CHAPTER ONE: INTRODUCTION

1.1 Introduction and Background

This mini-dissertation is concerned with corporate governance which deals with the structures and processes associated with management, decision making and control in organisations. 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. The function of the corporate governance practice is essentially nothing other than a performance management system to ascertain or assist directors on whether they have discharged their duties.

Good corporate governance is essentially about effective, responsible leadership. Responsible leadership is characterized by the ethical values of responsibility, accountability, fairness and transparency, which values underpin good corporate governance. In *South African Broadcasting Corporation Ltd v Mpofu* the court stressed that integrity is a key principle underpinning good corporate governance, and that ‘good corporate governance is based on a clear code of ethical behaviour and personal integrity exercised by the board, where communications are shared openly’. Practicing 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 and potential investors.

In 1994 the King Committee, formed at the instance of the Institute of Directors of Southern Africa (IoDSA), published the King Report on Corporate governance, which contained a Code of Corporate Practices and Conduct. This report was updated and suspended in 2001 by the King Report on Corporate Governance for South Africa (‘King II Report’). The King Report on Corporate Governance for South Africa 2009 (‘the King III Report’) and the King Code of Governance for South Africa 2009 (‘the Code’), which came into effect on 1 March 2010, have now replaced the King II Report and Code of Corporate Practice and Conduct.

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1 Tom Wixley and Geoff Everingham Corporate Governance 2 Ed (2005) 1.
2 See Mervyn King ‘The synergies and interaction between King III and the Companies Act 71 of 2008’ *2010 Acta Juridica* 446 at 447.
3 [2009] 4 All SA 169 (GSJ).
4 Paragraph 64.
The King III Report was prompted by changes in international governance trends and the changes and reforms implemented by the Companies Act\(^6\) (hereafter ‘the Act’). One of the very purposes of the Act, as embodied in s7 (b), is to encourage transparency and high standard of corporate governance as a means of promoting the development of the South African economy. This purpose encourages an interaction between the King III Report and the Act\(^7\).

The King III Report, which sets out a number of key corporate governance principles, must be read together with the Code, which sets out best practice recommendations on how to carry out each principle. 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 best available practice that may be relevant to the company in its particular circumstances.\(^8\) The IoDSA issues practice notes to the King III Report. These notes are intended to provide guidance to entities on implementing the key principle and should be read together with the principle contained in the King III Report.

1.2 Problem Statement

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 codes, the duty of directors and their liabilities versus legislating corporate governance principle in determining the best approach for South Africa. The other question that will be addressed in this study is whether the interests of stakeholders are advanced by the companies in their dealings.

Looking at companies, management will usually have an informational advantage over other stakeholders and hence the need for corporate governance. Good corporative governance means governing the corporation in such a way that the interests of the shareholders are protected whilst ensuring that the other stakeholders’ requirements are fulfilled as far as possible. For example, it means that the directors will ensure that the company obeys the law of the land while still remaining in business.

\(^6\) 71 of 2008.

\(^7\) See Mervyn King op cit n 2 at 447.

In recent years, some high profile business frauds and questionable business practices in the United Kingdom, the United States and other countries have led to doubt being cast on the integrity of business managers. This has led to scrutiny of corporative governance and a desire for governments to tighten the regulation around corporative governance further.

The argument is that with time governance practices eventually becomes the standard against which the board is measured. Should a court have to look at an incident in respect of governance, such standard (governance practices) will be used to measure the conduct of directors. The insinuation is clearly being made that components of King III stand a good chance to attain the standard of law. King III further argues that corporative governance practices, codes and guidelines therefore lift the bar of what are regarded as appropriate standards of conduct. Consequently, any failure to meet a recognised standard of governance, albeit not legislated, may render a board or individual director liable at law.

1.3 Literature Review

This is what some of the authors and legal academics had to say on corporate governance, Sir Adrian Cadbury, UK, and Commission Report: Corporate Governance 1992 says 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.”

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.”

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.”
“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.\textsuperscript{9}

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.”\textsuperscript{10}

“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.

While scholars in the developed economic have developed large body of literature on the subject, that in South Africa is still very then. The Dearth of literature is partly due to the fact that the separation of management and ownership of modern corporations is a fairly recent development in a large segment of South Africa, as must economies were dominated by SOEs whose ownership and management structure derived from a single source government.

1.4 Aims and objectives of the study

The study will examine the corporate governance reforms in South Africa as contained in the study Report on Company law, the Companies Act, 2008 and the code of Good Corporate governance; and their effectiveness in addressing corporate governance issue in the country and as an international competitor in the 21\textsuperscript{st} century. The scope of this analysis generally covers the principle of good corporate governance as they have to be widely accepted, but will concentrate more on the individual directors and their duties, but will not include risk management, disclosure and reporting. The study also analyses the corporate governance institutional framework in South Africa.

In assessing the corporate governance reforms and whether they are in harmony with reforms in other jurisdictions, the study makes a comparison with UK which is more advanced in

\textsuperscript{9} Business Day 2004.
\textsuperscript{10} Deloitte annual 2010 review.
terms of its company law. This has been motivated by the fact that English law is one of the common law sources of South African law. In the international arena, the corporate governance reforms of the UK as contained in the companies Act, 2006 and the Combined Code\textsuperscript{11} on corporate governance are examined.

1.5 Research Methodology

Basically, the research methodology to be adopted in this study is qualitative. Consequently, a combination of legal comparative and legal historical methods, based on jurisprudential analysis, is employed. Legal comparative method will be applied to find solutions, especially for the interpretation of corporate governance.

The purpose of historical research method on the other hand, will be to establish the development of legal rules, the interaction between law and social justice, and also to propose solutions or amendments to the existing law or constitutional arrangement, based on practical or empirical and historical facts. Concepts will be analysed, arguments based on discourse analysis, developed. A literature and case law survey of the company law will be provided.

This research is library based and reliance is made of library materials like textbooks, reports, legislations, regulations, case laws, articles and papers presented on the subject in conferences and recent changes on the internet based on every day consistent changes. This study will benefit for example law student’s studying business entities, business law, commercial law, students studying bachelor of commerce and accountancy. It will also benefit Executive Directors and Non-Executive who are currently in Boards. It will also benefit members of management of various companies and institutions to understand the corporate governance principles. It will also benefit non-governmental organisations which advocate for Good governance.

1.6 The structure of the mini-dissertation

This mini-dissertation consists of five inter-related chapters. Chapter one is the introductory chapter laying down the foundation. Chapter two discusses the application of the principles of corporate governance which are recommended by the King III Report and the Code which applies to all entities in South Africa, and focuses will be on discussion of all nine principles of corporate governance. Chapter three I will focus on the fiduciary duties and liability of directors. Chapter four discusses a comparative perspective on corporative governance between South Africa and the UK. This chapter will examine the role played by the UK in influencing South African company law specifically on the corporate governance to be in the same standard with the international trends. Chapter five is the summary of conclusion drawn from the whole study and makes some recommendations.
CHAPTER TWO: OVERVIEW AND PRINCIPLES OF CORPORATE GOVERNANCE

2.1 Introduction

Company law is essentially concerned with first, making available the corporate form to facilitate and regulate the process of raising capital (corporate finance or capitalization of a company) and, secondly, imposing controls on persons whose power is derived from the finance that the uses of the corporate form has put at their disposal (i.e. corporate governance).\(^\text{12}\)

Corporate governance is generally understood to mean the way in which companies are directed and controlled.\(^\text{13}\) Thus, the emphasis is on those organs which play vital role in corporative decision making and it is clear that the corporate governance, as widely defined,\(^\text{14}\) does not affect or apply exclusively to listed companies, as some writers insist.\(^\text{15}\) In order to simplify matters, a distinction needs to be drawn between corporate governance applicable to all companies and corporate governance applicable to ‘affected companies’\(^\text{16}\) as defined by the King Committee on Corporate Governance.\(^\text{17}\)

2.2 Application

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 that

\(^{12}\) Ellis Ferran Company law and Corporate Finance (1993) 3.

\(^{13}\) See, among others, Report of the Committee on the financial Aspect of Corporate Governance, December 1992, para 2.5. (‘Cadbury Report’) Most of the literature on corporate governance deals solely with listed companies. This is understandable since the term ‘corporate governance’ is fairly new and in the past the term used was ‘company management’. It is thus important to realize that corporative governance as it relates to all companies has been existence from time companies started to exist.

\(^{14}\) Cadbury Report op cit note 2, para 2.5.

\(^{15}\) This due to the fact that the term has only recently come into use as a result of corporate governance reforms in the USA, UK and South Africa. These corporate governance reforms focused almost exclusively on listed companies.

\(^{16}\) Para 1.1 of the Corporate Practice and Conduct in the King Report on Corporative Governance (Report of a Committee on Corporative Governance headed by Mervyn E King SC, Institute of Directors, Johannesburg, 2002 (‘King II’)) defines affected companies as ‘[a]ll companies with securities listed on the JSE securities Exchange South African Banks, financial and insurance entities as defined in the various legislation regulating South African financial sector; Public sector enterprise and agencies that fall under the Public Management Act and the Local Government ; Municipal Finance Management Bill including any department of State or administration in the national, provincial or local sphere of government or any other functionary or institution (i) exercising a power or performing a function in terms of the constitution or a provincial constitution; or (ii) exercising public power or performing public function in terms of any legislation, but not including a Court or judicial officer ….’.

\(^{17}\) See note 12 above.
establishment is in the public, private or non-profit sectors.\textsuperscript{18} In contrast, 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.

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.\textsuperscript{19} 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,\textsuperscript{20} 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 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.

