PERSONAL LIABILITY OF DIRECTORS
UNDER
THE OLD COMPANIES ACT 61 OF 1973
AS WELL AS
THE COMPANIES ACT 71 OF 2008

presented by

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INTRODUCTION

This lecture deals in the main with the rendering of “directors” personally liable for loss, damage, a debt or debts of a company.

For convenience I will refer to the repealed 1973 Companies Act as the Old Companies Act or the Old Act and the 2008 Companies Act as the New Companies Act or New Act.

Before the New Companies Act came into effect on 1 May 2011 and in dealing with the rendering of directors personally liable for the debt or debts of a company one relied on the provisions of the Old Companies Act

After May 2011 we now rely on two Acts

➢ The Old Companies Act
➢ The New Companies Act

Is this an improvement on the pre May 2011 position or is it now more difficult to render directors personally liable? Hopefully this lecture addresses this question.

At present there are potentially four methods or ways of rendering directors liable:

1. Under Section 424 of the Old Companies Act;

2. In terms of Section 22(1) as read with Section 77(3)(b) of the New Act. This is for carrying on a business recklessly, with gross negligence or with intent to fraud;

3. For breach of fiduciary duties (common law / statutory duties).

4. For breach of duty of care (i.e common law delict);
APPLICABLE SECTIONS OF THE ACTS

1. **Per The Old Companies Act**

1.1 Section 424(1) and (3) which reads as follows:

   **424 Liability of directors and others for fraudulent conduct of business**

   (1) When it appears, whether it be in a winding-up, judicial management or otherwise, that any business of the company was or is being carried on recklessly or with intent to defraud creditors of the company or creditors of any other person or for any fraudulent purpose, the Court may, on the application of the Master, the liquidator, the judicial manager, any creditor or member or contributory of the company, declare that any person who was knowingly a party to the carrying on of the business in the manner aforesaid, shall be personally responsible, without any limitation of liability, for all or any of the debts or other liabilities of the company as the Court may direct.

   (2) ... 

   (3) Without prejudice to any other criminal liability incurred, where any business of a company is carried on recklessly or with such intent or for such purpose as is mentioned in subsection (1), every person who was knowingly a party to the carrying on of the business in the manner aforesaid, shall be guilty of an offence.

2. **Per The New Companies Act**

2.1 Sections 20(6)(a), 22(1), 75, 76, 77, 78(3)(a) and (b) and 218(2)

   **20(6) Each shareholder of a company has a claim for damages against any person who intentionally, fraudulently or due to gross negligence causes the company to do anything inconsistent with—**

   (a) this Act;

   **22(1) A company must not carry on its business recklessly, with gross negligence, with intent to defraud any person or for any fraudulent purpose.**

   **75. Director’s personal financial interests.—**

   (1) **In this section—**

   (a) “director” includes—
(i) an alternate director;
(ii) a prescribed officer; and
(iii) a person who is a member of a committee of the board of a company, irrespective of whether the person is also a member of the company’s board; and

(b) “related person”, when used in reference to a director, has the meaning set out in section 1, but also includes a second company of which the director or a related person is also a director, or a close corporation of which the director or a related person is a member.

(2) This section does not apply—

(a) to a director of a company—

(i) in respect of a decision that may generally affect—

(aa) all of the directors of the company in their capacity as directors; or

(bb) a class of persons, despite the fact that the director is one member of that class of persons, unless the only members of the class are the director or persons related or inter-related to the director; or

(ii) in respect of a proposal to remove that director from office as contemplated in section 71; or

(b) to a company or its director, if one person—

(i) holds all of the beneficial interests of all of the issued securities of the company; and

(ii) is the only director of that company.

(3) If a person is the only director of a company, but does not hold all of the beneficial interests of all of the issued securities of the company, that person may not—

(a) approve or enter into any agreement in which the person or a related person has a personal financial interest; or

(b) as a director, determine any other matter in which the person or a related person has a personal financial interest,

unless the agreement or determination is approved by an ordinary resolution of the shareholders after the director has disclosed the nature and extent of that interest to the shareholders.

(4) At any time, a director may disclose any personal financial interest in advance, by delivering to the
board, or shareholders in the case of a company contemplated in subsection (3), a notice in writing setting out the nature and extent of that interest, to be used generally for the purposes of this section until changed or withdrawn by further written notice from that director.

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

(a) must disclose the interest and its general nature before the matter is considered at the meeting;

(b) must disclose to the meeting any material information relating to the matter, and known to the director;

(c) may disclose any observations or pertinent insights relating to the matter if requested to do so by the other directors;

(d) if present at the meeting, must leave the meeting immediately after making any disclosure contemplated in paragraph (b) or (c);

(e) must not take part in the consideration of the matter, except to the extent contemplated in paragraphs (b) and (c);

(f) while absent from the meeting in terms of this subsection—

(i) is to be regarded as being present at the meeting for the purpose of determining whether sufficient directors are present to constitute the meeting; and

(ii) is not to be regarded as being present at the meeting for the purpose of determining whether a resolution has sufficient support to be adopted; and

(g) must not execute any document on behalf of the company in relation to the matter unless specifically requested or directed to do so by the board.

(6) If a director of a company acquires a personal financial interest in an agreement or other matter in which the company has a material interest, or knows that a related person has acquired a personal financial interest in the matter, after the agreement or other matter has been approved by the company, the director must promptly disclose to the board, or to the shareholders in the case of a company contemplated in subsection (3), the nature and extent of that interest, and the material circumstances relating to the director or related person’s acquisition of that interest.
(7) A decision by the board, or a transaction or agreement approved by the board, or by a company as contemplated in subsection (3), is valid despite any personal financial interest of a director or person related to the director, only if—

(a) it was approved following disclosure of that interest in the manner contemplated in this section; or

(b) despite having been approved without disclosure of that interest, it—

(i) has subsequently been ratified by an ordinary resolution of the shareholders following disclosure of that interest; or

(ii) has been declared to be valid by a court in terms of subsection (8).

(8) A court, on application by any interested person, may declare valid a transaction or agreement that had been approved by the board, or shareholders as the case may be, despite the failure of the director to satisfy the disclosure requirements of this section.

76. Standards of directors conduct.—

(1) In this section, “director” includes an alternate director,

(a) a prescribed officer; or

(b) a person who is a member of a committee of a board of a company, or of the audit committee of a company,

irrespective of whether or not the person is also a member of the company’s board.

(2) A director of a company must—

(a) not use the position of director, or any information obtained while acting in the capacity of a director—

(i) to gain an advantage for the director, or for another person other than the company or a wholly-owned subsidiary of the company; or

(ii) to knowingly cause harm to the company or a subsidiary of the company; and

(b) communicate to the board at the earliest practicable opportunity any information that comes to the director’s attention, unless the director—

(i) reasonably believes that the information is—

(aa) immaterial to the company; or

(bb) generally available to the public, or known to the other directors; or

(ii) is bound not to disclose that information by a legal or ethical obligation of confidentiality.
Subject to subsections (4) and (5), a director of a company, when acting in that capacity, must exercise the powers and perform the functions of director—

(a) in good faith and for a proper purpose;
(b) in the best interests of the company; and
(c) with the degree of care, skill and diligence that may reasonably be expected of a person—

(i) carrying out the same functions in relation to the company as those carried out by that director; and

(ii) having the general knowledge, skill and experience of that director.

In respect of any particular matter arising in the exercise of the powers or the performance of the functions of director, a particular director of a company—

(a) will have satisfied the obligations of subsection (3) (b) and (c) if—

(i) the director has taken reasonably diligent steps to become informed about the matter;

(ii) either—

(aa) the director had no material personal financial interest in the subject matter of the decision, and had no reasonable basis to know that any related person had a personal financial interest in the matter; or

(bb) the director complied with the requirements of section 75 with respect to any interest contemplated in subparagraph (aa); and

(iii) the director made a decision, or supported the decision of a committee or the board, with regard to that matter, and the director had a rational basis for believing, and did believe, that the decision was in the best interests of the company;

(b) is entitled to rely on—

(i) the performance by any of the persons—

(aa) referred to in subsection (5); or

(bb) to whom the board may reasonably have delegated, formally or informally by course of conduct, the authority or duty to perform one or more of the board’s functions that are delegable under applicable law; and

(ii) any information, opinions, recommendations, reports or statements, including financial
statements and other financial data, prepared or presented by any of the persons specified in subsection (5).

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

(a) one or more employees of the company whom the director reasonably believes to be reliable and competent in the functions performed or the information, opinions, reports or statements provided;

(b) legal counsel, accountants, or other professional persons retained by the company, the board or a committee as to matters involving skills or expertise that the director reasonably believes are matters—

(i) within the particular person’s professional or expert competence; or

(ii) as to which the particular person merits confidence; or

(c) a committee of the board of which the director is not a member, unless the director has reason to believe that the actions of the committee do not merit confidence.

