under which SOEs operate as well as their operational practices.

C. Any specific obligations that an SOE is required to undertake in terms of public service provisions or special responsibilities above the generally accepted norm should be clearly identified by laws and regulations, disclosed to the general public, and provision made to cover related costs in a transparent manner. D. SOEs should not be exempt from the application of general laws. Other shareholders and stakeholders, including competitors, should have access to efficient redress mechanisms in case their rights are violated).

Although the King III Report and the code apply to all entities incorporated in and resident in south Africa, regardless of the manner and form of incorporation or establishment and whether such establishment is in the public, private or non-profit sector's.²⁴ In contrast, the King II Report only applied to certain categories of business enterprises, namely, listed companies, financial institutions and public sector enterprises, while companies falling outside these categories were merely required to consider the application of the king ii report insofar as it was applicable.²⁵ The United States of America codified a significant part of its corporate governance provisions in the Sarbanes-Oxley Act 2002 and the legal sanctions are applied for non-compliance with this act.²⁶

In South Africa, compliance with the King III report and the code is mandatory from companies listed on the Johannesburg Stock Exchange,²⁷ but for all other entities there is no statutory obligation to comply with the king iii report and the code. While corporate practice in South Africa may be voluntary, note that they are highly recommended and have considerable persuasive force. Commonwealth countries and the European Union states have also not legislated their corporate governance practices and adopt a similar approach to that adopted in South Africa.²⁸

According to Hussain J²⁹ it was stated that practicing good sound corporate governance is essential for the well-being of a company and is in the best interest of the growth of South Africa's economy, particularly in attracting new investments. The report then confirms that it is for the board of directors to act as the focal point and custodian of corporate governance.³⁰ Victor J,³¹ stressed, good corporate governance (particularly in state-owned enterprises) is ultimately about effective leadership. The court stressed further that an organization depends on its board of directors to provide it with direction.³²

²⁴ *Op cit note 4*, page 2, Sebola. King III report at 17.

²⁵ *Ibid.*

²⁶ *Ibid.*

²⁷ *Ibid.*

²⁸ *Ibid.*

²⁹ *Minister of Water Affairs and Forestry v Stilfontein Gold Mining co Ltd 2006 (5) SA 333 (W)*, paragraph 16.7.

³⁰ *Op cit note 4*, page 2, Sebola.

³¹ *South African Broadcasting Corporation v Mpofu [2009] 4 ALL SA 169 (GSJ)* paragraph 60.

³² *Ibid.*

The board should ensure that the company is, and is seen to be, a responsible corporate citizen³³ and should provide effective leadership based on an ethical foundation.

It is responsible for the strategic direction and the control of the company. Furthermore, the board of directors should act in the best interest of the company.³⁴ The report recommends that every board should have a charter setting out its responsibilities and should meet as often as required to fulfil its duties, but preferably at least four times per year. The board of directors should strive to achieve the appropriate balance between its various stakeholders' groupings, and is urged to take into account, as far as possible, the legitimate interest and expectations of its stakeholders when making decisions in the best interest of the company.

The King III Report requires the board to ensure the integrity of the company's integrated report, which should be prepared annually and should convey adequate information regarding the company's financial and sustainability performance.³⁵

Integrated reporting enables stakeholders to better assess the economic value of the company. The board should further more ensure that the company complies with applicable laws and that it is also considers adherence to non-binding rules, codes and standards.³⁶

The board should be responsible for the governance of both risks³⁷ and information technology, and should ensure that there is an effective risk-based internal audit.³⁸ In addition, the board should be responsible for dispute resolution and should ensure that disputes are resolved as effectively, efficiently and expeditiously as possible. Navsa JA,³⁹ stated that "of course, principles of good corporate of companies dictate that resolutions should be properly taken at general meetings or meetings of directors after due and

³³ *Op cit note 4, page 2, Sebola.*

³⁴ *Ibid.*

³⁵ *Ibid.*

³⁶ *ibid.*

³⁷ *ibid.*

³⁸ *ibid.*

³⁹ *Transcash Swd (Pty) Ltd v Smith 1994 (2) SA 295 (C).*

proper deliberation. This does not mean, however, that in instances where this course is not strictly followed the directors cannot otherwise bind a company".⁴⁰

On the 1 July 2002, Eskom was converted from a statutory body into a public company as Eskom Holdings Limited, in terms of the Eskom Conversion Act, 13 of 2001. The two-tier governance structure of the Electricity Council and the Management Board was replaced by a Board of Directors. The conversion of Eskom provided an ideal opportunity to review Eskom's existing governance structures and to design a more effective and streamlined decision-making process. The transition was accomplished smoothly and the conversion, including the creation of new Board committees and the induction of Board members, was carried out efficiently. The Board is the accounting authority of Eskom in terms of the PFMA.

4. Aims and Objectives of the Study.

The aim of this study of principles is to evaluate the challenges which have confronted the principles of corporate governance in state owned entities and to examine the laws regulating good corporate governance in South Africa, as corporate governance is known to be one of the criteria that foreign institutional investors are increasingly depending on when deciding on which companies to invest in.

5. Significance of the study.

The most importance of this study is to ensure that the integrity of the state owned entities is intact and to boost the investor's confidence. The purpose of this study is strived to achieve;

- a) Good corporate governance (which will ensure corporate success and economic growth).
- b) Strong corporate governance, to maintain investors' confidence, as a result of which, company can raise capital efficiently and effectively.
- c) To lower the capital cost.
- d) To have a positive impact on the share price.

⁴⁰ *Op cit note 4, page 2, Sebola.*

- e) To provide proper inducement to the owners as well as managers to achieve objectives that are in interests of the shareholders and the organization.
- f) Good corporate governance also minimizes wastages, corruption, risks and mismanagement.
- g) It helps in brand formation and development.
- h) It ensures organization in managed in a manner that fits the best interests of all.

6. Research Methodology.

The research methodology to be used in this study is qualitative. Legal comparative and legal historical methods based on this study will be employed. The legal comparative will be applied to find solutions, especially on good corporate governance. The purpose of historical research method on the other hand, will be to establish the development of legal rules, between law and social justice, and also to propose solutions or amendments to the existing laws or rules based on practical or empirical and historical facts.

This research is not only based on library materials, such as text books, reports, legislations, regulations, case laws, articles and papers presented on the subject in conferences but also based on internet sources.

7. Scope and the limitation of the study.

The study consists of five chapters. The first chapter deals with the introduction which will lay down the foundation of the study. Chapter two discusses the regulatory framework. Third chapter focuses on the concept of corporate governance. Chapter four Risk management. Chapter five is the summary of conclusion and recommendations.

CHAPTER TWO: REGULATORY FRAMEWORK

2.1 Introduction.

Good governance does not exist separately from the law, and a corporate governance code that applies on a voluntary basis may also trigger legal consequences. Voluntary codes such as King IV Report (2016) recommend leading practices for how governance duties should be discharged and therefore influence and affect what practices are considered and eventually adopted and implemented by governing bodies.

2.2 Application.

King I Report promotes the highest standards of corporate governance. It advocated an integrated and inclusive approach to corporate governance. This approach exhorted companies to widen their focus beyond financial matters and to consider the company's triple bottom line that is its economic, environmental and social impacts.⁴¹

The King III Report and the Code apply to all entities incorporated in and reside in South Africa, regardless of the manner and the form of incorporation or establishment, whether the establishment is in the public, private or non-profit sectors. In contrast to the Kings III report, the King II Report only applied to certain categories of business enterprises, namely listed companies, financial institutions and sector enterprises, while companies falling out of these categories were merely required to consider the application of the King II Report insofar as it was applicable.⁴²

The USA codified its corporate governance provisions in the Sarbanes-Oxley Act 2002 and the legal sanctions are applied for non-compliance with this Act.⁴³ In South Africa, compliance with the King III Report and the code is mandatory for the companies listed on the JSE, financial institutions and sector enterprises,⁴⁴ but for all other entities there is no statutory obligation to comply with the King III Report and the Code. While corporate governance practices in South Africa may be voluntary, note that they are highly

⁴¹ Good S, King III review, De rebus August 2009, p17.

⁴² *Ibid.*

⁴³ *Ibid.*

⁴⁴ *Ibid.*

recommended and have considerable persuasive force. Commonwealth countries and the European Union states have also not legislated their corporate governance practices and adopted a similar approach to that adopted in South Africa.⁴⁵

On 1 November 2016, the King Committee published the King IV Report on Corporate Governance for South Africa, 2016. King IV introduced various amendments and enhancements to its predecessor, the King III Report on Governance for South Africa, 2009. King IV constitutes a positive step in South African corporate governance which aims to embrace a more practical approach in the governance of organisations which King IV defines as *“a company, retirement fund, non-profit organisation, state-owned entity, municipality, municipal entity, trust, voluntary association and any other juristic person regardless of its manner of incorporation”*.

Codes of corporate governance are concerned with the role and responsibilities of the governing body and its interaction with management and other material stakeholders. The governing body is the focal point of corporate governance in an organisation, and hence the primary audience of King IV Report. The King IV Report aspires to apply to all organizations, regardless of their form of incorporation. The main objective of King IV Report is to broaden acceptance of corporate governance by making it accessible and fit for application across a variety of sectors and organizational types.

2.3 Eskom’s Governance Framework.

The governance framework that regulates the relationship between the shareholder, the company and the board includes the following:⁴⁶

- A memorandum of incorporation, which sets out certain powers of the shareholder and the board. Eskom’s revised memorandum of incorporation (MoI) is being finalised. The board and the shareholder are in consultation on various provisions of the MoI

⁴⁵ Nevondwe L, Corporate governance principles: lessons to be learnt, The Thinker Political Journal, Vol.44 October 2012, p16.

⁴⁶ Eskom Integrated report 31 March 2016.

- A strategic intent statement, which sets out the agreed mandate and strategy for Eskom
- The corporate plan, which forms the basis of Eskom's operations and outlines the company's purpose, values and strategic objectives
- A shareholder's compact, which sets out annual key performance indicators and targets in support of the strategic intent statement. To the extent necessary, the shareholder's compact seeks to clarify the objectives of Eskom in the context of the strategic intent statement
- Codes of good governance such as King III and the Protocol on Corporate Governance in the Public Sector. Eskom has endeavored to apply all the King III principles and practices. However, as a state-owned company, a few of these cannot be applied and Eskom has, in some instances, adopted alternative practices to those recommended by King III.
- Relevant legislation, including the Companies Act, the Public Finance Management Act (PFMA), National Treasury regulations, the Eskom Conversion Act (2001), and regulations of NERSA and the National Nuclear Regulator
- Materiality framework which sets out the requirements regarding matters needing approval in terms of the PFMA
- Relevant policies and procedures of the shareholder and Eskom
- Delegation of authority framework which delegates power and authority from the board to committees and employees. The revised delegation of authority framework was approved and is being implemented

Despite Eskom having the said framework, it still fails to adopt it. In simple terms Eskom has its own framework that it has to adhere to, however implementation is the problem.

2. 4. Principles of Corporate Governance.

The King III and IV Report provides the following principles of corporate governance;

Each of the principles contained in the Report is set out in the code, together with the recommended practices relating to each principle. Some of the main principles and practices of the King III and IV Report are discussed below.⁴⁷

2.4.1 Leadership, Ethics and Corporate Citizenship.

The governing body of a company should individually and collectively cultivate the following characteristics and exhibit them in their conduct to ensure good leadership and corporate citizenship based on ethical values.⁴⁸

- **Integrity:** with regard to corporate governance, good leadership ethics, integrity is possessing the quality of being honest and having strong moral principles. It encompasses consistency between stated moral and ethical standards, and actual conduct. In relation to the annual financial statements and other external reports issued by the organisation, refers to the reliability and usefulness of the report. The governing body of a company must act in good faith and in the best interest of the company. They should also avoid conflict of interest.⁴⁹
- **Competence:** with competence one has to look at possessing the skills and attributes, and exhibiting the conduct that are used to define and measure suitability for a certain role or function. The board should take steps that to ensure that they have sufficient working knowledge of the organisation, its industry, the triple context in which it operates, the capitals it uses and affects as well as of the key laws, rules, codes and standards applicable to the organisation. They should also act with due care, skill and diligence, and take responsibly diligent steps to become informed about matters for decision. They should also continuously develop their competence to lead effectively.⁵⁰

⁴⁷ Cassim FHI, Contemporary Company Law, 2nd Edition, pp. 475-504.