\textbf{2.3 Principles of corporate governance}

The King III Report provides and the code provides for eight principles of corporate governance:

- Ethical leadership and corporate citizenship,
- Boards and directors,
- Audit committees,
- The governance of risk,
- The use of information technology,
- Compliance with the laws, codes, rules and standards,
- Internal audit,
- Governing stakeholders relationships, and
- Integrated reporting and disclosure

\textsuperscript{18} King III Report at 17.

\textsuperscript{19} The Sarbanes-Oxley Act applies to all companies with securities trade publicly in the USA.

\textsuperscript{20} See Paras 7.F.5-7.F.6 and Para 8.63(a) of the JSE Listing Requirements.
The Report is divided into nine chapters. 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 Report are discussed below.21

2.3.1 Ethical leadership and corporate citizenship

The underlying philosophy of the King III Report revolves around leadership, sustainability and corporate citizenship.22 On the issue of leadership, the King III Report requires the board of directors to provide effective leadership based on ethical foundation.23 Ethics or integrity is the foundation of and very reason for corporate governance. An ethical corporate culture constitutes more than social philanthropy or charitable donations.24 The reasoning behind the ethics of corporate governance, which requires the board of directors to ensure that the company is run ethically, is that, as this is achieved, the company would earn the necessary approval from those affected by and affecting its operations.25 Ethical leaders should consider the short- and long-term impact of the strategy of the company, society and the environment and should take account of the company’s impact on internal and external stakeholders. Certain categories of companies are required to establish a social and ethics committee under section s 72(4) of the Act.26

The board should set the values to which the company will adhere and these values should be incorporated in a code of conduct.27 The board should ensure that all decisions and actions are based on the four values underpinning good corporate governance, namely responsibility, accountability, fairness and transparency, and should ensure that each director adheres to the duties of a director.28 The board should, in addition, ensure that its conduct and that of management aligns to the set values and is adhered to in all aspects of its business.29

As part of developing an ethical foundation, the board should ensure that the company’s ethical performance is assessed, monitored, reported and disclosed.30 The ultimate object of

22 King III Report, preface, at 10.
23 Principle 1.1 of the King III Report.
26 Act 71 of 2008
27 Principle 1.1.7 of the King III Report.
29 Principle 1.1.8 of the King III Report.
30 Principle 1.3.8 of the King III Report.
assessment, reporting and disclosure is to improve the company’s ethical culture by enhancing its ethical performance. Assessing, reporting and disclosure should thus enable users of ethics reports to form opinions and make decisions based on disclosed and verified information.  

Sustainability is a primary moral and economic imperative of the 21st century. It means having regard to the impact of a company’s business operations on the economic life of the community in which it operates, and includes environmental, social and governance issues. Sustainability considerations are rooted in the Constitution of the Republic of South Africa, 1996, which imposes responsibility upon individuals and juristic persons for realisation of the most fundamental rights. For sustainability to become integrated into the company, effective leadership is required.

On the issue of corporate citizenship, the board should ensure that the company is, and is seen to be, a responsible corporate citizen. Responsible corporate citizenship implies an ethical relationship of responsibility between the company and the society in which it operates. This means the board should consider not only the financial performance of the company, but also the impact of the company’s operations on society and the environment (Code 1.2.1). As a responsible corporate citizen, the company should protect, enhance and invest in the well-being of the economy, society and the environment.

2.3.2 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 in the full-time salaried employee of the company 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 management of the company, but plays an important role in providing objective

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31 Ibid Para 53 p27.
32 King III Report, preface, at 11.
33 Ibid.
35 King III Report, Para 19 p22.
36 Principle 1.2.1 of the King III Report.
37 King III Report, Para 19 p22.
38 Annex 2.2 of the King Report.
judgment, independent of management, on issues facing the company. Generally, non-executive directors contribute to the development of management strategies and monitor the activities of the executive directors.

In *Fisheries Development Corporation of SA Ltd v Jorgenses, Fisheries Development Corporation of SA Ltd v AWJ Investment (Pty) Ltd* 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 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. The role of non-executive directors and the independence that they are believed to bring to the board of directors have been a consistent theme of corporate governance theories, policies and programmes.

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. By 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. The King III Report 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 per cent of the group’s total number of shares in issue,

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39 Annex 2.3 of the King III Report. See *Fisheries Development Corporation of SA Ltd v Jorgenses, Fisheries Development Corporation of SA Ltd v AWJ Investment (Pty) Ltd* 1980 (4) SA156 (W) 165.
40 1980 (4) SA156 (W) 165.
41 King III Report Para 83 p41.
43 King III Report Para 66 p83.
45 *Ibid* Para 65 p38.
46 *Ibid* Para 67 p38.
• Does not have direct or indirect interest in the company that exceeds 5 per cent 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,

• 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 customers of supplier to the company, and

• Does not receive remuneration contingent upon the performance of the company.

2.3.3 Audit committees

The King III Report requires the board of directors to ensure that the company has an effective and independent audit committee. An independent audit committee plays central role in corporate governance and is vital to ensure the integrity of integrated reporting and financial controls and to identify and manage financial risks.

The report requires listed and state-owned companies to establish an audit committee. The shareholders must elect the members of the audit committee at each annual general meeting. Private companies, non-profit companies and personal liability companies may voluntarily appoint an audit committee and define its composition, purpose and duties in the

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47 Principle 3.1 of the King III Report.
48 King III Report Para 1 p56.
49 Ibid Para 3 p56.
50 Ibid. Under s 94(2) of the Act this does not apply where a company is a subsidiary company of another company that has an audit committee and the audit committee of the holding company will perform the functions required to be performed by the audit company on behalf of that subsidiary company.
Memorandum of Incorporation. The audit committee should meet as often as is necessary to perform its functions, but it is recommended that it meets twice a year. It should also meet with the internal and external auditors at least once in a year without the management being present.

The audit committee should compromise at least three members who should be suitably skilled and experienced independent non-executive directors. Section 94(4) of the Act prescribes further requirement to qualify as a member of the audit committee. The chairperson of the board of directors should not be the chairperson of or a member of the audit committee. This is because the chairperson of the board of directors has a strategic and comprehensive role to play in guiding the board and cannot simultaneously lead and participate objectively in the audit committee. But he or she may attend audit committee meetings by invitation. The chairperson of the audit committee should be independent non-executive director.

Some of the functions of the audit committee are to oversee the integrity of the integrated report for which the board of directors is responsible; oversee the internal audit; form an integral component of the company’s risk management process, recommend the appointment of the external auditor, and oversee the external process. The audit committee should report to the

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51 See s 94(2) read with s 34(2) of the Act.
52 Principle 3.1.4 of the King III Report.
53 Principle 3.1.5 of the King III Report.
54 See s 94(2) of the Act.
55 Principle 3.2 of the King III Report.
56 Under section 94(4) of the Act, a member of the audit committee must be director of the company who satisfies any minimum qualification requirements set out by the Minister of Trade and Industry as being necessary to ensure that the committee comprises persons with adequate relevant knowledge and experience to equip the committee to perform its functions. Furthermore, a member of the audit committee must not be: (i) involved in the day-to-day management of the company’s business or have been so involved at any time during the previous financial year; (ii) a prescribed officer, or full time employee of the company or another related or inter-related company, or have been such an officer or employee at any time during the previous three financial years; (iii) a material supplier or customer of the company, such that a reasonable and informed third party would conclude in the circumstances that the integrity, impartiality or objectivity of that director is compromised by that relationship; or (iv) related to any person who falls within any of the criteria set out (i), (ii) or (iii) above.
57 Principle 3.2.3 of the King III Report.
58 King III Report Para 11 p 57.
59 King III Report Para 11 p 57.
60 Principle 3.3 of the King III Report.
61 Principle 3.4 of the King III Report.
62 Principle 3.7 of the King III Report. The audit committee should assist the board in approving the disclosure of sustainability issues in the integrated report by ensuring that the information is reliable and that no conflicts or differences arises when compared with the financial results (King III Report Para 35 p 60).
63 Principle 3.8 of the King III Report.
64 Principle 3.9 of the King III Report.
board of directors and shareholders on how it has discharged its duties.\(^6^5\) Section 94(7) of the Act sets out further duties of the audit committees.\(^6^6\)

### 2.3.4 The governance of risk

The King III Report requires that the board of directors be responsible for the governance of risk and determine the levels of risk tolerance that the company is able to bear in the pursuit of its objectives.\(^6^7\) Risk is defined as the taking of risk for reward.\(^6^8\) The board of directors should determine the levels of risk tolerance at least once a year. It should review these limits during periods of increased uncertainty or any adverse changes in the business environment.\(^6^9\)

It is recommended that the board’s responsibility for risk governance be expressed in the board charter.\(^7^0\) In addition, the board’s responsibility for risk governance should manifest in a documented risk management policy and plan,\(^7^1\) which should be widely distributed throughout the company and reviewed by the board at least once a year.\(^7^2\) The board should also comment in the integrated report on the effectiveness of the system and process of risk management.\(^7^3\)

A risk committee or audit committee should assist the board in carrying out its risk responsibilities.\(^7^4\) The risk committee should have at least three members and should include executive and non-executive directors.\(^7^5\) The committee should comprise people with adequate risk management skills and experience to equip the committee to perform its functions, and may invite independent risk management experts to attend its meetings, if necessary.\(^7^6\) It should convene at least twice a year.\(^7^7\)