77. Liability of directors and prescribed officers.—

(1) In this section, “director” includes an alternate director, and—

(a) a prescribed officer; or

(b) a person who is a member of a committee of a board of a company, or of the audit committee of a company, irrespective of whether or not the person is also a member of the company’s board.

(2) A director of a company may be held liable—

(a) in accordance with the principles of the common law relating to breach of a fiduciary duty, for any loss, damages or costs sustained by the company as a consequence of any breach by the director of a duty contemplated in section 75, 76 (2) or 76 (3) (a) or (b); or

(b) in accordance with the principles of the common law relating to delict for any loss, damages or costs sustained by the company as a consequence of any breach by the director of—

(i) a duty contemplated in section 76 (3) (c);

(ii) any provision of this Act not otherwise mentioned in this section; or

(iii) any provision of the company’s Memorandum of incorporation.
(3) A director of a company is liable for any loss, damages or costs sustained by the company as a direct or indirect consequence of the director having—

(a) acted in the name of the company, signed anything on behalf of the company, or purported to bind the company or authorise the taking of any action by or on behalf of the company, despite knowing that the director lacked the authority to do so;

(b) acquiesced in the carrying on of the company’s business despite knowing that it was being conducted in a manner prohibited by section 22 (1);

(c) been a party to an act or omission by the company despite knowing that the act or omission was calculated to defraud a creditor, employee or shareholder of the company, or had another fraudulent purpose;

(d) signed, consented to, or authorised, the publication of—

(i) any financial statements that were false or misleading in a material respect; or

(ii) a prospectus, or a written statement contemplated in section 101, that contained—

(aa) an “untrue statement” as defined and described in section 95; or

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

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

(e) been present at a meeting, or participated in the making of a decision in terms of section 74, and failed to vote against—

(i) the issuing of any unauthorised shares, despite knowing that those shares had not been authorised in accordance with section 36;

(ii) the issuing of any authorised securities, despite knowing that the issue of those securities was inconsistent with section 41;

(iii) the granting of options to any person contemplated in section 42 (4), despite knowing that any shares—

(aa) for which the options could be exercised; or
(bb) into which any securities could be converted, had not been authorised in terms of section 36;

(iv) the provision of financial assistance to any person contemplated in section 44 for the acquisition of securities of the company, despite knowing that the provision of financial assistance was inconsistent with section 44 or the company’s Memorandum of Incorporation;

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

(vi) a resolution approving a distribution, despite knowing that the distribution was contrary to section 46, subject to subsection (4);

(vii) the acquisition by the company of any of its shares, or the shares of its holding company, despite knowing that the acquisition was contrary to section 46 or 48; or

(viii) an allotment by the company, despite knowing that the allotment was contrary to any provision of Chapter 4.

(4) The liability of a director in terms of subsection (3)(e)(vi) as a consequence of the director having failed to vote against a distribution in contravention of section 46—

(a) arises only if—

(i) immediately after making all of the distribution contemplated in a resolution in terms of section 46, the company does not satisfy the solvency and liquidity test; and

(ii) it was unreasonable at the time of the decision to conclude that the company would satisfy the solvency and liquidity test after making the relevant distribution; and

(b) does not exceed, in aggregate, the difference between—

(i) the amount by which the value of the distribution exceeded the amount that could have been distributed without causing the company to fail to satisfy the solvency and liquidity test; and

(ii) the amount, if any, recovered by the company from persons to whom the distribution was made.
(5) If the board of a company has made a decision in a manner that contravened this Act, as contemplated in subsection (3) (e)—

(a) the company, or any director who has been or may be held liable in terms of subsection (3) (e), may apply to a court for an order setting aside the decision of the board; and

(b) the court may make—

(i) an order setting aside the decision in whole or in part, absolutely or conditionally; and

(ii) any further order that is just and equitable in the circumstances, including an order—

(aa) to rectify the decision, reverse any transaction, or restore any consideration paid or benefit received by any person in terms of the decision of the board; and

(bb) requiring the company to indemnify any director who has been or may be held liable in terms of this section, including indemnification for the costs of the proceedings under this subsection

(6) The liability of a person in terms of this section is joint and several with any other person who is or may be held liable for the same act.

(7) Proceedings to recover any loss, damages or costs for which a person is or may be held liable in terms of this section may not be commenced more than three years after the act or omission that gave rise to that liability.

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

(a) to pay the costs of all parties in the court in a proceeding contemplated in this section unless the proceedings are abandoned, or exculpate that person; and

(b) to restore to the company any amount improperly paid by the company as a consequence of the impugned act, and not recoverable in terms of this Act.

(9) In any proceedings against a director, other than for wilful misconduct or wilful breach of trust, the court may relieve the director, either wholly or partly, from any liability set out in this section, on any terms the court considers just if it appears to the court that—

(a) the director is or may be liable, but has acted honestly and reasonably; or

(b) having regard to all the circumstances of the case, including those connected with the appointment of the director, it would be fair to excuse the director.
(10) A director who has reason to apprehend that a claim may be made alleging that the director is liable, other than for wilful misconduct or wilful breach of trust, may apply to a court for relief, and the court may grant relief to the director on the same grounds as if the matter had come before the court in terms of subsection (9).

2.1.1 214(1)(c)  

214. False statements, reckless conduct and non-compliance.

(1) A person is guilty of an offence if the person—

(a) ...;

(b) ...;

(c) was knowingly a party to an act or omission by a company calculated to defraud a creditor or employee of the company, or a holder of the company’s securities, or with another fraudulent purpose; or

(d) ...   

2.1.2 218(2)  

(2) Any person who contravenes any provision of this Act is liable to any other person for any loss or damage suffered by that person as a result of that contravention.

2.1.3 218(3)  

(3) The provisions of this section do not affect the right to any remedy that a person may otherwise have.
WHAT DOES THE TERM DIRECTOR MEAN?

1. In all of the sections of the New Act dealt with in this presentation:

   (i) The term “director” includes alternative directors, prescribed officers, members of board committees, members of an audit committee whether or not these committee members are directors on the board;

   (ii) The term “prescribed officer” is defined as “a person within a company who performs any function that has been designated by the Minister in terms of Section 66(10)” and regulation 38(1) elaborates on this term as follows:

                      "38 Prescribed officers of companies

                      (1) Despite not being a director of a particular company, a person is a "prescribed officer" of the company for all purposes of the Act if that person –

                          (a) exercises general executive control over and management of the whole, or a significant portion, of the business and activities of the company; or

                          (b) regularly participates to a material degree in the exercise of general executive control over and management of the whole, or a significant portion, of the business and activities of the company.

                      (2) This regulation applies to a person contemplated in subregulation (1) irrespective of any particular title given by the company to –

                          (a) An office held by the person in the company; or

                          (b) A function performed by the person for the company.”

2. The difficulty with this regulation is in applying it. It attempts to address the situation of a person who fulfils the role of a director but who is operating intentionally or unintentionally under a different designation. The defined term is the word “material”. In effect material refers to something that is “significant” of consequence in affecting a person’s judgment or decision making.

3. Essentially if one wants to render someone liable as a prescribed officer then one must prove that that person exercises executive control over the

   1 Section 1 of the New Act
management of the whole or a significant portion of the business and activities of a company or such person regularly participates to a material degree in the exercise of such control.
RECKLESS AND FRAUDULENT CONDUCT
WHICH ACT TO APPLY?
THE OLD? THE NEW? OR BOTH?

1. Section 424 of the old Companies Act permitted the Master, the liquidator, the judicial manager, any creditor or member or contributory of a company the right to declare that any person who was knowingly a party to the carrying on of the business of the company recklessly or with intent to defraud creditors of the company or creditors of any other person or for any fraudulent purpose … “to be personally responsible, without any limitation of liability for all or any debts or other liabilities of the company”.

2. Similarly worded sections exist in the New Act. These are Sections 22(1), 76(3)(b) and possibly Section 218(2).

3. Assuming one has prima facie facts of reckless trading or fraudulent conduct in the conduct of the business of a company does one bring such a claim(s) based on Section 424 of the Old Act or the New Act or both. I have assumed you are all familiar with Section 9(1) of the New Act as read with Section 79 of the New Act.

4. In attempting to answer the question as to which Act applies we find assistance in the Supreme Court of Appeals decision of Boschpoort ondernemings (B) Limited vs ABSA Bank Ltd 2014(2) SA 518 SCA.

