

***THE BUSINESS JUDGMENT RULE: DOES IT
OFFER ADEQUATE PROTECTION TO
DILIGENT COMPANY DIRECTORS IN
NAMIBIA?***

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ABBREVIATIONS

A J- Acting Judge

A J A- Acting Judge of Appeal

ALL ER- All English Law Reports

D- Durban and Coast Local Division

E- Eastern Cape Division

J- Judge

JBR- Business Judgment Rule

LAWSA- Laws of South Africa

MD- Managing Director

NC- Supreme Court of Namibia

Nm- High Court of Namibia

SA – South African Law Reports

SC- Supreme Court

SCA- Supreme Court of Appeal

SALJ- South African Law Journal

SMLJ- South African Mercantile Law Journal

WLD- Reports of the Witwatersrand Local Division

ABSTRACT: *The business judgment rule is ‘corporate law doctrine, persistently affecting the roles and duties of directors and officers of companies’. The rule originated in the United States as a common-law rule relating to directors’ duty of care, skill and diligence. In practice, the business judgment rule applies to the process of directors’ decision-making, and consists of a rebuttable presumption that in making business decisions, the directors of a company have acted on an informed basis, in good faith, and in the honest belief that the business decision taken was in the best interests of the company. The developments in company law has seen the codification of the common law rules into domestic legislations with the main object of creating legal certainty, and presumably offer adequate protection to directors. Section 256 the Companies Act of 2004¹ appears to be a codification of the rule. The section authorises a competent court, to relieve from liability, a director who has acted honestly and reasonably and in its opinion ought to be fairly excused when proceedings are pending against him for negligence, default, and breach of duty or trust.²*

Director’s aims and objectives are to achieve the top level of profitability, maximize growth and enter into risky but yet viable business enterprises. The common law imposes the following fiduciary duties on directors; that is the duty to act bona fide, avoid material conflict of interest, and exercise their duties for the purpose of which they were conferred; and duty of care, skill and diligence. The question which forms part of the contention though out this dissertation relate to the relief from liability for breach of both the duty of care, skill and diligence, and the fiduciary duties of directors.

The business judgment rule was introduced in order to rescue innocent and honest company directors from attracting personal liability for breach of their duties of care, skill and diligence or from claims of negligence against

¹ Act 28 of 2004.

²Cilliers H S et al (2000) *Cilliers and Benade Corporate Law*. 3rd Edition, p 160.

them. This dissertation discusses the business judgement rule as well as section 256, or (as developed and applied in our courts, or) in an attempt to establish whether there directors enjoy adequate protection.

In the dissertation writer intends to deal with the above issues as follows. Chapter one and two contain the introduction to the subject matter, including the research outline as well as the literature review. chapter three deals with addresses the common law duties of directors, chapter four will address the consequences of breach of duties of directors, the fifth chapter deals with the relief from liability and analyses the application of the common law business judgment rule, the sixth chapter deals with the statutory relief of directors from personal liability and final chapter deals with the conclusion and the answer to the question whether there are adequate protection to diligent company directors.

CHAPTER 1

GENERAL ORIENTATION

1.1. INTRODUCTION

The responsibilities of directors in corporate law should not be underestimated. Justice Stegmann in the foreword to the work of van Dorsten ³ correctly summarised it as follows:

"Corporate business is now so pervasive in our society... The responsibilities of company directors as a class are awesome. What regulates the exercise of their powers? It is a generally accepted proposition that the duty of the directors of a company is to run the business of the company in the best interests of the company. It is the mission of every company director to make and implement all operations and decisions that allow the companies to develop its social and commercial purposes. Directors oversee performance and operations of companies; they appoint and remove the senior managers, they draw and execute company's financial objectives and in general, the major operations of the company."

The board should exercise leadership, enterprise, integrity and judgment in directing the company so as to achieve continuing survival and prosperity for the company.⁴ Traditionally, an existing perception is that the director's role is the directors' role is to run the company for the benefit of its shareholders alone and to maximise profits for them. Directors may well be concerned that their conduct will be scrutinised should they be involved in a corporate collapse. Honest directors risk becoming entangled in litigation and face the associated reputational damage

³ Van Dorsten J L (1992) *Rights, Powers and Duties of Directors*. Sandston: Obiter Publishers CC.

⁴See Principle 1.1 of King III Report on corporate governance in South Africa.

and the potential for ultimate financial ruin as a result of their decisions, which may have lead to corporate collapse.⁵

The decisions of directors often involve some form of commercial risk and are sometimes made on the basis of limited information. There is a lot to be said about the director's duty of care, skill and diligence in conducting the company's affairs. Directors attract personal liability if they make business decisions and failed in achieving the objectives set, or if the desired deliverables are not met. Our law developed mechanisms to 'protect' directors from personal liability notwithstanding the fact that their decisions may have led to corporate collapse. . In order for one to understand the concept of director's liabilities and the relief from such liability, it is important to note that at common law, directors are clothed with the following duties *vis-a-vis* the entities entrusted on them:

- The duty to act with diligence, care, skill, and;
- The fiduciary duty to conduct the company affairs honestly and in the best interests of the company.⁶

This Dissertation will discuss the aforesaid duties of directors more elaborately in order to provide a better understanding of the personal liability of a director ensuing from the breach of one or more of the duties listed herein above.

It is the mission of company directors to make and implement all operations and decisions that allows the companies to develop its social and commercial purposes.⁷ In almost all common law jurisdictions, the law has established that in

⁵ Bainbridge B (2004) The Business Judgments Rule as Abstention Doctrine. *Vanderbilt law review*, 57 vant.

⁶ Van Dorsten J *supra*, P171.

Giraldo C A (2006) Factors Governing the Application of the Business Judgment Rule An Empirical Study of the US, UK, Australia And the EU. *Avenida Eldorado # 68D-35, Bogotá-Colombia, Vice Presidencia Juridical*, P120.

the decision making, the directors must act in accordance with the duties of care, skill and diligence. Our judiciary created doctrines to determine whether or not directors have acted beyond the boundaries of their duties and consequently entered into misconduct. The business judgement rule is one of the doctrinal legal instruments developed at common law. It is a corporate law's central doctrine, pervasively affecting the roles and duties of directors and officers of companies. The rule originated in the United States as a common law rule relating to directors' duty of care, skill and diligence.⁸ The business judgement rule applies to the decision making process of directors, and consists of a rebuttable presumption that in making business decisions, directors of a company have acted on an informed basis, in good faith, and in the honest belief that the action taken was in the best interests of the company.⁹

1.2. STATEMENT OF THE PROBLEM

Directors of companies are vested with enormous roles to play. For a company to become a successful concern, directors have to make commercial decisions which aims to maximise profits, and sometimes this requires the director to take risks. These decisions are sometimes undertaken by directors with limited information to their disposal, which creates risk. One would assume that in order to encourage reasonable and calculated 'risk taking', some form of insurance or security is afforded to directors in case the risk undertaken has lead to corporate collapse. It is against this background that the business judgment rule was developed in order to protect innocent directors from attracting personal liability for corporate collapse.

⁸ Jones E (2007) Directors' Duties: Negligence and the Business Judgment Rule. In 2007 *SA Merc LJ* 326 at p, 326.

⁹ Ibid.

Section 256 (1) ¹⁰ provides protection to any director, officer or auditor of a company who is or may be liable in respect of the negligence, default, breach of duty or breach of trust if he can show that he has acted honestly and reasonably. Based on the above protections, the dissertation will examine and establish whether the statutory provisions mentioned herein above and the common law business judgement rule provide adequate protection to diligent company directors, and if not whether there is a need to strengthen the current *status a quo*.

1.3. RESEARCH QUESTIONS

In dealing with the problem mentioned in the statement above this Dissertation aims at providing clarity and responds to the problem by canvassing the following questions;

- Does rule and statutory exemptions from liability of company directors under discussion offers adequate protection to diligent company directors.
- Is there a need to provide additional protection to diligent directors in addition to what is traditionally accorded in terms of the rule and statutory exemption thereof?

1.4. PURPOSE OF THE STUDY

This study aims to assess whether the business judgement rule and other equivalent statutory exemption from liability of diligent directors are adequate in offering then opportunities to take calculated risks without any threat of personal liability. The research will also make recommendations, if need be, on the appropriate legislative interventions and based on the findings.

¹⁰Companies Act No. 28 of 2004; this provision applies to directors, officers and auditors of the company. The position regarding the directors of companies is the only aspect that is relevant for the purposes of this study and the way in which other parties are affected in terms of this provision thereof does not form part of the scope of this study.

1.5. METHODOLOGY

The research used a desk study. The author gathered and analyzed the information published and available in different books, law journals publications, research articles, cases decided in our Courts, Legislations duly passed by the Namibian and other countries legislative bodies, companies internal code of conducts, board of directors resolutions and any other authentic publications on the internet in an attempt to establish whether there are adequate protections to our company directors.

Furthermore, other persuasive authorities borrowed from other jurisdictions are used in the dissertation where local authorities failed to provide us with satisfactory answers to any question of law and/or fact investigated. Authorities from jurisdiction such as South Africa, England and the United States Courts also form part of persuasive authorities in this dissertation.

1.6. LIMITATION OF THE STUDY

In the dissertation, reference is made to the term “*directors*” of companies. At times, the term ‘directors’ caused confusion as it is generally used not only to indicate the plural of an individual director but also the board of directors as a whole.¹¹ In terms of the Companies Act of 2004, the term “*director*” is defined as to “includes any person occupying the position of director or alternate director of a company, by whatever name that person may be designated.” Impliedly, one would also assume and rightly so, that it include “*executive directors*”. However, for the purposes discussion of relief from liability of directors in this dissertation, the use of the term “director” is limited and used only to refer to the “*board of directors*.”¹²

¹¹ Cilliers H S et al (2000): *ibid*, p116.

¹² Italic and underlined words are my emphasis.

Furthermore, the research is limited to the local legal principles of company law applicable and binding on our courts. Therefore, foreign authorities from other jurisdictions quoted herein are for persuasive purposes only.

