Directors Personal Liability for Irregular, Wasteful and Fruitless Expenditure in South African (SA) State owned Companies (SOC).

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DECLARATION

I, Daveraj Landor Sauls declare that ‘Directors Personal Liability for Irregular, Wasteful and Fruitless Expenditure in South African (SA) State owned Companies (SOC)’, is my work and has not been submitted for any degree or examination in any other University or academic institution. All sources and materials used are duly acknowledged and properly referenced.

Student Signature:

Date: 21 August 2019

Supervisor: Adv. F. Kotze

Signature:

Date:

LIST OF ABREVIATIONS

Auditor General	AG
Companies Act 71 of 2008	Companies Act/ Act
Companies Act 61 of 1973	Old Companies Act
Companies and Intellectual Properties Commission	CIPC
Constitution of the Republic of South Africa, 1996	Constitution
Denel SOC Ltd	Denel
Department of Public Enterprise	DPE
ESKOM holding SOC Ltd	ESKOM
International Reporting Council	IRC
Memorandum of incorporation	MOI
Minister of Trade and Industry	Minister
National Assembly	NA
National Council of Provinces	NCOP
Organisation for Economic Co-Operation and Development	OECD
Public Investment Corporation	PIC
Public Finance Management Act 1 of 1999	PFMA
State owned Company	SOC
Strategic Infrastructure Project	SIP
Transnet SOC Ltd	Transnet
The Republic of South Africa	South Africa
United States of America	USA

KEY WORDS AND PHRASES

Common law

Department of Public Enterprises

Directors

Directors’ duties

Irregular expenditure

South Africa

Stakeholder

State owned Companies

Shareholder

State

Wasteful and fruitless expenditure

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CHAPTER: 1

1.1 INTRODUCTION

Directors of companies are the forerunners in overseeing and strategically managing a company.[1] The Companies Act 71 of 2008 (the Companies Act) gives the board of directors the legislative obligation for a company to be managed by or under the direction of the board of directors.[2] The board of directors have a central role in the decision making and operation of a company; this position also applies to the board of directors of State owned Companies (SOC). This dissertation explores methods to hold directors of SOCs personally liable for irregular, wasteful and fruitless expenditure.

Irregular expenditure is defined as expenditure that does not comply with the provisions of the Public Finance Management Act 1 of 1999 (PFMA), the State Tender Board Act 86 of 1968 or any legislation that provides for provincial government procedure.[3] Fruitless and wasteful expenditure is defined as 'expenditure which was made in vain and would have been avoided had reasonable care has been exercised'.[4]

This research aims to analyse legislative mechanisms put in place that hold directors of SOCs personally liable for irregular, reckless, wasteful and fruitless expenditure. Section 77(2)*(b)* and 218(2) of the Companies Act contains the legislative basis for the personal liability of directors of SOCs for irregular, wasteful and fruitless expenditure.

[1] Mupangavanhu B *Directors' Standards of Care, Skill, Diligence, and the Business Judgment Rule in View of South Africa's Companies Act 71 of 2008: Future Implications for Corporate Governance* (2016) v.
[2] S 66(1) Companies Act 71 of 2008.
[3] S 1 Public Finance Management Act 1 of 1999.
[4] S 1 Public Finance Management Act.

The sections provide the following;

Section 77:[5]

(2) A director of a company may be liable-

(b) or in accordance with the principles of the common law relating to delict for any loss damage or cost sustained by the company as a consequence of any breach by the director of-

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

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

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

Section 218:[6]

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

1.2 RESEARCH PROBLEM

1.2.1 Background to research problem

SOCs are companies registered in terms of the Companies Act and categorised as a public entity which is listed in either schedule 2 or 3 of the PFMA.[7] A SOC includes a company owned by a municipality in terms of the Municipal Government Systems Act 32 of 2000. SOCs may either be entirely or partly owned by the State.

The national or provincial executive members of the departments in which the company falls are normally tasked with the role of being the shareholder representative of the State. The meaning of government in the context of a SOC includes government departments at

[5] Companies Act.
[6] Companies Act.
[7] S 1 Companies Act.

national, provincial and local level.[8] Companies which are established in terms of legislation are also SOCs.[9]

The Organisation for Economic Co-Operation and Development (OECD) defines a SOC as a corporate entity which is recognised by national legislation where the ownership or control is exercised by the State.[10] In the definition provided by the OECD, SOCs include private companies as well as companies having securities listed on an exchange. It also includes companies which are incorporated in terms of legislation including SOCs where the activities and purpose or part thereof is of an economic nature.[11]

Unlike the Old Companies Act, a SOC is recognised as a specific form of a profit company in terms of the New Companies Act.[12] The Old Companies Act recognised private and public companies and made accommodation for profit companies.[13] SOC's were not categorised as a specific form of a company in the Old Companies Act. This was done in order to prevent an overlap or conflict between legislation that specifically regulate SOC's and the Old Companies Act.[14]

SOC's are accountable to parliament depending on the level of government which owns and exercises control over the company.[15] SOC's may either be accountable to the National Assembly (NA) where it is owned and controlled by national government,[16] or by the

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[8] S1 Public Finance Management Act.
[9] South African Airways Act 5 of 2007; Eskom Conversion Act 13 of 2001; Broadcasting Act 4 of 1999.
[10] Organisation for Economic Co-Operation and Development *Guidelines on Corporate Governance of State-Owned Enterprises* (2015) 14.
[11] Organisation for Economic Co-Operation and development *Guidelines on Corporate Governance of State-Owned Enterprises* (2015) 14.
[12] S 8(2)*(a)* Companies Act.
[13] S 21 Companies Act 61 of 1973.
[14] S 4*(b)(iv) Memorandum on the Objects of the Companies Bill, 2008* (n5) Para 4.
[15] Institute of Directors Southern Africa *State-owned enterprises: Governance responsibility and accountability* Public Sector Working Group: Position Paper 3 (2011) 8.
[16] Institute of Directors Southern Africa *State-owned enterprises: Governance responsibility and accountability* Public Sector Working Group: Position Paper 3 (2011) 8.

National Council of Provinces (NCOP) where it is owned and controlled by the provincial government.[17]

The directors of SOC are governed by both the Companies Act and the PFMA. The provisions of the PFMA prevail where a conflict exist between the concurrent application of the PFMA and the Companies Act.[18] In the event of an inconsistency between any provision of the Companies Act and other national legislation the provisions of both Acts apply concurrently to the extent that it is possible.[19] The PFMA does not explicitly refer to directors; instead the term 'accounting authority' is used to encapsulate the various controlling and management bodies of public entities under the PFMA, including the board of directors of SOC's.[20] The Companies Act gives the board of directors the legislative obligation for a company to be managed by or under the direction of the board of directors.[21] All the powers and functions of the company are bestowed on directors although these powers and functions may be limited by a company's memorandum of incorporation (MOI) and the Companies Act. [22]

The standard of directors duties contained in the Companies Act[23] is enhanced by the provisions in the PFMA relating to the duties of directors and generally the board of directors of SOC's.[24] The provisions in the Companies Act which are applicable to public companies equally apply to SOC's.[25] The Minister of Trade and Industry (The Minister) may exempt a SOC from the application of any provision in the Companies Act where the provision overlaps or duplicates a regulatory scheme which is established in any other national

[17] Institute of Directors Southern Africa *State-owned enterprises: Governance responsibility and accountability* Public Sector Working Group: Position Paper 3 (2011) 8.
[18] S 5(4)*(b)(i)(ee)* Companies Act.
[19] S 5(4)*(a)* Companies Act.
[20] S 49(2)*(a)* Public Finance Management Act.
[21] S 66(1) Companies Act.
[22] S 66(1) Companies Act.
[23] S 76(3) Companies Act.
[24] S 50 & 51 Public Finance Management Act.
[25] S 9(1) Companies Act.

legislation.[26] An exemption by the Minister may only be to an extent where the regulatory scheme ensures the achievement of the purposes of the Companies Act or any other limitation which is necessary to achieve the purposes.[27]

SOC's are different to private companies. Unlike private companies, SOCs have a dual mandate which includes commercial and non-commercial obligations.[28] The commercial obligations are akin to that of other profit companies which include the generating of revenue to cover operational costs and a surplus of revenue after all liabilities have been satisfied in order to be profitable and to stay financially sustainable. Non-commercial objectives include the realisation of socio-economic rights and the enrichment of SOC's non-commercial funding which includes environmental, educational and other socio-economic initiatives.[29] SOC's are also the primary means of implementing strategic infrastructure projects according to the Government Strategic Infrastructure Projects (SIP).[30]

SOC's are the vehicles used by the government in the progressive realisation of economic growth by addressing socio-economic problems such as unemployment and poverty.[31] South African SOC's are responsible for providing services to millions of South Africans[32] of which the majority are poor and vulnerable. The majority of South Africans are dependent on the effective and efficient operation of SOC's due to its role in the realisation of socio-economic rights by providing *inter alia* energy,[33] transport[34] and telecommunications

[26] S 9(2) Companies Act.
[27] S 9(3) Companies Act.
[28] State-owned Companies and Rural Development Submission for the Division of Revenue (2017/18) 97.
[29] Peters S et al *State-owned Companies and Rural Development ch 4 Submission for the Division of Revenue* (2017/18) 97 available at *http://www.ffc.co.za/submissions/submission-chapters* (accessed on 18 May 2018).
[30] State-owned Companies and Rural Development Submission for the Division of Revenue (2017/18) 97.
[31] Presidential Review Committee on State-owned Entities (2012).
[32] Parliamentary Budget Office Report on State Owned Enterprises for the Standing Committee on Finance (2015).
[33] Eskom Holdings SOC Ltd; Central Energy Fund SOC Ltd and South African Nuclear Energy Corporation SOC Ltd.
[34] Transnet SOC Ltd; South African Airlines SOC Ltd; Airports Company South Africa SOC Ltd; Air Traffic and Navigation Services SOC Ltd and Passenger Rail Agency of South Africa SOC Ltd.

services.[35] Despite the critical role of South African SOC's, these companies are faced with major operational and governance problems.[36] The Auditor Generals' (AG) report on the national and provincial audit outcomes for 2016-17 indicates that irregular expenditure in Eskom Holdings SOC Ltd (ESKOM) amounted to R 4.04 billion, 923 million by Transnet SOC Ltd (Transnet) and 146 million by Denel SOC Ltd (Denel).[37]

SOC's have a significant role to play in the economic growth of a country by promoting economic stability, investor confidence, attracting foreign direct investment and job creation amongst other things. In the case of *Minister of Water Affair and Forestry v Stilfontein Gold Mining CO Ltd* the court held that thorough corporate governance is crucial for the well-being of a company and is in the best interest of the South African economy by attracting new foreign investors and prospective investors.[38] In addition to the socio-economic and profit making objectives of SOC's there is also an anticipation for SOC's to observe and be the forerunners in complying with good corporate governance principles, setting the example for both the private and public business community.[39] South African SOCs have been in the spotlight for adverse reasons, which include liquidity problems, fraud and corruption.[40] Allegations of non-compliance with tender processes,[41] irregular expenditure[42] and the

[35] South African Broadcasting Corporation SOC Ltd; South African Post Office SOC Ltd; Telkom SA SOC Ltd and Sentech SOC Ltd.
[36] National Development Plan (2013) 160.
[37] Status of State Owned Enterprises *General report on the national and provincial audit outcomes for 2016-17* (2017) 47 available at *http://www.agsa.co.za/Reporting/PFMAReports/PFMA2016- 2017.aspx* (accessed on 15 May 2018).
[38] Minister of Water Affairs and Forestry v Stilfontein Gold Mining CO Ltd 2006 (5) SA 333 (W) Para 16.7.
[39] Status of State Owned Enterprises *General report on the national and provincial audit outcomes for 2016-17* (2017) 97 available at *http://www.agsa.co.za/Reporting/PFMAReports/PFMA2016- 2017.aspx* (accessed on 15 May 2018).
[40] Auditor General of South Africa *Status of State Owned Enterprises General report on the national and provincial audit outcomes for 2016-17* (2017) 47 available at *http://www.agsa.co.za/Reporting/PFMAReports/PFMA2016- 2017.aspx* (accessed on 15 May 2018).
[41] 'Acsa CEO allegedly flouted tender rules' *ENCA* 25 June 2017 available at *https://www.enca.com/south-africa/acsa-ceo-allegedly-flouted-tender-rules* (accessed on 1 June 2018).
[42] 'Parliament gives auditor-general teeth' *Financial Mail* 31 May 2018.

appointment of dubious individuals in senior ranking positions are also major issues faced by SOCs.[43]

South African SOC's should be undertaking a balance between its commercial and non-commercial objectives. The problems encountered by SOCs cannot be dissociated and secluded from the inadequate corporate governance practices that are prevalent in SOCs.

A company is defined as a juristic person incorporated in terms of the Companies Act.[44] In *Solomon v Solomon Co Ltd* the court held a company and its liabilities is distinct from the shareholders, directors and other company agents.[45] This position was incorporated into South African law in the case of *Dadoo Ltd v Krugersdorp Municipal Council* where the court detailed that the start of the actuality of a company as a separate entity distinct from its shareholders is not merely a synthetic and procedural thing but rather a material matter.[46]

This dissertation proposes strengthening corporate governance practices in SOCs by holding the board of directors' personally liable for irregular, wasteful and fruitless expenditure. Legislative mechanisms will be explored in holding directors of SOCs personally liable for irregular, wasteful and fruitless expenditure. The promotion of good corporate governance practices in SOCs such as accountability, transparency and responsibility will be improved by holding the board of directors' accountable for the powers and functions they exercise.

1.2.2 Research question

Whether directors of SOCs can be held personally liability for irregular, wasteful and fruitless expenditure by South African SOCs?

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[43] Status of State Owned Enterprises *General report on the national and provincial audit outcomes for 2016-17* (2017) 42 available at *http://www.agsa.co.za/Reporting/PFMAReports/PFMA2016- 2017.aspx* (accessed on 15 May 2018).
[44] S 1 Companies Act.
[45] *Solomon v Solomon Co Ltd* [1897] AC 22 (HL).
[46] *Dadoo v Krugersdorp Municipal Council* 1920 AD 530.

1.2.3 Sub-inquiries to research question

In determining whether directors of SOCs can be held personally liable for irregular, wasteful and fruitless expenditure by South African SOCs the following are sub-inquiries:

- Does the stakeholder inclusive theory have any implication of the commercial and non-commercial obligations of SOCs? If yes, what are these implications?
- The effect of the Bill of Rights on accountability, responsibility and transparency in SOCs.
- Does the law bestow an amplified level of accountability and responsibility on directors of SOCs?
- What is the applicability of s 77(2) and s 218(2) of the Companies Act in promoting accountability and transparency within the governance of South African SOCs?
- Is it possible for a shareholder representative of the State to fall under the scope of s 77(2) and s 218(2) of the Act?

1.3 SIGNIFICANCE OF RESEARCH QUESTION

The dissertation makes an effort to elevate the standards of accountability and responsibility in SOCs by critically analysing the legislative mechanisms in place that hold directors of SOCs personally liable for irregular, wasteful and fruitless expenditure. The elevation of the aforementioned standards will improve the operation and governance of SOCs which is critical for an effective and well-functioning government. SOCs have a critical role to play in the progressive realisation of socio-economic rights for South Africans due to most SOCs providing basic services such as transport,[47] telecommunication[48] and energy.[49] The

[47] Transnet SOC Ltd; South African Airlines SOC Ltd; Airports Company South Africa SOC Ltd; Air Traffic and Navigation Services SOC Ltd and Passenger Rail Agency of South Africa SOC Ltd.
[48] South African Broadcasting Corporation SOC Ltd; South African Post Office SOC Ltd; Telkom SA SOC Ltd and Sentech SOC Ltd.

economic and social well-being of South Africa is very much influenced by the operation of SOCs; therefore it is imperative that the board of directors of SOC are transparent, accountable and responsible. The author of this dissertation is of the view that holding directors of SOCs personally liable will minimise and prevent fraud, corruption and other forms of maladministration that is prevalent in SOCs.