5. In this matter the SCA specified that in regard to companies which are commercially insolvent (i.e unable to pay their debts or are already in liquidation because they were unable to pay their debts) Chapter 14 of the old Companies Act applies\(^2\). The New Act applies to companies which are commercially solvent, i.e able to pay their debts as and when they fall due in the ordinary course notwithstanding that they may be factually insolvent in the sense that their liabilities exceed their assets.

\(^2\) Per Schedule 5, Section 9 of the Companies Act 71 of 2008
6. Thus theoretically per this case if a company is commercially insolvent and has been placed under winding-up or is in liquidation Section 424 can be applied by almost anyone who wishes to bring a claim against any person who was knowingly a party to the reckless trading of the business of a company or such business being carried out with intent to defraud creditors of any person or for any fraudulent purpose.

7. However, does that mean that companies that are commercially solvent can only bring such relief pursuant to the provisions of the New Act? In other words, does the New Act apply only to commercially solvent companies and the Old Act to commercially insolvent companies?

8. Let's try and answer this question by looking at and analysing certain sections of the New Act.

9. The New Act provides in Section 218(2) as follows:

   "218 (2) Any person who contravenes any provision of this Act is liable to any other person for any loss or damage suffered by that person as a result of that contravention"

10. The New Act also prohibits reckless trading. This it does in Section 22(1) which reads as follows:

   "22. Reckless trading prohibited.

   (1) A company must not carry on its business recklessly, with gross negligence, with intent to defraud any person or for any fraudulent purpose.

11. Section 77(3)(b) and (c) of the Act then provides as follows:

   "77(3) A director of a company is liable for any loss, damages or costs sustained by the company as a direct or indirect consequence of the director having—

   (a) ....

   (b) acquiesced in the carrying on of the company’s business despite knowing that it was being conducted in a manner prohibited by section 22 (1)"

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3 Section 22(1) of Act 71 of 2008
12. Prima facie at this time and until there is a High Court or Supreme Court of Appeals’ ruling to the contrary based on the wording of Section 424 and 218(2) as read with 22(1) as read with 77(3)(b) or (c) it appears that claims could be brought in terms of either the Old Act or New Act save that:

12.1 To apply Section 424 of the Old Act the company must be commercially insolvent;

12.2 The relevant portions of the New Act apply to both commercially solvent and insolvent companies;

12.3 Ignoring Section 218(2) at this time in terms of the New Act such claims may only be brought by the Company against a director (not any other person) who acquiesced in the carrying of the company’s business knowing that it was being conducted as prohibited by Section 22(1).

13. Therefore one’s choice in bringing a claim under Section 424 or the new Act would be influenced by factors such as:

13.1 Whether a company is commercially solvent or insolvent;

13.2 Who the plaintiff is?

13.3 Who the defendant is?

13.4 The nature of the evidence you have to sustain a claim, e.g can you prove the director acquiesced knowingly, or acted with gross negligence only as opposed to recklessly or fraudulently.

14. Let me explain by analysing some of the obvious differences between Section 424 and the provisions of the new Companies Act.
<table>
<thead>
<tr>
<th><strong>SECTION 424</strong></th>
<th><strong>THE NEW ACT</strong></th>
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<tbody>
<tr>
<td><strong>Potential Plaintiff</strong></td>
<td><strong>The company only in terms of 77(3)(b)</strong></td>
</tr>
<tr>
<td>• Creditors</td>
<td>• Any person if Section 218(2) applies, i.e. if that person contravened a provision of the Act</td>
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<tr>
<td>• The Master</td>
<td></td>
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<tr>
<td>• Liquidator(s), i.e the company in liquidation</td>
<td></td>
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<tr>
<td>• A member</td>
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<tr>
<td>• A contributory</td>
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<tr>
<td><strong>Must the company be in liquidation?</strong></td>
<td><strong>No. It can be a going concern</strong></td>
</tr>
<tr>
<td>No. It must however be commercially insolvent</td>
<td>No. It can be a going concern</td>
</tr>
<tr>
<td><strong>Can the company be in business rescue?</strong></td>
<td><strong>Yes</strong></td>
</tr>
<tr>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td><strong>Must the company be unable to pay its debts?</strong></td>
<td><strong>No - It can be a going concern</strong></td>
</tr>
<tr>
<td>Before the New Act was gazetted – No.</td>
<td>It can just be factually insolvent</td>
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<tr>
<td>After the New Act - Yes</td>
<td></td>
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<tr>
<td><strong>Can the company be a going concern?</strong></td>
<td><strong>Yes</strong></td>
</tr>
<tr>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td><strong>Potential Defendant</strong></td>
<td><strong>Per Section 218(2) any person</strong></td>
</tr>
<tr>
<td>Any person</td>
<td><strong>Per Section 77(3)(b) “only” the director</strong></td>
</tr>
<tr>
<td><strong>Is causation a requirement or not?</strong></td>
<td><strong>Yes (Section 77(3)(b))</strong></td>
</tr>
<tr>
<td>Only in the limited scenario of the company being able to pay its debts</td>
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<tr>
<td><strong>Are the elements of delict required to be proven or not?</strong></td>
<td><strong>Prima facie yes (per Section 77(2)(b))</strong></td>
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<tr>
<td>No</td>
<td></td>
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15. **AN ANALYSIS OF THE ABOVE**

15.1 As already stated, to determine which act applies we draw guidance from the SCA decision of *Boschpoort Ondernemings*. In that court and by unanimous judgment it was held that the test is commercial insolvency not factual insolvency.

15.2 Accordingly so it was held “a commercially solvent company (whether factually solvent or insolvent), may be wound-up only in terms of the *Companies Act 71 of 2008* and not the *Companies Act 61 of 1973*” and further at paragraph 21 it was held that:

> [21] “.... the retention by the legislature in the context of a winding-up of a solvent company in the new Act, of the deeming provision as to when a company is unable to pay its debts as contained in Section 345 of the old Act, is a clear indication of what is meant by an insolvent company in the new Act. It can only mean a company that is commercially insolvent. It therefore follows that a solvent company must be the converse, namely a company that is commercially solvent;”

> [22] consequently, in order for a solvent company to be wound-up in terms of either Section 80 or 81 of the new Act it must be commercially solvent. If it is commercially insolvent it may be wound-up in accordance with Chapter 14 of the old Act, as provided for in sub-item 9(1) of Schedule 5 of the new Act.

> [24] factual solvency in itself is accordingly not a bar to an application to wind-up a company in terms of the old Act on the ground that it is commercially insolvent .... It follows that a commercially solvent company (whether factually solvent or insolvent) may be wound-up in terms of the new Act only; a solvent company cannot be wound-up in terms of the old Act.

15.3 Does this in effect mean that:

15.3.1 one can only invoke Section 424 of the old Act when a company is commercially insolvent? Yes.
15.3.2 one can only invoke the provisions of Sections 22(1) read with 77(3)(b) and 218(2) against commercially solvent companies only? No!

15.3.3 irrespective of whether a company is commercially solvent or insolvent one can use either Section 424 of the old Act against directors who acted recklessly, with gross negligence or fraudulently or who contravene Section 77(3)(b) as read with Section 22(1) of the new Act? No.

15.3.4 put another way can one invoke Section 424 or Section 77(3)(b) or (c) as read with Section 22(1) irrespective of whether or not the company is commercially insolvent? No.

15.3.5 irrespective of whether a company is or is not commercially solvent may one at any time invoke the provision of Section 218(2) of the Companies Act as read with Section 77(3)(b) as read with Section 22(1)? Yes.

15.4 Clearly then if a company is commercially insolvent one can apply Section 424 of the old Companies Act.

15.5 There is nothing in the New Act to the effect that Section 22(1) or 77(3)(b) or 218(2) only applies where a company is commercially solvent.

15.6 If the Boschpoort Ondernemings Judgment solely regulates which Act applies to the launching of an application for liquidation for winding-up (which appears to be the correct interpretation of that case), one can unless a court in future finds differently, invoke the provisions of Section 22(1), 77(3)(b) and 218(2) in respect of both commercially solvent companies and in respect of commercially insolvent companies.

15.7 Thus it appears at this time that if a company is commercially insolvent one can use the relevant provisions of either Act.

16. This being so which Act should one utilise?
16.1 Section 424 as shown in the table above prima facie appears to be more litigation and user friendly than its counterparts in the new Act for the following reasons:

16.1.1 From a creditor’s perspective:

16.1.1.1 claims can be brought by almost anyone including creditors. Creditors are the ones who most frequently use this section.

