Room or Relegation?

A critical analysis of section 77(2)(a) of the Companies Act, 2008, in light of the common law remedy of disgorgement.

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1. CHAPTER ONE: INTRODUCTION

1.1 The Topic

Corporate heresy[1] or legislative oversight: is there room for the common law remedy of disgorgement under section 77 (2)(a) of the Companies Act[2] or has the remedy been relegated to the past? This controversial enquiry frames the groundwork for discussion upon which this dissertation is based.

Section 77(2)(a) reads as follows:

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

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

This dissertation seeks to shed light on the apparent legislative omission of the common law remedy of disgorgement from the ambit of section 77(2)(a). The effects and consequences of such a significant omission has come under the microscope given South Africa's recently reformed corporate law jurisprudence. The impact of such an omission on the interpretation and application of directors' duties and liabilities will be specifically examined and analysed.

1.2 Relevance of the Topic

The topic of this dissertation remains especially relevant to any discussion involving directors' duties and liabilities in the context of the new Companies Act ("the Act"). The Act has drastically reshaped the South African corporate law landscape and as such, each provision of the Act requires careful consideration in its interpretation and application.

Implementation of the Act, in 2011, brought about partial codification of directors' duties and liabilities. Partial codification has resulted in mandatory, unalterable and prescriptive provisions relating to directors' duties and liabilities which are applicable to all companies registered in the Republic.[4] Since its inception, critics have intimated that certain provisions of the Act hinder, as opposed to facilitate, the objective of clarifying directors' duties and liabilities.[5] Fear of statutory

[1] Cassim et Al, *Contemporary Company Law* 2ed (2012) at 583.
[2] Companies Act (Act No. 71 of 2008) at section 77(2)(a).
[3] Ibid.
[4] Cassim et Al Op Cit (note 1) at 507.
[5] Cassim et Al Op Cit (note 1) at 508.

liability gives further credence to the importance of clear, concise and uniform interpretation and application of the statutory duties.

The statutory duties and liabilities do not replace their common law equivalents. Interpretation, application and development of the statutory duties and liabilities must align with those embedded in the common law.[6] Alignment becomes increasingly difficult, however, when inconsistencies and contradictions between these two primary sources of law run rampant.

The provisions of section 77(2)(a), conceivably, showcase such a misalignment between the common law and the Act. In our common law jurisprudence, the remedy of disgorgement has been readily applied in the event of a director breaching the fiduciary duty known as the 'no-profit rule'.[7] This dissertation explores the possibility that, upon a literal interpretation of section 77(2)(a), specifically, *"for any loss, damages or costs'*[8] it would appear that the common law remedy of disgorgement has not undergone codification. Although, the fiduciary duty which gives rise to the remedy, namely the no-profit rule, has been codified in section 76(2)(a).[9] This anomaly leads to an interesting scenario in that a director now has a statutory fiduciary duty but there is no corresponding statutory remedy, in the instance of a breach of that duty.

If this anomaly rings true, omission of the remedy of disgorgement from section 77(2)(a) will undoubtedly cause great upheaval for a common law littered with its application. It seems unthinkable for such an established remedy to have been omitted from succeeding and paramount legislation. Interpretational havoc can reign supreme until such a time as courts are given the room to develop the statutory duties and liabilities, in line with common law principles, in the context of an ever evolving and ultimately dynamic South Africa.

This dissertation remains directly relevant to the controversial debate of how our courts are to interpret and apply section 77(2)(a) to fall in line with preceding common law principles, as required by the Act.

1.3 Assumptions

Assumptions need to be made to avoid unnecessary departures from the topic at hand. In this dissertation it will be assumed that any director of a company, whether acting individually or collectively, owes a fiduciary duty to the company. The company is the beneficiary of the director's fiduciary duties.[10] It is further assumed that reference to 'the company' indicates a company with separate, legal and juristic personality[11], distinct from its shareholders and stakeholders.[12]

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[6] Companies Act Op Cit (note 2) at section 158.
[7] *Regal (Hastings) v Gulliver* (1942) ALL ER (HL); (1967) AC; *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168; *Phillips v Fieldstone Africa (Pty) Ltd* 2004 (3) SA 465 (SCA).
[8] Companies Act. Op Cit (note 2) at section 77(2)(a).
[9] Ibid at section 76(2)(a)(i).
[10] *Greaves v Barnard* 2007 2 SA 593 (C).
[11] The CompaniesAct Op Cit (note 2) at section 19.
[12] Cassim et Al Op Cit (note 1) at 515; Blackman et Al. 2002. *Commentary on the Companies Act* at 8 – 51.

Categorization of the different types of directors and a lengthily discussion of the possible interpretations of 'the company' are beyond the scope of this dissertation.

1.4 The Three-fold Enquiry: Chapter Overview

The remedy of disgorgement is said to involve a three-fold enquiry, in terms of a breach of the no-profit rule. Such enquiry is based on the specific facts and circumstances of each case.[13] This dissertation will loosely follow the outline of this three-fold Enquiry.

Firstly, whether the no-profit rule, as a branch of the overarching fiduciary duty to avoid a conflict of interest[14], finds application in the circumstances and context of the case. This leg of the enquiry is covered in Chapter Two. Chapter Two will involve a brief comparison of a director's fiduciary duty versus the duty of care and skill. This is followed by an outline of the core fiduciary duty to avoid a conflict of interest. The two further duties stemming from the duty to avoid a conflict of interest will then be compared: the corporate opportunity rule and no-profit rule. The chapter will be concluded by a discussion of the partial codification of directors' duties.

Secondly, under what circumstances will a director be deemed to be in breach of the no-profit rule. Chapter Three covers the issue of a wide and narrow interpretation of the legal enquiry framing a breach of the no-profit rule. The cause of action upon which such a breach is based will then be discussed. Such a discussion gives rise to an outline of the defence of consent of the company following full disclosure. Lastly, instances in terms of which court relief and indemnification of directors are options will be deliberated.

Thirdly, whether the remedy of disgorgement is appropriate in the event of a breach of the no-profit rule. The disgorgement remedy requires the director to account for profit acquired by her, whilst standing in a fiduciary relationship, to the company. Chapter Four gives rise to a comparison of the remedy of disgorgement and damages remedy. Possible alternatives to the remedy of disgorgement will be proposed followed by a discussion of the evolution of the common law remedies to statutory ones.

Chapter Five provides an analysis of section 77 (2)(a) of the Act, with specific reference to the apparent omission of the common law remedy of disgorgement from it's ambit. Possible legislative amendments to section 77 (2)(a) are then proposed. Alternative remedies to the common law and section 218 (2) of the Act are outlined. The chapter is concluded by a brief analysis of the possible claimants, who institugate the remedy of disgorgement.

Chapter Six poses an alternative interpretation of section 77 (2)(a). This chapter delves into the controversial issue of the possible abrogation to disuse of the common law remedy of

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[13] *Phillips v Fieldstone Africa (Pty) Ltd.* Op Cit (note 7).
[14] Cassim et al Op Cit (note 1) at 535.

disgorgement. A comparative analysis is then undertaken in light of application of the remedy of disgorgement, with specific focus on English law and the law of Delaware in the United States of America. The liberal approach taken by our South African courts is then examined.

Chapter Seven provides a comprehensive conclusion of the current account of the common law remedy of disgorgement, in light of South African corporate law jurisprudence.

1.5 Argument Summary

The Achilles heel of proponents for the inclusion of the remedy of disgorgement in section 77(2)(a) rests in the specific wording of the section. Namely, *"for any loss, damages or costs sustained by the company"*[15] which, arguably, indicates inclusion of a claim for damages but not for disgorgement. If this is so and a litigant cannot rely on application of section 77(2)(a) in a claim for disgorgement, there must be alternatives which are readily available. Arguably, reliance will have to be placed on the common law remedy for disgorgement or a remedy based on application of section 218 (2) of the Act.[16] Whether or not these alternatives will give rise to a satisfactory result, has yet to be seen.

Proponents for inclusion, however, would argue against such a literal interpretation of section 77(2)(a) due to the importance of the common law remedy of disgorgement in our corporate law jurisprudence. Exclusion of the remedy from the ambit of section 77(2)(a) may entail relegation of the remedy one of an exceptional status or of last resort. The effect of this relegation, once established, will prompt an outcry of 'corporate heresy' as it presupposes departure from a long list of cases in which courts have confirmed the importance and strictness of the no-profit rule. Our courts have readily applied the remedy of disgorgement as a stick with which to beat directors into submission.

One would be at odds with the traditional approach of our courts to support an interpretation of section 77(2)(a) which excludes from its ambit the common law remedy of disgorgement. Nevertheless, all avenues need to be addressed in order to provide a comprehensive examination of the common law and statutory directors' duties and liabilities.

2. CHAPTER TWO: THE NO-PROFIT RULE

It is trite in our common law that directors owe a fiduciary duty to act in the best interest of the company. Distinct from the duty of care and skill, a director's fiduciary duty entails many ancillary obligations which, together, prescribe acting in the best interests of the company. One of the core fiduciary duties of a director is to avoid a conflict of interest. That is, a director is under a duty to ensure that his personal interests do not conflict with the interests of the company. The

[15] The Companies Act. Op Cit (note 2) at section 77(2)(a).
[16] Ibid at section 218 (2).

overarching duty to avoid a conflict of interest distinguishes two further and distinct duties known as the corporate opportunity rule and the no-profit rule. The fiduciary duty to avoid a conflict of interest has been partially codified with the advent of the Act.

2.1 Fiduciary Duties and the Duty of Care and Skill

In the first leg of the enquiry relating to a breach of a director's fiduciary duty, it is prevalent to establish the specific duty based on the facts and circumstances of the case. It is well-established in South African corporate law jurisprudence that directors owe two prominent duties to the company. Firstly, directors are under fiduciary duties, based predominantly on the pillars of loyalty, honesty and trust. Secondly, directors are also under a duty of care and skill, specifically: a duty to act with a reasonable degree of care and skill in wielding their powers, in the best interests of the company.[17]

The aforesaid directors' duties are now derived from two separate, yet equally important, sources of law: the common law and the Act. The sources are not mutually exclusive and the interpretation and application of a director's duty would not be complete without reference to both. From a common law perspective, our courts have often looked to English law as the background and context from which directors fiduciary duties are derived.[18] Such derivation stems from the fact that the English law boasts a comprehensive set of statutory and common law duties.[19] Implementation of the Act saw partial codification of the common law fiduciary duty and duty to act with reasonable care and skill.[20]

A director's fiduciary duty and the duty to act with a reasonable degree of care and skill are two distinct duties. The commonality of both is that the director must, at all times, act in the best interests of the company. One of the main distinctions between the two duties stems from the application thereof to the facts of each case. The application of a fiduciary duty contains a subjective element whereas the duty of care and skill comprises an objective element. These differing elements give rise to two distinctive, yet equally fundamental, tests.

The fiduciary duty of a director is ascertained subjectively: whether the director believed that she was acting honestly and in good faith, in the best interests of the company.[21] In such a subjective test, the belief of the court or a third party is immaterial and the director's belief is the only one of any consequence in the enquiry.[22] There have, however, been suggestions as to the limit of the director's subjective belief. Courts have laid down an element of reasonableness in the subjective

[17] *Da Silva v CH Chemicals (Pty) Ltd* 2008 (6) SA 620 (SCA) at para 13, 627B.
[18] Cassim et Al Op Cit (note 1) at 509; *Fisheries Development Corporation of SA Ltd v Jorgensen*; *Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd* 1980 (4) SA 156 (W) 165.
[19] The United Kingdom Companies Act, 2006.
[20] The Companies Act Op Cit (note 2) at section 76 (3)(a)(b) and (c).
[21] Cassim et Al Op Cit (Note 1) at 524; *Re Smith v Fawcett Ltd* [1942] Ch 304 at 306.
[22] Ibid.

test: there must be reasonable grounds upon which the director's belief is based.[23] However, the extent and effect of this objective element on the subjective test is far from settled.

Conversely, the duty of care and skill is determined from an objective perspective: whether the director acted reasonably, with a degree of care and skill that would be expected of that specific director when acting in the best interests of the company.[24] An assessment of reasonableness begets an objective test which gives rise to a delictual or Aquilian action based on negligence.[25] There has been some debate as to the possible presence of a subjective element in the aforesaid objective test, with reference to the skill and knowledge of the specific director.[26] Amplification of such a debate is beyond the scope of this dissertation.

The focus of this dissertation is around the fiduciary duty of a director. Therefore, further discussion on a director's duty of care and skill is unnecessary, save for the distinction so above drawn.

2.2 A Director's Fiduciary Duty

In a possibly oversimplified explanation, a director's fiduciary duty entails the duty to act, individually and collectively, *bona fide* and honestly, in the best interests of the company.[27] The nature, interpretation and contours of a director's fiduciary duty are determined with reference to the facts and circumstances of each case.[28] There is no magic in the term "fiduciary duty"[29] and our courts have reiterated that a fiduciary relationship is based on trust and confidence where a fiduciary is someone who acts on behalf of, and in the interests of, another person.[30] The fiduciary relationship requires the fiduciary to act in good faith and in the best interests of the beneficiary.[31] The fiduciary relationship between a director and a company is said to be analogous and akin to the relationship as between an agent and his principal, a guardian and his ward or a trustee and a beneficiary.[32] However, there are notable distinctions and the fiduciary relationship between a director and a company is best described as *sui generis*.[33]

Once a fiduciary relationship has been established, on the facts of the case, the specific contours of the duties imposed on the directors, as a result of the fiduciary relationship, need to be

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23 *Teck Corp Ltd v Millar* (1972) DLR (3d) 288 (BCSC); *Extrasure Travel Insurances Ltd v Scuttergood* [2003] 1 BCLC 598 (ChD) at 619; Cassim et Al Op Cit (note 1) at 524.
24 Cassim et Al. Op Cit (note 1) at 524.
25 *Ex Parte Lebowa Development Corporation Ltd* 1989 (3) SA 71 (T); *Du Plessis NO v Phelps* 1995 (4) SA 165 (C).
26 *Re Brazilian Rubber Plantations & Estates Ltd* [1911] Ch 425 (CA) 437; *Re Equitable Life Assurance Society v Human* [2002] 1 AC 408.
27 *Re Smith v Fawcett Ltd* [1942] Ch 304 306.
28 *Phillips v Fieldstone* Op Cit (note 10).
29 Ibid at 477H.
30 *Robinson V Randfontein Estates.* Op cit (note 7); *Canadian Aero Service Ltd v O'Malley* 1974 10 DLR (3d) 371; *Phillips v Fieldstone* as referred to in *Volvo (Southern Africa) (Pty) Ltd v Yssel* 2009 (SCA) at para 179.
31 Cassim et al Op Cit (note 1) at 513.
32 *Robinson v Randfontein Estates.* Op Cit (note 7).
33 *Robinson v Randfontein Estates.*Op Cit (note 7); *Du Plessis v Phelps* Op Cit (note 25).

determined.[34] The scope and extent of the fiduciary duty depends, to a large extent, on the nature of the relationship between the parties as well as the designated tasks and mandate given to the fiduciary.[35] A number of fiduciary duties exist to ensure that the fiduciary does not abuse his position of trust and confidence to the detriment of his vulnerable beneficiary. The overarching duties being those of good faith, loyalty and the avoidance of a conflict of interest.[36]

This dissertation specifically focuses on the fiduciary duty to avoid a conflict of interest and more specifically the duty embedded therein: the duty to avoid making a secret profit. This specific fiduciary duty has been commonly dubbed the no-profit rule. The no-profit rule, stemming from the duty to avoid a conflict of interest, is the specific fiduciary duty which forms the basis of this dissertation. In order to completely understand the constraints of the no-profit rule, a background of the overarching duty to avoid a conflict of interest begets a brief discussion.

2.3 The Duty to Avoid a Conflict of Interest

The duty imposed on directors to avoid a conflict of interest is a well-established common law principle and has been codified in section 76 (2)(a)(i) and (ii) of the Act.[37] It is commonplace that the duty to avoid a conflict of interest is one of the most fundamental duties of a fiduciary which has been strictly enforced by our courts.[38] The underlying purpose of the duty lies in its ability to act as a preventative measure to deter the bad behavior of directors. This purpose behests its strict application.[39]

The duty to avoid a conflict of interest, effectively labelled the no-conflict rule, requires that directors avoid a situation, to the best of their ability, where their personal interests conflict with those of the company.[40] Such a conflict would, undoubtedly, impair the director's ability to bring an independent mind to bear on decisions to be taken in the best interests of the company. It goes without saying that in such a conflicted situation, the company's interests are paramount. However, given human nature, impartial and independent judgement is often sidelined when personal gains are in the offing. Hence, the need for a strict and unyielding application of the duty to avoid a conflict of interest, without exception.