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\(^6^5\) Principle 3.10 of the king III Report.
\(^6^7\) Principle 4.1 and 4.2 of the King III Report.
\(^6^8\) King III Report Para 11 p 74.
\(^6^9\) Ibid.
\(^7^0\) Principle 4.1.3 of the King III Report.
\(^7^1\) Principle 4.1.5 of the King III Report.
\(^7^2\) Principle 4.3.2 and 4.3.3 of the King III Report.
\(^7^3\) Principle 4.10.2 of the King III Report.
\(^7^4\) Principle 4.3 of the King III Report.
\(^7^5\) Principle 4.3.2.2 and 4.3.2.4 of the King III Report.
\(^7^6\) King III Report Para 20 p 75.
\(^7^7\) Principle 4.3.2.4 of the King III Report.
Regarding risk disclosure, the King III Report recommends that the board of directors should ensure that there are processes in place that enable complete, timely, relevant, accurate and accessible risk disclosure to stakeholders.\textsuperscript{78} Undue, unexpected or unusual risks should be disclosed in the integrated report.\textsuperscript{79}

2.3.5 The governance of information technology (IT)

The governance of IT is dealt with for the first time in the King III Report. As acknowledged by the King III Report, IT has become an integral part of doing business and is fundamental to support, sustain and grow the business.\textsuperscript{80} The King III Report states that IT governance is not an isolated discipline, but an integral part of overall corporate governance.\textsuperscript{81}

Information technology governance can be considered as a framework that supports the effective and efficient management of IT resources to facilitate the achievement of a company’s strategic objectives.\textsuperscript{82} The IT governance framework should include the relevant structures, processes and mechanisms to enable IT to deliver value to the business and to mitigate IT risks.\textsuperscript{83} It should focus on the governance of the information as well as the governance of technology.\textsuperscript{84}

The King III Report requires the board of directors to be responsible for IT governance.\textsuperscript{85} The board may appoint an IT steering committee or similar forum to assist with its governance of IT.\textsuperscript{86} It is recommended that the Chief Executive Officer (CEO) appoints a Chief Information Officer (CIO) to be responsible for the management of IT.\textsuperscript{87} There is an increased risk to organizations that embraces IT and its directors should ensure that the reasonable steps have been taken to govern IT.

\textsuperscript{78} Principle 4.10 of the King III Report.
\textsuperscript{79} Principle 4.10.2 of the King III Report.
\textsuperscript{80} King III Report Para 1 p 82.
\textsuperscript{81} \textit{Ibid} Para 6 p 82.
\textsuperscript{82} \textit{Ibid} Para 6 p 82.
\textsuperscript{83} \textit{Ibid} Para 6 p 82.
\textsuperscript{84} \textit{Ibid} Para 6 p 82.
\textsuperscript{85} Principle 5.1 of the King III Report.
\textsuperscript{86} King III Report Para 18 p 83.
\textsuperscript{87} Principle 5.3.3 of the King III Report.
As a part of the IT governance framework, the board of directors should ensure that an IT governance charter and policies are established and implemented.\textsuperscript{88} The board should also monitor and evaluate significant IT investments and expenditure.\textsuperscript{89} The King III Report recommends further that companies understand and manage the risks, benefits and constraints of IT\textsuperscript{90} and suggests that IT should form an integral part of the company’s risk management.\textsuperscript{91} Companies must comply with the applicable IT laws and consider adherence to applicable IT rules, codes, standards, guidelines and leading practices.\textsuperscript{92}

2.3.6 Compliance with laws, rules, codes and standards.

The King III Report requires the board of directors to ensure that the company complies with all applicable and relevant laws and that it considers adherence to non-binding rules, codes and standards.\textsuperscript{93} A compliance culture should be encourage through leadership, establishing the appropriate structures, education and training, communication and the measurement of key performance indicators relevant to compliance.\textsuperscript{94} The board has a duty to take necessary steps to ensure the identification of laws, rules, codes and standards that apply to the company.\textsuperscript{95} Details must be disclosed by the board in its integral report on how it has discharged its responsibility to establish an effective compliance framework and process.\textsuperscript{96}

The King III Report goes as far as to require the board and each individual director to have a working understanding of the effect of the applicable laws, rules, codes and standards on the company and its business.\textsuperscript{97} Directors should sufficiently familiarize themselves with the general content applicable laws, rules, codes and standards to be able to adequately discharge their fiduciary duties and their duty of care, skill and diligence in the best interest of the company.\textsuperscript{98}

\textsuperscript{88} Principle 5.1.2 of the King III Report.  
\textsuperscript{89} Principle 5.4 of the King III Report.  
\textsuperscript{90} King III Report Para 1 p 82.  
\textsuperscript{91} Principle 5.5 of the King III Report.  
\textsuperscript{92} King III Report Para 33 p 85.  
\textsuperscript{93} Principle 6.1 of the King III Report.  
\textsuperscript{94} King III Report Para 21 p 91.  
\textsuperscript{95} Ibid Para 11 p 90.  
\textsuperscript{96} Principle 6.1.2 of the King III Report.  
\textsuperscript{97} Principle 6.2 of the King III Report.  
\textsuperscript{98} Principle 6.2.2 of the King III Report.
Compliance risk, which is the of damage arising from non-adherence to the law and regulations, to the company’s business model, objectives, reputation, going concern, stakeholders relationships or sustainability, should form integral part of the company’s risk management process.  

The King III Report suggests that the board delegates to management the implementation of an effective compliance framework and process. An independent, suitably skilled compliance officer may be appointed. He or she should have access to, and interact regularly on, strategies compliance matters the board and/or appropriate board committee and executive management. Although the chief executive officer may appoint a compliance officer to assist in the execution of the compliance function, note that accountability to the board of directors remains with the chief executive officer.

1.4.7 Internal audit

The King III Report requires the board of directors to ensure that there is an effective risk based internal audit. An internal audit should evaluate business processes, perform an objective assessment of the effectiveness of risk management and the internal control framework, systematically analyse and evaluate business processes and associated controls, and provide a source of information, as appropriate, regarding instances of fraud, corruption, unethical behaviour and irregularities. An internal audit plays an important role in providing assurance to the board regarding the effectiveness of the system of internal controls and risk management of the company.

It is suggested that an internal audit charter be formally defined and approved by the board of directors, and that at a minimum the internal audit Professional Practice of Internal Auditing and Code of Ethics.

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100 Principle 6.4 of the King III Report.
101 Principle 6.4.6 of the King III Report.
102 Principle 6.4.7 of the King III Report.
103 King III Report Para23 p 91.
104 Principle 7.1 of the King III Report.
105 Principle 7.1.2 of the King III Report.
107 Principle 7.1.3 of the King III Report.
The King III Report recommends further that the internal audit should provide a written assessment of the effectiveness of the company’s system of internal control and risk management.\textsuperscript{109} It is the audit committee that should be responsible for overseeing the internal audit.\textsuperscript{110}

2.4.8 Governing stakeholders relationships

(a) Stakeholders-inclusive approach

The King III Report adheres to the ‘triple context’ or integrated approach, which acknowledges that companies should act with economic, social, and environmental responsibility.\textsuperscript{111} Directors should consider economic, social and environmental factors when they manage the company. Thus the Report advocates the notion that the board of directors is responsible not merely for the company’s financial bottom-line, but rather for the company’s performance within the triple context in which it operates (‘triple bottom-line’).\textsuperscript{112}

There are two main schools of thought relating to the question of in whose interest the company should be managed. The enlightened shareholder value approach holds that directors must have regard to the longer term interest of shareholders, as opposed to the immediate term and, where appropriate, must have regard to the need to ensure productive relationship with all stakeholders. However, it is ultimately the shareholder’s interest that retains primacy. In other words, directors may prioritise the interest of other stakeholders only if this would promote the success of the company for the benefit of shareholders in general. Stakeholders are any group that could affect the company’s operations or could be affected by the company’s operations. This would include shareholders, institutional investors, creditors, lenders, supplies, customers, regulators, employees, trade unions, the media, analysts, consumers, society in general, communities, auditors and potential investors. The list is not exhaustive.

The pluralist approach, on the other hand, holds the view that companies have a social responsibilities to the society and that shareholders are just one constituency among many. Directors must consider the interest not only of shareholders, but of all stakeholders in the

\textsuperscript{108} Principle 7.1.4 of the King III Report.
\textsuperscript{109} Principle 7.3 of the King III Report.
\textsuperscript{110} Principle 7.4 of the King III Report.
\textsuperscript{111} Paragraph 18 p 22.
\textsuperscript{112} Paragraph 16 p 22.
company. This approach asserts that directors have a legal duty to balance the interest of shareholders and stakeholders, and must give independent value to the interest of stakeholders, whose interests are not subordinate to those of shareholders. While the enlightened shareholder value approach is a profit maximizing approach, the pluralist approach is a profit sacrificing, social responsibility approach.\textsuperscript{113}

(b) Shareholders activism and shareholder apathy

One implication of the right to vote being a right of property is that shareholders may choose not to exercise their right to vote at all. But if shareholders are passive, it undermines good levels of compliance by management. To encourage shareholders activism, an environment should be created where shareholders are not mere speculators, but owners concerned with the well being of the company in which they hold shares, constantly checking whether the directors are practising good corporate governance.\textsuperscript{114}

(c) Dispute resolution

Alternative dispute resolution (ADR) has become a worldwide trend in resolving disputes. The King III Report has recognized that ADR is a vital element of good corporate governance. As the Report points out, ADR has been a most effective and efficient methodology to address the costly and time consuming features associated with more formal litigation.\textsuperscript{115} The ADR procedures take into account the needs of both parties and strive to achieve flexible solutions that may help to preserve relationships. Alternative dispute resolution processes may thus be used as a tool to manage and preserve stakeholder’s relationships and to resolve dispute quickly and inexpensively.