16.1.1.2 on the other hand, Section 22(1) as read with Section 77(3)(b) prima facie deprives creditors of a remedy, this by virtue of the use of the word “the Company”;

16.1.2 Onus of Proof

16.1.2.1 prima facie (because of the wording of 77(2)(b)) one has to prove the requirements for delictual claims if one utilises the new Act, e.g wrongfulness, causation, negligence, damages and quantum;

16.1.2.2 this is not so if Section 424 proceedings are brought especially if the company is unable to pay its debts;

16.1.2.3 to succeed with a claim under Section 424 one has to prove that any person who was knowingly a party to the carrying on of the business of a company recklessly or with intent to defraud creditors of the company or creditors of any other person or for any other fraudulent purpose. If you do, such person can be rendered personally responsible without limitation of liability for all the debts or other liabilities of the company;

16.1.3 What does a company have to prove in terms of Section 22(1) as read with Section 77(3)(b)?

16.1.3.1 One has to prove that a director:
16.1.3.1.1 acquiesced in the carrying on of the business;

16.1.3.1.2 knowing it was conducted in a manner prohibited by Section 22(1).

16.1.3.2 The term “knowing” is defined in Section 1 of the Act and pertains to actual knowledge or knowledge that one ought to reasonably have had after investigation or have taken measures to uncover.

16.1.3.3 If the company can prove this then the company in question can recover “any loss, damage or costs sustained by the company as a direct or indirect consequence of this director(s) conduct”.

16.1.4 Is causation an element of Section 424?

16.1.4.1 In the early 424 decisions a director found to have contravened Section 424 was in effect penalised by being rendered personally liable for all the debts or liabilities of the company.

16.1.4.2 A creditor or plaintiff did not have to prove a causal connection between the reckless and/or fraudulent conduct.

16.1.4.3 This position prevailed until the decision of the SCA of LMP Plant Hire and others v Bosch and others and Saincic and Others v Industrial-Clean (Pty) Ltd and another. These cases created some uncertainty as to whether or not a plaintiff in a Section 424 claim had to prove “causation”

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4 2001 [JOL] 9144 (A)

5 [2006 JOL] 17559 (SCA)
between the company’s inability to pay debt and the reckless or fraudulent conduct of the director in question.

16.1.4.4

This was cleared up in *Fourie v First Rand Bank* and *Tsung & Another v Industrial Development Corporation of South Africa Limited & Another* where it was held that it was not necessary to prove a causal link between reckless or fraudulent conduct and a company’s inability to pay its debts where the company was hopelessly insolvent. This court found that the *LMP Plant Hire* case had not changed the law and that this case never intended to deviate from those decisions of the SCA which expressly laid down the general principle that Section 424 did not require proof of a causal link between the relevant conduct and the company’s ability to pay the debt. This court found that if a plaintiff could show on probabilities that the defendant acted recklessly or fraudulently and that the business was unable to pay its debts, the defendants would be liable to the plaintiff under Section 424.

17. The term “reckless” has been dealt with in this section in many reported decisions including in our High Court, the most famous of which are:

17.1 *Howard v Herrigal*

17.2 *Philotex v Simon*

17.3 *Ozinsky v Lloyd*

17.4 *Ex Parte Leboa Corporation*

18. To summarise the findings and as set out in the leading case of Philotex the test of recklessness is objective and subjective. Firstly, you measure the conduct against the standard of a reasonable person and secondly, you measure the

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6 [2012] ZA SCA 119; and 2013 (3) SA 468 (SCA)
conduct of a person against what is expected of people in the same sphere as that person, same knowledge or access to knowledge as he has.

19. In Howard’s case it goes somewhat further and requires that you look at the circumstances of the company including the role of the director in question, the debts of the company, its finances, business etc.

20. Philotex states that gross negligence is at least the de facto test for recklessness and each case has to be determined on its own facts. In effect gross negligence equals a scenario where non payment by a company of a creditor’s debt is almost guaranteed.

21. Recklessness includes gross negligence as a minimum standard – there is nothing to distinguish these two concepts except that recklessness can precede gross negligence.

22. **ADVANTAGES OF USING SECTION 77(3)(b) AS READ WITH SECTION 22(1) VERSUS SECTION 424**

22.1 **Section 424** does not allow a company as a plaintiff which was a going concern to sue its directors. (This is because such company is not commercially insolvent.)

22.2 **Section 22(1)** however permits of a company even if a going concern when read with **Section 77(3)(b)** to sue a director for carrying on the business recklessly, with gross negligence or with intent to defraud any person or for any fraudulent purpose. This is a profound new change in the Act.

22.3 **Section 424** permits creditors (in fact any person) to bring actions against any person who breaches the section.

22.4 **Section 77(3)(b)** by virtue of its wording allows a company only to bring such a claim against a director only (the path for a creditor or any other person to bring such an action potentially lies in **Section 218(2)**). To repeat - this section allows any person who contravenes any provision of the Act (this includes directors but is not limited to directors) to sue any
other person (this permits for creditors or any other person) for any loss or damage suffered by that person as a result of that contravention.

22.5 The above sections to my knowledge has only once before come before the High Courts in 2013 in the matter of *Rabinowitz v Van Graan & Others*. In this matter defendants five and six took exception to the plaintiff’s particulars of claim in which the plaintiff sought to render directors of companies personally liable on various alleged grounds for reckless, gross negligence and the fraudulent and conduct of the company’s business in terms of Section 22(1) read with Sections 77(3)(b), Section 162(5)(c)(iv)(bb) and Section 218(2) of the Companies Act of 2008.

23. On receipt of the fifth and sixth defendants’ exception the plaintiffs endeavoured to amend their particulars of claim. This judgment dealt with the fifth and sixth defendants’ objection to the amendment.

24. In this case Du Plessis AJ after hearing various arguments as to the interpretation to be placed on Section 22(1) stated as follows:

"bearing in mind that the Act specifically contemplates that the business and affairs of a company are to be managed by or under the direction of its board, it is hard to conceive on any basis upon which the legislator intended to prevent a company from acting in the manner provided for in Section 22, but did not intend to prevent the directors responsible for the management of the company from acting in that matter. I agree with these submissions and find that a third party [not only a company] can hold a director personally liable in terms of the Act for acquiescing in or knowing about conduct that falls within the ambit of Section 22(1) thereof”.

25. This matter was heard whilst the Companies Act was still fresh in lawyers and judges minds and for the reasons set out below it is doubted whether the findings in this case will be followed by other courts or the appeal courts.

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7 2013(5)SA 315 (GSJ)
26. **WAS RABINOWITZ AND VAN GRAAN CORRECTLY DECIDED?**

26.1 As referred to by the SCA in cases such as *Saincic*, multiple creditors can bring the same Section 424 claim against the directors and secure multiple judgments. This gives rise to a multiplicity of judgments for the same debts of the same company in favour of multiple plaintiffs.

26.2 This leads to a duplication of litigation and costs, a duplication of judgments against the same person. This is undesirable.

26.3 As stated most 424 claims are brought by aggrieved creditors.

26.4 These claims are usually brought by creditors who themselves are not financially distressed. They are creditors who have deep pockets and are willing to invest large sums of money in risky litigation.

26.5 Distressed creditors or creditors who do not have deep pockets are usually precluded from this process and are in effect prejudiced.

26.6 The deep pocket creditors can also make claims against the insolvent company. This they can do simultaneously with their Section 424 proceedings.

26.7 They thus in effect they get two bites at the same cherry. They get the benefit of the proceeds of their litigation and in addition a dividend if any assets are realised by the company.

26.8 In the result the deep pocket creditors are by virtue of their wealth preferred above the less fortunate “poor” creditors.

26.9 The new Companies Act makes it clear that directors must act in the best interests of the company (*Section 76(3)(b)*). If they don’t who then has the claim? Obviously the company.

26.10 *Section 22(1)* as read with *Section 77(3)* prima facie addresses the creditor inequality. It makes the plaintiff the company. It avoids the
preference of the deep pocket wealthy creditors above the “poor” creditors.

26.11 The sections appear to create a uniformity amongst creditors and at the same time avoids the multiplicity or duplication of litigation, costs and the like and the multiplicity of judgments against the same defendants.

26.12 In effect, if this view is correct Section 77(3) preserves the concursus creditorum. This is because the company as plaintiff keeps the creditors together as one unit. Therefore on all these good grounds it can be argued that the use of the word “Company” in Section 77 was deliberate and well thought out.

26.13 For these reasons, inter alia, one can argue then that Section 22(1) as read with Section 77(3)(b) intentionally bars creditors (others) from instituting action against directors and only permits the company to bring such proceedings.

26.14 Applying these arguments, common sense dictates that the exclusion of creditors from relief as provided for in Sections 77(3)(b) and (22)(1) was well thought out, deliberate and that the New Act intends to (and should be interpreted as such) to exclude creditors (and others) from bringing claims against directors for breaches of Section 77 including when read with Section 22(1) of the Act.