The statutory relief from liability in terms of section 256 of the Act is applicable to directors, auditors and officers of companies. However, the discussion in this dissertation limited to the protection of the innocent and yet innovative company directors. Other stakeholders such as the shareholders, auditors and officers including the Managing Director of companies and their protection thereof, fall outside the scope of this study. It should be noted that the term 'director' used within this paper is limited to the board of directors and exclude any other officers of the company who forms part of the management.

CHAPTER 2

REVIEW OF RELATED LITERATURE

2.1. Introduction

Relief from Personal liability that attach to company directors is a complex matter in company law. It involves an understating of the duties of directors, the consequences of breach of such a duty and the basis for liability. In addition to different articles and books cited hereunder, other related literature surveyed for this report includes the following:

Companies Act, 1973;¹³

Companies Act, 2004 and;¹⁴

King III Report on corporate governance in South Africa.

The survey of the related literature has confirmed that there seems to be adequate protection to company directors either in terms of the common law or by virtue of the statutory provisions of the above mentioned legislations.

2.2. Duties of directors in company law

In order to establish whether there are adequate protections to the directors of companies, one would have to discuss their duties in the first instance. There are different duties of directors in company law. Van Dorsten¹⁵ opines that, all directors are required by law to exercise the necessary care, skill and diligence in the performance of their duties. This duty is concerned with the management; decision-making within companies and in the efforts of directors to survives competitive markets and achieved the required level of profitability within the

¹³ Act 61 of 1973.

¹⁴ Act 24 of 2004.

¹⁵ Van Dorsten J *supra*, P171.

companies. Although the director is required to exercise care, he/she is also required to show initiative and to be enterprising and dynamic.¹⁶ Therefore, a director who breached his duty of care, skill and diligence will be personally liable to the company for loss suffered as a result of the breach. It is on this basis that, if the director in exercising this duty and if have done so in observance of all relevant factors and circumstances, may be exempted from any personal liability thereof.

Additionally, personal liability attach to any director who failed to exercise any other duty imposed either by statute or at common law. According to Cilliers et al,¹⁷ duties of directors are not only limited to the duty of care, skill and diligence for the purpose of establishing personal liability, but it also includes the breach of fiduciary duties; the fiduciary duties includes, duty of trust, duty to act under available powers, duty to act *bona fidei* and in the best interest of the company, duty to avoid conflict of interest and account for secret profits,¹⁸ as well as the duty to exercise an independent discretion.

2.3. Justification for director's liability

Du Plessis¹⁹ in her justification for the basis of director's liability argues that, it is beyond dispute that fault (*culpa* (negligence) or *dolus* (intent)) is a requirement before a director could be held liable for a breach of his or her duty of care, skill and diligence.

Personal liability does not attach only by mere breach of the duty, but there must be some form of negligence or intention on the part of the director. Cilliers *et al*²⁰ in

¹⁶ Ibid.

¹⁷ Cilliers H S et al (2000) *Cilliers and Benade Corporate Law*. 3rd Edition: Durban,; Butterworth: LexisNexis, p116.

¹⁸ See *Parker v McKenna* (1874) LR 10 Ch App 96 at 118.

¹⁹ Du Plessis J (2003) *A Comparative Analysis of Directors' Duty of Care, Skill and Diligence in South Africa and in Australia*. Paper delivered at the 2009 Corporate Law Teachers Association, hosted by the UTS, Sydney on 1-3 February 2009.

²⁰ Cilliers H S et al (2000), p124.

an attempt to define the directors' duty of care, skill and diligence argued that, it not a requisite for a director to have special business acumen or expertise, or singular ability or intelligence or even experience in the business of the company. He is, however, expected to exercise the care which can reasonably be expected of a person with his knowledge and experience.²¹ That is to say that a director is not liable for mere errors of judgment.

2.4. The business judgement rule and statutory exemption

It is clear that directors attract personal liability as a result of breach of their duties. In order to protect innocent and honest directors, at common law, the business judgment rule was formulated. .there is no uniform definition of the rule, however, Giraldo²² a standard of non-review, entailing no review of the merits of a business decision corporate officials have made.

Jones²³ defined the business judgment rule as it applies to the process of directors' decision-making, and consists of a rebuttable presumption that in making business decisions, the directors of a company have acted on an informed basis, in good faith, and in the honest belief that the action taken was in the best interests of the company.

Havenga²⁴ went further to describe the rule that it usually serves to protect directors from liability to the company or to its shareholders for losses resulting from poor decision making.

²¹ Jean J, Du Plessis A (2009) *A Comparative Analysis of Directors' Duty of Care, Skill and Diligence in South Africa and in Australia*. A paper delivered at the 2009 Corporate Law Teachers Association, hosted by the UTS, Sydney on 1-3 February 2009, published, on invitation, in a special edition of the, *Acta Juridica*, the official law review journal of the Faculty of Law, University of Cape Town in 2010.

²² Giraldo C A (2006),p120.

Jones E (2007) *Directors' Duties: Negligence Duties: Negligence And The Business Judgment Rule*. 2007 *SA Merc LJ* 326 at p, 326.

²⁴ Havenga M (2000) *The Business Judgement Rule – Should We Follow The Australian Example?* 2000 *SA Merc LJ* 25.

Naidoo²⁵ in defining the application of the rule extended it to as far as it includes the protection of directors against breach of fiduciary duties. She argued that, 'while directors are bound by their fiduciary duty to act in the best interest of the company, the business judgment rule is based on the recognition that, business, by its very nature, is risky and directors, however diligent, cannot guarantee the success of the company.'

In the Australian case of *Shuttleworth v Cox Brothers & Co*²⁶ Scruton LJ in describing the rule, held that "it is not the business of the Court to manage the affairs of the company. That is for the shareholders and directors...I should be sorry to see the Court...take upon itself the management of concerns which others may understand far better than the Court does".²⁷

Furthermore, Section 256 (1) the Companies Act²⁸, thereof, appears to be a codification of the business judgement rule in terms of which our courts are empowered to relieve from liability any director of a company where in managing the company affairs, he/she has acted honestly and reasonably, and that, having regard to all the circumstances of the case, including those connected with his or her appointment, he or she ought fairly to be excused for the negligence, default, breach of duty or breach of trust.

Additionally, section 256 (2) gives the rights to an individual director to *mero muto*²⁹ bring an application before court in order to be excused from personal liability where she/he have acted honestly and reasonably and in the opinion of the

²⁵ Naidoo R (2009) *Corporate Governance: An Essential guide for South African Companies*. Second edition. Durban: LexisNexis, p251.

²⁶ 1927(2) KB 9 at 23-24.

²⁷ Ibid.

²⁸ Act 28 of 2004 and formerly section 248 of the repealed Companies Act 61 Of 1973.

²⁹ That is to say on their own; individually or in association with others by way of application.

court ought fairly to be excused when proceedings are pending against him for negligence, default, and breach of duty or trust.

The question that forms part of this research is thus whether in view of the above protections afforded to the directors, are adequate to deal with the fears of directors attraction of personal liabilities. Clearly, there is significant debate as to the application of section 248 of the Companies Act, 1973 now section 256 of the Companies Act, 2004 and the common law's business judgement rule. In *Ex Parte Lebowa Development Corporation Ltd*³⁰ the court concluded that the section empowers the court to grant relief, firstly against a claim by the company itself (or its liquidators) and secondly, against criminal liability. Whereas *Customs and Exercise Commissioners v Heldon Alpha Ltd*³¹ on the other hand held that the remedy as provided for in the context of the provision shall only be available to proceedings brought by the company itself. Certainly, uncertainty therefore exist as to whether the remedy is applicable in all proceedings against directors by anyone (including the criminal liability proceedings) or whether their application is limited to proceedings against directors specifically instituted by the companies for damages or any other consequential loss. Additionally, what causes a further threat to the protection to the directors in terms of the rule and the later provisions thereof is the interpretation of section 256. As Lord Hoffman in one of the English courts³² expressed in the following terms;

"It may seem odd that a person found to have been guilty of negligence, which involves failing to take reasonable care, can ever satisfy a court that he acted reasonably. Nevertheless, the section clearly contemplates that he may do so

³⁰ Supra.

³¹ [1981] 2 All ER 697 (CA).

³² *Re D'Jan of London Ltd; Copp v D'Jan* [1994] 1 BCLC 561.

and it follows that conduct may be reasonable for the purposes of s 727³³ despite amounting to lack of reasonable care at common law.”

Therefore, it is difficult if not impossible for the court to find the director guilty of negligence at the same time find that directors have acted reasonably.

The dissertation contributes immensely to the understanding and application of the statutory relief of directors from personal liability. It enables both legal practitioners and academics to apply section 256 in any relevant proceedings against directors.

³³ Companies Act 1985.

CHAPTER 3

DUTIES OF COMPANY DIRECTORS

3.1. INTRODUCTION

It is trite law that companies as legal entities operate through its functionaries. At the top of these functionaries, you find directors. The term director at times causes confusion as it is generally used not only to indicate the plural of an individual director, but also as a *board of directors*³⁴ as a whole.³⁵ The meaning of the word director depends on the context in which it is used. Generally speaking, directors' are tasked with the management of the company, creation of innovations as well as being the forerunners in an attempt to improve profitability of the entities whose management is their responsibility.

For the purpose of the current discussion, any reference to the term director shall be construed as directly referring to directors serving on the board of directors of a corporate entity. While the Namibian legislature imposed no obligations on companies to assign any particular task to the board of directors, the existence of such board is mainly to manage the company's affairs. A variety of management responsibilities of board of directors are normally set out in the articles of association of companies. In most cases, the business of companies is to be managed by or under the direction of its directors.³⁶

The rights and duties of the directors are primarily determined by the company constitution³⁷ and the common law. The common law duties of directors can be divided into (a) fiduciary duties towards the company, (b) and duty of care, skill and diligence. For the purpose of this paper, more emphasis will be placed to the

³⁴ Italic words are my emphasis.

³⁵ Cilliers H S et al (2000) *Cilliers and Benade Corporate Law in South Africa*. 3rd Edition. Durban: Butterworth LexisNexis, p116.

³⁶ Ibid.

