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A comparative study of selected aspects of corporate liability of directors under Swiss and South African law

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I hereby declare that I have read and understood the regulations governing the submission of Master of Laws dissertation, including those relating to length and plagiarism, as contained in the rules of this University, and that this dissertation conforms to those regulations.

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Abbreviations

BGE	Bundesgerichtsentscheid (decision of the Swiss Federal Court; available on: http://www.bger.ch)
CA	Companies Act 61 of 1973 of South Africa
CO	Swiss Code of Obligations (Available on: http://www.admin.ch/ch/d/sr/2/220.de.pdf. The official version of the CO is available in German, French and Italian. I will use the translation of the official version by the Swiss-American Chamber of Commerce; http://www.amcham.ch/)
cit	cited
eg	exempli gratia (for instance)
et al	et alii (and others)
et seq	et sequens (South African system to refer to the following paragraph, section or note)
f	following (system in Switzerland to refer to the following paragraph, page or note)
ff	following (system in Switzerland to refer to more than one following paragraph, page or note)
FN	footnote
ie	id est (that it to say)
N	note
p	page
s	section
SA Merc LJ	South African Mercantile Law Journal
SR	Systematische Sammlung des Bundesrechts (systematic collection of the Swiss Federal Acts)
Vol.	Volume

A. Introduction

Corporate liability of directors is a current issue all over the world due to the financial failures of corporations in the United States and Europe in the past years. The current proceedings in Switzerland against former directors of Swissair, who are accused of having caused the grounding of the airline in October 2001, attracts not only the attention of the Swiss public but also the interest of the neighbouring countries.

In this dissertation I will first point out the relevant principles of the Swiss corporate law dealing with liability of directors and then compare the legal situation in Switzerland with the legal situation in South Africa. As the analysis of the whole corporate liability issue would go beyond the scope of this dissertation I will focus on Article 754 of the Swiss Code of Obligations (organ liability) and compare it with the South African grounds of liability of directors for breach of their fiduciary duties and their duty of care and skill.

B. Personal liability of members of board of directors under Swiss corporate law

1. Broad discussion of the relevant principles of the Swiss corporate law

a) Corporate law regarding board of directors

Corporate law is regulated in the Articles 620 to 763 of the Swiss Code of Obligations (thereafter called CO).[1] The decisive provisions regarding the board of directors and the responsibility of its directors are regulated in the Articles 707 ff CO. Important for the interpretation of the relevant articles are the decisions of the Swiss Federal Court and the academic writings of established law professors and lawyers.[2]

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[1] SR 220

[2] I will refer to the academic writings of established law professors and lawyers as doctrine

b) Organisation of board of directors

The management can partially be delegated to individual members of the board or third parties in accordance with an internal organisational guideline (Article 716b (1) CO). The Swiss system has decided on a monistic organisation of the executive body and not on a dualistic system as in Germany (with a separate supervisory board and board of directors). The board of directors is the executive body of a corporation and has the main duty to ultimately manage the corporation (Article 716a (1) (1) CO). The board of directors can make decisions on all matters of the company, which by law or the articles of association are not allocated to the general meeting of the shareholders (Articles 716 (1) and 698 CO). In practice a mixture of both systems has evolved and the Swiss system has approached the German dualistic system. Most of the larger Swiss corporations have delegated the executive management to a separate board of management ("Geschäftsleitung"). The board of directors ("Verwaltungsrat") has the duty to appoint and remove the persons entrusted with the management.[3] The main difference between the Swiss solution and the pure dualistic system is that in Switzerland there is no strict separation between the supervision of the board of management by the board of directors on the one hand and the management of the business on the other hand. The Swiss board of directors has along with the duty to appoint, remove, and supervise the board of management the overall management function.[4] The overall management function is mandatory (Article 716a CO) and cannot be delegated to the board of management.

c) Relationship between directors and the company

The legal relationship between directors and the company is regulated through the compulsory provisions of corporate law (Articles 707 ff CO dealing inter alia with personal prerequisites of directors, organisation of the board, rights and duties of directors). The doctrine and the judgments of the Swiss courts qualify this relationship as an innominate contract,

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[3] Article 716a (1) (4) CO
[4] Böckli *Aktienrecht* at § 13 N 957 ff

similar to the law of mandate[5], with corporate law content.[6] The mandate of directors contains a dual characterisation: a contractual position and a position as an organ. If a director is also a member of the management (executive director), there will be an employment contract between him and the company regarding his function as an executive director and the director can be held liable on grounds of corporate liability (Article 754 CO) and on contractual grounds.

d) Relationship between directors and shareholders

There is no statutory relationship between the directors and the shareholders. A contractual relationship between a shareholder as a beneficiary and a director as a fiduciary can be established.[7] The director then has a contractual obligation to act in accordance with the instructions of the shareholder.[8] A director who follows the instructions of a shareholder will put himself in a conflict situation between his legislative corporate duties as an organ and his contractual duties towards the shareholder as a fiduciary.[9] The question whether such a fiduciary contractual relationship results in a breach of a director's duty of loyalty towards the company will be discussed under paragraph B.3.2.3.2.a).

e) Legal nature of corporate liability

The question whether the legal nature of corporate liability of a director is in contract or in delict (extra-contractual) is somewhat controversial in the Swiss doctrine. The difference is important for the question on whom the onus of proof rests. If the liability is in contract the fault of the director is assumed and the onus rests on him to proof that he

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[5] Articles 394 ff CO

[6] BGE 125 III 81 and BGE 128 III 129; Forstmoser et al *Aktienrecht* at § 28 N 5

[7] As opposed to South African law the relationship between directors and the company under Swiss law is not said to be a fiduciary relationship. A director in Switzerland owes legislative corporate duties to the company and not fiduciary duties as understood by South African law. The question whether a director owes duties to a company does not depend on a fiduciary relationship between the company and the director but on the fact whether the director is a formal, material or de facto organ. A contractual fiduciary relationship can be established between a director and a shareholder. Therefore the concept of a fiduciary relationship is different under Swiss law.

[8] Bauen/Venturi *Verwaltungsrat* at N 64

[9] Forstmoser et al *Aktienrecht* at § 28 N 175 ff

did not act in fault (Article 97 (1) CO). If the liability is in delict the onus to proof that the director acted in fault rests on the injured party. *Forstmoser / Meier-Hayoz/ Nobel*[10] are of the opinion that the liability towards the company and the shareholders is in contract, and that therefore the fault of the director can be assumed and that the director has to exculpate himself. They are further of the opinion that the liability towards the creditors is in delict, and that the creditors have the onus to proof that the member acted in fault.

2. Corporate liability in terms of Articles 752-760 CO

2.1. Article 754 CO

Corporate liability is primarily governed through the Articles 752-760 CO. These provisions regulate the liability of persons in the conduct of administration, management and liquidation (organ liability, CO 754), auditing (CO 755), incorporation (CO 753), and the issue of prospectus (CO 752). The liability norms apply to all stock corporations organised under Swiss law and are mandatory. Liability cannot be waived or limited in the company's articles of association.[11]

The dissertation will focus on Article 754 CO (organ liability), as it is the most important liability norm for directors in practice, which states that:

> '(1) The members of the board of directors (Art. 707 et seq.) and all persons engaged in the management (Art. 718-721) or liquidation (Art. 739 et seq.) are liable not only to the company, but also to each shareholder and to the company's obligees for the damage caused by an intentional or negligent violation of their duties.
>
> (2) Whoever rightfully delegates the fulfillment of a duty to another corporate body (Art. 718, para. 2) is liable for any damage caused by it unless he proves that he applied the necessary care in selection, instruction and supervision under the circumstances.'[12]

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[10] Forstmoser et al *Aktienrecht* at § 36 N 35

[11] Forstmoser et al *Haftung* at N 5

[12] English translation of the Official Text by the Swiss-American Chamber of Commerce

2.2. Group of people who can be liable under Article 754 CO

Article 754 CO applies not only to members of the board of directors but also to other persons "engaged" in the management. Generally speaking it applies to formal organs as well as material and de facto organs.

a) Formal Organs

Organs according to the meaning of the norms governing corporate law liability are all members of a board of directors, irrespective of which tasks they actually perform. It is the formal organ function entered in the Register of Commerce, which is decisive.[13] Thus, all members of a board of directors, and members of a board of management, which are registered in the Register of Commerce, are organs in a formal sense and liable in terms of Article 754 CO. Organs in the formal sense can be held liable for all events concerning a company.

b) Material and de facto organs

All persons who actually make decisions reserved by statute to organs in the formal sense are treated as organs, and are therefore also liable under corporate law.[14]

Material organs have been appointed by delegation. They are provided with an area of responsibility, put down in the organisational guidelines. As opposed to formal organs material organs are not registered in the Register of Commerce.

De facto organs are persons who de facto perform a management function without having been appointed to do so.[15] They usurp a management function.

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[13] Forstmoser et al *Aktienrecht* at § 37 N 4
[14] BGE 117 II 572
[15] Bauen/Venturi *Verwaltungsrat* at N 655

The terms include persons who manage the company and play a decisive role in forming its will. However, this should apply only to the highest management of a company. Other persons who influence the course of business on a lower level can be held liable on other legal grounds.[16] In opposition to formal organs, the liability of material and de facto organs extends only to such areas where they have actually acted and exercised influence.[17] An organ in the material sense or a de facto organ can also be a person that is not working in the company. For example shareholders with large holdings or a parent company which exercises effective influence on the conduct of business.[18] An external advisor who exceeds his mandate and participates actively in the decision making process could be a de facto organ.[19]

The question whether a parent company can incur liability as a material or de facto organ, is controversial in the Swiss doctrine. In general, only individuals can be administrative and managing organs. Therefore, the persons acting for the parent company can be deemed to be material organs of the subsidiary. This leads to the same result as if the parent company was an organ, since the acts of their directors can be imputed to the parent company (Article 722 CO).[20]

c) Assumed organ function

The Federal Court has held that an organ function may be assumed when third parties can, in good faith, infer such a position from the circumstances. That is: 'where appearances create the impression that the person in question has an organ function'.[21] An advisor who boasted to third parties that he was a "sleeping" or

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[16] Article 321a (1) CO (liability of employee) and Article 398 (1) and (2) CO (liability of mandataries)

[17] Forstmoser et al *Aktienrecht* at § 37 N 8

[18] Forstmoser et al *Haftung* at N 22

[19] BGE 128 III 92

[20] Article 722 CO states that 'The company is liable for any damage called by illicit acts performed in the course of business by a person authorised to manage or represent it'

[21] BGE 117 II 572 and Forstmoser et al *Haftung* at N 25

undisclosed member of the board of directors was held liable under corporate law.[22]

2.3. Commencement and termination of organ functions

The organ function for formal organs begins at the time of registration in the Register of Commerce or where the individual was active prior to the registration in the Register of Commerce, at the time of appointment to a board of directors. For material, de facto, and assumed organs the organ function commences in general when the person starts to act in the interest of the company and interferes with the company's business.[23] The liability of an organ ends with the factual termination of the organ function, ie when the possibility of influencing the company's decisions ceases.[24]

3. Conditions of liability

Corporate law liability is personal and does not affect the board of directors or the board of management as such. It affects only the individual members of a board of directors or managers. The conditions of liability have to be examined separately for every person involved.[25] For a person to be liable under the corporate liability norm, the following conditions must be fulfilled cumulatively: Damage, breach of duty, adequate causal lien and fault.

3.1. Damage

3.1.1. In general

A precondition for liability is damage, ie financial loss. Damage is the difference between the state of the assets of the injured party and the hypothetical state, which those assets would have had if the damaging event had not taken place.[26] Any form of financial loss is relevant, including

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[22] BGE 117 II 572
[23] Forstmoser et al *Haftung* at N 28
[24] BGE 111 II 484 and BGE 112 V 5
[25] Forstmoser et al *Aktienrecht* at § 36 N 5
[26] BGE 127 III 76

actual loss (*damnum emergens*), ie the decrease of assets or the increase of liabilities, and thwarted profit (*lucrum cessans*).[27] It is irrelevant whether the damaging person made any profit or intended to make any profit from his actions.[28]

3.1.2. Direct and indirect damage

A member of the board of directors can cause harm or loss to the company, the shareholders and the creditors. While a company can only suffer direct damage shareholders and creditors can suffer both direct and indirect damage. Their possibilities to sue depend on the type of damage suffered.[29]

Examples of direct damage would be the case where a creditor has given a company a loan based on a false balance sheet, or where a shareholder has subscribed to a capital increase based on a misleading prospectus. [30]

If a company is damaged directly, its shareholders suffer indirect damage, as the shares are worth less. If the financial loss leads to insolvency and to bankruptcy proceedings the creditors will also suffer indirect damage, because they have to accept a shortfall. Direct damage to a company therefore always implies indirect damage to its shareholders. Creditors on the other hand are only indirectly damaged if a company is bankrupt and can no longer fulfil its obligations.[31]

According to the recent jurisdiction of the Swiss Federal Court, creditors suffer direct damage when the damaging conduct of an organ infringes corporate law provisions designed exclusively to protect the interest of creditors, or constitutes an unlawful act pursuant to Article 41 CO (extra contractual liability) or in the case of *culpa in contrahendo* (conduct in

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[27] BGE 128 III 184 and BGE 129 III 132
[28] Forstmoser et al *Aktienrecht* at § 36 N 60
[29] Bauen/Venturi *Verwaltungsrat* at N 691
[30] BGE 110 II 393
[31] Forstmoser et al *Haftung* at N 82

violation of good faith in the course of contractual negotiations).[32] Indirect damage is given when corporate law provisions, intending to protect the interest of both the company and the creditors, are infringed.