26.15 As shown Section 218(2) can potentially disturb this view.

26.16 Difficulties in interpreting Section 22(1), 77(3)(b) with Section 218(2)

26.16.1 Section 218(2) requires a person to “contravene any provision of this Act”. It is not clear what is meant by the use of these words.

26.16.2 Not all sections of the New Act can be contravened.

26.16.3 Is it possible to contravene 77(3)(b)? How do you contravene it? You do so by complying with Section 22(1). If you comply how do you contravene?
26.16.4 On a reading of Section 22(1):

26.16.4.1 A director can’t personally contravene this section.

26.16.4.2 A director can only contravene it when acting in his capacity as a director of a company.

26.16.4.3 Strictly speaking then only the company can contravene the provisions of Section 22(1). This it does when one of its directors acts in its capacity as director in contravention of that section.

26.16.5 Assuming a director can contravene Section 22(1) can a director contravene then Section 77(3)(b) without contravening Section 22(1).

26.16.6 It appears from the wording of Section 22(1) that only when a company harms itself does it contravene Section 22(1).

26.16.7 A director’s duty not to acquiesce in the carrying on of a company’s business despite knowing it was being conducted in a manner contravening Section 22(1) is not a duty owed to a creditor. It is a duty owed to a company. Can then, this section via Section 218(2) vest creditors (or any other person) with locus standi to sue directors?

26.16.8 Thus on a strict interpretation of Section 218(2) read with Section 77(3)(b) – it can be argued that there is no contravention and thus no cause of action which can be brought by a creditor against a director for a breach of this Section. Notwithstanding, the reported High Court case⁸ on these Sections is of a contrary view. If the legislature intended for Section 218(2) to provide creditors with a remedy to sue directors it could and should have stated as much.

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⁸ Rabinowitz v Van Graan
26.16.9  **Section 424** refers to directors acting with “intent to defraud the creditors of a company or any other person”.

26.16.10  **Section 22(1)** refers to “intent to defraud any person”.
BREACH OF FIDUCIARY DUTY

1. A fiduciary duty is a duty of trust. It is a *sui generis* duty\(^9\). A fiduciary acts on behalf of and in the interests of another.

2. Directors act in a fiduciary capacity vis-à-vis a company. They act in a position of trust with regard to the assets and the business of the company. They owe duties to their company. Their duty is to act in good faith and for the benefit of the company.

3. The fiduciary duties are found at common law and many are now legislated for in the New Act. Common law fiduciary duties include, but are not limited to:

   3.1 disclosure of personal financial interests;
   3.2 improper use of position or corporate information;
   3.3 failure to communicate relevant information to the company;
   3.4 duty to act in good faith and for proper purpose and in the best interests of the company;
   3.5 disgorgement of profits made by a director in breach of the no profit rule.

4. Section 75 of the New Act legislates for the disclosure of a director’s personal financial interests and how directors must deal with them. (see 3.1 above)

5. Section 76(2) legislates for the improper use of a director of corporate information and failure to communicate relevant information to the company. (see 3.3 above)

6. Section 76(3)(a) or (b) legislates for the duty of a director to act in good faith and for proper purpose and in the best interests of the company. These processes remove any doubt that the directors of a company owe then duty to a company only. (see 3.4 above)

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\(^9\) Robinson v Randfontein Estates Gold Mining Co 1921 AD 168 and Cohen N.O. v Siegal 1970 (3) SA 702 (W) at 706 G
7. **Section 77(2)(a)** links the statutory fiduciary duties with the common law fiduciary duties. It does not include the common law duty of disgorgement of profits made by a director in breach of the no profit rule which common law duty applies even where the profit is not made at the expense of the company.

8. Importantly with regard to directors’ powers and duties, **Section 76(3)** is to be read subject to the provisions of sub-sections (4) and (5) (dealt with in detail below) i.e the **business judgment rule** and when acting in the best interests of a company a director has the full benefits of this **business judgment rule** including those benefits I deal with shortly.

9. **The breach of a fiduciary duty**

9.1 **Section 77(2)(a)** applies to such breaches and it provides that a director of a company will be held liable in accordance with the principles of the common law (preserving the common law principles) relating to breach of a fiduciary duty for any loss or damage or cost sustained by the **company** (the plaintiff) as a consequence of any breach by the director of a duty contemplated in **Section 75** (disclosure of personal financial interests), **Section 76(2)** (use of information in the capacity as director and communication to a board of directors certain information) or **76(3)(a)** (in good faith and for proper purpose) and **76(3)(b)** (whilst acting in the best interests of the company).

9.2 Per the New Act the common law principles applicable to fiduciary duties run in parallel with the statutory duties.

9.3 To succeed with an action for breach of fiduciary duty one must satisfy the requirements for such action as legislated for in the above sections of the New Act.

9.4 “**Proper Purpose**” is not defined in the Act. Directors must not just act in the best interests of the company, they must also act with proper purpose, i.e in accordance with the purpose for which the power was given to a director.
BREACH OF CARE AND SKILL (SECTION 76(3)(c))

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

(a) …

(b) …

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

(i) carrying out the same functions in relation to the company as those carried out by that director; and

(ii) having the general knowledge, skill and experience of that director.

1. This duty is a non-fiduciary duty. The concept of a director having to exercise a duty of care and skill is not new and has always been part of South African law.\(^\text{10}\)

2. The duty of care, skill and diligence is based on delictual or aquilian liability for negligence. Section 77(2)(b)(i) confirms this. It has been formulated by our courts in largely subjective terms – based on “the general knowledge, skill and experience of that director”.

3. Applying both tests there is in the result now an unreasonably low standard of care required of directors.

4. I say so because directors are thus expected to exercise a degree or level of care and skill that they are capable of. Ironically then, the more inexperienced, the more skills a director lacks and the less knowledge a director has the lower the standard of care expected of him when exercising his powers and performing his functions. This test in the result favours lack of skill and the ignorant director.

4.1 The Act refers to “general knowledge”, “experience” and “skill” of a director.

4.2 “Care” and “skill” are not one and the same thing.

\(^{10}\) Mthinunye Bakoro v Petroleum Oil & Gas Corporation of South Africa (SOC) Limited & Another [2015] JOL 33 744 (Hennochsberg Section 76)
4.3 "Care" is the manner in which this skill is applied\textsuperscript{11}.

4.4 "Care" may be objectively assessed.

4.5 "Skill" varies from person to person.

4.6 "Skill" is a special competence resultant on special training, experience and aptitude developed by a director. It is subjective in nature.

4.7 South African law as well as English law have adopted the approach that directors need not have any special qualifications to hold their office.

4.8 In South Africa in \textit{Fisheries Development Corporation of SA Ltd v Jorgenssen}\textsuperscript{12} the court distinguished between executive and non-executive directors stating that the non-executive director is not liable for mere errors of judgment; he is not required to have any special business acumen, expertise, singular ability, intelligence or even experience in the business of the company. He must however not be indifferent nor shelter behind culpable ignorance of the company’s affairs nor must he accept information or advice blindly even if this is given by an apparently suitably qualified person.

4.9 It appears that as there is this subjective element to the test distinction between an executive and non-executive director is more profound and that a different standard of care may be expected of a non-executive director (per the words “\textit{carrying out the same functions … as those carried out by that director}”).

4.10 \textbf{Section 76(3)(c) in effect –}

4.10.1 imposes a less subjective test and a slightly more demanding standard of care on directors and prescribed officers of a company than the common law does.

\textsuperscript{11} Daniels v Anderson [1996] 16 ASCR 607 (NSW); [1995] 37 NSW LR 438

\textsuperscript{12} 1979(3) SA 1331 (W)
4.10.2 reflects the contemporary attitude towards management of the company and corporate governance best practices;

4.10.3 imposes a mandatory duty which like other fiduciary duties is owed not to the shareholders but to the company.

4.11 By the use of the word “diligence” in Section 76(3)(c) –

4.11.1 it appears that the legislator intended it to have a different meaning to the word “care”;

4.11.2 prima facie it indicates that the failure now by a director (unlike in the past) to attend a directors meeting may be seen as a failure to exercise reasonable care and diligence.

4.11.3 prescribes that the test is both objective (76(3)(c)(i)) and subjective (76(3)(c)(ii)).

4.12 The wording of 76(3)(c) requires that the test be measured against that of a “reasonable person” and not that of a “reasonable director”. This is somewhat unfair.

4.13 If the skill or knowledge of the director exceeds that of a reasonable diligent person the higher level of knowledge, skill and expertise must be taken into account in deciding whether that particular director has exercised reasonable care and skill and has complied with the requirements of 76(3)(c).