³⁷ That is the memorandum and articles of association.

later because of the nature of the defence of the business judgement rule which is formulated in the US for breach of the later.

3.2. FIDUCIARY DUTIES OF COMPANY DIRECTORS

3.2.1. General remarks

Every company director stands in a fiduciary relationship to his company.³⁸ The fiduciary duty is encountered when a person is in control of the assets of another.³⁹ In general it entails acting in good faith, that is, honestly and in the best interests of that other person or, in the present context, the company as a whole.⁴⁰ Types of conduct which have been held to breach this duty include making a profit at the company's expense, exceeding the limits of authority, acting for an improper purpose, and fettering the director's discretion. The cause of action for breach of this duty is one for breach of trust.⁴¹ It is *sui generis*, and is not based on either contract or delict.⁴² It has been argued that in our law⁴³ its origins lie in Roman-Dutch rather than English law.⁴⁴ It has been further suggested that, a director cannot be relieved of this duty in the articles, in a contract or in any other way, any act amounting to an invasion of this duty is seen in the same light as breach of duty itself.⁴⁵ In *Cyberscene Ltd and Others v I-Kiosk Internet and Information (Pty) Ltd*⁴⁶ it was confirmed that a director stands in the fiduciary relationship to the company for which he or she is a director.

³⁸ Cilliers et al (2000), P139.

³⁹ Jones E (2007) Directors' Duties: Negligence and the Business Judgment Rule. 2007 *SA Merc LJ* 326, at p333.

⁴⁰ Cilliers H S et al supra, P 138.

⁴¹ See discussions in details hereunder.

⁴² Jones E (2007), P334.

⁴³ In terms of the South African and subsequently the Namibian law.

⁴⁴ Blackman M, S (1996) Companies. In Joubert WA (Ed) *the Law of South Africa*: vol 4, part 2 in par 116n2.

⁴⁵ See *Howard v Herrigel 1991 (2) SA 660 (A)* at 678-B. the court observed that, at common law, once a person accepts an appointment as a director, he becomes in a fiduciary relationship to the company and is obliged to display utmost good faith towards the company in its dealings on its behalf.

⁴⁶ 2000 (3) SA 806 (C).

3.2.2. The nature of a fiduciary relationship

Directors are likened to trustees and thus even though the concept “fiduciary duty” has escaped a precise definition, it is said that such duty arises “*where, as a result of one person’s relationship to another, the former is bound to exercise rights and powers in good faith and for the benefit of the latter*”.⁴⁷ Fiduciary duties can be imposed in two ways: (i) it can be imposed under the general law, for example, between a director and owner or company, or (ii) it may arise because of an undertaking by one person to another.

The term “fiduciary” derives from the term “fiduciaries” which signifies a trustee. A fiduciary undertakes to act for or on behalf of another which requires him to act *selflessly* and with *undivided loyalty*⁴⁸ in the interests of the other person. The obligation to act selflessly is what distinguishes a person who owes fiduciary obligations from a person who owes mere contractual duties.⁴⁹

The doctrine of fiduciary relationship is one of fairness, justness and equity, the rule being that a person must not take advantage of this relation to benefit himself.⁵⁰ In *Phillips v Fieldstone Africa (Pty) Ltd*,⁵¹ it was said that the principles governing the actions of a person who occupies a position of trust towards another were adopted in South Africa from the equitable remedy of English law. In *Sibex Construction (SA) (Pty) Ltd v Injectaseal CC*⁵² the court held that, “*there is high authority both in this country and in other countries where similar legal principles*

⁴⁷ Hood P (2000) what is so Special about Being a Fiduciary? 2000, Vol 4. *Edinburgh Law Review* 308, p, 308.

⁴⁸ My emphasis.

⁴⁹ De Waal, MJ (2000) *The Core Elements of the Trust: aspects of English, Scottish and South African Trusts Compared*. *SALJ*, Vol 1. 548, P 558.

⁵⁰ Rahman L (2006) *Defining the Concept “Fiduciary Duty” In the South African Law of Trusts*. Thesis Submitted in Partial fulfilment for the degree of *Doctor Legum*. University of Western Cape.

⁵¹ 2004 (3) SA 465 (SCA).

⁵² 1988 (2) SA 54 (T).

obtain for the proposition that a director of a company is a trustee for his company and that a fiduciary relationship arises there from”.

3.2.3. Formulation and application of fiduciary duties

As eluded to earlier, director’s duties are equivalent to that of trustees in our law; hence, in *Doyle v Board of Executors*⁵³ the court held that a trustee undoubtedly occupies a fiduciary office. The concept of fiduciary duty in our law is not defined in clear terms. In *Phillips v Fieldstone Africa (Pty) Ltd*⁵⁴ it was said that ‘there is no magic in the term ‘fiduciary duty’. The existence of such a duty and its nature and extent are questions of fact to be adduced from a thorough consideration of the substance of the *relationship*⁵⁵ and any relevant circumstances which affect the operation of that *relationship*.’ Therefore, a discussion of how a fiduciary relationship is formulated in our law is essential as well. A person in a fiduciary duty such as a director is under a legal duty to prevent a conflict arising between his own interest and those of the parties whom he serves.

A director may not place himself in a position in which he has, or can have, a personal interest or a duty to another, conflicting, or which possibly may conflict, with his duties to company. This duty is based on the consideration that, human nature being what it is, there is a danger, in such circumstances, of the person holding a fiduciary position being swayed by self interest rather than duty, and thus prejudicing those whom he is bound to protect.

The duty of directors to avoid conflict of interest entails that directors should not exploit assets or opportunities of the company for their own benefit.⁵⁶ For example, in *Robinson v Randfontein estate Gold Mining Co Ltd*⁵⁷ the chairman of the board

⁵³ 1999 (2) SA 805 (C).

⁵⁴ 2004 (3) SA 465 (SCA) 477H.

⁵⁵ Italic are my emphasis.

⁵⁶ *Robinson v Randfontein estate Gold Mining Co Ltd* 1921 AD 168.

⁵⁷ 1921 AD 168.

purchases a farm in his own name after his company which was anxious to acquire farm, could not reach finality with the seller. He later purchased the farm through an agent and thereafter sold the farm to the company. The court held that, 'Robinson was not justified in making a profit from his office nor in placing himself in a position where his personal interest conflict with the duty arising out of his fiduciary position.'

It is trite that a man who stands in a position of trust towards another, cannot, in matters affected by that position, advance his own interest i.e. making a profit, at the expense of that other.⁵⁸ This principle is twofold. The first is that directors are in general not entitled to any benefit deriving from them holding the office of the director in a company, beyond what the company is willing to pay them. The second is that they cannot in general conclude valid contracts with the company. A director must not use the position of director, or any information obtained in that capacity, to gain personal advantage or for personal gain, nor advantage for any other person, other than the company itself. Neither must the director cause harm to the company.⁵⁹

A director is in a fiduciary duty with the company to observe the powers of the company as well as the limit of their own authority to act on behalf of the company.⁶⁰ A fiduciary duty simply means that a director of a company must exercise the powers and perform his functions in *good faith* and in *the best interests* of the company. The director owes the duty to the company itself and not to shareholders or other stakeholders. In *Cyberscene case*⁶¹ the court held that a director acts in breach of his fiduciary duty to the company where he sabotages the company's contractual opportunities for his own advantage, or where he uses

⁵⁸ Ibid 177.

⁵⁹ Geach W (2009) *Statutory, Common Law and Other Duties of Directors*. Paper for CIS Corporate Governance Conference on 10 to 11 September; University of KwaZulu-Natal, Graduate School of Business, P10.

⁶⁰ Cilliers et al (2000) p, 144.

⁶¹ Ibid.

confidential information to advance the interests of a rival concern or his own business to the prejudice of those of his company.

In *Industrial Development Consultants v Cooley*⁶², the MD, Cooley, unsuccessfully tried to obtain a building for his company the client was simply not prepared to enter into a contract with that company. The client approached C to form his own company to take up the contract, which C then did. Despite the fact that the client was not prepared to contract with former company, C was nevertheless held liable to account to that company for his profits since the profits were made as a result of information which C obtained in the capacity as its Managing Director (MD). In *Atlas Organic fertilizers v Pikkewyn Ghano*⁶³, a MD was held to have breached his fiduciary duties where he sabotaged his company chances to obtain a contract and later, after severing connections with his company, subverted and took over that contract for his new company.

In *Sibex Construction v Injectaseal CC*⁶⁴ a provisional interdict was granted against Injectaseal, because their directors who used confidential information to prepare tenders in competition with their former company, acted in breach of their fiduciary duties toward Sibex. As a general rule a director, is not prohibited from serving as a director of other companies, apparently not even if the other company is a competitor of the first company, but he then occupies an almost untenable position in that he may not use or disclose confidential information of the one company for the benefit of the other.⁶⁵

⁶² [1972] 2 ALL ER 969 (CA) 972.

⁶³ 1981 (2) SA 173 (T) 197.

⁶⁴ Ibid.

⁶⁵ Ibid.

3.3. DUTY OF CARE, SKILL AND DILIGENCE

2.3.1 General Remarks

Directors of companies in addition to having to act honestly and in good faith when exercising their powers are required to act with diligence when managing the affairs of the company. It is fair to say that directors act with *care, skill and diligence* in managing the affairs of the company and in particular duty of directors may provide valuable safeguard for the interest of the company and all the stakeholders.⁶⁶ The concepts care, skill and diligence have been discussed by many commentators and especially in English case law.⁶⁷ The duty of care, diligence and skills relates to a duty to pay attention and try to make good decisions.

It is clear that, directors must exercise the required degree of care, skill and diligence. The duty of care addresses the question of delictual conduct in the form of negligence rather than honesty. The standard of care in our law is derived from the English common law.⁶⁸ The duty of care reaches broadly, applying to all decisions directors make and indeed even more broadly, to all decisions they should make, were they to exercise ordinary care. In *Fisheries Development Corporation of SA Ltd v Jorgensen*⁶⁹ the court held that the extent of a director's duty of care, skill and diligence depends to a considerable degree on the nature of the company's business and on any particular obligations assumed by or assigned to him. The duty of care includes the requirement that directors inform themselves of all material information reasonably available to them before making a business decision. This is a process requirement, and directors may be liable (unless

⁶⁶ Ibid, p159.