The nature of the damage influences the claims of the shareholders and creditors. Where a shareholder or a creditor has suffered direct damage caused by the conduct of a director he can sue the director and claim damages, regardless whether the company suffered any damages. Where a shareholder has suffered indirect damages (that is where the company has suffered loss) he can only claim that the company be compensated. A creditor who suffered indirect damages can only claim damages if the company is bankrupt.

3.2. Breach of duty

3.2.1. In general

The breach of duty is a special form of unlawfulness and is very important in corporate liability. A financial loss may be replaced only if the damaging party infringed a legal norm aiming to protect the interest of the company, the shareholders, and/or the creditors.[33]

The duties of members of the board of directors are not set out in detail in the corporate liability law. Article 754 (1) CO speaks generally of 'damage caused by an intentional or negligent violation of their duties'. This article implies a reference to duties set out elsewhere in statute (ie Article 716a CO which details non-transferable and inalienable duties of board of directors and Article 717 CO which states the general duties of equal treatment of the shareholders, the duty of care and loyalty), or in the articles of association.[34]

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[32] BGE 125 III 88 and BGE 127 III 377

[33] Bauen/Venturi *Verwaltungsrat* at N 698

[34] Forstmoser et al *Haftung* at N 91 and Böckli *Aktienrecht* at § 18 N 379

The duty of care is the essential norm of corporate liability of directors.[35] This duty is not an independent norm of conduct but rather a minimal standard of how to fulfil specific duties.[36] The duty of loyalty has two arguments to it. On the one hand it contains – like the duty of care – a general standard of conduct for the fulfilment of the duties. Members of board of directors have to fulfil their duties not only with due care but also in "good faith", ie in the interest of the company and without conflict of interests. On the other hand the duty of loyalty contains an independent duty of conduct; an independent duty to refrain from intentionally or contingently committing financial damage.[37] The equal treatment of shareholders has to be seen as a relative and not an absolute equality: the shareholders have to be treated equally under the same circumstances.[38]

3.2.2. Specific duties of directors: Non-transferable and inalienable duties in terms of Article 716a CO[39]

Article 716a (1) CO contains a list of non-transferable and inalienable duties. These duties are non-transferable and inalienable because they cannot be delegated to a board of management. The list was intended to be exhaustive but it is not since the Code of Obligations allocates further inalienable duties to the board of directors, eg Article 652g (1) CO (ascertainment that an ordinary capital increase has been carried out).[40]

> "(1) The board of directors has the following non-transferable and inalienable duties:
> 1. The ultimate management of the Company and the giving of the necessary directives;
> 2. The establishment of the organization;
> 3. The structuring of the accounting system and of the financial controls as well as the financial planning insofar as this is necessary to manage the Company;
> 4. The appointment and removal of the persons entrusted with the management and the representation (Arts. 718-721);

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[35] Bauen/Venturi *Verwaltungsrat* at N 699

[36] Böckli *Aktienrecht* at § 18 N 380

[37] The duty of loyalty is seen as an independent norm because its breach can result in a criminal offence and is regulated by Article 158 of the Criminal Code ("disloyal management").

[38] Böckli *Aktienrecht* at § 18 N 383 and see paragraph B.3.2.3.3.

[39] There are other specific duties in the Code of Obligations, as for example in Article 634a (1) (Demands that partially unpaid-for shares be fully paid up)

[40] Forstmoser et al *Haftung* at N 112

5. The ultimate supervision of the persons entrusted with the management (Arts. 718-721), in particular, in view of compliance with the law, the articles of incorporation, regulations, and directives;
6. The preparation of the business report (Art. 663d) as well as the preparation of the general meeting of shareholders (Art. 698 et seq.), and the implementing of its resolutions;
7. The notification of the judge in the case of over indebtedness (Arts. 725-725a).'

a) Ultimate management of the company (Article 716a (1) (1) CO)

With the expression "ultimate management" the Code of Obligations seeks to emphasise the difference between important but transferable duties and non-transferable duties. The board of directors is expected to ultimately manage the company, and to determine the strategic direction of the company. All other management functions can be delegated to a board of management. Ultimate management contains inter alia the duty to set the goals and lay down corporate policies, select the means and resources to achieve the goals, and give the necessary directives to the board of management on how to achieve these goals.[41]

b) Establishment of the structure of the organisation (Article 716a (1) (2) CO)

The board of directors – and not the general meeting of shareholders as an organ – has the responsibility to establish the company's organisation. The intervention of the shareholders' meeting is limited, since it is not allowed to approve the organisational guidelines. The organisational guidelines form the basis of the organisational structure of any company. Furthermore the board of directors has the duty to examine the organisational structure regularly and to adapt the existing organisational structure to the changing circumstances.[42]

c) Financial responsibility (Article 716a (1) (3) CO)

The board of directors is obliged to take care of the financial position of the company both in the expansion and in the retrenchment of the business.[43] The financial function can be delegated to other persons but the

[41] Böckli *Aktienrecht* at § 13 N 306
[42] Bauen/Venturi *Verwaltungsrat* at N 435
[43] Böckli *Aktienrecht* at § 13 N 340 f

board of directors bears the responsibility that the function is being executed properly.

d) Appointment and removal of the board of management (Article 716a (1) (4) CO)

With the appointment of the members of the board of management, the board of directors decides in principle on the success or failure of the company. Therefore the board of directors is not only obliged to appoint the appropriate members to the board of management but also to observe and support them after their appointment.[44] If the board of directors realises that an appointed member of the board of management is not able to perform its essential duties, the board of directors is obliged to act. It has to remove the member if the member of the board of management does not comply with the law, the articles of association or the guidelines and directives of the board of directors.[45]

As pointed out before the board of directors can delegate the management to a board of management (Article 716 (2) CO). The delegation of management competence is not only a right but, under certain circumstances, a duty, in particular when a director is not in a position to properly perform the necessary management tasks.[46] Corporate law sets out formal restrictions and material limitations to the delegation of tasks. Article 716b (1) CO governs the formal conditions for the delegation of competence:

> 'The Article of incorporation (Art. 627, subpara. 12) may authorize the board of directors to fully or partially delegate the management to individual members or third parties in accordance with an organizational regulation.'[47]

Therefore a basis in the articles of association and a set of organisational guidelines are necessary for a partial or full delegation of management. The board of directors is not free to dispose of all of its duties simply by delegating them to the board of management and thus concentrating entirely on the supervision. The material limitation of the

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[44] Bauen/Venturi *Verwaltungsrat* at N 453
[45] Böckli *Aktienrecht* at § 13 N 360 and 363
[46] Forstmoser et al *Haftung* at N 100
[47] English translation of the Official Text by the Swiss-American Chamber of Commerce

delegation is set out in Article 716a (1) CO, which contains the substantial list of non-transferable and inalienable tasks of a board of directors.[48]

Proper delegation can considerably reduce the liability risk of directors according to Article 754 (2) OR:

> ' Whoever rightfully delegates the fulfilment of a duty to another corporate body (Art. 718, para. 2) is liable for any damage caused by it unless he proves that he applied the necessary care in selection, instruction and supervision under the circumstances.'[49]

The wording of Article 754 (2) CO emphasises the residual liability, which remains despite delegation. More important though is the exemption from liability permitted by this provision: a person who properly delegates a task is not liable if he can prove that in the selection, instruction and supervision of such an organ the necessary diligence was exercised under the circumstances. The onus lasts on the director to prove that he exercised the necessary diligence in the selection, instruction, and supervision. [50]

e) Ultimate supervision of the board of management (Article 716a (1) (5) CO)

The ultimate supervision of the board of management is one of the most important duties of the board of directors besides the duty to appoint the appropriate members to the board of management. The supervision of the board of management is not limited to the examination of compliance with the law, articles of association, guidelines or directives. It also includes business aspects, as for example the suitability of a decision.[51]

f) Annual report and organisation of the general meeting of shareholders (Article 716a (1) (6) CO)

The board of directors is responsible for the annual report, which consists of the financial statement, where appropriate the consolidated financial statements, and the business report. The composition of the annual report can be delegated to the board of management. The board of

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[48] See paragraph B.3.2.2.
[49] English translation of the Official Text by the Swiss-American Chamber of Commerce
[50] Forstmoser et al *Haftung* at N 103
[51] Böckli *Aktienrecht* at § 13 N 373 f

directors has to submit the annual report to a qualified external auditor. The board of directors has furthermore the duty to organise and lead through the general meeting of shareholders.[52]

g) Notification of the judge in the case of over indebtedness (Article 716a (1) (7) CO

If there is a substantiated concern of over indebtedness[53] an interim balance sheet must be prepared and submitted to an external auditor for examination. If the interim balance sheets shows that the claims of the company's creditors are neither covered if the assets are appraised at on-going business values nor at liquidation values, the board of directors has to notify the judge (Article 725 CO).

3.2.3. Duty of care, duty of loyalty and duty of equal treatment

The duty of care, duty of loyalty and duty of equal treatment have their legal grounds in Article 717 CO:

> '(1) The members of the board of directors as well as third parties engaged with the management shall carry out their duties with due care and must duly safeguard the interests of the Company.
>
> (2) Circumstances being equal, they shall give equal treatment to shareholders.'[54]

3.2.3.1. Duty of care

3.2.3.1.1. Manifestations of duty of care

When being appointed to the board of directors every director must bring the required knowledge and ability and apply due care and time in the management of the company.[55] In addition to that directors must act with due care in the selection, instruction, and supervision of the persons entrusted with the management.[56] There is no specific duty of skill in the Swiss law. The duty of care includes such a duty of skill. A director is required to procure the ability and knowledge generally required to perform

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[52] Bauen/Venturi *Verwaltungsrat* at N 477 f

[53] Over indebtedness means that half of the share capital and the legal reserves are no longer covered

[54] English translation of the Official Text by the Swiss-American Chamber of Commerce

[55] Forstmoser et al *Aktienrecht* at § 28 N 19

[56] "curia in eligendo, instruendo et custodiendo"

his duties and keep his knowledge up to date. A director who takes on the mandate despite his lacks of necessary expertise or experience will be at fault for this very reason ("assumption of fault").[57]

3.2.3.1.2. Standard of care

The standard of care is determined by objective criteria. The judge will compare the conduct of a director with the conduct of a reasonable and proper person under the given circumstances.[58] The Roman law principle of "diligentia quam in suis"[59] is not applicable.[60]

As the objective standard is also applicable in the determination of fault, the theoretical line between the duty of care on the one hand and fault on the other is virtually redundant. In practice breaches of duty of care and fault are rarely distinguished. The same can be said for the business judgement rule.[61] As the objective standard and the business judgement rule have an effect both on assessments of compliance with duties of care as well as questions of possible fault, it will be discussed under paragraphs B.3.4.2. and B.3.4.3. (fault).

3.2.3.1.3. Examples of care

a) Care in accepting and holding a directorship

A person who is elected to the board of directors must procure the ability and knowledge generally required to perform his duties and keep it up to date.[62] A person taking on or continuing a mandate without being up to the position acts without care. In this case the person should ask for further training, support and advice of specialists or give up his mandate.[63]

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[57] The concept of "assumption of fault" states that a person who knew or should have known that he or she lacks the necessary education and knowledge in order to fulfil a duty with due care cannot escape liability by stating that he or she was not skilled enough. The person should not have taken on the mandate or function. BGE 124 III 155

[58] BGE 99 II 179, BGE 113 II 56 and BGE 122 III 198

[59] The Roman law principle states the standard of care that a person would apply in his own affairs.

[60] Bauen/Venturi *Verwaltungsrat* at FN 142

[61] Forstmoser et al *Haftung* at N 152 f

[62] Forstmoser et al *Aktienrecht* at § 28 N 19

[63] BGE 122 III 197 and BGE 97 II 411

A director cannot avoid liability by pleading his own inexperience, lack of knowledge or insufficient ability.[64]

b) Care in the structure of the organisation

Members of board of directors have the duty to set up the company's organisation and to adapt a suitable organisational structure and enact suitable directives so that the members of the board of management are able to fulfil their own duties.[65]

c) Care in the fulfilment of duties

Directors have to dedicate a necessary amount of time to their duties. Lack of time is no reason for exculpation. They have to read the reports of the management very critically, ask follow-up questions and exercise their right of examination, in order to perform their supervisory duty with care.[66]

d) Care in the financial management

Members of the board of directors have to keep themselves informed about the development of the cash flow, liquidity, and the general financial situation in a substantial manner. Not only on the occasion of the annual financial statement but also during the business year.[67]

e) Care in the investment of the assets

Members of the board of directors must comply with the principle of an appropriate risk distribution and avoid a cluster risk for non-essential operating capital.[68]

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[64] BGE 99 II 179
[65] Böckli *Aktienrecht* at § 13 N 565
[66] Bauen/Venturi *Verwaltungsrat* at N 173 and Böckli *Aktienrecht* at § 13 N 567
[67] Böckli *Aktienrecht* at § 13 N 568
[68] Bauen/Venturi *Verwaltungsrat* at N 175

f) Care in the selection of the board of management and duty to intervene

Directors have the duty to select and instruct the managers. If a member of the board of management does not meet the demands, the directors have also the duty to relieve this person from office. If the directors do not carry out this duty of intervention they act in breach of their duty of care.[69]

3.2.3.2. Duty of loyalty

The duty of care obliges the directors to act in a reasonable and conscientious manner. The duty of loyalty goes beyond the standard of duty of care and requires that the directors refrain from any conduct that could possibly damage the company.[70]