4.14 It appears now that in determining the degree of care, skill and diligence that may be reasonably expected of a director, the courts will in all likelihood take into account the nature of the company, the nature of the decision in question, the position of the director and the nature of the responsibilities undertaken by him.
5. **AS I HAVE ALREADY STATED ONE IS OBLIGED TO READ SECTION 76(3) “SUBJECT TO SUB-SECTIONS (4) AND (5)”.

5.1 These sections read as follows:

76(4) In respect of any particular matter arising in the exercise of the powers or the performance of the functions of director, a particular director of a company—

(a) will have satisfied the obligations of subsection (3) (b) and (c) if—

(i) the director has taken reasonably diligent steps to become informed about the matter;

(ii) either—

(aa) the director had no material personal financial interest in the subject matter of the decision, and had no reasonable basis to know that any related person had a personal financial interest in the matter; or

(bb) the director complied with the requirements of section 75 with respect to any interest contemplated in subparagraph (aa); and

(iii) the director made a decision, or supported the decision of a committee or the board, with regard to that matter, and the director had a rational basis for believing, and did believe, that the decision was in the best interests of the company; and

(b) is entitled to rely on—

(i) the performance by any of the persons—

(aa) referred to in subsection (5); or

(bb) to whom the board may reasonably have delegated, formally or informally by course of conduct, the authority or duty to perform one or more of the board’s functions that are delegable under applicable law; and

(ii) any information, opinions, recommendations, reports or statements, including financial statements and other financial data, prepared or presented by any of the persons specified in subsection (5).

76(5) To the extent contemplated in subsection (4) (b), a director is entitled to rely on—

(a) one or more employees of the company whom the director reasonably believes to be reliable and competent in the functions performed or the
information, opinions, reports or statements provided;

(b) legal counsel, accountants, or other professional persons retained by the company, the board or a committee as to matters involving skills or expertise that the director reasonably believes are matters—

(i) within the particular person’s professional or expert competence; or

(ii) as to which the particular person merits confidence; or

(iii) a committee of the board of which the director is not a member, unless the director has reason to believe that the actions of the committee do not merit confidence.

5.2 **Sections 76(4)** (material personal financial interest) and **(5)** (of delegation) contain the well known common law principles of the duty of care. These principles have now been modernised, expanded and codified in these sections.

5.3 In summary a director will satisfy the obligations of **Section 76(3)(b) and (c)** (not **76(3)(a)**) if the director:

5.3.1 has taken reasonably diligent steps to become informed about a matter by either having no material interest in the matter or having a material interest has complied with Section 75;

5.3.2 makes a decision in the best interests of a company and had a rational basis for doing so. (We analyse below the meaning of rational.)

5.3.3 in addition a director in exercising his powers and performing is functions is entitled to rely on performance by any person such as an employee, legal counsel, accountant or professional persons retained by the company, the board or a committee to matters involving skill or expertise that the director believes are matters within that person’s professional expert competence or in which that particular person merits confidence.
5.4 **Section 76(4)** is commonly referred to as the **business judgment rule**. This rule:

5.4.1 appears to have its genesis in the United States and has been adopted in Australia and Hong Kong. It has been rejected in the UK and New Zealand.

5.4.2 in the USA it acts to essentially prevent a court from interfering with the benefit of hindsight in the honest and reasonable business decision of directors of a company (strangely so the same words used in Section 77(9)(a)).

5.5 In summary it has the following requirements:

5.5.1 the decision must be an informed one;

5.5.2 the director must have no personal financial interest in it;

5.5.3 a director must have had a **rational** basis (not a reasonable basis) for believing and did believe that a decision was in the best interests of the company.

5.6 **The introduction of the rationality basis**

5.6.1 This test of rationality is an objective one.

5.6.2 This test is one of the main ingredients of the business judgment rule. Its underlying basis is that an irrational decision is indicative of bad faith.

5.6.3 What is not clear from **76(4)** is who bears the onus of establishing the requirements of **76(4)(a)(i)** to (iii). Is it the plaintiff company or the defendant director?

5.7 **Rationality (76(4)(a)(iii))**

5.7.1 One must not confuse reasonableness with rationality.
5.7.2 Only one case has been found which deals with this Section. It is the case of *Visser Citrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd and Others 2014 (5) SA 179 (WCC)*.

5.7.3 Rogers J. in this matter held as follows:

[74] Section 76(4) makes clear that the duty imposed by Section 76(3)(b) to act in the best interest of the company is not an objective one, in the sense of entitling a court, if a board decision is challenged, to determine what is objective speaking in the best interests of the company. What is required that the directors, having taken reasonably diligent steps to become informed, should subjectively have believed that their decision was in the best interests of the company and this belief must have had "a rational basis". The subjective test accords with the convention and approach to directors’ duties ..."

[75] Section 76 requires the bona fide assessment of the directors to have a rational underpinning. This requirement has been articulated less frequently in the conventional statement of directors’ duties but is not necessarily an innovation ...”

[76] The rationality criterion as laid down in Section 76 is an objective one but its threshold is quite different from, and more easily met than, a determination as to whether the decision was objectively in the best interests of the company. In the context of the legality principle applicable to the exercise of public power, Chaskalson P said the following in *Pharmaceutical Manufacturers Association of SA and Another: In re Ex parte President of the Republic of South Africa and Others 2000 (2) SA 674 (CC) (2000 (3) BCLR 241; [2000] ZACC 1) (para 90):*

’... The setting of this standard [rationality] does not mean that the Courts can or should substitute their own opinions as to what is appropriate for the opinions of those in whom the power has been vested. As long as the purpose sought to be achieved by the exercise of public power is within the authority of the functionary, and as long as the functionary’s decision, viewed
objectively, is rational, a Court cannot interfere with the decision simply because it disagrees with it or considers that the power was exercised inappropriately. A decision that is objectively irrational is likely to be made only rarely but, if this does occur, a Court has the power to intervene and set aside the irrational decision ...”

[77] Again in the context of the exercise of public power, the requirement of rationality has been held to concern the relationship between the decision and purpose for which the power was given. Was the decision or the means employed rationally related to the purpose for which the power was given? ...”

[78] These principles relating to rationality in the exercise of public power can, I think, be applied with appropriate modifications to the rationality requirements for the proper exercise by directors of their powers. “

[80] As to proper purpose (Section 76(3)(a)), the test is objective, in the sense that once one has ascertained the actual purpose for which the power was exercised, one must determine whether the actual purpose falls within the purpose for which the power was conferred, the latter being a matter of interpretation of the empowering provision in the context of the instrument as a whole. In the context of decisions by directors, there will often be, in my view, a close relationship between the requirement that the power should be exercised for a proper purpose and the requirement that the directors should act in what they consider to be the best interests of the company. Put differently, the overarching purpose for which directors must exercise their powers is the purpose of promoting the best interests of the company.”

5.7.4 In this matter the directors took a decision to refuse to register a transfer of shares.

5.7.5 The Courts found that in doing so they acted in the best interests of the company which prejudiced a shareholder. They believed
that the best interests of the company were served by not allowing one shareholder to increase his shareholding. Rogers concluded that in refusing to approve the transfer the board met the standards set out by Section 76 of the Act and refusal was a lawful one.

5.7.6 The question was then whether the directors decision was unfairly prejudicial within the meaning of Section 163 of the New Act. Rogers stated that the Courts should be wary of making such a finding where directors have complied with their fiduciary duties but did concede that there may be exceptional cases where despite such compliance the decision might be found to be unfairly prejudicial to a particular shareholder although this was not present in this case.

5.7.7 Rogers' test provides that one must look at the:

5.7.7.1 purpose of the administrative action;

5.7.7.2 purpose of its authorising provision;

5.7.7.3 information that was available to the administrator when he made the decision;

5.7.7.4 reasons provided for this decision.

5.7.8 Then one must determine whether the decision was rationally related to the purpose for which the power was given.

5.7.9 Rogers then said that there must be a rational relationship which exists between:

5.7.9.1 The belief and the concomitant decision; and

5.7.9.2 The reasoning behind it (i.e the director's opinion).
5.7.10 For a decision to be rational it must not be inconsistent with its purpose.

5.7.11 In this case the court stated “the rationality criteria as laid down in Section 76 is an objective one but its threshold is quite different, and more easily met than a determination as to whether the decision was objectively in the best interests of the company”.

5.7.12 The question is can a director escape liability if he acted unreasonably yet he can prove that he acted rationally? (Yes per Visser.) The question then is how unreasonably can he act before he loses this protection of rationality?

5.7.13 If one analyses Section 76(4) it appears that an unreasonable decision does not result in automatic liability for a director and the director can escape liability if:

5.7.13.1 the director was reasonably informed about the matter; and

5.7.13.2 the decision was rational in relation to its basis.