The King III Report requires the board of directors to ensure that disputes are resolved as effectively, efficiently and expeditiously as possible.\textsuperscript{116} The successful resolution of dispute entails choosing a dispute resolution method that best serves the interest of the company. Consideration must be given to the preservation of business relationships, and cost dispute

\textsuperscript{113} See further chapter 3: The duties and liability of Directors on the pluralist and enlightened shareholders value approach.
\textsuperscript{114} Conrad Rademeyer and Johan Holzhausen ‘King II, corporate governance and shareholders activism’ (2003) 120 SALJ 767 at 768.
\textsuperscript{115} Paragraph 39 p 104.
\textsuperscript{116} Principle 8.6 of the King III Report.
resolution in particular must be cost effective and must not a drain on the finances and resources of the company.\textsuperscript{117}

It is suggested that the board of directors should adopt formal dispute resolution processes for internal dispute (dispute within the company) and external disputes (disputes between the company and outside entities or individuals)\textsuperscript{118} and that the board should select appropriate individual to represent the company in alternative dispute resolutions processes.\textsuperscript{119} Internal dispute may be addressed by recourse to the provision of the Act and by ensuring that internal disputes resolution system are in place and function effectively.\textsuperscript{120} External disputes may be referred to arbitration or to a court, but these may not always be the most effective means of resolving external disputes.\textsuperscript{121} The King III Report suggest that mediation may be more appropriate channel to resolve disputes where interests of the disputing parties need to be addressed and commercial relationship need to be preserved and even enhanced.\textsuperscript{122}

The King III Report defines ‘mediation’ as ‘a process where parties in dispute involve the service of an acceptable, impartial and neutral third party to assist them in negotiating a resolution to their dispute, by way of settlement agreement’.\textsuperscript{123} A mediator does not have any independent authority and does not render a decision; all decision making powers in regard to the dispute remain with the parties.\textsuperscript{124} Conciliation, on the other hand, is also a structured negotiation process involving the service of an impartial third party, but in addition to playing the role of mediator, a conciliator makes a formal recommendation to the parties as to how the dispute can be resolved.\textsuperscript{125}

2.4.9 Integrated reporting and disclosure

The board of directors should ensure the integrity of the company’s integrated report.\textsuperscript{126} Integrated report means a holistic and integrated representation of the company’s

\textsuperscript{117} King III Report Para 38 p 104.
\textsuperscript{118} Principle 8.1.6 of the King III Report.
\textsuperscript{119} Principle 8.6.2 of the King III Report.
\textsuperscript{120} \textit{Ibid} Para 42 p 104.
\textsuperscript{121} \textit{Ibid} Para 43 p 105
\textsuperscript{122} \textit{Ibid}.
\textsuperscript{123} \textit{Ibid} Para 50 p 105.
\textsuperscript{124} \textit{Ibid}.
\textsuperscript{125} \textit{Ibid} Para 51 p 105.
\textsuperscript{126} Principle 9.2 of the King III Report.
performance in terms of both its finances and its sustainability.\textsuperscript{127} The integrated report should be prepared every year, and should convey adequate information regarding the company’s financial and sustainability performance.\textsuperscript{128}

Sustainability reporting and disclosure should be integrated with the company’s financial reporting.\textsuperscript{129} The annual financial statements should be included in the integrated report, and the board should include a commentary on the company’s financial results. This commentary should include information to enable a stakeholder to make informed assessment of the company’s economic value.\textsuperscript{130} The board should ensure positives and negatives impacts of the company’s operations and plans to improve the positives and eradicates or ameliorate the negatives in the financial year ahead are conveyed in the integrated report.\textsuperscript{131}

The king III Report emphasises that companies should recognise that the principle of transparency in reporting sustainability information is a critical element of effective reporting.\textsuperscript{132} The central consideration is whether the information provided has allowed stakeholders to understand the key issues affecting the company and the effect of the company’s operation has had on the economic, social and environmental well being of the community, both positive and negative.\textsuperscript{133}

Sustainability reporting and disclosure should be independently assured.\textsuperscript{134} The general oversight and reporting of sustainability should be delegated by the board of directors to the audit committee, which should assist the board by reviewing the integrated report to ensure that the information contained is reliable and it does not contradict the financial aspects of the integrated report.\textsuperscript{135}

\textsuperscript{127} King III Report Para 1 p 108.  
\textsuperscript{128} Principle 9.1.5 of the King III Report.  
\textsuperscript{129} Principle 9.2 of the King III Report.  
\textsuperscript{130} King III Report Paras 8-9 p 109.  
\textsuperscript{131} Principle 9.2.4 of the King III Report.  
\textsuperscript{132} Paragraph 13 p 109.  
\textsuperscript{133} Ibid.  
\textsuperscript{134} Principle 9.3 of the King III Report.  
\textsuperscript{135} See further chapter 13: The Auditor, financial Records and Reporting.
2.5 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 s 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.
CHAPTER THREE: DUTIES AND LIABILITIES OF DIRECTORS

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 fundamental importance to any developed corporate law system. 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 behaviour. A further reason for imposing these duties on directors is deterrence. 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 and the duty to manage the business of the company. In this regard, see s 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.

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.

3.2.1 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 the court stated: ‘The essential principles of this branch of company law are however the same as

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137 1980 (4) SA 156 (W) 165.
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)* 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.

### 3.2.2 Who owes fiduciary to the company?

The directors of the company are fiduciaries who owe duties to the company of which they are directors. There are of course many types of directors. Directors may be said to be the persons responsible for the management of the affairs of the company. But the legal definition of a ‘director’ of a company differs vastly from this description of a director. Section 1 of the Act contains an open ended non-exhaustive definition of a director, which is both tautologous and unhelpful.

Section 1 states that a ‘director means a member of the board of a company, as contemplated in section s 66, or an alternate director and includes any person occupying the position of director or alternate director, by whatever name designated’. This is an adequate definition, because all it does is provide that certain persons may be regarded as directors, even though designated or described by a different name.

The definition of a director in s 1 of the Act is wide enough to include most types of directors, such as executive and non executive directors, *de facto* and *de jure* directors, alternate directors, nominee directors, *ex officio* directors and shadow directors. A shadow director would for instance be someone who, although not formally appointed as a director, is a retired director or a person who, has resigned as director but who is still able give instructions (from the shadow) to the board or to puppet directors appointed by him or her to carry out his or her instructions relating to the management of the affairs of the company. The definition of a director may be even wider than intended, because if the board is accustomed to act in accordance with the advice and instructions of professional persons given hi or her professional capacity, that person

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138 2001 (2) SA 727 (C) Para 37 at 738.
139 See chapter 10: Governance and the Board of directors for a detailed discussion.
140 S v Shaban 1965 (4) SA 646 (W). A shadow director is person occupying the position of director within the scope and ambit of the definition of a director in s 1 of the Act.
may be well regarded as ‘occupying the position of director. This possibility arises because s 1 of
the Act fails to adopt s 1(2) of the Companies Act 61 of 1973 (hereafter ‘the Act’) which
explicitly excludes from the definition of a director a person who gives advice or instructions to
the board in a professional capacity. The UK Companies Act 2006 similarly excludes such
professional persons from the definition of a director. 141

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.

Section 76(3) (a) and (b) states that, subject to s 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 duties
are discussed below. As stated above, the standard of directors’ conduct prescribed by s 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.

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’. 142

In Re Smith & Fawcett Ltd 143 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 [emphasis
added] consider not what a court may order is in the interest of the company. A director’s duty is

141 See 251 (2) of the UK Companies Act 2006, which states that a person is not to be regarded as a shadow director
by reason only that the directors act on advice given by him in a professional capacity.
142 Da Silva v CH Chemicals (Pty) Ltd 2008 (6) (SCA) Para 13, 627B.
143 [1942] Ch 304 at 306.
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.\footnote{Darvall v North Sydney Brick & Tile Co ltd (1989) 15 ACLR 230 SC (NSW).} 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.\footnote{Ibid.} In\textit{ Hogg v Cramphorn Ltd}\footnote{[1967] Ch 254 at268.} it was likewise stated that it was not for the courts to review the merits of a decision of the directors honestly arrived at.\footnote{In \textit{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.}

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 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.\footnote{Greenhalgh v Ardene [1950] 2 All ER 1120 (CA); Regentcrest plc v Cohen [2001] 1 BCL 80 at 104.}

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.\footnote{Scrutton LJ in\textit{ 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.}

\footnote{[1967] Ch 254 at268.} \footnote{In \textit{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.}

\footnote{Greenhalgh v Ardene [1950] 2 All ER 1120 (CA); Regentcrest plc v Cohen [2001] 1 BCL 80 at 104.}

In\textit{ Shuttleworth v Cox Bros & Co (Maidenhead)Ltd} 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\textit{ Extrasure Travel Insurance Ltd v Scattergood}\footnote{(1972) 33 DLR (3d) 288 (BCSC).} 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*\(^{152}\) 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)*\(^{153}\) 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 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.\(^{154}\)

It may be noted at this stage, that s 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.

**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.\(^{155}\) 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.\(^{156}\)

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 s 76, and more specifically, in s 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.

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\(^{152}\) [1970] Ch 62 at 74.
\(^{153}\) [1995] 1 BCLC 352 (ChD).
\(^{154}\) See also *Re W & M Roith Ltd* [1967] 1 All ER 427.
\(^{155}\) See *Kregor v Hollins* (1913) 109 LT.
\(^{156}\) Andrew Keay ‘The duty of directors to exercise an independent judgment’ (2008) 29 *The Company Lawyer* (No 10) 290.
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. In *Fulham Football Club Ltd v Cabra Estates Plc*,\(^{157}\) 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*,\(^{158}\) 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.

\(^{157}\) [1994] 1 BCLC 363 (Ch and CA).
\(^{158}\) (1964) 112 CLR 597.
In *Boulting v Association of cinematograph, Television and Allied Technicians* \(^{159}\) Lord Denning MR stated:

Or 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 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 contract \(^{160}\) that exceeds the legal capacity of the principal.