1.4 LITERATURE REVIEW

It has been proposed by Hansmann and Kraakman that there should be a change in the way the corporate law doctrine of limited shareholders liability is viewed.[50] They argue that shareholders can be held personally liable equal to the value of shares they have in a company for delictual claims against the company.[51] This research argues for the personal liability of directors of SOCs. It is argued that the extent of personal liability by a director should be determined by taking into account the actual loss incurred as well as the material role played by the directors that result in the loss incurred by the SOC.

Hansmann and Kraakman's view has been criticised by Alexander[52] who identifies procedural difficulties in the enforcement of shareholder extended liability due to the fact that companies in the United States of America (USA) is governed by various State and federal law.[53] The debate amongst American academics does not specifically refer to the personal liability of directors of SOCs. However, it is relevant to this research by highlighting how the procedural difficulties do not prevent the directors of South African SOCs from being held personally liable. South Africa is not in strict terms a federal State but rather a combination of

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[49] Eskom Holdings SOC Ltd; Central Energy Fund SOC Ltd and South African Nuclear Energy Corporation SOC Ltd.
[50] Hansmann H & Kraakman R 'Toward Unlimited Shareholder Liability for Corporate Torts' (1991) 100 *Yale Law Journal*.
[51] Hansmann H & Kraakman R 'Toward Unlimited Shareholder Liability for Corporate Torts' (1991) 100 *Yale Law Journal*.
[52] Alexander J 'Unlimited Shareholder Liability through a Procedural Lens' (1992) 106 *Harvard Law Review*.
[53] Alexander J 'Unlimited Shareholder Liability through a Procedural Lens' (1992) 106 *Harvard Law Review* 388-389.

a federal and unitary State.[54] The South African legislature is divided into a national legislature[55] and provincial legislatures.[56] The basis for holding directors of SOCs personally liable for irregular, wasteful and fruitless expenditure lies in the Companies Act and the PFMA which are both national legislation. Provincial legislation is subject to national legislation such as the Companies Act and the PFMA, which finds application in the whole of South Africa. Herzberg and Anderson[57] posit that company directors must be civilly liable for the contravention of the breach of directors' duties which they call the 'stepping stones'. The author is aligned with liability based on directors' contravention of their duties although in this dissertation liability will be expanded to include liability for irregular, wasteful and fruitless expenditure by directors of SOCs. Herzberg and Anderson further contend that holding directors' civilly liable balances the need for directors to take risks for the company while simultaneously performing their supervisory and executive roles.[58] They also argue that directors should only be civilly liable for their own under-performance and not for the company's civil or criminal conduct.[59] The author of this dissertation counters this view because a company is a juristic person whose performance is in line with the conduct and decisions of its agent. It is inconceivable to distinguish with certainty the criminal and civil conduct of a company against that of directors of a company when directors perform their functions in their capacity as directors.

[54] Organisation for Co-operation and Economic Development *Profile South Africa* (2016) available at http://www.oecd.org/regional/regional-policy/profile-South-Africa.pdf (accessed on 30 May 2018).
[55] S 44(1) Constitution of the Republic of South Africa, 1996.
[56] S 104(1) Constitution of the Republic of South Africa, 1996.
[57] Herzberg A & Anderson H 'Stepping Stones – From Corporate Fault to Directors' Personal Civil Liability' (2012) 40 *Federal Courts Law Review.*
[58] Herzberg A & Anderson H 'Stepping Stones – From Corporate Fault to Directors' Personal Civil Liability' (2012) 40 *Federal Courts Law Review* 25.
[59] Herzberg A & Anderson H 'Stepping Stones – From Corporate Fault to Directors' Personal Civil Liability' (2012) 40 *Federal Courts Law Review* 26.

1.5 LIMITATIONS OF STUDY

This study is restricted to determining whether directors of SOCs can be held personally liable for irregular, fruitless and wasteful expenditure in terms of the Companies Act. The dissertation is confined to the personal liability of directors of SOCs due to the unique commercial and non-commercial objectives of SOCs. Liability of directors will include instances where the duties in terms of the common law, the Companies Act and the PFMA are contravened. When referring to directors in this dissertation director includes executive, non-executive and independent directors. In the dissertation there is no difference in the duties that directors have based on the different types of directors. The focus of the dissertation is on major SOCs which fall under schedule 2 of the PFMA.

1.6 METHODOLOGY OF RESEARCH

The dissertation is of a descriptive nature setting out the legal framework under which directors of SOCs have the duty to prevent irregular, fruitless and wasteful expenditure in terms of the PFMA. Directors' fiduciary duties and the duties of care, skill and diligence will be analysed by utilising legislation, more specifically the Companies Act and the PFMA. South African common law and judicial precedent will also be utilised in order to demonstrate how South African courts applied and developed directors duties contained in the PFMA, the Companies Act and common law. The Companies Act will be used to substantiate that directors of SOCs should be held personally liable for irregular, fruitless and wasteful expenditure. Relevant secondary sources including articles, books, and chapters of books, journal articles, dissertations and newspaper articles will be used in order to substantiate arguments throughout this dissertation.

1.7 CHAPTER OUTLINE

The dissertation is divided into five chapters. The first chapter introduces the dissertation it contains the research problem, the significance of the study, limitations of the study and the research method used throughout the dissertation. Chapter two outlines various corporate management theories with a focus on the transition from a shareholder centric corporate management theory to a more stakeholder inclusive corporate management theory and the implication of this transition on the governance of SOCs. Emphasis is placed on the manner in which directors of SOC's should perform their powers and functions under the stakeholder approach. Chapter three identifies directors duties of SOC's which is contained in the Companies Act, the PFMA and the common law a link is provided between the duties of directors in SOCs to prevent irregular, reckless, wasteful and fruitless expenditure and directors' duties in the Act and the common law. Chapter four explores legislative mechanism in the Companies Act that allows for the personal liability of directors for non-compliance with their duties in the Companies Act, the PFMA and the common law including how the legislative mechanisms can be used to promote accountability, responsibility and transparency. Chapter five contains the conclusion to this thesis, recommendations and areas identified for further research.

1.8 CONCLUSION

This chapter is an introduction to this research by highlighting the importance of this research in order to resolve challenges which are prevalent in the governance of South African SOCs. In order to resolve or minimise challenges faced by South African SOCs it is proposed that directors of South African SOCs be held personally liable for fruitless, wasteful and irregular expenditure. The next chapter expounds on the development of corporate governance theories and the applicability of these theories in South Africa. It provides an overview of the effect

the constitutional dispensation have on South African corporate law which led to the promulgation of the Companies Act and the current position of South African corporate law.

CHAPTER: 2 CORPORATE MANAGEMENT THEORIES IN RELATION TO SOUTH AFRICAN CORPORATE LAW

2.1 INTRODUCTION

The emergence of corporate governance theories and the study of the governance of companies are due to the drastic expansion and the separation between the ownership and management of companies.[1] During the nineteenth century politicians and legal theorists' conferred separate legal personality on companies which detached the liabilities of company from that of its owners.[2] A consequence of a company having separate legal personality is that the owners have limited liability; this was attractive and led to the raising of capital for the companies from investments.[3] The separation of the company's assets and liabilities from the assets and liabilities of its owners paved the way for modern day companies.

Modern companies differ from earlier companies in that the ownership and control of a company was predominantly entrusted to a single individual or a limited group of people. Large modern public companies consist of a large amount of diverse shareholders that have residual claims against the company even though they do not have direct control over the operation of the company.[4] These shareholders are not necessarily connected to one another and in many instances they are not acquainted which makes it challenging to collectively

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[1] Mohamed E, Rasid S, Basiruddin R 'Why does Corporate Governance Become So Important? An Attempt to Identify the Major Causes for Calls to Improve' (2015) 7 *European Journal of Business and Management Corporate Governance* 123.

[2] Nordberg D *Corporate Governance Principles and Issues* (2011) 4.

[3] Nordberg D *Corporate Governance Principles and Issues* (2011) 16.

[4] Marks S *The Separation of Ownership and Control (1999)693* available at *https://reference.findlaw.com/lawandeconomics/5630-the-separation-of-ownership-and-control.pdf* (accessed on 15 September 2018)

manage a company. This is why directors are appointed to strategically manage, monitor and operate the company on behalf of shareholders.[5]

The transition from the earlier form of companies to modern companies created a path for an increased interest and focus on corporate governance.[6] Due to a divide between the ownership and control of companies' corporate governance attempts to control the risks and difficulties that arise due to this separation. Corporate governance does not have a set definition,[7] although it is commonly defined as a system by which companies are directed and controlled.[8] Corporate governance has also been defined as the collective decision making by a multitude of individuals and groups within the corporation.[9]

In an effort to understand the manner in which directors and other company agents make decisions, including how and why such decisions are made, corporate management theories were formed.[10] An important inquiry which corporate management theories attempt to answer is for whose benefit a company should be managed?

Modern companies operate in a globalised corporate environment where there is a focus on the social and environmental impact the operations of a company have in the form of corporate social responsibility (CSR).[11] The United Nations Industrial Development Organisation (UNIDO) specialising in environmental sustainability defines CSR as a

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[5] Donaldson L & Davis J 'Stewardship Theory or Agency Theory: CEO Governance or Shareholder Returns' (1991) 16 *Australian Journal of Management* 50.

[6] Wiese T *Corporate Governance in South Africa with International Comparisons* (2014) 3.

[7] Abdullah H & Valentine B 'Fundamental and Ethics Theories of Corporate Governance' (2009) 4 *Middle Eastern Finance and Economics* 88.

[8] Cadbury A *The Committee on the Financial Aspects of Corporate Governance* (1992) para 2.5.

[9] Chhotray V & Stroker G *Governance Theory and Practice: A Cross-Discipline Approach* (2009) 3.

[10] Nordberg D *Corporate Governance Principles and Issues* (2011) 25.

[11] Levy D & Kaplan R 'CSR and Theories of Global Governance: Strategic Contestation in Global Issue Arenas' (2007) *The Oxford Handbook on CSR* available at https://www.unido.org/who-we-are/unido-brief (accessed 20 August 2018).

management model whereby companies incorporate social and environmental concerns in their business operations and interfaces with stakeholders.[12]

Corporate governance is a relatively new subject that is being influenced by the economic, political, legal, managerial and financial sectors.[13] Based on this, the chapter will be an interdisciplinary study of corporate management theories that are centred on legal, economic and political studies. The corporate governance theories attempt to form a theory detailing the important qualities in corporate governance, resulting in the optimal operation of companies. A number of corporate management theories have been established, namely the Agency Theory, Stewardship Theory, Stakeholder Theory, resource dependency theory, Transaction Cost Theory and Political Theory. The aforementioned corporate management theories originated amongst economist and academics in developed countries such as Germany, the United Kingdom (UK) and the USA where companies are dominant, powerful and increasingly have the ability to influence the economy and society.[14]

The various corporate management theories are analysed in this chapter focusing on the strengths and weakness as well as the suitability of the corporate governance theories in South Africa. It will be determined whether or not a transition has occurred in South African company law which raise awareness amongst companies of various internal and external stakeholders. Furthermore the impact of the Constitution of the Republic of South Africa[15] (the Constitution) on South African corporate law is examined in this chapter. The examination highlights the effect of the Constitution on South African corporate law with a

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[12] United Nations Industrial Development Organisation 'What is CSR?' available at https://www.unido.org/our-focus/advancing-economic-competitiveness/competitive-trade-capacities-and-corporate-responsibility/corporate-social-responsibility-market-integration/what-csr (accessed on 14 August 2018).

[13] Abid G, Khan B, Rafiq Z et *al* 'Theoretical Perspective of Corporate Governance' (2014) 4 *Bulletin of Business and Economics* 166.

[14] Abdullah H & Valentine B 'Fundamental and Ethics Theories of Corporate Governance' (2009) 4 *Middle Eastern Finance and Economics* 88.

[15] Constitution of the Republic of South Africa, 1996.

focus on the substantive and interpretive influence on the Companies Act. The concept of transformative constitutionalism will be utilised to fortify the argument for a progressive approach to the interpretation of the Companies Act, to address prevalent matters in the public and private business community as well as South Africa's socio-economic disparities. Inferences will also be drawn from the company law reform initiatives instituted by the Department of Trade and Industry (DTI) that resulted in the enactment of the Companies Act. These inferences will ultimately display the legislative duties bestowed on SOCs in the Companies Act to enhance transparency and accountability in the management and operation of SOCs.

2.3 CORPORATE MANAGEMENT THEORIES

2.3.1 Agency Theory

The agency relationship arises between parties when one party who is the agent is designated to act for and on behalf of another party who is the principal.[16] The agency relationship is evident in many disciplines including political studies, sociology and economics.[17] Jensen and Meckling identified the agency problem between owners and managers in the governance of corporations.[18] They identified directors as the agents and the shareholders as their principals, directors have to fulfil their duties of directorship when acting for and on behalf of the shareholders.[19] In South African corporate law the company is identified as the principal and the directors are the agents of the company.[20] The position is supported by the legislative standards of a directors' conduct in the Companies Act which provides that, *inter alia*,

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[16] Ross S 'The Economic Theory of Agency: The Principal's Problem' (1973) 63 *The American Economic Review* 134.

[17] Kiser E 'Comparing Varieties of Agency Theory in Economics, Political Science, and Sociology: An Illustration from State Policy Implementation' (1999) 17 *Sociological Theory* 146.

[18] Jensen M & Meckling W 'Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure' (1976) 3 *Journal of Financial Economics* 308.

[19] Bonazzi L & Islam M 'Agency Theory and corporate Governance A study of the effectiveness of board in their monitoring of the CEO' (2007) 2 *Journal of Modelling Management* 7.

[20] Cassim F, Cassim M, Cassim R *et al Contemporary Company Law* 2 ed (2012) 187.

directors must act in the best interest of the company.[21] In terms of the Agency Theory, the relationship between the agent and the principal is of a contractual nature. The theory seeks to outline the most ideal terms of a contract that efficiently manage and control the risks between the agent and principal.[22] There is no contract between the shareholders and directors of a company in South African corporate law. A MOI serves as a contract between the company and the directors as well as between the company and its shareholders.[23] However, shareholders are permitted to have additional agreements with the company provided such agreement is not in conflict with the Companies Act and the companies MOI.[24] In the principal-agent relationship the agent has to act on behalf of, and in accordance with the instruction as well as in the interest of the principal.[25] The company is a juristic person that has the same rights and legal powers that a natural person has.[26] A company is therefore capable of being the principal even though the Agency Theory does not recognise it as such.