5.7.14 The business judgment rule suggests that we treat rational differently from reasonableness and that rationality has a lower standard than the subjective standard of reasonableness for care and skill.

5.8 Commercial activity entails risk. You must act rationally in making decisions. Proving irrationality can go to proving unreasonableness and possibly gross negligence.

5.9 Having regard to Section 76(4) and (5) it appears overall now that the standard for liability for care and skill appears to be set at the level of gross negligence, i.e a high level of negligence.
6. **MINI SUMMARY**

6.1 Modern corporate law recognises that corporate decisions made by directors more often than not entails the taking of risks.

6.2 If directors have acted honestly and reasonably and the requirements of 76(4)(a) have been complied with, they will not incur liability for honest errors of judgment or for poor business decisions even if subsequent events show that the decision of the board had a disastrous effect on the company.

7. **LIABILITY OF DIRECTORS AND PRESCRIBED OFFICERS – SECTION 77 OF THE COMPANIES ACT 71 OF 2008**

7.1 Section 77(2) to (5) sets out the liability of a director of a company as follows:

7.1.1 Section 77(2)(a):

(2) A director of a company may be held liable—

(a) in accordance with the principles of the common law relating to breach of a fiduciary duty, for any loss, damages or costs sustained by the company as a consequence of any breach by the director of a duty contemplated in section 75, 76(2) or 76(3)(a) or (b);

7.1.2 Pursuant hereto a director will be liable in accordance with the principles of the common law relating to breach of fiduciary duties for any loss or damage or costs sustained by the company as a consequence of any breach by a director of a duty contemplated in Section 75 (i.e. disclosure of a director’s personal financial interests and Section 76(2) (i.e use of position of corporate information and failure to communicate relevant information to the company) or Section 76(3)(a) or (b) (duty to act in good faith with the proper purpose and in the best interests of the company).

7.1.3 As already stated this section links the statutory duties of a director with a director’s common law fiduciary duties.
7.1.4 It thus appears that now most (not all) of the common law duties of a director have been legislated for in Section 76(2), 76(3)(a) or (b).

7.2 Breach of duty of care and skill or other provisions

7.2.1 This is dealt with in Section 77(2)(b) which reads as follows:

77(2) A director of a company may be held liable -
(b) in accordance with the principles of the common law relating to delict for any loss, damages or costs sustained by the company as a consequence of any breach by the director of—
(i) a duty contemplated in section 76 (3) (c);
(ii) any provision of this Act not otherwise mentioned in this section; or
(iii) any provision of the company’s Memorandum of Incorporation.

7.2.2 Clearly then Section 76(3)(c) (failure to exercise reasonable care, skill and diligence) confirms that the duty of care is a delict and this section endeavours to preserve the traditional common law principles insofar as delictual liability is imposed on a director for breach by a director of his duty of care and skill.

7.2.3 In terms of Section 77(2)(a) and (b) duties are owed to the company and not to its shareholders or creditors.

7.2.4 The only plaintiff for claims pursuant to these sections is the company. It is not shareholders or creditors. This is not surprising at all.

7.2.5 If a shareholder or creditor wishes to seek redress against a director he must use other Sections in the New Act, e.g a derivative action (per Section 165), a claim in terms of Section 218(2) (although this section itself is not at this time without difficulties) and Section 162 (and for shareholders Section 20(6)(a)).
7.2.6 Common law and delict will also apply to any breach of the Act not otherwise mentioned in Section 77(2) (per 77(2)(b)(ii)) and for any breach of any provision of the company's Memorandum of Incorporation (per 77(2)(b)(iii)). These sections should not be underestimated as to effect and purpose.

7.3 Additional statutory claims are created in terms of Section 77(3) which reads as follows:

(3) A director of a company is liable for any loss, damages or costs sustained by the company as a direct or indirect consequence of the director having—

(a) acted in the name of the company, signed anything on behalf of the company, or purported to bind the company or authorise the taking of any action by or on behalf of the company, despite knowing that the director lacked the authority to do so;

(b) acquiesced in the carrying on of the company’s business despite knowing that it was being conducted in a manner prohibited by section 22 (1);

(c) been a party to an act or omission by the company despite knowing that the act or omission was calculated to defraud a creditor, employee or shareholder of the company, or had another fraudulent purpose;

(d) signed, consented to, or authorised, the publication of—

(i) any financial statements that were false or misleading in a material respect; or

(ii) a prospectus, or a written statement contemplated in section 101, that contained—

(aa) an “untrue statement” as defined and described in section 95; or

(bb) a statement to the effect that a person had consented to be a director of the company, when no such consent had been given, despite knowing that the statement was false, misleading or untrue, as the case may be, but the provisions of section 104 (3), read with the changes required by the context, apply to limit the liability of a director in terms of this paragraph; or
(e) been present at a meeting, or participated in the making of a decision in terms of section 74, and failed to vote against—

(i) the issuing of any unauthorised shares, despite knowing that those shares had not been authorised in accordance with section 36;

(ii) the issuing of any authorised securities, despite knowing that the issue of those securities was inconsistent with section 41;

(iii) the granting of options to any person contemplated in section 42(4), despite knowing that any shares—

(aa) for which the options could be exercised; or

(bb) into which any securities could be converted, had not been authorised in terms of section 36;

(iv) the provision of financial assistance to any person contemplated in section 44 for the acquisition of securities of the company, despite knowing that the provision of financial assistance was inconsistent with section 44 or the company’s Memorandum of Incorporation;

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

(vi) a resolution approving a distribution, despite knowing that the distribution was contrary to section 46, subject to subsection (4);

(vii) the acquisition by the company of any of its shares, or the shares of its holding company, despite knowing that the acquisition was contrary to section 46 or 48; or

(viii) an allotment by the company, despite knowing that the allotment was contrary to any provision of Chapter 4.

7.4 Most of these sections are self explanatory.

7.5 The important ones are 77(3)(a), (b) and (c).

7.6 We have already discussed 77(3)(b). Interesting however is Section 78(2) and (6). These sections read as follows:
78(2) Subject to subsections (4) to (6), any provision of an agreement, the Memorandum of Incorporation or rules of a company, or a resolution adopted by a company, whether express or implied, is void to the extent that it directly or indirectly purports to—

(a) relieve a director of—

(i) a duty contemplated in section 75 or 76; or

(ii) liability contemplated in section 77; or

(b) negate, limit or restrict any legal consequences arising from an act or omission that constitutes wilful misconduct or wilful breach of trust on the part of the director.

78(6) A company may not indemnify a director in respect of—

(a) any liability arising—

(i) in terms of section 77(3)(a) (lack of authority), (b) (Section 22(1)) or (c) (party to an act or omission to defraud); or

(ii) from wilful misconduct or wilful breach of trust on the part of the director; or

(b) any fine contemplated in subsection (3).

7.7 Essentially subject to sub-sections 4 to 6 any provision in any agreement or the MOI or rules of a company or resolution adopted by a company which relieves a director of any of his duties contemplated in Section 75, 76 or liability in 77 is void and in terms of 78(6) a company is prohibited from indemnifying a director in respect of any liability arising out of Section 77(3)(a), (b) or (c) or from wilful misconduct or wilful breach of trust on the part of a director.

7.8 Section 162(5)(c)(iv)(bb) provides that a court must make an order declaring a person to be a delinquent director if that person acted in the manner contemplated in Section 77(3)(a)(b) or (c).

7.9 Section 214(1)(c) imposes a criminal sanction of a director for reckless conduct. This section reads as follows:

214. False statements, reckless conduct and non-compliance.—

(1) A person is guilty of an offence if the person—

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ATTORNEYS
7.10 The offence is punishable by a fine or imprisonment for a period not exceeding ten years or both (per Section 216(a)).

7.11 **Section 77(4)** explains in more detail how one would apply a breach of **Section 76(3)(e)(vi)**, i.e. a distribution contrary to **Section 46**. It is self explanatory.

7.12 **Section 77(5)** deals with contraventions in terms of **77(3)(e)**. Again it is self explanatory.

7.13 **Section 77(6)** provides that the liability of a person in terms of **77** is joint and several with any other person who is or may be held liable for the same act. This appears to be in line with the law of delict and applies to both awards for capital and costs.

7.14 **Section 77(7)** creates a three year prescriptive period. This three year period commences to run on the date of the act or omission that gave rise to the liability. This appears to be a statutory amendment to the Prescription Act. This Act does not contain nor incorporate the provisions of the Prescription Act dealing with suspension of prescription, interruption of prescription and the like. It will thus then probably be strictly applied and it must be borne in mind when one wishes to bring actions against directors for liability pursuant to **Section 77**.