The *ultra vires* doctrine was however abolished by s 36 of the 1973 Act. \(^{161}\) 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. \(^{162}\) 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 (s 20(2)). However, a contract that contravenes of the Act may not be ratified (s 20(3)).

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\(^{159}\) [1963] 1 All ER 716 (W) 651.

\(^{160}\) See *Ashbury Railway Carriage and Iron Co v Riche* (1875) LR 7 HL 653.

\(^{161}\) See FHI Cassim ‘The rise, fall and reform of the ultra vires doctrine’ (1998) 10 SA *Merc LJ* 293.

\(^{162}\) This topic is more fully discussed in chapter 5: Corporate Capacity, Agency and the Turquand Rule (Contemporary Company Law Textbook by Farouk HI Cassim).
In *Cullerne v London and Suburban General Permanent Building Society*\(^{163}\) 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 question\(^{164}\) or any fault on his or her part.

Once again there is no explicit reference in s 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.

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. 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. 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 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, s 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

\(^{163}\) (1890) 25 QBD 485.

\(^{164}\) *Re Lands Allotment Company* (1894) 1 Ch 616 (CA).
action by or on behalf of the company despite knowing that he or she lacked the authority to do so.

Also relevant here is s 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.

In Australian law, In *R v Byrnes* 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 stated 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 s 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. It is discussed separately below.

**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*. 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

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166 (1726) Sel. Cas. Ch 61.
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. 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.\footnote{Imageview Management Ltd v Jack [2009] BCLC 725 at 739 (CA).}

The rule is an inflexible one that must be applied inexorably by a court.\footnote{Parker v Mckenna (1874) LR 10 Ch App 96 at 124.} In \textit{Sibex Construction (SA) (Pty) Ltd v Injectasteel CC}\footnote{1988(2) SA 54 (T) at 66D.} the court observed that:

\begin{quote}
[a]n expectation of these 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.
\end{quote}

This fundamental and inflexible principle was enunciated as long ago as 1854 in \textit{Aberdeen Railway Co v Blaikie Bros},\footnote{(1854) 1 Macq 461 at 471.} where the court stated:

\begin{quote}
[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.
\end{quote}

In \textit{Boardman v Phillips}\footnote{[1966] 3 ALL ER 721 at 756H.} the court explained the phrase ‘possibly may conflict’ in the above extract from \textit{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 \textit{Bhullar v Bhullar}.\footnote{Sub Nom Re Bhullar Bros Ltd [2003] 2 BCLC 241.}

In \textit{Aberdeen Railway Co v Blaikie Bros} the court referred to a conflict of ‘interest’ [emphasis added], but the principle applies also to a conflicting duty.\footnote{Lord Denning in \textit{Boulting v Association of Cinematograph, Television and Allied Technicians} (1963) 1 All ER 716 (CA) 723.} 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. 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.\(^{175}\)

In *Robinson v Randfontein Estates Gold Mining Co Ltd*\(^{176}\) 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 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.\(^{177}\)

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).\(^{178}\) In *Bray v Ford*\(^{179}\) 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] [my insertion]; he is not allowed to put himself in a position where his interest and duty conflict [no-conflict rule] [my insertion].

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.\(^{180}\) The two rules are nevertheless different in concept.

The rationale of both the ‘no-profit’ and the ‘no-profit’ is to underpin the fiduciary’s duty of undivided loyalty to his or her beneficiary.\(^{181}\) The strict application of the two rules enhance their deterrent their effect.

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\(^{174}\) See also 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’.

\(^{175}\) *Regal (Hastings) Ltd v Gulliver* [1942] 1All ER 378 at 385-6.

\(^{176}\) 1921 AD 168 at 178-9.


\(^{178}\) See *Re Allied Business & Financial Consultant Ltd Sub Nom O’Donnel v Shanahan* [2009] 2 BCLC 666 (CA); see also *Ultraframe (UK) Ltd v Fielding* [2005] EWHC 1638 (Ch).

\(^{179}\) [1896] AC 44 at 51-2.

\(^{180}\) See *Re Allied Business & Financial Consultant Ltd Sub Nom O’Donnel v Shanahan* (supra) 372.
(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 director had not made the profit at the expenses of the company. It must, however, be emphasised that ‘profit’ in this context is not confined to money, but includes every gain or advantage obtained by a miscreant director.\textsuperscript{182}

(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.\textsuperscript{183} But in the recent decision of the Supreme Court of Appeal in \textit{Da Silva v CH Chemicals (Pty) Ltd}\textsuperscript{184} the court acknowledged the corporate rule by Stating:

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.\textsuperscript{185}

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.\textsuperscript{186} It is of no consequence that the opportunity would not or could not have been

\textsuperscript{181} This entire discussion of the no-profit rule and the corporate opportunity rule remains directly relevant to the Companies Act of 2008.
\textsuperscript{182} \textit{Robinson v Randfontein Estates Gold Mining Co Ltd} 1921 AD 168.
\textsuperscript{183} See Blackman et al op cit n 11 8-164.
\textsuperscript{184} 2008 (6) SA 620 (SCA) 627 Para 18.
\textsuperscript{185} See also \textit{Phillips v Fieldstone Africa} 2004(3) SA 465 (SCA) 482E.
\textsuperscript{186} At Para 19.
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*\(^{187}\) the court stated that a director or senior officer may not usurp or divert for himself, or for another person or another company with which he [or she] is associated, a maturing business opportunity which his 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.\(^{188}\)

A corporate opportunity is seen in law to be a corporate asset that belongs to the company.\(^ {189}\) 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*.\(^ {190}\) 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. In *Sebex Construction (SA) (Pty) Ltd v Injectaseal CC*\(^ {191}\) 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*\(^ {192}\) 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.\(^ {193}\)

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\(^{187}\) Supra.

\(^{188}\) At 391.

\(^{189}\) *CMS Dolphin Ltd v Simonet* [2001] 2 BCLC 704.

\(^{190}\) [1966] 3 All ER 721 (HL); [1967] 2 AC 46.

\(^{191}\) [1998] (2) SA 54 (T).

\(^{192}\) [1965] 1 WLR 1293.

\(^{193}\) These common law principle are relevant to s 76(2)(a) of the Act, which is discussed below.
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.\textsuperscript{194} The basis of this 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.

(i) \textit{Cook v Deeks}

The classic illustration of a corporate opportunity is \textit{Cook v Deeks}\textsuperscript{195}. In this case, three of the four directors who were also equal shareholders of T Co, a railway construction company, decided to appropriate for themselves a new, lucrative construction contract that was expected to be offered to T Co by the Canadian Pacific Railway Co, which had previous dealing with T Co. T Co had in the past built railway lines for the Canadian Pacific Railway Co. The new Contract involved the continuation of a railway line that had already been laid by the T Co. Instead of obtaining the new construction contract for T Co, the defendants obtained the contract for themselves to the exclusion of T Co. They thereafter sought, at a general meeting of shareholders of T Co, to obtain approval of what they had done by passing a resolution in terms of which T Co declared that it had no interest in the new construction contract from the Canadian Pacific Railway Co. The defendants were able to pass the resolution as a result of their 75 per cent shareholding in the company. The court ruled that the benefit of the contract belonged to T co and that the resolution passed by the company was of no effect. Directors, the court said, could not validly use their voting power to divert an opportunity to themselves. The court proclaimed\textsuperscript{196} that men who assumed the complete control of a company’s business must remember that they are not at liberty to sacrifice the interest which they are bound to protect, and, while ostensibly acting for the company, divert their own favour business that should properly belong to the company they represent. The benefit of the contract thus belonged to the company. The court held further that directors holding a majority of the votes are not permitted

\textsuperscript{194} \textit{Ultraframe (UK) Ltd v Field stone} [2005] EWHC 1638 (Ch).
\textsuperscript{195} [1916] 1 AC 554 (PC).
\textsuperscript{196} At 563.
to make a gift to themselves. To do this would be to allow the majority to oppose the minority shareholders. The defendants were in this case making a gift of corporate assets to themselves. The new contract should have been dealt with as an asset of the company, which is what it was.

The importance of the distinction between the non-profit rule and the corporate opportunity rule is that the non-profit rule requires the consent of a majority of the shareholders for a director to retain the profit made by him or her. The corporate opportunity rule, on the other hand, requires the unanimous approval of the shareholders for a director to take the opportunity for him or herself. Cook v Deeks illustrate that even a 75 per cent majority approval for a director to take a corporate opportunity for him or herself is not sufficient.

(ii) Robinson v Randfontein Estates Gold Mining Co Ltd

In Robinson v Randfontein Estates Gold Mining Co Ltd 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.

The vital difference between Robinson v Randfontein Estates Gold Mining Co Ltd and Regal (Hastings) Ltd v Gulliver, (is the classic example of the no-profit rule) is that in Regal (Hastings) the company simply did not have the funds to subscribe for more shares in A Co, whereas in Robinson v Randfontein Estates Gold Mining Co Ltd the company had a definite interest in acquiring the farm for itself, it was actively pursuing that opportunity. The same may be said of the new construction contract that was expected to be offered to the company in Cook v Deeks. The contract, furthermore, in both Cook v Deeks and Robinson v Randfontein Estates Gold Mining Co Ltd was in the line of the business of the company.

197 At 564.
198 Canada Safeway Ltd v Thompson (1952) 2 DLR 591; RC Beuthin op cit n 138.
199 2921 AD 168.
200 Supra.
In *Industrial developments Consultants Ltd v Cooley*\(^{201}\) 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 of the defendant company and took for himself the contract offered by the Eastern Gas Board. 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. 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. 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.

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. 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.