⁴⁸ Principle 1 of King IV Report, 2016.

⁴⁹ *Ibid.*

⁵⁰ *Ibid.*

- **Responsibility:** the board should assume collective responsibility for steering and setting the direction of the organisation, approving policy and planning; overseeing and monitoring of implementation and execution by management and ensuring accountability for organisational performance. Furthermore to take exercise courage in taking risks and capturing opportunities but in a responsible manner and in the best interest of the organisation.⁵¹
- **Accountability:** the governing body should have an obligation to answer for the execution of responsibilities. Accountability cannot be delegated, whereas responsibility can be delegated without abdicating accountability for that delegated responsibility.⁵²
- **Fairness:** fairness refers to the equitable and responsible treatment of the resources of value creation, including relationship capital as portrayed by the legitimate and responsible needs, interests and expectations of material stakeholders of the organisation.⁵³
- **Transparency:** it is the unambiguous and truthful exercise of accountability such that decision-making processes and business activities, outputs and outcomes, whether positive or negative are easily able to be discerned and compared with ethical standards.⁵⁴

Corporate citizenship is the recognition that the organisation is an integral part of the broader society in which it operates, affording the organisation standing as a juristic person in that society with rights but also responsibilities and obligations. It is also the recognition that the broader society is the licensor of the organisation. The board should ensure that the origination is and seen to be a responsible corporate citizen. They should also set a direction on how it should be approached and addressed by the organisation. Furthermore they should make sure that their citizenship is in compliance with the Constitution of the Republic of South Africa.⁵⁵ Their core purpose will be to ensure that their values, strategy and conduct are congruent with it being a responsible corporate

⁵¹ *Op cit note 48.*

⁵² *Ibid.*

⁵³ *Ibid.*

⁵⁴ *Ibid.*

⁵⁵ 108 of 1996.

citizen.⁵⁶ Their citizenship should attribute positively on the following aspects: workplace, economy, society and environment.⁵⁷

Eskom's leadership focuses on effective ethical leadership and corporate citizenship. As can also be seen from what is set out earlier regarding the performance of Eskom and its key priorities, the board and executive management have recognised the need to integrate strategy, governance and sustainability.⁵⁸

2.4.2 Audit Committee.

The establishment of an audit committee is a statutory requirement for some organisations. As a matter of leading practice, the governing body of any organisation that issues audited financial statements should consider establishing an audit committee, the role of which should be to provide independent oversight of among others, the effectiveness of the organisations assurance functions and services, with particular focus on combined assurance arrangements, including external assurance service providers, internal audit and the finance function and the integrity of the annual financial statements and, to the extent delegated by the governing body, other external reports issued by the organisation.⁵⁹ The audit committee has the power to make decisions regarding its statutory duties and is accountable for its performance in this regard. In addition the governing body may delegate other responsibilities to the audit committee, such as the approval of the annual financial statements, but the governing body remains ultimately accountable for such delegated responsibilities.⁶⁰ The governing body may delegate risk governance to the audit committee, the audit committee should satisfy itself that it dedicates sufficient time to this responsibility. Whether or not the governance risk is delegated to the audit committee should oversee the management of financial and other risks that affect the integrity of external reports issued by the organisation.⁶¹

⁵⁶ Principle 3 of King IV Report, 2016.

⁵⁷ *Ibid.*

⁵⁸ Eskom Annual report, 2016.

⁵⁹ Principle 8 of King IV Report, 2016.

⁶⁰ *Ibid.*

⁶¹ *Ibid.*

2.4.3 Risk Governance.

The governing body should assume responsibility for the governance of risk by setting the direction for how risk should be approached and addressed in the organisation. Risk governance should encompass both; the opportunities and associated risks to be considered when developing strategy and the potential positive and negative effects of the same risks on the achievement of organisational objectives. The governing body should treat risk as integral to the way it makes decisions and executes its duties. It should also approve policy that articulates and gives effect to its set direction on risk.⁶²

2.4.4 Boards and Directors.

The King III Report differentiates between executive and non-executive directors. An executive director is involved with the day today management of the company. He or she is a full-time salaried employee of the company⁶³ and is generally under a contract of service with the company. A non-executive director, on the other hand, is a part-time director. He or she is not involved in the daily management of the company, but plays an important role in providing objective judgment, independent of management, on issues facing the company.⁶⁴ Generally, non-executive directors contribute to the development of management strategies and monitor the activities of the executive directors.⁶⁵

In *Fisheries Development Corporation of SA Ltd v Jorgenses, Fisheries Development Corporation of SA Ltd v AWJ Investment (Pty) Ltd*⁶⁶ the court stated that non-executive directors are not bound to give continuous attention to the affairs of the company. Their duties are of an intermittent nature, to be performed at periodical board meetings and at any other meetings that may require immediate their attention. It is expected of non-executive directors to attend board and board committee meetings and to acquire and maintain a broad knowledge of the economic environment, industry and business of the company.⁶⁷ The role of non-executive directors and the independence that they are

⁶² Principle 11 of King IV Report, 2016.

⁶³ *Op cit note 4 page 4, Sebola.*

⁶⁴ *Ibid.*

⁶⁵ *Ibid.*

⁶⁶ 1980 (4) SA156 (W) 165.

⁶⁷ *Op cit note 4 page 4, Sebola.*

believed to bring to the board of directors have been a consistent theme of corporate governance theories, policies and programmes.⁶⁸

*“An independent non-executive director is a director who is required to be independent in character and judgment. There should be no relationships or circumstances that are likely to affect, or could appear to affect, their independence.⁶⁹By independence is meant the absence of undue influence and bias that could be affected by the intensity of the relationship between the director and the company, rather than any particular fact such as length of service or age. Not only should the director be independent in fact, but he or she should also appear or be perceived to be independent in the perception of a reasonably informed outsider”.*⁷⁰ The King III Report⁷¹ defines an independent non-executive director as a non-executive director who:

- Is not a representative of a shareholder who has the ability to control or significantly influence management or the board,
- Does not have direct or indirect interest in the company that exceeds 5 percent of the group’s total number of shares in issue,
- Does not have direct or indirect interest in the company that exceeds 5 percent of the group’s total number of shares in issue, but is material to or her personnel wealth,
- Has not been employed by the company or the group which it currently forms part in any executive capacity, or has been appointed as the designated auditor or partner in the group’s external audit firm, or as senior legal advisor in the preceding three financial years,

⁶⁸*Ibid.*

⁶⁹*Ibid.*

⁷⁰ Lufuno Nevondwe, Kola O. Odeku and Clarence I. Tshoose, Promoting the Application of Corporate Governance in the South African Public Sector.

⁷¹*Op cit note 4 page 4, Sebola.*

- Is not a member of the immediate family of an individual who is, or has, during the preceding three financial years, been employed by the company or the group in an executive capacity,
- Is not professional adviser of the company or the group, other than as a director,
- Is free from any business or other relationship (contractual or statutory) that could be seen by an objective outsider to interfere materially with the individual's capacity to act in an independent manner, such as being a director of a material customer or supplier to the company, and
- Does not receive remuneration contingent upon the performance of the company.

It is believed that the role of non-executive directors is not to explain to fellow board members what they know, but to ask questions about what they don't know. This is to ensure they act in the best interests of the company and pursue this by making prudent decisions that ensure their fiduciary duty is being carried out. King also highlights integrity, competence, responsibility, accountability, fairness, and transparency, the pillars of governance that all board members need to embrace on a foundation of intellectual honesty.

So what questions are the non-executive directors of SA's state-owned enterprises asking?

Not a week goes by without a state-owned enterprise coming under the spotlight. The High Court in Pretoria recently set aside the National Energy Regulator of SA's (Nersa's) proposed 9.4% Eskom tariff hike; the Organisation Undoing Tax Abuse is threatening court action because of the lack of public consultation on nuclear and Thyspunt; the Treasury is seeking clarification on the pricing of coal contracts; and Future Growth and Jyske Bank say they will no longer lend to Eskom. There is also a rising chorus claiming Eskom's comparisons of the cost of one form of energy with another are fallacious, and part of its persistent campaign to prove electricity procured from independent producers is more expensive than coal or nuclear.

2.4.5 Information and Technology.

King III recognized the concept of information technology as one source of value creation, King IV separates information and technology, which may overlap in certain instances, but which constitute two distinct sources of value creation in terms of King IV, and in terms of which separate risks and opportunities may exist.⁷²

King IV recognizes the effects which the advances of technology and information may, separately, have on businesses. Accordingly, King IV requires that the governing body exercise ongoing oversight of the management of, both, information and/or technology, as the case may be, so as to ensure:⁷³

- the leveraging of information to sustain and enhance the organization's intellectual capital;
- an information architecture that supports confidentiality, integrity and availability of information and a technology architecture that enables the achievement of strategic and operational objectives;
- the protection of privacy of personal information; and
- the monitoring and appropriate responses to developments in technology, including the capturing of potential opportunities and the management of disruptive effects on the organisation and its business model.
-

2.4.6 Stakeholders.

Stakeholders are groups of individuals that can be reasonably be expected to be significantly affected by an organization's business activities, outputs or outcomes, or whose actions can reasonably be expected to significantly affect the ability of the organisation to create value for time.⁷⁴

⁷² Principle 12 of King IV Report, 2016.

⁷³ *Ibid.*

⁷⁴ Principle 16 of King IV Report, 2016.

The following are requirements which are introduced by King IV:⁷⁵

- a governing body should exercise ongoing oversight of stakeholder relationship management and in particular that it results in, inter alia,
- methodologies for identifying stakeholders,
- formal mechanics for stakeholder engagement, and
- measurement of the quality of material stakeholder relationship and appropriate responses to outcomes; and
- The board of a company should oversee that the company encourages proactive engagement with shareholders, including engagement at the general meeting of the company and that all directors should be available at the said meeting to respond to shareholders' queries on how the board executed its governance duties.

The amendments introduced by King IV, place an increased responsibility on the governing body to facilitate and ensure an increased level of engagement between stakeholders, in particular shareholders, and the company.⁷⁶

King IV recognizes the need for the ability of the board, which controls the company and has access to information which shareholders do not, to explain their decisions to the shareholders and engage with the shareholders regarding certain matters affecting the company at AGM's. In this regard King IV requires that all directors be available at AGM's to respond to shareholders' queries on how the board executed its governance duties.⁷⁷

In 2013, Eskom's tariff model was economically unsustainable. Recommendations were made to rectify or solve the said problem. What did Eskom's board decide to do? Nothing, they did not consider the recommendations. As a stakeholder, one can only assume it carried on as normal, which makes one wonder, what questions are their non-executive directors asking?

⁷⁵ Principle 16 of King IV Report, 2016.

⁷⁶ *Ibid.*

⁷⁷ *Ibid.*

Are they asking why Eskom is still chasing a revenue model when it does not foster prudence? Chasing tariff hikes and applying to Nersa for claw-backs through the Regulatory Clearing Account does not promote the effective, efficient, and economic optimization of the national electricity supply.

Compounding the woes are municipalities who hold onto the electricity revenues they have collected to balance their shortfalls. This revenue model approach creates a perverse incentive that will eventually price Eskom out of the market, if it has not already done so. Which is why Eskom does not want independent producers to expand, because it compromises the utility's revenue model by reducing its inflated revenues.

Kantor and Holland made it very clear if Eskom continues to demand unsustainably high rates of return on nonproductive assets in their fleet, the cost of electricity in SA will be unsustainable. It will compromise all consumers, including commerce and industry, with Eskom ending up as a beached whale.