7.15 Claims in terms of **Section 424** of the Old Act are still subject to the Prescription Act.

7.16 **Section 77(9)** and **(10)** created further defences or exemptions to directors who have acted in breach of their duty of care or fiduciary duties. It reads as follows:
77(9) In any proceedings against a director, other than for wilful misconduct or wilful breach of trust, the court may relieve the director, either wholly or partly, from any liability set out in this section, on any terms the court considers just if it appears to the court that—

(a) the director is or may be liable, but has acted honestly and reasonably; or

(b) having regard to all the circumstances of the case, including those connected with the appointment of the director, it would be fair to excuse the director.

77(10) A director who has reason to apprehend that a claim may be made alleging that the director is liable, other than for wilful misconduct or wilful breach of trust, may apply to a court for relief, and the court may grant relief to the director on the same grounds as if the matter had come before the court in terms of subsection (9).

7.17 These are not entirely new provisions. They are in fact very similar to Section 248 of the Old Act with the following differences:

7.17.1 Section 248 is confined to legal proceedings against directors for negligence, default, breach of duty or breach of trust.

7.17.2 Section 77(9) is not so limited. It could also include gross negligence, trading under insolvent circumstances. It is doubtful whether it will apply to reckless trading. Certainly it does not apply to “wilful misconduct” or “wilful breach of trust”.

7.18 The words “reasonably” and “honestly” as used in 77(9)(a) appears to exclude claims against directors in terms of 76(3)(c) as this latter section involves or requires a director to have acted both reasonably and honestly.

7.19 Section 77(9) confers the discretion on a court to relieve a director from liability if he has acted honestly and reasonably or ought fairly to be excused from liability in respect of conduct which is not wilful or constitutes a wilful breach of trust.
7.20 Perhaps and this is a concern that directors’ standards of conduct will boil down to what is set out in 77(9), i.e they get excused from liability on one of the basis set out in 77(9)(a) or 77(9)(b).

8. **CRIMINAL OFFENCES OF DIRECTORS**

8.1 Generally under the Companies Act a breach of a director’s duties generally gives rise to civil not criminal consequences.

8.2 There was a deliberate policy decision made to decriminalise company law sanctions, this in line with, *inter alia*, the constitution and the decisions of that court.

8.3 **Section 214** offences are effectively confined to reckless (fraudulent or insolvent) trading or more generally fraudulent breaches of directors’ duties.

8.4 The 2008 Act creates additional sanctions for directors (i.e above the civil such as (1) **Section 69** – disqualification sanctions; (2) **Section 162** – for disciplinary and probation. **Section 69** and **162** protect the public for (offending) directors).

8.5 At common law a director can be liable as a socius criminus for crimes committed by the company (**Stilfontein Estates Gold Mining** case).

9. Taking all into account and up to this point one can summarise rights and alternatives under the Act as follows:

9.1 Firstly, determine whether the company is or is not commercially solvent.

9.2 **Commercially solvent companies**

9.2.1 Claims can be brought by the company against directors for breaches of care and skill (per **Section 77(2)(a)** and **3(b)** and their various sub-sections).
9.2.2 A company which is not in liquidation or able to pay its debts who breaches **Section 22(1)** has a choice of litigating on the basis of reckless trading and/or fraud or breach of duty of care and skill.

9.2.3 As displayed it is far more difficult for a company to prove a breach of duty and skill (i.e a delict) than to prove fraud and recklessness. The latter remedies are for a number of reasons more attractive.

9.2.4 Creditors may have no protection against directors under **Section 22(1)** as they appear to prima facie be excluded from bringing such claims.

9.2.5 The only route in terms of the New Act (albeit at the time dubious) is for creditors to proceed against directors is via **Section 22(1)** and **77(3)(b)** as read with **Section 218(2)**.

9.2.6 **Section 22(1)** and the other provisions of the new Companies Act for the first time allow actions against directors insofar as a company is solvent and a going concern. This is a new and welcomed innovation.

9.2.7 Creditors can jointly and severally bring a derivative action in terms of **Section 165(2)(d)** on behalf of a company against directors who have caused the company to trade recklessly or fraudulently.

9.2.8 A safer (although not clearly a safe) remedy for creditors is to utilise **Section 218** for breach of duty of care and skill (i.e in terms of **Section 76(3)(c)**).

9.2.9 Companies can bring claims for reckless and fraudulent conduct in terms of **Sections 22(1)** as read with **77(3)(b)**.

9.2.10 **Shareholders** have a remedy in terms of **Section 20(6)(a)**. It reads as follows:

20(6) Each shareholder of a company has a claim for damages against any person who intentionally, fraudulently or due
to gross negligence causes the company to do anything inconsistent with—
(b) this Act;

9.3 Re Commercially Insolvent Companies

9.3.1 Per the New Act:

9.3.1.1 Plaintiff companies

9.3.1.1.1 Can use the remedy for breach of care and skill.

9.3.1.1.2 Can use the remedy for breach of reckless trading and fraud.

9.3.1.2 Plaintiff Creditors

9.3.1.2.1 Appears (save for Section 218(2)) to be precluded from bringing claims against directors.

9.3.1.2.2 Can and should bring a claim under Section 424, this from a evidential version perspective and to avoid the difficulties with the interpretation of the new Companies Act.

9.3.1.3 Shareholders

9.3.1.3.1 Shareholders have a limited remedy in terms of Section 20(6)(a) of the New Act.
SUMMARY

1. In summary, having regard to the recent case law\(^\text{13}\) where a company is being wound-up because it is commercially insolvent or is in liquidation because it is commercially insolvent creditors are relying more on Section 424 of the Old Act than the provisions of the New Act.

2. For breaches of duty of care and fiduciary duties in general, creditors appear to have been precluded from bringing claims for breaches of Section 76 read with 77 as per the wording of these sections these claims can only be brought by the company itself.

3. If a company is commercially insolvent then when bringing claims against the directors one should tend towards Section 424 of the Old Act.

4. Insofar as commercially solvent companies are concerned, claims can be brought against directors for:
   4.1 reckless trading;
   4.2 fraud;
   4.3 gross negligence;
   4.4 breaches of fiduciary duty;
   4.5 breach of standard of the duty of care and skill,

   for all losses and damages which the company has suffered.

5. Claims can be brought by shareholders for damages against any person who intentionally, fraudulently or due to gross negligence causes a company to do anything inconsistent with the New Act, e.g contravenes Section 22(1).

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\(^{13}\) e.g the Engelbrecht v Zuma matter
6. In regard to claims brought under Section 76(3) for, *inter alia*, a statutory breach of fiduciary duties, common law fiduciary duties, breaches of care and skill, directors who breach these sections can escape liability if they can show that:

6.1 they have taken reasonably diligent steps to become informed about the matter;

6.2 they had no material personal financial interest in the subject matter of the decision or if they did, they complied with the requirements of Section 75;

6.3 the director made a decision or supported a decision of a committee of the board and had a rational basis for believing and did believe that the decision was in the best interests of the company and in exercising any powers or performance of its functions as a director, a director is entitled to rely on certain persons such as managers, committees, lawyers, accountants and the like.

7. If a company has found a director wanting in regard to Section 76 or has found a director liable for breach of one or more of the provisions of Section 76(3) and in addition overcomes the hurdles of Section 76(4) and (5) a director can still escape liability if he can prove to the court that:

7.1 he acted *honestly* and *reasonably*; or

7.2 having regard to all the circumstances of the case, including those connected with the appointment of the director, it would be fair to excuse the director.

8. With regard to Section 218(2) – one High Court Judge thus far to date appears to favour interpreting this Section in a fashion which allows *any person* including creditors locus standi to sue directors for a breach of Section 22(1). These sections however are not without difficulty and will be subject to further interpretation in the future. My reading of the Act appears to deprive creditors of this remedy in favour of the company which ironically appears to be correct and in creditors’ interests.
9. **Section 218(2)** certainly allows creditors to pursue directors for breach of their fiduciary duties and duties of care and skill.

10. Despite all of the aforegoing, overall there are a number of new ways of rendering directors personally liable to the company, creditors and shareholders, this in addition to **Section 424** which remains extant in regard to commercially insolvent companies. Thus, it appears the position certainly from a company’s perspective and from the perspective of creditors and shareholders, creates additional rights to rendering directors personally liable for the losses and damages that a company, a creditor or a shareholder has suffered as a consequence of such director’s recklessness, gross negligence, fraud or breach of fiduciary duty or standards of the duty of care and skill.

Overall, taking all into account, the company, creditors and shareholders are in a more favourable position today in addressing the wrongs perpetrated by directors and in rendering them liable for such wrongs.