The following aspects of the duty of loyalty have to be considered:

a) Duty to act in the interests of the company

Article 717 (1) OR states the duty of directors to 'safeguard the interests of the company'.[71] The question is though what the interests of the company are. According to a common but not undisputed opinion it is beyond doubt that Swiss corporate law seeks to protect the company as a going concern.[72] In addition to the interests of the company, the interests of the shareholder group, creditors, and – to some extent – the interests of the employees have to be considered.[73] The duty to act in the interest of the company can best be explained in its negative aspect: The directors are required not to place the interest of other persons – themselves, individual shareholders or third persons – above the interest of the company.[74] Therefore they are not allowed to conclude a contract adversely affecting the company, as they would be liable in terms of Article 754 OR.[75] If a

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[69] Böckli *Aktienrecht* at § 13 N 570 f
[70] Bauen/Venturi *Verwaltungsrat* at N 190
[71] See paragraph B.3.2.3.
[72] BGE 51 II 427 and BGE 100 II 393
[73] Forstmoser et al *Aktienrecht* at § 3 N 11
[74] BGE 113 II 56
[75] Böckli *Aktienrecht* at § 13 N 600

director concludes a contract with the company the contract has to be dealt with "at arm's length".[76]

The question whether directors of subsidiaries are allowed to follow the instruction of the parent company in the interest of the group is controversial in the Swiss doctrine. In practice there are cases where directors of subsidiaries conclude contracts with the parent company and undertake to submit to the directives of the parent company. *Böckli*[77] is of the opinion that such a contract does not conflict with the Swiss law. He explains that the intention of Article 663e CO that speaks of 'one or more companies under a common management' implies an overall management, the consolidation of competences and the restriction of self-management of the subsidiary. A breach of duty of the director of the subsidiary would only occur if the director did not act in the overall interest of the group. In a decision of the Swiss Federal court, a director of a subsidiary was held liable, not because he acted in the interest of the group but because he acted in the interest of a sister company of the same group. The Court did not decide whether the director would have breached his duty had he acted in the interest of the overall group.[78]

If there is a contractual relationship between a shareholder as a beneficiary and a director as a fiduciary the question arises to what extent the director may follow the instructions of the shareholder without breaching his duty of loyalty towards the company. The theory of "double nexus of duties" states that a director can follow the instructions of third persons as long as the instructions are in line with the interest of the company. A director breaches his duty of loyalty only if he – in a conflict situation – acts in the interest of the shareholder rather than in the interest of the company.[79]

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[76] "Dealing at arm's length" means that the contract between the director and the company has to be concluded to the same conditions as if the company would conclude the contract with a third party.

[77] Böckli *Aktienrecht* at § 13 N 618

[78] BGE 130 III 113

[79] Forstmoser et al *Aktienrecht* at § 28 N 177

The question is though how does a board member have to act in a situation where a conflict of interests occurs. A legal transaction, tainted with a conflict of interests between a director and the company, has to be approved by the board of directors and not by the general meeting of shareholders.[80] Directors are required to disclose their interests.[81] A director is in principle permitted to vote in a matter that affects his own interests. Only where the director's interests conflict with the interests of the company in a very material manner – for example where the director harms the company to the same extent as he benefits himself or third parties – will he not be allowed to vote in his own favour.[82]

b) Competition with the company and corporate opportunities

A director should not poach customers of the company and grasp corporate opportunities. The restraint of trade requires a case-to-case consideration of the facts and is a matter of opinion of the courts. The duty of executive directors not to compete goes further than the duty of non-executive directors. The restraint of trade can conflict with the acceptance of a directorship in a competing company.[83] The provisions of Article 423 (1) CO ("management without a mandate") may under certain circumstances allow the company to take over the competing business of the member of the board of directors and to acquire the profits gained. Under the principle of "management without mandate" the company will have to show that the director acted in the interest of the company, and that he was obliged to act for the company and not for himself.

c) Insider dealing

The duty of loyalty in terms of Article 717 (1) CO prohibits directors from taking advantage of insider information. This applies not only to the

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[80] The general meeting of shareholders is not suited to make such decisions because the concept of the general meeting is not to make decisions regarding the management of the company. The general meeting is an organ qualified to elect the board of directors, to accept the statement of the board of directors, the capital structure of the company and the articles of association. Bauen/Venturi *Verwaltungsrat* at N 207

[81] Forstmoser et al *Aktienrecht* at § 28 N 32

[82] Böckli *Aktienrecht* at § 13 N 637

[83] Forstmoser et al *Aktienrecht* at § 28 N 37

buying and selling of assets but also to every information and event that has an impact on the quoted share price and is not publicly known.[84] Insider dealing is a criminal offence and regulated by Article 161 of the Criminal Code.

d) Duty of secrecy

The duty of loyalty includes a duty of secrecy.[85] The duty of secrecy concerns internal affairs of the company such as financial details, economic concepts, ongoing contract negotiations, existing business relations, structure of shareholders, and trade secrets. Infringement of this duty is a criminal offence and regulated by Article 162 of the Criminal Code.

3.2.3.3. Duty of equal treatment

The directors are under the duty to treat all shareholders equally under equal conditions (Article 717 (2) CO). Contrary to the wording of Article 717 (2) CO the shares and not the shareholders have to be treated equally.[86] According to the jurisdiction of the Swiss Federal Court, unequal treatment can be permissible if it is not arbitrary and if it is a suitable way to achieve a permissible goal.[87] The unequal treatment of different groups of shareholders is justified if the difference is based on objective grounds, justified by the interest of the company, necessary, and proportional. The principle of equal treatment under equal conditions would for example be violated if not all shareholders had the possibility to sell a part of their shares in a buy-back or if the conditions for the buy-back were different without any justification.[88]

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[84] Böckli *Aktienrecht* at § 13 N 616

[85] Forstmoser et al *Aktienrecht* at § 28 N 40

[86] There are different classes of shares, ie bearer shares, registered shares, shares with privileged voting rights, preferred shares, participation certificates, profit sharing certificates. The shareholders of different classes of shares have different rights depending on the class of shares or certificate. Therefore not all the shareholders but the shareholders within the classes of shares have to be treated equally. Bauen/Venturi *Verwaltungsrat* at N 210

[87] BGE 117 II 312

[88] Forstmoser et al *Aktienrecht* at § 39 N 50

3.3. Adequate causal lien between the damage and the breach of duty

There must be a causal lien between a breach of duty and the damage. The act or omission in question must be a cause of the damage i.e. without the breach of duty no damage would have arisen. It is to say though that there is liability only where the damage is not too remote. A natural causal lien is not sufficient; such causation must be adequate.[89] The standard test applied by the Swiss Federal Court requires that the breach of duty be such that in the normal course of events and according to general experience of life it is capable of causing damage of the type, which has occurred, so that the occurrence of such damage is generally furthered by such conduct.[90] The adequate causal lien can be interrupted by a major fault of the injured party, a major fault of a third party or by force majeure.[91]

3.4. Fault

3.4.1. In general

Any form of fault is sufficient for liability under Articles 752 ff CO. This includes mere negligence. Negligence requires that the damage is foreseeable to the organ causing the damage. It is sufficient that such an organ should have noticed, given the standard of care and awareness that can reasonably be expected of him, that there was a specific risk of damage being caused. The conduct in question must be judged bearing in mind the exponent's state of mind and the circumstances at the time of the event.[92]

3.4.2. Determination of the required care

The courts apply an objective standard of fault, according to which it is not sufficient that an organ applies the same care as he would apply in his own affairs.[93] The question whether an organ is at fault is judged according to how a reasonable and correct person should have behaved under the

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[89] Forstmoser et al *Haftung* at N 157
[90] BGE 123 III 112 and BGE 113 II 56
[91] Krneta *Die Haftung des Verwaltungsrates* 2003 at p 4
[92] Forstmoser et al *Aktienrecht* at § 36 N 75 ff
[93] BGE 122 III 198 and BGE 113 II 56

given circumstances.[94] The objective standard of fault has two consequences:[95]

- There can be no subjective excuse, for example lack of time, ignorance or incompetence. Therefore, someone who takes on a mandate although he lacks the necessary expertise or time is at fault for this very reason ("assumption of fault")[96].

- The specific circumstances must be considered, for example the justification of incurring certain risks as a result of the purpose of a company, or on the contrary that particular caution would have been appropriate.

Specific knowledge or abilities of directors have to be taken into account. Directors can rely on the opinion of other directors with specific knowledge, because it cannot be expected that all directors have specific knowledge in all areas.[97]

The courts and the doctrine have pointed out some principles according to which the required care can be determined. These principles can be divided in a) instances in which a higher degree of care is required, and b) in arguments that are not accepted as sufficient in the case of an alleged breach of care. [98]

a) Instances in which a higher degree of care is required:

- The more responsibilities the activities of the persons involved, the greater the degree of care that is required from them.
- A higher degree of care can be expected of organs with special professional qualifications as far as activities in their field are concerned.

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[94] BGE 113 II 56 and BGE 99 II 179
[95] Forstmoser et al *Haftung* at N 139 f
[96] See FN 57
[97] Bauen/Venturi *Verwaltungsrat* at N 695
[98] Forstmoser et al *Haftung* at N141; Forstmoser et al *Aktienrecht* at § 36 N 84 ff

b) Arguments that are not accepted as sufficient in the case of an alleged breach of care:

- The person responsible cannot exculpate himself by showing that he used the same care as in his own affairs.
- A particularly strict standard applies in the case of conflict of interest that is where the damage is caused by an act which an organ performs for his own benefit or for the benefit of a third party.
- Lack of time or unjustified absence is not a ground for exculpation.

3.4.3. Carefully deliberated but wrong management decisions and Business Judgement Rule

Business activities involve taking risks. Such risks are linked with the attainment of entrepreneurial opportunities. It is important that wrong (not careless) decisions of directors do not automatically lead to their liability. If a director can show that he made his decision after careful deliberation, he did not act in fault. A judge shall decide on the situation as it was at the time of the decision-making i.e. under consideration of the level of knowledge of that time and in ignorance of the future events.[99] The Anglo-American principle of the business judgement rule is based on this idea. It states that not all decisions by directors will result in a benefit for the company or will appear to be prudent. The courts will not second-guess business decision by directors so long as they follow an appropriate procedure in making the decision.[100]

This Anglo-American principle can be used for the Swiss board of directors as a guideline since the level of care in the decision-making is examined. However, a sole restriction to this formal aspect is not possible under Swiss law because Swiss law does not deal with the formation of the decision-making but asks the question whether the decision was well founded. The decisions of directors have to be understandable and

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[99] Bauen/Venturi *Verwaltungsrat* at N 180

[100] Knepper/Bailey *Liability of Corporate Officers and Directors* at § 2.01-2.14 in Bauen/Venturi *Verwaltungsrat* at N 182

objectively justified.[101] A disputed decision of a director is in principle proper and has carefully been made if the following criteria are given:

- The decision does not infringe compulsory law provisions (as for example a contravention of the Competition Act);
- The decision was made in the interest of the company and does not contradict the purpose of the company;
- The decision was made in a proper manner;
- The decision was made without any relevant conflicts of interests;
- The decision has to be understandable and objectively justified.[102]

Even if the decision appears to be wrong in retrospect it has to be seen as an acceptable business judgement if the criteria mentioned above are complied with.[103] In such a case a director cannot be accused of violating his duty of care.[104]

The business judgement rule may have found its way into decisions of the Federal Court but it is not the standard criterion to decide whether a member of board of directors acted with fault. *Forstmoser / Sprecher / Töndury*[105] hope that in the future the business judgement rule will be used more often to assess the conduct of organs. They are of the opinion that it would lead to more objective and foreseeable court practice in questions of corporate liability.

4. Grounds for the extinction of the claim or exclusion of a suit

The most common reasons for the extinction of a claim or the exclusion of a suit are release (Décharge), court judgements and

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[101] Bauen/Venturi *Verwaltungsrat* at N 183
[102] Böckli *Aktienrecht* at § 13 N 584 and 588 ff
[103] Bauen/Venturi *Verwaltungsrat* at N 189
[104] Böckli *Aktienrecht* at § 13 N 585 f
[105] Forstmoser et al *Haftung* at N 150

settlements, the limitation of time, conduct on account of a decision of the shareholder meeting, and conduct with the approval of all shareholders.

4.1. Release (Décharge)

Release leads under certain circumstances to the extinction of some claims for damages according to Article 758 CO:

> '(1) The resolution of release passed by the general meeting of shareholders is effective only for facts that have been disclosed and only vis-à-vis the Company and those shareholders who consented to the resolution, or who acquired shares subsequently with knowledge of the resolution.'[106]

Resolutions granting release fall in the inalienable competence of the shareholders' meeting and are normally made at the ordinary annual meeting of the shareholders (Article 698 CO). The release affects the liability of directors. If the conduct of a director has been released in the shareholders' meeting, the director cannot be held liable. The facts are discussed at the annual meeting of shareholders and the shareholders grant release by passing the resolution with the absolute majority[107] of the votes allocated to the shares represented (Article 699 CO).