Eskom needs a CEO and executive directors who can collectively operate as a virtuoso conductor in the electricity orchestra, who can holistically assess the company, and balance prudent expenditure, return on assets, and all the other costs and associated revenues. And it needs nonexecutive directors who can recommend which instruments are detracting from the performance; in Eskom's case, which assets are not performing. They should either be addressed or shut down, and planned projects that are not prudent should be cancelled.

While it may shrink Eskom's asset base, it would make for a far more robust entity, working with the independent producers to create an electricity supply that is fit for purpose and more financially sustainable.

Unless they demand of Eskom's board, then if the proposed nuclear plants are approved, we will carry the cost of them for many years before any power is generated, and we all know that Eskom's development costs have a knack of doubling, tripling, and more. Civil society needs to be increasingly vigilant, because corporate governance principles are not being adequately applied. When this happens the motive and mandates of the board can no longer be trusted. If they don't keep up the pressure, as it states in When Money

Destroys Nations by Philip Haslam with Russell Lamberti, they will find themselves diving down suicide gorge without any opportunity of turning back.

2.4.7 COMPLIANCE GOVERNANCE.

AS in King III, the King IV code recommends that those charged with governance should ensure that compliance is understood, not only as an obligation, but also as a source of rights and protection. A holistic view is needed on how applicable laws and non-binding rules, codes and standards relate to one another. This includes how corporate governance codes relate to applicable statutes. The code further recommends that governing bodies should ensure continual monitoring of the regulatory environment, and that developments are responded to as necessary.⁷⁸

The governing body should delegate to management responsibility for implementation and execution of effective compliance management. The governing body should exercise ongoing oversight of compliance and in particular, oversee that it results in the following;⁷⁹

- Compliance being understood not only for the obligations it creates, but also for the rights and protections it affords.
- Compliance management taking a holistic view of how applicable laws and non-binding rules, codes and standards' relate to one another.
- Continual monitoring of the regulatory environment and appropriate responses to changes and developments.

When it comes to the King code, Eskom's version of reality takes a peculiar twist. "In the spirit of good corporate governance, we endeavour to apply the principles and practices of the King Code" Eskom evidently doesn't think it has any problems with corporate governance. It generously awarded itself a AAA score for governance in its 2016 integrated report. And while Thuli Madonsela was given a measly R1.5m for her state capture report, Eskom probably spends far more on consultants each year, overseeing compliance with all sorts of regulations from the Companies Act to the King Code.

⁷⁸ Principle 13, King IV Report, 2016.

⁷⁹ Principle 14, King IV Report, 2016.

2.8 Conclusion.

There is no doubt that corporate governance is a key element in improving economic efficiency and growth as well as enhancing investor confidence. The King III report and the Code provide useful guidance to directors on how to direct and control the business of the company and make decisions on behalf of the company. As discussed, the purpose of the Act (as embodied in section 7 (b)) of encouraging transparency and high standard of corporate governance as a means of promoting the development of the South African economy, would encourage an interaction between the King III Report and the Act, which complement each other and ought to be read and applied together.

Poor corporate governance is causing immeasurable damage to South Africa's state owned enterprises (SOEs) warns the Institute of Directors of Southern African (IoDSA). IoDSA issued a statement expressing a particular concern about the many boardroom wars that have pitched CEO's of several SOEs and their boards. Before the ink could dry, Eskom joined the list of SOEs with suspended executives like South African Airways.

This is after the Eskom board with the support of the ministry of public enterprises suspended its top four executives including its CEO Tshediso Matona. The board said the suspension was to allow for the company to conduct an unfettered independent enquiry. This has solicited some criticism. Peter Montalto, an analyst at global investment house Nomura, said the suspension of the Eskom executives was sending negative messages to the market. "This news adds further negativity to the Eskom bond story and sovereign credit, though local rates and the currency are unlikely to be affected," said Montalto.

He added that "We do not believe an inquiry is necessary. We think it does not indicate that a crisis is being sorted out or dealt with, but (communicates) the exact opposite. It is an unnecessary distraction at a time when Eskom needs decisive, stable and strong leadership."⁸⁰ In addition, said Montalto, there are a whole host of parastatals and government agencies that do not have permanent CEOs in place. Eskom is now basically

⁸⁰<http://www.ujuh.co.za/poor-corporate-governance-is-damaging-soes/> accessed on 18 March 2017.

taking a three-month gap of leadership in which time difficult decisions are unlikely to be made.”

However, it's also worth mentioning that the board has to have confidence in the executive management of the company, and thus must have full control over who holds the executive positions. Nevertheless she warned that the spectacle of a board at loggerheads with the executives who are supposed to report to it is extremely damaging to the company, and is typically a result of loyalties being divided. The litmus test must always be the company's best interest and its long-term, strategic goals.

CHAPTER THREE: THE CONCEPT OF CORPORATE GOVERNANCE.

3.1 Introduction.

The common law duties of directors are the fiduciary duties of good faith, honesty and loyalty. In addition, directors have the duty to exercise reasonable care and skill. The fiduciary duties of directors are of fundamental importance to any developed corporate law system.⁸¹ Under the Companies Act, the fiduciary duties of directors are mandatory, prescriptive and unalterable, and apply to all companies. Their object is to raise the standard of corporate and directorial behavior. A further reason for imposing these duties on directors is deterrence.⁸² The fiduciary duties are protective of the company and its shareholders and indeed even of the public interest.

The fiduciary duties of directors are now of even greater importance, because for the first time in our corporate law history the Companies Act confers on the board of directors a new statutory duty to manage the business of the company. In this regard, see section 66 (1) of the Companies Act 71 of 2008 (hereafter 'the Act'). Since this original power is derived from statute instead of the constitution of the company, it is subject to shareholders' control to a much lesser extent than has hitherto been the case.⁸³

In the common law jurisdictions, including South Africa, the fiduciary duties of directors have since the 18th and 19th centuries been judicially created and developed, mainly in English law, on a case by case basis. Their exact contours and limits are still uncertain. In short, the fiduciary duties are never static; they are dynamic and are still evolving. One hopes that nothing in the new Act will freeze or stifle judicial development of the fiduciary duties. It is essential for the courts to be given room to develop these fiduciary duties gradually so that the duties are suitably adopted to meet constantly changing circumstances.⁸⁴

⁸¹ *Op cit note 4, page 2.*

⁸² *ibid.*

⁸³ *Ibid.*

⁸⁴ *Ibid.*

3.2. The Fiduciary Duties of Company directors.

In examining the fiduciary duties of directors, it is important to bear in mind that these duties are largely derived from English law. This has been stated by the courts on many occasions.

For instance, in *Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd*⁸⁵ the court stated: 'The essential principles of this branch of company law are however the same as those in English law and English law cases provide a valuable guide'.

Likewise, in *Le Roux Hotel Management (Pty) Ltd v E Rand (Pty) Ltd (FBC Fidelity Bank Ltd (Under Curatorship), intervening)*⁸⁶ the court stated: 'This progressive approach in South African company law was not based on any precedent in the English Companies Act, the usual source of inspiration for matters relating to companies.' Historically there have been, and to a lesser extent now continue to be, strong links between South African Corporate law and English law.⁸⁷

3.3 The Fiduciary Duties of Directors and the Standard of Directors' Conduct.

The duties of directors are now derived from two sources, namely the Act and the common law as found in the decisions of the courts.⁸⁸

Section 76(3) (a) and (b) states that, subject to section 76(4) and (5), a director of a company, when acting in that capacity, must exercise the powers and perform the functions of director:

- in good faith and for a proper purpose, and
- in the best interest of the company

At common law, the duty to act in good faith and in the best interest of the company is the overarching fiduciary duty of directors from which all other fiduciary duties flow. These

⁸⁵ 1980 (4) SA 156 (W) 165.

⁸⁶ 2001 (2) SA 727 (C) Para 37 at 738.

⁸⁷ *Op cit note 4, page 2 Sebola.*

⁸⁸ *Ibid.*

duties are discussed below. As stated above, the standard of directors' conduct prescribed by section 76 apply to all directors, including an alternate director, prescribed officers, and members of a board committee or audit committee, irrespective of whether or not such persons are also members of the company's board of directors.⁸⁹

3.3.1 The duty to act in good faith and in the best interest of the company.

The fundamental duty of good faith is now imposed by both the common law as the Act. 'It is a well-established rule of common law that directors have a fiduciary duty to exercise their powers in good faith and in the best interests of the company'.⁹⁰

In *Re Smith & Fawcett Ltd*⁹¹ the court laid down the long standing and often legal principle that directors are bound to exercise the powers conferred upon them *bona fide* in what they consider not what a court may order is in the interest of the company. A director's duty is thus to act in what he or she in good faith honestly considers to be in the best interest of the company.

Honesty is subjective. A breach of this fiduciary duty consequently requires subjective awareness of wrongdoing. The directors of a company have more knowledge, time and expertise at their disposal to evaluate the best interest of the company than judges.⁹² The courts will not assume that they can act as a kind of supervisory board over directors' decision that are honestly arrived at within the powers of their management.⁹³

In *Hogg v Cramphorn Ltd*⁹⁴ it was likewise stated that it was not for the courts to review the merits of a decision of the directors honestly arrived at.⁹⁵ The duty of honesty and good faith is the paramount and overarching duty of a director of a company. Section 76(3) (a) couples the duty of good faith with the duty of director to exercise his or her powers for a proper purpose. The test of good faith is subjective not objective, since the

⁸⁹ *Op cit* note 4, page 2 *Sebola*.

⁹⁰ *Da Silva v CH Chemicals (Pty) Ltd* 2008 (6) (SCA) Para 13, 627B.

⁹¹ [1942] Ch 304 at 306.

⁹² *Darvall v North Sydney Brick & Tile Co Ltd* (1989) 15 ACLR 230 SC (NSW).

⁹³ *Ibid*.

⁹⁴ [1967] Ch 254 at 268.

⁹⁵ In *Carlen v Drury* (1812) Ves & B54, it was said that it was not for the courts to review or judge the merits of a business decisions made by the company.

question is whether the director honestly believed that he or she acted in the best interest of the company. The issue is about the director's state of mind.⁹⁶

But there are limits to the subjective test. The absence of a reasonable ground for believing that the director is acting in the best interest of the company may be the basis for finding lack of good faith.⁹⁷

In *Shittleworth v Cox* the court stressed that the best interest of the company are not assessed by the court itself; instead, the test is whether a reasonable man would have regarded the act of the directors to be in the best interest of the company. This was also emphasized,

In *Teck Corp Ltd v Millar*⁹⁸ where the court stated that there must be reasonable for the directors' belief that they were acting in the best interest of the company.

So too in *Extrasure Travel Insurance Ltd v Scattergood*⁹⁹ the court ruled that there must be reasonable grounds for the belief of the directors that they were acting in the best interest of the company.

The test as formulated in *Charterbridge Corporation Ltd v Lloyd's Bank*¹⁰⁰ is whether an intelligent and honest person in the position of the director could in the whole of the circumstances have reasonably believed that he or she was acting in the best interest of the company.

By way of illustration, in *Neptune (Vehicle Washing Equipment) Ltd v Fitzgerald (No2)*¹⁰¹ it was held that, quite apart from any issue of self-dealing, the sole director of a company had not acted in the best interest of the company by arranging for the company to make

⁹⁶ *Greenhalgh v Arden* [1950] 2 All ER 1120 (CA); *Regentcrest plc v Cohen* [2001] 1 BCL 80 at 104.

⁹⁷ *Scrutton LJ in Shuttleworth v Cox Bros & Co (Maidenhead) Ltd* [1927] 2 KB 9at 23; [1926] All ER Rep 498 (CA) 506; *Gething v Kilner* [1972] 1 WLR 337 at 342; [1972] 1 All ER 1166 at1170.

⁹⁸ (1972) 33 DLR (3d) 288 (BCSC).