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\(^{201}\) [1972] 2 All ER 162.
In *Canadian Aero Services Ltd v O’Malley*\(^{202}\) O’Malley and ‘Z’, a respected specialized in geodesy, were senior officers\(^{203}\) although not directors of Canadian Aero Services Ltd (‘Canaero’). O’Malley and Z had unsuccessfully attempted on behalf of Canaero to obtain a contract to carry out topographical survey and mapping services of a certain part of Guyana. They had subsequently resigned from Canaero and formed their own surveying company which was awarded the contract sought by Canaero. This was achieved only as a result of business contacts made by the defendants while performing services on behalf of Canaero. The defendants were held to be in a fiduciary relationship to Canaero, which the court stated had betokened loyalty, good faith and avoidance of a conflict of a duty and self-interest.\(^{204}\) As fiduciaries, they were liable to Canaero for breach of fiduciary duty in diverting to themselves or another person or a company with whom they were associated a maturing business opportunity that the company was actively pursuing. The court held that the defendants could not usurp a corporate opportunity even after their resignation, if their resignation had been prompted by a desire to acquire for themselves the opportunity sought by the company.\(^{205}\) The court swept aside the argument that it was the company formed by the defendants, and not the defendants personally, that had signed the contract in question. The defendants had on the facts diverted to themselves a maturing business opportunity belonging to the plaintiff company.

The fact that the defendants were not directors did not matter, because senior officers such as a keyperson or top management are under the same fiduciary duties as those imposed on directors.\(^{206}\) It is significant that the liability of the defendants did not depend upon proof by Canaero that, had it not been for the defendants, intervention, Canaero would have obtained the Guyana contract.\(^{207}\)

(v) Bhullar v Bhullar

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\(^{202}\) (1973) 40 DLR (3d) 371 (SCC).
\(^{203}\) O’Malley was president and Chief Executive of Canaero while Z was an executive vice-president.
\(^{204}\) At 382.
\(^{205}\) Ibid.
\(^{206}\) This was followed and applied in *Volvo (Southern Africa) (Pty) Ltd v Yssel* 2009 (6) SA 531 (SCA)
\(^{207}\) At 392.
Strict approach was adopted in *Bhullar v Bhullar*,\(^{208}\) which approved and followed *Industrial developments Consultants Ltd v Cooley*.\(^{209}\) The court strongly reaffirmed that the no-profit rule and the no-conflict rule remain universal and inflexible.\(^{210}\)

In this case, two directors of Bhullar Bros Ltd (‘B Co’), a family controlled property investment company, had learned that property adjacent to that owned by B Co had become available for purchase. They purchased the property for themselves through the medium of a company controlled by them, without informing B Co of the opportunity. Shareholders holding 50 per cent of the shares of B Co instituted legal proceedings within the scope of s 459 of the companies Act of 1985,\(^{211}\) alleging that the manner in which the affairs of B Co had been conducted had instituted unfair prejudice arising from a breach of fiduciary duty. The appellant (who were the respondents in the court *a quo*) contended on appeal that the relations between the two groups of shareholders, each holding 50 per cent of shares of B Co, had been deteriorating for some time and had broken down. The appellant had been told by the petitioners at a board meeting that they had no desire that any further properties be acquired by B Co. This was accepted in principle by the appellants. The parties had in fact decided to wind down the company’s business and to go their own separate ways.

The court ruled that the appellants were in breach of their fiduciary duty. Following *Industrial developments Consultants Ltd v Cooley*,\(^{212}\) the court found that the appellant had only one capacity in which they were carrying on business at the material time, namely as directors of B Co. In that capacity, they were in a fiduciary relationship with B Co.\(^{213}\) Since the company was still trading at the material time, it would have been ‘worthwhile’ for it to acquire further property. The property was commercially attractive to the company given its proximity to its business premises. Whether or not the company would have taken the opportunity was beside the point. The existence of the opportunity and the information relating to it were relevant to the company. As in *Industrial developments Consultants Ltd v Cooley*,\(^{214}\) the appellants were under

\(^{208}\) [2003] 2 BCLC 241 (CA). *Bhullar v Bhullar* may usefully be compared and contrasted with the approach of the court in *Belliars v Hodnett* 1978 (1) 1109 (A).

\(^{209}\) Supra.

\(^{210}\) Paragraph 31.

\(^{211}\) Substituted now by s 994 of the UK Companies Act 2006 which deals with unfair prejudicial conduct.

\(^{212}\) Supra.

\(^{213}\) Paragraph 40.

\(^{214}\) Supra.
a duty to communicate it to the company.\textsuperscript{215} The appellate were consequently accountable to B Co for the profit made by them. They were ordered to transfer the property to B Co at coast.

Both \textit{Bhullar v Bhullar} and industrial development Consultants Ltd v Cooley adopt the view that the fact that the company would not or could not avail itself of the opportunity is not of direct relevance to the liability of a director for breach of fiduciary duty in usurping that opportunity for him or herself. Bhullar v Bhullar appears to have extended the criteria for identifying a corporate opportunity. There was no emphasis in the case on a maturing corporate opportunity or any improper dealing with property belonging to the company.\textsuperscript{216} The appellants had instead diverted to themselves an opportunity in circumstances where there was ‘a real possibility of a conflict of interest’.\textsuperscript{217}

The difficulty with the judgment in Bhullar v Bhullar is that the court did not consider the possibility of the corporate opportunity having ceased to be such when the petitioners had informed the appellants that they had no desire that any further properties to be purchased by B Co, which was accepted by the appellants. This is tantamount to a decision of the board of directors of B to reject any further opportunities to purchase property for the company.

(iv) \textit{Da Silva v CH Chemicals (Pty) Ltd}

The facts of \textit{Da Silva v CH Chemicals (Pty) Ltd}\textsuperscript{218} were as follows: Resinex, a company engaged in the distribution of chemical and plastic products, wished to enter the South African market, and was contemplating either entering into a joint venture with the respondent, CH chemicals (‘CHC’), or alternatively, establishing its own business in South Africa in competition with CHC. The first appellant, Da Silva, the managing director of CHC, had handled its negotiations with Resinex. Resinex subsequently informed Da Silva that it had decided against collaborating with CHC and would instead enter the South African subsidiaries. Resinex offered Da Silva a position as a managing director of these subsidiaries. Da Silva did not inform CHC of the offer at that stage, but continued to negotiate with Resinex on behalf of CHC. Eventually Da Silva accepted the offer made by Resinex, and they entered into an agreement under which Da Silva was to establish the two South African subsidiaries of Risinex (a holding company and a trading company), Da Silva was to be the managing director of both companies, future acquisitions by

\textsuperscript{215} Paragraph 41.
\textsuperscript{216} See Para 27.
\textsuperscript{217} See \textit{Aberdeen Railway Co v Baikie Bros}, discussed in 12.4.1 3.4.1 above.
\textsuperscript{218} 2008 (620) (SCA).
the Resinex group in the territory would be directed through the said holding company, and Da Silva would be allocated a 25 percent interest in the said holding company. During his notice period with CHC, Da Silva acquired two shelf companies which subsequently became the two subsidiaries of Resinex. Da Silva was appointed a director of both companies and hired premises for the two companies. During his notice period, Da Silva also purchased and then sold on behalf of the trading subsidiary of Resinex three containers of LLDPE, a plastic product (the ‘LLDPE transaction’). The respondent instituted action against Da Silva for breach of disgorgement of profit damage. The Supreme Court of Appeal according concluded that Da Silva had not breached his fiduciary duty to CHC insofar as the Resinex transaction was concerned.

The decision of the court on the Resinex transaction is open to criticism. Maleka Femida Cassim219 questions the decision on three grounds:

With respect, the judgment of the Supreme Court of Appeal may be criticized on three grounds. First, the court’s analysis of the corporate opportunity rule doctrine is debatable. Secondly, the court concluded its analysis after interrogating the corporate opportunity rule, but failed to consider the no-profit rule. Thirdly, the court did not take account of the broader that a director may not place himself in a position of conflict of interest.

### 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 s 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 ss 75, 76(2),76(3)(a), (b) or (c). Regrettably, this is 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 ss 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.

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219 Maleka Femida Cassim ‘Da Silva v CH Chemicals (Pty) Ltd: Fiduciary duties of resigning directors’ 2009 SALJ 61 at 55. I am indebted to Fedima for her comments and insight on Da Silva which I have incorporated here.
Section 76(3)(a) and (b) was discussed above in 3.2.4 and 3.3. 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 (s 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 s 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 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.

The duty of care, skill and diligence, which is not a fiduciary duty but is based on delictual or Aquilian liability for negligence, 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. 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. 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.

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

220 Ex parte Lebowa development Corporation Ltd 1989(3) SA 71 (T); Du Plessis No v Phelps 1995 SA 165 (C).
221 See FHI Cassim ‘Fraudulent or reckless trading and s 424 of the Companies Act 1973’ (1981) 98 SALJ 162.
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. 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, and his or her particular skills and knowledge, position in the company and responsibilities.

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. In *Re Brazilian Rubber Plantation & Estates Ltd* 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. 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. More importantly, it was held that a director is not liable for damage caused by errors of judgment (i.e. for imprudence).

Built into the test of care and skill laid down by the court is a basis in favour of the inexperienced director. At the same time, it subjects the more experienced director to a higher risk of liability for the failure to exercise reasonable care skill.

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222 [1911] Ch 425 (CA) 437.
223 This principle was laid down in *Lagunas Nitrate Co v Lagunas Syndicate* [1899] 2 Ch 392.
Before proceeding further, it is important to bear in mind that care and skill are not the same thing. In *Daniels v Anderson* the court stated that skill refers to the knowledge and experience that a director brings to his office. Skill perhaps means the technical competence of a director, while care is the manner in which the skill is applied. Care may be objectively assessed, but skill varies from person to person. Care and skill are different, although the line between them is not always easy to draw.