The effects of a resolution granting release shall not be overestimated for two reasons: The resolution only covers disclosed facts and the majority of liability suits are brought after the opening of a bankruptcy proceeding by the administrator in bankruptcy, and a release grants no protection against such claims.[108]

The effects of a valid resolution granting release are that any claims of a company for damages are extinguished (Article 758 (1) CO). Furthermore a valid resolution extinguishes the claims of those shareholders who voted in favour of the release for indirect damage, as well as of those shareholders who acquired their shares subsequent to the resolution but in awareness thereof (Article 758 (1) CO). The release has no

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[106] English translation of the Official Text by the Swiss-American Chamber of Commerce
[107] Absolute majority means 51% of the votes allocated to the shares represented
[108] Forstmoser et al *Haftung* at N 169

effect on the right of creditors to sue for indirect damages, and the resolution granting release cannot be pleaded as a defence against an action after the opening of bankruptcy proceedings. To conclude the resolutions have no influence on claims of shareholders and creditors for direct damages.[109]

4.2. Judgments and settlements

The effects of judgments and settlements on liability claims are controversial in the doctrine and have only partially been clarified by the courts. The question whether claims are extinguished by judgment or settlement must be examined from case to case. The most frequent case of a court judgment in proceedings is brought by the administrator in bankruptcy[110] and is binding on both shareholders and creditors and terminates the matter.[111]

4.3. Statute of limitations and debarment

Article 760 CO contains a uniform rule governing the statute of limitations, regardless of the type of damage and the legal basis for damages. Claims become statute-barred five years after an injured party becomes aware of the existence and the quantum of the damage, the identity of the person who caused the damage, and the facts giving rise to liability (relative statute of limitations). Ten years from the day of the damaging event (absolute statute of limitations) is the latest.[112]

4.4. Act based on a shareholders' resolution or ratified by shareholders

A company cannot claim damages where its organs caused damage by executing valid and not contested resolutions of the general shareholders' meeting. Even an invalid resolution of the shareholders' meeting in favour of which all the shareholders voted precludes the right of

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[109] Forstmoser et al *Haftung* at N 165

[110] If the company is bankrupt it is not allowed to act without the consent of the administrator in bankruptcy

[111] Forstmoser et al *Haftung* at N 170 f

[112] Forstmoser et al *Haftung* at N 172 f

the company to sue. It may also be assumed that informal consent by all the shareholders or the sole shareholder has the same effect.[113]

5. Conclusion

A director can be held liable in terms of Article 754 CO for a breach of his duties if the plaintiff can show, that the company suffered damage, that the director infringed one of his duties, and that there is an adequate causal lien between the damage and the breach of duty. The liability towards the company and the shareholders is in contract, and the fault of the director can be assumed. The director will have to exculpate himself and show that he did not act in fault. If the plaintiff is a creditor, the liability is in delict and the creditor has to prove that the director acted in fault.

C. Corporate liability of company directors in South Africa

1. In general

South African law does not follow the same approach as the Swiss corporate law. There is no equivalent section to Article 754 CO regarding the liability of companies' directors. Rights and duties of directors are primarily determined by their contracts (if any) with the company, the Companies Act 61 of 1973 (thereafter called the "Act"), the company's memorandum or articles of association and the common law.[114] As the South African Company law developed from English law, English cases have a great influence on the South African jurisdiction and are often cited in the court cases and in the commentaries of writers.

The personal liability of directors is to some extend regulated trough the provisions of the Act (eg s 424: Liability for reckless or fraudulent conduct of business, s 86: Liability of directors for buy-backs). There are furthermore duties that are not codified and the grounds of liability for the

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[113] Forstmoser et al *Aktienrecht* at § 36 N 157 f
[114] Cilliers et al *Corporate Law* at p 134

breach of these duties have to be found in common law.[115] The common law imposes on directors a) the fiduciary duty to conduct the company's affairs honestly and in the interest of the company; and b) the duty to act with care and skill.[116]

As the analysis of all duties of companies' directors would go beyond the scope of this dissertation, I will focus on the common law duties. The analysis of these duties will include a comparison with the Swiss rules of directors' liability discussed before.

2. Fiduciary duties

a) South African law

2.1. Existence of a fiduciary relationship

To ascertain whether a person owes fiduciary duties to a company a fiduciary relationship between this person and the company has to exist. The existence of a fiduciary relationship was discussed in the *Phillips*[117] case, where the court referred to English and South African cases. The appellant in the *Phillips* case submitted that the claim was based on breaches of contractual terms and not on breaches of fiduciary duties. The court referred to the *Hodgkinson*[118] case where it was held that '(T)he existence of a contract does not necessarily preclude the existence of fiduciary duties between the parties. On the contrary, the legal incidents of many contractual agreements are such as to give rise to a fiduciary duty.' It was held that the existence of a fiduciary duty and its nature and extent depends on the substance of the relationship and on 'any relevant circumstances which affect the operation of that relationship'.[119] The court went on to cite the *Robinson*[120] case where it was held that 'Where one

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[115] Some of these duties will be included in the revised Companies Bill (latest draft: Draft 2008)

[116] Blackman *Vol. 2* at 8-29

[117] *Phillips v Fieldstone Africa (Pty) Ltd and Another* 2004 (3) SA 465 (SCA)

[118] *Hodgkinson v Simms* [1994] 3 SCR 377 (SCC)

[119] *Phillips v Fieldstone Africa (Pty) Ltd and Another* 2004 (3) SA 465 at 477 and *Bellairs v Hodnett and Another* 1978 (1) SA 1109 (A) at 1130

[120] *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168 at 177-80

man stands to another in a position of confidence involving a duty to protect the interests of that other, he is not allowed to make secret profits at the other's expense or place himself in a position where his interests conflict with his duty.' It was further held that 'Whether a fiduciary relationship is established will depend upon the circumstances of each case.' The court held that these principles remain true.[121] The appellant submitted further that a distinction existed between the doctrine as applied to company directors and agents on the one hand and employees on the other. The court replied that 'The South African cases which recognise the duty of an employee to account for profits received in breach of a fiduciary duty do not lay down that such a duty can arise only in the relationship of managerial employees to their employers'.[122] They further referred to the *Hodginkson*[123] case where it was held that 'It is the nature of the relationship, not the specific category of actor involved that gives rise to the fiduciary duty.' In conclusion the court referred to the *Hodgkinson*[124] case and pointed out three characteristics for the question whether fiduciary obligations have been imposed in a relationship:

> ' (1) scope for the exercise of some power; (2) that power or discretion can be used unilaterally so as to effect the beneficiary's legal or practical interests; and (3) a peculiar vulnerability to the exercise of that discretion of power.'

To sum up it can be held that any relationship that meets these requirements are fiduciary relationships and result in fiduciary duties. The nature of the relationship and not the title as director or officer is decisive for the question whether a person owes fiduciary duties to a company.

The fiduciary relationship imposes various fiduciary duties on the directors. These duties will be discussed under paragraph C.2.4.

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[121] *Phillips v Fieldstone Africa (Pty) Ltd and Another* 2004 (3) SA 465 at 479
[122] *Phillips v Fieldstone Africa (Pty) Ltd and Another* 2004 (3) SA 465 at 481
[123] *Hodgkinson v Simms* [1994] 3 SCR 377 (SCC)
[124] *Hodgkinson v Simms* [1994] 3 SCR 377 (SCC) where the Judge referred to *Frame v Smith* [1987] 2 SCR 99 (SCC) at 136

2.2. Group of people that may owe fiduciary duties

Each person that holds the office of director, regardless whether he is an executive, non-executive or managing director owes fiduciary duties[125], when a fiduciary relationship between that person and the company is established. Officers of a company, whether defined as such by the Companies Act or not stand under the same fiduciary relationship as directors and are subject to the same fiduciary duties.[126]

Directors are entrusted with the protection of the company's interests and the care of its business and with the custody and disposal of the company's assets.[127] The purpose of the fiduciary duties imposed on the directors is to ensure that the directors exercise their powers for the purpose for which they were given and to protect the company and the shareholders from vulnerability.[128]

A formal appointment to the office of director (de jure director) is not necessary. Also nominee directors, de facto directors and puppeteer directors have the same fiduciary duties as de jure directors.

aa) Nominee directors

A nominee director is a person nominated to act as a director by another person, for example a shareholder. The duties of nominee directors are the same as those of other directors and they may not subordinate the interests of the company to the interests of the persons who nominated them.[129]

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[125] Van Dorsten *Law of company directors* at p 223
[126] Blackman *Vol. 2* at 8-29
[127] Van Dorsten *Law of company directors* at p 223
[128] *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168 at 177-78
[129] *Fisheries Development Corporation of SA Ltd v Jorgensen* 1980 (4) SA 156 (W) at 163

ab) De facto directors

A de facto director is a person who has been appointed as a director but the appointment is subsequently shown to be defective.[130] A person who has not been appointed as a director will under no circumstances be a director for the purpose of the Companies Act.[131]

ac) Puppet or dummy directors

A puppet director is a person placed on the board who pretends to have taken part in resolutions of which he knows nothing. The person who manipulates the puppet director does not escape the fiduciary duties of a director either.[132] A dummy director is a person who is indifferent to, or ignores or does not understand the affairs of the company and has the same duties and responsibility as any other director.[133]

ad) Commencement and termination of relationship

If there is no formal appointment, the relationship will exist from the time the person concerned commenced to act as a director.[134] The general rule is further, that a person ceases to be under fiduciary duties when he ceases to hold office. This general rule is subject to some exceptions: termination of office does not release a person from fiduciary duties in relation to confidential information and taking corporate opportunities.[135]

b) Comparison with Swiss law

Directors under Swiss law do not owe fiduciary duties as understood by South African law. But they owe similar duties (duty of loyalty), as will be

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[130] *R v Mall and Others* 1959 (4) SA 607 (N) at 622
[131] Van Dorsten *Law of company directors* at p 20
[132] *S v De Jager* 1965 (2) SA 616 (A); *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168
[133] *Fisheries Development Corporation of SA v Jorgensen* 1980 (4) SA 156 (W) at 166
[134] Blackman *Vol. 2* at 8-36
[135] Blackman *Vol. 2* at 8-36

shown in the following paragraphs. The basis for the duties is different under Swiss law. As pointed out under paragraph C.2.1. the fiduciary duties in South Africa flow from the fiduciary relationship. It has to be shown that there is a fiduciary relationship between a person and the company in order to tell whether this person owes fiduciary duties. In Swiss law the duty of loyalty is rooted in Article 717 (1) CO, where it is held that 'The members of the board of directors as well as third parties engaged with the management ...must duly safeguard the interests of the Company.' The decisive question under Swiss law to ascertain whether a person owes duties to the company is whether a person is an organ of the company and not whether there is a fiduciary relationship between that person and the company. If a person is a formal, material or de facto organ[136] he owes the statutory duties (including duty of loyalty) to the company.

The distinction between different groups of directors is also made under South African law but it does not have the same importance as under Swiss law. The distinction under Swiss law is important for the question whether a person owes duties to a company and whether this person can be held liable under Article 754 CO. Under South African law the important question is whether there is a fiduciary relationship between a person and the company and not whether a director is a nominee, de facto or other director.

2.3. Fiduciary relationship to shareholders, holding, group, subsidiaries and creditors

2.3.1. Relationship to individual shareholders

a) South African law

Directors do not owe in general any fiduciary duties to individual shareholders.[137] In the *Allen v Hyatt*[138] case it was held, that directors may become agents of shareholders for a particular transaction, in which case the situation of agency gives rise to fiduciary duties. In the *Fisheries*

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[136] See paragraph B.2.2.
[137] *Percival v Wright* [1902] 2 Ch 421 at 425-27
[138] *Allen v Hyatt* [1914] 30 TLR 444

Development[139] case it was held, that a director may represent the interests of the person who nominated him, and that he may even be the servant or agent of that person, but that he is in law obliged to serve the interests of the company to the exclusion of the interests of such a person.

In my opinion, the general fiduciary duty of a director towards the company and a possible contractual fiduciary relationship between a director and a shareholder has to be distinguished. If the director acts in the interest of the shareholder – with whom he stands in a contractual relationship – he is liable towards the company for a breach of his fiduciary duties and the shareholder cannot claim execution of the contractual obligations.

b) Comparison with Swiss law

The situation regarding the relationship between directors and individual shareholders is similar under Swiss law. A director who stands in a contractual fiduciary relationship towards a shareholder breaches his duty of loyalty towards the company if he does not act in the interest of the company. According to Swiss law, it is allowed to conclude a fiduciary contract with a shareholder and to follow his instructions, as long as the instructions are in line with the interests of the company and as long as there is no conflict situation.[140]

2.3.2. Relationship to holding, group and subsidiaries

a) South African law

Directors of a company do not owe fiduciary duties to the holding, the group as a whole or subsidiary companies.[141] A director who is also employed by another company must not let the interests of the employer company interfere with the proper performance of his duties as a director.[142]

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[139] *Fisheries Development Corporation of SA v Jorgensen* 1980 (4) SA 156 at 157 D
[140] See paragraph B.3.2.3.2.a)
[141] *Lipschitz and Another NNO v Landmark Consolidated (Pty) Ltd* 1979 (2) SA 482 at 488
[142] Van Dorsten *Law of company directors* at p 226

b) Comparison with Swiss law

As pointed out under paragraph B.3.2.3.2.a) the question whether a director of a subsidiary who follows the instructions of the parent company to act in the interest of the group, can be held liable by the shareholders or creditors of the subsidiary is controversial. Part of the doctrine is of the opinion, that if the director of the subsidiary acts in the overall interest of the group, he cannot be held liable. The Swiss Federal Court[143] has not decided whether the opinion of the doctrine was in accordance with the law.