The no-conflict rule is, conceivably, one of the core fiduciary duties and enjoys an unfettered, wide and strict application.[41] Firstly, the duty applies not only in situations where an actual conflict

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[34] *Robinson v Randfontein Estates*. Op Cit (note 7) at 180; *Phillips v Fieldstone*. Op Cit (note 7) at para 159.
[35] *Robinson v Randfontein Estates*. Op Cit (note 7) at 178-179.
[36]Cassim et Al. Op Cit (note 1) at 514.
[37] The Companies Act Op Cit (Note 2) at section 76 (2)(a)(i) & (ii).
[38] *Keech v Sandford* (1726) Sel Cas Ch 61; *Regal (Hastings) v Gulliver*. Op Cit (note 7);, *Phillips v Fieldstone*. Op Cit (note 7); *Imageview Management Ltd v Jack* [2009] BCLC 725 at 739 (CA), *Parker v Mckenna* (1874) LR 10 Ch App 96 at 124; *Sibex Construction (SA) (Pty) Ltd v Injectaseal CC* 1988 (2) SA 54 (T) at 66D; *Canadian Aero Service Ltd v O'Malley*. Op Cit (note30).
[39] Cassim et Al. Op Cit (note 1) at 536.
[40] Ibid at 535.
[41] Ibid.

arises but also those in which there would appear to be a real, sensible possibility of conflict.[42] Secondly, only the free consent of the principal, after full disclosure by the fiduciary, will suffice as a defence to escape liability in the event of a breach of the duty.[43] Thirdly, directors are required to avoid a conflict of interest between themselves and the company as well as between themselves and any third party, in respect of the company. For instance, a nominee director must advance the interests of the company over those of its's nominator in situations where conflicts of interest between the nominator and the company arise.[44] Fourthly, courts often refer to a conflicting interest but the principle extends to any conflicting duty as well.[45] Finally, breach of the duty is not dependent on an absence of good faith, the presence of fraud or the proof of loss suffered by the company.[46]

The no-conflict rule yields two further and distinct rules: the no-profit rule and the corporate opportunity rule. Although both under the umbrella of the overarching duty to avoid a conflict of interest, the no-profit rule and the corporate opportunity rule have been readily differentiated. Both rules, however, underpin the same rationale and purpose: to ensure a fiduciary's undivided loyalty and honesty to her beneficiary.[47] Whilst distinct, the principles governing the no-conflict, no-profit and corporate opportunity rules sometimes overlap and it becomes very difficult for courts to draw lines in the sand.[48] Nevertheless, the no-conflict, no-profit and corporate opportunity rules are to be interpreted independently from one another as they comprise differing elements and yield converse results.[49] This appears easier said than done as our common law seems littered with cases where it is by no means clear exactly which rule was being applied to the facts and circumstances of the case.

Nevertheless, before embarking on a controversial discussion around the generally inept application of the rules, the corporate opportunity rule must be distinguished from the no-profit rule.

2.3.1 The Corporate Opportunity Rule

The corporate opportunity rule is derived from the overarching fiduciary duty to avoid a conflict of interest.[50] The rule is best summarized by the court in *Da Silva v CH Chemicals (Pty) Ltd*: *"A consequence of the rule is that a director is, in certain circumstances, obliged to acquire an*

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42 *Boardman v Phipps* [1966] 3 ALL ER 721 at 756H and applied in *Bhullar v Bhullar Sub Nom Re Bhullar Bros Ltd* [2003] 2 BCLC 241; *Phillips v fieldstone*. Op Cit (note 7) at 217.
43 *Phillips v Fieldstone*. Op Cit (note 7) at 161.
44 *Boulting v Association of Cinematograph, Television and Allied Technicians* [1963] 1 ALL ER 716 (CA) 723.
45 Cassim et Al. Op Cit (note 1) at 535.
46 Ibid.
47 Ibid at 536.
48 *Industrial Developments Consultants Ltd v Cooley* [1972] 2 ALL ER 162.
49 Cassim et Al. Op Cit (note 1) at 536.
50 Ibid at 540.

economic opportunity for the company if it is acquired at all. Such an opportunity is said to be a 'corporate opportunity' or one which is the 'property' of the company."[51]

The corporate opportunity rule is apparently distinct from the no-profit rule. However, it becomes apparent on an examination of numerous cases, in this respect, that the two rules often collide. In these cases, elements of the corporate opportunity rule are used to supplant a cause of action based on the no-profit rule, and vice versa. The causes of action for both rules are different and the consequences of a breach of each yield distinct results. In a breach of the corporate opportunity rule, the director may be required to transfer the opportunity to the company. In a breach of the no-profit rule, the director may be required to account for the profit to the company. While it is possible to claim both the opportunity and the profit from the miscreant director, it is still relevant to sustain two separate causes of action. This is often not the case which can result in confusing and unclear pleadings, as became evident upon an analysis of the *Symington* case.[52]

As a detailed discussion of the corporate opportunity rule is beyond the ambit of this dissertation, a summary of the most notable elements pertaining to the rule will suffice. A 'corporate opportunity' has not been given a definitive construction by our courts. However, it has generally been defined to indicate an opportunity which the company is actively pursuing or one which falls within the company's existing or prospective business activities or is related to the operations of the company within the scope of, or in line with, its business.[53] A corporate opportunity is said to be an asset of the company and extends to confidential, corporate information which directors have used to make a profit for themselves.[54] A director is duty bound to report the existence of, and information relating to, a possible corporate opportunity to the company and to acquire such opportunity for, and on behalf of, the company as its asset.[55]

A corporate opportunity is considered 'property' of the company and if the director obtains such an opportunity for herself then the law will refuse to give effect to the intention of the director and will treat the acquisition as having been made for the company.[56] A director cannot divest herself of the fiduciary duty to acquire a corporate opportunity for the company by first resigning as director and then acquiring the opportunity.[57] The duty remains applicable in post resignation scenarios where the existence of the opportunity, or information relating to it, became apparent to the director before her resignation.[58]

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[51] *Da Silva v CH Chemicals* Op Cit (note 17) at para 33 at 480G.
[52] *Symington v Pretoria-Oos Privaat Hospitaal Bedryfs (Pty) Ltd* 2005 ALL SA 403 (SCA).
[53] *Phillips v Fieldstone*. Op Cit (note 7) at para 19.
[54] *Boardman v Phipps*. Op Cit (note 42), *Sibex Construction (SA) (Pty) Ltd v Injectaseal CC*. Op Cit (note 38).
[55] *Industrial v Cooley*. Op Cit (note 48); *Bhullar v Bhullar*. Op Cit (note 42); *Bellairs v Hodnett* 1978 (1) SA 1109 (A).
[56] *Da Silva*. Op Cit (note 17) at para 18; Havenga, M. 2013. *Directors' Exploitation of Corporate Opportunities and the Companies Act 71 of 2008. TSAR* 2 at 259.
[57] *Da Silva*. Op Cit (note 17).
[58] *Industrial v Cooley*. Op Cit (note 48); *Canadian Aero Service Ltd v O'Malley*. Op Cit (note 30); *Spieth v Nagel* (1997) 3 ALL SA 316 (W); *Da Silva*. Op Cit (note 17).

The abovementioned points sufficiently summarize the salient elements of the corporate opportunity rule, insofar as a brief overview of the rule is relevant to this dissertation. Distinct from the corporate opportunity rule is its sibling, the no-profit rule.

2.3.2 The No-Profit Rule

Succinctly put by the court *in Regal (Hastings) v Gulliver*, the no-profit rule is: *"the rule which insists on those, who by use of a fiduciary position make profit, being liable to account for the profit...'*[59] The rule, distinct from the corporate opportunity rule, also stems from the overarching duty to avoid a conflict of interest. The conflict generally arises as such: a director learns of a profit to be made while acting in her capacity as director and instead of acquiring the profit for the company, as is her fiduciary duty, she retains it for herself.[60] In this instance there is said to be a conflict between the director's own personal interests and the interests of the company. In her attempts to retain the secret profit she is compromising her fiduciary duty to act in the best interests of the company.

The most quoted dicta in common law jurisprudence on this subject comes from Innes, CJ in *Robinson v Randfontein Estates* and it is apparent that no dissertation would be complete without quoting it verbatim:

"*where one 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 a secret profit at the other's expense or place himself in a position where his interests conflict with his duty. The field of legal relationship: a guardian to his ward, a solicitor to his client, an agent to his principal afford examples of persons occupying such a position*".[61]

The no-profit rule is well established in our common law jurisprudence and has been strictly, and sometimes unnecessarily, upheld by our courts over the last few decades. The seminal case of *Regal (Hastings) v Gulliver* is the leading case which best describes the elements of the no-profit rule.[62] The rule was reaffirmed by the Supreme Court of Appeal in *Phillips v Fieldstone* as a strict rule which allows little room for exception.[63] The harshness of the rule is further compounded by its wide ambit. The no-profit rule extends to any and all gains or advantages obtained by the director and is not limited to monetary 'profit'.[64] Furthermore, the rule extends not only to actual conflicts of interest but also situations in which there is a real sensible possibility of conflict.[65]

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[59] *Regal (Hastings) v Gulliver.* Op Cit (note 7).
[60] Cassim et Al. Op Cit (note 1) at 536, *Dorbyl v Vorster* 2011 (4) ALL SA 387 (GSJ) quoting *Robinson v Randfontein.*
[61] *Robinson v Randfontein Estates.* Op Cit (note 7) at 177 and 178.
[62] *Regal (Hastings) v Gulliver.* Op Cit (note 7).
[63] *Phillips v Fieldstone.* Op Cit (note 7) at para 31.
[64] *Robinson v Randfontein Estates.* Op Cit (note 7), *Volvo (Southern Africa) (Pty) Ltd v Yssel.* Op Cit (note 30).
[65] *Aberdeen Railway Co v Baikie Bros* (1854) 1 Macq 461.

Moreover, the elements giving rise to a breach of the no-profit rule also contribute to its wide and extensive application. These elements will be more fully canvassed under Chapter Three.

The most notable aspect of the no-profit rule is whether the profit was obtained by the director as a result of her occupation of office.[66] This aspect, arguably, distinguishes the no-profit rule from the corporate opportunity rule. A director must have acquired the profit by virtue of her office as director of the company, in order to be in breach of the no-profit rule. In terms of the corporate opportunity rule, the profit need not necessarily be made by virtue of the director's position in the company.[67] All that is required is that the director took the opportunity for herself instead of acquiring it for the company. In that event the director will be in breach of the corporate opportunity rule. If the company can no longer appropriate the exploited opportunity for itself, the company may claim any profit made by the director as a result of the breach of duty.[68] Alternatively, the company may claim damages, in respect of any loss caused to the company due to the breach.[69]

It is in the event of proving a breach where the no-profit rule and the corporate opportunity seem mostly likely to overlap and it becomes difficult for a distinction to be drawn.[70] A breach of both the no-profit rule and the corporate opportunity rule may result in a disgorgement of profit to the company. More often than not, the distinction lies in the fact that if the company cannot usurp the corporate opportunity (primary claim) then there may be a claim for disgorgement of profits made as a result of exercising the opportunity (alternative claim). [71]

2.4 Codification

The Act has partially codified the common law duty to avoid a conflict of interest. Specifically, the no-profit rule can be found under the provisions of section 76 (2)(a)(i).[72] Interestingly, the Act does not explicitly mention the corporate opportunity rule and same has to be inferred through application of the statutory no-profit rule.[73]

Section 76 (2)(a)(i) and (ii) embody the common law duty to avoid a conflict of interest and no-profit rule:

"(2) A director of a company must –

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

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[66] Havenga, M. Op Cit (note 56) at 258.
[67] Ibid.
[68] *Robinson v Randfontein Estates*. Op Cit (note 7).
[69] *Robinson v Randfontein Estates*. Op Cit (note 7) at 177-178; *Phillips v Fieldstone*. Op Cit (note 7) at para 30; *Symington v Pretoria-Oos Privaat Hospitaal Bedryfs*. Op Cit (note 52) at para 27.
[70] *Dorbyl v Vorster*. Op Cit (note 60) at 586.
[71] *Da Silva*. Op Cit (note 17) at 627B.
[72] The Companies Act Op Cit (note 2) at section 76 (2)(a)(i).
[73] Cassim et Al. Op Cit (note 1) at 551.

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

(ii) *To knowingly cause harm to the company or a subsidiary of the company."*[74]

The Act exhibits only partial codification of the duty to avoid a conflict of interest, the no-profit rule and the corporate opportunity rule, as the common law duties remain preserved.[75] The idea behind partial codification is to allow the statutory duties to run alongside, and parallel with, the common law duties. As the argument goes, partial codification of the common law duties begets their strict enforcement and assists in clarification and accessibility to the greater public.[76] This argument rests on the assumption that the statutory duties align perfectly with the common law duties. The legislator has, arguably, negated this assumption with an exhibition of poor draftsmanship which is evident throughout the Act. Poor draftsmanship stems from an inability to cohesively marry the statutory fiduciary duties with its common law equivalents.

Such misalignment becomes evident upon an examination of section 76(2)(a)(i). The wording of the section suggests that the statutory duty is wider in some respects and narrower in others, in comparison to its common law counterpart.[77] It is wider in the following respect: a director of a holding company now owes a fiduciary duty to its subsidiary.[78] The Act, however, is narrower in the following respect: knowledge of the harm caused is a pre-requisite to breach of the fiduciary duty in instances where no gain is made by the director but the company, or its subsidiary, is harmed.[79]

The fact that the statutory duties do not perfectly align with their common law equivalents has given way to modification of the duties as opposed to clarification.[80] Such modification hinders the ability of the court, as well as the public, to coherently and cogently interpret and apply the principles pertaining to directors' fiduciary duties. It is due to such inherent failure, on the part of the legislators, that the topic of this dissertation inevitably arises. It is now up to the courts to interpret and apply the statutory and common law duties so that they align with, and reinforce, one another.[81]

3. CHAPTER THREE: BREACH OF THE NO-PROFIT RULE

Once the specific contours of the fiduciary duty have been established, the second leg of the breach enquiry focuses on alleging and proving a breach by the director of her fiduciary duty.[82]

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[74] Ibid at section 76 (2)(a)(i) and (ii).
[75] Ibid at section 158.
[76] Cassim et Al Op Cit (note 1) at 508.
[77] Ibid at 551.
[78] The Companies Act. Op Cit (note 2) at 76 (2)(a)(i).
[79] Ibid at section 76 (2)(a)(ii) and section 1 for the definition of "knowingly".
[80] Cassim et Al. Op Cit (note 1) at 551.
[81] Cassim et Al. Op Cit (note 1) at 551.
[82] *Phillips v Fieldstone*. Op Cit (note 7) at 159; *Bellairs v Hodnett*. Op Cit (note 55) at 1130; *Boardman v Phipps*. Op Cit (note 42) at 758.

The specific legal issue to be addressed, in the instance of a breach of the no-profit rule, has varied throughout numerous cases. On an examination of the relevant case law, in this respect, it is evident that a wide and narrow version of the legal issue can be readily identified. Aside from a debatable legal issue, the cause of action in terms of a breach of the no-profit rule has given rise to some notable controversy. Once a breach of the no-profit rule has been determined, the only escape from liability is the consent of the company following full disclosure by the director. Director insurance and court relief are also means to limit the personal liability of directors, in the event of a breach of the no-profit rule.

3.1 What Constitutes a Breach of the No-Profit Rule?

The no-profit rule has been strictly applied by our courts with little room for exception. The prevailing legal issue in determining a breach of the no-profit rule seems to be formulated as follows: if the director stood in a fiduciary relationship to the company at the time she acquired the profit, then the profit must be accounted for to the company and cannot be retained by the director for her own personal account.[83]

The underlying reason for a director's accounting for her profit to the company lies in the English law principles of agency and equity.[84] The benefit acquired by the director was as a result of her office and, had she not held such office, she would likely not have acquired the profit at all. Therefore, there is a causal link between the acquisition of profit and the director's position. The equity principle has been enunciated by our courts in the so called 'but for' test. But for the director holding his position as director, she would not have acquired the profit.[85] The principle of equity then dictates that the director must account for the acquired profit to the company which she serves.[86] The underlying principle of equity perhaps begets the strict application of the no-profit rule.