The agent has fiduciary duties towards the principal though this position is not only applicable to the agent-principal relationship in the context of corporate law. The duties of directors of SOCs in South Africa, is derived from common law, the Companies Act and the PFMA.[27] According to the Agency Theory, both the agent and the principal seek to obtain maximum value for themselves whilst simultaneously being efficient.[28] A company is not a physical person and is incapable of performing physical acts therefore directors' act on its behalf.[29] When acting on behalf of a company, directors are fulfilling the role as an agent of

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[21] S 76(3)(b) Companies Act.
[22] Podrug N 'The Strategic Role of Managerial Stewardship Behaviour for Achieving Corporate Citizenship' (2011) 62 *Economic Review* 406.
[23] S 15(6) Companies Act.
[24] S 15(7) Companies Act.
[25] Abdullah H & Valentine B 'Fundamental and Ethics Theories of Corporate Governance' (2009) 4 *Middle Eastern Finance and Economics* 89.
[26] S 19(1) Companies Act.
[27] Public Finance Management Act.
[28] Davis J, Schoorman F & Donaldson L 'Toward a Stewardship Theory of Management' (1997) 22 *Academy of Management Review* 22.
[29] Cassim et al Contemporary Company Law.

the company. The Agency Theory identifies that the dominant interest of the principal (shareholders) is of an economic nature whereby the agent is a means of increasing shareholder value; conversely the agent seek to fulfil their own personal financial interests.[30] Shareholders may gain financial benefits as a consequence of a company being profitable. However, there is no positive obligation on directors to generate financial gain for shareholders, regardless of the fact that a director may have been appointed by a specific shareholder. Directors have a duty to disclose and recuse themselves from any decision-making process in the company where they have a personal financial interest in the outcome of such decisions;[31] this disclosure attempts to prevent conflicting interests between the company and directors of the company. Additionally, the Agency Theory postulates that an agent has to utilise the company assets they have access to in order to maximise profit for the principals in return for a fee, salary or incentives.[32]

In *Cohen v Segal,* the court held that directors have a fiduciary duty towards to company, they must exercise their powers in good faith and for the benefit of the company as a whole.[33] This confirms the assertion of a director being the agent of the company. The Agency Theory seeks to address the costs incurred by the principal in verifying that the agent is acting in line with the instructions of the principal.[34] The definition of a principal in the Agency Theory is in conflict with the position in South African law. The theory defines the principal as the shareholders of the company and not the company itself. The Agency Theory can only be applied in South African corporate law if the principal is interpreted to mean the company.

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[30] Davis J, Schoorman F & Donaldson L 'Toward a Stewardship Theory of Management' (1997) 22 *Academy of Management Review* 22.
[31] S 75 Companies Act.
[32] Bonazzi L & Islam M 'Agency Theory and corporate Governance A study of the effectiveness of board in their monitoring of the CEO' (2007) 2 *Journal of Modelling Management* 8.
[33] *Cohen v Segal* 1970 (3) SA 702(W) 706.
[34] Eisenhardt K 'Agency Theory: An Assessment and Review' (1989) 14 *The Academy of Management Review* 58.

In terms of the Agency Theory, the company's directors and managers are viewed as self-centred individuals whose objectives and aims might be opposed to that of the shareholders and the company.[35] Centred on the individualistic presumption of directors and managers, the Agency Theory attempts to realign the interest and goals of the directors and managers with that of the principal by monitoring the activities of the directors.[36] Directors have to fulfil their fiduciary and legislative duties towards the company, this position has been confirmed in the case of *Re Smith v Fawcett Ltd.*[37] In this case the court held that the overarching duty of directors are to act in good faith and what they consider to be in the best interest of the company.[38] This duty explicitly provides the company as the principal because it limits the obligation of directors towards the company alone. The Agency Theory posits the separation of the chief executive officer (CEO) and the chairperson of the board of directors in order to facilitate the objective supervision of senior managers by directors as a monitoring mechanism.[39] In addition to the monitoring of agents, incentives are also encouraged. These incentives are in the form of bonuses and options for the purchase of company securities when managers make decisions that result in the increase of shareholders value, financial return to the company and its shareholders in the form of dividends.[40]

The Agency Theory is not without defects; first, the identification of the shareholders as the principals, and secondly, the company is centred on wealth maximisation for shareholders based on their financial investment in the company. These defects fail to recognise that the company is a juristic person separate from its members. Non-financial investments in the

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[35] Donaldson L & Davis J 'Stewardship Theory or Agency Theory: CEO Governance or Shareholder Returns' (1991) 16 *Australian Journal of Management* 51.

[36] Jensen M & Meckling W 'Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure' (1976) 3 *Journal of Financial Economics 310.*

[37] [1942] Ch 304 at 306 (CA).

[38] Re Smith v Fawcett Ltd [1942] Ch 304 at 306 (CA).

[39] Donaldson L & Davis J 'Stewardship Theory or Agency Theory: CEO Governance or Shareholder Returns' (1991) 16 *Australian Journal of Management* 50.

[40] Bonazzi L & Islam M 'Agency Theory and corporate Governance A study of the effectiveness of board in their monitoring of the CEO' (2007) 2 *Journal of Modelling Management* 8.

company by stakeholders such as goods conveyed to companies by suppliers and favourable treatment by the government in the form of tax reduction is not recognised by the Agency Theory. The concept of a company in terms of the Agency Theory does not supplement the increasing pressure on companies to address socio-economic matters and CSR.

Company agents are assumed to be individualistic and self-serving in terms of the Agency Theory. This presumption may not be applicable to agents who align their aims with the company and openly display willingness to further the objectives of the company as required by the Companies Act[41] and common law. The rights and responsibilities of shareholders and the company are primarily regulated by the Companies Act and the companies' MOI. Directors enter into a contract of directorship and an employment contract with the company where the director serves as an executive director. There is no contract between shareholders and directors, instead a contract exist between directors and the company[42] which supports the position of directors being the agents of a company. The divergence between the interest of shareholders and directors as envisaged by the Agency Theory is immaterial because directors' fiduciary and legislative duties are owed to the company alone. The Agency Theory overlooks situations where a separation between the objectives of the shareholders and managers is non-existent. In other words, the theory does not provide a solution to a situation where shareholders and managers objectives are aligned and there is no discourse.

[41] S 75, S76 Companies Act.
[42] S 15(6) Companies Act.

2.3.2 The Stewardship Theory

The Stewardship Theory is premised on the notion that company directors and managers are collectivist and pro-organisational.[43] In other words, the theory contends that directors are motivated by the goals of their principal which are the shareholders.[44]

The Stewardship Theory rejects the position of the Agency Theory classifying directors and managers as opportunistic and self-serving.[45] This theory posits that managers who are left on their own will act responsibility and act in the best interest of the company as a whole. In terms of the Stewardship Theory, the position of chairman of the board of directors and the CEO should be occupied by the same person. According to the theory, this will promote leadership and clarity with regard to the authority and duties of individuals within the governance structures of companies.[46] Stewards are not self-actualizing individuals; instead they are intrinsically motivated by the objectives of the shareholders.[47] The interest of stewards and principal are converged, although stewards need facilitation and empowerment from the shareholders in order to achieve organisational growth which is considered more

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[43] Abid G, Khan B, Rafiq Z et al 'Theoretical Perspective of Corporate Governance' (2014) 4 *Bulletin of Business and Economics* 171.

[44] Davis J, Schoorman F & Donaldson L 'Toward a Stewardship Theory of Management' (1997) 22 *Academy of Management Review* 21.

[45] Keay A 'Stewardship Theory: Is Board Accountability Necessary?' (2017) 59 *International Journal of Law and Management 1293*.

[46] Donaldson L & Davis J 'Stewardship Theory or Agency Theory: CEO Governance or Shareholder Returns' (1991) 16 *Australian Journal of Management* 52.

[47] Abid G, Khan B, Rafiq Z et al 'Theoretical Perspective of Corporate Governance' (2014) 4 *Bulletin of Business and Economics* 172.

important than individual goals.[48] The management philosophy in the Stewardship Theory is involvement oriented and based on trust mechanisms between the principal and the steward.[49]

The selection of either the agency or the Stewardship Theory is dependent on the degree of risk the principal is prepared to take.[50] Principals that are in favour of minimising risks will elect the Agency Theory focusing on control and monitoring mechanisms. The decision is made in order to reduce the potential risk of opposing interest between principals and agents. Alternatively, the Stewardship Theory is appropriate where the degree of risk is inherently low due to a greater priority being placed on organisational interest. The appropriateness of the Stewardship Theory is due to the theory postulating that managers are not required to be monitored and controlled in order to align their interest with that of the company.[51]

The Stewardship Theory does not recognise that a divergence between company shareholders and directors exist. The theory fails to address issues where a divergence in the interest between shareholders and managers is apparent. It attempts to resolve the narrow shareholder centric objective of the Agency Theory by identifying the shareholder as the principal, though simultaneously recognising the interest of company being closely related to, or presented by the interest of the shareholders. The emphasis on the objectives of the shareholders as the principals is a narrow and defective view due to a variety of factors that must be taken into account which contributes to the success of companies. The Stewardship Theory fails to concede that other external factors have an effect on the existence and progress of a company

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[48] Donaldson L & J Davis 'Stewardship Theory or Agency Theory: CEO Governance or Shareholder Returns' (1991) 16 *Australian Journal of Management* 25.See Melina M & Donaldson L 'Stewardship Theory and Board Structure: a contingency approach' (1998) 6 *Scholarly Research and Theory Papers* 6.See also Abid G, Khan B & Rafiq Z et al 'Theoretical Perspective of Corporate Governance' (2014) 4 *Bulletin of Business and Economics* 173.

[49] Abid G, Khan B, Rafiq Z et al 'Theoretical Perspective of Corporate Governance' (2014) 4 *Bulletin of Business and Economics* 173.

[50] Davis J, Schoorman F & Donaldson L 'Toward a Stewardship Theory of Management' (1997) 22 *Academy of Management Review* 26.

[51] Davis J, Schoorman F & Donaldson L 'Toward a Stewardship Theory of Management' (1997) 22 *Academy of Management Review* 26.

besides that of shareholders. This includes but is not limited to the views that the public have of the company and the economic circumstances under which the company operates.

2.3.3 Stakeholder Theory

The Stakeholder Theory identifies that the company's interests extend beyond shareholders; it includes other stakeholders of the company.[52] Stakeholders are defined as any group or individual who can affect or is affected by the achievement of the organisation's objectives.[53] In addition to managers and shareholders, stakeholders include employees, customers, suppliers, creditors as well as the communities in which a company operate.[54] The definition of stakeholders is extended to include any group or constituent who has a legitimate claim against the company; legitimacy is based on the exchange of a relationship between the stakeholder and the company.[55] Stakeholders of a company can be divided into internal and external stakeholders; internal stakeholders are those individuals or groups that are part of the operation of the company including employees, directors, managers, shareholders and suppliers. External stakeholders are the individuals and groups that are not part of the operation of the company but affect and are affected by the activities of the company such as, the local community, the government, competitors, the media and the natural environment.[56]

Directors' must make strategic operational decisions in respect of the company by considering the interest of both the internal and external stakeholders of the company. The Stakeholder Theory posits that a company is a nexus of both implicit and explicit contracts

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[52] Fontaine C, Haarman A & Schmid S *The Stakeholder Theory of the Multinational Corporation* (2006) 3 available at *https://pdfs.semanticscholar.org/606a/828294dafd62aeda92a77bd7e5d0a39af56f.pdf* (accessed on 27 August 2018).
[53] Freeman R *Strategic Management: A stakeholder Approach* (1984) 25.
[54] Hill C & Jones T 'Stakeholder-Agency Theory' (1992) 29 *Journal of Management Studies* 131.
[55] Mitchell R, Agle B & Wood D 'Toward a Theory of Stakeholder Identification and Salience: Defining the Principle of Who and What Really Counts' (1997) 22 *The Academy of Management Review* 882.
[56] Freeman R, Harrison J, Wicks A et al *Stakeholder Theory the State of Art* (2010) 89.

between stakeholders.[57] Implicit contracts may be in the form of an implied expectation by the local community in which the company operates to address specific problems in that community, such as poverty and unemployment. Globalisation and widespread socio-economic problems motivated the interest in the Stakeholder Theory in order for companies to utilise their financial resources to alleviate and resolve socio-economic issues.[58]

The expectation of companies to assist in addressing socio-economic problems is fuelled by the massive quantity of financial resources that companies have which are occasionally more than the gross domestic product (GDP) of small countries.[59]`The Stanford Research Institute (SRI) introduced the use of the term stakeholder during the 1960s.[60] The Stakeholder Theory suggests that the modern existence and performance of the company is contingent on the interest of all stakeholders being satisfied.[61] The Stakeholder Theory requires companies to incorporate and consider the environmental and socio-economic impact their decisions and operations have.[62] By including the aforementioned factors in the operation of companies, the Stakeholder Theory aims to combine both business and ethics.[63]

There is no hierarchy of stakeholder interests where the importance of one stakeholder undermines the other, the interest of all stakeholders are equal and have inherent worth.[64] It has been found that a correlation exists between the social performance efforts of a company

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[57] Hill C & Jones T 'Stakeholder-Agency Theory' (1992) 29 *Journal of Management Studies* 134.

[58] Hillman A & Keim G 'Shareholder Value, Stakeholder Management, and Social Issues: What's the Bottom Line?' (2001) 22 *Strategic Management Journal* 125.

[59] Green D *The world's top 100 economies: 31 countries; 69 corporations* The World Bank 20 September 2016 available at *https://blogs.worldbank.org/publicsphere/world-s-top-100-economies-31-countries-69-corporations* (accessed on 6 September 2018).

[60] Freeman R & McVea J 'A Stakeholder Approach to Strategic Management' 2018 *Darden Graduate School of Business Administration University of Virginia Working Paper 2*.

[61] Freeman R & McVea J 'A Stakeholder Approach to Strategic Management' (2018) *Darden Graduate School of Business Administration University of Virginia Working Paper* 8.

[62] Amarah B & Langston C 'Development of a Triple Bottom Line Stakeholder Satisfaction Model' (2017) 19 *Journal of Corporate Real Estate* 24.

[63] Freeman R, Harrison J, Wicks A et al *Stakeholder Theory the State of Art* (2010) 6.

[64] Donaldson T & Preston L 'The Stakeholder Theory of the Corporation: Concepts, Evidence, and Implications' (1995) 20 *The Academy of Management Review* 67.

and the positive consequence on the financial performance of a company.[65] Social performance is a company's efforts in performing non-financial activities such as community work and other moral duties. According to Wood, there are four important parties to a company: the customers, employees, communities and shareholders.[66] This supports the supposition that both internal and external stakeholders are essential for the operation and survival of companies.

The Stakeholder Theory highlights pertinent contributors to the existence and development of companies even more so with the growing response towards greater CSR. Non-financial influences of companies are greatly recognised by the Stakeholder Theory which the agency and Stewardship Theory fail to achieve. The originators of the Stakeholder Theory created a model that is coherent with the modern day thinking of companies being entities that have an obligation towards addressing socio-economic and environmental issues. The Stakeholder Theory is sophisticated in correctly recognising the holistic framework in which companies operate. However, the theory fails to identify financial stability as a foundational prerequisite in order to satisfy stakeholder interest.

Evidence provides sufficient prove that correlates financial performance as an outcome of stakeholder satisfaction. However, the Stakeholder Theory does not sufficiently respond to companies who are under financial pressure due to economic factors that may hamper the satisfaction of stakeholder interest. The author argues that even though the Stakeholder Theory is aligned to current expectations with regard to the socio-economic and environmental responsibility of companies, it should be noted that companies in possession of adequate financial resources are more inclined to adopt a stakeholder inclusive approach.

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[65] Hillman A & Keim G Shareholder Value, Stakeholder Management, and Social Issues: What's the Bottom Line? (2001) 22 *Strategic Management Journal* 126.

[66] Preston L & Sapienza H 'Stakeholder Management and Corporate Performance' (1990) 20 *Journal of Behavioural Economics* 362.

The Stakeholder Theory fails to provide guidelines relating to the preferred proportion of investment by the company, which includes financial and non-financial investment by simultaneously satisfying stakeholder well-being and maintaining financial viability.