⁹⁹ [2003] 1 BCLC 598 at 619.

¹⁰⁰ [1970] Ch 62 at 74.

¹⁰¹ [1995] 1 BCLC 352 (ChD).

gratuitous or redundancy payment to him on the termination of his service contract with the company. The director was acting in his own, rather than in the company's interests.¹⁰²

It may be noted at this stage, that section 76(4) of the Act, which adopts the US Business Judgment Rule applies also to the directors' duty to act in the best interest of the company.¹⁰³

3.3.2 The duty to exercise an independent judgment.

The common law principle is clear in the exercise of their powers and in deciding what is in the best of the company, the directors must exercise an independent and unfettered discretion.¹⁰⁴ Directors must consider the affairs of the company in an unbiased and objective manner. Accordingly, a voting agreement under which a director binds him or herself to vote or to exercise his or her power in accordance with the instructions of some other person, thereby fettering the director's discretion, will not be enforced by the court. The effect of such a voting agreement, if it were binding, would be that the directors thereby disable themselves from acting honestly in what they believe to be the best interest of the company.¹⁰⁵

The duty to exercise an independent judgment is seen by some commentators as merely an aspect of directors' duty to act *bona fide* in the interest of the company. This perhaps explains why this specific common law duty not explicitly referred to in section 76, and more specifically, in section 76(2) and (3). On this basis, the duty to exercise an independent judgment continues to form part of the fiduciary and statutory duties of directors.

As a general principle, a director cannot bind him or herself in the present on how to vote in future. It is relevant to this study whether or not the director is deriving any personal benefit from such an agreement.

¹⁰² *Re W & M Roith Ltd* [1967] 1 All ER 427.

¹⁰³ *Op cit note 4*, page 2 Sebola.

¹⁰⁴ *Ibid.*

¹⁰⁵ *Ibid.*

In *Fulham Football Club Ltd v Cabra Estates Plc*,¹⁰⁶ where a football club and its directors undertook in return for substantial payment to vote in particular way, the court rejected the contention that the future exercise of their powers in a particular way, even though the court as a whole is manifestly for the benefit of the company. The directors were in this case binding themselves under a commercial contract which had conferred benefits on the company and which at they had honestly believed was in the interest of the company.

The Australian case of *Thorby v Goldberg*,¹⁰⁷ which *Fulham Football Club Ltd v Cabra Estates Plc* followed, is a similar effect.

Moreover, a company cannot simply escape from binding contractual obligation that has willingly been undertaken by its directors on the basis of their alleged failure to exercise an independent judgment. There is of course distinction between the situation where the entire board of directors has entered into such agreement and one where an individual director has done so. The former may in certain circumstances be beyond reproach, as in the *fulham Football Club* case.

The duty to exercise an independent judgment is a particularly important to nominee directors, i.e. persons who are appointed by a nominator to represent his or her interest at board meetings. A nominee director is a lawfully elected director appointed to the board of directors by a creditor, a financier or a significant shareholder who controls sufficient voting power for this purpose. For instance, a holding company may appoint a nominee director to the board of directors of a subsidiary company or, to take another common example, it may be agreed that a bank that has financed a company may appoint a representative to that company's board of directors. The nominee director is expected to represent the interest of the nominator. This means that a nominee director is undertaking a duty to a person other than the company in addition to the fiduciary duty that he or she owes to the company.

¹⁰⁶ [1994] 1 BCLC 363 (Ch and CA).

¹⁰⁷(1964) 112 CLR 597.

In *Boulting v Association of cinematograph, Television and Allied Technicians*¹⁰⁸ Lord Denning MR stated: take a nominee director, that is, a director of a company who is nominated by a large shareholder to represent his interests. There is nothing wrong in that. It is done every day. Nothing wrong, that is, so long as the director is left free to exercise his best judgment in the best interest of the company he serves. But if he is put on terms that he is bound to act in the affairs of the company in accordance with the directions of his patron, it is beyond doubt unlawful or if he agrees to subordinate the interest of the company to the interest of his patron, it is conduct oppressive to the other shareholder for which the patron can be brought to book.

3.3.3 The duty to act within their powers.

At common law, directors are under a distinct fiduciary duty not to exceed their powers or the limits of their authority. One aspect of this duty is that they may not enter into *ultra vires* contract on behalf of the company or a contract that is illegal. At common law, since a company could not itself enter into such transactions, it inevitably followed that its directors likewise could not possibly have the power to do so, because an agent cannot have authority to enter into a contract¹⁰⁹ that exceeds the legal capacity of the principal.¹¹⁰

The *ultra vires* doctrine was however abolished by section 36 of the 1973 Act.¹¹¹ Section 19(1) (b) of the new Act takes this further by conferring on companies all the legal powers and the capacity of an individual subject to the company's Memorandum of Incorporation.¹¹² If a company's Memorandum of Incorporation limits, restricts or qualifies the power or the activities of the company, the directors of the company would be acting beyond their powers by entering into a contract that is inconsistent with such a provision. They would consequently incur liability to the company for breach of their fiduciary duty, unless their act has been ratified by a special resolution of the company's shareholders

¹⁰⁸[1963] 1 All ER 716 (W) 651.

¹⁰⁹ *Ashbury Railway Carriage and Iron Co v Riche* (1875) LR 7 HL 653.

¹¹⁰ *Op cit note 4*, page 2 Sebola.

¹¹¹ FHI Cassim 'The rise, fall and reform of the ultra vires doctrine' (1998) 10 SA Merc LJ 293.

¹¹² This topic is more fully discussed in chapter 5: Corporate Capacity, Agency and the Turquand Rule (Contemporary Company law Textbook by Farouk HI Cassim).

(section 20(2)). However, a contract that contravenes of the Act may not be ratified (section 20(3)).¹¹³

In *Cullerne v London and Suburban General Permanent Building Society*¹¹⁴ the court ruled that, if a director exceeds the powers conferred on them by the company. They would be liable to the company for breach of their fiduciary duty. Similarly, if a director has made payments as a result of transactions that are beyond the capacity of the company, he or she may be called upon to compensate the company. This liability for breach of fiduciary duty arises irrespective of the *bona fides* of the director in question¹¹⁵ or any fault on his or her part.¹¹⁶

Once again there is no explicit reference in section 76 of the Act to this fiduciary duty as a separate and distinct duty. This duty is nevertheless an aspect of the fiduciary duty of directors to exercise their powers in good faith for a proper purpose and in the best interest of the company, as provided in s 76(3) (a) and (b). It is notable that there is a distinction between a lack of authority and abuse of authority (i.e. where a power is exercised for collateral purpose or an improper purpose), which of course also results in a lack of authority.¹¹⁷

Where a director disregard a constitutional limitation on his or her authority and abuse of authority, a number of relevant statutory may be triggered. Section 77(2)(a) imposes liability on a director in accordance with the principle of common law relating to breach of fiduciary duty for any loss, damages or costs sustained by the company as a result of breach of duty.¹¹⁸ It follows that, if directors disregard a constitutional limitation on their authority to act on behalf of the company, they could incur liability to the company for any loss, damages or costs sustained by the company as a result of their failure to act within constitutional limits of their authority.¹¹⁹ A director may also be held liable in accordance with the principle of the common law relating to delict for any loss, damages or costs

¹¹³ *Op cit note 4, page 2 Sebola.*

¹¹⁴ 163 (1890) 25 QBD 485.

¹¹⁵ *Re Lands Allotment Company* (1894) 1 Ch 616 (CA).

¹¹⁶ *Op cit note 4, page 2 Sebola.*

¹¹⁷ *Ibid.*

¹¹⁸ *Ibid.*

¹¹⁹ *Ibid.*

sustained by a company as a consequences of any breach by a director of (among other things) any provision of the company's Memorandum of Incorporation.

Moreover, section 77(3) (a) imposes liability on a director for any loss, damages or costs sustained by a company as a direct or indirect consequences of the director having done some act in the name of the company, or purported to bind the company or authorize the taking of any action by or on behalf of the company despite knowing that he or she lacked the authority to do so.¹²⁰

Also relevant here is section 20(6) of the Act, which confers a right on each shareholder to claim damages from any person who fraudulently or due to gross negligence causes the company to do anything inconsistent with the Act or with a limitation, restriction or qualification of the powers and activities of the company unless this ratified by a special resolution of the shareholders of the company.¹²¹

In Australian law, In *R v Byrnes*¹²² the court held that, where directors enter into an unauthorized transaction, when they knew or ought to have known that they had no authority to enter into transaction, they would thereby be making an improper use of their position as directors. Based on the persuasive authority of *R v Byrnes*, it may state that, if a director has knowingly entered into an unauthorized transaction on behalf of the company, there is a strong possibility of the court finding that the director has contravened the statutory duties under section 76(3) (a) or (b) of the Companies Act. The duty of directors to avoid a conflict of interest is also a fiduciary and statutory duty.¹²³

¹²⁰ *Ibid.*

¹²¹ *Ibid.*

¹²² (1995) 183 CLR 501. See Austin & Ramsy Para 9.280 at 475.

¹²³ *Op cit note 4, page 2 Sebola.*

3.4 Conflict of Interest.

3.4.1 The Common law.

The duty to avoid a conflict of interest is one of the most important fiduciary duties of directors. Before turning to the new Act, a discussion of the relevant common law principles that continue to be relevant is essential to obtain a proper understanding of the new statutory provisions relating to his duty. The company law principles in this area of the law have been heavily influenced by trust law and particularly by the case of *Keech v Sanford*.¹²⁴

As fiduciaries, company directors are under fiduciary duty to avoid placing themselves in a position in which their duties to the company conflict with their personal interests. Directors may furthermore not, without the informed consent of the company, make profit or retain a profit made by the course of and means of their offices as directors, i.e. while performing their duties as directors.¹²⁵ This test ensures that the profit made by directors that derives from their position as directors are disgorged by them. The duty to avoid a conflict of interest is undoubtedly the core duty of a fiduciary. It requires the director to account for any profit he or she received in breach of this fiduciary duty.¹²⁶

The rule is an inflexible one that must be applied inexorably by a court.¹²⁷ In *Sibex Construction (SA) (Pty) Ltd v Injectasteel CC*¹²⁸ the court observed that:

*An expectation of this case law in this court and in the courts of other jurisdiction on the fiduciary duties of directors and senior officers shows the pervasiveness of a strict ethic in this area of law. Persons in position of trust may be less tempted to place themselves in a position where duty conflicts with interest if the courts recognised and enforced the strict ethic in this area of the law.*¹²⁹

¹²⁴ (1726) Sel. Cas. Ch 61.

¹²⁵ *Op cit note 4, page 2 Sebola.*

¹²⁶ *Imageview Management Ltd v Jack [2009] BCLC 725 at 739 (CA).*

¹²⁷ *Parker v Mckenna (1874) LR 10 Ch App 96 at 124.*

¹²⁸ 1988(2) SA 54 (T) at 66D.

¹²⁹ *Op cit note 4, page 2 Sebola.*

This fundamental and inflexible principle was enunciated as long ago as 1854 in *Aberdeen Railway Co v Blaikie Bros*,¹³⁰ where the court stated: It is rule of universal application that no one having such duties to discharge, shall be allowed to enter into engagements in which he has or can have, a personal interest conflicting, or which possibly may conflict, with the interest of those whom he is bound to protect. So strict is this principle adhered to, that no question is allowed to be raised as to the fairness or unfairness of a contract so entered into.¹³¹

In *Boardman v Phillips*¹³² the court explained the phrase ‘possibly may conflict’ in the above extract from *Aberdeen Railway Co v Blaikie Bros* “to mean where a reasonable man looking at the relevant facts and circumstances of the particular case would think that there was a real sensible possibility of conflict”. This test was applied in *Bhullar v Bhullar*.¹³³

In *Aberdeen Railway Co v Blaikie Bros* the court referred to a conflict of ‘interest’, but the principle applies also to a conflicting duty.¹³⁴ “A director may also not place himself, without the consent of the company, in a situation in which he or she has conflicting duties to some other person. This may arise in multiple directorships, where a director is also a director of another company, or in the case of nominee director.¹³⁵ The rule (duty to avoid a conflict of interest) does not depend on fraud or absence of good faith or whether the company has incurred a loss as a result of a breach fiduciary duty. The liability to account arises from the mere fact of a profit having been made by the director”.¹³⁶

In *Robinson v Randfontein Estates Gold Mining Co Ltd*¹³⁷ the court likewise proclaimed that one who has a duty to perform shall place himself in a situation where their interest conflict with their duty. A director must be precluded from being swayed by his/her

¹³⁰ (1854) 1 Macq 461 at 471.