Application of the no-profit rule, to the facts and circumstances of the case, has given rise to a wide and narrow interpretation of the legal issue pertaining to a breach of the no-profit rule. Varying formulations of the legal issue which determines a breach of the no-profit rule may result in differing consequences and a standardized legal issue should be resolved.

3.1.1 Wide versus Narrow – the Legal Issue

Our courts have reiterated that mere acquisition of the profit by the director, while standing in a fiduciary relationship to the company, is enough to establish a breach of the no-profit rule.[87] As the court in *Phillips v Fieldstone* confirmed: "*the fundamental question is not whether the appellant*

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[83] *Robinson v Randfontein Estates.* Op Cit (note 7) at 179 & 214 – 215, *Regal (Hastings) v Gulliver.* Op Cit (note 7) at para 9.
[84] *Regal (Hastings) v Gulliver.* Op Cit (note 7) at para 11; *Phillips v Fieldstone.* Op Cit (note 7) at para 30.
[85] *Robinson v Randfontein Estates.* Op Cit (note 7) at 215.
[86] Robinson v Randfontein Estates. Op Cit (note 7) at 233; *Regal (Hastings) v Gulliver.* Op Cit (note 7) at para 9.
[87] *Phillips v Fieldstone.* Op Cit (note 7); *Regal (Hastings) v Gulliver.* Op Cit (note 7).

appropriated an opportunity belonging to the respondents, but whether he stood in a fiduciary relationship to them when the opportunity became available to him; if he did, it belonged to the respondents".[88] Furthermore, Heher JA also stated that "*because the fiduciary who acquires for himself is deemed to have acquired for the trust... once proof of a fiduciary duty is adduced it is of no relevance that....*"[89] These quotations illustrate the wide of application of the no-profit rule which dictates its strictness, with little or no room for exceptions.

Framing the legal question in the context of a mere acquisition of profit, regardless of a specific duty cast upon the director to acquire the profit for the company, produces an extremely broad fiduciary duty. Such a broad duty becomes overly burdensome on directors who are constantly looking over their shoulders to ensure compliance with the no-profit rule, in order to avoid liability. The specific contours of the obligations upon each director, in a discharge of her fiduciary duty, are seemingly redundant as a breach can be ascertained by mere acquisition of profit alone. The necessity of proving that the director was under a specific obligation to acquire the property, or profit, at the behest of the company, is no longer the focal point of this enquiry.

In the premise of a wide application of the no-profit rule, the crux of the issue becomes an analysis of the facts and circumstances of the case which may determine whether the director was standing in a fiduciary relationship with the company when the profit was acquired. The specific contours of the obligations imposed on the director, in terms of discharging her fiduciary duty, form the periphery of the enquiry. The facts and circumstances of the case are examined to determine the relationship between the director and the company at the time of acquisition of the profit.[90] If it is proven that the director stood in a fiduciary relationship to the company, at the time of acquisition, the director is deemed to be in breach of the no-profit rule. No further analysis of the nature and context of the specific duties on the director is necessary. This seems to be the approach first enunciated in the seminal case of *Regal (Hastings) v Gulliver* and later followed in *Phillips v Fieldstone Africa (Pty) Ltd* and confirmed in *Volvo (Southern Africa) (Pty) Ltd v Yssel.*[91]

By contrast, other courts have taken to narrowing the legal issue at hand by examining the nature and extent of the specific obligations imposed on the director, in discharging her fiduciary duty. The legal issue in this context is narrowed by enquiring whether the director was under an obligation to acquire the profit for the company when she took it for herself.[92] The focus in these cases is not proof of the fiduciary relationship at the time of acquisition of profit but rather whether the director was under a specific obligation to acquire the profit for the company. Under this narrower legal issue, the duty to avoid a conflict of interest can be clearly ascertained. If the

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[88] *Phillips v Fieldstone*. Op Cit (note 7) at para 34.
[89] Ibid at para 31.
[90] Ibid.
[91] *Regal (Hasting) v Gulliver*. Op Cit (note 7), *Phillips v Fieldstone*. Op Cit (note 7), *Volvo (Southern Africa) (Pty) Ltd v Yssel*. Op Cit (note 30).
[92] *Robinson v Randfontein Estates*. Op Cit (note 7) at 216 – 218 and 245; *Burland v Earle* 1902 AC 83.

director was under an obligation to acquire the profit for the company when she took it for herself then there is a clear conflict between the director's interests and her duty to act in the best interests of the company. The director will be in breach of the no-profit rule if she acquired the profit when she was under a fiduciary obligation to acquire it for the company.

Application of this narrower formulation establishes a two-fold legal enquiry. Firstly, whether the director stood in a fiduciary relationship to the company at the time of acquisition of profit? Secondly, whether there was a specific obligation on the director, in discharging her fiduciary duty, to acquire the profit for the company? In this premise, focus shifts from establishing the fiduciary relationship to a careful analysis of the specific contours of the obligations imposed on the director in fulfilling her fiduciary duty to the company.

In a broad application of the no-profit rule, there was little, to no, attention paid to the specific obligations imposed on the director. Mere acquisition of the profit, while in a fiduciary relationship to the company, was sufficient. In the narrow enquiry, the main business of the company is also considered in determining whether the director was under a duty to acquire the profit for the company. This is akin to a determination of a breach of the corporate opportunity rule.

The narrow approach seems to be initially suggested in *Robinson v Randfontein Estates*.[93] In this case, the court dedicated much deliberation to determining whether the director was under a specific obligation to acquire the property for the company when he took it for himself and subsequently sold it to the company at a profit.[94] This approach was also, conceivably, adopted in the more recent case of *Ghersi v Tiber developments (Pty) Ltd*. [95] In the *Robinson* case, the narrower legal issue was applied due to the argument that while the board is an agent of the company, each individual director is not and is therefore, as a rule, free to transact for her own account, even in competition with the company, of which she is a director.[96]

Furthermore, if the acquisition of the profit or property does not fall squarely within the scope of the business of the company then the company cannot, surely, be said to have an interest in its acquisition.[97] This argument has been made more frequently in cases where a director is alleged to have usurped a corporate opportunity belonging to the company, as opposed to an acquisition of profit. Specifically, if the company was actively pursuing the opportunity when the director acquired it for herself, then the conflict of interest is quite pronounced.[98] Although this is not a requirement for application of the no-profit rule (that the company be actively pursuing the

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[93] *Robinson v Randfontein Estates*. Op Cit (note 7) at 216 – 218.
[94] Ibid at 267.
[95] *Ghersi and Others v Tiber Developments (Pty) Ltd and Others* (84/06) [2007] ZASCA 43; [2007] SCA 43 (RSA); [2007] 4 ALL SA 847 (SCA) at para 9.
[96] *Robinson v Randfontein Estates*. Op Cit (note 7) at 216.
[97] *Robinson v Randfontein Estates*. Op Cit (note 7); *Cooks v Deeks* [1916] 1 AC 554 (PC); *Industrial Developments v Cooley*. Op Cit (note 48), *Bhullar v Bhullar*. Op Cit (note 42); *Canadian Aero Service Ltd v O'Malley*. Op Cit (note30).
[98] Ibid.

opportunity when it is usurped by the director) it may be suggested as a means to narrow the wide ambit of the rule.

The wide ambit of the no-profit rule can have dire consequences for inadvertent breaches by *bona fidei* directors. It is in this vein that the preferred legal issue should be the narrower version. The test for a breach of the no-profit rule should, therefore, be expressed as a three-fold enquiry. Firstly, was the director in a fiduciary relationship with the company when she acquired the profit?[99] Secondly, was the director under an obligation to acquire the property or profit for the company when she acquired it for herself; in essence did the director place herself in a position where her interests conflicted with those of the company?[100] Thirdly, did the director acquire the profit without the company's consent following full disclosure by the director?[101] If the answer to all of the above questions is in the affirmative, then it is likely that the director will be in breach of the no-profit rule and will have to account to the company for the acquired profit.

3.1.2 A Controversial Cause of Action

An analysis of the case law, in respect of a breach of the no-profit rule, has yielded certain common elements. It matters not whether the company could've acquired the profit for itself.[102] It is of no consequence whether the company suffered any loss or damage as a result of the breach.[103] The fact that the director acted *bona fidei* in her acquisition of the profit is also of no consequence.[104] The director need not be under a specific mandate to acquire the profit for the company in order to be in breach of the no-profit rule.[105] The rule extends not only to actual conflicts of interest but also to those which are a reasonable, sensible possibility.[106] The fiduciary duty of the director may also extend beyond the term of employment.[107] The only defences open to a director who wants to acquire profit, as a result of her position as director, would be the free consent of the company following full disclosure.[108]

These elements have attracted criticism which is levied against the harshness of the no-profit rule and its drastic consequences for directors. Dubbed as a "dog in the manger" remedy, the most criticized element of a breach of the no-profit rule is the 'no loss' requirement.[109] It seems

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[99] *Boardman v Phipps.* Op Cit (note 42) at 758 and *Robinson v Randfontein Estates.* Op Cit (note 7) as quoted in *Phillips v Fieldstone.* Op cit (note 7) at para 31.
[100] *Phillips v Fieldstone.* Op Cit (note 7) at para 38.
[101] Ibid at para 38.
[102] *Regal (Hastings) v Gulliver.* Op Cit (note 7) at 378 and *Boardman v Phipps.* Op Cit (note 7) at 746I; *Keech v Sandford.* Op Cit (note 38); *Phillips v Fieldstone.* Op Cit (note 7) at para 30.
[103] *Regal (Hastings) v Gulliver* at para 386B, 392F; *Phillips v Fieldstone.* Op Cit (note 7) at para 30.
[104] *Regal (Hastings) v Gulliver* at para 10*; Parker v McKenna* (1874) LR 10 Ch App 96 at 118; *Phillips v Fieldstone* at 161.
[105] *Regal (Hastings) v Gulliver.* Op Cit (note 7) at 378 and 386B; *Phillips v Fieldstone.* Op Cit (ntoe 7) at para 30.
[106] *Phillips v Fieldstone.* Op Cit (note 7) at para 30.
[107] *Cyberscene Ltd and Others v i-Kiosk Internet and Information (Pty) Ltd* 2000 (3) SA 806 (C) at 820I; *Da Silva v CH Chemicals* Op Cit (note 17).
[108] *Robinson v Randfontein Estates.* Op Cit (note 7) at 178; *Boardman v Phipps.* Op Cit (note 42) at 737D, 744H, 747D.
[109] *Regal (Hastings) v Gulliver.* Op Cit (note 7) at para 18.

counterintuitive to claim profit from a director when the company itself has not suffered any loss or damage, as a result of the director's acquisition of the profit. The fact that the company need not suffer any loss, in order to sustain a cause of action based on breach of the no-profit rule, primarily distinguishes the remedy of disgorgement from the damages remedy. [110] This differentiation is fully analysed in Chapter 4 below.

The fact that it is of no consequence that the company would have or could have acquired the profit for itself, is another controversial element. The no-profit rule stems from the overarching duty to avoid a conflict of interest. The fact that the company could not, or would not, have acquired the profit for itself seems to be at odds with the purpose of the duty to avoid a conflict of interest. If the company could not, or would not, have acquired the profit for itself then the director was not under a duty to acquire it for the company. Hence, there can be no conflict of interest between the director's personal interest and her duty to the company when she acquired the profit for herself. Therefore, an argument for a breach of the no-profit rule, in these instances, cannot logically be based on the overarching duty to avoid a conflict of interest.

This landmine seems to have been sidestepped by widening application of the no-profit rule. The mere acquisition of profit by the director, while standing in a fiduciary relationship to the company, is deemed a breach of the no-profit rule.[111] As in the case of *Keech v Sandford*, the overriding issue was whether the trustee acquired the benefit in the course and scope of his duties as trustee.[112] The fact that the lease was not open for renewal to the trust was of no consequence. The court found that the only person not entitled to acquire the lease, was the trustee, by virtue of his office.[113] Acquisition of the lease by the trustee was a benefit which was due to the trust, in terms of the underlying principles of equity.[114] The inadvertent effect of this element seems to result in a negation of the no-conflict principle which does not seem adequately sidestepped by casting a very wide net in a strict application of the rule. This argument makes out a case for a narrowing of the scope of the no-profit rule. The focus of the legal enquiry for determining a breach of the no-profit rule should be whether the director was under an obligation to acquire the property, or profit, for the company. This narrow version is opposed to the wide version which dictates a breach by mere acquisition of the property or profit by the director.

Furthermore, the fact that a director, who acted *bona fidei* in her acquisition of the profit, can still be in breach of her fiduciary duty, has raised some issues.[115] A director's fiduciary duty to the

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[110] *Regal (Hastings) v Gulliver*. Op Cit (note 7); *Phillips v Fieldstone*. Op Cit (note 7) at para 31; *Volvo (Southern Africa) (Pty) Ltd v Yssel*. Op Cit (note 30) at 501.
[111] *Regal (Hastings) v Gulliver*. Op Cit (note 7) at para 9.
[112] *Keech v Sandford*. Op Cit (note 38).
[113] Ibid.
[114] Ibid.
[115] *Parker v McKenna*. Op Cit (note 38) at 118; *Phillips v Fieldstone*. Op Cit (note 7) at 161; *Regal (Hastings) v Gulliver*. Op Cit (note 7) at para 9.

company is based on the overarching pillars of good faith, loyalty and honesty. A director inadvertently acquiring profit whilst standing in a fiduciary relationship to the company, should surely be allowed a *bona fidei* defence. Such a defence has been allowed by English and Australian courts.[116] If it can be proven that the director acquired the profit under a genuine belief that she was not required to acquire for the company, the court should use its discretion to determine the appropriateness of requiring the director to account for that profit. Although it would be difficult to determine the contours of a good faith defence because it is based on a director's genuine belief which is ultimately a subjective test. It is perhaps in an effort to avoid uncertainty that our courts opt to adopt blanket strict application of the no-profit rule.

The no-profit rule espouses strict application which casts an extremely wide net where directors may find themselves in breach of the rule, inadvertently, by mere acquisition of profit whilst standing in a fiduciary relationship to the company. As a result of its wide scope, a breach of the no-profit rule may give rise to drastic, far-reaching consequences for the unsuspecting director. It is arguable that the rule should be narrowed in two respects. Firstly, the director needs to be under a specific duty to acquire the profit for the company when she retained it for herself. Secondly, the director is only in breach of the no-profit rule if it can be proven that the profit would have gone to the company, but for, the director's usurpation. The counter-argument against narrowing the rule would be that the director should safeguard herself by obtaining the consent of the company, after making full disclosure. However, this is easier said than done.

3.2 Defences

The only defence open to a director who has breached the no-profit rule is the free consent of the company following full disclosure of the conflict of interest by the director.[117] If a director obtains the consent of the company following full disclosure, of her personal interest in the matter, then she may escape any liability imposed as a result of a breach of the no-profit rule.[118] It must be noted that consent of the company must be coupled with full disclosure by the director. Disclosure or consent alone will not suffice as a defence to a breach of the no-profit rule.