2.3.4 Resource Dependency Theory

The Research Dependency Theory (RDT) was popularised by Pfeffer and Salancik in 1978.[67] The RDT attempts to explain a company's performance by focusing on the importance of a company's access to resources. This is critical for the optimal performance of companies as well as how company agents can reduce dependence and insecurity in an environment where these sources are situated.[68] The RDT postulates that the behaviour of companies are influenced by the degree of significant resources held by internal and external agents; it is usually stakeholders, such as suppliers controlling critical resources that have an influence over the company.[69] Power in the RDT refers to the degree of dependency a company has on a provider of critical resources required by the company.

The RDT describes companies as having a continuous power tussle amongst each other with the aim of increasing their own resources and power; this unavoidably reduces the access to resources and power of other companies.[70] Resources must be acquired by the directors[71] and other agents of the company from outside of the company setting;[72] consequently the existence of independent directors and directors with multiple directorships are an integral

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[67] Pfeffer J & Salancik G *The External Control of Organizations, A Resource Dependence Perspective* (1978).

[68] Hillman A, Withers M & Collins B 'Resource Dependence Theory: A Review' (2009) 35 *Journal of Management* 1404.

[69] Nienhuser W 'Resource Dependence Theory - How Well Does It Explain Behavior of Organizations?' (2008) 19 *Management Review* 10.

[70] Hillman A, Withers M & Collins B 'Resource Dependence Theory: A Review' (2009) 35 *Journal of Management* 1404.

[71] Abdullah H & Valentine B 'Fundamental and Ethics Theories of Corporate Governance' (2009) 4 *Middle Eastern Finance and Economics* 92.

[72] Hillman A & Dalziel T 'Boards of Directors and Firm Performance: Integrating Agency and Resource Dependence Perspectives' (2003) 28 *Academy of Management Review* 385.

part of the RDT. In terms of the RDT, the board of directors and other company agents consist of resources which are divided into human capital and relational capital.[73] Directors that provide the resources to the company include business experts, community leaders and internal managers.[74] Community leaders provide resources such as the expectations of the community as well as how the communities view the company. Business experts on the other hand, provide their experience and knowledge obtained in the various business environments, while internal managers have the knowledge of the daily operation and long standing practices of the business. This is a vital resource in order to determine the operational strengths and weaknesses of the business.

In promoting access to resources, the RDT supports the appointment of independent agents in the governance structure of companies that have access to organisations which have the resources needed by the companies. The access and availability of vital resources provides stability and enhances the performance of a company.[75]

The author concurs with the position in the RDT that resources are a fundamental part of the operation of companies as well as the existence of a correlation between the amount of resources and the degree of power that a company has. However, the concept of the RDT as a corporate management theory focusing on human and relational resources as a determining factor in the management of a company is a one sided concept. The RDT fails to recognise other external factors which influence and contribute to the existence and operation of companies. These factors includes stakeholders of the company as it is recognised by the

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[73] Hillman A & Dalziel T 'Boards of Directors and Firm Performance: Integrating Agency and Resource Dependence Perspectives' (2003) 28 *Academy of Management Review* 383.

[74] Abdullah H & Valentine B 'Fundamental and Ethics Theories of Corporate Governance' (2009) 4 *Middle Eastern Finance and Economics* 92.

[75] Casciaro T & Piskorski M 'Power Imbalance, Mutual Dependence, and Constraint Absorption: A Closer Look at Resource Dependence Theory' (2005) 50 *Administrative Science Quarterly* 167.

Stakeholder Theory or the possible divergence or convergence of management and shareholder interests as depicted in the Agency and Stewardship theory respectively.

2.3.5 Transaction Cost Theory

The Transaction Cost Theory is a collaboration of economics, law and other disciplines.[76] This theory focuses on how proficient and effective managers of the company can perform transactions between the company and internal or external agents.[77] Similar to the Agency Theory, the Transaction Cost Theory is based on the presumption that company managers are opportunistic and self-interested which influences their ability to perform efficient and effective transactions.[78] Opportunism in the Transaction Cost Theory refers to incomplete or distorted information which is aimed at misrepresenting, covering or complicating a commercial transaction.[79] The position held in the Transaction Cost Theory is that every company transaction consists of an opportunity for managers to exploit in order to satisfy their own interest.[80]

The emphasis of the Transaction Cost Theory on company transactions, including the assumption of managers being self-centred and opportunistic, is comparable to the position in the Agency Theory. There are similarities between the Transaction Cost Theory and the Agency Theory. Both theories view the objective of the company is to make profits. The Agency Theory postulates that in order to achieve the profit making objective of the company, divergences between the interest of shareholders and directors must be monitored and minimised. The Transaction Cost Theory sees company transactions as the central matter

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[76] Abdullah H & Valentine B 'Fundamental and Ethics Theories of Corporate Governance' (2009) 4 *Middle Eastern Finance and Economics* 92.
[77] Williams O 'The Economics of Organization: The Transaction Cost Approach' (1981) 87 *The University of Chicago Press Journals* 549.
[78] William O *The Mechanism of Governance* (1996) 48.
[79] Williamson O *The Economic Institutions of Capitalism* (1985) 47.
[80] Hill C 'Cooperation, Opportunism, and the Invisible Hand: Implications for Transaction Cost Theory' (1990) 15 *The Academy of Management Review* 500.

to be monitored in order for companies to fulfil their profit making objectives, therefore opportunistic managers must be monitored with regard to implementing and completing transactions. The criticisms against the Agency Theory only recognising financial gain as the objective of the company equally applies to the Transaction Cost Theory.

The author critiquing the notion of a company as a method to acquire financial gain does not overlook the importance and need for a company to be financially sound. However the fact that companies should not only have financial objectives but rather financial, socio-economic and environment objectives in order to support public concern and simultaneously promote sustainability is emphasised.

2.3.6 Political Theory

The Political Theory postulates that companies are largely influenced by the political system in which it operates which may differ between countries or regions.[81] The basis for the relation between corporate behaviour and politics is the legal and regulatory background in which companies operate. This justification is based on the following model: the law and regulations are enacted by the government of which politics is a component.[82]

The Political Theory forwards the importance of the legal and regulatory framework in which a company function that influences the interaction between companies and its various stakeholders.[83] A country's laws and regulations ordinarily specify the composition of a company's governance structure, for example the minimum number of directors and shareholders that a company may have, the protection afforded to various company agents

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[81] Afza T & Nazir M 'Theoretical Perspective of Corporate Governance: A Review' (2014) 119 *European Journal of Scientific Research* 261.

[82] Pagano M & Volpin P 'The Political Economy of Corporate Governance' (2005) 95 *The American Economic Review* 1005.

[83] Htay S & Salman S 'Transaction Cost Theory, Political Theory and Resource Dependency Theory in The Light of Unconventional Aspect' (2013) 12 *Journal of Humanities and Social Science* 91.

and the duties bestowed on directors when acting in their capacity as directors.[84] Laws and regulations similarly cover the protection afforded to investors of a company along with the rights afforded to employees of the company. This has a practical effect on the investors and employees in the company including the capabilities of the company to attract employees and investors.[85] Furthermore the Political Theory places an emphasis on gaining voting support from company shareholders in order to influence the company decisions instead of making an attempt to purchase shares in the company to obtain additional voting power in the company.[86]

The implications of political and legal influences on the operation of a company are duly noted and accepted, however these are not the only influences that have a material impact on the performance of the firm. The Political Theory fails to adequately recognise the non-legal elements that have an equal or even greater impact on the structure and operation of companies. Non-legal and non-political components have been highlighted by the aforementioned corporate management theories that might have an effect on the operation of the company. These include the resources available to the company in terms of the RDT, the varying interest of company stakeholders in terms of the Stakeholder Theory as well as the degree of self-interest and opportunism as emphasised in the Agency and Stewardship Theory.

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[84] Pagano M & Volpin P 'The Political Economy of Corporate Governance' (2005) 95 *The American Economic Review* 1005.

[85] Pagano M & Volpin P 'The Political Economy of Corporate Governance' (2005) 95 *The American Economic Review* 1007.

[86] Afza T & Nazir M 'Theoretical Perspective of Corporate Governance: A Review' (2014) 119 *European Journal of Scientific Research* 261.

2.3.7 The application of corporate management theories in South Africa

The corporate management theories discussed present valid assessments of corporate governance aspects and tensions in companies, but not without fault. Viewing the corporate management theories individually as either being the correct or incorrect theory will do injustice to significant views another corporate management theories present.

The author is of the view that in order to obtain the full benefit from important aspects highlighted in the aforementioned corporate management theories, a holistic instead of a singular approach should be adopted. When the corporate management theories are viewed together the aspects in one theory fortifies the other. The corporate management theories detail tensions and issues in corporate governance as well as challenges faced by companies. These tensions and challenges may be from different perspectives but is nevertheless valuable insight in addressing the tensions and issues which commonly arise in the governance of South African SOCs.

In the South African context, there is an obvious disparity between the rich and poor. Further the widespread poverty and unemployment, suggests that the Stakeholder Theory is well suited, though failings have been highlighted. In order for companies to avoid being characterised by South Africans as being a means of wealth creation for the minority of citizens, the purposes and objectives of companies should be more aligned with the Stakeholder Theory. In the context of SOCs that have commercial and non-commercial objectives, the observation and model of a company as a device to satisfy the interest of all its stakeholders should be more authentic and palpable.

The corporate governance theories discussed above are general theories that have their origin in several countries and regions with its own circumstances and factors that may have

influenced the creation and formulation of these theories. Consequently, the applicability of these theories within the South African context is questioned.

The subsequent inquiry analyses the status of South African corporate law under the post-apartheid legal system which is based on constitutional supremacy. The advent of the Constitution initiated the development of the South African legal system to a legal system where the Constitution is supreme,[87] the supremacy is manifested by transformative constitutionalism,[88] as well as the reconstruction of South African law based on justification rather than authority.[89]

2.4 SOUTH AFRICAN CORPORATE LAW AND CONSTITUTIONAL SUPREMACY

2.4.1 Corporate Law Reform by the Department of Trade and Industry

The late Chief Justice Langa, during a lecture on transformative constitutionalism at the University of Stellenbosch highlighted the formalistic and authoritative nature of South African corporate law, in addition to the need for the development of South African corporate law within the constitutional framework vis-à-vis transformative constitutionalism.[90] The change brought about by the Constitution should not be limited to substantive law but rather include a change in the mind-set of legal practitioners, academics and law students.[91]

According to Klare transformative constitutionalism involves:

> ‘a long term project of constitutional enactment, interpretation, and enforcement committed to transforming a country’s political and social institutions and power relationships in a democratic, participatory, and egalitarian direction’.[92]

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[87] S 2 Constitution of the Republic of South Africa.
[88] *S v Makwanyane* 1995 3 SA 391 (CC) para 262.
[89] Langa P ‘Transformative Constitutionalism’ (2006) 17 *Stellenbosch Law Review* 353.
[90] Langa P ‘Transformative Constitutionalism’ (2006) 17 *Stellenbosch Law Review* 355.
[91] Langa P ‘Transformative Constitutionalism’ (2006) 17 *Stellenbosch Law Review* 356.
[92] Klare K ‘Legal Culture and Transformative Constitutionalism’ (1998) 14 *South African Journal on Human Rights* 146.

In 2004, the DTI under Minister Mandisi Mpahlwa published a report which outlined the proposal for corporate law reform.[93] The guidelines published by the DTI were in response to the change in South Africa's commercial environment due to the abolishment of apartheid and the formation of the new constitutional dispensation.[94] The new constitutional dispensation is founded on the realisation of equality, human dignity and the advancement of human rights and freedoms.[95] South African companies have the potential to play a key role in the realisation of constitutional values; therefore it is imperative for South African company law to reinforce the constitutional values.

The transition from a political system based on racial discrimination and the marginalisation of the majority of citizens to a constitutional dispensation based on equality, dignity and freedom brought about an interest by the global business community in South Africa's economy and business environment.[96] The reform of South Africa's company law and the publication of the plans for reform by the DTI were in response to a need for South African company law to reflect the constitutional values. It was also imperative for South African company law to reflect the legal position of an economy and business environment that is globally competitive and cooperative.

A company should operate for the benefit of the company as a whole.[97] One of the fundamental inquiries which the DTI intended to resolve, in conjunction with the reform of

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[93] Department of Trade and Industry South African *Company law for the 21st Century Guidelines for Corporate Law Reform* (2004) available at https://www.gov.za/sites/default/files/26493_gen1183a.pdf (accessed on 5 September 2018).
[94] Department of Trade and Industry *South African Company law for the 21st Century Guidelines for Corporate Law Reform* (2004) 4 available at https://www.gov.za/sites/default/files/26493_gen1183a.pdf (accessed on 5 September 2018).
[95] S 1*(a)* Constitution of the Republic of South Africa.
[96] Department of Trade and Industry *South African Company law for the 21st Century Guidelines for Corporate Law Reform* (2004) 5 available at https://www.gov.za/sites/default/files/26493_gen1183a.pdf (accessed on 5 September 2018).
[97] *Re Smith & Fawcett Ltd* [1942] Ch 304, at 306.

South African corporate law, was what is meant by 'a benefit for the company?'[98] This inquiry is connected to the corporate management theories previously discussed in this chapter. The DTI concluded that there are generally three views in determining 'what is meant by the benefit of the company as a whole'; these approaches are the shareholder approach, the enlightened shareholder value approach and the pluralist approach. The three approaches reflect either one or a combination of the corporate management theories previously discussed and were considered by the DTI in determining what constitutes the benefit of the company.

2.4.2 Shareholder Oriented Approach

The shareholder-orientated approach reflects the model of the Agency Theory whereby the operation of the company is based on the interest and wealth maximisation of the shareholders, including the shareholders being at the centre of corporate activity.[99] The rationale for the shareholder-oriented approach is that the shareholders are the group who invest capital in the company and therefore have a right to the finances generated by the company after all liabilities have been paid. The shareholder orientated approach identifies the shareholders as the most suited group to monitor the efficiency of the company and that non-financial benefits will automatically be bestowed on stakeholders provided the company do not financially fail. Shareholders do not have the automatic right to the proceeds or profits of the company because the directors have the authority to retain profits and not declare dividends to the shareholders; therefore the application of the shareholder-centric approach is debateable.

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[98] Department of Trade and Industry *South African Company law for the 21st Century Guidelines for Corporate Law Reform* (2004) 20 available at <u>*https://www.gov.za/sites/default/files/26493_gen1183a.pdf*</u> (accessed on 5 September 2018).
[99] Department of Trade and Industry *South African Company law for the 21st Century Guidelines for Corporate Law Reform* (2004) 24 available at <u>*https://www.gov.za/sites/default/files/26493_gen1183a.pdf*</u> (accessed on 5 September 2018).

In practice companies who are financially successful do not automatically bestow benefits on stakeholders. Instead, in order for benefits to accrue to stakeholders, companies are required to actively undertake programmes which are aimed at benefitting stakeholders such as CSR programmes. The Companies Act does not provide a mandatory obligation that stakeholder interest must be taken into account.[100] More effort should be made by companies to achieve socio-economic development within the new South African constitutional framework. The framework identifies that companies have the responsibility to respect and promote the rights in the Bill of Rights, including the promotion of accountability and transparency in the governance of companies. Globally shareholders are focused on the financial performance of the company due to their financial investment in the company.

The monitoring by shareholders to ensure directors strategically direct a company in the interest of the company and shareholders collectively is a narrow approach that should take into consideration the socio-economic conditions in which South African companies operate. The shareholder orientated approach prioritises the financial interest of shareholders over the socio-economic issues which companies may be able to alleviate by incorporating a more stakeholder inclusive approach.