2.3.3. Relationship to creditors

a) South African law

The directors do in general not owe any fiduciary duties to the creditors of the company. This was stated in the *Kuwait Asia Bank* case[144]: 'A director does not by reason only of his position as director owe any duty to creditors of...of the company....'. But where a company is financially unstable or insolvent, the directors have the duty to act in the interest of the company's existing creditors, or at least to take their interests into account.[145]

b) Comparison with Swiss law

The situation under Swiss law is comparable to the South African law. Directors do not owe duties of care, loyalty and equal treatment to creditors, but there is proposition that the interests of creditors shall be taken into account when acting in the interests of the company.[146] In the case of bankruptcy of the company, the creditors are legitimated to claim that the company be compensated (Article 757 (1) CO). But directors are not allowed to act in the interests of certain creditors as this would lead to an offence against bankruptcy law and would be sanctioned by Article 167 of the Criminal Code.

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[143] BGE 130 III 313

[144] *Kuwait Asia Bank EC v National Mutual Life Nominees Ltd* [1991] 1 AC 187 at 217-18

[145] Blackman *Vol. 2* at 8-75

[146] See paragraph B.3.2.3.2.a)

2.4. Specific fiduciary duties

2.4.1. Duty not to exceed powers

a) South African law

Directors have a fiduciary duty to observe limitations of powers of the company as well as the limits of their own authority to act on behalf of the company. Should a director enter into a transaction on behalf of the company, which falls beyond the capacity of the company, neither the company nor the other party can claim the transaction void. This is stated in s 36 of the Act, where it is held that 'No act of a company shall be void by reason only of the fact that...the directors had no authority to perform that act on behalf of the company...' However, the director may incur liability to the company on the basis of a breach of fiduciary duties.[147]

b) Comparison with Swiss law

The situation under Swiss law is similar to the South African law. If a director acts on behalf of the company in a matter, which falls beyond the capacity of the company, the contravention of the director's power has in general only internal consequences and the director can be held liable in terms of Article 754 CO. However, if the limitation of powers was apparent from the Register of Commerce or if the other party to the contract knew or should have known, that the director's power was limited, the contravention of the director's power will have external consequences and the contract with a third person will be invalid.[148]

2.4.2. Duty to exercise powers for proper purpose

Directors must exercise their powers *bona fide* in the interests of the company as a whole and must not exercise their powers for a purpose not authorised by the company's memorandum or articles.[149] These duties are

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[147] Cilliers et al *Corporate Law* at p 139
[148] Bauen/Venturi *Verwaltungsrat* at N 537
[149] Blackman *Vol. 2* at 8-55

included in the revised Companies Bill (Draft 2008). S 76 (3) has the following wording:

> ' (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 –
> in good faith and for a proper purpose; and
> in the best interests of the company;...'

2.4.2.1. Duty to act bona fide *in the interests of the company*

Directors must act *bona fide* in the interests of the company as a whole.[150] The interests of a company are the interests of the shareholders qua shareholders as a general body, including the interests of future shareholders.[151] The test is a) subjective as to means (what is to be done in order to promote the company's interests), but b) objective as to ends (the interests to be promoted are the interests of the company).[152]

2.4.2.1.1. Subjective as to means

a) South African law

Directors must act in what they – and not what the courts – consider to be in the interests of the company as a whole.[153] Therefore the courts will not question the correctness of the director's decision regarding the means to serve the company's interests. The court will not usurp the function of the directors and consider what is best for the company from a business point of view.[154] The court will consider whether there are reasonable grounds for the belief of the directors. It has been suggested that the test as to means is not entirely subjective. In the *Charterbridge* case[155] it was held namely, that it has to be considered 'whether an intelligent and honest man in the director's position could, in the existing circumstances, have reasonably believed that the transaction in question was for the company's benefit'. *Blackman* does not agree with this test of reasonableness. He refers to

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[150] *Atlas Organic Fertilizer (Pty) Ltd c Pikkewyn Ghwano (Pty) Ltd* 1981 (2) SA 173 at 197
[151] Blackman *Vol. 2* at 8-68
[152] Blackman *Vol. 2* at 8-63
[153] *In re Smith and Fawcett Ltd* [1942] Ch 304 (CA) at 306
[154] Blackman *Vol. 2* at 8-63
[155] *Charterbridge Corporation Ltd v Lloyds Bank Ltd* [1970] Ch 62 at 74

English cases and points out that 'the better view is, that there is no objective limitation on the test, but that the absence of any reasonable grounds may be a ground for finding lack of good faith or for finding that directors have not considered matters which they ought to have considered'.[156]

In all cases where the exercise of director's powers is challenged on the ground of improper purpose, the court will determine the primary purpose for the director's action. Directors act in breach of their duty to act *bona fide* in the interests of the company as a whole when their primary purpose is not to further the interests of the company. Whether the company suffered loss or actually benefited as a result, is always irrelevant.[157]

aa) Business judgment rule in South Africa

As the test is a subjective one, there seems to be no need for the business judgment rule, where the decision-making of the directors is questioned. The business judgment rule leads to the following principle in American law: 'When directors make a decision in good faith, with care and on an informed basis, and reasonably believing it to be in the best interest of the company, they will have no liability for results of that decision, however bad those may be'.[158] The courts in South Africa will at the moment only question the propriety of the purpose for which the directors acted and will review whether the directors' conduct was in the interest of the company. The courts will not question the correctness and reasonableness of the directors' decisions.[159] The business judgment rule is also relevant in the context of a breach of duty of care.

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[156] Blackman *Vol. 2* at 8-64
[157] Blackman *Vol. 2* at 8-66
[158] Havenga *The Business Judgement Rule – Should we follow the Australian example?* (2000) 12 SA Merc LJ 25 at p 28
[159] Blackman *Vol. 2* at 8-64/65

ab) Developments

An interesting development has happened in the amendment process of the Companies Act 61 of 1973. In the Draft of the Companies Bill 2007 a business judgment rule (subsection a) and a reasonableness test regarding the best interest of the company (subsection b) was integrated into the wording of the law (s 91 (2)):

> '(2) A director's judgment that an action or decision is in the best interest of, or for the benefit of, the company is reasonable, if-
> (a) the director-
> (i) has taken reasonably diligent steps to become informed about the subject matter of the judgment, having regard to subsection (4) and (5); and
> (ii) does not have personal financial interest in the subject matter of the judgment; and
> (b) it is a judgment that a reasonable individual in a similar position could hold in comparable circumstances.'

In the Draft of the Companies Bill 2008 the reasonableness test was removed, but the business judgment rule remained. Section 76 (3) (b) requires the directors to act 'in the best interest of the company'. Section 76 (4) states the following:

> '(4) ....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; and
> (ii) either –
> (aa) the director had no material personal financial interest in the subject matter of the decision, ...
> (bb) the director complied with the requirements of section 75 with respect to any interest contemplated in clause (aa); and
> (iii) if the director made a decision, or supported the decision of a committee or the board, with regard to that matter, the director had a rational basis for believing, and did believe, that the decision was in the best interests of the company; and...'

The main difference between the Draft 2007 and Draft 2008 is that according to the latest draft, a judge will not ask whether the director made a judgement that a reasonable individual in a similar position could hold in comparable circumstances. The judge will only question whether the director had a rational basis for believing that the decision was in the best interest of the company. With the removal of the reasonableness test in the Draft 2008 the test of what is considered to be in the best interest of the company remains – as under current law – a subjective one.

In conclusion it can be held that the South African legislator has included the business judgement rule in the revised Companies Bill, although there has never been such a rule in the South African law before, there has been no need for the business judgment rule so far and a business judgement rule – for the question whether a director acted in the best interest – is not required and does not make any sense, as the test remains a subjective one.

The situation is different for the duty of care, where the test whether a director has exercised reasonable care is an objective one.[160] The conduct of a director will be measured against an objective standard of care and the business judgement rule could be applied to escape liability for a breach of duty of care.

In my opinion the legislator should have dealt with the business judgment rule separately for fiduciary duties and for the duty of care because different tests apply.

b) Comparison with Swiss law

As opposed to

In opposition to the position under South African law, Swiss law requires the courts to apply an objective standard of care and fault when determining whether a director acted in the best interest of the company. Therefore the judge will have to compare the conduct of a director with the conduct of a reasonable person in the same situation. The judge will not ask whether there are reasonable grounds for the belief of the director but whether a reasonable person in the position of the director would have acted in the same way. As pointed out before under paragraph B.3.4.3. the Anglo-American principle of the business judgement rule can only be used as a guideline for ascertaining the level of care in the decision-making of directors. The courts will apply certain criteria to find out whether the directors' decision was properly and carefully made, and even if the

[160] See paragraph C.3.2.

decision of a director appears to be wrong, it has to bee seen as an acceptable business judgement if the criteria are complied with.[161]

The main difference between the Swiss law and the current position under South African law is that the test regarding the decision-making is a subjective one in South Africa and that therefore the courts do not question the reasonableness of the decision, whereas the courts in Switzerland apply an objective test to ascertain, whether the decision of the director was reasonable. In both countries the courts do not apply the business judgment rule as understood by the Anglo-American law. Under current South African law the rule is not being applied because the test regarding the decision-making is a subjective one and therefore it would not make sense to ask whether the decision was reasonable in an objective way. In Switzerland the rule is not being applied because this would mean a formal restriction of the criteria applied by Swiss courts. As pointed out before a business judgement rule will be integrated into the revised Companies Bill. The situation regarding the application of a business judgement rule for fiduciary duties will not change though as the test regarding "the best interest of the company" remains a subjective one.

2.4.2.1.2. Objective as to ends

The rule that the directors must act in what they consider, and not what the courts consider, to be in the interest of the company applies only so long as the directors have correctly identified the company's interests as they are defined in law. Therefore, a director who *bona fide* but mistakenly believes, that he acts in the interests of the company will despite his *bona fide* belief, act in breach of his duty.[162]

a) Interest of the company according to South African law

As mentioned above, the interest of the company is the interest of the shareholders qua shareholders[163] as a general body. The company has

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[161] See paragraph B.3.4.3.
[162] Blackman *Vol. 2* at 8-67
[163] *Australian Metropolitan Life Assurance Co Ltd v Ure* (1932) 33 CLR 199 at 217

to be treated as a going concern, taking into consideration the interests of both its present and future shareholders.[164] The identification of the interests of the company with the interests of the shareholders has been criticised on the ground that the existence of the company as a legal person is ignored. *Blackman*[165] is of the opinion that the principle that the interests of the company are the interests of its shareholders is 'grounded on a principle of company law which attributes the interests of the shareholders to the company: in law, the company's interests are the interests of its shareholder qua shareholder, ie their interests in the prosperity of the company as a business concern.' He went on to state, that '...it would seem obvious that a mere legal entity can have no interests on its own.' *Blackman* further refers to the *Brady* case[166], where it was held, that '[t] he interests of a company, an artificial person, cannot be distinguished from the interests of the persons who are interested in it.'

b) Comparison with Swiss law

In opposition thereto, Swiss directors are required to act in the interests of the company as a going concern and not in the interests of the shareholders qua shareholders as a general body. However, as pointed out before under paragraph B.1. in addition to the interests of the company, the interests of the shareholder group, creditors and employees have to be considered. The main difference between the Swiss and South African concept of "acting in the interest of the company" is that according to South African law, the directors may not take the interests of other stakeholders into consideration.[167] In the Swiss law there is proposition that the larger the company and the more important the company as an employer and for the political economy the more the interests of other stakeholders have to be taken into account.[168] The question whether the law ought to require the consideration of the interests of other stakeholders has received some

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[164] *Brady v Brady* [1988] BCLC 20 40 (CA)
[165] Blackman *Vol. 2* at 8-69
[166] *Brady v Brady* [1988] BCLC 20 40 (CA)
[167] Blackman *Vol. 2* at 8-75
[168] Forstmoser et al *Aktienrecht* at § 3 N 27

attention in South Africa, but the law does not follow this proposition.[169] Therefore, only the interests of the company as defined by law can be considered when identifying the interests of the company.

c) Equal treatment of shareholders according to South African law

The director's duty to act in the interest of the company is a duty to act in what they believe to be the best interests of its business. If the interests of the company as a business are not at stake, another test than the test of "the interests of the company" has to be applied. The test seems to be whether the directors consider that what they are doing is necessary to achieve fairness between the shareholders.[170] According to *Blackman*[171] there is authority for the proposition that where the actions of directors affect the rights *inter se* of different classes or groups of shareholders, the directors fiduciary duties require them to exercise their powers not only in good faith in the interests of the company, but also fairly as between the different classes or groups of shareholders. If the interests of the company can be advanced by more than one proposal, directors are required to adopt the proposal, which treats the shareholders equally or at least less unequally.

d) Comparison with Swiss law

This duty of South African directors to exercise their powers fairly as between different classes or groups of shareholders is comparable with the statutory duty of equal treatment of Swiss directors. South African law requires that the shareholders be treated equally – or at least less unequally – and fairly. From this it becomes clear, that the treatment has to be equal in a relative and not in an absolute way. The same applies under Swiss law, where shareholders have to be treated equally under equal conditions (Article 717 (2) CO).[172]

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[169] Blackman *Vol. 2* at 8-75
[170] *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821 at 835
[171] Blackman *Vol. 2* at 8-70
[172] See paragraph B.3.2.3.3.