3.2.1 Consent

The concept of consent is a common law principle which states that a director is liable to account to the company for any profits made by her unless the contract or agreement has been approved or ratified by the shareholders of the company.[119] It has been suggested that a director may retain profit made whilst standing in a fiduciary relationship to the company if she obtains the consent of the company. The court, in *Regal (Hastings) v Gulliver* held, *obiter,* that the directors could

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[116] *Phillips v Fieldstone.* Op Cit (note 7) at para 31.
[117] Regal (Hastings) v Gulliver. Op Cit (note 7); *Robinson v Randfontein Estates.* Op Cit (note 7).
[118] Ibid.
[119] Cassim et Al. Op Cit (Note 1) at 567.

have safeguarded themselves from disgorging their profits to the company by obtaining the consent of the company.[120] Consent would be in the form of an ordinary shareholders resolution passed at a general meeting called for that purpose.[121] In the event that such consent is not obtained, the directors must account for the profit to the company.[122]

The court in *Robinson v Randfontein Estates* stressed that the consent of the company has to be freely obtained.[123] In other words, the director who acquired the profit cannot herself, or with the use 'puppet' directors, influence the consent to be provided by the shareholders of the company. The shareholders of the company are to pass the ordinary resolution with unfettered discretion and not under the influence or at the behest of any director of the company. The director must at all times bring his own independent mind to bear on the decisions taken in the best interests of the company.[124]

Consent of the company will be made by virtue of a shareholders resolution passed at a general meeting called for that purpose.[125] A distinction has been drawn between consent in terms of the no-profit rule and the corporate opportunity rule. In *Cooks v Deeks*, the court held that consent of the company was required by way of a unanimous resolution of the shareholders in order for the director to retain the opportunity.[126] In terms of the no-profit rule, consent by virtue of a majority shareholders resolution is required in order for the director to retain the acquired profit.[127]

The consent may be provided before or after acquisition of the profit by the director. Obtaining the consent of the company after acquisition of the profit is allowed by way of ratification.[128] Therefore, it is plausible that the company's shareholders may, by ordinary resolution, ratify a director's acquisition of profit while standing in a fiduciary relationship to the company.[129] Ratification by way of a shareholders ordinary resolution would have been a perfect solution to the breach by the directors of the no-profit rule in *Regal (Hastings) v Gulliver* where all of the directors were also shareholders of the company.[130]

The statutory no-profit rule is encompassed under section 76 (2)(a) and It has yet to be seen whether a director in breach of the statutory duty may escape liability imposed under section 77(2)(b) through ratification by way of a shareholders ordinary resolution. Although not explicitly mentioned in the Act, the common law principle of ratification still persists and, arguably, may be

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[120] *Regal (Hastings) v Gulliver*. Op Cit (note 7) at para 13.
[121] Ibid.
[122] Ibid.
[123] *Robinson v Randfontein Estates*. Op Cit (note 7) at 224.
[124] *Robinson v Randfontein Estates*. Op Cit (note 7) at 185.
[125] *Regal (Hastings) v Gulliver*. Op Cit (note 7) at para 13.
[126] *Cook v Deeks*. Op Cit (note 97).
[127] Cassim et Al. Op Cit (note 1) at 541.
[128] Ibid at 541.
[129] Ibid.
[130] *Regal (Hastings) v Gulliver*. Op Cit (note 7).

applied to a breach of the statutory no-profit rule.[131] This theory of statutory ratification, through implementation of the common law principle, has yet to be put to the test through our case law.

3.2.2 Disclosure

The second mandatory requirement to fulfill, in order to escape liability for a breach of the no-profit rule, is full disclosure. Before the ordinary resolution is passed by the shareholders, the director is required to make a full disclose of her interest in the matter.[132] If the disclosure requirement is not met then the defence will not stand, despite the provision of consent by the company. Disclosure by the director is made to the board of directors of the company who are then under a duty to ensure that the shareholders of the company are aware of the conflict before passing the ordinary resolution.[133] In practice, any personal financial interest of a director, in a matter, is stipulated in the circular or notice which is delivered to shareholders prior to the meeting.

The common law principle of disclosure is well entrenched in our case law as a defence to a breach of the fiduciary to avoid a conflict of interest.[134] Our courts have pronounced that full and frank disclosure by the director is necessary. This entails a detailed account of the conflict of interest and the specific nature of the director's interest in the matter.[135] Mere disclosure by the director that there is a conflict of interest will not suffice.[136] Knowledge of a conflict of interest is also not tantamount to full disclosure.[137] The court in *Robinson v Randfontein Estates* was at pains to state that the director blatantly avoided disclosure of his personal financial interest in acquiring the farm for himself and then later selling it to the company at a profit.[138] He, and his agent, had numerous opportunities to disclose the interest but failed to do so at any stage. This avoidance in itself may be evidence of the director's attempt to make a 'secret' profit whilst standing in a fiduciary relationship to the company. Therefore, it can be assumed that non-disclosure by the director is often an indicator of sinister behavior.

The common law duty of disclosure, in conflict of interest scenarios, was codified in section 234 to 241 of the 1973 companies act and has now been codified in section 75 of the current Act.[139] Section 75 details with the nature, extent and procedure of a director making full disclosure of her personal financial interests.[140] The personal financial interest is disclosed as it relates to the matter to be decided on by the board or the shareholders.[141] The Act then provides for approval of the transaction or agreement, in which the director has a personal financial interest, in three

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131 Cassim et Al. Op Cit (note 1) at 582.
132 Ibid at 572
133 Ibid at 572; *Guiness plc v Saunders* [1988] 2 ALL ER 940 (CA) 944.
134 *Regal (Hastings) v Gulliver*. Op Cit (note 7) and *Robinson v Randfontein Estates*. Op Cit (note 7).
135 *Phosphate of Lime Co v Green* (1871) LR 7 CP 43; Cassim at 581.
136 *Robinson v Randfontein Estates*. Op Cit (note 7) at 198; *Marler's Estates v Marler* 114 L.T at 604.
137 *Robinson v Randfontein Estates*. Op Cit (note 7) at 260.
138 Ibid.
139 The Companies Act (No. 61 of 1973) at Section 234 – 241; The Companies Act. Op Cit (note 2) at section 75.
140 Ibid.
141 Ibid.

respects. Firstly, by ordinary resolution of the shareholders following full disclosure.[142] Secondly, by way of ratification by an ordinary resolution of the shareholders following full disclosure, despite approval by the company without prior disclosure.[143] Thirdly, and without prior full disclosure, by court order.[144]

The detailed codification of the disclosure principle confirms the common law position and enhances the statutory duties and liabilities of directors.[145] Section 75 is wide in its ambit and, when uncertainty prevails, and in order to avoid a breach of their fiduciary duty which can lead to statutory liability, directors are urged to disclose any personal interest in a matter to the board prior to the shareholders passing an ordinary resolution. In this way, directors safeguard themselves against incurring any liability if it later comes to pass that they had a personal interest in the matter which they failed to disclose. Non-disclosure paves the way for an argument of concealment. If the director has nothing to hide, and no 'secret' profit to gain, then full disclosure is a means to avoid liability.

However, that is easier said than done. Arguably, directors may fail to err on the side of caution in uncertain situations because they are weary of vengeful shareholders. A disgruntled shareholder may use the director's personal interest, disclosed to board, as a reason to vote against the resolution even if the director's interest does not hinder the interests of the company. This weariness would find traction in terms of the corporate opportunity rule more so than the no-profit rule. As a unanimous resolution is required in light of an interest in a corporate opportunity whereas an ordinary resolution is required for an interest in acquisition of profit. Therefore, negation of a resolution by vengeful shareholders is more easily avoided when only a majority vote of the shareholders is required.

Whatever the semantics, human nature is sometimes overlooked in discussions of legality. However, they can often play a distinctive role in the practical implementation of legal theories and should, therefore, be given due cognizance in the formulation of legal requirements. Stringent legal requirements can be wielded as weapons to prevent overly cautious directors from acquiring benefits. In order to uphold the principle of equity, these situations need to be avoided and recourse needs to be provided for directors in the event that consent is unreasonably withheld. If such recourse is provided, more directors may disclose their interests as they will be safeguarded against vengeful shareholders. Legality is always a system of checks and balances and, in this respect, there seems to be little or no checks for disgruntled shareholders simply looking to stir the pot.

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[142] Ibid at section 75 (7)(a).
[143] Ibid at section 75 (7)(b)(i).
[144] Ibid at 75 (7)((b)(ii).
[145] *Phillips v Fieldstone*. Op Cit (note 7) at 479F.

3.3 Court Relief and Director Indemnification

The Act provides for court relief where a director is found to be liable due to breach of the no-profit rule.[146] In order for the court to excuse the director, the director has to have acted honestly and reasonably or, having regard to all of the circumstances of the case, it would be fair to excuse the director.[147] These two possibilities are fairly broad in their scope and ambit. They provide a proper escape for directors found to be statutorily liable, as a result of breaching their fiduciary duties. Perhaps these lenient measures were implemented by the legislators as a way of softening the dire consequences which a breach of the no-profit rule may have on *bona fidei* directors.

Under the 1973 companies act, section 248 governed court relief for director's found to be personally liable.[148] Section 77 (9), arguably, mirrors the provisions of the 1973 act.[149] In terms of section 248, the court was empowered to relieve a director for negligence, default or breach of duty or trust if the director acted honestly and reasonably and the director ought fairly to be excused.[150] This is akin to the provisions of section 77 of the current Act.

The provisions of section 78 of the Act govern directors' insurance and indemnification.[151] In this respect, an agreement or provision in the company's Memorandum of Incorporation is void in two instances. Firstly, if it purports to relieve a director of a duty encapsulated under section 75 or 76. Secondly, if such provision indemnifies a director against any liability arising in terms of section 77.[152] Therefore, a director may not, under any circumstances, contract out of her statutory duties or liabilities. Furthermore, a company may not indemnify a director in respect of any liability arising under section 77.[153] A director cannot contract out of, nor can the company indemnify, a director found to be in breach of the statutory no-profit rule under section 76 (2)(a). As stated, consent of the company following full disclosure will be the only defence available for a director hoping to escape liability due to a breach of the no-profit rule.

[146] The Companies Act. Op Cit (note 2) at Section 77(9)(a) and (b).
[147] Ibid.
[148] The Companies Act. Op Cit (note 139) at section 248.
[149] The Companies Act. Op Cit (note 2) at section 77 (9).
[150] Ibid.
[151] Ibid at section 78.
[152] Ibid at section 78 (2) (a).
[153] Ibid at section 78 (6).

4. CHAPTER FOUR: DIRECTOR'S LIABILITY DUE TO BREACH

At common law, a breach of the no-profit rule gives rise to a remedy of disgorgement or a remedy of damages, based on the circumstances and context of each case.[154] Emphasis has been placed on a claimant's right to claim one remedy or the other but not both which has been confirmed by our courts.[155] The cause of action upon which each remedy is based stems from the common element of a director's breach of the no-profit rule. However, the specific requirements of each remedy are quite different. Courts have often found it difficult to ascertain the remedy being relied upon in an examination of claimant's pleadings. This has resulted in a prolonged analysis of the appropriateness of the remedy of disgorgement or damages, based on the facts and circumstances of the case. The battle still ensues between these two primary remedies and more appropriate remedies, such as the common law remedy of unjustified enrichment, are overlooked.

The common law remedies of disgorgement and damages have been partially codified with the advent of the Act. Codification of directors' duties and liabilities is, arguably, an attempt to bring South African corporate governance practices in line with international trends. Many developed nations have sophisticated corporate governance systems in place which include statutory duties and liabilities for directors. Whether or not our current corporate law jurisprudence has hit the mark, in terms of international developments, has yet to be determined. The implementation and enforcement of directors statutory duties and liabilities is a step in the right direction.

4.1 The Common Law Remedy of Disgorgement

The remedy of disgorgement has been readily applied by our courts, following the seminal English case of *Regal (Hastings) v Gulliver* which was handed down in 1942.[156] The earlier decision of *Robinson v Randfontein Estates* involved a 'claim for profits' which was a remedy labelled as *sui generis*.[157] However, the court did not specifically refer to the remedy of disgorgement.[158] The remedy of disgorgement, as set out in *Regal (Hastings) v Gulliver*, has been upheld and confirmed by our courts on numerous occasions.[159] The most notable of which being the case of *Phillips v Fieldstone*, a judgement handed down by the Supreme Court of Appeal.[160] Our courts have confirmed that the remedy is not one of last resort or to be applied only in limited circumstances.

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[154] *Debrigum Manufacturing (Pty) Ltd v Callegaro and Others [2013] ZAGPJHC 32; Robinson v Randfontein Estates.* Op Cit (note 7), *Phillips v Fieldstone.* Op Cit (note 7), *Regal (Hastings) v Gulliver.* Op Cit (note 7).
[155] *Du Plessis NO v Phelps.* Op Cit (note 25).
[156] *Regal (Hastings) v Gulliver.* Op Cit (note 7).
[157] *Robinson v Randfontein Estates.* Op Cit (note 7) at 242.
[158] Ibid.
[159] *Regal (Hastings) v Gulliver.* Op Cit (note 7).
[160] *Phillips v Fieldstone.* Op Cit (note 7).

It is a remedy which seeks to uphold the sacrosanct and core fiduciary duty of directors: to avoid a conflict of interest.

Directors are under a fiduciary duty to avoid a conflict of interest between their personal interests and their duty to act in the best interests of the company. A director who acquires profit whilst standing in a fiduciary relationship to the company may be in breach of the no-profit rule.[161] Once breach has been established, the director, under our law, will not be allowed to retain the acquired profit and may be required to disgorge it to the company.[162] Disgorgement of profit is not necessarily automatic upon establishing a breach of the no-profit rule.[163] Upon establishing a breach of the no-profit rule, the company can elect to rescind the sale and restore all parties to their original positions or claim the profit acquired by the director.[164] In the event that the company chooses to acquire the profit from the director, the appropriate remedy, in most instances, is the remedy of disgorgement.

The remedy of disgorgement has been described as *sui generis* due to its uniqueness and non-categorization as any distinct type of remedy in our law.[165] It is not a remedy based on contract or damages but on a breach of the fiduciary duty by the director.[166] The liability imposed in terms of the remedy of disgorgement hinges on a breach by the director of the no-profit rule. Breach of the no-profit rule is based on a careful and comprehensive consideration of the facts and circumstances of each case. Disgorgement of profit to the company only arises upon breach of the no profit rule. More specifically, upon acquisition of the profit by the director, while standing in a fiduciary relationship to the company.[167]

Our courts have frequently sought to differentiate the disgorgement remedy from the damages remedy, in light of a director's breach of her fiduciary duty.[168] Although the common element in both causes of action is a breach of the no-profit rule, the other elements are quite different. As is evidenced from the *Symington* case, establishing exactly which remedy is being relied upon is crucial to sustaining a clear cause of action.[169] Unlike the remedy of damages, actual loss need not be suffered by the company in order to sustain a cause of action based on the remedy of disgorgement.[170] Furthermore, there need not be proof of fault or wrongdoing on the part of the

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[161] *Symington v Pretoria-Oos Privaat Hospitaal Bedryfs (Pty) Ltd.* Op Cit (note 52) at para 24; *Phillips v Fieldstone.* Op Cit (note 7) at para 31.
[162] *Robinson v Randfontein Estates.* Op Cit (note 7) at 233.
[163] *Du Plessis NO v Phelps.* Op Cit (note 25) at 473.
[164] *Robinson v Randfontein Estates.* Op Cit (note 7) at 263.
[165] Ibid.
[166] Ibid at 199.
[167] *Symington v Pretoria-Oos Privaat Hospitaal Bedryfs (Pty) Ltd.* Op Cit (note 52) at para 25.
[168] *Debrigum Manufacturing (Pty) Ltd v Callegaro and Others.* Op Cit (note 154); *Du Plessis NO v Phelps.* Op Cit (note 25), *Symington v Pretoria-Oos Privaat Hospitaal Bedryfs (Pty) Ltd.* Op Cit (note 52); *Robinson v Randfontein Estates.* Op Cit (note 7) at 241.
[169] *Symington v Pretoria-Oos Privaat Hospitaal Bedryfs (Pty) Ltd.* Op Cit (note 52).
[170] *Robinson v Randfontein Estates.* Op Cit (note 7) at 241.

director in order to sustain a cause of action based on the remedy of disgorgement. The director may have even been acting honestly and in good faith when she acquired the profit. However, she may still be required to disgorge the acquired profit to the company.[171] The only escape from liability for the director would be the free consent of the company following full disclosure.

Similar in their common element of a breach of the no-profit rule, the damages remedy and the remedy of disgorgement espouse different elements upon which their causes of action are based. An outline of the damages remedy, in so far as it relates to the remedy of disgorgement, is necessary to landscape the substantial differences between the two remedies.