2.4.3 Enlightened Shareholder Approach

The enlightened shareholder value approach is a combination of the Agency and Stakeholder Theories, which was the approach adopted by the Companies Act. In terms of the enlightened shareholder approach regard should be given by directors to the long term consequences of their actions although shareholder importance must be retained. Priority may be given to the stakeholders' interests by the directors of the company only if it is for the benefit and success of the company and shareholders as a whole.

[100] Cassim F, Cassim M, Cassim R et al Contemporary Company Law 2 ed (2012) 517.

The enlightened shareholder approach postulates that directors should have regard, where appropriate, to ensuring a productive and balanced relationship between the shareholders and other stakeholders, such as employees, customers, suppliers, creditors and the community. The enlightened shareholder approach is generally adopted by the Companies Act but lacks consistency due to submissions in the Act towards a shareholder centric approach by viewing a company as a model for shareholder maximisation. This is evident in the definition of a company in the Companies Act. A company is defined as; *inter alia*, an institution incorporated for financial gain,[101] as well as the voluntary winding up of a company where the company is not conducted to the advantage of its shareholders.[102]

The Companies Act fails to define company stakeholders, though a definition of stakeholders is provided for in the King IV Report on Corporate Governance for South Africa 2016 (King Code IV).[103] King Code IV is a voluntary code that can be adopted by companies with the exception of companies listed on a security exchange such as the Johannesburg Stock Exchange (JSE) who are required to comply with the King Code IV in order to promote and strengthen governance practices. The King Code IV has adopted a definition of stakeholders from the International Reporting Council (IRC) but makes a distinction between internal and external stakeholders of a company.[104] The IRC defines stakeholders as a group or persons that significantly affect or can be expected to significantly affect the business activities, outputs and the ability of the business to create value over a period of time.[105]

[101] S 1 Companies Act.
[102] S 81(1)*(d)(i)(bb)* Companies Act.
[103] Institute of Directors Southern Africa *King IV Report on Corporate Governance for South Africa* (2016).
[104] Institute of Directors Southern Africa *King IV Report on Corporate Governance for South Africa* (2016) 117.
[105] The International Integrated Reporting Council *The Internal <IR> Framework* (2013) 33 available at http://integratedreporting.org/resource/international-ir-framework/ (accessed on 10 October 2018).

2.4.4 Pluralist Approach

The pluralist approach is more aligned with the Stakeholder Theory whereby the interest of the shareholders and stakeholders must be balanced. Initially this was the preferred approach by the DTI in its guidelines for corporate law reform. The DTI opted for an approach which resembles a combination of the enlightened shareholder and pluralist approach. The dual approach suggests that the interest of the shareholders and the stakeholders of the company must be balanced, and that priority should not be given to one set of interests over the other.[106]

Similarly, the Stakeholder Theory focuses on the interests of all the stakeholders in a company. The Stakeholder Theory further views the company within the social environment in which it operates. The pluralist approach underlines the broader role of companies in society which includes the promotion of constitutional values and the Bill of Rights. The Companies Act attempts to adopt a pluralistic approach by deviating from the traditional view of a company as a means of profit generation and financial gain. It does this by incorporating non-financial aspects into the purposes of the Companies Act such as, *inter alia,* the achievement of socio-economic benefits by the company,[107] the promotion of investment into the South African market,[108] and promoting compliance with the Bill of Rights.[109]

The corporate law reform guidelines by the DTI in 2004 led to the enactment of the Companies Act. It further helped develop South African corporate law by recognising the specific legal and socio-economic context in which South African companies operate, as well

[106] Cassim R & Cassim F 'The reform of corporate law in South Africa' (2005) 16 *International Company and Commercial Law Reports* 411-2.
[107] S 7*(a)* Companies Act.
[108] S 7*(c)* Companies Act.
[109] S 7*(d)* Companies Act.

as promoting compliance with the Bill of Rights in interpreting the Companies Act.[110] The Bill of Rights binds both natural and juristic persons.[111] South African companies are therefore afforded the protection of the rights in the Bill of Rights depending on the nature of the right.[112] However, companies also have the responsibility to promote the realisation and protection of the rights contained in the Bill of Rights.[113] The Constitutional Court in the case of *Investigating Directorate: Serious Economic Offences v Hyundai Motor Distributors (Pty) Ltd; In re Hyundai Motor Distributors (Pty) Ltd v Smit NO* cautioned against the application of the Bill of Rights to juristic persons by stressing that companies are incapable of being bearers of the right to dignity.[114]

The Companies Act must be interpreted to give effect to its purposes;[115] this includes the promotion of the Bill of Rights.[116] Additional purposes of the Companies Act are the use of South African company law as method to promote the development of the South African economy,[117] the drawing of investment into South Africa, as well as utilising companies in order to achieve entrepreneurial and economic development.[118] The purpose of the Companies Act is a combination of constitutional and economic objectives of company law, specifically considering the broader role South African companies have in the progressive realisation of socio-economic development.

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[110] S 19*(1)(b)(i)* Companies Act.
[111] S 8(2) Constitution of the Republic of South Africa.
[112] S 19(1)(b)(i) Companies Act.
[113] S 19(1)*(b)(i)* Companies Act.
[114] *Investigating Directorate: Serious Economic Offences v Hyundai Motor Distributors (Pty) Ltd; In re Hyundai Motor Distributors (Pty) Ltd v Smit NO* 2001 (1) SA 73 (W) 106-7.
[115] S 5*(1)* Companies Act.
[116] S 7*(a)* Companies Act.
[117] S 7*(b)* Companies Act.
[118] S 7*(d)* Companies Act.

The supremacy of the Constitution is fortified by the invalidity of any law that is inconsistent with the provisions of the Constitution[119] and includes the interpretation of all laws to reflect the spirit, purport and object of the Bill of Rights.[120] Accountability and transparency are key constitutional values and objectives particularly with regard to the exercise and fulfilment of duties by public officials and institutions, including the operation and management of South African SOCs by its directors. Accountability and transparency by SOCs are further enhanced by the object of the PFMA that includes an undertaking to secure transparency and accountability in the management of public institutions[121] including major and other public institutions listed in schedule 2 and 3 of the PFMA respectively.[122]

2.5 THE ENHANCEMENT OF TRANSPARENCY AND ACCOUNTABILITY IN TERMS OF THE COMPANIES ACT

Provisions in the Companies Act that apply to public companies equally apply to SOCs.[123] However, the Minister may grant a SOC an exemption for the application of any provision in the Companies Act.[124] This is only possible provided that the exemption of an alternative regulation or section achieves the purposes of the Companies Act.[125] An exemption by the Minister may either be a total, partial or conditional exemption from the application of a provision in the Companies Act.[126] This depends on whether such a provision overlaps or duplicates a regulation established in terms of any other national legislation.[127]

[119] S 2 Constitution of the Republic of South Africa.
[120] S 39(2) Constitution of the Republic of South Africa.
[121] S 2 Public Finance Management Act.
[122] S 3*(b)* Public Finance Management.
[123] S 9(1) Companies Act.
[124] S 9(3) Companies Act.
[125] S 9(3)*(a)* Companies Act.
[126] S 9(3)*(a)* Companies Act.
[127] S 9(3)*(b)* Companies Act.

The Companies Act contains extensive provisions in order to achieve its purpose *inter alia*, encouraging transparency and high standards of corporate governance[128] with regard to the registration of companies[129] and the location and access to company records.[130] The accessibility and storing of accounting records[131] and financial statements of a company further promotes accountability and transparency.[132] Measures are put in place by the Companies Act to enhance accountability and transparency specifically with regard to public companies and SOCs; these include the appointment of a company secretary,[133] auditor[134] and an audit committee.[135]

2.5.1 The Location and Accessibility of Company Records

A company registered in terms of the Companies Act must include the address of its office or principal place of business when filing a notice of incorporation.[136] A company should also keep records of all reports presented at annual general meetings (AGM) including minutes of the meetings, accounting records, financial statements, the MOI and amendments thereto. Communications to shareholders, regardless of the class of shares, as well as the details of current and previous directors of the company, must also be stored by the company. All the above mentioned records should be kept by a company for a period of at least seven years.[137] If a company exists for a period shorter than seven years, then the records must be kept for

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[128] S 7*(b)(iii)* Companies Act.
[129] S 23 Companies Act.
[130] S 25 & 26 Companies Act.
[131] S 28 Companies Act 2008.
[132] S 31 Companies Act 2008.
[133] Chap 3 Part A Companies Act.
[134] Chap 3 Part B Companies Act.
[135] Chap 3 Part C Companies Act.
[136] S 23(3)*(b)(i)(aa)* Companies Act.
[137] S 24*(1)(b)* Companies Act.

the period which the company exists,[138] either at its registered office or another location in South Africa.

If a company keeps these records at a place other than its registered office, or intends on relocating these records, then a notice of such relocation, including the details of the location other than the registered office at which the records are kept, must be filed with the Companies and Intellectual Properties Commission (CIPC).[139] Persons who hold securities in the company, or have a beneficial interest in the securities of the company, should have access to the company records and information mentioned above.[140] Access should be granted during business hours and within a reasonable period of time for inspection upon payment of a fee.[141]

It is an offence for the company to deny, interfere or impede with a request to access the company's records by a member of the company.[142] This includes failure by the company to keep accurate and complete accounting records within the prescribed form, or to falsify or permit the falsification of its accounting records.[143]

2.5.2 Publication of a Company's Annual Financial Statements

All companies must publish annual financial statements within six months after the end of its financial year.[144] Financial statements published by public companies and SOCs must be audited.[145] Depending on the annual turnover, the number of employees, and the nature of its activities, a private company may also be required to have its annual financial statements

[138] S 24(2) Companies Act.
[139] S 25(2) Companies Act.
[140] S 26(1) Companies Act.
[141] S 26 () Companies Act.
[142] S 26(6) Companies Act.
[143] S 28(3) Companies Act.
[144] S 30(1) Companies Act.
[145] S 30(2)*(a)* Companies Act.

either voluntarily audited[146] or independently reviewed.[147] A company's financial statements must include the remuneration of directors and prescribed officers[148] including allowances, financial assistance or bonuses given to a director or prescribed officer by the company.[149] There are different requirements for the annual financial statements of various types of companies and requirements pertaining to the format and procedure of an audit or independent review.[150] The Minister may in terms of regulations, outline requirements to be met by persons auditing or independently reviewing the financial statements of companies.[151]

2.5.3 The Appointment of an Auditor, Company Secretary and an Audit Committee in terms of the Companies Act.

Public companies and SOCs must appoint an auditor, company secretary and an audit committee.[152] An auditor and company secretary appointed should not be disqualified to fulfil the position as a director.[153] An auditor cannot simultaneously act as a director at the same company.[154] Similarly, a director cannot concurrently occupy the position of company secretary.[155] Furthermore, directors cannot appoint one of the other directors to fulfil the position of company secretary in the same company.[156] The Companies Act provides for the appointment of a company secretary that is experienced and knowledgeable in the laws applicable to a company secretary.[157] Company secretaries must be resident in South Africa for the duration of their term.[158] It is possible for the position of auditor and company

[146] S 30(2)*(b)(i)* Companies Act.
[147] S 30(2)*(b)(ii)* Companies Act.
[148] S 30(4)*(a)* Companies Act.
[149] S 30(6) Companies Act.
[150] S 30 (7) Companies Act.
[151] S 30(7) Companies Act.
[152] S 84(4) Companies Act.
[153] S 84(5) Companies Act.
[154] S 90(2)*(b)(i)* Companies Act.
[155] *Dey v Goldfields Building Finance & Trust Corporation Ltd* 1927 WLD 180 at 193.
[156] *Dey v Goldfields Building Finance & Trust Corporation Ltd* 1927 WLD 180 at 193.
[157] S 86(1) Companies Act.
[158] S 86(2) Companies Act.

secretary to be occupied by a juristic person[159] and in the case of company secretaries, partnerships are also permitted to fill this position.[160]

The duties of company secretaries are expansive and include the following; first, to provide guidance to directors of the company with regard to their duties, powers and responsibilities.[161] Secondly, to inform the directors if the company fails to comply with the provisions of the Companies Act or the–company's MOI.[162] Thirdly, to ascertain the legal position or legal consequences of the companies conduct,[163] and to declare whether information in the company's annual financial statements are true, accurate and up to date.[164] A company secretary has fiduciary duties towards the company[165] which is not necessarily related to the management of the company. Furthermore a company secretary is not a company agent and therefore it cannot act on behalf of the company.[166]

The duties of auditors are confined to the auditing of a company's annual financial statements,[167] including the drafting of the auditor's report included in the company's annual finance statements.[168] In order to occupy the position of company auditor a person should not be disqualified to occupy the position of director in terms of s 69(8) of the Companies Act.[169] A company auditor may either be a natural or juristic person[170] who is a registered auditor.[171]

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[159] S 85(1)*(b)* Companies Act.
[160] S 87(1) Companies Act.
[161] S 88(2)*(a)* Companies Act.
[162] S 88(2)*(c)* Companies Act.
[163] S 88(2)*(b)* Companies Act.
[164] S 88(2)*(e)* Companies Act.
[165] *In re Morvah Consols Tin Mining Co; McKay's Case* (1875 2 Ch 1 (CA).
[166] *Newlands v The National Employers Accident Association Ltd* (1885) 54 LJ QB 428 (CA).
[167] S 30(2) Companies Act.
[168] S 30(3)*(a)* Companies Act.
[169] S 84(5) Companies Act.
[170] S 90(2) Companies Act.
[171] S 1 & 3 Auditing Profession Act 26 of 2005 defines a registered Auditor as: an individual or firm registered as an auditor with the Independent Regulatory Board for Auditors. A firm includes a partnership, sole proprietor or company.

A company auditor may not be a director, employee, consultant or company secretary; this includes an employee of a director or officer of the company and individuals who have habitually done any bookkeeping or accounting work for the company.[172] Any person or firm that conducted any of the duties mentioned for the company in the previous five financial years is also excluded from being appointed as a company auditor.[173]

A company must appoint an auditor within 40 days from the date a vacancy becomes available. In the instance of a company having more than one auditor, then an appointment can be made anytime by a company whenever such a vacancy arises.[174] A proposal must be forwarded to the audit committee by the board of directors' within 15 days after a vacancy for the position of company auditor becomes available. Thereafter, the directors can move forward to appoint the proposed individual or firm, provided that the audit committee does not provide a written notice to the board of directors rejecting their proposal.[175]

Auditors appointed to a company must be rotated after occupying the position for a period of five consecutive financial years.[176] Where an auditor has occupied the position for at least two consecutive financial years, there is a waiting period of two years before the same auditor may reapply to occupy the position.[177] The company auditor has the right to access all the companies accounting records and financial statements in order to fulfil his duties.[178] This extends to the accounting records and financial statements of subsidiaries where the auditor is appointed by a holding company.[179] In conjunction to having access to the records of the company an auditor may also attend all company meetings and receive all company notices

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[172] S 90(2)*(b)* Companies Act.
[173] S 90(2)*(b)* Companies Act.
[174] S 91(2) Companies Act.
[175] S 91(3) Companies Act.
[176] S 92(1) Companies Act.
[177] S 92(2) Companies Act.
[178] S 93(1)*(a)* Companies Act.
[179] S 93(1)*(b)* Companies Act.

including the right to address such meetings.[180] All the restrictions and disqualifications regarding individuals that has or had relations with the company being excluded from being appointed as a company auditor is to ensure the independence of the company auditor and prevent a possible conflict of interest. Where the auditor lacks independence he is prohibited from rendering services to the company.[181] An auditor may approach a court to make an order to prevent him from being restricted and impeded during the fulfilment of his duties and the exercise of his rights in terms of the Companies Act; the order made by the court must be just and reasonable.[182] A court can make an order for company directors or prescribed officers to be personally liable for cost where it is proved that the director or prescribed officer wilfully frustrate or impede the auditor from fulfilling his duties in terms of the Companies Act.[183]

A SOC and a public company must appoint an audit committee[184] that consist of at least three members[185] that are also directors of the company.[186] Companies who voluntarily decide to have their annual financial statements audited can also provide for the voluntary appointment of an audit committee in terms of its MOI.[187] Directors of the company appointed as a member of the audit committee must not be involved in the day to day operation of the company for the previous financial years.[188] Directors serving as members on the audit committee cannot be a prescribed officer or an employee of the company during the preceding three financial years of the company.[189] Material suppliers and customers of the company who are also directors of the company are disqualified from serving as a member of

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[180] S 93(1)*(c)* Companies Act.
[181] S 93(3) Companies Act.
[182] S 93(2)*(a)* Companies Act.
[183] S 93(2)*(b)* Companies Act.
[184] S 84(1) Companies Act.
[185] S 94(2) Companies Act.
[186] S 94(4)*(a)* Companies Act.
[187] S 34(2) Companies Act.
[188] S 94(4)*(b)(i)* Companies Act.
[189] S 94(4)*(b)(ii)* Companies Act.

the audit committee where third parties will reasonably and objectively perceive such a person as being impartial.[190]

The duties of the audit committee are *inter alia*, to nominate a person to be appointed by the board of directors as the company auditor, engage with the company auditor with regard to terms of service. An audit committee further ensures that there is compliance by the board of directors and auditor with the provisions of the Companies Act. Additionally, an audit committee is responsible for the drafting of a report to be included in the company's annual financial statements.