¹³¹ *Op cit note 4, page 2 Sebola.*

¹³² (1854) 1 Macq 461 at 471.

¹³³ *Sub Nom Re Bhullar Bros Ltd [2003] 2 BCLC 241.*

¹³⁴ *Lord Denning in Boulting v Association of Cinematograph, Television and Allied Technicians (1963) 1 All ER 716 (CA) 723.*

¹³⁵ Blackman et al op cit n 11 at 8-111: ‘[a] director may not place himself in a position in which he has, or can have, a personal interest or duty to another, conflicting, or which possibly conflict with his duties to the company’.

¹³⁶ *Op cit note 4, page 2 Sebola.*

¹³⁷ 1921 AD 168 at 178-9.

personal interests. The objective of the no-profit-rule is to preclude directors from misusing or making improper use of their position as directors for their own personal advantage.¹³⁸

There are two separate and independent but closely related legal principle that apply here: (a) a duty to avoid a conflict of personal interests (the no-conflict-rule), and (b) a duty to make a profit from the fiduciary's position as a director (known as the no-profit-rule).¹³⁹

In *Bray v Ford*¹⁴⁰ Lord Herschell expressed the rule as follows: It is inflexible rule of a court of Equity that a person in fiduciary position is not, unless otherwise expressed provided, entitled to make a profit (no-profit rule), he is not allowed to put himself in a position where his interest and duty conflict (no-conflict rule).The distinction between the 'no-conflict' rule is not always easy to identify and there a number of reported decisions where the distinction has not been rigidly observed. In some cases, both rules apply.¹⁴¹ The two rules are nevertheless different in concept.¹⁴²

The rationale of both the 'no-conflict' and the 'no-profit' is to underpin the fiduciary's duty of undivided loyalty to his or her beneficiary.¹⁴³The strict application of the two rules enhance their deterrent their effect.¹⁴⁴

(a) The no-profit rule.

According to the no-profit rule directors may not retain any profit made by them in their capacity as directors while performing their duties as a director. Profits made by reason of and in the course of their office as a director must be disgorged, unless the majority of shareholders in general meeting have consented to the director making profit. The rule applies even if the company could not itself have made a profit, that is to say, even if the

¹³⁸ *Chan v Zacharia (1984) 154 CLR 178 at 198.*

¹³⁹ *Op cit note 4, page 2 Sebola.*

¹⁴⁰ [1896] AC 44 at 51-2.

¹⁴¹ *Re Allied Business & Financial Consultant Ltd Sub Nom O'Donnell v Shanahan (supra) 153.*

¹⁴² *Op cit note 4, page 2 Sebola.*

¹⁴³ This entire discussion of the no-profit rule and the corporate opportunity rule remains directly relevant to the Companies Act of 2008.

¹⁴⁴ *Op cit note 4, page 2 Sebola.*

director had not made the profit at the expenses of the company. It must, however, be emphasised that the ‘profit’ in this context is not confined to money, but includes every gain or advantage obtained by a miscreant director.¹⁴⁵

(b) The corporate opportunity rule.

In sharp contrast to the no-profit rule is the corporate opportunity rule that prohibits a director from usurping any contract, information or other opportunity that properly belongs to the company and that came to him or her as director of the company. Since the opportunity belongs to the company, it is a breach of fiduciary duty for a director to divert the opportunity to him or herself. Until recently, the courts regarded the corporate opportunity rule as an aspect of the no-profit rule or the rule against secret profits.¹⁴⁶

But in the recent decision of the Supreme Court of Appeal in *Da Silva v CH Chemicals (Pty) Ltd*¹⁴⁷ the court acknowledged the corporate rule by Stating:¹⁴⁸

A consequence of the rule is that a director is in certain circumstances obliged to acquire an economic opportunity for the company if it is acquired at all. Such an opportunity is said to be a ‘corporate opportunity’ or one which is the ‘property’ of the company.¹⁴⁹

*“The Court also opined that, while any attempt at an all-embracing definition is likely to prove a fruitless task, a corporate opportunity is one that the company was actively pursuing or one that can be said to fall within the company’s existing or prospective business or that falls within its line of business.¹⁵⁰ It is of no consequence that the opportunity would not or could not have been taken up by the company, the opportunity would, according to *Da Silva v CH Chemicals (Pty) Ltd*, remain a corporate opportunity”.*

In *Canadian Aero Services Ltd v O’Malley*¹⁵¹ the court stated that a director or senior officer may not usurp or divert for himself, or for another person or another company with

¹⁴⁵ *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168.

¹⁴⁶ *Op cit note 4, page 2 Sebola.*

¹⁴⁷ 2008 (6) SA 620 (SCA) 627 Para 18.

¹⁴⁸ *Op cit note 4, page 2 Sebola.*

¹⁴⁹ *Phillips v Fieldstone Africa* 2004(3) SA 465 (SCA) 482E.

¹⁵⁰ *Op cit note 4, page 2 Sebola.*

¹⁵¹ *Supra.*

which he [or she] is associated, a maturing business opportunity which his or [or her] company is actively pursuing. In determining a breach of the corporate opportunity rule or the duty to avoid a conflict of interest, some of the factors to be taken into account are the position held by the defendant, the nature of the corporate opportunity, its ripeness, the circumstances in which it was obtained and the director's position in relation to it.¹⁵²

A corporate opportunity is seen in law to be a corporate asset that belongs to the company.¹⁵³ The corporate opportunity rule is not, however, confined to property or assets only, it extend to confidential corporate information which a director has used to make a profit for him or herself. This is exactly what the defendants did in *Boardmans v Phillips*.¹⁵⁴ The defendants had in this case acquired confidential information belonging to a trust, which they exploited for their own profit. They were held in liable to disgorge the profits that they had made from the transaction.¹⁵⁵

In *Sebex Construction (SA) (Pty) Ltd v Injectaseal CC*¹⁵⁶ the court similarly held that directors may not use confidential information obtained by virtue of their office as directors to acquire a business opportunity for themselves. The legal principle that emerges from these authorities is that a fiduciary may not use confidential information obtained as a fiduciary for purpose that are detrimental to the company.

In *Cranleigh Precision Engineering (Pty) Ltd v Bryant*¹⁵⁷ "a managing director had used confidential information obtained as managing director to set up a rival business after resigning as managing director. He was held liable to the company for breach of fiduciary duty.¹⁵⁸ The misuse of a corporate opportunity may also be analysed in terms of the no-profit rule or the no-profit rule, as has been done in English law.¹⁵⁹ The basis of this

¹⁵²*Op cit* note 4, page 2 *Sebola*.

¹⁵³*Ibid.*.

¹⁵⁴ [1966] 3 All ER 721 (HL); [1967] 2 AC 46.

¹⁵⁵ *Ibid.*

¹⁵⁶ 1998 (2) SA 54 (T).

¹⁵⁷ [1965] 1 WLR 1293.

¹⁵⁸ These common law principle are relevant to s 76(2)(a) of the Act.

¹⁵⁹ *Ultraframe (UK) Ltd v Field stone* [2005] EWHC 1638 (Ch).

approach is that, historically, the corporate opportunity rule is derived from the rule that a director must avoid a conflict of duty and personal interest”.

(c) Illustrative cases on the corporate opportunity rule.

This section discusses few relevant cases to illustrate the corporate opportunity rule. The cases are also used to show critical distinction between the corporate opportunity rule and the no-profit rule.¹⁶⁰

(i) *Robinson v Randfontein Estates Gold Mining Co Ltd.*

In *Robinson v Randfontein Estates Gold Mining Co Ltd*¹⁶¹ Robinson, a director and chairperson of the board of directors of the plaintiff company, had purchased a farm for himself through an agent when a company, which had been keen to purchase the farm, could not reach finality with the sellers. Robinson then sold the farm to the company on a massive profit. The court held that the company was entitled to claim from Robinson the profit made by him on the basis that, where a man stands in a position of confidence in relation to another involving a duty to protect interest of that other, he is not permitted to make a secret profit at the expenses of the other or to place himself in a position where his interest conflict with his duty.¹⁶²

(ii) *Industrial Developments Consultants Ltd v Cooley.*

In *Industrial developments Consultants Ltd v Cooley*¹⁶³ the court was arguably faced with the corporate opportunity rule rather than the no-profit rule. The facts of this case were as follows: The defendant, an architect and managing director the plaintiff company, had entered into negotiations with the eastern Gas Board to secure certain valuable construction contracts for the plaintiff company. The eastern Gas Board was not prepared to enter into any business with the plaintiff company, but a year later the board approached the defendant in his private capacity and offered the contract personally to him. The defendant thereupon, on the pretext of ill health, resigned as managing director

¹⁶⁰ *Op cit note 4, page 2 Sebola.*

¹⁶¹ 2921 AD 168.

¹⁶² *Op cit note 4, page 2 Sebola.*

¹⁶³ [1972] 2 All ER 162.

of the defendant company and took for himself the contract offered by the Eastern Gas Board.¹⁶⁴

The contract in question was substantially the same contract that the plaintiff company had been attempting to obtain for itself in the previous year. The defendant was held to be accountable to the plaintiff company for the profits made by him on the contract with the Eastern Gas Board.¹⁶⁵ The court found that the defendant had placed in a position in which his duty to the company conflicted with his personal interests. He had one capacity at the time and that was as managing director of the plaintiff company. Information which came to him while he was managing director was information which he had a duty to convey to the plaintiff company.¹⁶⁶ The fact that he had resigned as managing director was irrelevant; it did not relieve him of his fiduciary duty to avoid a conflict of interest, because the opportunity had come to him while he was a managing director of the plaintiff company. It was consequently an opportunity that belonged to the company.¹⁶⁷

The actual basis of the decision was the no-conflict rule and the fact that the defendant had used for himself information that had come to him in his capacity as a managing director.¹⁶⁸ But it is cogently arguable that *Industrial Development Consultants Ltd v Cooley* concerned a corporate opportunity that belonged to the company, as there had been no decision by the board of directors of the plaintiff company to abandon the possibility of obtaining the contract from the Eastern Gas Board. The company could thus still be said to be pursuing the opportunity, thereby rendering the defendant's action a breach of the corporate opportunity rule.¹⁶⁹

The fact that the defendants were not directors did not matter, because senior officers such as a key person or top management are under the same fiduciary duties as those imposed on directors.¹⁷⁰ It is significant that the liability of the defendants did not depend

¹⁶⁴ *Op cit* note 4, page 2 *Sebola*.

¹⁶⁵ *Ibid*.

¹⁶⁶ *Ibid*.

¹⁶⁷ *Ibid*.

¹⁶⁸ *Ibid*.

¹⁶⁹ *Ibid*.