2.4.2.2. Purposes not authorised by the company's memorandum or articles

a) South African law

In addition to the duty to act *bona fide* in the interests of the company as a whole, a director is under a fiduciary duty not to exercise his powers for unauthorised or collateral purposes.[173] The purposes have to be authorised by the company's memorandum or articles. The powers may not be exercised for an ulterior or improper purpose even if the act falls within the scope of the director's powers. Thus the director's purpose must be not only to benefit the company, but also to do so by authorised means. In so far as the director's duty not to exercise his powers for an unauthorised or collateral purpose is concerned, the question whether the director acted in what he *bona fide* believed to be in the interests of the company is irrelevant.[174] In the Australian case *Piercy v S Mills & Co*[175] the directors issued shares with the object of creating a sufficient majority to enable them to resist the election of additional directors and to keep their power. It was held that 'directors are not entitled to use their powers of issuing shares merely for the purpose of maintaining their control...or merely for the purpose of defeating the wishes of the existing majority...'.[176] The directors were not authorised by the articles of association to issue shares for that purpose.

b) Comparison with Swiss law

There is no specific duty in the Swiss law that would prevent directors from exercising their power for purposes not authorised by the company's memorandum or articles. The only statutory restriction is stated in Article 716 (1) CO where it is held that the directors may make decisions on all matters, which by law or the articles of association are not allocated to the general meeting of shareholders. If resolutions of the board of directors limit the rights of shareholders in a material manner or disregard the fundamental structure of the company or violate the provisions for the

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[173] Blackman *Vol. 2* at 8-79
[174] Blackman *Vol. 2* at 8-81
[175] *Piercy v S Mills Co* [1920] 1 Ch 77
[176] *Piercy v S Mills Co* [1920] 1 Ch 77

protection of the capital in terms of Article 706b CO, they are null and void (Article 714 CO). Therefore, directors are in principle allowed to exercise their power for purposes not authorised by the company's articles as the power of directors are very general and not all purposes are authorised by the company's articles. However, if the company has suffered loss from a conduct of a director, a Swiss court would have to determine, whether a reasonable person would have acted in the same manner in the same circumstances and whether the director acted in fault. Only if the court came to the conclusion that the director had acted in a breach of duty and in fault, the director could be held liable for any damages of the company (Article 754 CO).

2.4.3. Duty to exercise independent and unfettered discretion

a) South African law

A director must exercise an independent and unfettered discretion.[177] Even if a director may have to rely on the knowledge and experience of others, he must always bear his own mind. Therefore directors must not be mere dummies or puppets and not blindly follow the instructions of others.[178] Where a director was elected by a shareholder to represent that shareholder's interests (nominee director), the director must at all times exercise an independent judgement and must protect the interests of the company even where they conflict with the interests of the shareholder who elected him.[179] The same can be said about the position of directors of a subsidiary company, as the directors of the subsidiary company do not stand in a fiduciary relationship to the holding company. The directors owe their fiduciary duties to the subsidiary alone.[180]

A director is not allowed to exercise his discretion in a certain way. If he does, but later decides that what he has undertaken to do will not be in the interests of the company, the court will not interfere with his discretion

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[177] *Fisheries Development Corporation of SA Ltd v Jorgensen* 1980 (4) SA 156 at 163
[178] Van Dorsten *Law of company directors* at p 233
[179] *Fisheries Development Corporation of SA Ltd v Jorgensen* 1980 (4) SA 156 at 163
[180] *Fisheries Development Corporation of SA Ltd v Jorgensen* 1980 (4) SA 156 at 163

and compel him to do what he honestly believes will be detrimental to the company.[181] Such an undertaking would be contrary to public policy and void. An undertaking requiring the director to exercise his powers in a certain way is, however, enforceable if entered into by the directors and all the members.[182] The board of directors or an individual director may not delegate its or his discretion to others if there is no authority in the articles to do so. Even when the directors are empowered to do so, they cannot delegate their ultimate power of control.[183]

b) Comparison with Swiss law

The duty of care and the duty of loyalty towards the company includes such a duty as directors are required to act in the interest of the company and not in the interest of a third person. As pointed out before under paragraph B.3.2.3.2.a) a director who stands in a contractual relationship with a shareholder is allowed to follow the instructions of the shareholder as long as the instructions are in line with the interests of the company. From this it follows that the Swiss director – like the South African director – cannot blindly follow the instructions of the shareholder. The director has to bear his own mind and analyse whether the instructions are in line with the interests of the company. If the company suffered loss due to a director's conduct the director cannot escape liability by stating that he was dependent from a third person or that his discretion was fettered. If a court would come to the conclusion that the director acted in a breach of duty according to an objective standard of care and that he acted in fault, the director would be liable for the damages occurred to the company.

As in the South African law a Swiss board of directors can delegate the management to individual members or to a board of management if authorised by the article of association and if based on a set of organisational guidelines (Article 716 and Article 716b (1) CO). The directors cannot delegate the non-transferable and inalienable duties in

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[181] *Blackman Vol. 2* at 8-107
[182] *Blackman Vol. 2* at 8-107
[183] *Blackman Vol. 2* at 8-111

terms of Article 716a CO and they have to retain the ultimate management power. As pointed out before, if directors can show that the duties were rightfully delegated to the board of management and that they applied the necessary care in selection, instruction and supervision, they will not be liable for the damages caused by the board of management.[184]

2.4.4 Conflict of interest and duty

a) South African law

Another basic duty is the duty that there must be no conflict between the personal interests of directors and the interests of the company.[185] There are two rules that are applicable where directors have an interest in a contract entered into by their company.

The first rule is the rule against "self-dealing", which precludes the director from acting for or on behalf of the company in a matter where the director has an interest that conflicts or may conflict with his duty to act in the interest of the company.[186] The rule does not state though that a director may not have a personal interest in the matter, but that he shall not have a personal interest in the matter, that conflicts with his duty.[187] A director may act in a matter in which he has an interest, if he obtains the consent of the general meeting, after making full disclosure of his interest. The articles of association may permit to make full disclosure of the director's interest to the other members of the board. Even where the director is permitted to act in a matter in which he has an interest conflicting with his duty, the director remains subject to his primary duty to act in what he *bona fide* believes to be in the best interest of the company, ie he must prefer his company's interests to his own.[188]

The second rule is the "fair dealing" rule, which imposes the duty to disclose the director's interests to the company. A director who wants to

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[184] See paragraph B.3.2.2.d)
[185] Van Dorsten *Law of company directors* at p 238
[186] *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168 at 177-79
[187] *Blackman Vol. 2* at 8-123
[188] *Blackman Vol. 2* at 8-124

contract with his company, or who has an interest that conflicts, or may conflict, with the interests of the company, must disclose his interests, act openly and in good faith and deal with the company at arm's length.[189] Where the articles of association do not provide otherwise, disclosure of the director's interests must be made to the members in the general meeting. An interested director can vote in his own interest on a resolution in general meeting for approval of such a contract, except where the transaction itself is an improper one and the director would by voting commit fraud on the minority.

The difference between the self-dealing and the fair-dealing rule is that the first rule applies where the director acts for the company and has an interest that conflicts or may conflict with the interests of the company. The second rule applies where the director does not act on behalf of the company but has an interest in the company's business.

S 234 et seq. of the Act deals with the conflict of interest of directors and will be amended by s 75 of the Companies Bill (Draft 2008).

Both rules are breached no matter how fair the transaction was. The rules render the contract voidable at the instance of the company as against the director who failed to comply with the duties they impose, and as against a third party with knowledge of the director's breach of duty.[190] The company is furthermore permitted to claim any profits made by the director as a result of the breach of his duties.

b) Comparison with Swiss law

The same rules apply under Swiss law where the duty of loyalty requires the directors not to place the interests of other persons above the interests of the company. Directors are required to disclose their interests to the board of directors and not to the general meeting of shareholders. As pointed out before under paragraph B.3.2.3.2.a) a director is in principle

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[189] *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168 at 178
[190] *Blackman Vol. 2* at 8-121

permitted to vote in his own favour, as long as his interests do not conflict with the interests of the company in a very intensive manner. As under South African law Swiss directors are also required to deal with the company at arms' length in a conflict situation. The main difference between the South African and the Swiss law is the fact that directors in South Africa are – unlike directors in Switzerland – in general required to disclose their interests to the general meeting of shareholders. Only if stated in the articles of association the directors are allowed to disclose the interests to the board of directors.

2.4.5. Duty not to profit ('Non-profit' rule)

a) South African law

Directors are not allowed to make profits, which they can acquire only by use of their fiduciary position, except with the consent of the company. It is not necessary though that the profit be obtained without the knowledge of the company. The important issue is that such profits may not be made without the consent of the company.[191] But, the mere fact that a director has made a profit is not enough; the profit must be made by use of the director's position or office or in the course and execution of his office.[192] The liability arises from the mere fact of a profit having been made, even where the director acted in good faith and in the interests of the company.

This non-profit rule is stated in the revised Companies Bill (Draft 2008). In s 76 (2) it is held that

> '(2) A director of a company-
> (a) must 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;...'

The liability for such profits depends not on fraud or proof of *mala fides* or fault or on whether or not he *bona fide* believed that he was justified

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[191] *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134n at 154
[192] Van Dorsten *Law of company directors* at p 245

in acting as he did. It arises form the mere fact of a profit having been made.[193]

A director may use his position to make a profit with the fully informed consent of the members in the general meeting or by the unanimous assent of the shareholders.[194] Unless permitted by the articles of association, such a disclosure cannot be made and the consent to retain the profit cannot be given, by the board of directors.[195]

b) Comparison with Swiss law

In Swiss corporate law there is a provision that requires directors to return unjustified dividends, shares of profits or other profit shares that they received in bad faith (Article 678 (1) CO). The company and any shareholder have a claim for return, the latter brings legal action for payment to the company (Article 687 (3) CO). There is another provision in the Criminal Code that prohibits directors to take profits for themselves that belong to the company (Article 158 of the Criminal Code "disloyal management").

The duty of loyalty and duty of care can also include the duty not to make unjustified profits, as directors are required not to act in the interests of themselves or third persons. The company will have to show that it suffered loss and that the director breached his duty of care or loyalty and acted in fault.

If the company can show that the profit was made in the course of the director's office and that it would belong to the company, it can also claim the profit according to Article 423 (1) CO ("management without a mandate").

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[193] *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134n at 144
[194] *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168 at 178
[195] Blackman *Vol. 2* at 8-161

2.4.6. Duty of director not to acquire corporate opportunities for himself

a) South African law

A director may not usurp or misappropriate business opportunities which the company is pursuing or which he is obliged to acquire for the company.[196] He is sometimes obliged to acquire economic opportunities for the company, if they are acquired at all.[197]

If a director breaches his duty and acquires such an opportunity for himself the law refuses to give effect to his intention and treats the acquisition as having been made for the company.[198] Therefore the company can claim the opportunity from the director. Where such a claim is no longer possible, the company can alternatively claim any profits that the director has made as a result of his breach of duty, or damages in respect of any loss suffered.[199]

Havenga[200] defines corporate opportunity as 'any economic or business opportunity, whether property or rights, which rightfully "belongs" to the company or to which the company has some kind of claim.' She then goes on to explain that various tests have been suggested to determine whether a particular opportunity is corporate in nature (ie belongs to the company) and that a number of tests, originating in American law, have been applied. The "interest or expectancy test" states that corporate fiduciaries are precluded from taking on an opportunity in which the company has an interest or expectancy, eg an accrued legal right.[201] The "line of business test" says, that corporate fiduciaries are precluded form taking for themselves a business opportunity that is closely related to the existing or prospective activities of the corporation and which is of present

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[196] Van Dorsten *Law of company directors* at p 251

[197] Havenga *Corporate Opportunities: A South African Update* Part 1 (1996) 8 SA Merc LJ 40 at p 42

[198] *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168 at 200

[199] *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168 at 179 and 241

[200] Havenga *Corporate Opportunities: A South African Update* Part 1 (1996) 8 SA Merc LJ 40 at p 43

[201] *Blackman Vol. 2* at 8-164/5

or potential advantage to it.[202] The "fairness test" takes inter alia the particular relationship between the director concerned and his company into account. In *Robinson v Randfontein*[203] is was held, that the duty to take corporate opportunities for the company arises from the particular relationship existing either between the director concerned and his company or between the company and the particular opportunity.

In the *Phillips*[204] case it was held that the fundamental question was not whether the appellant appropriated an opportunity belonging to the company, but whether the director stood in a fiduciary relationship to the company when the opportunity became available to him. If he stood in a fiduciary relationship, the opportunity belonged to the company. The court examined the relationship between the appellant and the respondent and held that the appellant stood in a fiduciary relationship to the respondent because of his position of faith. In conclusion the court held that 'It is irrelevant ... that the opportunity "properly belonged to the company" unless this means no more that it was an opportunity which arose in the context of the appellant's fiduciary duty to the respondents...'.

b) Comparison with Swiss law

The issue of corporate opportunities seems to be treated differently in both laws. Under South African law the courts will ascertain whether there is a fiduciary relationship between the director and the company – and whether the director therefore owed fiduciary duties – and whether the director breached his fiduciary duty not to acquire corporate opportunities for himself. The Swiss company can claim the opportunity not directly as a result of a breach of loyalty but according to the principle of "management without mandate" (Article 423 (1) CO).[205] According to this principle the company has to show that the director acted in the interest of the company and that he ought to have acted for the company when taking on an opportunity but acted for him. The result will be very similar under both

[202] *Blackman Vol. 2* at 8-165
[203] *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168 at 180
[204] *Phillips v Fieldstone Africa (Pty) Ltd and Another* 2004 (3) SA 465 at 482
[205] See paragraph B.3.2.3.2.b)

laws, as the relationship between the director and the company is examined to ascertain whether a director should have taken the corporate opportunity for the company and not for him.