The Minister has the authority to prescribe minimum qualifications required by members of the audit committee.[191] At least one third of the members of a company's audit committee must have either an academic qualification or experience in economics, law, corporate governance, finance, accounting, commerce, industry, public affairs or human resource management.[192] The appointment of an audit committee by the board and the delegation of authority to the committee do not constitute the board of directors fulfilling their duties, except with regard to the appointment of the company auditor, their terms of service and the remuneration of company auditors.[193]

SOCs and public companies with listed securities and companies with a public interest score of 500 points or more must appoint a social and ethics committee (SEC).[194] The abovementioned companies may be exempted from appointing a SEC when it is a subsidiary of a company which has appointed a SEC and the SEC of the holding company will perform the functions on behalf of the subsidiary. An exemption can also be granted by the Companies Tribunal where a company is required to have a formal structure in terms of other

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[190] S 94(4)*(b)(iii)* Companies Act.
[191] S 94(5) Companies Act.
[192] Reg 24 Companies Regulations 2011 in GNR.351 GG 34239 of 26 April 2011.
[193] S 94(10) Companies Act.
[194] S 72(4) Companies Act.

legislation which performs the same or similar functions that the SEC would have performed[195] or where it is not necessarily in the interest of the public for the company to have a SEC,[196] these exemption are valid for five years.[197]

The functions of the SEC are to monitor activities regarding the company's implementation and compliance with the Employment Equity Act,[198] the Broad Based Black Economic Empowerment Act,[199] the 10 principles set out in the UN Global Compact Principles[200] and the recommendations of the OECD.[201] The SEC functions also include *inter alia*, the monitoring of a company's efforts in promoting equality, unfair discrimination as well as the reduction of corruption,[202] the development of communities where a company conducts its business or sells its products,[203] and the impact of the company on the environment, health and public safety.[204]

A company's board of directors can appoint any number of committees[205] and delegate any authority which the board has to the committees that were appointed.[206] The delegation of any authority by the board of directors to any committee does not constitute the fulfilment of directors' duties in terms of s 76 of the Companies Act.[207] The board of directors is still responsible for the fulfilment of its duties except for the duties prescribed to the audit committee.[208] The board of directors can either delegate some or all of its authority to a committee but this does not mean the board of directors is absolved from their duties. The

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[195] S 72(5)*(a)* Companies Act.
[196] S 72(5)*(b)* Companies Act.
[197] S 72(6) Companies Act.
[198] Reg 43(5)*(i)(cc)* Companies Regulations 2011.
[199] Reg 43(5)*(i)(dd)* Companies Regulations 2011.
[200] Reg 43(5)*(i)(aa)* Companies Regulations 2011.
[201] Reg 43(5)*(i)(bb)* Companies Regulations 2011.
[202] Reg 43(5)*(ii)(aa)* Companies Regulations 2011.
[203] Reg 43(5)*(ii)(bb)* Companies Regulations 2011.
[204] Reg 43(5)*(iii)* Companies Regulations 2011.
[205] S 72(1)*(a)* Companies Act.
[206] S 72(1)*(b)* Companies Act.
[207] S 72(3) Companies Act.
[208] S 94(10) Companies Act.

board of directors must retain ultimate control; it can delegate but not give up its authority and duties.[209] The application of the standards of directors conduct is broadened to include members of committees who are not directors,[210] therefore members of committees who are not directors of the company have the same duties to fulfil regardless of being a company director or not.

2.6 CONCLUSION

The concept of corporate governance came about due to the separation between the ownership and management of a company. Corporate governance as a discipline resulted in the formulation of corporate management theories which fundamentally aim to determine for whose benefit a company exists, and what influences the success or demise of a company. The ultimate aim of the corporate governance theories is to provide a governance structure for companies that result in the optimal and efficient operation of companies. In an attempt to analyse the suitability of the corporate governance theories in South Africa the Agency Theory, Stewardship Theory, Stakeholder Theory, Transaction Cost Theory, Political Theory and Resource Dependency Theory have been analysed.

It is argued that not one of the theories are strictly suitable to South Africa, though the Stakeholder Theory is aligned to the realisation of a company having non-commercial obligations towards stakeholders as opposed to the traditional view of the company as a means of only creating wealth for its shareholders. All of the corporate management theories have shortcomings which are fortified by considering factors highlighted in another corporate governance theory. For this reason, in determining an appropriate corporate management theory, it is recommended that a combination of the theories best promote a company that will operate efficient and optimally.

[209] *Barlows Manufacturing CO Ltd v RN Barrie Pty Ltd* 1990 (4) SA 608 (C) para 610-611.
[210] S 76(1) Companies Act.

It is proposed that a theory be developed which attaches intrinsic importance to all stakeholders of the company regardless of whether those stakeholders are internal or external stakeholders. Companies without the co-operation of all stakeholders, including the financial and non-financial contribution from all its stakeholders, will find it difficult if not impossible to operate efficiently and effectively. A company does not have physical abilities to fulfil and conduct duties that are necessary in order for a company to operate.[211] This inability of a company as a juristic person displays the important role stakeholders have in the operation of companies. Therefore, it is proposed that the adoption of a corporate management theory which recognises company stakeholders as having equal value amongst each other and the realisation of companies integrating the interest of all stakeholders in the operation of the company. This means a transition from a purely financial objective to a more balanced objective between the socio-economic and financial expectation of companies in South Africa. The socio-economic conditions in South Africa cannot be addressed by the government alone. South African SOCs are the governments' vehicle in the progressive realisation of socio-economic rights while simultaneously providing an opportunity for the promotion of economic growth in South Africa.

South African corporate law had to be updated to reflect the new constitutional dispensation as well as to supplement South Africa's role as a participant in the global business community. The collapse of both South African and global companies also called for a need to revise and improve South Africa's corporate governance. The realisation of the potential role companies can play in addressing social economic disparities in South Africa influenced a reform of South African corporate law. South African corporate law is influenced by the overarching constitutional values as well as transformative constitutionalism which demands

[211] Cassim F, Cassim M, Cassim R et al Contemporary Company Law 2 ed (2012) 31.

laws to be enacted, interpreted and enforced in a manner that promotes the realisation of the rights in the Bill of Rights.

The subsequent chapter in analysing the fiduciary duties and the duty of care, skill and diligence of directors of state owned companies is premised on the analysis of the following; the corporate management theories, and how it relates to transformative constitutionalism. Furthermore, the aspirations of the DTI when initiating the South African corporate law reform guidelines outlined in this chapter will be analysed in the next chapter. Additionally, the enlightened shareholder value approach adopted by the Companies Act, the purposes of the Companies Act to promote the rights in the Bill of Rights, good corporate governance, and the key role companies have in the realisation of socio-economic benefits are linked to the following chapter.

CHAPTER: 3 THE FIDUCIARY DUTIES AND THE DUTY OF CARE, SKILL AND DILIGENCE OF DIRECTORS OF STATE OWNED COMPANIES VIS-À-VIS THE DUTY TO PREVENT FRUITLESS, WASTEFUL AND IRREGULAR EXPENDITURE

3.1 INTRODUCTION

The conduct of directors of South African SOC's is regulated by the PFMA and the Companies Act. The provisions of the PFMA will prevail where there is a conflict with the provisions the Companies Act.[1] The board of directors of a SOC is the accounting authority for that SOC;[2] they have the duty to prevent irregular, fruitless and wasteful expenditure.[3] These duties are in addition to a director's fiduciary duties and the duty of care, skill and diligence in the Companies Act.[4]

The Companies Act partially codifies a director's duty to act with care, skill and diligence.[5] The Act further provides that a director's fiduciary duties include; the duty to act in good faith and for a proper purpose,[6] and the duty to act in the best interest of the company.[7] The partial codification aims to achieve the objectives of the DTI policy paper which is to *inter alia*, clarify and provide access to the duties of directors.[8] However, it is debatable whether these aims have been achieved. Directors' fiduciary duties and their duty of care, skill and diligence in the common law apply concurrently with the Companies Act to the extent that it does not conflict with the Companies Act.[9] Directors are in a relationship of trust with the company. This relationship bestows the overarching fiduciary duties of honesty and loyalty

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[1] S 5(4)*(b)(i)(ee)* Companies Act.
[2] S 49(2)*(a)* Public Finance Management Act.
[3] S 51(b)*(ii)* Public Finance Management Act.
[4] S 75; 76(2) & (3) Companies Act.
[5] S 76(3)*(c)* Companies Act.
[6] S 76(3)*(a)* Companies Act.
[7] S 76(3)*(b)* Companies Act.
[8] Department of Trade and Industry *South African Company Law for the 21st Century: Guidelines for Corporate Law Reform* GN 1183 GG 26499 of 23 June 2004 25.
[9] Cassim F *et al Contemporary Company Law* 2 ed (2012) 508.

towards the company.[10] The aim of fiduciary duties is to encourage good corporate behaviour by directors requiring them to act objectively for the benefit of the company while simultaneously curbing directors from acting for their own benefit or in bad faith. Directors' duty of care, skill and diligence is premised on the position that directors are liable for the negligent manner in which they fulfil their duties. The focus is therefore more on how a function is fulfilled by the director and not what the specific function is.

Fiduciary duties derive from Roman Dutch law;[11] they are *sui generis* and do not form part of any branch of law.[12] Conversely the duty of care, skill and diligence derives from the English law duty of care and skill.[13] Although the basis for the duty of care, skill and diligence is in English law the Roman Dutch *Lex Aquilia* may be used to hold directors liable for the breach of the duty of care, skill and diligence.[14] The dissimilarity between the origin of the duty of care, skill and diligence and the basis upon which to hold a director liable for a breach of his duty of care, skill and diligence adds to the uncertainty of this duty.

This chapter provide a nexus between directors of SOC's duty to act with care, skill and diligence in the Companies Act and a director's duty to prevent fruitless, wasteful and irregular in the PFMA. The nexus points toward the relation and potential contravention of a director's duty to act with care, skill and diligence in the Companies Act where a director of a SOC fails to prevent fruitless, wasteful and irregular expenditure in terms of the PFMA.

The business judgement rule (BJR), on the other hand, protects a director by creating a presumption that a director acted with care, skill and diligence, provided the requirements of the BJR are met. It is therefore necessary to analyse a director's fiduciary duties, including an assessment of the BJR, in order to provide a holistic view of a director's duty to act with care,

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[10] Cassim F *et al Contemporary Company Law* 2 ed (2012) 514.
[11] Blackman MS 'Companies' in Joubert WA (founding editor) *The Law of South Africa* (1996) 4 116.
[12] Cilliers H *et al Corporate Law* 3 ed (2000) at 136.
[13] Jones E 'Directors' Duties: Negligence and the Business Judgment Rule' (2007) 19 *SA Merc LJ* 334.
[14] S 77(2)*(b)(i)* Companies Act; *Du Plessis NO v Phelps* 1995 (4) SA (165) C at 170.

skill and diligence in terms of the common law and the Companies Act. Furthermore, the duty to prevent fruitless, wasteful and irregular expenditure in the PFMA is analysed with the intention to display its relation and effect on the potential contravention of the duty of care, skill and diligence.

3.2 THE FIDUCIARY DUTIES OF DIRECTORS IN SOUTH AFRICAN CORPORATE LAW[15]

The Companies Act defines a director as 'a member of the company's board or any alternate director, or any person occupying the position of a director or an alternate director'.[16] This definition includes persons legally recognised as a director, as well as persons occupying the position of a director by fulfilling obligations that company directors would generally fulfil even though they are not formally appointed as such. Professional persons are not excluded from the definition of directors in the Companies Act when acting on behalf of directors, unlike s 1(2) of the Old Companies Act. Therefore the scope of persons owing fiduciary duties to the company may include professional persons such as legal practitioners, accountants or auditors when they fulfil duties on behalf of directors.

Sections in the Companies Act dealing with a director's personal financial interest,[17] and directors' standard of conduct,[18] contain a broader definition of directors. The broader definition includes prescribed officers and members of board committees even though such a member is not a director of the company.[19] A prescribed officer has executive control over the company or a substantial part of the company and frequently takes part in the executive control and activities of the company or in a substantial part thereof.[20] The result of the

[15] This section briefly analyses a directors fiduciary duties.
[16] S 1 Companies Act.
[17] S 75 Companies Act.
[18] S 76 Companies Act.
[19] S 75(1)*(b)*; s 76(1)*(b)* Companies Act.
[20] Reg 38(1)*(a)* Companies Regulations in GG 34239 of 26 April 2011.

broader definition of directors is that prescribed officers and members of board committees owe fiduciary duties to the company even though they are not directors; this bestows greater responsibilities and duties on members of board committees even though they do not share the legislative authority with directors to strategically manage the company.[21]

3.2.1 Directors' fiduciary duties: the common law and the Companies Act 71 of 2008.

Directors' fiduciary duties are not stagnant or restricted to a closed list;[22] it is flexible in order to adapt to the changes and demands of society. Directors owe fiduciary duties to the company regardless of being an executive or non-executive director. Once a person is appointed as a director a fiduciary relationship is established between the director and the company where the director owes the utmost good faith to the company.[23] The duty to act in good faith in terms of the common law and the Companies Act[24] is subjective, focusing on the directors' state of mind. The duty to act in good faith requires a director to act honestly, without any wrongdoing or malice. Therefore focus is placed on whether the director believes that he is acting in good faith without any wrongdoing or malice. In order for the duty of good faith to be contravened a director must be aware of any wrongdoing or malice; furthermore the absence of reasonable grounds for good faith may be indicative of wrongdoing, dishonesty or malice by a director.[25]

The duty of a director to act for a proper purpose[26] is an objective duty, preventing a director from acting for an ulterior motive and out of his scope of authority, by providing that a power must be exercised for the objective purpose for which it was given. The duties to act in good faith and for a proper purpose are both encapsulated in s 76(3)*(a)* of the Companies Act,

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[21] S 66 of the Companies Act.
[22] *English v Dedham Vale Properties Ltd*: ChD 1978.
[23] *Howard v Herrigel NO* 1991 (2) SA 660 (A) at 678.
[24] S 76(3)*(a)* Companies Act.
[25] *Shuttleworth v Cox Brothers & Co (Maidenhead) Ltd* [1927] 2 KB 23.
[26] S 76(3)*(a)* Companies Act.

however these two duties remain distinct and separate. To determine whether a director acted in good faith, it is immaterial in determining whether a director acted for a proper purpose. Where multiple purposes exist the court must consider the dominant purpose that resulted in a decision or conduct by a director.[27] In order to determine if the conduct or a decision by a director was exercised for a proper purpose the following enquiry should be applied; the particular power being challenged and the proper purpose for which a power was given.[28] Furthermore the dominant purpose for which the power was exercised must be identified and it must be determined whether the dominant purpose is within the ambit of the proper purpose for which the particular power was actually given.[29] For example, the courts traditionally adopted a purely objective approach with regard to the proper purpose where the directors of a company issued shares. However, the proper purpose for the issuing of shares is not a purely objective test when it is to avoid a takeover.[30] A company may be protected by its directors in preventing a takeover when they believe on reasonable grounds that it will damage the interest of the company.[31] In *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd and Others,*[32] Roger J held that the directors of the respondent company did not contravene their fiduciary duties by refusing to register additional shares in favour of the applicant.[33] The refusal by the directors was based on their view of the applicants' ambitions, visions, strategic outlook and policies not being in the interest of the respondent company.[34] This indicates that the directors' refusal to issue the shares will be for a proper purpose when they reasonably believe that avoiding a takeover is in the best interest of the company. In

[27] *Piercy v Mills* [1920] 1 Ch 77.
[28] *Extrasure Travel Insurance Ltd v Scattergood* [2003] BCLC 598 (ChD) 619.
[29] *Extrasure Travel Insurance Ltd v Scattergood* [2003] BCLC 598 (ChD) 619.
[30] *CDH Invest NV v Petrotank South Africa (Pty) Ltd and Another* [2018] 1 All SA 450 (GJ) para 67.
[31] *Teck Corporation Ltd v Millar et al* 1972 CanLII 950 (BC SC).
[32] 2014 (5) SA 179 (WCC).
[33] *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd and Others* 2014 (5) SA 179 (WCC) para 95.
[34] *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd and Others* 2014 (5) SA 179 (WCC) para 82.

such circumstances the refusal to issue shares by directors is not based on an improper purpose.