¹⁷⁰ *Volvo (Southern Africa) (Pty) Ltd v Yssel 2009 (6) SA 531 (SCA)*.

upon proof by Canaero that, had it not been for the defendants, intervention, Canaero would have obtained the Guyana contract.¹⁷¹

3.4.2 The Act and the duty to avoid a conflict of interest.

The foregoing common law provides the background against which the new provisions of the Act pertaining to the fiduciary duty to avoid a conflict of interest may be properly understood. It must also be reiterated that section 77(2) preserves the common-law principles relating to the liability of 'directors' for any damages or costs sustained by the company in consequence of any breach of a duty contemplated in section 75, 76(2), 76(3)(a), (b) or (c).¹⁷²

Regrettably, this statutory provision is not a model of clear draftsmanship since it is not free from ambiguity. Superimposed on these common-law fiduciary duties are the new statutory duties embodied in section 75 and 76. Section 76(3) preserves the director's duty to act in good faith and in the best interests of the company and the duty to exercise reasonable care, skill and diligence in the performance of his or her duties. Because the statutory duties are not properly aligned with the common-law duties, they inevitably have the effect of modifying the common-law duties. Here only the statutory provisions relating to an avoidance of a conflict of interest and duty are discussed.

3.5 Duty of care, Skill and Diligence (section 76(3) (c)).

A brief discussion of the common law prior to the new Act is once again of importance in gaining a proper understanding of section 76(3) (c) of the Act, which relates to the director's duty to exercise reasonable care, skill and diligence. The broad general principle is clear: directors are liable for negligence in the performance of their duties. The issue is the extent to which the directors, whether executive or non-executive directors, are liable for loss caused to the company by their incompetence or carelessness.

In striking contrast to the directors' fiduciary duty of good faith, honesty and the avoidance of a conflict of interest, which have been rigorously enforced, the courts have adopted a

¹⁷¹ *Op cit note 4, page 2 Sebola.*

¹⁷² *Ibid.*

very lenient attitude to the positive duty of a director to exercise reasonable care, skill and diligence in the performance of his or her duties. However, in recent years, at least in other jurisdictions, a more rigorous approach has been adopted.¹⁷³

The duty of care, skill and diligence, which is not a fiduciary duty but is based on delictual or Aquilian liability for negligence,¹⁷⁴ has been formulated by the courts in largely subjective terms, that depend on the skill, experience and the ability of the particular director in question.¹⁷⁵ The consequence has been that a very low or lenient standard of care was required of directors. The duty was couched in undemanding terms. Directors were expected to exercise only that degree or level of care and skill that they were capable of, so that the more inexperienced or incompetent a director was, the lower the standard of care expected of him or her.¹⁷⁶

*“According to this subjective test of care and skill, it is the director’s ignorance or inexperience that protects him or her from liability, since the less the director knows, the less is expected of him or her.¹⁷⁷ Unlike a professional person, a director is not required by law to have any special qualification for his or her office. Directors are not members of the professional body, and no objective standard of care and skill is thus applicable to the directors. It is also very difficult to formulate a single objective standard that will apply to all directors of all companies, ranging from small owner managed companies to large multinational ones. Not only are there different types of companies, there are also different types of directors”.*¹⁷⁸

An Executive director will naturally be expected to know more than a non- executive director about the internal affairs of the company. Consequently the duty of care and skill must depend on the type of company, the type of director, senior manager or employee,

¹⁷³ *Op cit note 4, page 2 Sebola.*

¹⁷⁴ *Ex parte Lebowa development Corporation Ltd 1989(3) SA 71 (T); Du Plessis No v Phelps 1995 SA 165 (C).*

¹⁷⁵ *Op cit note 4, page 2 Sebola.*

¹⁷⁶ *Ibid.*

¹⁷⁷ *FHI Cassim ‘Fraudulent or reckless trading and s 424 of the Companies Act 1973’ (1981) 98 SALJ 162.*

¹⁷⁸ *Supra.*

and his or her particular skills and knowledge, position in the company and responsibilities.¹⁷⁹

There clearly are practical difficulties in prescribing an appropriate and acceptable standard of care and skill for company directors across the board. At common law, a director was required, in the performance of his or her duties, to exercise the care and skill that may be expected of a person with *his or her* knowledge and experience.¹⁸⁰

In *Re Brazilian Rubber Plantation & Estates Ltd*¹⁸¹ the directors were unsuccessfully sued for losses as a result of their disastrous speculation in rubber plantations in Brazil. The directors had based their decision to invest in rubber plantations on a false and fraudulent report on the output of rubber plantations. In dismissing the proceedings, the courts held that a director's duty is to act with such care as is reasonably to be expected from him, having regard to *his* knowledge and experience.¹⁸² "*The court stated that a director is not bound to bring any special qualification to his office. He may undertake the management of a rubber company in a complete ignorance of anything connected with rubber, without incurring responsibility for the mistakes which may result from such ignorance. On the other hand, if he is acquainted with the rubber business, he must give the company the benefit of his knowledge when transacting the company's business.*"¹⁸³

In *Re City Equitable Fire Insurance Co Ltd*¹⁸⁴ the company had suffered a huge shortfall in its funds as a result of which its managing director was convicted of fraud. The liquidator of the company sought to hold other directors of the company liable for their failure to detect the fraud of the managing director. In this the liquidator was successful, as the court found the director to have been negligent.

¹⁷⁹ *Op cit* note 4, page 2 Sebola.

¹⁸⁰ *Ibid.*

¹⁸¹ [1911] Ch 425 (CA) 437.

¹⁸² This principle was laid down in *Lagunas Nitrate Co v Lagunas Syndicate* [1899] 2 Ch 392.

¹⁸³ *Op cit* note 4, page 2 Sebola.

¹⁸⁴ [1925] Ch 407.

They were, however, protected from liability by a provision in the constitution of the company.¹⁸⁵

The three legal proposition laid down in *Re City Equitable Fire Insurance Co*, which are relevant to a proper understanding of s 76(3)(c) of the Act, are as follows:¹⁸⁶

- First, a director need not exhibit in the performance of his or her duties a greater degree of skill than may reasonably be expected from a person of *his or her* [emphasis added] knowledge and experience. This legal principle leaves no doubt that the standard is not that of a reasonable director. It clearly is a subjective standard. The director of a life insurance company does not guarantee, for instance, that he or she has the skill of an actuary or a physician. Directors are not liable for mere errors of judgment.¹⁸⁷
- Secondly, a director is not bound to give continuous attention to the affairs of the company. His or her duties are of an intermittent nature to be performed at periodical board meetings. This legal principle is more relevant to non-executive directors who may not be required by their contract or by the terms of their appointment to attend all board meetings. But in modern times, this second principle no longer reflects what is expected even of a non-executive director.¹⁸⁸
- Thirdly, in respect of all duties that, having regard to the exigencies of business and the articles of association, may properly be left to some official, a director is, in the absence of grounds of suspicion, justified in trusting that official to perform such duties honestly.¹⁸⁹

A director is thus entitled, in the absence of grounds of suspicion, to rely on the company's accountant, auditor or attorney or other such persons to perform their functions properly and honestly. Unquestioning reliance on others is however not acceptable.¹⁹⁰

¹⁸⁵ *Op cit* note 4, page 2 *Sebola*.

¹⁸⁶ *Ibid*.

¹⁸⁷ *Ibid*.

¹⁸⁸ *Ibid*.

¹⁸⁹ *Ibid*.

¹⁹⁰ *Re Equitable Life Assurance Society v Human* [2002] 1 AC 408.

Both English law and South African law have adopted the attitude that the directors need not have any special qualification for their office. But unlike South African law, English law has imposed a more rigorous duty of care on the director of the company. This new trend was not adopted in South African common law.¹⁹¹

In *Fisheries Development Corporation of SA Ltd v Jorgensen*¹⁹² the court distinguished between the executive and the non-executive director,¹⁹³ stating that the non-executive director is not liable for mere errors of judgment ; he is not required to have any special business acumen, expertise, singular ability or even experience in the business of the company. But he must not be indifferent nor shelter behind culpable ignorance of the company's affairs, and nor must he accept information or advice blindly even if this is given by an apparently suitably qualified person.¹⁹⁴

The approach of the common-law jurisdictions may be contrasted by reference to s 8-30b of the US Model Business Corporation Act 1984 which states that the members of the board of directors or a committee' shall discharge their duties with the care that a person in a like position would reasonably believe appropriate under similar circumstances'. This entails an objective standard which at the same time recognises the different nature and extent of the responsibilities and duties imposed on the director of a particular company. In the USA the liability of directors for failure to exercise reasonable care and skill depends on the business judgment rule.¹⁹⁵

The common law standard of care imposed by the courts in South African law under the previous company regime is manifestly inadequate in modern times to protect shareholders from carelessness and the negligence of the directors of a company.

As the court stated in *Daniels t/s Deloitte Haskins & sells v AWA Ltd*,¹⁹⁶ it is no longer appropriate to judge directors' conduct by the subjective tests that were applied in

¹⁹¹ *Op cit note 4, page 2 Sebola.*

¹⁹² *Supra.*

¹⁹³ An executive director may be under a duty to exercise a higher standard of care arising from the terms, whether express or implied, of his [or her] contract of service with the company.

¹⁹⁴ *Op cit note 4, page 2 Sebola.*

¹⁹⁵ *Ibid.*

¹⁹⁶ (1995) 37 NSWLR 438.

outdated precedents. The court suggested that a more objective approach to the director's duty to exercise care and skill is appropriate. In South African law, it was s 40(c) and (d) of the Banks Amendment Act¹⁹⁷ that led the way towards legislating a more rigorous and less subjective duty of care and skill for the directors, the manager, the chief executive and the secretary of a bank.¹⁹⁸ The new Companies Act of 2008 continues this trend.¹⁹⁹

3.6 The Disclosure of the director's financial interest (section 75).

The no-profit rule requires that director avoid putting themselves in a situation in which their personal interests conflict or may possibly conflict with their duties to the company.²⁰⁰ The most obvious form of conflict of interest and duty situation, or self-dealing, arises where a director has a material interest in a contract entered into by his or her company. In this situation, the no-profit rule will also apply so that both the no-conflict and the no-profit rules are relevant here.²⁰¹

There is moreover a real possibility of directors abusing their position as directors whenever they enter into a contract with their company. It consequently makes sense to subject such contract to additional restrictions and safeguards.²⁰² To prevent the abuse of the fiduciary powers of a director, the courts had long ago laid down the rule that, where a director contracts with his or her company, the contract is voidable at the portion of the company.²⁰³ A director would then be liable to account to the company for any profits made by him or her unless the contract had been approved or ratified by the stakeholders. This common law consequently accepted that the common law principle would not apply if the constitution of the company permitted the director to enter into contract with their company subject to disclosure of their interest in the contract to the board of directors, as

¹⁹⁷ 19 of 2003.

¹⁹⁸ MP Larkin and FHI Cassim 2004 Annual Survey of SA law 551.

¹⁹⁹ *Op cit note 4, page 2 Sebola.*

²⁰⁰ *Brey v Ford [1896] AC 44; Aberdeen Railway Co v Blaikie Bros (1854) 1 Macq 461.*

²⁰¹ *Op cit note 4, page 2 Sebola.*

²⁰² *Ibid.*

²⁰³ *North-West Transportation Co Ltd v Beatty (1887) 12 App Cas 589 (PC); Aberdeen Railway Co v Blaikie Bros.*

opposed to obtaining the approval of the members in general meetings that was required at common law.²⁰⁴

The detailed and lengthy statutory provisions relating to the disclosure by directors of their interest in a contract or a proposed contract entered into by their company were located in section 234 to 241 of the 1974 Act. Failure to comply with these statutory provisions constituted a criminal offence, an indication of the importance attached to the common law duty of a director to avoid such a conflict of interest and duty. Section 75 of the new Act, consisting of eight subsections, replaces section 234 to 241 of the 1973 Act.²⁰⁵

In *Hospital Products Ltd v United States Surgical Corp*²⁰⁶ it was stated that a material financial interest is likely to be one that would give rise to a real or sensible possibility of conflict of interest.²⁰⁷

Section 75(5) is triggered when a director or related person (to the knowledge of the director) has a direct material financial interest in a matter to be considered by the board of directors.²⁰⁸ The section requires disclosure rather than approval of the director's personal financial interest in the matter to be decided by the board.²⁰⁹ If section 75(5) is complied with, and the board duly makes a decision or approves of the transaction or agreement, or if it is ratified by ordinary resolution of the shareholders, the decision, transaction or agreement will be valid despite any personal financial interest of a director or related person (section 75(5)). Section 75(8) provides that a court, on application by an interested person, may declare valid a transaction or agreement approved by the board or the shareholders, as the case may be, despite a failure by the director to comply with the requirements of section 75.²¹⁰

²⁰⁴ *Op cit note 4, page 2 Sebola.*

²⁰⁵ *Ibid.*

²⁰⁶ (1984) 156 CLR 41.