⁶⁷ The most famous authority in English case law is *In Re City Equitable Fire Insurance Co Ltd* [1925]1 Ch 407,427.

⁶⁸ Ibid.

⁶⁹ 1980 (4) SA 156 (W) 165.

exonerated by statute and common law) if they are found to be grossly negligent in the process.⁷⁰

2.3.2 Formulation and application of the duty

In our Law, a director's duty to act with care, skill and diligence has its basis from English law. A director who was negligent in managing the affairs of the company may incur personal liability based on the general principles of *lex Aqualia*.⁷¹ In our law, directors' duty to act with care, diligence and skill forms part of their common law duties. Thus, a director who was negligent in managing the affairs of the company is duty bound to incur personal liability based on the general delictual principle of *lex Aqualia*. In Namibia, there has been lack if not almost none of the cases decided on this subject matter. All authorities available are those of the South African Courts and decisions emanating from the English courts.

A director must exercise his duty in good faith and for the benefit of the company. In determining whether the director acted with care, skill and diligence in managing the affairs of the company, one must have regard to the nature of business of the company and in particular the obligations assumed by the individual director.

Directors of companies are appointed in terms of the constitution of the company and in terms of the Act. Each director of a company has a duty to exercise a degree of care, skill and diligence that would be exercised by a reasonably diligent individual who has both:

⁷⁰ I.e. section 256 of the Companies Act, 2004 and the common law's Business Judgment rule.

⁷¹ Concept under the law of delict which is concerned with the damage unlawfully inflicted.

- a. the general knowledge, skill and experience that may reasonably be expected of an individual carrying out the same functions as are carried out by a director in relation to the company; and⁷²
- b. A fiduciary duty to act in good faith and in a manner that the director reasonably believes to be in the best interests of the company.

In *African Land Co, Ltd v W.J Langermann*⁷³ the court held that, An ordinary director is a mandatory, entrusted, in conjunction with his co-directors, with the management of the company's affairs; bound to exercise the utmost good faith in transacting them; to give the company the benefit of his judgment and experience; and to render that amount of diligence which an ordinary prudent and careful man would display under the circumstances. These things are expected of a director when acting as the company's functionaries. This duty comprises of three distinct competencies, namely;

- duty of care,
- skill; and
- Diligence.

They are now considered separately hereunder;

(i) Duty of care

Every company director is under the obligation to act with care when managing the affairs of the company. The duty of care has been defined to mean serious mental attention; concern, caution and close attention.⁷⁴ In *Fisheries Development*

⁷² Ibid.

⁷³ 1905 TS 494, At 504.

⁷⁴ Van Dorsten *Supra*, P, 172.

*corporation v Jorgensen*⁷⁵ the court did not clearly define the standard of care. Margo J said:

“He is nevertheless expected to exercise the care which can reasonably be expected of a person with his knowledge and experience.”

Therefore, the standard one may use in determining whether one had exercised a duty of care is a reasonable man test. What is expected on a reasonable person was stated in *Peri-Urban Areas Health Board v Munarin*⁷⁶ in which the court held that, *culpa* and foreseeability are tested by reference to the standard of a diligent *paterfamilias*⁷⁷ in the position of a person whose conduct is in question. ‘One does not expect of diligent *paterfamilias* any extremes such as Solomonic wisdom, prophetic foresight, nervous timidity or trained reflexes of a racing driver. In short, it entails the prudent common sense.’

(ii) Duty of skill

A director must exercise reasonable skill in the performance of his duties. Skills imply ‘practical knowledge in combination with ability, cleverness, expertness and judgement.’⁷⁸ A director is expected to show a high degree of skill that may reasonably be expected of his particular knowledge and experience. It is submitted that the test is therefore a subjective one.⁷⁹ In *Fisheries Development case*, the court quoted Romer J⁸⁰ with approval that;

“A director need not exhibit in the performance of his duties a greater degree of skill than may be reasonably expected from a person of his knowledge and experience. A director of a life insurance company for

⁷⁵ *Supra*, fn 36.

⁷⁶ 1965 (3) SA 367 AT 373F.

⁷⁷ That notional personification or epitome of reasonable man.

⁷⁸ Van Dorsten *Supra*. P, 177.

⁷⁹ *Ibid*.

⁸⁰ In *Re City Equitable Fire Insurance Co Ltd* [1925] Ch 425 (CA) at 437.

instance, does not guarantee that he has the skill of an actuary or a physician.”

A director must therefore make the necessary efforts to understand the company affairs and to exercise his own judgement based on his own knowledge and experience and the information and advice given to him by his company officials.

(iii) Diligence

All directors of companies must show the necessary diligence in the performance of their duties.⁸¹ Diligence is a measure of prudence, activity, or assiduity, as is properly to be expected from, and ordinarily exercised by, a reasonable and prudent person under the particular circumstances; not measured by any absolute standard but depends on the relative facts of the special case.⁸²

⁸¹ Ibid.

⁸² <http://www.charlesmillsconsulting.com/due-diligence-definition.htm>. Last accessed 09 August 2011 at 17h26.

CHAPTER 4
CONSEQUENCES FOR BREACH OF DIRECTORS DUTIES

4.1. Breach of fiduciary duties

Directors shall observe and comply with their fiduciary duties at all time. Over the years, the question that has been difficult to answer in our courts has always been what constitutes breach of fiduciary duties.⁸³ Types of conduct which have been held to breach this duty include making a profit at the company's expense, exceeding the limits of authority, acting for an improper purpose, and fettering the director's discretion. The cause of action for breach of this duty is one for breach of trust.⁸⁴ It is *sui generis*, and is not based on either contract or delict. Therefore, Where a Director acts dishonestly to the interest of the company, he will be held personally liable for breach of fiduciary duty.

Most of the powers of directors are powers in trust and, therefore, should be exercised in the interest of the company and, not in the interest of the directors or, any section of members. Thus, in a case where the Directors, placed his interest before that of the company, acted mala fide in managing the affairs of the company, derived economic benefits from the deals where the company ought to derive its profit, it was held to be a wrongful exercise of the fiduciary powers of the directors.

Traditionally, the company have three remedies in respect of breach or impending breach of fiduciary duties, namely; setting aside of the particular act, recourse

⁸³ M Havenga (2004) Directors in Competition with their Companies. (2004) 16 SA Merc LJ 275 at 286.

⁸⁴ Ibid.

against a particular director,⁸⁵ and obtaining an interdict to prevent a threatening breach of fiduciary duties.⁸⁶ It is submitted that, directors who breached their fiduciary duties and thereby caused a loss to the company may be held personally liable for such loss, without the company having to prove negligence.⁸⁷ Similarly, director who made secret profit for themselves by not avoiding conflict of interest and those of the company are accountable for any such profit to the company, even though the company suffers no damage as a result of their conduct.⁸⁸

In our law, a plaintiff alleging breach of fiduciary obligations will bring an action based on breach of trust. One of the consequences of breach of the fiduciary duty is that a contract entered into in breach of the fiduciary duty will usually be voidable at the company's option.⁸⁹ The other consequence of breach of the fiduciary duty is that the director makes restitution to the company, either for loss suffered by the company, or for a benefit gained by the director.⁹⁰

4.2. Breach of duty of care, skill and diligence

Directors are expected to serve the corporation with reasonable care, diligence and skill and with utmost loyalty. A director fails to exercise the requisite due care, skill and diligence, or breaches any other provision of either the Company Act or the Memorandum of Association; he will be delictually liable for any loss, damage or cost sustained by the company as a result of the breach. The general principle in our law is that if a director fails to exhibit in the performance of his duties that

⁸⁵ I.e. personal liability of a director, claiming secret profits made by the director etc...

⁸⁶ This remedy was applied in *Sibex Construction (SA) (Pty) Ltd v Injectaseal CC* 1988 (2) SA 54 (T).

⁸⁷ Lombard S (2007) *Directors Duties to Creditors*. Thesis submitted in partial fulfillment for the Degree Doctor Legum. Pretoria; University of Pretoria Faculty of Law, P156.

⁸⁸ *Ibid*, P159.

⁸⁹ Jones E (2007) *Directors' Duties: Negligence and the Business Judgment Rule*. (2007) 19 *SA Merc LJ* 326–336 AT 334.

⁹⁰ *Ibid*.

degree of skill and care, which in the circumstance may reasonably be expected from a person of his knowledge and experience, he is liable to the company for any damages it may suffer in consequence. Failure to properly perform these duties may render a director personally liable to pay monetary damages.

Personal liability would arise if due diligence has not been observed in the conduct and management of the company affairs. Directors are expected to manage the corporation with reasonable diligence, care and prudence. They can be held personally or in association of others, liable for wilful dishonesty and negligence.⁹¹ Directors should keep themselves sufficiently informed about the general condition of their business and to some extent the manner in which it is conducted; if due to their fault or negligence, the corporate assets are wasted or lost, each of them may be held responsible for any loss proximately caused by the wrongful acts or omissions. Liability extends jointly and severally.

Broadly speaking, a director will be liable for direct or indirect loss, damage or costs sustained by the company if:

- a. he/she acts beyond the scope of his authority;
- b. he/she allowed the company to carry on business with the knowledge that it was being conducted recklessly, negligently and fraudulently, or with the knowledge that the company traded under insolvent circumstances;
- c. Being party to an act or omission of the company despite knowing that the act or omission was calculated to defraud a creditor, employee or shareholder, or had another fraudulent purpose.

⁹¹Blackman M S (1996) Companies. In WA Joubert (Ed) *the Law of South Africa*. Vol 4 part 2 in par 116n2.