A director's duty to act in the best interest of the company[35] is central to the exercise of a director's powers or the performance of his function in good faith and for a proper purpose. This duty reinforces the position that directors owe their fiduciary duties to the company alone.[36] It is a subjective duty[37] requiring directors to act independently by performing their functions in relation to what they think is in the best interest of the company[38] and not what any other person or the court thinks.[39] Courts are reluctant to replace a directors' view of what is in the best interest of the company with their own view.[40] Due to the subjective nature of this duty a director does not breach his duty to act in the best interest of the company even though he mistakenly and unreasonably believes that he is pursuing the best interest of the company.[41] Although the duty to act in the best interest of the company is not objective the courts in determining whether directors acted in the best interest of the company may investigate whether an honest and informed person in the position of the director could have reasonably believed to be acting in the best interest of the company.[42]

The purpose of the fiduciary duties is to instil good corporate governance practices amongst directors and senior company officials when acting on behalf of the company. The partial codification of directors' fiduciary duties in the Act allows for the continuation and

[35] S 76(3)*(b)* Companies Act.
[36] Cassim F et al *Contemporary Company Law* 2 ed (2012) 515.
[37] *Greenhalgh v Arderne Cinemas* [1950] 2 All ER 1120 1126.
[38] *Da Silva v CH Chemicals (Pty)* Ltd [2009] 1 All SA 216 (SCA) 221.
[39] Du Plessis J 'Directors' Duty to Use their Powers for Proper or Permissible Purposes' (2004) 16 *SA Merc LJ* 308.
[40] Du Plessis 'Directors' Duty to Use their Powers for Proper or Permissible Purposes' 2004 16 *SA Merc LJ* 312.
[41] *Extrasure Travel Insurances Ltd v Scattergood* [2003] 1 BCLC 598 (ChD) 619.
[42] *Charterbridge Corporation Ltd v Lloyds Bank Ltd* [1969] 2 All ER 1185.

development of the common law fiduciary duties to give effect to the rights contained in the Act.[43]

3.3 THE DUTY OF CARE, SKILL AND DILIGENCE OF DIRECTORS IN SOUTH AFRICAN CORPORATE LAW[44]

The duty of care, skill and diligence focuses more on how a function is fulfilled by a director. An action for the breach of the duty of care, skill and diligence requires the elements of a delict to be proven.[45] South African courts adopted the subjective approach of English courts in determining whether a director acted with care, skill and diligence. The justification for the application of a subjective test is that directors are not a homogenous group requiring specific qualifications, knowledge or skill in order to be appointed as a director and do not form part of a professional body such as accountants, lawyers and doctors. The subjective inquiry resulted in a low standard set for directors to fulfil their duty to act with care, skill and diligence. This low standard may have influenced the reluctance of South African courts to hold directors liable for the breach of their duty of care, skill and diligence. Consequently only one South African case has been reported where a director was held liable for the breach of his duty of care, skill and diligence, namely *Niagara Ltd (in liquidation) v Langerman & Others*.[46]

The Companies Act partially codifies the duty of care, skill and diligence[47] and as a result it is now regulated by both the Companies Act and the common law. The examination of the duty of care, skill and diligence in terms of the common law and the Act is a prerequisite in order to provide the contemporary position of this duty.

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[43] S 158*(a)* Companies Act.
[44] This section briefly analyses a directors fiduciary duties.
[45] Jones E 'Directors' Duties: Negligence and the Business Judgment Rule' (2007) 19 *SA Merc LJ* at 334.
[46] 1913 WLD 188.
[47] S 76(3)*(c)* Companies Act.

3.3.1 The duty of care and skill under the common law.

The South African common law position of a director's duty of care, skill and diligence is a subjective duty centred on the knowledge, skill and abilities of a director.[48] This duty has been greatly influenced by two prominent English cases; *Re Brazilian Rubber Plantation & Estates Ltd*[49] *(Re Brazilian Rubber Plantation)* and *In re City Equitable Fire Insurance CO Ltd*[50] *(In re City Equitable Fire Insurance).* The positions held in these two English cases regarding a director's duty of care, skill and diligence have been approved by Margo J in *Fisheries Development Corporation of SA Ltd v Jorgensen & Another; Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd & Others (Fisheries Development Corporation of SA Ltd).* [51]

In terms of the common law duty of care, skill and diligence directors are not liable for contravening their duty of care, skill and diligence where damages results from a director who acted honesty, unless they are found guilty of gross negligence.[52] A director is required to act with such reasonable care expected from him, having regard to his knowledge and experience.[53] A director is also not required to bring any special expertise or experience into the company and is not liable for damages caused by mere errors of judgement.[54] However, if a director has any special qualifications and knowledge it must be utilised for the benefit of the company. A director that fulfils a management role in the company is required to exercise reasonable care, equivalent to that of an ordinary person in his position.[55] A distinction is recognised between an executive director who participates in the day to day management of the company and a non-executive director who is not required to give continuous attention to

[48] Cassim F et al Contemporary Company Law 2 ed (2012) 555.
[49] [1911] Ch 425 (CA).
[50] [1925] Ch 407.
[51] 1980 (4) SA 156 (W).
[52] *Re Brazilian Rubber Plantation & Estates Ltd* [1911] Ch 425 (CA) 436.
[53] *Re Brazilian Rubber Plantation & Estates Ltd* [1911] Ch 425 (CA) 436.
[54] *Re Brazilian Rubber Plantation & Estates Ltd* [1911] Ch 425 (CA) 437.
[55] *Re Brazilian Rubber Plantation & Estates Ltd* [1911] Ch 425 (CA) 437.

matters of the company; instead his duties are of an intermittent nature, periodically performed at board meetings.[56] Directors are permitted to delegate duties and rely on the judgement, advice and information of others provided there are no grounds for suspicion and no proper reasons for questioning the judgement, advice and information.[57] Furthermore a director in exercising reasonable care should not accept such judgements, information and advice blindly.[58]

The common law subjective duty of care, skill and diligence has been influenced by the position that company shareholders are responsible for the appointment of incompetent directors.[59] This influence has also developed into the position that the duty of care, skill and diligence is applicable to directors, regardless of their different qualifications and experience.

Fisheries Development Corporation of SA Ltd is the leading South African case displaying the common law position of a director's duty of care, skill and diligence, even though Margo J adopted principles of *In re City Equitable Fire Insurance* which was decided more than 50 years prior. The common law duty of care, skill and diligence fail to protect shareholders from directors who are negligent or careless.[60] It absolves directors from liability based on their lack of knowledge or experience by requiring a degree of care, skill and diligence to be exercised based on the knowledge and experience of the director regardless of how low such degree might be.

The subjective duty of care, skill and diligence articulated in the case law above does not represent the contemporary view, the expectations of director have changed[61] since the early 20th century cases of *Re Brazilian Rubber Plantation* and *In re City Equitable Fire Insurance*.

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[56] *In re City Equitable Fire Insurance CO Ltd* [1925] Ch 429.
[57] *In re City Equitable Fire Insurance CO Ltd* [1925] Ch 429-430.
[58] *In re City Equitable Fire Insurance CO Ltd* [1925] Ch 429-430.
[59] *Turquand v Marshall* (1868-69) LR 4 Ch App 376.
[60] Cassim F *et al Contemporary Company Law* 2 ed (2012) 558.
[61] Havenga M 'The Business Judgment Rule – Should We Follow the Australian Example' (2000) 12 *SA Merc LJ* 26.

The contemporary view is that directors are more informed and aware of company matters when compared to the common law position. The Federal Court of Australia in *Australian Securities and Investments Commission v Healey*[62] provided a contemporary view displaying the expectation of company directors. The court remarked that a director should at least acquire a basic understanding of the company and become familiar with the fundamentals of the business in which the company engages, as well as be informed about the company's activities.[63] Furthermore, a director should monitor the corporate affairs and policies, but is not required to have an in-depth knowledge of the day to day activities of the company.[64] A director should have an inquisitive mind by maintaining familiarity with the financial affairs of the company, regularly reviewing and understanding financial statements.[65] They are expected to pay attention to the company's affairs to the extent which might reasonably attract their attention, although the director is not an expert in the area.[66] Directors should also take all reasonable steps to be in a position to monitor and guide the company.[67]

The position held in *Australian Securities and Investments Commission v Healey*[68] relating to the contemporary view and expectation of company directors to the extent that it applies to non-executive directors is a favoured approach. Executive directors are expected to be even more informed and aware of the operational and financial position of the company due to their involvement in the day to day operation of the company. The position in *Australian Securities and Investments Commission v Healey*[69] provides the general expectation of directors, but it is submitted that these views and expectation may vary depending on the size and nature of the company, as well as the specific position fulfilled by a director, the nature

[62] [2011] FCA 717.
[63] *Australian Securities and Investments Commission v Healey* [2011] FCA 717 para 17.
[64] *Australian Securities and Investments Commission v Healey* [2011] FCA 717 para 17
[65] Australian Securities and Investments Commission v Healey [2011] FCA 717 para 17.
[66] *Australian Securities and Investments Commission v Healey* [2011] FCA 717 para 18.
[67] *Australian Securities and Investments Commission v Healey* [2011] FCA 717 para 16.
[68] [2011] FCA 717.
[69] [2011] FCA 717.

of the company relates to the specific industry in which a company operates as well as the impact such operations may have on society. The position fulfilled by a director may be influenced by factors such as whether the director is an executive director, or the conclusion of any contract between the company and a director in addition to the company's MOI which may bestow more responsibilities and duties on a director.

3.3.2 The duty of care, skill and diligence: the Companies Act 71 of 2008.

The partial codification of a directors' duty of care, skill and diligence in the Act is aimed at enhancing and promoting good corporate governance practices in South Africa. It is also in response to the failure of the subjective common law duty of care, skill and diligence to stay in touch with the contemporary view and expectation of directors, as well as developments in the commercial environment such as South Africa's re-entrance into the global economy. The Institute for Directors of South Africa campaigned for the codification of directors' duty of care, skill and diligence in King I[70] and King II[71] to ensure that directors' fulfil their duties adequately.

Section 76(3)*(c)* reads:

> *(3) Subject to subsection (4) and (5), a director of a company, when acting in that capacity, must exercise the powers and perform the functions of a director-*
> *(c) with the degree of care, skill and diligence that may be reasonably be expected of a person-*
> *(i) carrying out the same functions in relation to the company as those carried out by that director; and*
> *(ii) having the general knowledge, skill and experience of that director.*

Section 76(3)*(c)* of the Companies Act introduces objective and subjective elements when measuring the degree of care, skill and diligence required from directors in the exercise or

[70] Institute of Directors in South Africa King *Report on Corporate Governance* 1994.
[71] Institute of Directors in South Africa King *Report on Corporate Governance* 2002.

performance of their functions. The effect of an objective/subjective test is the imposition of a more rigid duty of care, skill and diligence on directors. The introduction of an objective inquiry,[72] equivalent to that of a reasonable person in the position of a director marginally increases the standard of care, skill and diligence in the Act when compared to the common law. The result is a stricter duty of care, skill and diligence in the Act when equated to its common law counterpart, although it cannot be said that duty of care, skill and diligence in the Act is demanding.

The adoption of a marginally stricter objective duty of care, skill and diligence in the Act may have been influenced by the purposes of the Act which aim to encourage commercial participation from a broader range of individuals by making directorship positions more attractive. These purposes also include, amongst other things, to reaffirm the concept of the company as a means of achieving economic-socio benefits,[73] to promote the development of companies within all sectors of the economy and to encourage participation in economic activities and productivity.[74] The degree of care, skill and diligence expected of a reasonable person against whom the conduct of the director will be measured is influenced by the nature of the company and the functions assigned to the director.[75] The aim of the legislature in taking into account the functions of a director in relation to the company is to compare the director with a reasonable person in the same hypothetical circumstances as the director which allegedly contravened his duty of care, skill and diligence. Du Plessis points out that the inclusion by the legislature of the functions carried out by a director as a factor in

[72] S 76(3)*(c)* Companies Act.
[73] S 7*(d)* Companies Act.
[74] S 7*(f)* Companies Act.
[75] *Fisheries Development Corporation* 1980 4 SA 156 (W); *Re City Equitable Fire Insurance CO Ltd* [1925] Ch 407.

determining the degree of care, skill and diligence required by a director aims to ensure ‘apples are compared with apples’.[76]

In addition to the objective inquiry introduced by the Act, the common law subjective inquiry is retained by referring to the general knowledge, skill and experience of a director[77] when determining the degree of care, skill and diligence required to be exercised. A consequence of the objective/subjective inquiry in the Act[78] is the establishment of a minimum standard of care, skill and diligence as opposed to a uniform standard, which would have been the result of the adoption of a strictly objective duty of care, skill and diligence. If a director possesses a higher degree of knowledge, skill and experience than a reasonable person then the degree of care, skill and diligence required by the director will be measured against the knowledge, skill and experience that the director in fact possess.[79] The subjective inquiry may increase the degree of care, skill and diligence required from a director in relation to the knowledge, skill and experience possessed by the director. Courts are required to make a value judgement in determining the degree of care, skill and diligence a reasonable person would exercise relative to the knowledge, skill and experience of the director.[80] The subjective inquiry applies concurrently with the objective expectation of the director to fulfil his duty of care, skill and diligence equivalent to what a reasonable person would if the knowledge, skill and experience of the director is equivalent to or higher than that of a reasonable person.