²⁰⁷ See s 182(6)(a) of the UK Companies Act 2006 which states this as a specific requirement of the section.

²⁰⁸ *Op cit note 4, page 2 Sebola.*

²⁰⁹ *Ibid.*

²¹⁰ *Ibid.*

(a) What must be disclosed.

In terms of section 75(5) (a) to (c) the following matters must be disclosed by the directors:²¹¹

- the personal financial interest that he or she or a related person has and its general nature, before the matter is considered at the meeting.
- Any material information relating to the matter and known by him or her (this must be disclosed at the meeting.
- Any observations or pertinent insights relating to the matter. These may – not must – be disclosed if requested by the other directors.²¹²

In English law, the courts have insisted on strict compliance with the equivalent requirements of s 182 of the companies Act 2006.²¹³ It is very likely that the strict English law approach will also be adopted by our courts. Disclosure in terms of section 75(5) must of course be made before the company enters into transaction or the particular matter in question. The manner of disclosure is not prescribed. While disclosure of the general nature of the interest (section 75(5)(a)) requires prior notice, it seems that this could be prior written or oral notification, either would suffice. Disclosure of material information and observations or insights relating to the matter may be disclosed at the meeting itself.²¹⁴

As stated above, section 75(5) is intentionally limited to a proposed matter ‘to be’ considered at a board meeting.²¹⁵ The underpinning rationale is that, if the board is informed of a director’s interest in a proposed matter or transaction, it is then free to decide whether and on what terms to enter into the transaction.²¹⁶ In order to disclose a personal financial interest of a related person, the director must obviously have been

²¹¹ *Op cit note 4, page 2 Sebola.*

²¹² *Ibid.*

²¹³ *Movitex Ltd v Bulfield [1988] BCLC 104 (ChD).*

²¹⁴ *Op cit note 4, page 2 Sebola.*

²¹⁵ *Ibid.*

²¹⁶ This was the explanation given by the Attorney-General in England.

aware of or have known about it. But section 1 of the Act defines 'knowing', 'knowingly' or 'knows' very widely:

When used with respect to a person, and in relation to a particular matter, means that the person either had actual knowledge of that matter 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 measures which, if taken, would reasonably be expected to have provided the person with actual knowledge of the matter.

In some circumstances, as specified above, constructive knowledge would thus suffice. It is unclear whether the section will apply to a material person financial interest held by a director through a company that is not related person. It is also uncertain whether disclosure must be made at a board meeting or whether disclosure to a committee of the board will suffice. It is suggested that the reference in s 76(5) to 'a meeting of the board' indicates that disclosure to a board committee as opposed to the board itself will not comply with section 76(5).²¹⁷

Disclosure must be made to the board of directors. In *Guinness plc v Saunders*²¹⁸ The court held that the disclosure must be made to the board of directors; disclosure to a board committee is not sufficient.

In the case of a private company with one director,²¹⁹ disclosure will entail disclosure to oneself. To avoid this ludicrous situation, section 75(3) provides that if the sole director of the company is not also the sole beneficial securities holder of the company, disclosure of the nature and extent of the director's personal financial interest must be made to the shareholders of the company, and their approval must be obtained by a way of an ordinary

²¹⁷ *Guinness plc v Saunders* [1988] 2 All ER 940 (CA).

²¹⁸ (1988) 2 All ER 940 (CA) 944 (see 3.6.2 above).

²¹⁹ A company with one director can only be a private company.

resolution (section 75(3)(a) and (b)). The same applies where a director or related person acquires a personal financial interest in the matter after its approval by the company. Here too disclosure must be made to the shareholders (section 75(6)).

3.7 Conclusion.

In general, director's duties can be divided into two categories, namely the duty of care, skill and diligence and fiduciary duties. When exercising their duties of care, skill and diligence, the point of departure is that a director must display the utmost good faith towards the company and he must act with the necessary skill and care in performing his functions. The fiduciary duties includes the duty to act in good faith and in the best interests of the company, the duty to avoid conflicts of interest, not to use the position as director for personal gain and to exercise their powers for the purposes for which they are granted.

Section 76 of the Companies Bill contains the existing common law principles of both the fiduciary duty and duty of care and skill. When acting in capacity as director of a company, the director must exercise the powers and perform the functions of director in good faith and for the proper purpose, in the best interest of the company and with the degree of care, skill and diligence that may reasonably be expected of a person carrying out the same functions in relations to the company as those carried out by the director and having the general knowledge, skill and experience of the specific director.

Directors must also disclose any personal financial interest that they, or a related person, might have in a matter that will be considered at a board meeting. Only direct, material interests of financial, economic or monetary value need to be disclosed. Directors are required to disclose interest in an existing contract in which the company has a material interest.

CHAPTER FOUR: RISK MANAGEMENT.

4.1 Introduction.

The definition of risk used in the King IV consist of three parts, namely uncertainty of events, the likelihood of such events occurring and their effect, both positive and negative. The King IV's understanding of risk thus balances the traditional negative view risk with one that recognizes the potential opportunities inherent in some risks. Thus, an opportunity may present itself as the potential upside of a risk that could adversely affect the achievement of organizational objectives. However it is also recognized in the King IV that opportunities do not always originate from the current risks of the organisation. This is particularly true of the strategic opportunities that should be considered when setting the organization's strategic direction.

Consideration of the risks associated with such strategic opportunities affect whether the opportunity will be captured by the organisation or not. Due to the rising complexity of risk and hence the need to strengthen oversight, the King IVB code recommends that the risk committee comprises a majority of non-executive members of the governing body.

As a result of widespread mismanagement of company assets by a number of British company directors during the latter part of the 1980's.²²⁰ Various significant changes were made to corporate governance regime in the United Kingdom. These changes came about as a result of the recommendations made by Cadbury,²²¹ Greenbury²²² and Hampel committees,²²³ which were the initiatives of the London Stock Exchange and the accounting profession in the United Kingdom. South Africa also realized that there was a need to review corporate governance standards in the vein of the Cadbury recommendations.

²²⁰Among some of the companies whose mismanagement led to corporate governance reform initiative were Maxwell Group of Companies, Polly Peck International Plc and Guinness Plc. Richard Smerdon *A Practical Guide to Corporate Governance* (1998) 1-3.

²²¹See note above.

²²²Directors' Remuneration, Report of a study Group chaired by Sir Richard Greenbury, 1995 ('Greenbury Report').

²²³Committee on Corporate Governance, Final Report, 1998 ('Hampel Report').

Ultimately, the Institute of Directors in Southern Africa formed the King Committee to review corporate governance and make recommendations to the corporate world, and in particular the JSE Securities Exchange in order to improve the standard of corporate governance. In 1994, the King Committee issued a report and a Code of Corporate Practices and Conduct.²²⁴ The JSE has implemented many of the recommendations made by the King Committee which is now form part of the listing requirements.²²⁵ Since it was the duty of the King Committee to review corporate governance on an ongoing basis, it adopted the King Report II in 2002.²²⁶

As a result of the recommendations made by the four committees mentioned above, the attention paid to the question of corporate governance has dramatically increased in both South Africa and the United Kingdom. However in South Africa, Eskom seems to fail to adopt such recommendations or to even follow the principles of corporate governance and that's what leads to their incompetence.

4.2 THE HISTORY OF CORPORATE GOVERNANCE.

Tricker comments that 'corporate governance has been practiced for as long as there been corporate entities, yet the study of the subject is less than half a century old'²²⁷ (having been triggered by the inadequacy of the traditional corporate governance regime to adapt to the condition of a modern corporation). "Triker's statement²²⁸ is, however, in my view partially correct. This is because of the correctness or otherwise of this statement depends on how one defines corporate governance...If one assumes that corporate government refers to no more than the system of directing and controlling a corporation - and nothing more- then of I am prepared to concede the correctness of the statement".

However, if, as is indeed generally accepted , corporate governance is taken to be inextricably intertwined with the all-inclusive approach to corporate decision-making

²²⁴The King Report on Corporate Governance, Report of a committee on corporate governance headed by Mervyn E King SC, 1994, Institute of Directors. Johannesburg. ('King I'). This code was in force until 31st of December 2001 until 2002, when the new code was implemented. The new Code was not published until 26 March 2002.

²²⁵See Schedule 22 to the JSE Listing Requirements.

²²⁶King II *op cit* note 5.

²²⁷ Tricker (ed) *op cit* note 38 at xiii.

²²⁸ *Ibid.*

(requiring boards and directors to consider stakeholders interests and , in certain instances, benefit other stakeholders at the expense of shareholders),²²⁹ then Tricker's statement is wrong. And it may, furthermore, be wrong in another important respect as well: "The introduction of tougher controls on the board of directors, in the form recommended by a number of bodies undertaking corporate reviews world-wide, is very modern. Indeed, it must be borne in mind that corporate governance as it was known during the mid-nineteenth century did not envisage modern corporate issues such as the maintenance of a proper balance between executive and non-executive directors, the separation of the roles of the chief executive officer and the chairman, the establishment of remuneration committees to determine directors' remuneration packages and many other issues with which modern day corporate governance attempts to deal. It is therefore fair to say that Tricker²³⁰ seems to have been influenced by the narrow view of corporate governance in alleging that corporate governance is as old as corporate entities."

In discussing the history of corporate governance, this article intends to commence with the analysis of the concept corporate governance as it was understood prior to the 1990s, even if the term was seldom used during that time. Thus, it will be assume, in this section,²³¹ that the phrase 'corporation governance' is the equivalent of company management²³² as it is traditionally understood to mean. It is thus conceded, in this section, that corporate governance is as old as corporate entities.

4.3 DEVELOPMENTS IN THE 1980S AND 1990S.

Tricker submits that the main emphasis in governance in the 1980s was on companies enhancing the return on capital and this was because 'stakeholder concerns became overshadowed by the market driven, growth orientated attitudes of Thatcher and Reaganite economics'.²³³ It is clear that during this time 'the accountability to the shareholder' notion of corporate governance was reinforced. In other words, directors'

²²⁹ Only in certain designated.

²³⁰ *Op cit note 41.*

²³¹ The history of corporate governance.

²³² This is company management in abroad sense and is not confined to the day to day management activities. It can more broadly be said to be the equivalent of company or corporate direction.

²³³ *Ibid.*

responsibility to increase shareholder value was emphasized, while at the same time safeguards against the abuse of power by the directors were still lax.

“However, as the 1980s drew to a close the shortcomings of traditional corporate governance system began to be exposed. In the UK one of the cases that sparked corporate governance debate was that of *Guinness Plc v Saunders*.²³⁴ In this case the committee of the board of directors of Guinness agreed to pay a sum of £5, 2 million to one director of the company for his services in connection with a take-over bid being made by the company. The bid was successful and the board of directors paid the agreed amount. However, it later became apparent that the director to whom the money was paid had a financial interest in the transaction”.

Subsequently the company claimed recovery of the money from the director, on the ground that he had received the payment in breach of his fiduciary duty as a director in that he had not disclosed his interest in the agreement to the company as required by the Act. The House of Lords held that the payment was in contravention of the company’s articles of association in that article 91 provided that special remuneration could be awarded to a director serving on committee only by the board of directors, not by the committee, notwithstanding the definition of ‘the board’ by art 2 as in ‘any committee’. Thus, the board could not delegate its power to make that special payment to a committee.