4.2 The Common Law Remedy of Damages

Said to be akin, in some respects, to the remedy of disgorgement, the damages remedy has been applied by our courts in instances of a breach of the no-profit rule. A claim for damages based on breach of a fiduciary duty is, arguably, a delictual action.[172] This claim for damages, however, is unlike the general claim for damages, based on the *Lex Aquilia*, because fault is not a requirement to sustain the cause of action.[173] A director may be in breach of his fiduciary duty without being negligent as mere acquisition of profit, while standing in a fiduciary relationship to the company, may result in a breach of the no-profit rule.[174] In order to sustain a cause of action giving rise to a damages remedy, causation and wrongfulness are essential elements.[175] Loss or damage suffered by the company as a result of the director's acquisition of profit is also central to a claim for damages.[176]

A damages claim, based in delict and on the *Lex Aquilia,* can also be brought in the event of breach by a director of his duty of care and skill.[177] In this claim, fault would be an essential element of the cause of action. A director may be liable in the event of her failing to take reasonable care in the management of the company's affairs.[178]

The nature of the claim being brought by the claimant is essential in distinguishing a remedy of disgorgement from a damages remedy. A claimant relying on a damages remedy is faced with a greater challenge in proving all the elements necessary to sustain a cause of action. It would appear that in order to sustain a cause of action based on disgorgement, the claimant would have

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171 *Du Plessis NO v Phelps*. Op Cit (note 25) at 474.
172 *Debrigum Manufacturing (Pty) Ltd v Callegaro and* Others. Op Cit (note 154) at para 25.
173 *Debrigum Manufacturing (Pty) Ltd v Callegaro and Other.* Op Cit (note 154) at para 25; *Du Plessis NO v Phelps*. Op Cit (note 25) at 473; *Cohen v Segal* 1970 (3) SA 702 (W).
174 *Du Plessis NO v Phelps*. Op Cit (note 25) at 474.
175 *Debrigum Manufacturing (Pty) Ltd v Callegaro and Others.* Op cit (note 154) at para 27; *Du Plessis NO v Phelps.* Op Cit (note 25) at 475.
176 Ibid.
177 *Debrigum Manufacturing (Pty) Ltd v Callegaro and Others.* Op Cit (note 154) at para 25.
178 Ibid; *Du Plessis NO v Phelps*. Op Cit (note 25) at 170.

to prove that the director acquired profit, while in a fiduciary relationship with the company, thereby breaching the no-profit rule. However, in order to sustain a cause of action based on damages, the claimant would have to prove that there was an actual loss suffered by the company as a result of the director breaching his fiduciary duty, in a manner which was wrongful.[179] Causation in such a delictual claim is established with use of the 'but for' test.[180] As in, 'but for' the wrongful act of the director's acquisition of the profit, the company would not have suffered the loss.[181]

In a litigant's choice between the cumbersome damages remedy and the conceivably amiable remedy of disgorgement, a claimant would do well to rely on disgorgement. Whilst the tiresome task of establishing a fiduciary duty on the director remains common to both remedies, it would appear that the disgorgement remedy is based on a far less burdensome cause of action. Without requiring actual loss or wrongfulness, all the claimant need prove, is the acquisition of profit by the director while standing in a fiduciary relationship to the company. This, seemingly, is a much less daunting task. Our courts have the last word on the matter and retain the responsibility of determining the appropriateness of the claimant's remedy which is dependent on the facts and circumstances of each case, in a breach of the no-profit rule.

4.3 A Battle of Remedies: Damages versus Disgorgement

As previously suggested, the appropriateness of the remedy brought against the miscreant director rests on the facts and circumstances of each case. There are no fixed rules to ascertain which remedy must be applied in each instance of a breach of the no-profit rule. It is evident on an examination of the relevant case law, in this regard, that there is little clarity for claimants in sustaining accurate causes of action based on damages or disgorgement remedies.

Our courts have set a precedent that a claim for disgorgement does not equate to a claim for damages.[182] While the common element remains a breach of the director's fiduciary duty, the rest of the essential elements giving rise to the two separate claims are distinct. It is paramount for litigants to assemble their pleadings with the correct cause of action in mind, either giving rise to a remedy of disgorgement or a remedy of damages. Erroneously identifying exactly which remedy is being relied upon, can be fatal to pleadings. As was evident in the *Symington* case where the court had difficulty ascertaining, from the pleadings, whether the plaintiffs claim was one sounding in damages or disgorgement.[183] Based on the facts and circumstances of the case, as well as the

[179] *Du Plessis NO v Phelps.* Op Cit (note 25) at 475.
[180] *Du Plessis NO v Phelps.* Op Cit (note 25) at 477; *Siman & Co (Pty) Ltd v Barclays National Bank Ltd* 1984 (2) SA 888 (A).
[181] Ibid; *Atlas Organic Fertilizers (Pty) Ltd v Pikkewyn Ghwano (Pty) Ltd and Others* 1981 (2) SA 173 (T) at 197F- H.
[182] *Robinson v Randfontein Estates.* Op Cit (note 7) at 241.
[183] *Symington v Pretoria-Oos Privaat Hospitaal Bedryfs (Pty) Ltd.* Op Cit (note 52).

pleadings, the court held that the plaintiffs claim was one based on damages.[184] As a result, the three year period of prescription had been completed before the plaintiff's summons was served on the defendants.[185] This proved the undoing of the plaintiff's case. Had they chosen to frame their cause of action based on the remedy of disgorgement, as opposed to damages, the result might have been very different.

The plaintiff bears the onus of establishing and proving a breach of the no-profit rule which may subsequently give rise to liability for the director. It is, thus, the plaintiff's responsibility to ensure that accurate facts have been placed before the court upon which the cause of action is founded. Where the plaintiffs claim is unclear, the court must have regard to the facts and circumstances of the case in order to determine the specific nature of the claim. If this is the case, plaintiffs place themselves at a great disadvantage. The court, not privy to all of the facts of the case, must interpret pleadings to ascertain the nature of the claim before even delving into the merits.

In the *Callegaro* case, the court had to establish the nature of the plaintiff's claim when granting an order based on a special plea of *res judicata*.[186] In deciding the matter, the court paid specific attention to the calculation of the amounts claimed by the plaintiff. The court held that there were two distinct amounts being claimed for by the plaintiff.[187] One claim was calculated on the basis of the loss suffered by the company, as a result of the breach of the fiduciary duty – a claim for damages. The other claim was for the profits realized by the defendant as a result of a breach of his fiduciary duty – a claim for disgorgement. The courts distinction between the two separate claims indicated, perhaps inadvertently, a method for claimants to distinguish between the disgorgement and damages remedies.

It would appear that the method of calculation, in terms of the amount being claimed by the plaintiff is the best identifier of whether there is a claim for damages or disgorgement. This is supported by the cases of *Du Plessis NO v Phelps* and *Derbigum Manufacturing (Pty) Ltd v Vincent Callegaro.*[188] In both cases, the court determined the nature of the claim based on an analysis of the calculation used to arrive at the amount claimed by the plaintiffs.[189] The calculations being distinguished in terms of an actual loss suffered by the company which can be quantified into a damages claim and the profit gained by the director which can be distilled into a disgorgement

[184] Ibid.
[185] Ibid.
[186] *Debrigum Manufacturing (Pty) Ltd v Callegaro and Others.* Op Cit (note 154).
[187] Ibid at para 32.
[188] *Du Plessis NO v Phelps.* Op Cit (note 25); *Debrigum Manufacturing (Pty) Ltd v Callegaro and Others.* Op Cit (note 154).
[189] *Du Plessis NO v Phelps.* Op Cit (note 25); *Debrigum Manufacturing (Pty) Ltd v Callegaro and Others.* Op Cit (note 154)

claim. In both these cases, the determining factor lay in the amounts claimed by the plaintiffs. On this basis, the court was able to establish the appropriate remedy sought by the claimant.[190]

Claimants would do well to quantify the amount claimed and work backwards to ascertain the remedy and corresponding cause of action upon which the remedy is based. For instance, if amount claimed is calculated to represent an actual loss suffered by the company as a result of the director's breach, then a damages claim is appropriate. If, however, the amount cannot be quantified into an actual loss suffered by the company but profit acquired by the director during the course and scope of the duties of her office, then the appropriate remedy would be disgorgement. From this premise, the cause of action can materialize, in terms of the remedy sought, having due regard to the differing elements apparent in a cause of action based on disgorgement or damages.

Claimants who are unclear about which remedy is being sought often compile pleadings illustrating a mixture of the elements for a cause of action to sustain a damages or disgorgement remedy. In these instances, the cause of action and the remedy sought do not marry. In the *Symington* case, the plaintiff's pleadings were particularly muddled.[191] The pleadings set out a cause of action based on deprivation by the defendant of a corporate opportunity away from the plaintiff. It was alleged that the defendant's breach, of diverting the corporate opportunity, deprived the plaintiff of a rental stream. In consequence, and as a result of the defendants' breach of his fiduciary duty to the defendant, the plaintiff alleged the defendant was liable for the present value of the rental stream and provided a quantifiable amount.

The plaintiff admitted, in a counter plea, that the claim was one for damages. The court a quo disagreed with this supposition by the plaintiffs and held that the claim was one based on disgorgement of profits.[192] The Supreme Court of Appeal disagreed with the court a quo and held that the plaintiff's claim was one sounding in damages and not disgorgement. In coming to its conclusion, the court emphasized the plaintiff's election to rely on the damages remedy and stated that their papers had been prepared with this remedy in mind. Specifically, the court held that the plaintiff's pleadings did not make reference to the receipt of any profits by the defendants.[193] Because the receipt of profits constitutes a central element in a claim for disgorgement, the absence of such an allegation in the plaintiffs pleadings, meant that they could not relay on a disgorgement remedy.[194]

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[190] Ibid.
[191] *Symington v Pretoria-Oos Privaat Hospitaal Bedryfs (Pty) Ltd.* Op Cit (note 52).
[192] Ibid at para 24.
[193] Ibid.
[194] Ibid at para 31.

In essence, if the claimant's pleadings are unclear as to which remedy is sought, the court, on the papers and facts presented, must draw its own conclusions. This does not always invoke the promise of certain outcomes. When claimants make an election as to whether to rely on a damages remedy or a remedy of disgorgement, they are loathe to make the wrong election as they will likely be kept to it. The courts do not always get it right either and to avoid any unwarranted outcomes, it is imperative that the distinction between the damages remedy and the remedy of disgorgement remains clear.

4.4 Other Remedies

Over the years, our courts have suggested alternative remedies to restore profit to the company, other than the remedy of disgorgement. As the remedy of disgorgement is one *sui generis*, it's scope and ambit are somewhat unclear which creates uncertainty. In the past, it was plausible that claimants would rather frame their causes of action based on more frequently used remedies, the constraints of which are readily ascertainable. However, the remedy of disgorgement has become more familiar in our common law and other remedies are now seldom used, in instances of a breach of the no-profit rule. It is still noteworthy to briefly outline the most commonly suggested alternatives: the common law *condictio indebiti* and unjustified enrichment remedies.

4.4.1 Condictio Indebiti

Our courts have stated that the remedy to restore profit acquired by a director, whilst standing in a fiduciary relationship to the company, is not a *condicitio indebiti* remedy. The remedy known as *condictio indebiti* is framed as follows: "*it is an action by which, when there has been a payment of money not due, induced by ignorance of fact, the money so paid may be reclaimed.*"[195] The remedy of disgorgement of profits is distinguished from the *condictio indebiti* remedy. A restoration of profit under disgorgement is not made due to an incorrect or erroneous payment and it is not akin to a refund of the profit to the company.[196] Therefore, courts have denounced the use of the *condictio indebiti* remedy as an alternative to the remedy of disgorgement.[197]

4.4.2 Unjustified Enrichment

It is arguable that the remedy of unjustified enrichment may be proposed as another alternative to the remedy of disgorgement.[198] Unjustified enrichment is a remedy used to restore the plaintiff to the position before the enrichment took place by removing the benefit from the person who has been unjustifiably enriched.[199] The principle of equity underpins the remedy of unjustified enrichment in that it would be inequitable for a person to be unjustifiably enriched at another's

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195 *Robinson v Randfontein Estates*. Op Cit (note 7) at 199.
196 Ibid.
197 Ibid.
198 Du Plessis, J.E. 2012. *The South African Law of Unjustified Enrichment*, 1st ed: Juta at 371.
199 Du Bois, F. 2007. *Willie's Principles of South African Law*. 9ed: Juta at 1043.

expense.[200] The remedy is founded in Roman law and has been adopted into South African common law.[201] The essential elements to sustain a cause of action giving rise to a remedy of unjustified enrichment are three-fold. Firstly, the enrichment of the defendant and corresponding impoverishment of the plaintiff. Secondly, a causal link between the enrichment and the impoverishment. Thirdly, the absence of a cause which justifies retention of the enrichment by the defendant.[202]

The element of impoverishment assimilates the remedy of unjustified enrichment to the remedy of damages. The damages remedy requires loss or damage to be sustained by the company. Therefore, the impoverishment element is, arguably, akin to the loss element of the damages remedy. The enrichment element would be the profit acquired by the director. Enrichment requires economic benefits to be acquired by the plaintiff which would, arguably, include profit acquired by a director in breach of his fiduciary duty.[203]

However, it has been suggested that, because of the impoverishment element, the law of enrichment cannot be extended to instances where the enrichment arises from an encroachment on the rights of another.[204] Therefore, arguably, the liability to disgorge profits from the unlawful use of another person's image or intellectual property is not recognized in South African law as it is in English and German law.[205] This argument can possibly be extended to a disgorgement of profits, as a result of a breach of the no-profit rule. There is no 'impoverishment' of the company in a claim for disgorgement of profits. The unjustified enrichment claim is, thus, a more likely substitute for the damages claim as opposed to the disgorgement claim, in the event of a breach of the no-profit rule.

It has yet to be determined whether the remedy of unjustified enrichment would be a suitable alternative to the remedy of disgorgement in the event of a breach of the no-profit rule. It would be difficult to satisfy the requirements of the unjustified enrichment remedy in an account for the director's profits simply because the profit gained by the director was not at the expense of the company. Therefore, the impoverishment element would not be satisfied in an attempt to disgorge a director of profit acquired by him through the unjustified enrichment remedy. It has been enunciated by our courts that the director's acquisition of profit need not be at the expense of the company, in terms of the remedy of disgorgement. It is, however, a requirement of the remedy of unjustified enrichment.[206]

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[200] Ibid.
[201] Ibid.
[202] Ibid.
[203] Du Plessis, JE. Op Cit (note 198) at 371.
[204] Du Bois, F. Op Cit (note 199) at 1043.
[205] Ibid.
[206] Du Plessis. Op Cit (note 198) at 371.

4.5 Evolution: the Statutory Remedies

Implementation of the Act in May 2011, saw partial codification of the fiduciary duties of directors. An entirely novel concept, legislated for the first time in South African history, partial codification of the directors common law duties and liabilities has been a controversial issue. The fiduciary duties, specifically, the no-profit rule, was codified in section 76 (2)(a) of the Act.[207] The personal liability of a director, in the event of a breach of the no- profit rule, was codified in section 77 (2)(a). Although not without flaws, codification of the director's duties and liabilities, is a welcome introduction in South African corporate law jurisprudence.

Enacted in 1973, the old companies act was outdated in numerous respects and introduction of the Act saw an update in many antiquated company law and corporate governance practices. In keeping with international corporate governance trends, partial codification of the common law directors' duties and liabilities accords standardization and certainty.[208] The old companies act did not contain any reference to director's duties and liabilities, save for court relief, in any proceedings for "*negligence, default, breach of duty or breach of trust against any director.*"[209] The new Act, thus, addressed the need for aligning South African corporate governance trends with those on the international stage. Increasing globalization requires that directors be held to the same high accountability standards which are evident in most developed countries.

The approach towards partial codification of directors' duties and liabilities, as an international trend, was confirmed in the King III Code of Governance for South Africa.[210] King III pronounced the partial codification of directors' duties and liabilities as the most fundamental change in our corporate governance practices over the last decade.[211] The King Code and Reports showcase principles pertaining to good corporate governance practices which should be adhered to by any company wishing to be labelled a 'good corporate citizen'.[212] The Code suggests, *inter alia*, that the board is under a responsibility to ensure that all of its directors adhere to all of their common law and statutory duties.[213] The statutory duties, and the principles laid down in King III, depict South Africa's corporate governance evolution to align with international standards. Implementation and enforcement of the statutory duties and liabilities is the next hurdle to traverse in entrenching our new and enhanced corporate governance practices.