However, directors cannot be held liable for mistakes or errors in the exercise of their business judgment, provided they act in good faith and with due care and prudence or diligence.⁹² A director who negligently breaches his duty of care will be personally liable to the company for the loss suffered as a result of such a breach. In *Benson v De Beers Consolidated Mines Ltd*⁹³ the court narrated the justification of the director's liability for the breach of duty of care as follows;

*'the duty of care doctrine and therefore the principle that an action for damages can be based on a breach of such duty resulting in damages being sustained, has been received in our law and grafted on to it as an extension of the principle of aquilian liability.'*⁹⁴

In an action based on a breach of a duty of care, the first enquiry is whether the defendant owed the plaintiff such a duty.⁹⁵ The test is whether such a duty exists in a particular case. In absence of such a duty, an act or omission cannot be wrongful or unlawful.⁹⁶ If such duty was owed, it must be determined whether it was breached and, if so, whether it was breached negligently, and if that is answered in the affirmative, whether the plaintiff suffered damages as a consequence of negligent breach of the duty and what extent thereof is.⁹⁷ A director's conduct which breached his duty of care may be condoned either by resolution of other board of directors or by court order.⁹⁸

⁹² *Fisheries Development Corporation of SA Ltd v Jorgensen, Supra* 165.

⁹³ 1988 (8) SA 834 (NC).

⁹⁴ At 836 as quoted by Van Dorsten *Supra*. P, 175.

⁹⁵ *Union Government v Ocean Accident and Guarantee Corporation Ltd* 1956 (1) SA 577 (A).

⁹⁶ *Ibid* at 558.

⁹⁷ See Van Dorsten *Supra*. P175 quoted with Approval *Administrator, Natal v Trust Bank van Africa Bpk* 1979 (3) SA 824 (A) at 833A.

⁹⁸ See detailed discussion in the next Chapter of this Dissertation.

CHAPTER 5

RELIEF FROM LIABILITY: THE BUSINESS JUDGMENT RULE

5.1. INTRODUCTION

Directors are expected to maintain profitability in a tough competitive market and in so doing, major business decision have to be made. Lombard⁹⁹ argued that, major corporate governance problem is the intricate balance between maximizing the efficiencies necessary to create wealth and ensuring that the controlling parties are accountable to the company. Having different examples of corporate collapse as a result of negligent management of affairs of companies lately, a consistent and unambiguous standard of directors liability, has become an urgent issue. Directors shall at all time act with due care, skill and diligence in conducting the business affairs of the company. A director owes the company a duty to act in good faith and with a duty of care, skill and diligence.¹⁰⁰ They are duty bound to observe this duty *ex lege*, at the same time, in an attempt to survive tough market competitions, create innovations and maximize profits for the benefit if the company, directors are required to take calculated risky business decision. Some of which may end up in collapse and prompting directors to incur personal liabilities as a result thereof.

Directors who breached their duty to act with care, skill and diligence shall be personally liable for the damages suffered as a result of their conducts.¹⁰¹ In determining the liability of directors for breach of duty of care, skill and diligence, the King Committee¹⁰² recommended the use of the so-called “business judgment rule” as a test for determination of a director’s personal liability for corporate collapse resulting from the breach of duty of care, skill and diligence.

⁹⁹ Lombard S, *supra*, p332.

¹⁰⁰ *Ibid*.

¹⁰¹ *Ibid*.

¹⁰² In their famous King III report on corporate governance in South Africa, Chapter 5, Par 39.

The business judgment rule provides that an officer is taken to have discharged their statutory and other duties of care, skill and diligence if they:

- Made a judgment in good faith;
- Did not have a material personal interest;
- Informed themselves to the extent they reasonably believed to be appropriate; and
- Rationally believed the judgment was in the best interests of the company. The belief will be rational unless it is a belief that no reasonable person would hold.¹⁰³

The business judgment rule applies to the process of directors' decision-making, and consists of a rebuttable presumption that in making business decisions, the directors of a company have acted on an informed basis, in good faith, and in the honest belief that the action taken was in the best interests of the company.¹⁰⁴ Havenga¹⁰⁵ argued that, It addresses the issues of both the honesty of directors and, to a limited extent (i.e., whether they have properly informed themselves as to the circumstances surrounding the particular decision), whether the director has breached the duty of care. This means that the rule usually serves to protect directors from liability to the company or to its shareholders for losses resulting from poor decision-making.

In order to encourage directors to act innovatory and efficiently, adequate protection to company directors in cases of collapse of reasonable and informed business deals is required in our law. The business judgment rule is one of them. As an alternative, some academic commentators¹⁰⁶ proposed that, one should look at corporate law measures providing relief from liability under specified circumstances.

¹⁰³ *ASIC v Rich* [2009] NSWSC 1229.

¹⁰⁴ Jones E *Supra*, P 236.

¹⁰⁵ Havenga M (2000) The Business Judgment Rule – Should We Follow the Australian Example? (2000) 12 *SA Merc LJ* 28.

¹⁰⁶ Lombard S, *supra*, p333.

Measures such as these play an important role in striking the balance between imposing liability on diligent directors, thus ensuring accountability, while providing freedom to take calculated business risks without the threat of personal liability, should the corporation fail. Protection such as these may serve to attract persons of the right calibre to serve on the boards of companies.¹⁰⁷

5.2. FORMULATION OF THE RULE

The business judgment rule can be outlined as a standard of non-review; entailing no review of the merits of a business decision corporate officials have made.¹⁰⁸ Business judgment rule¹⁰⁹ entails that, a director should not be liable for a breach of duty¹¹⁰ if he/she made a business judgment in good faith and if such decision was an informed decision, the decision which have taken all relevant factors including those beyond the business core values and risk into consideration, and decision which is rational and taken in the best interest of the Company.¹¹¹ As emphasised earlier, the business judgment rule was developed in the United States of America alongside the duty of care, skill and diligence and relates to one aspect of this duty, namely, decision making. The rule is a concept in company law whereby a *court will refuse to review the actions* of a company's board of directors in managing the company unless there is some allegation of *conduct that violates the director's duty of care, loyalty, or good faith or the decisions of the directors lack a rational basis*.¹¹² The rule creates a presumption in favour of the board of directors,

¹⁰⁷ Ibid.

¹⁰⁸ Ibid.

¹⁰⁹ Hereafter the 'Rule'.

¹¹⁰ This duty implies either the breach of a duty of care, skill and diligence or breach of fiduciary duties.

¹¹¹ Horn R C (2005) *the Legal Regulation of Corporate Governance with Reference to International Trends*. Thesis presented in Partial Fulfilment for the Degree of Masters of Laws: University of Stellenbosch.

¹¹² Italic and underlined words are my emphasis.

freeing the members of the board of directors from possible personal liability for decisions that result in harm to the company.¹¹³

To determine whether there was negligence in any of the conduct alleged, it is necessary to have regard to relevant aspects of a director's duty of care, skill and diligence. The extent of a director's duty of care, skill and diligence depends to a considerable degree of the nature of the company's business and on any particular obligations assumed by or assigned to a particular director, of course if he has reasonable grounds for believing such to be necessary, he ought to call for further meetings. Nowhere are his/her duties and qualifications listed as being equal to those of an auditor or accountant. Nor is a director required to have special 'business acumen or expertise, or singular ability or intelligence, or even experience in the business of the company. ... He is nevertheless expected to exercise the care which can reasonably be expected of a person with his knowledge and experience and as such a director is not liable for mere errors of judgment.'¹¹⁴

Furthermore, in applying this rule in any judicial proceedings, courts will not interfere in matters of business judgment, in which it is presumed that in exercising business judgments—reasonable care, skill and diligence—has in fact been exercised. Consequently, a director cannot close his eyes to what is going on about him/her in the conduct of business judgments that may have serious effects and implications on the company operations and thereby undermining the company's prospect of success.¹¹⁵

The business judgment rule only protects judgments made by directors, auditors and officers of companies, especially, decisions which are consciously made and

¹¹³Malokane M (2010) *The Introduction of Business Judgment Rule by the New Companies Act*. De Rebus; June 2010, p53.

¹¹⁴ *Fisheries Development Corporation of SA Ltd v Jorgensen and Another, Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd and Others* 1980 (4) (SA) 156 (W) at 165 – 166 B.

¹¹⁵ *Ibid.*

involve the exercise of corporate judgments. It is submitted that, failure to act (omission) seems not protected under the rule unless it is a decision taken by exercise of judgment. Accordingly, the rule does not protect omissions to act such as failure in oversight or monitoring.¹¹⁶ Thus, where directors have failed to exercise any financial oversight functions and the lack of any such system has enabled fraud by a subordinate official to occur, the rule's protection is unavailable and their conduct would be judged by reference to the duty of care standard.¹¹⁷

Courts have given directors wide latitude in the management of the affairs of the corporation provided that the judgment is *unbiased, honest and reasonably exercised*.¹¹⁸ Even if the director was negligent, in terms of the business judgment rule, he/she may be excused. Negligence must be determined at the time of the transaction. It is submitted that, mistakes or errors in the exercise of honest business judgments do not subject the officers and directors to liability for negligence in the discharge of their appointed duties. Directors are entrusted with the management of the affairs of the corporation only; provided that in the day to day management of the affairs of companies, a director is duty bound to scrutinise the implications of the decisions they are about to make and having considered all the relevant information at their disposal including recommendations of technical officers of the company, they are convinced that the decision is the only best viable option and its implementation will be in the best interest of the company.

Accordingly, If in the course of management the board of directors arrive at a decision for which there is a reasonable basis, and they acted *bona fidei*¹¹⁹ as a result of their independent judgment, and uninfluenced by any other consideration

¹¹⁶ Paul Redmond (1997) Safe Harbours or Sleepy Hollows: Does Australia Need A Statutory Business Judgment Rule? In Ramsay I, M (1997) *Corporate Governance and the Duties of Company Directors*. Centre for Corporate Law and Securities Regulation; Faculty of Law: The University of Melbourne, p200.

¹¹⁷ Ibid.

¹¹⁸ Emphasis is mine.