2.4.7. Duty not to compete with the company

a) South African law

In the absence of any agreement to the contrary a managing director and other executive directors are not allowed to carry on a business or work for another company if those companies are competing with one another.[206]

There is authority for the proposition that in the absence of a precluding term in the articles a non-executive director can become a director of a competing company.[207] This view has been challenged in more recent cases, where it was held that the duty is breached if there is or may be a possible conflict of interests or if there is a danger of using confidential information in a competing business.[208] If a director acts in breach of his duty not to compete with his company the company may claim any profits the director may have acquired[209], or damages in respect of any loss it may have suffered. The duty not to compete has to be distinguished from the duty not to take corporate opportunities.[210] In the case of the duty not to compete the company does not assert that it has a better right to any particular opportunity that the director may have taken. It asserts that the director, in taking an opportunity, entered into competition with the company and, for that reason, is or was in a breach of duty.[211] A director may furthermore be liable in damages on grounds of unlawful competition under the *actio legis Aquilia.*

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[206] *Bellairs v Hodnett* 1978 (1) SA 1109 (A) at 1126-27
[207] *Atlas Organic Fertilizers (Pty) Ltd v Pikkewyn Ghwano (Pty) Ltd* 1981 (2) SA 173 (T) at 198
[208] *Sibex Construction (SA) Ltd v Injeciaseal CC* 1988 (2) SA 54 (T) 67
[209] *Bellairs v Hodnett* 1978 (1) SA 1109 (A) at 1133
[210] *Bellairs v Hodnett* 1978 (1) SA 1109 (A) at 1127-28 and 1132-33
[211] *Blackman Vol. 2* at 8-184

b) Comparison with Swiss law

The duty not to compete under Swiss law arises from the duty of loyalty towards the company. As pointed out under paragraph B.3.2.3.2.b) the duty goes further for executive directors than for non-executive directors. The Swiss law does not make the same differentiation as the South African law where the duty not to compete is separate from the duty not to take corporate opportunities. The provisions of Article 423 (1) CO ("management without mandate") may under certain circumstances allow the company to take over the competing business and acquire the profits gained. The same applies to the duty not to take corporate opportunities.[212]

2.4.8. Duty not to misuse confidential information

a) South African law

A director is under a fiduciary duty not to use for his own purposes or to disclose confidential information entrusted to him concerning his company's affairs.[213] In certain cases, the director may even be restrained from doing so after the termination of his office. Confidential information includes information of direct commercial value to the company (eg trade secrets or customer lists), but it is not limited to such information. Oral or written communications of company's directors and employees can also fall under the definition of "confidential information".[214] A director is liable for all profits made as a consequence of a breach of this fiduciary duty, irrespective of whether or not the company has suffered harm. The company may be entitled to rely upon two distinct causes of action: Breach of fiduciary duty and an action in delict, grounded on either unlawful competition or infringement of the company's right of privacy.[215]

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[212] See paragraph C.2.4.6.b)
[213] *Blackman Vol. 2* at 8-185
[214] *Blackman Vol. 2* at 8-187
[215] *Sibex Construction (SA) Ltd v Injeciaseal CC* 1988 (2) SA 54 (T) 63

b) Comparison with Swiss law

The statutory duty of loyalty towards the company includes a duty of secrecy.[216] There is no difference between the South African and Swiss duty not to misuse confidential information.

2.5. Basis of liability

a) South African law

The breach of a fiduciary duty gives rise to a particular form of liability, which is neither based on contract nor delict. In the *Cohen's* case[217] it was held that '...their [directors] liability need not necessarily be based on fraud or delict. ...In our law the action based on breach of trust is *sui generis*.' This was already stated in the Robinson v Randfontein case[218], where it was held that '...the action with which we have to do falls under none of the specific classes [condictio or contract] suggested...'

The company's primary remedies entitle it to set aside all transactions entered into in breach of a fiduciary duty and to claim all profits obtained by the director by use of his position or otherwise as a result of his breach of fiduciary duty. These remedies are not a substitute for an action of damages. Where a director causes the company harm as a consequence of his breach of fiduciary duty, the company is entitled to claim both damages and any profit that the director may have made.[219]

As the liability is not based on delict the plaintiff will not have to claim the requisites of the lex Aquilia (wrongful act, fault, causation and patrimonial loss). In the *Phelps*[220] case it was held that the claim for profits arises by the virtue of the fact that the director, in breach of his fiduciary duty, obtained for himself a profit, which he should have obtained for the company. The position is different where damage is claimed from a breach

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[216] See paragraph B.3.2.3.2.d)
[217] *Cohen NO v Segal* 1970 (3) SA 702 at 706
[218] *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168 at 199 and 242
[219] Blackman *Vol. 2* at 8-33; See paragraph C.2.3.
[220] *Du Plessis NO v Phelps* 1995 (4) SA (C) 165 at 171

of fiduciary duty. The facts to be pleaded by a plaintiff suing for loss arising of a breach of fiduciary duties were also stated in the *Phelps* case[221]. It was held that '...even though the claim is not based on fault, it is necessary for the company to allege and prove the causal connection between the damages claimed and the breach of fiduciary duty giving rise thereto'. [222] Furthermore it was stated that 'A plaintiff is required in his particulars of claim to allege the material facts on which he relies his claim...It is not sufficient to plead a conclusion without alleging the material facts which, if proved, would warrant that conclusion...; the link between the wrongful act and the damages, ie that the damages were caused by the wrongful act, must be pleaded.'[223]

In summary it can be held that the company can claim the profits gained by the director, but it cannot simply claim financial loss from a breach of a director's fiduciary duty. Where damage is claimed, the company has to show the causal connection between the breach of fiduciary duties and its loss suffered from this breach and to allege the material facts on which it relies its claim. Therefore the company will have to show the following facts: Breach of fiduciary duty, financial loss and causal connection. The only requisite that the company will not have to prove is fault. Therefore it can be said, that even if the liability for a breach of fiduciary duty is said to be *sui generis,* the only difference between this *sui generis* liability – when claiming damages – and the aquilian liability is the proof of fault.

In the *Phillips*[224] case the court referred to the English *Boardman*[225] case where a practical way of dealing with cases of breach of fiduciary duties was presented:

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[221] *Du Plessis NO v Phelps* 1995 (4) SA (C) 165
[222] *Du Plessis NO v Phelps* 1995 (4) SA (C) 165 at 171
[223] *Du Plessis NO v Phelps* 1995 (4) SA (C) 165 at 172
[224] *Phillips v Fieldstone Africa (Pty) Ltd and Another* 2004 (3) SA 465 at 480
[225] *Boardman v Phipps* [1966] 3 All ER 721 (HL) 758

'1. The facts and circumstances must be carefully examined to see whether in fact a purported agent and even a confidential agent is in a fiduciary relationship to his principal.

2. Once it is established that there is such a relationship, that relationship must be examined to see what duties are thereby imposed on the agent, to see what is the scope and ambit of the duties charged on him.

3. Having defined the scope of theses duties one must see whether he has committed some breach thereof by placing himself within the scope and ambit of those duties in a position where his duty and interest may possibly conflict. It is only at this stage that any question of accountability arises.

4. Finally, having established accountability, it only goes so far as to render the agent accountable for profits made within the scope and ambit of his duty.'

The revised Companies Bill (Draft 2008) will not change the nature of liability of directors for the breach of fiduciary duties. In s 77 (2) (a) it is only stated that 'A director of a company may be held liable in accordance with the principles of the common law relating to breach of a fiduciary duty...'

b) Comparison with Swiss law

As opposed to the South African law corporate liability under Article 754 CO is not *sui generis*. As pointed out before under paragraph B.1. it is controversial in the Swiss doctrine, whether the grounds for liability are in contract or in delict. The difference affects only the question of fault, whereas the onus of proof for the other requisites (damage, causal lien and breach of duty) rests with the plaintiff (either company, shareholders or creditors). The Swiss Federal Court has held that the liability of directors towards the company and the shareholders is contractual.[226] When asserting contractual claims, the fault of the person is assumed (Article 97 (1) CO) and the person has to exculpate itself. Therefore, the company or the shareholders will have to show that they suffered damage, that the director breached one of his duties and that there is a causal connection between the damage and the breach of duty. As the fault of the director is assumed, he will have to show, that he did not act in fault. The liability of

[226] BGE 46 II 455

directors towards creditors is said to be in delict.[227] The plaintiff has to prove that the other person acted in fault. Therefore, creditors have to prove not only the requisites of damage, causal lien and breach of duty but also fault.

A Swiss court would apply a similar test to the test mentioned in the *Phillips*[228] case. The court would have to examine:

- Whether the plaintiff suffered damage;
- Whether the injuring party is a director of the company (either formal, material or de facto director);
- What duties were imposed on the director;
- Whether the director breached one of his duties according to an objective standard;
- Whether there is an adequate causal connection between the damage and the breach of duty;
- Whether the director acted in fault according to an objective standard of fault.

The only actual difference between the *sui generis* liability for the breach of a fiduciary duty under South African law and the corporate liability in terms of Article 754 CO is the proof of fault. The question whether a director acted in fault is not relevant for the liability for the breach of fiduciary duties under South African law. A director is liable irrespective of the fault, whereas a director in Switzerland is only liable for a breach of his duties when he acted in fault.

3. Duty of care, skill and diligence

3.1. In general

In addition to his fiduciary duties, a director is subject to a duty of care and skill in the performance of his duties.[229] If in the performance of his duties a director fails to display either the same care as a reasonable man

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[227] Forstmoster et al *Aktienrecht* at § 36 N 35
[228] *Phillips v Fieldstone Africa (Pty) Ltd and Another* 2004 (3) SA 465 at 480
[229] Van Dorsten *Law of company directors* at p 216

would display in the conduct of his own affairs or that degree of skill which may reasonably be expected from a person of his knowledge and experience, he is liable to his company for any damage it may have suffered.[230] The standard is one of negligence, and not gross negligence, and the liability of directors is aquilian.[231]

Blackman[232] treats the duty of care and skill as two separate aspects and discusses the duties separately. Other authors see it as one concept of care and skill.[233] I will discuss the subjects of duty of care and duty of skill separately and the delegation and breach of duty of care and skill together.

3.2. Duty of care

a) South African law

Directors must exercise necessary caution and show the necessary concern when exercising the company's powers and safeguarding the company's assets.[234] In the *Brazilian Rubber* case[235] it was held that '...Such reasonable care must...be measured by the care an ordinary man might be expected to take in the same circumstances on his own behalf...' Therefore the test whether a director has exercised reasonable care is an objective one, ie it is not limited by the director's knowledge, experience, ignorance or inaction.[236] The extent of a director's duty of care depends to a certain degree on the nature of the company's business and on any particular obligations assumed by or assigned to him.[237] The standard of care is the same for both executive and non-executive directors. The degree of care expected of an executive director differs from the care expected of a non-executive director. Executive directors participate in the day-to-day management of a company and are bound to give continuous

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[230] *Blackman Vol. 2* at 8-190

[231] *Re City Equitable Fire Insurance Co Ltd* [1925] Ch 407 at 427-28 and *Du Plessis NO v Phelps* 1995 (4) SA (C) 170 C

[232] *Blackman Vol. 2* at 8-189

[233] Cilliers et al *Corporate Law* at p 142 and Pennington *Directors' Personal Liability* at p 81

[234] Van Dorsten *Law of company directors* at p 217

[235] *Re Brazilian Rubber Plantations and Estates Ltd* [1911] 1 Ch 425 (CA) at 428 and 437

[236] *Blackman Vol. 2* at 8-191

[237] *Fisheries Development Corporation of SA Ltd v Jorgensen* 1980 (4) SA 156 at 165 G

attention to the company's affairs. The duties of a non-executive director are of an intermittent nature to be performed at periodical board meetings and at any particular obligations assumed by or assigned to him.[238] Each director has an ongoing duty to check that the company's funds are in a proper state. This may be delegated to a committee of directors, in which case the directors will be responsible for supervising the investments.[239]

b) Comparison with Swiss law

The subject of care is the same in both laws, as directors are required to act with due care when exercising the company's powers and management.

The main difference between the Swiss and the South African law is the standard of care. Even though both laws apply an objective test when determining whether a person acted with due care, the South African law applies the Roman law principle of "diligentia quam in suis". Thus the care is measured by the care an ordinary man might be expected to take in the same circumstances on his own behalf.[240] Under Swiss law however, it is not sufficient that a director applies the same care as he would apply in his own affairs. The question whether a director acted with due care is judged according to the conduct of a reasonable and correct person under the same circumstances.[241] From this I conclude that the Swiss courts apply a more stringent standard of care because the court will have to determine whether a director acted in the same way as a reasonable person would have acted. The question is not reduced to the fact whether the person acted in the same way as he would have acted on his own behalf.

The differentiation between the duty of care of executive directors and the duty of non-executive directors is also applied under the Swiss law. The doctrine has held that the more responsibilities the activities of persons

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[238] *Fisheries Development Corporation of SA Ltd v Jorgensen* 1980 (4) SA 156 at 165 H
[239] *Re City Equitable Fire Insurance Co Ltd* [1925] Ch 407 at 467
[240] See paragraph C.3.2.a)
[241] See paragraph B.3.4.2

involved, the greater the degree of care that applies to them.[242] Thus, an executive director bears in general greater responsibility than a non-executive director, as the executive director manages the day-to-day business and therefore has a different level of information and knowledge.