Although introduction of statutory duties and liabilities was, theoretically, an improvement to our corporate governance practices, the implementation of such duties and liabilities has proven

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[207] The Companies Act. Op Cit (note 2) at section 76 (2)(a).
[208] Mongalo, T. 2003. *The Emergence of Corporate Governance as a Fundamental Research Topic in South Africa.* SALJ 181.
[209] The Companies Act. Op Cit (note 2) at section 248.
[210] Institute of Directors Southern Africa, *The King Code of Governance for South Africa*, (2009) at 6; Institute of Directors Southern Africa, *The King Report on Governance for South Africa*, (2009) at 6.
[211] Ibid.
[212] Ibid.
[213] Ibid at 20.

problematic. This is largely due to inept interpretational practices, specifically, in respect of section 77 (2)(a). Partial codification of the common law remedies, in the event of a breach of a director's fiduciary duty, was the legislative intention behind section 77 (2)(a). However, if the common law remedies are not cogently and coherently codified, huge gaps can be created between legislation and the common law. As is evident upon examination of section 77 (2)(a), where the common law remedies and the statutory remedies are misaligned. This misalignment is caused, in part, through an apparent omission of the common law remedy of disgorgement from the ambit of section 77 (2)(a). The fact that the common law is preserved and not replaced by the Act, allows for the misalignment to be somewhat cured in the interim, until a possible legislative amendment is enacted.[214]

5. CHAPTER FIVE: STATUTORY REMEDIES

Implementation of the Act saw the introduction of statutory remedies, in the event of a director breaching her duty to act in the best interests of the company. The statutory remedies, encapsulating the personal liability of a director, are found under section 77 of the Act.[215] Section 77 (2) specifically encompasses the statutory remedies available in the instance of a breach by a director of her duties to the company. Section 77(2)(a) refers to the remedy available in the event of a breach of a fiduciary duty.[216] Section 77 (2)(b) to the remedy available in the event of a breach of the duty of care and skill.[217]

The statutory remedies to be brought in light of a breach of the no-profit rule, a fiduciary duty, should be found under section 77 (2)(a). It is arguable, however, that section 77 (2)(a) does not incorporate the common law remedy of disgorgement, in the event of a breach of the no-profit rule.[218] Section 77 (2)(a) could possibly be amended to ensure inclusion of the popular common law remedy of disgorgement. In the interim, alternative remedies such as the common law and section 218 (2) may be utilized, in the event of breach of the no-profit rule. In the event of a breach by a director of the no-profit rule, the company is usually the claimant bringing the action against the director.

5.1 Section 77 (2)

The common law liability arising from a breach of the no-profit rule has been partially codified under section 77 (2)(a) of the Act. The implementation of section 158 ensures that the common law liability is preserved and not replaced by the statutory liability.[219] Therefore, the common law

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[214] Mclennan. 2009. *Directors' Fiduciary Duties and the 2008 Companies Bill.* TSAR 1 at 185.
[215] The Companies Act. Op Cit (note 2) at section 77.
[216] Ibid at section 77 (2)(a).
[217] Ibid at section 77 (2)(b).
[218] Cassim et Al. Op Cit (note 1) at 583.
[219] The Companies Act. Op Cit (note 2) at section 158.

liability and the statutory liability run alongside each other and must be interpreted to complement and enhance each other.[220] Accordingly, if a director breaches the statutory no-profit rule, encapsulated under section 76 (2)(a), she may be held personally liable under section 77(2)(a) of the Act. The no-profit rule and corresponding liability, in the event of breach, now stem from two primary sources of law: the common law and the Act.

Section 77(2) reads as follows:[221]

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

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

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

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

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

(iii) any provision of the company's Memorandum of Incorporation."

Section 77 (2)(a) deals with statutory liability in the event of a breach of a director's fiduciary duty. Section 77 (2)(b) encompasses statutory liability in the event, *inter alia*, of a breach of a director's duty of care and skill. Section 77 (2)(a) specifically refers to liability in the event of a breach of a duty contemplated in section 76 (2) - the no-profit rule. It follows that a breach of the statutory no-profit rule should give rise to the statutory liability. However, the case is not as clear cut as legislators would have hoped.

Unfortunately, the wording of section 77 (2)(a) does not specifically provide for, or allow for an interpretation of, the common law remedy of disgorgement. The remedy of disgorgement is the corresponding liability, implemented in the instance of a breach of the no-profit rule. Is this respect, the statutory fiduciary duty and corresponding statutory remedy are misaligned. Such misalignment may cause uncertainty for ensuing litigants.

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[220] Cassim et Al. Op Cit (note 1) at 508.
[221] The Companies Act. Op Cit (note 2) at section 77 of the Act.

5.2 The Wording of Section 77 (2)(a)

It is trite that the primary rule of statutory construction is that words in the statute are to be given their ordinary, grammatical meaning.[222] The words in a statute should also be interpreted in light of their context.[223] The meaning of 'context' should be construed as firstly indicating the rest of the statute and secondly, the purpose, scope and ambit for which the statute was enacted.[224] The first port of call is, therefore, a literal interpretation of the words in a statute, attributing to them their ordinary grammatical meaning. There is a growing trend in statutory interpretation to have regard to the context in which the words appear even when they appear clear and unambiguous.[225] It is no longer a requirement to peer at words in a statute in order to readily ascertain their meaning whilst disregarding the context.[226] It is only when words in a statute are interpreted to be given their ordinary, grammatical meaning, in light of their context, that the true intention of the legislature can be attained.[227]

Ascribing a literal interpretation to section 77 (2)(a), it does not provide for the common law remedy of disgorgement. Specifically, the words *"for any loss, damages or costs"* are to be given their ordinary, grammatical meaning, in light of their context. The context indicating the rest of section 77, the rest of the statute, as well as the purpose for which the statute was enacted. The requirement of loss or damage is a necessary element giving rise to an action based on damages. It has been readily ascertained that the company need not suffer any loss, damages or costs, in order to sustain a cause of action giving rise to the remedy of disgorgement. It would, therefore, appear, upon a literal interpretation of section 77 (2)(a), that the common law remedy of disgorgement has been omitted from the Act. Over the last decade, our common law has seen more and more cases implementing the remedy of disgorgement. Therefore, omission of the remedy from the paramount piece of legislation which governs company law in South Africa seems an unlikely oversight.

Perhaps it was not the intention of the legislators to omit the remedy of disgorgement from the ambit of section 77 (2)(a). A purposive interpretation of section 77 (2)(a) would have to be undertaken in order to accommodate the common law remedy of disgorgement. Section 77 (2)(a), read with section 158, may allow for a remedy of disgorgement, although, the wording of section 77 (2)(a) still poses a problem. Possible omission of the common law remedy of disgorgement depicts an odd scenario in that a breach of the statutory no-profit rule, codified in section 76 (2)(a), will give rise to the common law remedy of disgorgement.

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222 *Bato Star Fishing (Pty) Ltd v Minister of Environmental Affairs and Tourism and Others* 2004 (4) SA 490; 2004 (7) BCLR 687 (CC) at para 89.
223 *Jaga v Donges, NO and Another; Bhana v Donges, NO and Another* 1950 (4) SA 653 (A).
224 Ibid.
225 *Thoroughbred Breeders' Association v Price Waterhouse* 2001 (4) SA 551 (SCA)
226 *University of Cape Town v Cape Bar Council and Another* 1986 (4) SA 903 at 914D – E.
227 Ibid.

Even though a breach of the statutory duty is referred to in section 77 (2)(a), the actual wording of the section does not support an imposition of the remedy of disgorgement. Claimants will thus be left with the option of proving a statutory breach of the no-profit rule followed by implementation of a common law remedy or a statutory damages remedy but not a statutory remedy of disgorgement. This seems an odd situation and could not have been the intention of the legislators. It is thus suggested that omission of the remedy of disgorgement is a mere legislative oversight. That being the case, an amendment of section 77 (2)(a) provides a likely solution.

5.3 Possible Legislative Amendments

A possible amendment of section 77 (2)(a) could be framed as follows:

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

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

By inserting the words "or otherwise", the door is left open for a disgorgement of profit to the company, in terms of a breach of the statutory no-profit rule contained in section 76 (2)(a). The section will then indicate that a director may held liable for something other than a loss, damage or cost sustained by the company – for a disgorgement of profit.

Alternatively, the words *"for any loss, damages or costs sustained by the company, as a consequence of any breach"* may be omitted from section 77 (2)(a). Such an omission will widen the provisions of section 77 (2)(a) and allow for inclusion of the remedy of disgorgement, in light of a breach of the statutory no-profit rule.

As a further alternative, the whole of section 77 (2) can be amended to afford an extensively wide application of statutory remedies, akin to the United Kingdom Companies Act. Section 178 (1) of the UK Companies Act reads as follows:

"(1) The consequences of breach (or threatened breach) of sections 171 to 177 are the same as would apply if the corresponding common law rule or equitable principle applied."[228]

Our Act could also be amended to accord a wide interpretation to statutory liabilities, in the event of a breach of directors' duties. The possible amendment, as suggested, would ensure application of the remedy of disgorgement, in the event of a breach of the no-profit rule. Amending section 77 (2) to simply refer to application of the common law remedies in the event of a breach of section 76 (2)(a) would solve the apparent omission of a statutory remedy of disgorgement.

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[228] United Kingdom Companies Act. Op Cit (note 17) at section 178.

The remedy of disgorgement is a prevalent common law remedy in our jurisprudence. The suggested amendments would allow for the common law remedy to be codified into a statutory remedy. Alternatively, the common law remedy could be applied in the event of a breach of the statutory duty. However which way the amendment occurs, it is essential to ensure that the remedy of disgorgement finds application within the contours of the Act.

5.4 Alternative Remedies

In the event that the legislature chooses not to amend the Act or an amendment takes time to enact, there are possible alternatives to a statutory remedy of disgorgement. The most prominent of which are section 218 (2) of the Act and the common law.

5.4.1 Section 218 (2) of the Act

Section 218 (2) of the Act reads as follows:

"Any person who contravenes any provision of this Act is liable to any other person for any loss or damage suffered by that person as a result of the contravention."[229]

This section is extremely broad in its interpretation and application and allows for any person to claim against any other person, in terms of a contravention of the Act. The section affords an opportunity to the company to bring an action against a director and is wide enough to include a claim for personal liability, in light of the remedy of disgorgement.[230]

Furthermore, this section would also allow for the possibility of a shareholder, or any other person, bringing a claim against the director. The section does not limit the claimant to being the company alone. Although, the beneficiary of a directors fiduciary duties is the company and, in that premise, it would appear that the logical claimant, in an action for breach of a director's fiduciary duty, is the company itself. However, section 218 (2) remains broad and the courts, therefore, have the discretion to determine whether the claimant is appropriate, given the facts and circumstances of the case.

It is arguable that the scope of the section is also wide enough to encompass the common law remedy of disgorgement. Although, the same interpretational issue arises on proper construction of this section as in section 77 (2)(a). The words "*any loss or damage*" do not leave room for the common law remedy of disgorgement, for which loss or damage suffered to the company is not a requirement.[231] Conceivably, section 218 (2) does not provide for a cause of action based on a benefit or profit being received. As a result, it is arguable that section 218 (2) does not allow for the implementation of the remedy of disgorgement.

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[229] The Companies Act. Op Cit (note 2) at section 218 (2).
[230] Havenga, M. Op Cit (note 56) at 267.
[231] Ibid at 267.

It would, thus, appear that section 218 (2) is not a suitable alternative to the omitted statutory remedy of disgorgement. That being the case, litigants would have to rely on the common law, in the instance of a breach of the statutory no-profit rule, contained in section 76 (2)(a).

5.4.2 The Common Law

Section 158 of the Act allows for the common law to be applied alongside the provisions of the Act. Therefore, the common law remedy of disgorgement may be applied in the event of a breach of the statutory no-profit rule, embedded in section 76 (2)(a).[232] Claimants would be able to formulate a cause of action pertaining to a breach of the statutory no-profit rule which would give rise to the common law remedy of disgorgement. Claimants are also able to rely on the common law remedy of disgorgement based on a breach of the common law no-profit rule, which has been preserved. Causes of action would have to be carefully considered, in this respect, in order to avoid any ambiguities or uncertainties.

Furthermore, as stated above, claimants would be able to frame the common law remedy of disgorgement as the primary claim, with claims for damages or unjustified enrichment in the alternative. Each remedy stems from differing causes of action, however, the common element is a breach of the no-profit rule. As a result of section 158, an omission of the common law remedy of disgorgement from the ambit of section 77 (2)(a) is not a complete disaster. However, it would be easier and more logical for litigants to rely on the Act to sustain a clear cause of action based on a breach of the statutory no-profit rule. In this way, a breach of the statutory no-profit rule would be followed by application of the corresponding statutory remedy of disgorgement.

In an attempt to play the devil's advocate, it may be arguable that the common law remedy of disgorgement was intentionally disregarded by legislatures. Possible arguments for and against the importance of the remedy of disgorgement, in light of a breach of the no-profit rule, will be fully considered in chapter six below.

5.5 The Claimants

The beneficiary of a director's fiduciary duties is the company.[233] It, therefore, follows that the company is the one to bring an action against a director, in the event of a breach of her fiduciary duty. The claimant in an action for disgorgement, in the event of a breach of the no-profit rule by directors of the company, would be the company itself. This is evident upon on analysis of the pivotal cases involving a breach of the no-profit rule and implementation of the remedy of disgorgement. There is no doubt that application of any statutory remedy against a director, in

[232] The Companies Act. Op Cit (note 2) at section 158 and section 77 (2)(a).
[233] Cassim et Al. Op Cit (note 1) at 540.

terms of section 77 (2)(a) would follow suit with the common law and the company would be the one to bring an action against the miscreant director.

In *Robinson v Randfontein Estates*, Robinson was a director of the company, Randfontein Estates and the company brought an action against him for breaching the no-profit rule.[234] He was ordered to disgorge his profits to the company.[235] In *Phillips v Fieldstone*, Phillips was a director of the company, Fieldstone Private Capital Group.[236] The company and its South African counterpart, Fieldstone Africa (Pty) Ltd, brought an action against Phillips for acquiring a profit in his personal capacity while standing in a fiduciary relationship with the company. This constituted a breach of the no-profit rule and the company demanded the profits acquired by Phillips. The same can be said of the cases of *Debrigum Manufacturing (Pty) Ltd v Callegaro*, *Da Silva v CH Chemicals (Pty) Ltd*, *Pretoria-Oos Privaat Hospitaal Bedryfs (Pty) Ltd v Symington* and *Volvo (Southern Africa) (Pty) Ltd v Yssel*.[237]

The company, as the claimant, may also bring an action against a former director of the company, for breaching her fiduciary duty. The company need only allege and prove that the director acquired a profit while standing in a fiduciary relationship with the company, in order to be in breach of her fiduciary duty. If the director resigns from the company, or her employment is terminated, it does not relieve her of the consequences of her breach.[238] The breach remains and the company is able to claim the profits from the former director under the remedy of disgorgement. This was the case in *Da Silva v CH Chemicals* where the court vehemently confirmed that a director does not escape his liability by simply resigning from the company.[239]

In *Regal (Hastings) v Gulliver*, the company, Regal (Hastings), brought an action against its former directors for disgorgement of the profit made by the director's when all of the shares of the company were sold to a third party.[240] In this instance, it was a newly constituted board of the company which instituted a derivative action on behalf of the company.[241] In comparison to *Robinson v Randfontein Estates*, the acquisition of profit by the directors of Regal (Hastings) was an inadvertent bonus received by the directors when the company was sold.[242] Unlike Robinson, the directors did not acquire the profit by usurping an opportunity that was in the direct line of business of the company and then reselling it to the company at an increased price. The directors of Regal (Hastings) were forced to subscribe for shares in the company's subsidiary because the

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[234] *Robinson v Randfontein Estates.* Op Cit (note 7).
[235] Ibid.
[236] *Phillips v Fieldstone.* Op Cit (note 7).
[237] *Debrigum Manufacturing (Pty) Ltd v Callegaro and Others.* Op Cit (note 154); *Da Silva v CH Chemicals (Pty) Ltd.* Op Cit (note 17); *Symington v Pretoria-Oos Privaat Hospitaal Bedryfs (Pty) Ltd.* Op Cit (note 52); *Volvo (Southern Africa) (Pty) Ltd v Yssel.* Op Cit (note 30).
[238] Cassim et Al. Op Cit (note 1) at 540.
[239] *Da Silva v CH Chemicals (Pty) Ltd.* Op Cit (note 17).
[240] *Regal (Hastings) v Gulliver.* Op Cit (note 7).
[241] Cassim et Al. Op Cit (note 1) at 537.
[242] *Robinson v Randfontein Estates.* Op Cit (note 7); Cassim et Al. Op Cit (note 1) at 537.

company simply did not have enough funds to do so itself. The directors were, in essence, bailing the company out and would later suffer the consequences for their well-intended actions.

This case has been widely criticized, in this respect, as it has been suggested that the purchaser of the company was opportunistic in claiming disgorgement of the profits made by the directors on the sale of their shares. It has been suggested that the new purchaser of the shares received an "undeserved windfall or discount".[243] Further, that the claim was not a meritorious one which resulted in an unfair and inequitable conclusion.[244] Unfortunately, this precedent has now been set and lays the groundwork for claims to be brought by opportunistic purchasers against unsuspecting, honest directors.

Our courts should have more discretion in these specific circumstances and be weary of newly constituted boards looking to make a quick buck for the company, for which it would otherwise not have been entitled. An equitable and fair result should always be of the utmost import in any ruling. Blind application of the disgorgement remedy, in the event of a breach of the no-profit rule, does not promote discretion and equitable results.