¹¹⁹ The term *bona fidei* implies that a director should act in good faith.

than what they honestly felt was in the best interests of the company, the business judgment rule becomes the doctrinal principle under which their breach of duty of care, skill and diligence as well as negligence may be condoned.¹²⁰

5.3. JUDICIAL JUSTIFICATION OF THE RULE

It is beyond debate that the business judgment rule only applies to director's decision making.¹²¹ There are different policy justifications for the existence of this rule. In order to understand the judicial application of the business judgment rule hereunder, one have to give regard to the arguments in favor of the rule over the years. It has been observed that policies underlying the business judgment rule include the protection of honest directors from liability where a decision turns out to have been an unsound one, and the prevention of the 'stifling of innovation and venturesome business activity'.¹²²

5.3.1. Judicial reluctance to interfere in the business decisions

Firstly, the judiciary is well known for its apparent reluctance to interfere with the management of affairs of companies.¹²³ There is the judicial concern that persons of reason, intellect and integrity will not serve as directors if the law expects from them a degree of prescience not possessed by people of ordinary knowledge. Even without pressing liability, qualified persons will not serve if their decisions can be a subject matter of court's review and thus second guessed at every business corner. Directors themselves may not be subject to review of their decisions by persons who may not be equipped to do so and further who may enjoy the unfair advantage

¹²⁰ Malokane, *ibid*.

¹²¹ *Aronson v Lewis* 473 A 2d 805 (Del 1984).

¹²² Havenga *Supra*, P28.

¹²³ *Horward Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821 832. Where the court expressed its views that, it would be wrong for the court to substitute its opinion for that of the management. Or to question the correctness of the management's decision as long as it was arrived at *bona fidei*.

of hindsight.¹²⁴ Questions like, should we buy a new truck today? Or should we give Eliaser a pay raise, are simplistically, types of business judgments which the rule was developed to protect. Courts have no place substituting their judgments for that of the directors. It is submitted that, corporate governance principles recognized corporate power and competence to be lodged primarily with the board of directors. A resolution or transaction pursued within the corporate powers and business operations of the corporation, and passed in good faith by the board is valid and binding, and generally courts have no authority to review the same or substitute their own judgment which may be flawed with theoretical reasoning's as opposed to practical applications of business judgments by those entrusted with the management of the institutions.

5.3.2. Risk taking encouragement

The second rationale is to encourage the type of informed and calculated risk - taking with which corporate enterprise is undertaken especially in increasingly tough market competitions, without the fear of personal liability continuously hanging over their heads.¹²⁵ The aims is to encourage directors to take calculated business risks in an attempt to maximize profits, survive competitive markets and at the same time ensure that the companies they serve becomes a successful concern.

5.3.3. Decisions on incomplete information

Thirdly, on a more fundamental level, courts are ill equipped to discredit and examine business decisions. Company directors make many decisions on the basis of incomplete information, intangibles such as experience or intuition and wide ranging general considerations such as consumer preferences, local and regional economic trends and competitive outlook. Even if courts were able to assemble

¹²⁴ Lombard, *Supra*, P352.

¹²⁵ *Ibid.*

before them sufficient data on these topics, most courts would feel ill at ease in re-evaluating that data.¹²⁶

5.3.4. Management to managers' principle

Fourthly, the rule represents a well established judicial policy of leaving management to managers and a reluctance to undertake or second guess business decisions. The directors need certainty in taking business decisions; that is to say that at the time when they took business decisions, that if specified prerequisites are met and that their decisions will be beyond challenge. The business judgment rule may well fulfill just that.¹²⁷ This position is raised on what they call 'directors sovereignty', a company law principle that was recognized in the famous case *Smith v. Van Gorkom*¹²⁸ that the 'business judgment rule is the offspring of the fundamental principle that the business and affairs of a Delaware corporation are managed by or under its board of directors.'... The business judgment rule exists to protect and promote the full and free exercise of the managerial power granted to Delaware directors. In other words, the rule ensures that the default is deference to the board's authority as the corporation's central and final decision maker.

5.4. APPLICATION OF THE BUSINESS JUDGMENT RULE

It has been emphasized that, it is the mission of company directors to make and implement all operations and decisions that allow the companies to develop its social and commercial purposes and become a successful concern. Directors oversee the performance of the corporation; they appoint and remove the senior managers; they draw and execute the company's financial objectives and in general the major operations of the company.¹²⁹ Briefly, the business judgment rule has

¹²⁶ Ibid.

¹²⁷ Farrar M (1993) Corporate Governance, Business Judgment and Professionalism of Directors. 1993, Volume 6; *Corporate and Business Law Journal* 1 23-24.

¹²⁸ 488 A.2d 858 (Del. 1985).

¹²⁹ Bainbridge A, Stephen M (2004) the Business Judgment Rule as Abstention Doctrine. 2004 *Vanderbilt Law Review*, 57 Vand. L. Rev.p, 83.

been defined as a doctrine that protects officers and directors from personal liability only if they have acted in good faith but nonetheless breached their duty of due care, skill and diligence within the officer or director's authority. The rule becomes a shield for directors against liability imputations.¹³⁰ Even though the understanding of the rule is very similar in the countries that have recognized it, its model of application may vary substantively. This paper focuses on the application of the rule in both Namibia and South Africa.¹³¹

The rule is applicable to directors and officers acting within such business judgments and as such cannot be personally be held liable for the consequences of such acts.

- Exceptions:
 - i. When the director wilfully and knowingly vote for patently unlawful acts of the corporation;
 - ii. When he is guilty of gross negligence or *mala fidei* and;
 - iii. When he acquires any personal or pecuniary interest in conflict with his duty as such directors.

It has been suggested the business judgment rule is not only a substantial rule of law, but also a rule of evidence. That is to say that, any director invoking any defence on the basis of this rule shall substantiate such defence with evidence. Once entered into by the board in the exercise of its judgment, it will be presumed to be valid.

¹³⁰ Laguado, *Supra*, P118.

¹³¹ The main reason for the discussion of the Namibian and South African authorities interchangeably is very simple. Both jurisdictions previously shared the same company legislations, i.e. the Companies Act 61 of 1973. Moreover, the law applied in South Africa became applicable immediately in Namibia at the date of independence, unless otherwise repealed by an Act of Parliament.

The business judgment rule is only applied to protect directors if they have informed themselves prior to making a business decision, of all material information reasonably available to them and that having become so informed, they acted with the requisite care, skill and diligence. It is submitted that this is a low standard of care.¹³² It has been argued and in my view rightly so that, for the rule to apply, first, the *director must have made a decision*; second, *he or she must be free of self interest in the judgment*; third, *he or she must adopt the decision under informed basis*; and lastly, *the director must have had a rational¹³³ basis for the decision*.¹³⁴ Rational basis in this respect means that in taking business decisions, a director must evaluate all available option, weight their implications and base his/her decision on those options.

Furthermore, Laguado¹³⁵ argued that, the rule constitutes a 'safe-harbour' to which directors can apply if they can prove that the requirements of the rule are fulfilled. It should be noted that, the burden of proof is on the directors to show to the court that they have taken all relevant factors in consideration at the time of making a business judgment and having considered so, the decisions taken was in the best possible and reasonable viable in the *best interest* ¹³⁶of the company.

¹³² See discussion on the standard required hereunder.

¹³³ Rational have been defined in the decision making process as follows; "The thought process of selecting a logical choice from the available options. When trying to make a good decision, a person must weight the positives and negatives of each option, and consider all the alternatives. For effective decision making, a person must be able to forecast the outcome of each option as well, and based on all these items, determine which option is the best for that particular situation. See <http://www.businessdictionary.com/definition/decision-making.html>, last accessed 25 July 2011.

¹³⁴ Branson S, Douglas M (2002) The Rule that isn't a Rule - the Business Judgment Rule. 2002, 36 Vol. A. *U.L. Rev.* 631, p 634.

¹³⁵ *Supra*, P230.

¹³⁶ Underlinings are my emphasis. It is submitted that, the phrase "*best interest*" of the company implies a high standard degree of consideration and evaluation of business judgments. As was stated by Scott J in *Da Silva v CH Chemicals (Pty) Ltd* 2008 (6)SA (SCA) at Para 18, "*it is a well established rule of company law that directors have fiduciary duty to exercise their powers in good faith and in the best interest of the company. Interest in this case is only those of the company itself as a corporate entity and those of its members as a body as such.*"

In application of the rule in any judicial proceedings, the rule is rather seen as a presumption that the directors have met the various criteria in the decision making context. These criteria constitute the essential elements of the business judgment rule, namely, (a) that the directors obtained the necessary required information before any business decision is taken; (b) that they acted with the required degree of care in making the decision that, the directors acted in genuine good faith; and (c) that they ensured the absence of personal interests.¹³⁷ In simplest words, the plaintiff have to overcome the presumption that the directors complied with these criteria to be successful with an action against directors. Consequently, if they fail to do so, the action will also fail.¹³⁸

(a) The Standard of Care Test

In applying the business judgment rule, an action based on a director's breach of the duty of care, skill and diligence must necessarily involve an inquiry into the relevant standard of care. In South Africa (including Namibia) and the United Kingdom, the standard of care test is based on *dictum* in *Re City Equitable Fire Insurance Co Ltd*¹³⁹ where Romer J concluded that, firstly, 'a director need not exhibit in the performance of his duties a greater degree of skill than may reasonably be expected from a person of his knowledge and experience, and secondly, a director is 'not bound to give continuous attention to the affairs of his company.'¹⁴⁰ It is submitted that the first part of Romer J's judgment could be justified and reasonable. However, in view of the fact that the directors are imposed with the duty of care, skill and diligence, it is imperative that an executive director shall give continuous attention to the affairs of the company.¹⁴¹ The court is not concerned to enquire on the financial wisdom of the director's decisions. But

¹³⁷ Lombard, *Supra* p346.

¹³⁸ *Ibid*.

¹³⁹ [1925] Ch 407 at 428.

¹⁴⁰ Jones, *Supra*, P335.