In *Re City Equitable Fire Insurance Co Ltd* 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. They were, however, protected from liability by a provision in the constitution of the company. In approving the subjective test laid down in *Re Brazilian Rubber Plantations & Estates Ltd*, the court in its classic judgment laid down three basic legal propositions, which over 50 years later were simply adopted without critical examination in *Fisheries Development Corporation of SA Ltd v Jorgens; Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd.* The court in this case simply ignored the fact that *Re City Equitable Fire Insurance Co* had been decided at a time when directors were honorary directors or figureheads appointed as directors more because of their title and status than their business acumen. The modern director is quite a different person altogether, usually with a superior grasp of commercial matters.

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:

- 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.

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225 [1925] Ch 407.
226 Supra.
227 1980 (4) SA 156 (W).
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.

- 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.

- 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.

  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.\(^{228}\)

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. In *Fisheries Development Corporation of SA Ltd v Jorgensen* \(^{229}\) the court distinguished between the executive and the non-executive director, \(^{230}\) 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

\(^{228}\) *Re Equitable Life Assurance Society v Human* [2002] 1 AC 408.

\(^{229}\) Supra.

\(^{230}\) 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.
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.

The approach of the common-law jurisdictions may be contrasted by reference to s 8-30b of the US Model Business Corporation Act 1984 (as revised through 2002) 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.

Likewise, s 117 of the Canada Business Corporations Act, 1985 adopts an objective approach in providing that ‘a director shall exercise that degree of care, diligence and skill which a reasonably prudent person would exercise in comparable circumstances’.

The common law standard of care imposed 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,\(^{231}\), it is no longer appropriate to judge directors’ conduct by the subjective tests that were applied in 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 Act\(^{232}\) 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.\(^{233}\) The new Companies Act of 2008 continues this trend.

\(^{231}\) (1995) 37 NSWLR 438.
\(^{232}\) 19 of 2003.
\(^{233}\) See MP Larkin and FHI Cassim 2004 Annual Survey of SA law 551.
3.6 The Disclosure of the director’s financial interest (section 75)

3.6.1 Introduction

The no-profit rule (as discussed above in 3.4.1) 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.\(^{234}\) 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 (see 3.4.1(a) above), so that both the no-conflict and the no-profit rules are relevant here.

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.

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 option of the company.\(^ {235}\) 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 (i.e., the articles of association 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 opposed to obtaining the approval of the members in general meetings that was required at common law.

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 ss 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 ss 234 to 241 of the 1973 Act.

\(^{234}\) Brey v Ford [1896] AC 44; Aberdeen Railway Co v Blaikie Bros (1854) 1 Macq 461, both discussed above in 3.4.1.

\(^{235}\) North-West Transportation Co Ltd v Beatty (1887) 12 App Cas 589 (PC); Aberdeen Railway Co v Blaikie Bros, discussed in 3.4.1.
3.6.2 Section 75(5): Proposed transactions

The general principle is straightforward: a director (in the extended sense) is required by s 75 (5) to disclose any ‘personal financial interest’ that he or she or a related person has in respect of a matter to be considered at a meeting of the board of directors. This declaration or disclosure of the director’s interest in the matter must be made before it is considered by the board of directors (s 75(5)). The meaning of the phrase ‘personal financial interest’ lies at the very core of s 75.

A ‘personal financial interest’ is defined in s 1 of the Act to mean ‘a direct material interest of that person, of a financial, monetary or economic nature, or to which a monetary value may be attributed’. An interest held by a person in a unit trust or collective investment scheme is excluded from this definition, unless that person has direct control over the investment decisions of that fund or investment. The director’s interest must be a ‘direct’ material interest, not an indirect one. Since, however, the interest of a person related to the director who is known by the director to hold a personal financial interest falls within the ambit of s 75(5), the omission of the word ‘indirect’ may be less significant in practice.

The financial interest must not only be a direct one, it must also be material. While a ‘material’ interest is not defined in s 75, it is defined in s 1, which states that:

‘material’ when used as an adjective, means significant in the particular circumstances to a degree that is-

(a) of consequence in determining the matter; or

(b) might reasonably affect a person’s judgment or decision-making in the matter.

In view of this definition, there are no hard and fast rules as to when a financial interest would be ‘material’. The word; material’ is clearly not an exact concept that can be accurately defined; its meaning will depend on the particular facts and circumstances. However, what may be confidently stated is that the interest must be significant and not a trivial one. The de minimis rule will thus apply.

236 The extended meaning of director has been discussed above. The draft companies Amendment Bill, 2010 (cl 46) propose to delete the reference to members of the audit committee for the purposes of s 75.
What exactly is meant by an ‘interest’ remains to be seen. It has been left to the courts to decide what financial interest will fall within the ambit of the section. It is clear from the definition of a ‘personal financial interest’ that a director need not be a party to the matter in order to have an ‘interest’ in the matter. A shareholding company that is not insignificant or immaterial in a company that is contracting with the company of which he or she is a director will probably fall within the scope s 75(5) if the director directly or indirectly ‘controls’ the former company (as determined in accordance with s 2 of the Act and definition of ‘related persons’). Likewise, a director’s interest in his or her own service contract which is to be considered by the board (or the remuneration committee) has been held in English law to be an interest that must be disclosed. All non-pecuniary interests are excluded from s75. In Hospital Products Ltd v United States Surgical Corp 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.

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. The section requires disclosure rather than approval of the director’s personal financial interest in the matter to be decided by the board. If s 75(5) is complied with, and the board duly makes a decision or approves of the transaction or agreement, 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 (s 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 s 75.

(a) What must be disclosed

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239 See s 182(6)(a) of the UK Companies Act 2006 which states this as a specific requirement of the section.
240 For the meaning of ‘related persons’ see generally ss 1 and 2 of the Act and chapter 6: Groups of Companies and Related Persons. An important amendment is proposed by the draft Companies Amendment Bill, 2010 (cl 46) in that ‘related persons’ in the context of s 75 also includes a second company of which the relevant director (or related person) is also a director or a close corporation of which he or she is a member.
In terms of s 75(5) (a) to (c) the following matters must be disclosed by the directors:

- 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.

In English law, the courts have insisted on strict compliance with the equivalent requirements of s 182 of the companies Act 2006.\(^{241}\) It is very likely that the strict English law approach will also adopted by our courts. Disclosure in terms of s 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 (s 75(5)(a)) requires prior notice, it seems that this could be prior written or oral notification, either would suffice (see further s 75(4). Disclosure of material information and observations or insights relating to the matter may be disclosed at the meeting itself (see s 75(5)(b) and read with (d).

As stated above, s 75(5) is intentionally limited to a proposed matter ‘to be’ considered at a board meeting. 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.\(^{242}\)

In order to disclose a personal financial interest of a related person, the director must obviously have been aware of or have known about it. But s 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-

(a) had actual knowledge of that matter;
(b) was in a position in which the person reasonably ought to have-
   (i) had actual knowledge;
   (ii) investigated the matter to an extent that would have provided the person with actual knowledge; or

\(^{241}\) Movitex Ltd v Bulfield [1988] BCLC 104 (ChD).
\(^{242}\) This was the explanation given by the Attorney-General in England.
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 s 76(5).243

Section 75(5)(a) and (b) requires that the director must disclose his or her interest and its general nature and material information relating to the matter. This does not seem to require disclosure of the extent of the director’s interest in the proposed matter.244 All that is required is disclosure of the fact of the interest held by him or her and its ‘general nature’ [emphasis added] but not necessarily its extent. Any material information relating to the matter, rather than the interest held by the director, must be disclosed. In English law, the courts have insisted on ‘full and frank’ disclosure.245 Perhaps the proper approach is that the amount of detail disclosed depends in each case on the nature of the contract or matter to be considered at the board meeting and the context in which it arises.246 By the same token, sufficient detail should be disclosed to enable the board to assess the benefit that the director may reap, a mere suggestion or mere statement that the director has an interest may not suffice.

3.6.3 Section 75(6): Declaration of an interest in existing contracts

If a director, or a related person to the knowledge of the director, acquires any personal financial interest in an agreement or other matter in which the company has a material interest, after the agreement or matter was approved by the company, the director must in terms of s 75(6) ‘promptly’ disclose to the board of directors (or to shareholders in the case of a company that has only one director who is not the sole beneficial securities holder) the nature and extent of the

244 See in this respect s 75(6), which distinctively require disclosure of the nature and extent of the director’s interest. The same applies to s75(4)
245 Ultraframe (UK) Ltd v Fielding [2005] EWHS 1638 (Ch); see also Neptune (Vehicle Washing Equipment) Ltd v Fitzgerald (No 2) [1995] BCC 1000at 1016; Movitex Ltd v Bulfield [1988] BCLC 104.
interest and the material circumstances relating to the acquisition of the interest. One can only assume that by ‘promptly’ in this context is meant that disclosure must be made as soon as is reasonably practicable after the acquisition of the interest.

Section 75(6) refers to a ‘personal financial interest’ of the director or related person, which is defined in s 1 to mean a material financial interest. But disclosure is to be made in terms of s 75(6) only if the company has a ‘material’ interest in the agreement or the matter. No such requirement is prescribed by s 75(5) which as discussed above in 3.6.2, applies to the interest held in a proposed transaction as opposed to an existing transaction.

3.6.4 General notice in advance

Section 75(4) provides that a director may at any time disclose any personal financial interest in advance, by delivering to the board of directors (or shareholders in the case of a board consisting of one director who is not the sole beneficial securities holder) a general notice or a standing notice in writing that states the nature and extent of his or her interest, to be used generally for the purpose of s 75. The general notice remain operative until it has been changed or withdrawn by the director by written notice (s 75(4)). This particular provision does not refer, either expressly or impliedly, to an interest which to the knowledge of the director is held by a related person. There is no explicit provision in s 75 that notice may be given in electronic form, but perhaps S 6(10) may apply here to permit such notice to be given in this form.