6. CHAPTER SIX: AN ALTERNATIVE INTERPRETATION OF SECTION 77 (2)(A)

It is arguable that there was a legislative intention to disregard the common law remedy of disgorgement from the ambit of section 77 (2)(a). The Act has been in operation since May 2011 and there have been no attempts by legislators to amend section 77 (2)(a) to make room for the prevalent common law remedy of disgorgement.[245] Perhaps legislators are waiting for all of the errors in the Act to become apparent before attending to an overall legislative amendment. Alternatively, and in the interim, the fact that the common law has been preserved, which still allows for application of the common law remedy of disgorgement, may appease opponents of the Act.

An intentional legislative omission of the common law remedy of disgorgement, needs to be explored, however remote. The apparent abrogation to disuse of the common law remedy of disgorgement will initially be considered. A brief comparative foreign analysis will shed further light on the omission, with specific reference to the jurisdictions of Delware (United States) and England. These jurisdictions have provided guidance for our corporate law jurisprudence and therefore, extremely influential during the drafting procedures for the Act. Lastly, the future of the common law remedy of disgorgement, as a default remedy as opposed to an exceptional remedy, will be proposed.

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243 Cassim et Al. Op cit (note 1) at 537.
244 Ibid.
245 RSA, DTA, Companies Bill, 2007. B61 – 2008; the Companies Amendment Act (No. 3 of 2010).

6.1 Abrogation to Disuse

The alternative, yet controversial, interpretation of section 77 (2)(a), is a legislative intention of the abrogation to disuse of the common law remedy of disgorgement. Our courts have readily applied the remedy of disgorgement, following the seminal English case of *Regal (Hastings) v Gulliver*.[246] There will be many critics to an interpretation of section 77 (2)(a) which lends itself to an intentional omission of the common law remedy of disgorgement. There have been suggestions of using alternative remedies as substitutes for the remedy of disgorgement, such as the damages remedy, unjustified enrichment and the *condictio indebiti* remedy. However, none of these alternative remedies exactly emulate the elements of the remedy of disgorgement. It is arguable that the remedy of disgorgement has stretched the common law too far. Its *sui generis* label possibly suggests its status as an exceptional remedy which is to be applied in limited instances as opposed to a widespread, default remedy, akin to the damages remedy.

The first draft of the Companies Bill was published in 2007.[247] There were a number of further drafts before the Bill was finally approved by Parliament in November 2008. Assented to by the President of the Republic, it became law in April 2009.[248] However, due to numerous errors found within the Act, it's enactment was suspended for a further year. Remedying of the Bill necessitated enactment of the Companies Amendment Act.[249] The Act, as amended, then finally came into operation on 1 May 2011.[250] It is noteworthy that throughout the various amendments of the Bill, it was never suggested that section 77 (2)(a) be amended to make room for the common law remedy of disgorgement. Whether this omission was due to mere oversight or intentional, the end result remains the same: the Act does not provide for a statutory remedy of disgorgement.

There are a number of arguments against frequent application of the remedy of disgorgement in the instances of a breach of the no-profit rule. One such argument is that the remedy goes against the concept of mitigation of loss.[251] Where a claimant is pursuing a cause of action they are under an obligation to mitigate the loss suffered by them as much as is reasonably possible. In order to sustain a cause of action giving rise to the remedy of disgorgement, one need not prove that the company suffered any loss or damage. Therefore, the company is under no obligation to mitigate its loss in application of the remedy of disgorgement.[252] This gives rise to the further argument that the company may not have been entitled to the profit that the director acquired. Specifically, there may have been special circumstances and negotiations made by the director which would

[246] *Regal (Hastings) v Gulliver*. Op Cit (note 7).
[247] RSA, DTA, Companies Bill. Op Cit (note 245).
[248] GG Notice 32121. 9 April 2009.
[249] The Companies Amendment Act. Op Cit (note 245).
[250] GG Notice 34239; Pretoria 26 April 2011. Regulation 32/2011.
[251] McCamus, J. 2003. *Disgorgement for Breach of Contract: a Comparative Perspective.* 36 Loy . L.A. L. Rev. 943. Available At: http://digitalcommons.lmu.edu/cgi/viewcontent.cgi?article=2362&context=llr at 950.
[252] Ibid.

not have been available to the company. In the same instance, had the profit been acquired by the company, its quantification would not be entirely certain. A company which then acquires the director's profit verbatim, without context or calculation, seems to give rise to inequitable consequences.

Bolstering an argument for inequitable consequences, the principle of restitution bears mention, in light of the remedy of disgorgement. In *Robinson v Randfontein Estates*, Lord Wright even referred to the remedy of disgorgement as a 'dog in the manger policy'.[253] He stated that the fact that the company suffered no loss and that the company could not have acquired the profit for itself made the equity principle questionable. The principle underpinning the disgorgement remedy remains steadfast: "*that if a person in a fiduciary relationship makes a secret profit cut of the relationship, the Court will not enquire whether the other person is damnified or has lost a profit which otherwise he would have got. The fact is in itself a fundamental breach of the fiduciary relationship*".[254] The strict rule is implemented to deter directors from being tempted to seek to their own advantage while under a duty to act in the best interests of the company, with unfettered discretion.[255]

The enquiry pertaining to a breach of the fiduciary duty relates to what the position would have been had the director not acted as she did.[256] Alternatively, what she might have done if there had there not been a temptation to seek to her own advantage.[257] If, in short, her interest had not conflicted with her duty.[258] The principles of equity and fairness dictate that the profit acquired by the director in such a capacity must be accounted for to the company.

However, this restoration theory which underpins the remedy is flawed in that if the company could never have acquired the profit for itself then it would be in the same position had the director not acted the way she did. In other words, it would still not have the benefit of the profit. Therefore, the remedy of disgorgement does not restore the parties to the position had the director not breached her fiduciary duty. The damages remedy is a better restorative solution than the remedy of disgorgement. If the company suffered a loss as a result of the breach, then the damages remedy is appropriate as it restores the party to the position it would have been, had the loss not occurred. Specifically, the damages remedy restores the company to the position had the director not breached her duty and the company not suffered a loss. The remedy of disgorgement affords the company a benefit or gain to which it otherwise would not have been privy. The equity and fairness of the disgorgement remedy is rather questionable, in this respect.

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[253] *Robinson v Randfontein Estates*. Op Cit (note 7) at para 18.
[254] Ibid.
[255] McCamus, J. Op Cit (note 251) at 950.
[256] Ibid.
[257] Ibid.
[258] Ibid.

A further issue pertaining to the application of the remedy of disgorgement is that the facts of the case are also generally difficult to ascertain. The only person in full knowledge of the profit and fiduciary relationship, is the director herself.[259] Unless there are witnesses who can corroborate the version of events, it may be increasingly difficult for a court to ascertain the genuineness of the facts presented before it. The facts and circumstances of the case are essential in ascertaining the existence of a fiduciary duty, and the specific contours of that duty, at the time the profit was acquired. The court must rely on the pleadings placed before it in order to determine whether a director is in breach of her fiduciary relationship. This is not always the easiest of tasks, as previously stated, pleadings upon which a remedy of disgorgement is based are often muddled and unclear.

The impact of the remedy of disgorgement on unsuspecting, honest directors may have unintended but far-reaching consequences. The wide ambit of the no-profit rule may impact the decision taking abilities of many directors. Fear of liability, which can be imposed due to the mere acquisition of profit, may prevent directors from otherwise taking important decisions.[260] This fear of retribution can stifle economic activity as directors may act too conservatively in order to avoid disgorgement of their deserved profit. Furthermore, our constitution promotes the right of free trade and the extensive and wide application of the remedy of disgorgement may negatively, although indirectly, impact this right.[261] Fear of retribution, if unchecked, can have dire consequences on a budding economy such as South Africa where risk taking is part and parcel of the corporate world. The checks and balances are somewhat skewed in this respect and application of the remedy of disgorgement should be limited to exceptional circumstances where all other remedies have all already been exhausted. Especially, in light of the fact that a director cannot be insured against, or indemnified from, the remedy of disgorgement.

It can also be seen from an examination of the case law, in this respect, that the remedy of disgorgement has been used by opportunistic new boards of the company. In many instances in which the remedy of disgorgement has been applied, the company had been recently taken over by a new board of directors. This was clearly the case in *Regal (Hastings) v Gulliver* where all of the shares of the company were purchased, and subsequent to the purchase, the new board claimed the profit which was acquired by the previous directors, under the remedy of disgorgement.[262] It is a concern that the remedy of disgorgement is subject to abuse by opportunistic boards seeking to acquire profit to which the company would not normally be entitled. The courts should be weary of these instances and guard against them by scrutinizing the facts of each case and the appropriateness of the remedy of disgorgement, specifically, with

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[259] *Robinson v Randfontein Estates*. Op Cit (note 7) at para 19.
[260] McCamus, J. Op Cit (note 251) at 951.
[261] Constitution of the Republic of South Africa (Act No. 108 Of 1996).
[262] *Regal (Hastings) v Gulliver*. Op Cit (note 7).

reference to the principle of equity. A narrower and limited application of disgorgement as an exceptional remedy would also curb potential abuses.

Despite its possible shortcomings, there are many proponents of the remedy of disgorgement. The most common argument for application of the remedy of disgorgement being its usefulness as a deterrent to future breaches of the no-profit rule. As a result of the wide and extensive ambit of the no-profit rule as well as the harshness of personal liability, directors are loathe to commit a breach. This is a well-intended consequence of the remedy's strict application, in terms of miscreant directors looking to utilize their positions as directors to make undue gains. However, honest and well-intended directors acting *bona fidei* also get caught up in the mix due to strict application of the remedy. It would appear inequitable to allow the remedy of disgorgement to be utilized by opportunistic boards against unsuspecting and honest directors. As was the case in *Regal (Hastings) v Gulliver* where well-intended directors were disgorged of their profit in comparison to the miscreant director in *Robinson v Randfontein Estates* who had undoubtedly hatched a plan to make a personal profit in his capacity as director of the company.[263]

In conclusion, it would appear that, despite its flaws, the remedy of disgorgement is still the preferred common law remedy, in the event of a breach of the no-profit rule. Therefore, it is a long way off from abrogation to disuse as a prevalent common law remedy which is frequently imposed by our courts. However, the remedy should possibly be limited to use in exceptional circumstances and as a remedy of last resort when all other remedies have been exhausted. In this way, the remedy will remain but its scope will have been limited to prevent abuse by opportunistic purchasers and curb its dire consequences for *bona fidei* directors.

6.2 Other Jurisdictions and the Remedy of Disgorgement

Our common law and statutory directors' duties and liabilities draw inspiration from many other corporate law jurisdictions. However, two jurisdictions merit specific reference, in respect of the formulation of our common law and statutory duties. Our common law directors' duties and liabilities are predominantly based on their English common law equivalents. Furthermore, the drafting of our Act was ultimately influenced by American attorneys and specifically, corporate law practices stemming from the state of Delaware.[264]

6.2.1 English Law

Our common law directors' duties and liabilities are predominantly based on the English common law duties and liabilities. The seminal case of *Regal (Hastings) v Gulliver,* which showcases the

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[263] *Regal (Hastings) v Gulliver.* Op Cit (note 7); *Robinson v Randfontein Estates.* Op cit (note 7).
[264] Olson, JF. 2010. *South African moves to a global model of corporate governance but with important national variations.* Available at:
http://www.gibsondunnlaw.com/publications/Documents/OlsonSouthAfricaGlobalModelCorporateGovernance.pdf
[Accessed on 1 January 2016].

remedy of disgorgement, was a decision handed down by the House of Lords.[265] Our courts have, thus, relied on English law to interpret and apply our common law duties and liabilities. A discussion of the South African no-profit rule and subsequent liability, in the event of a breach, merits a brief outline of, and comparison to, the English law approach.

English company law comprises a comprehensive set of common law and statutory directors' duties. As with our law, the common law duties are not replaced by the statutory ones, which are set out in the United Kingdom Companies Act.[266] Partially codified, the director's duties are established in Chapter 2 of the Act and the general fiduciary duties of directors as well as the duty of care and skill set out in sections 171 to 177.[267] A breach of a director's duty will result in the application of the common law remedies, as stated in section 178 of the Act.[268] The only defence available to a director in breach of her duties is authorization of the company. As is the case with our Act, directors are under a duty to disclose any interest in a transaction or arrangement to the company.[269]

The fiduciary duty to avoid a conflict of interest is encompassed under section 175 and the duty not to accept benefits from third parties under section 176.[270] It is not clear whether these two sections, read together, resemble our no-profit rule. Although, the English courts have a long list of cases depicting application of the corporate opportunity rule.

The Privy Council in *Cooks v Deeks* upheld the strict rule that directors of a company are restricted from usurping a corporate opportunity which should properly have belonged to the company they represented.[271] The Council further held that only a unanimous resolution passed by the shareholders of the company would allow the director to take the opportunity for herself.[272] In 1972, the House of Lords, was faced with application of the duty to avoid a conflict of interest where a director resigns from a company in order to take up a corporate opportunity.[273] The court held that resignation by the director did not relieve him of his fiduciary duty to avoid a conflict of interest as the opportunity had become apparent to him whilst acting in his capacity as director. The opportunity, thus, rightly belonged to the company and the director was required to take it up for the company and not himself. The basis of the court's decision rested on application of the no-

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[265] *Regal (Hastings) v Gulliver*. Op Cit (note 7).
[266] United Kingdom Companies Act. Op Cit (note 17) at section 170.
[267] Ibid at section 171 to 177.
[268] Ibid at section 178.
[269] The Companies Act. Op Cit (note 2) at section 75; The United Kingdom Companies Act. Op Cit (note 17) at section 177.
[270] The United Kingdom Companies Act. Op Cit (note 17) at section 175 and 176.
[271] *Cooks v Deeks*. Op Cit (note 97).
[272] Ibid.
[273] *Industrial Developments Consultants Ltd v Cooley*. Op Cit (note 48).

conflict rule, however, it is cogently arguable that the case concerned a corporate opportunity which belonged to the company.[274]

The court, in the case of *Bhullar v Bhullar*, followed the decision laid down in *Industrial Development Consultants v* Cooley.[275] The court again confirmed and upheld the strictness of the no-profit rule and the no-conflict rule.[276] As stated in *Industrial Development Consultants v Cooley*, it was of no consequence whether the company would be successful in acquiring the corporate opportunity for itself.[277] The directors remain under a fiduciary duty to communicate the existence of the opportunity to the company. At the company's request, the directors were under a duty to acquire the opportunity for the company and account for any profits made by virtue of the opportunity.[278] The court ordered the directors to transfer the property, acquired by them in their capacities as directors, to the company.

In the most recent case of *Philip Towers v Premier Waste Management Limited*, the court held that directors are under a fiduciary duty to the company to observe the no-conflict rule which embraced the duty not to make a secret profit.[279] The court reiterated the fact that it is of no consequence that the company suffered an actual loss in order to satisfy a claim to account for profits made by the directors to the company. If the directors acquired a profit by virtue of the offices held by them, then they are in breach of their fiduciary duty to avoid a conflict of interest and are required to disgorge the said profit to the company. The court relied on the seminal case of *Regal (Hastings) v Gulliver* in coming to its decision and followed the case of *Foster Bryant Surveying Limited v Bryant*.[280]

While it is apparent that the English courts have taken to application of the corporate opportunity rule, application of the no-profit rule is a rare occurrence. Furthermore, the corporate opportunity is said to be transferred to the company. However, mention of profits being 'disgorged' to the company is not explicitly stated. There are academics who argue that the remedy of disgorgement is the primary profits-based remedy, established in English law jurisprudence.[281] It is described as an equitable remedy which is not only used in limited instances. It has also been extended to cover instances in a breach of contract scenario.[282]

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[274] Cassim et Al. Op Cit (note 1) at 542.
[275] *Industrial Developments Consultants Ltd v Cooley*. Op Cit (note 48); *Bhullar v Bhullar Sub Nom Re Bhullar Bros Ltd*. Op Cit (note 42).
[276] *Industrial Developments Consultants Ltd v Cooley*. Op Cit (note 48) at para 31.
[277] Ibid.
[278] Ibid at para 41.
[279] *Philip Towers v Premier Waste Management* Ltd [2011] EWCA Civ 923.
[280] *Regal (Hastings) v Gulliver*. Op Cit (note 7); *Foster Bryant Surveying Limited v Bryant* (2007) EWCA Civ 200 (2007).
[281] Hondius, E. 2015. *Disgorgement of Profits: Gain Based Remedies throughout the World*. Springer International Publishing Switzerland at 33.
[282] *Attorney-General v Blake* [2001] 1 AC 268.