¹⁴¹ *Fisheries* case *supra* at 165-166 per Nargo J.

in deciding whether the duty of care, skill and diligence has been observed, the court may properly consider whether in the circumstances a reasonable man could have believed a particular act was in the best interest of the company.¹⁴²

In respect of all duties that may properly be left to some other official, a director is, in the absence of specific grounds for suspicion, justified in trusting certain officials to perform such duties honestly. A director is entitled to accept and rely on the judgment, information and advice of the management, unless there are proper reasons for questioning such advice and reasonable grounds to divert there from. Obviously, a director exercising reasonable care, skill and diligence would not accept information and advice blindly.¹⁴³ He would accept it, and he would be entitled to rely on it, but he would give it due consideration and exercise his own judgment accordingly. This argument is based in the director's reliance on professional advice from the officials who are equipped with special expertise in specific subject matters that affects the operations and profit margins of the company. I.e. a director would rely on the professional legal advice provided by the company's legal advisor. A prudent director holding the office of directorship shall evaluate the advice provided; weigh its implication before a business judgment is taken. It would thus follow that the decision to be taken will be an informed one.

¹⁴² *Charterbridge Corporation Ltd v Lloyds Bank Ltd* [1970] Ch 62 at 74.

¹⁴³ See *Fisheries Development Corporation case Supra, Benson v De Beers Consolidated Mines Ltd* 1988(1) 834 (NC) at 836.

CHAPTER 6

STATUTORY RELIEF FROM LIABILITY: SECTION 256 IN PERSPECTIVE

6.1. INTRODUCTION

As a generally, directors may be personally liable for any civil damages suffered by the company in cases where they are in breach of their duty of care, skill and diligence in managing the affairs of the companies they are entrusted with.¹⁴⁴ As discussed in the previous chapter of this dissertation, our law employed a mechanism¹⁴⁵ which aims to protect honest directors whose decision have lead to corporate collapse. In terms of section 256 (1) of the Companies Act,¹⁴⁶ any proceedings for breach of duty or negligence, if it appears to court that a director acted honestly and reasonably, he may be excused from personal liability if in the opinion of the court and all surrounding circumstances he/she ought fairly to be excused. This section is similar to section 248¹⁴⁷ of the previous Companies Act.¹⁴⁸ It should be noted that, any reference to section 248 in this chapter shall be construed or bear the same meaning as section 256 of the new Companies Act. ¹⁴⁹Section 256 (1) provides as follows;

“256. (1) If in any proceedings for negligence, default, breach of duty or breach of trust against any director, officer or auditor of a company it appears to the Court that the person concerned is or may be liable in respect of the negligence, default, breach of

¹⁴⁴ See Chapter 3 above; consequences for breach of duties of directors.

¹⁴⁵ The Business Judgment rule in specific.

¹⁴⁶ Act no 28 of 2004 (the new companies Act).

¹⁴⁷ Section 248 (1) provides as follows: “Relief of directors and others by Court in certain cases”

“ (1) If in any proceedings for negligence, default, breach of duty or breach of trust against any director, officer or auditor of a company it appears to the Court that the person concerned is or may be liable in respect of the negligence, default, breach of duty or breach of trust, but that he has acted honestly and reasonably, and that, having regard to all the circumstances of the case, including those connected with his appointment, he ought fairly to be excused for the negligence, default, breach of duty or breach of trust, the Court may relieve him, either wholly or partly, from his liability on such terms as the Court may think fit.”

¹⁴⁸ The Old Companies Act (old Act).

¹⁴⁹ Act No 61 of 1977 (the old Companies Act).

duty or breach of trust, but that he or she has acted honestly and reasonably, and that, having regard to all the circumstances of the case, including those connected with his or her appointment, he or she ought fairly to be excused for the negligence, default, breach of duty or breach of trust, the Court may relieve him or her, either wholly or partly, from his or her liability on terms which the Court considers appropriate.”

“(2) Any director, officer or auditor who has reason to believe that any claim will be made against him or her in respect of any negligence, default, breach of duty or breach of trust, may apply to the Court for relief, and the Court has, on that application, the same powers to grant relief as are by subsection (1) conferred on it with reference to proceedings referred to in that subsection.”

It is submitted that the new Companies Act thus introduces or codifies the business judgment rule into Namibia Company law. The section enables total or partial relief from liability in proceedings or apprehended proceedings for negligence to be granted to a director of a company where it appears to the court that he acted honestly and reasonably in the circumstance the court thinks fit.¹⁵⁰ It should be noted that, special circumstance must exist for the above provision to be applicable. This provision may not apply to all cases involving director’s breach of duties which causes damages to the company.

In *Niagara Ltd v Langerman*,¹⁵¹ the court held that, special circumstances will have to prevail before the court grant this relief. The court should establish that director

¹⁵⁰ Phillip M et al (1985) *Henochsberg on the Companies Act*. Durban: Butterworth, p385.

¹⁵¹ 1913 WLD188.

acted honestly and reasonably, and that having regard to all the circumstances of the case, including those connected with his appointment, he ought to be fairly excused.¹⁵²

6.2. APPLICATION OF SECTION 256

As a general rule, it is beyond dispute that anyone who injures another either by fraud (*dolus*) or negligence (*culpa*) is of course personally liable to the victim in terms of the common law remedies respectively deriving from the *actio doli* and the *actio legis Aquiliae* for the patrimonial loss resulting from the fraud or negligence.¹⁵³ Section 256¹⁵⁴ allows the court to enquire on the reasonability of the business decision that injures another and where it is found that the directors acted unreasonably, the court will refuse to grant the relief and the director's immunity to liability flows away. The relief may be granted on such terms as the court thinks fit. A director accused of breach of duty of care, skill and diligence and breach of any other fiduciary duty at common law should therefore be entitled to the relief in terms of the provisions of section 256

Henochsberg¹⁵⁵ suggest that, on the ordinary meaning of the language in section 248,¹⁵⁶ means the provision of the Act apply to proceedings by anyone against a director, provided that they are proceedings for *negligence, breach of duty or breach of trust*¹⁵⁷ by defendant in his capacity as director of the company. However, In *Ex Parte Lebowa Development Corporation Ltd*¹⁵⁸ the court concluded that section 248 empowers the court to grant relief, firstly against a claim by the company itself (or its liquidators) and secondly, against criminal liability. The court

¹⁵² Cilliers *Supra*, P160.

¹⁵³ *Ex Parte Lebowa Development Corporation Ltd* 1989 (3) SA 71 at 1061-J.

¹⁵⁴ Section 248 of the Old Act.

¹⁵⁵ Phillip M et al, *supra*.

¹⁵⁶ With specific reference to section 248 of the Old Act.

¹⁵⁷ Emphasis is mine.

¹⁵⁸ *Supra*, at 107F-G.

further held that section 248¹⁵⁹ does not empower the court to grant relief to a director against claims by third parties such as creditor of the company.¹⁶⁰ This section therefore, of no comfort to a director or other officers of a company when faced with a claim made against them personally by creditors of the company for damages suffered by the creditors as a result of the negligence or breach of duty by that director. The only relief a director can get under s248 (if any relief at all can be justified) is the relief from liability to the company itself (not outsiders) and from criminal accountability.

It is submitted however, that, there seems to be an oversight in respect of the application of section 248 in *Ex Parte Lebowa case*¹⁶¹ above. It is submitted that, the remedy as provided for in the context of the provision shall not only be available to proceedings brought by the company itself. Reasonably speaking, in my view, the grammatical meaning of the later provision relates to the court's power to relieve directors from personal liability. It is immaterial whether such proceedings were brought by the company itself and its members or by the creditor.

There are three requirements that a director who seeks relief must satisfy before such relief is granted, namely, that the person concerned;

- a. Acted honestly;¹⁶²
- b. Reasonably and;
- c. Ought fairly to be excused.

¹⁵⁹ Section 256 of the New Act.

¹⁶⁰ Ibid At 107H.

¹⁶¹ *Supra*, FN158.

¹⁶² In *Re J Franklin & Son Ltd* 1937 4 All ER 43 47, it was said by way of an *orbiter dictum* that honesty in this section means "without direct motive", and that where directors act recklessly, but without considering the interest of the company, they may said to have acted dishonestly.

The requirement that the director acted honestly and reasonably means that, the court is not empowered to relieve a director from any liability resulting from fraudulent conduct on his part. However, difficulty arises with the requirement that the director must have acted *reasonably* where such liability sought to be relieved from by the director arises from negligence. Stegman J¹⁶³ expressed his difficulty in the following terms:

“The provision...envisages a situation in which a director’s act or omission may be found to be both *negligent and reasonable*¹⁶⁴ at one and the same time. since an act (or omission) is only negligent if it is something which would not be done (or left undone) by a reasonable man acting reasonably, there is some uncertainty as to what the legislature have had in mind when it empowered the court to relieve a director from liability to the company for his negligence, provided that he acted ‘reasonably’. The concept of reasonable negligence appears on the face of it to be self contradictory.”

It has been suggested that, the legislature may have intended that the court’s readiness to find that a director who has been guilty of negligence has nevertheless acted reasonably, should vary inversely to the degree of negligence proved. Even where it is accepted that the person concerned acted honestly and reasonably, even a technical effect may in the circumstances be such that he ought not fairly to be excused.¹⁶⁵

Furthermore, the protection envisaged in sub section (1)¹⁶⁶ has to be made by a way of a defence. The burden of proof then rest on the person seeking relief to establish

¹⁶³ In *Ex Parte Lebowa* ibid at p108E-F.

¹⁶⁴ My emphasis.

¹⁶⁵ Blackman et al (2003) Commentary on the Companies Act. *LAWSA*, Vol.4(1),par 158, P288.

¹⁶⁶ As quoted herein above.

on a balance of probabilities his entitlement to such relief.. The defendant has to show that he acted honestly, reasonably and that he ought fairly to be excused.¹⁶⁷

On the other hand, sub section (2) give the right to a director to *mero motu* ask the court to excuse him/her from personal liability as a result of corporate collapse of his/her commercial decisions. It is submitted that, sub rule (2) is applied by way of motion proceedings. That is to say that, an application brought by notice of motion setting out the grounds upon which the court shall exercise its discretion to relief a director. Some commentators suggested that, some trends in the exercise of judicial discretion can be identified.

In summary, a director may partially succeed under section 256 and the business judgment rule if:

- the director (or a related party) did not stand to personally benefit from the breach;
- the director did not actually know or was not wilfully blind as to the “wrongfulness” of his conduct;
- The director did not deviate greatly from commercial standards of reasonableness.