3.6.5 Disclosure to whom?

Disclosure must be made to the board of directors. In Guinness plc v Saunders\(^{247}\) the court held that the disclosure must be made to the board of directors; disclosure to a board committee is not sufficient (see further 3.6.2)

In the case of a private company with one director,\(^{248}\) disclosure will entail disclosure to oneself. To avoid this ludicrous situation, s 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 (or related person’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

\(^{247}\) (1988) 2 All ER 940 (CA) 944 (see 3.6.2 above).

\(^{248}\) A company with one director can only be a private company.
resolution (s 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 (s 75(6)). See further the above discussion of 75 in 3.6.3.

3.6.6 Where no declaration of interest is necessary

According to s 75(2) of the Act, no declaration of personal financial interest is required in the following circumstances:

- in respect of decisions generally affecting all the directors in their capacity as directors,
- in respect of decisions generally affecting a class of persons of which the director is a member, unless the only members of that class are the directors or a person related or interrelated to him or her,249
- in respect of a proposal to remove that director from office in terms of s 71, or
- where one person holds all the beneficial interest of all the issued securities of the company and that person is the sole director of the company.

A possible solution in the last instance is to have an express provision in the Companies Act that this event, the director’s personal financial interest must be recorded in the minutes of a board meeting.250 Since there is no such provision in our Companies Act, the effect of s 75(2) (b)(i) and (ii) is that a sole director and shareholder is not subject to the statutory duty to disclose his or her interest under s 75. A sole director who is also the sole shareholder will fall outside the scope of s 75.

3.6.7 Failure to comply with s 75

As pointed out above, if the decision, transaction or agreement is approved by the board of directors (or shareholders, as the case may be) on compliance with the disclosure requirements of s 75, it is valid despite any personal financial interest of a director (s 75(7)). Section 75(7) also provides scope for ratification by ordinary resolution of the shareholders. This will seemingly apply where a transaction has been approved without the requisite disclosure by the director, in these circumstances the shareholder may later ratify the transaction, presumably after disclosure

249 There is no longer any definition of interrelated persons. The draft Companies Bill defined this term, but the definition was strangely removed from the Act itself. The draft Companies Amendment Bill, 2010 now proposes to remedy this.

250 See Runciman v Walter Runciman plc [1992] BCLC 1084, discussed in 3.6.2. But see s 57(3).
is made. On the other hand, on a failure by a director to comply with the disclosure requirement of s 75, it may still be possible for the court on application by any interested person to declare the transaction, decision or agreement that had been approved by the board of directors or the shareholders, as the case may be, to be a valid decision, agreement or transaction, despite the director’s failure to disclose the relevant interest (s 75(8)). As regards the miscreant director who has failed to declare a personal financial interest held by him or her or a related person, logically the director will be in breach of his or her fiduciary duty to avoid a conflict of interest, unless the transaction is ratified by ordinary resolution of the shareholders.

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. Should directors come across any information that may be relevant to the company, they are obliged to release that information to the company unless that information is immaterial, available to the public in general or if there is an ethical or legal duty on the director not to divulge the information.
Another duty of a director is the duty not to use the director’s position or information obtained while acting in the capacity as director for personal gain or to cause harm to the company or a subsidiary of the company. The business judgment test needs to be applied to determine whether a director acted with the necessary care, skill and diligence. A director will be deemed to have satisfied its obligations to act in the best interest of the company, to act in good faith and for the proper purpose if the director has taken reasonable diligent steps to become informed about the matter and did not have a material personal interest in the subject matter of the decision or in the event that the director did have an interest, he declared the interest to the company and the director has a rational basis for believing and did indeed believe that the decision was in the best interest of the company.
CHAPTER FOUR: COMPARATIVE ANALYSIS STUDY OF UK AND SOUTH AFRICA

4.1 Introduction

As a result of widespread mismanagement of company assets by a number of British company directors during the latter part of the 1980’s. 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, Greenbury and Hampel committees, 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. 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. The JSE has implemented many of the recommendations made by the King Committee, which now form part of the listing requirements. Since it was the duty of the King Committee to review corporate governance on an on-going basis, it issued on the 26th march 2002, the second report of corporate governance in South Africa.

As a result of the recommendations made by the 4 committees mentioned above, the attention paid to the question of corporate governance has dramatically increased in both South Africa and the United Kingdom.

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251 Among some of the companies whose mismanagement led to corporate governance reform initiative were Maxwell Group of Companies, Polly Peck International Plc and Guiness Plc. See also Richard Smerdon A Practical Guide to Corporate Governance (1998) 1-3.
252 See note above.
254 Committee on Corporate Governance, Final Report, 1998 (‘Hampel Report’).
255 The 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 31 December 2001 until 2002, when the new code was implemented. The new Code was not published until 26 March 2002.
256 See Schedule 22 to the JSE Listing Requirements.
257 King II op cit note 5.
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’ 258 (having been triggered by the inadequacy of the traditional corporate governance regime to adapt to the condition of a modern corporation). Triker’s statement 259 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 (requiring boards and directors to consider stakeholders interests and, in certain instances, benefit other stakeholders at the expense of shareholders), 260 then Triker’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 Triker 261 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, 262 that the

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258 Tricker (ed) op cit note 38 at xiii.
259 Ibid.
260 Only in certain designated.
261 Op cit note 41.
262 The history of corporate governance.
phrase ‘corporation governance’ is the equivalent of company management\textsuperscript{263} 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’.\textsuperscript{264} It is clear that during this time ‘the accountability to the shareholder’ notion of corporate governance was reinforced. In other words, directors’ 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.\textsuperscript{265} 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 articled of association in that art 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.

\textsuperscript{263} 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.

\textsuperscript{264} Ibid.

\textsuperscript{265} [1990] 2 AC 663.
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.

As if the Guinness scandal were not enough, then came the collapse of Robert Maxwell’s empire of companies. 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 Plc 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 1922 recommendations entitled ‘The Report of The Committee on The Financial Aspects of Corporate Governance’. 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

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266 See generally Tricker op cit note 38 and other book on corporate governance in the UK.
267 See the case of 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.
268 Supra note 2.
1995 by the Greenbury Committee, chaired directors’ remuneration. The committee emphasized the need for strong and independent remuneration committees in boards of directors. 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. The Hampel committee also reported on the implementations of the recommendations made by the predecessors. 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. 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. 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 activity was not left

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269 Op cit note 13.
271 The Cadbury and the Greenbury committees.
273 Although there are some recommendations in the King Report which reflect the unique political and social context of South Africa.
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 blueprint\textsuperscript{274} laid down a number of objectives. One such objective set was put down in the following terms:

\begin{quote}
‘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.’
\end{quote}

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 governance\textsuperscript{275} 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,\textsuperscript{276} in recognizing such political developments, dedicated a whole chapter to dealing with affirmative action. Affirmative action was provided for in the interim Constitution\textsuperscript{277} as part of the right to Section 8(2) and (3) of the constitution provided as follows:

\begin{quote}
‘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.’
\end{quote}

\begin{footnotes}
\item \textsuperscript{274} Reconstruction and Development Programme Document, para 4.4.6.3, reproduced in \textit{BEE Blueprint (Final Report)} (200) 1.
\item \textsuperscript{275} The King Committee under the auspices of the Institute of Directors of Southern Africa.
\item \textsuperscript{276} The King Report I op cit note 15.
\item \textsuperscript{277} Act 200 of 1993.
\end{footnotes}
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 Committee\(^ {278}\) refers to the recognition of black economic empowerment by companies as a good corporate governance practice.

The final Constitution of the Republic of South Africa\(^ {279}\) 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,\(^ {280}\) 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,\(^ {281}\) Skills Development Act\(^ {282}\) and the Black Economic Empowerment Commission Report.\(^ {283}\) That is the main reason why King II specifically makes recommendations regarding black economic empowerment.\(^ {284}\)

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

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\(^{278}\) King II op cit note 5 s 4.

\(^{279}\) Act 108 of 1996.

\(^{280}\) The 1993 and 1996 Constitution of the Republic of South Africa.

\(^{281}\) The 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.

\(^{282}\) Important 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.

\(^{283}\) The BEE Blueprint op cit note was published in April 2001.

\(^{284}\) See section 4 of King II at 114.
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.
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 my study 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 law and governance strategy aims to promote an effective framework for corporate 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. The provisions as contained in the Companies Bill, 2004 and various codes and guidelines on corporate governance are commendable achievements and a base for future improvement and modification. Corporate law review is a continuous process that ensures that laws are reflective of market practices and societal needs. Therefore, South Africa should put in place mechanisms to ensure constant review of corporate laws to keep up-to-date with trends taking place else-where in the world.

It should be noted that a lot of time has passed since 2007 when the Companies Bill was drafted; the Bill is just before cabinet. The delay in tabling the Bill before Parliament for debate and enactment into law means that however good the provisions are, they cannot be implemented. There is therefore need to speed up the process of putting in place the regulatory and institutional framework to ensure good corporate governance in the country. There is also need to establish a specialized body to co-ordinate the enforcement of various regulations on corporate governance.

The inclusion of the Code on corporate governance as a Schedule to the Companies Bill is likely to make its implementation very difficult. Section 11 of the Bill makes the Code applicable to only those companies which choose to include it, or part of it, in their articles. The companies that will not include the Code in their articles will not be obliged to comply with its provisions. It is important to separate the Code from the Companies Bill, and spell out the companies to which it applies following the example in the UK. Those companies would be encouraged to comply with the provisions of the Code, or explain no-compliance. Such a move
would make the Code applicable to a wide range of companies and the enforcement would not be very difficult.

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.
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