3.3. Duty of skill

a) South African law

Directors must exercise reasonable skill in the performance of their duties.[243] The skill that a director is required to apply will depend on whether or not he was appointed for any particular skill or expertise in a given field. A director must however show the degree of skill that may reasonably be expected from a person of his particular knowledge and experience. The test is therefore a subjective one.[244] In the *City Equitable Fire Insurance*[245] case it was also held that '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. A director of a life insurance company, for instance, does not guarantee that he has the skill of an actuary or a physician.' Directors are not expected to have special business expertise and will not be liable for mere errors of judgement.[246] In the *Brazilian Rubber*[247] case very little was expected of the ordinary director: '[a director] is, I think, not bound to bring any special qualifications to his office. He may undertake the management of a rubber company in complete ignorance of everything connected with rubber, without incurring responsibility for the mistakes which may result from such ignorance.' This proposition was challenged and the better view is that even though a director is not required to have special business acumen or expertise, or singular ability or intelligence, or experience in the business of the company, a director may not shelter behind culpable ignorance or failure to understand the company's affairs, or be indifferent or a mere dummy or

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[242] See paragraph B.3.4.2
[243] *Howard v Herrigel and Another NNO* 1991 (2) SA 660 at 674
[244] *Fisheries Development Corporation of SA Ltd v Jorgensen* 1980 (4) SA 156 at 166 A
[245] *Re City Equitable Fire Insurance Co Ltd* [1925] Ch 407 at 428
[246] *Fisheries Development Corporation of SA Ltd v Jorgensen* 1980 (4) SA 156 at 165-66
[247] *Re Brazilian Rubber Plantations and Estates Ltd* [1911] 1 Ch 425 (CA) at 437

puppet, blindly following the instructions of others.[248] Each director must make the necessary effort to understand the company's affairs and exercise his own judgement based on personal knowledge and experience and the information and advice provided by the company officials.[249]

b) Comparison with Swiss law

There is no specific duty of skill in the Swiss law. The duty of care includes such a duty of skill. In contrast to the South African law a Swiss director is not required to show the degree of skill that may reasonably be expected from a person of his particular knowledge and experience but to procure the ability and knowledge generally required to perform his duties and keep his knowledge up to date. The knowledge required has to be compared with the knowledge a person must have in the function of that directorship. Therefore the test is not a subjective one as in South African law but an objective one. In contrast to the South African law, where a director is not required to have special business acumen or expertise, or singular ability or intelligence, or experience in the business of the company, it is evident under the Swiss principle of an objective standard of care that there can be no subjective excuse, for example ignorance or missing abilities. A Swiss director who takes on the mandate despite his lacks of necessary expertise or experience will be at fault for this very reason ("assumption of fault").[250] However the Swiss Federal Court applies a typification of roles according to which not all directors have to have detailed knowledge in every business area. Thus, in a case where a director who is a scientist is being elected to the board of directors of a pharmaceutical company and where financial problems occur, a different standard of care than for a Chief Financial Officer (CFO) should be applied to the director. The CFO has been elected because of his financial literacy.[251]

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[248] *Fisheries Development Corporation of SA Ltd v Jorgensen* 1980 (4) SA 156 at 163 and 166; *Re City Equitable Fire Insurance Co Ltd* [1925] Ch 407 at 444; *S v Shaban* 1965 (4) SA 646 (W) at 651-52

[249] Van Dorsten *Law of company directors* at p 221

[250] See FN 57

[251] Bauen/Venturi *Verwaltungsrat* at N 178 and Böckli *Aktienrecht* at § 13 N 576

3.4. Care and Skill in the Draft Companies Bill 2008

The wording of s 76 (3) (c) of the revised Companies Bill (Draft 2008) changes the test to ascertain whether a director acted with due care and skill:

> '(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 -
> (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;
> (i) having the general knowledge, skill and experience of that director.'

The expected degree of care, skill and diligence is not the degree of care, skill and diligence a director would apply on his own behalf, but the degree a person in the same function as the director would apply. The main change in s 76 (3) of revised Companies Bill is that the degree of care, skill and diligence is measured by the knowledge, skill and experience of the director. This is not the case in current common law regarding the duty of care. As pointed out before under C.3.2. the test regarding the duty of care is an objective one and exactly not limited by the director's knowledge and experience. In conclusion it can be held that even though the test regarding the duty of care remains an objective one, it is subjectified by s 76 (3) (c) (i) of the revised Companies Bill.

3.5. Delegation of duties

a) South African law

3.5.1. Current law

The duties can be delegated only as far as permitted by the articles of association. The overall responsibility is not delegable, only the discharge of particular functions is.[252] The functions may not be entrusted to inappropriate persons or persons not qualified to carry them out or over which the directors cannot exercise control. The power of delegation does not absolve the directors from the duty to supervise the discharge of the

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[252] *Blackman Vol. 2* at 8-196

delegated functions. Where duties and functions have been entrusted to appropriate and suitably qualified persons, the director's duty to exercise due care in overseeing the affairs of the company cannot be met by relying on them to carry out the duties and functions. The directors remain responsible for the delegated functions and retain a residual duty of supervision and control. [253] In the absence of grounds for suspicion, the directors are justified in trusting the officers to perform all duties or functions honestly. As a general rule, in the absence of proper reasons for inquiry, the directors are entitled to rely without verification on the judgement, information and advice of the officers.[254] This does not mean of course that the directors are entitled to accept information and advice blindly. Acceptance of information and reliance on judgement must be reasonable in the circumstances.[255] They are required to give the information due consideration and to exercise their own judgement in the light thereof.[256]

3.5.2. Companies Bill 2008

The delegation of directors' functions will be included in the wording of s 76 (4) (b) and (5) of the revised Companies Bill (Draft Companies Bill 2008). In s 76 (4) (b) of the revised Companies Bill it is stated that a particular director of a company is entitled to rely on the performance by certain other persons. These persons are specified in subsection (i) and (5). Subsection (i) (bb) deals with the delegation and has the following wording:

> 'b) [a director] is entitled to rely on-
>
> (i) the performance by any of the persons-
> (bb) to whom the board may reasonably have delegated, formally or informally by course of conduct, the authority or duty to perform 1 o more of the board's functions that are delegable under applicable law;...'

As under current law, a delegation in terms of the Companies Bill is permitted for particular functions and if it is reasonable and delegable under applicable law. Subsection (5) of the revised Companies Bill specifies the persons on whom the directors can rely. The directors have to

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[253] *Blackman Vol. 2* at 8-197
[254] *Fisheries Development Corporation of SA Ltd v Jorgensen* 1980 (4) SA 156 at 166 C
[255] *Blackman Vol. 2* at 8-199
[256] *Fisheries Development Corporation of SA Ltd v Jorgensen* 1980 (4) SA 156 at 166 D

reasonably believe that the persons are reliable and competent in the functions performed. The directors can furthermore rely on persons with professional or expert competence. The Companies Bill has not changed the current concept of delegation; it has only specified the reliance on others and integrated the reliance and the delegation in one subsection. As under current law, reliance on other persons is only permitted, if it seems reasonable and if the persons seem reliable and competent. Therefore a director who would like to delegate some of his duties will have to make his own mind whether the person he relies on is competent to perform these duties.

b) Comparison with Swiss law

As pointed out under paragraph B.1. a Swiss board of directors has a statutory right to delegate some of the management functions to individual directors or to a board of management (Article 716b (1) CO). As in the South African law, such delegation is only permissible if authorised by the articles of association. The residual duties of a Swiss board of directors are similar to those of a South African board of directors. The only difference is that Swiss directors are not only required to supervise and control the board of management but also to give the appropriate instructions in order that the board of management is able to fulfil its duties. If the board of management cannot fulfil its duties because the board of directors or a director withholds important information or gives unhelpful instructions, the directors will not be able to exculpate themselves and will be held liable for a breach of duty committed by the board of management.

3.6. Breach of duty of care and skill

a) South African law

A director who negligently fails to exercise the necessary care or skill will personally be liable to the company for any loss suffered as a result of the breach.[257] As pointed out before, the liability of directors for negligence is based on the principles of the *lex Aquilia*. The basic requisite for liability

[257] *Re City Equitable Fire Insurance Co Ltd* [1925] Ch 407 at 428-29

under the *lex Aquilia* is fault which results in loss to the plaintiff.[258] The test used to establish liability were discussed in the *Benson*[259] case where it was held that 'In an action based on breach of duty of care, the first enquiry is whether the defendant owed the plaintiff such a duty...In the absence of such a duty, an act or omission cannot be wrongful or unlawful.' It was further stated that 'If such a duty was owed, it must be determined whether it was breached and, if so, whether it was breached negligently, if that is also answered in the affirmative, whether the plaintiff suffered damages...and what the extent thereof is.'

The revised Companies Bill (Draft 2008) will not change the nature of liability of directors for a breach of a duty of care and skill. In s 77 (2) (b) it is stated that 'A director of a company may be held liable in accordance with the principles of the common law relating to delict...'

b) Comparison with Swiss law

The liability of a director under Article 754 CO has been discussed in its entirety under paragraph B.3. When comparing the liability for a breach of duty of care it becomes evident that there are no significant differences between the Swiss law and the South African law. The courts will determine whether the director owed a duty of care to the company, whether the company suffered loss, whether there is a causal connection between the damage and the breach of duty and whether the director acted in fault. The only difference is that according to Swiss law the fault of the director is assumed, if the company or a shareholder claims for damages. Then the director has to prove, that he did not act in fault.[260]

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[258] *Du Plessis NO v Phelps* 1995 (4) SA (C) 170

[259] *Benson v De Beers Consolidated Mines Ltd* 1988 (1) 834 (NC) at 836

[260] See paragraph B.1.

4. Ratification of a director's breach of duty and prior consent and release

4.1. Ratification

a) South African law

The company may ratify a director's breach of duty in the general meeting.[261] A ratification of a breach of duty is a decision by the company, made after full disclosure of all facts, to release a director form liability arising from a particular breach of duty on his part.[262] This absolution for specific and properly disclosed infringement of the director's duties must be distinguished from blanket release where the director is released from any liability that he has or may have incurred. Such blanket releases are void in terms of s 247 CA. The term 'ratification' is used to refer to decisions by the company i) to affirm contracts rendered voidable by the director's breach of duty, and ii) to waive or release or abandon the company's rights against directors. Those rights vest in the members in general meeting and are exercised by ordinary resolution.[263]

b) Comparison with Swiss law

The ratification of a director's breach of duty is the equivalent to the Swiss principle of 'Décharge' (Release).[264] In both laws, a director can be released from liability after full disclosure of the facts and for liability arising from a particular breach of duty. As under South African law a blanket release is not permitted under Swiss law either.

4.2. Prior consent and release

a) South African law

Generally, the company can prospectively render directors immune from liability for breach of duty in regard to a particular act or transaction not

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[261] *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168
[262] *Blackman Vol. 2* at 8-205
[263] *Regal (Hastings) Ltd v Gulliver Ltd* [1967] AC 134n 150; [1942] 1 All ER 378 389 (HL)
[264] See paragraph B.4.1.

yet performed or not yet entered into.[265] *Blackman* makes a distinction between 'prior consent', where the duty in question is a duty not do something without the consent of the company (eg not to act in a matter in which a director has an interest), and 'prior release', an exercise of the company's power to grant immunity from liability for breach of otherwise absolute duties (eg release from liability for damages in the case of breach of duty of care and skill). The prior release must be in regard of a particular act, as the blanket release form liability is prohibited by s 247 of the Act.[266] The rights of prior consent and release vest in the member in general meeting and they can be exercised by ordinary resolution.[267] The company's powers of prior release is limited, for there can be no prospective release in fraud of the company's creditors or in fraud on the minority.

b) Comparison with Swiss law

There is no such equivalent in the Swiss law, where the company would prospectively render directors immune from liability for a breach of duty. The only comparable situation is where the general meeting of shareholders made a resolution and where the director incurred damages by executing this resolution. The difference to the South African principle of prior consent or release is though, that the general meeting of shareholders does not give its consent to a breach of duty of the director. The breach of duty occurs because the director executes the resolution of the general meeting of shareholders. Therefore, there is no prospective release or consent under Swiss law.

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[265] *Blackman Vol. 2* at 8-221

[266] *Blackman Vol. 2* at 8-222

[267] *Regal (Hastings) Ltd v Gulliver Ltd* [1967] AC 134n 150; [1942] 1 All ER 378 389 (HL)

D. Conclusion

The comparison between the South African and the Swiss law has demonstrated that even though both laws regulate corporate liability in a different way, the results regarding corporate liability of directors are very similar. Whereas in South Africa not all duties of directors are regulated by a statute and the principles for liability for breach of fiduciary duties and duty of care and skill have to be found in common law, the duties of Swiss directors and the Swiss principles regarding corporate liability are regulated in the Code of Obligations. Nevertheless, it is inherent in both laws, that court cases and academic writings of scholars are taken into account for the interpretation of the principles. Even though the fiduciary duties as understood by South African law do not apply to directors under Swiss law, the comparison has shown, that some of the fiduciary duties are equal or very similar to the duties of care and loyalty under Swiss law. Differences lie above all in the tests applied to ascertain whether a director breached his duties. Whereas under Swiss law corporate liability is regulated by the same statutory provision for the breach of all duties of directors (Article 754 CO), South African law distinguishes between the breach of a fiduciary duty under common law, the breach of the duty of care and skill under common law and the breach of statutory duties according to the Companies Act. Whereas the liability for a breach of fiduciary duties does not require fault and the grounds for liability are *sui generis,* the liability for breach of duty of care and skill does require fault and the liability is aquilian. Under the Swiss law, a director can only be held liable for a breach of duty if he acted in fault. Therefore, the same rules and system apply for every breach of a director's duty.

At first sight the Swiss system seems to be more straightforward because of the statutory regulation. On closer examination though it becomes obvious that the statutory provisions do not contain all details that are necessary to ascertain whether a director can be held liable for a breach of his duties. The statutory provisions have to be interpreted with the

help of court decisions and the opinion of the doctrine. Therefore it can be held that corporate liability under the South African common law and case law system is regulated very similarly to the provisions under the Swiss statutory system.

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