6.3. CONTRAST OF SECTION 256 AND THE BUSINESS JUDGMENT RULE

Section 256 is slightly distinct from the business judgment rule. The business judgment rule, provides that directors or other officers of a corporation who make a business judgment are taken to meet the requirements of the common law duty to exercise care, skill and diligence, in respect of any decision and if they:

¹⁶⁷ *Niagara Ltd v Langerman* ibid.

- make the judgment in good faith for a proper purpose;
- do not have a material personal interest in the subject matter of the judgment;
- inform themselves about the subject matter of the judgment to the extent they reasonably believe to be appropriate; and
- Rationally believe that the judgment is in the best interests of the corporation.

Therefore, should their decisions which meet the above criteria lead to corporate collapse, the court is empowered to relieve them from civil liability. The business judgment rule does not require the exercise of discretion and vindicates the director's decision. It only operates in respect of the duty of care, skill and diligence and the equivalent duties at common law and equity. In contrast, section 256 presupposes that the director is otherwise liable and is discretionary only.¹⁶⁸

The business judgment rule is concerned with the judicial non-review policy of the decisions of the directors whereas section 256 only deals with the relief granted to directors for breach of either the duty of care, skill and diligence or the common law fiduciary duties of directors. It is submitted that, section 256 requires an investigation of the conducts of the directors in order to determine the reasonability of their decision before the court exercise its discretion to grant relief.¹⁶⁹ The business judgment rule is developed alongside with the specific duty of care, skill and diligence, whereas the application of section 256 involves breach of all common law duties of directors.

¹⁶⁸ Wong S (2009) *Forgiving a Director's Breach of Duty: A review of recent decisions*. http://cclsr.law.unimelb.edu.au/files/stevenwong_essay_6_May_20091.pdf: Last accessed 21 July 2011 at 15h03.

¹⁶⁹ *Ibid.*

CHAPTER 7

CONCLUSION

7.1. INTRODUCTION

The purpose corporate law is for permitting the economy to be advantaged by such entrepreneurial ventures with limited liability and to regulate the rights of members *inter se*, the rights between members and creditors of corporations. However, in determination of civil liabilities of company directors, the law must strike a balance between allowing directors entrepreneurial freedom and holding delinquent directors liable for their mistakes.¹⁷⁰ It is clear within this paper that directors assume some duties when take up the office of directorship with the companies. Directors make corporate decisions and exercised business judgments in order to achieve maximum profitability and improve on their performances. In making business decisions, directors are imposed with the duty of care, skill and diligence. However, it must be emphasised that, directors need protection to instil confidence and encourage innovations in making business decisions. *Innovation*, entrepreneurial freedom, and collaboration are key aspects of any transition to sustainability – innovation provides new ways of doing things, including profitable responses to sustainability; fairness is vital because social injustice is unsustainable; and collaboration is often a prerequisite for large scale change.¹⁷¹

Evidently, the business judgment rule was developed to limit the extent of the application of the duty of care, skill and diligence of company directors. It is submitted that, the functions of the judiciary must not be that of making business decision. Therefore, in any proceedings involving personal liabilities of directors, the court must assume that the decision was made in *good faith, reasonably* and in

¹⁷⁰Wong S (2009) *Forgiving a Director's Breach of Duty: A review of recent decisions*. http://cclsr.law.unimelb.edu.au/files/stevenwong_essay_6_May_20091.pdf: Last accessed 21 July 2011 at 15h03.

¹⁷¹ King III Report. *ibid*, P13.

an honest belief that such decision was in the best interest of the company. The burden proof lies with any person who allege that a particular director breached his/her duty of care, skill and diligence; and the defendant on the other side is vested with the burden to prove that the business judgment was made in a reasonable and honest believe that it is in the best interest of the company despite its corporate collapse. The purpose of section 256 on the other hand is to protect honest and prudent directors from the unfair operation of penalty provisions in companies' legislation. It recognizes directors must take risks in making commercial decisions and assists the application of the business judgment rule.

7.2. RELIEF FROM LIABILITY: ADEQUATE PROTECTION TO DILIGENT COMPANY DIRECTORS?

Following the interpretation and application of the rule and statutory relief in terms of section 256 above, the following could be possible threats to the protection afforded to directors in terms of the business judgment rule and section 256;

7.2.1. It is clear from the chapters¹⁷² above that there is an uncertainty on the application of the statutory provision to relieve directors from personal liability. In *Ex Parte Lebowa Development Corporation Ltd*¹⁷³ the court concluded that the section empowers the court to grant relief, firstly against a claim by the company itself (or its liquidators) and secondly, against criminal liability. Whereas *Customs and Exercise Commissioners* case¹⁷⁴ opines that the remedy as provided for in the context of the provision shall only be available to proceedings brought by the company itself, uncertainty therefore

¹⁷² Chapter 5.

¹⁷³ *ibid*.

¹⁷⁴ *Supra*, FN158.

exist as to whether the remedy is applicable in all proceedings against directors by anyone (including the third parties, i.e. creditors) or whether their application is limited to proceedings against directors specifically instituted by the company itself.¹⁷⁵ It is submitted that, although there may be uncertainty in respect of the application of section 256, most commentators¹⁷⁶ are of the view that, this remedy should be available to actions of directors on the basis that they breached their duty of care, skill and diligence and therefore, any action brought by anyone including third parties shall be tested against section 256. It thus follow to say that section 256 and the business judgment rule shall protect diligent company directors provided that they acted honestly and reasonably in making the business decisions in question.

7.2.2. Another possible argued threat to the directors against the defence of the business judgement rule and section 256 is the ground that, a person who acted *negligently* may be relieved from liability if it can be shown that he acted *reasonably*.¹⁷⁷ The question that may be challenging in our law is that - how can one be reasonable if he/she have already been found negligent, which presupposes a deviation from the standard of the reasonable man/director? Lombard¹⁷⁸ suggests that, when a decision has to be made on whether relief should be granted in respect of *negligence*, the term '*reasonably*' should be interpreted to mean understandably. Lord Hoffman in one of the

¹⁷⁵ *Customs and Exercise Commissioners v Heldon Alpha Ltd* [1981] 2 All ER 697 (CA).

¹⁷⁶ Lombard supra, Jones Supra.

¹⁷⁷ The underlining is my emphasis.

¹⁷⁸ *Supra*, p342, quoting with approval Honochberg 461, with reference to *Niagra Ltd v Langerman* 1913 WLD 188; *Selangor United Rubber Estates Ltd v Cradock* (3) [1968] ALL ER 1073, a director wishing to avail himself of the relief offered in terms of s128 will to prove on a balance of probabilities that he acted honestly, reasonably and he ought fairly to be excused.

English courts¹⁷⁹ expressed the above difficulty in the following terms; “It may seem odd that a person found to have been guilty of negligence, which involves failing to take reasonable care, can ever satisfy a court that he acted reasonably. Nevertheless, the section clearly contemplates that he may do so and it follows that conduct may be reasonable for the purposes of s 727¹⁸⁰ despite amounting to lack of reasonable care at common law.” Whether this suggestion adequately protects the innocent directors, it is a question which requires further research and interpretation within our judiciary.

- 7.2.3. A further problem that seems to threaten the safety of the directors is the uncertainty as to the extent of the court’s discretion to grant relief to the directors. This is indicated by phrases granting a wide and flexible discretion to the court hearing the matter, for example that a director ought “fairly be excused...., having regard all circumstances of the case.” Lombard¹⁸¹ further argued that, the absolute discretion in the provision of section 256 that a court “*may relieve*” a director under these circumstances. Therefore, the effect of this provision and a threat to the protection granted to the directors is that, even if the director acted honestly and reasonably, there seems to be no guarantee that he/she will escape personal liability. However, it is submitted that even though the discretion of the court to excuse directors may appear wide and absolute, it should be exercised judiciously. That is to say that the court is bound to consider all the relevant factors and having investigated the circumstances upon which the director made the business judgment and so acted

¹⁷⁹ *Re D'Jan of London Ltd; Copp v D'Jan* [1994] 1 BCLC 561.

¹⁸⁰ Companies Act 1985.

¹⁸¹ *Supra*, P344

honestly and reasonably, the court will have no other choice than to excuse such a director.

7.2.4. Moreover, if we take the business judgment rule which is a policy of judicial non-review; and in light of the fact that the courts are reluctant to pronounce on the wisdom of managerial decisions, it is quite possible that directors are in a much more favourable position to obtain relief from personal liability where the relief depends on the discretion of the court.¹⁸² Therefore, a strict statutory framework in respect of which circumstances the court is placed under the obligation to grant relief may work against innocent directors. It is submitted that the fact that the relief granted by the court is discretionary does not justify the conclusion that the protection afforded in terms of both common law business judgment rule and statutory relief under section 256 is not adequate. In my view, with the discretion in the hands of the courts potentially affords directors a wide protection than would have been available had the court been obliged to grant relief within a strict regulatory framework.

It is now clear that directors owe their companies the duty of care, skill and diligence, in terms of which directors must manage the business of the company as a reasonably prudent person would manage his own affairs. The standard of care is a mixed objective and subjective test, in the sense that the minimum standard is that of a reasonably prudent person but a director who has greater skills, knowledge or experience than the reasonable person must give to the company the benefit of those greater skills, knowledge and experience. However, it is also clear that directors need protection against action of the companies which may attract

¹⁸² *ibid*

personal liabilities. Innovations, imitations and profitability are some of the feature that dominates the mind of the directors in running the operations of the companies. It should be noted that, as much as the directors are imposed with the duty to act with care, skill and diligence in managing the affairs of companies, so as they are equally imposed with the duty to ensure that the entities they manage becomes a successful concern and therefore, the pressure is placed on directors to maximise all efforts to clinch the ladder to profitability including taking calculated risk. , it is submitted that, In any proceedings involving breach of duty or negligence by directors of any company, the courts should not only consider the decision taken by the directors, but in totality, the court must look at the nature of complexity of the company operations, nature of its profitability and evaluate the risk taken by the directors, should the decision found to be irresponsible one, any defence raised in terms of either the business judgment rule or section 256 must fail.

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