Arguably the English common law duties and liabilities have largely influenced our common law in the same field. The South African courts have followed suit with the English courts in terms of interpretation and application of directors' fiduciary duties and the corresponding liabilities. Specifically, English courts appear to liberally apply the remedy of disgorgement, in the event of a breach of the no-profit rule and the corporate opportunity rule. The remedy has even been extended to instances of a breach of contract. South African corporate law has not delved into the realms of a breach of contract. Although, the common law remedy of disgorgement has been extensively applied in the event of a breach of the no-profit rule.

Lastly, the English common law remedies enjoy wide application, in terms of the Companies Act, which allows for any remedy or equity principle available in the common law to be applied, in the event of a breach of a common law or statutory duty.[283] Seemingly, our Act would have done well to follow this catch-all clause which would prevent significant legislative oversights or omissions. The classic case in point in this respect is the common law remedy of disgorgement, which appears to have been omitted from the ambit of section 77 (2)(a). Although, its equivalent statutory duty, the no-profit rule, is encompassed under section 76 (2)(a). The drafting of our Act was influenced by many other jurisdictions and perhaps over analysis and comprehensive comparisons has resulted in the legislative oversight. Our legislature should have focused on the UK Companies Act, in the area of directors' duties and liabilities and perhaps our Act would have been clearer in its interpretation and application.

6.2.2 United States: Delaware

Our Act has been compared to similar statutes enacted in developed countries, such as the United States. Specifically, the corporate law practices exhibited in Delaware are notably similar to those displayed in South African corporate law jurisprudence. Especially since implementation of the Act, in May 2011.[284]

In the state of Delaware, the statute known as the Delaware General Corporation Law is the primary piece of legislation governing directors' duties.[285] The statute was enacted due to the controversial case of *Smith v Van Gorkom* which first pronounced on the imposition of directors duties in the State.[286] The fiduciary duties imposed on directors specifically state that directors must, when making corporate decisions, fulfill the traditional duties of care and loyalty and, in some instances, a duty to provide full and fair disclosure.[287] The fiduciary duties are not as strictly imposed on directors in Delaware as they are in South Africa. This is mainly due to the presumption that directors' act in accordance with their fiduciary duties while making corporate

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283 The Companies Act. Op Cit (note 2) at section 177.
284 Olson. Op Cit (note 264).
285 Delaware, United States. Delaware General Corporation Law. Title 8 Chapter 1 of the Delaware Code.
286 488 A.2d 858 (Del. 1985)
287 Hondius. Op Cit (note 281).

decisions. This presumption is known as the 'business judgement rule'.[288] The 'business judgement rule' entails a presumption that the director, in making corporate decisions, acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.[289]

The Delaware 'business judgement rule' was incorporated into our Act under section 76 (4).[290] The section was arguably based on the Delaware General Corporations Law. It is, thus, conceivable that the statutory duties and liabilities of directors, encompassed in the Act, can be likened to Delaware corporate governance practices. Our courts strictly enforce directors' fiduciary duties and liabilities, such as the no-profit rule and the disgorgement remedy. Whilst in Delaware the courts apply fiduciary duties in a distinctly lenient manner. Especially, due to the heavy reliance placed by courts on the 'business judgement rule'.[291]

The remedy of disgorgement was first recognized as a cause of action in Delaware in the seminal *Brophy* case.[292] In light of the seminal case, claims against directors, specifically found to be in breach of their fiduciary duties, by engaging in insider trading, are dubbed 'Brophy' claims. The court espoused dicta that corporate fiduciaries may not profit from their positions of trust.[293] Such 'Brophy' claims were infrequently used and were only granted in limited instances. In order to sustain a cause of action based on the 'Brophy' claim, the claimant's case was two-fold. Firstly, the plaintiff had to show that the corporate fiduciary was in possession of material, non-public company information.[294] Secondly, it had to be proven that the corporate fiduciary used that information in making trades and was motivated, in whole or in part, by the substance of that information.[295]

Since the *Brophy* case, there has been drastic growth in the body of federal securities law in Delware which specifically encompasses the remedy of disgorgement for profits unduly gained by directors, in terms of prohibited insider trading.[296] This comprehensive growth in the body of federal securities law has given way for an argument to be made that the 'Brophy' claims are a dispensable remedy in Delaware corporate law. In the *Pfeiffer* case, the important policy question of whether the 'Brophy' claims are an outdated precedent of corporate law was again raised and decided.[297] The court held that 'Brophy' claims were good in law and consistent with, and supportive of, federal securities law.[298] This was because a distinction was drawn between

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[288] Ibid.
[289] *Aronson v Lewis* 473 A. 2d 805, 812 (Del. 1984)
[290] The Companies Act. Op Cit (note 2) at section 76 (4).
[291] Hondius. Op Cit (note 281).
[292] *Brophy v Cities Service Co.* 70 A. 2d 5 (Del.CH.1949).
[293] Ibid.
[294] Ibid.
[295] Ibid.
[296] Hondius. Op Cit (note 281).
[297] *Pfeiffer v Toll* 989 A 2d 683 (Del. CH. 2010).
[298] Ibid.

application of the 'Brophy' claims and those claims brought in terms of federal securities law. 'Brophy' claims remedied harms against the corporation whereas claims brought in terms of federal securities law were designed to remedy harms against stockholders.[299] The court simultaneously pronounced that 'Brophy' claims were only to be granted in exceptional cases and that damages were limited to the actual damages suffered to the corporation.[300]

The validity of the 'Brophy' claims were further upheld and confirmed by the Delaware Supreme Court in the *Kahn* case.[301] The court held that 'Brophy' claims should not only be granted in exceptional circumstances and may be readily applied.[302] The court further overruled the *Pfeiffer* case in that the damage suffered to the corporation was not a requirement of the 'Brophy' claim which is inherently a disgorgement remedy. The validity of the 'Brophy' claims was again recently confirmed by the Court of Chancery in the case of *In re Primedia Inc. Shareholders Litigation*.[303]

6.3 The Liberal South African Approach

There are schools of thought which suggest that the remedy of disgorgement, as a *sui generis* remedy, should be applied only on a limited and exceptional basis.[304] As a unique and distinctive remedy, it should not be applied as the default remedy, in the event of a breach of the no-profit rule. The remedy should enjoy limited application as an exceptional remedy and one of last resort.[305] It is not a remedy governed by fixed rules and the facts and circumstances of each case need to be carefully analysed, in order to ascertain whether disgorgement is the appropriate remedy.

Arguably, the limited applicability of the remedy of disgorgement should be determined with reference to the specific elements of each case. For instance, in each case the plaintiff must have a legitimate interest in depriving the party in breach of profits, such as for deterring future breaches.[306] The court should also use its discretion to ascertain whether the claimant in the case is simply an opportunistic purchaser looking to abuse the remedy to receive an undeserved windfall. In which event, the scope of the remedy should be limited so as not to undeservedly enrich the purchaser.

The equitableness of the remedy should be of paramount concern to the court. Our courts seem distracted in attempting to determine exactly which rule or duty has been breached rather than focusing on the equitableness of the remedy. This can lead to inequitable and unfair results. Inequitable results also arise due to blind application of the remedy of disgorgement, in the event

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[299] Ibid.
[300] Ibid.
[301] *Kahn v Kolberg Kravis Roberts & Co.* L.P 23 A 3d 831 (Del. 2011)
[302] Ibid.
[303] 67 A. 3d 455 (Del. Ch. 2013).
[304] Du Plessis, JE. Op Cit (note 198) at 371.
[305] Ibid.
[306] Ibid.

of breach of the no-profit rule. Instead of comprehensively examining the appropriateness of the remedy, the court gets tied up in attempting to understand the pleadings, cause of action, contours of the fiduciary duty and the difference between a damages and disgorgement remedy. Therefore, once it is established that there has been a breach of the no-profit rule, the remedy of disgorgement is almost automatically applied, without further question.

The courts should delve further into the facts and circumstances even after breach has been established in order to ascertain whether disgorgement is the most suitable remedy. If the court is able to mitigate the inequitable result for the director, who may have acted *bona fidei*, as in the *Regal (Hastings) v Gulliver* case, then surely it should use its discretion in some or other way to soften the blow. The aspect of ratification, in respect of the acquisition of profit, may be considered. Especially, in cases where all of the directors of the company are the shareholders as well.

All being said and done, the remedy of disgorgement conceivably enjoys a wide and unfettered application, in the event of a breach of the no-profit rule. In some instances this has led to illogical and inequitable results. The focus of the enquiry, after an establishment of a breach of the no-profit rule, should shift to the appropriateness of the remedy, as opposed to blind application of the remedy of disgorgement. Disgorgement is a *sui generis* remedy which is exceptional and should be used in limited instances as a remedy of last resort once all other remedies have been exhausted.

7. CHAPTER SEVEN: CONCLUSION

There are two prominent duties which govern a director's conduct: the fiduciary duty and the duty of are and skill. The common rationale behind the core duties is the duty to act in the best interests of the company for which they serve. This dissertation focuses on a director's fiduciary duty to the company. Namely, the duty to avoid acquiring a profit whilst standing in a fiduciary relationship to the company. Commonly referred to as the no-profit rule, this duty stems from the overarching duty to avoid a conflict of interest which is one of the core fiduciary duties. The no-profit rule is similar to its sibling, the corporate opportunity rule. Although both rules stem from the duty to avoid a conflict of interest, their elements are distinct. The common law no-profit rule has been codified under section 76 (2)(a) of the Act. As a result of the preservation of the common law, there is now a statutory and common law duty on directors to avoid making a secret profit.

A director who acquires profit whilst standing in a fiduciary relationship to the company may be in breach of the no-profit rule, unless she has received the free consent of the company following full disclosure. The wide ambit of the no-profit rule has been criticized on many occasions as the mere acquisition of profit seems enough to constitute a breach of the duty. Furthermore, application of the elements for the cause of action, in the event of a breach of the no-profit rule, illustrates its extensive scope. Firstly, it is of no consequence that the company did not suffer a loss. Secondly, it matters not that the director acted *bona fidei* in her acquisition of the profit. Thirdly, the duty may extend beyond the director's term of employment.

The wide application of the no-profit rule opens the door for abuse. It is arguable that the legal enquiry should be narrowed in two respects. Firstly, it should have to be proven that directors are under a specific obligation to acquire the profit for the company when they retained it for themselves. Secondly, a causal link between the director's acquisition of the profit and the company's ability to acquire the profit for itself, would have to be proven. Under this narrower enquiry, the focus shifts from the establishment of a fiduciary duty at the time of acquisition to the specific contours of the fiduciary duty and the business of the company.

A narrower application of the no-profit rule would restrict the dire consequences of its breach, namely: personal liability for directors. In the event of a breach of the no-profit rule, the only escape from liability for directors is the free consent of the company following full disclosure. The requirements of disclosure have been codified under section 75 of the Act and are quite pedantic in their application. The only other protective measures for directors are the provisions of the Act relating to court relief and director's indemnification. Although, these measure are somewhat diluted and consent of the company, following full disclosure, is a much more effective safeguard for directors.

In the event that a director is found to be in breach of the no-profit rule, the remedy of disgorgement is applicable. The remedy requires directors to account to the company for profit acquired by them whilst standing in a fiduciary relationship to the company, without the consent of the company. Described as a *sui generis* remedy, disgorgement should only be imposed by the courts upon a careful analysis of the facts and circumstances of each case.

The disgorgement and damages remedies have often been compared in their application to a breach of the no-profit rule. The disgorgement remedy, unlike the damages remedy, does not require a loss to be suffered by the company. Litigants often confuse their pleadings and use elements of the causes of action for disgorgement and damages to sustain a case. The common element to both remedies is a breach of the no-profit rule. Although, the requirements of each remedy are quite different. Claimants are urged to set out a clear cause of action, as courts are willing to grant disgorgement or damages, in the event of a breach, but not both. It would appear that our courts will have to struggle through further inept pleadings before the distinction between the disgorgement and damages remedies becomes apparent.

While the battle between the two predominant remedies ensues, some further alternatives have been suggested. The common law *condictio indebiti* remedy is inappropriate as it refers to an amount of money to be refunded to the company, which a disgorgement of profits is not. The common law remedy of unjustified enrichment is also not a suitable remedy, in the event of a breach of the no-profit rule, specifically because of its 'impoverishment' element. The impoverishment element requires that the company be impoverished as a result of the breach which is akin to a loss suffered by the company. Disgorgement does not require a loss to be sustained by the company but rather an undue gain to the director. In this respect, both of these common law remedies have proven unsuitable substitutes to the remedy of disgorgement.

The common law no-profit rule was codified under section 76 (2)(a) of the Act. Directors personal liability, in the event of a breach of the statutory no-profit rule, was partially codified under section 77 (2)(a). The introduction of statutory directors' duties and liabilities depicts South Africa's attempt to align its corporate governance practices with those of other sophisticated corporate law regimes. The King III code and report emphasize the importance of requiring directors to comply with their common law and statutory duties. However, the Act is not without flaws and a misalignment between the statute and the common law can give rise to uncertainties and confusion. Specifically, upon an examination of section 77 (2)(a), it is possible that the common law remedy of disgorgement has not been codified. This possible legislative oversight may hinder the development of South Africa's corporate law jurisprudence.

A interpretive analysis of section 77 (2)(a) gives rise to an argument that the common law remedy of disgorgement has been omitted from the ambit of the section. As a prevalent common law remedy, this legislative oversight may have drastic consequences for claimants wishing to bring an action against a director in breach of the statutory or common law no-profit rule. It is suggested that the legislators amend section 77 (2)(a), or section 77 (2) as a whole, to allow for inclusion of the common law remedy of disgorgement. In the interim, the common law and section 218 (2) may be utilized as possible alternatives to a statutory remedy of disgorgement. As the beneficiary of a director's fiduciary duties is the company, it is the company who is the logical claimant of the remedy of disgorgement. Our courts should be weary of opportunistic claimants who use the remedy of disgorgement against a company to receive an undeserved windfall.

It is arguable that the legislature intentionally omitted the common law remedy of disgorgement form the ambit of section 77 (2)(a) in an effort to downgrade its status. There are many unfavourable elements of the remedy of disgorgement. The concepts of mitigation and restitution fuel an argument against frequent use of the remedy. As a company does not need to suffer loss as a result of the breach, the company is under no obligation to mitigate its loss when the remedy is applied. Furthermore, if the director acquires profit to which the company would never have been entitled, then the remedy of disgorgement is a means of undeservedly enriching the company at the expense of the director. This result does not equate to an equitable restitution which is counterintuitive to the underlying purpose of the remedy. This has led to the remedy of disgorgement being dubbed a 'dog in the manger' remedy.

The extensive no-profit rule and its dire consequences for directors may negatively affect directors' decision making abilities. This in turn could stifle economic activity as directors' fear of personal liability prevents them from taking risks and promoting healthy competition which is vital for the growth of a budding economy.

A comparative foreign analysis will shed further light on the importance of the remedy of disgorgement in our jurisprudence. Our common law directors' duties and liabilities are largely influenced by English law. Our Act was drafted with reference to the corporate law practices in sophisticated jurisdictions such as the state of Delaware in the United States. In both jurisdictions the remedy of disgorgement seems to be readily applied by courts. Its importance, as a remedy, has not waivered over time and English law has even taken to extending its contours to a breach of contract. Arguably, our courts seem more willing, over the last few decades, to apply the remedy of disgorgement, following the English law and Delaware approaches.

However, this seemingly liberal approach needs to be examined. Our courts should be careful to avoid blanket application of the remedy in all instances of a breach of the no-profit rule. Discretion and careful analysis of all of the facts and circumstances of each case is paramount to avoid inequitable results in application of the remedy of disgorgement. As a *sui generis* and unique remedy, it should be used sparingly, especially, given the drastic consequences for *bona fidei* directors. The remedy of disgorgement should enjoy narrow application and be utilized as an exceptional remedy once all other avenues have been exhausted.

In conclusion, the remedy of disgorgement has not always found favourable application although it would appear that its enduring popularity will prevent abrogation to disuse. Instead of abrogation to disuse, the remedy should be utilised in exceptional cases, having regard to the specific facts and circumstances of each case. Application of the remedy of disgorgement will be much more effective if used in an exceptional manner due to its *sui generis* status and, sometimes, unfortunate consequences.

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