“This case exposed the weakness of delegating the board’s powers without a clear guideline regarding how this must be done. It became obvious that the traditional board had to give way to a more affective board, subject to checks and balances. The payment of such a lot amount of money to a single individual revealed that shareholders can easily be misled by talk of market forces that they are often expected to accept the notion of offensively large remuneration packages which are economically unfeasible. This made it all the more clear that a call for corporation governance reform could no longer be ignored.”

²³⁴ [1990] 2 AC 663.

As if the Guinness scandal were not enough, then came the collapse of Robert Maxwell's empire of companies.²³⁵ This came about due to a deliberate expropriation of assets and other advantages belonging to the companies. Corporate problems of the Maxwell group of companies involved, among other things, creative accounting, implementation of innovative and fraudulent schemes and expropriation, by the Maxwell family, of other stakeholders' funds.

It became clear with the fall of Polly Peck International Plc²³⁶ that powerful executive directors dominated boards of directors in the UK and that there was a need for checks and balances, particularly where the posts of chief executive and chairman of the board were combined and the non-executive directors were not vigilant.

As a result of these other corporate scandals, the London Stock Exchange commissioned the establishment of a committee to be headed by Sir Adrian Cadbury. The committee is known by the name of its chairman and it released in 1992 recommendations entitled 'The Report of The Committee on The Financial Aspects of Corporate Governance'.²³⁷ The recommendations of the Cadbury Report, together with its code of best practice, emphasized the importance of independent, non-executive directors on the board.

The report further recommended the implementation of board committees such as nomination and remuneration committees for effective corporate governance. It also advocated audit committees and the need to separate the role of the chairman and that of the chief executive officer. The Cadbury Report was followed in 1995 by the Greenbury Committee, chaired directors' remuneration.²³⁸ The committee emphasized the need for strong and independent remuneration committees in boards of directors.

²³⁵ Tricker *op cit* note 38 and other book on Corporate governance in the UK.

²³⁶ *Polly Peck International Plc v Asil Nadir [1992] 2 Lloyd's Rep. 238*, in which the CEO of a public company (incorporated in England and which carried on business as the holding company of a group of over 200 subsidiaries including 80 trading subsidiaries) was a signatory of all the branch accounts of the company and was in a position to control and direct the company's funds to and from the various subsidiaries. The CEO allegedly misappropriated over \$378 million of the company's funds, it was clear that he was the most powerful official of the company and there was either no, or inappropriate, control over his exercise of power.

²³⁷ *Supra note 2*.

²³⁸ *Op cit note 13*.

The Cadbury committee recommended in its report, that there was a need for the establishment of a committee which would review its recommendations. Accordingly, the Hampel Committee, chaired by Sir Ronald Hampel was set up to review the recommendations of the Cadbury as well as the Greenbury reports.²³⁹ The Hampel committee also reported on the implementations of the recommendations made by the predecessors.²⁴⁰

The London stock exchange has implemented many of the recommendations made by these panels by amending its Listing Rules, known as the 'Yellow Book'. At present, an appendix to the Yellow Book referred to as 'the Combined Code' constitutes the definite guide to corporate governance for companies listed on the Stock Exchange.²⁴¹ In South Africa the King Report on corporate Governance was published for the first time in 1994. The King Committee reviewed the first report and published a comprehensive one in March 2002.

4.4 THE UK AS A MODEL FOR SOUTH AFRICA IN CORPORATE GOVERNANCE.

The Cadbury Report was a major breakthrough in corporate governance circles and the system of involving the stock exchange in implementation of the corporate governance principle made the first of its kind in the world. Thus, there is no doubt that the Cadbury report would become significant in influencing thinking worldwide. South Africa followed the model of the Cadbury Report.²⁴² The King Report of 1994 led to the amendment of schedule 22 of the listing requirements by introducing the Code of Corporate Practices Conduct as recommended by the King Report.

4.5 THE KING REPORT AND CONSTITUTION IN SOUTH AFRICA.

During the apartheid era, all aspects of socio-economic and political wellbeing were governed by discriminatory laws. Needless to say, the corporate sphere of economic

²³⁹ *Op cit note 14.*

²⁴⁰ The Cadbury and the Greenbury committees.

²⁴¹ Financial Services Authority Listing Rules (2000). See also Cheffins *op cit* note 26 at 11, Smerdon *op cit* note 11 at 16 and 67

²⁴² Although there are some recommendations in the King Report which reflect the unique political and social context of South Africa.

activity was not left unscathed. These discriminatory had, by the time of the dismantling of apartheid; created such inequities that meaningful efforts had to be undertaken to redress them.

In 1994, when the democratic government took office, it vowed to eradicate all forms of discrimination wherever they existed in the democratic country. One of the main tasks it undertook was to publish the Reconstruction and Development Programme, which was a broad-based programme aimed at giving the marginalized majority of citizens of this country access to the means of production and allowing them into the mainstream economy. This blueprint²⁴³ laid down a number of objectives. One such objective set was put down in the following terms:

'The domination of business activities by white business and the exclusion of black people and women from the mainstream of economic activity are causes for great concern for the reconstruction and development process. A central objective of the RDP is to deracialise business ownership and control completely through focused policies of Black Economic Empowerment. "These policies must aim to make it easier for black people to gain access to capital for business development. The democratic Government must ensure that no discrimination occurs in financial institutions. State and parastatal institutions will also provide capital for the attainment of BEE objectives. The democratic Government must also introduce tendering out procedures, which facilitate BEE. Special emphasis must also be placed on training, upgrading and real participation in ownership. 'It was at the time of the negotiations for a constitutional democratic state, based on, among others, equality of all citizens of South Africa, that corporate governance reforms all around the world were at their embryonic stage".

It became obvious to those charged with the responsibilities of reviewing corporate governance²⁴⁴ that a blind eye could not be turned to political developments in forging a good corporate governance system in South Africa. Indeed, the 1994 King Report,²⁴⁵ in

²⁴³Reconstruction and Development Programme Document, para 4.4.6.3, reproduced in *BEE Blueprint (Final Report)* (200) 1.

²⁴⁴The King Committee under the auspices of the Institute of Directors of Southern Africa.

²⁴⁵The King Report I *op cit* note 15.

recognizing such political developments, dedicated a whole chapter to dealing with affirmative action. Affirmative action was provided for in the interim Constitution²⁴⁶ as part of the right to Section 8(2) and (3) of the constitution provided as follows:

‘No person shall be unfairly discriminated against, directly or indirectly, and, without derogating from the generality of this provision, on one or more of the following grounds in particular: race, gender, sex or language. ‘The Constitution went to say that the previous provision should not preclude measures designed to achieve the adequate protection and advancement of persons or groups or categories of persons disadvantaged by unfair discrimination, in order to enable the full and equal enjoyment of all rights and freedom’.

It is the latter sentence which bears witness to the fact that affirmative action is part of the right to equality. Therefore, it came as no surprise when the King Report I considered the implementation of affirmative action measures within companies as good corporate governance practice. The Draft Report of the King Committee²⁴⁷ refers to the recognition of black economic empowerment by companies as a good corporate governance practice.

The final Constitution of the Republic of South Africa²⁴⁸ echoes the provisions of the interim Constitution in so far as affirmative action (the right to equality) is concerned. In addition to these two most important legislative enactments,²⁴⁹ the legislature is passing an array of legislation aimed at giving all citizens of South Africa equal access to opportunities. King II, for example, followed major legislative and other initiatives such as the Employment Equity Act,²⁵⁰ Skills Development Act²⁵¹ and the Black Economic

²⁴⁶Act 200 of 1993.

²⁴⁷King II op cit note 5 s 4.

²⁴⁸Act 108 of 1996.

²⁴⁹The 1993 and 1996 Constitution of the Republic of South Africa.

²⁵⁰The Employment Equity Act 55 of 1998, which obliges companies to develop an Employment Equity plan and to report on progress in the achievement of the objective set out in such a plan.

²⁵¹Important legislation which was promulgated in the period preceding King II includes the skill Development Act 97 of 1998 and the Skill Development Levies Act 9 Of 1999, which govern the provision or resources for skills development and training by companies. Another legislative initiative of importance was the Promotion of Access to Information Act 2 of 2000, aiming at providing access to information held by companies to encourage better transparency.

Empowerment Commission Report.²⁵² That is the main reason why King II specifically makes recommendations regarding black economic empowerment.²⁵³

Corporate governance schemes derived from the UK model should, in certain respects, differ from those employed in other commonwealth countries like South Africa. This is epitomized by the King Report's discussion, among other things, of affirmative action policies which are, apparently, not necessarily significant in the UK. Traditional corporate governance enabled companies to embark on an exclusive approach, the main focus being owners of equity that is the shareholders. The emphasis, in accordance with the traditional corporate law, has been on the role of directors and shareholders in managing the company's business.

4.6 CONCLUSION.

This study recommends that the Eskom's must always adhere to the Risk Management Framework which was published by the Department of Public Enterprises, King IV Code of Good Governance, PFMA and Treasury Regulations. This study further recommend the Government as the majority shareholder must always clarify its role in the governance on Eskom in relation to risk management. The study further recommends that the Board must have an independent oversight towards Eskom; they must be given responsibilities to appoint executives and their role and responsibilities needs to be defined in the shareholder compact and furthermore the board must act in good faith and best interest of the company.

²⁵²The *BEE Blueprint* op cit note was published in April 2001.

²⁵³Section 4 of King II at 114.

CHAPTER FIVE: CONCLUSION AND RECOMMENDATIONS.

Corporate governance involves the balance of power with which the organization is directed, managed, supervised and held accountable. The basic theme of this paper was to analyse the corporate governance principle in South Africa in relation to developments in other jurisdictions with specific reference to the United Kingdom.

The South African corporate governance strategy aims to promote an effective framework for governance in the country, giving confidence to investors, business, and other stakeholders to underpin the relationship between an organization and those who hold future financial claims against that organization. Since 1994, South Africa has undertaken corporate governance reforms that include a number of codes, review of the Companies Act and new regulations. In addition to the nature of the laws and regulations on corporate governance, one must also consider the quality of the law enforcement in the country. The effectiveness of corporate governance legislation and regulations depends on the competence, integrity and forcefulness of the courts and regulatory agencies.

The rules and decisions of certain private bodies, such as stock exchanges, professional accounting institutions and industry organizations, also influence corporate governance. There is need to equip the office of the Registrar of Companies to investigate alleged breach of the provisions of the Companies Act. A specialized institution should also be established to monitor the progress of enforcement of corporate governance regulations and guidelines, in addition to role of criminal and civil courts in company law enforcement.

The basic principles of corporate governance fairness, transparency, accountability and responsibility are relevant all over the world. Corporate governance is an effective policy instrument in many areas of the operation of the national economy. While it should certainly not be perceived as some sort of panacea, the wide spread practice of good corporate governance can help to achieve multiple objectives in both developed and developing countries. The principles, structure, and systems of corporate governance can and should be applied in a wide range of organizations – not just publicly listed joint stock companies, but also throughout the banking sector, in state enterprises, in cooperatives, and in the ever-growing and increasingly important NGO sector. To survive in the global

market and to increase economic growth, South Africa must address the inherent challenges and meet international corporate governance standards while maintaining allegiance to the needs of the country.

Clearly market economies require certain legislative and regulatory controls and South Africa is trying to put in place such regulatory framework. However, such controls are no substitute for corporate character, and ultimately the efficient exchange of goods and services will never occur in any market if the character of a contracting partner is in doubt. The government cannot legislate ethics and while regulatory systems and enforcement schemes may encourage people to follow the law, ultimately the decision to act responsibly must come from within.

There is no doubt that corporate governance is a key element in improving economic efficiency and growth as well as enhancing investor confidence. The King III report and the Code provide useful guidance to directors on how to direct and control the business of the company and make decisions on behalf of the company. As discussed, the purpose of the Act (as embodied in section 7 (b)) of encouraging transparency and high standard of corporate governance as a means of promoting the development of the South African economy, would encourage an interaction between the King III Report and the Act, which complement each other and ought to be read and applied together.

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