If it is established that the knowledge, skill and experience of a director is lower than that expected of a reasonable person, then the degree of care, skill and diligence required to be exercised will be measured against the objective reasonable persons criterion in s 76(3)*(c)* of the Act. The objective/subjective inquiry in the duty of care, skill and diligence in the Act

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[76] Du Plessis J ‘A comparative analysis of directors' duty of care, skill and diligence in South Africa and in Australia’ (2010) 1 *Acta Juridica* 270.
[77] S 76(3)*(c)(ii)* Companies Act.
[78] S 76(3)*(c)* Companies Act.
[79] Conradie L ‘More indulgent approach to the directors’ duties’ (2011) *Without Prejudice* 14.
[80] Cassim F *et al Contemporary Company Law* 2 ed (2012) 560.

applies to all directors provided their knowledge, skill and experience is equivalent or higher that that expected of a reasonable person occupying the position of director and carrying out the same functions in relation to the company.

The dual objective/subjective inquiry in the Act, along with its distinction from the common law duty of care and skill, is not entirely recognised by all academics. Some of the differing views are that directors only have to meet the degree of care, skill and diligence in the Act relevant to their knowledge, skill and experience, regardless of how low a degree might be expected of directors.[81] It has been contended that s 76(3)(*c*) of the Act is ambiguous because of the failure to explicitly provide for the subjective inquiry when it is established that a director possesses knowledge, skill or experience equivalent to or higher than that expected of a reasonable person.[82] Furthermore, academics also hold the view that the subjective inquiry destabilises the objective inquiry in s 76(3)*(c)* of the Act, which might result in courts adopting a purely subjective inquiry as in the common law.[83]

The author is of the view that the knowledge, skill and experience of a director, as well as the functions carried out by a director in the company, are factors utilised in determining what is reasonably expected of a person fulfilling the position of a director. Therefore the actual criterion against which the degree of care, skill and diligence required to be exercised by a director in the Act is measured against that of a reasonable person. The objective reasonable person's inquiry in the duty of care, skill and diligence in the Act marginally increased this duty when it is compared to the subjective duty of care and skill in the common law. The duty of care, skill and diligence in the Act is more stringent than the common law position of

[81] Cassidy J 'Models for reform: The directors' duty of care in a modern commercial world' (2009) 20 (3) *Stell L R* 393.
[82] Cassidy J 'Models for reform: The directors' duty of care in a modern commercial world' (2009) 20 *Stell L R* 398.
[83] Cassidy J 'Models for reform: The directors' duty of care in a modern commercial world' (2009) 20 *Stell L R* 398.

this duty even though the degree of care, skill and diligence expected of a reasonable person[84] may possibly be achieved by directors' without difficulty. The dual objective/subjective inquiry in s 76(3)*(c)* of the Act also provides for a flexible and balanced application of the duty of care, skill and diligence, however this could result in easy compliance with the duty.

3.3.3 The effect of the Business Judgement rule on the duty of care skill and diligence in the Companies Act 71 of 2008.

The BJR rule was developed in the USA to limit litigation relating to commercial decisions and the judicial review commercial decisions taken by directors.[85] The Companies Act introduces a statutory version of the BJR[86] to protect directors from personal liability where it is alleged that a director contravened the duty to act in the best interest of the company or the duty to exercise a degree of care, skill and diligence.[87] Due to the limited scope of this research, the analysis of the BJR is limited to its position in the Companies Act and the effect the BJR has on the duty of care, skill and diligence in the Act.

The BJR is a standard of review protecting directors from personal liability, and from courts reviewing decisions taken by directors which appear unreasonable based on information which became available after a decision was taken by a director.[88] In order for a director to be afforded protection by the BJR the decision made by the director must be an informed decision.[89] The director or a person related to the director must not have a material financial interest in the subject matter or such a material financial interest was disclosed in terms of s 75 of the Act,[90] and the director must have a rational basis for believing and in fact did

[84] S 76(3)*(c)* Companies Act.
[85] The American Law Institute *Principles of Corporate Governance and Structure: Analysis and Recommendations* (1994) 135.
[86] Even though it is not referred to as the BJR.
[87] S 76(4)*(a)* Companies Act.
[88] Cassim F *et al Contemporary Company Law* 2 ed (2012) 565.
[89] S 76(4)*(a)(i)* Companies Act.
[90] S 76(4)*(a)(ii)* Companies Act.

believe that his decision was in the best interest of the company.[91] Furthermore the BJR in the Act permits a director to rely on the performance, information, opinion, recommendations, reports or statements of one or more employees of the company, which the board reasonably believes to be reliable and competent.[92] Company employees include legal counsel, accountants or any professional persons retained by the company,[93] who the board of directors has delegated their authority to or duty to perform any of the boards' functions.[94] The result of the delegation is that the director is protected by the BJR, provided the requirements in s 76(4)*(a)* of the Act are met.

If the above mentioned requirements are met, the courts cannot substitute the director's judgement with that of its own, except in cases where a decision of a director involves fraud[95] or gross negligence. A director is also exempted from personal liability for the contravention of the duty to act in the best interest of the company and with care, skill and diligence where the requirements in s 76(4)*(a)* of the Act are met. This is primarily based on the proposition that courts do not have the business expertise to review commercial decisions of directors.[96] Courts are also not permitted to take over the functions of the directors and to consider what is best for the company from a commercial viewpoint.[97]

The rationality requirement s 76(4)*(a)(iii)* Companies Act is an objective criterion[98] and essential to the BJR. Section 76(4)*(a)(iii)* of the Act does not empower the court to decide if a director's decision was in the best interest of the company, but rather whether the decision of the director is rational.[99] Roger J in *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd and*

[91] S 76(4)*(a)(iii)* Companies Act.
[92] S 76(5)*(a)* Companies Act.
[93] S 76(5)*(a)* Companies Act.
[94] S 76(4)*(b)(i)(bb)* Companies Act.
[95] Good SK & Coetzee L *The Business Judgement Rule* (2006) Obiter 64.
[96] Cassim F *et al Contemporary Company Law* 2 ed (2012) 565.
[97] *Levin v Feld and Tweeds Ltd* 1951 (2) SA 401 (A) 402C-D.
[98] *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd and Others* 2014 (5) SA 179 (WCC) para 76.
[99] *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd and Others* 2014 (5) SA 179 (WCC) para 74.

Others[100] made reference to *Charterbridge Corporation Ltd v Lloyds Bank Ltd and Another*,[101] where a rationality test was applied by questioning whether a reasonable person might believe that the decision of the director was in the best interest of the company.[102] In order for a director to have a rational basis for his believe that a decision is in the best interest of the company, it should not be a belief that an unreasonable person would hold.[103]

The BJR provides for requirements to be met in order to presume that a director complied with his duty to act with care, skill and diligence when a director made a decision. The effect of the presumption created by the BJR is the mitigation of the objective inquiry in the duty of care, skill and diligence in the Act, which aims to introduce a more stringent duty of care, skill and diligence. Furthermore the BJR potentially confines the duty of care, skill and diligence in the Act to the requirements that have to be proven in s 76(4)*(a)* of the Act in order for a director to be protected by the BJR. It is argued that the adoption of the BJR in the Act cannot be consolidated with the purpose of the Act to *inter alia*, encourage transparency and high standard of corporate governance[104] when it has the effect of limiting the effectiveness and the application of a more stringent duty of care, skill and diligence in the Act.

[100] 2014 (5) SA 179 (WCC).
[101] [1969] 2 All ER 1185 (Ch).
[102] *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd and Others* 2014 (5) SA 179 (WCC) para 75.
[103] Cassim F *et al Contemporary Company Law* 2 ed (2012) 564.
[104] S 7*(b)(iii)* Companies Act.

3.4 THE FAILURE TO PREVENT FRUITLESS WASTEFUL AND IRREGULAR EXPENDITURE BY DIRECTORS OF STATE OWED COMPANIES: THE POTENTIAL CONTRAVENTION OF A DIRECTOR'S DUTY OF CARE, SKILL AND DILIGENCE.

SOCs fulfil an essential role in South Africa by providing basic services to all South Africans. These services include, but are not limited to, transport,[105] telecommunication[106] and energy.[107] SOCs are also expected to play a vital role in the expansion, progress and stability of the South African economy, government departments and the private sector requires the delivery of these essential services by SOC's in order to be operational.

The realisation and delivery of these basic essential services are dependent on the successful and optimal operation of South African SOCs. In addition to this, SOCs also owe responsibilities towards other stakeholders, which include the government as a shareholder and the country's citizens.[108]

3.4.1 The duty to prevent fruitless wasteful and irregular expenditure in the Public Finance Management Act, 1 of 1999.

A SOC is a subcategory of a public entity[109] therefore the provisions of the PFMA apply to SOCs. The PFMA aims to secure the transparency, accountability and the sound management of the revenue, expenditure, assets and liabilities of public entities.[110] In promoting and achieving these aims, the directors of SOCs have a duty to prevent fruitless, wasteful and

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[105] Transnet SOC Ltd; South African Airlines SOC Ltd; Airports Company South Africa SOC Ltd; Air Traffic and Navigation Services SOC Ltd and Passenger Rail Agency of South Africa SOC Ltd.

[106] South African Broadcasting Corporation SOC Ltd; South African Post Office SOC Ltd; Telkom SA SOC Ltd and Sentech SOC Ltd.

[107] Eskom Holdings SOC Ltd; Central Energy Fund SOC Ltd and South African Nuclear Energy Corporation SOC Ltd.

[108] PWC & Institute of Directors of Southern Africa *State-owned enterprises: Governance responsibility and accountability Public Sector Working Group: Position Paper 3* (2015) 2 available at *https://www.pwc.com/gx/en/psrc/publications/assets/pwc-state-owned-enterprise-psrc.pdf 42*.

[109] S 3 Public Finance Management Act.

[110] S 2 Public Finance Management Act.

irregular expenditure.[111] The PFMA defines fruitless and wasteful expenditure as expenditure made in vain and which would have been avoided had reasonable care been exercised.[112] Fruitless and wasteful expenditure emanates from the conduct or omission by a director or agent of the SOC resulting in financial loss to the SOC.[113] 'In vain' refers to a transaction or condition that has been undertaken without value or substance and does not end in a desirable outcome.[114] 'Reasonable care' refers to the exercise of due diligence in ensuring that the probability of a transaction, event or condition not being achieved as planned is managed to an acceptable level by directors.[115] Fruitless and wasteful expenditure take place when a director of a SOC fails to exercise reasonable care by assessing the subject matter of a transaction and the consequence of such a failure is an undesirable outcome for which a transaction was not intended.

'Irregular expenditure' is defined as expenditure in contravention of the PFMA, and the requirements in the State Tender Board Act[116] and its regulations, or any provincial legislation providing for procurement procedures.[117] Therefore irregular expenditure is a consequence of the failure of a SOC to comply with legislative or regulatory procedures applicable to a specific transaction. This requires an omission or oversight of a process prescribed, either in terms of legislation or regulations, by an agent of a SOC with regard to the expenditure of the SOC. In addition to directors of a SOCs duty to prevent fruitless, wasteful and irregular expenditure, they also have the duty to exercise utmost care to ensure

[111] S 51*(b)(ii)* Public Finance Management Act.
[112] S 1 Public Finance Management Act.
[113] Office of the Accountant-General *Guideline on Fruitless and Wasteful Expenditure* (2014) at 3-4 available at *http://www.treasury.gov.za/legislation/pfma/guidelines/Guideline%20on%20Fruitless%20and%20Wasteful%20Expenditure%2027%20May%202014.pdf* (accessed on 15 February 2019).
[114] Office of the Accountant-General *General Guideline on Fruitless and Wasteful Expenditure* (2014) 1 available at *http://www.treasury.gov.za/legislation/pfma/guidelines/Guideline%20on%20Fruitless%20and%20Wasteful%20Expenditure%2027%20May%202014.pdf* (accessed on 15 February 2019).
[115] Office of the Accountant-General *Guideline on Fruitless and Wasteful Expenditure* (2014) at 1 available at *http://www.treasury.gov.za/legislation/pfma/guidelines/Guideline%20on%20Fruitless%20and%20Wasteful%20Expenditure%2027%20May%202014.pdf* (accessed on 15 February 2019).
[116] 86 of 1968.
[117] S 1 Public Finance Management Act.

the reasonable protection of the assets and records of the SOC.[118] One way in which the assets of a SOC can by protected by directors' is if they successfully prevent fruitless, wasteful and irregular expenditure.

Directors of SOCs are required to take effective steps to prevent fruitless, wasteful and irregular expenditure;[119] this includes appropriate disciplinary steps against employees who make or permit fruitless, wasteful or irregular expenditure.[120] The annual financial statements of SOCs should also indicate the losses[121] as well as criminal and disciplinary steps taken as a consequence of fruitless, wasteful and irregular expenditure.[122]

Reasonable care must be exercised by directors of SOCs in the course of implementing effective, efficient and transparent processes of financial risk management.[123] The ability of SOCs to operate effectively and to provide essential services may be adversely affected and impeded as a consequence of the failure by directors of SOCs to prevent fruitless, wasteful and irregular expenditure.

In order to demonstrate the prevalence and extent of fruitless, wasteful and irregular expenditure in South African SOCs, the Consolidated General Report on National and Provincial Outcomes[124] (General Report) by the Auditor General of South Africa (AGSA) is analysed.

The office of AGSA is an institution established chapter 9 of the Constitution.[125] AGSA is mandated to audit and report on the accounts, financial statements and financial management of national and provincial state departments, including municipalities and any other

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[118] S 50*(a)* Public Finance Management Act.
[119] S 51(1)*(b)(ii)* Public Finance Management Act.
[120] S 51(1)*(e)(iii)* Public Finance Management Act.
[121] S 55(2)*(b)(i)* Public Finance Management Act.
[122] S 55(2)*(b)(ii)* Public Finance Management Act.
[123] Reg 9.1.1 Treasury Regulations 2005 Gazette No. 27388 dated 15 March 2005.
[124] [124] AGSA *Consolidated General Report on National and Provincial Outcomes 2017-2018* available at https://www.agsa.co.za/Reporting/PFMAReports/PFMA2017-2018.aspx (accessed on 13 February 2019).
[125] Chapter 9, S 188 of the Constitution of the Republic of South Africa, 1996.

institution required by legislation to be audited by the AG.[126] A number of SOCs are audited by private firms and not by AGSA; this follows a decision taken by the board of directors of the respective SOC. However, AGSA has a close relationship with private firms tasked with auditing other SOCs, including providing directives, guidance and technical support to these firms.[127]

During the 2017-2018 financial year, 80 per cent of SOCs failed to comply with legislation relating to procurement and expenditure procedures; this often contributes to irregular expenditure.[128] The overall 2017-2018 audit outcomes of SOCs, including SOCs that are not audited by AGSA, declined since the 2015-2016 financial year. According to AGSA the South African Broadcasting Corporation (SABC) is commercially insolvent;[129] Transnet and ESKOM have been identified as being significant risks by failing to confirm that all their irregular expenditure has been disclosed.[130] Furthermore, AGSA identifies lack of accountability, transparency and good governance, including the failure to implement recommendations by AGSA, as the root causes of the current financial position of South African SOCs which reveal high amounts of money lost due to fruitless, wasteful and irregular expenditure.[131] Irregular expenditure by SOCs amounted to R1.86 billion for the 2017-2018 financial year. The AG highlighted the possibility of this amount increasing if the

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[126] S 188(1) Constitution of the Republic of South Africa, 1996.
[127] [127] AGSA *Consolidated General Report on National and Provincial Outcomes 2017-2018* at 112 available at *https://www.agsa.co.za/Reporting/PFMAReports/PFMA2017-2018.aspx* (accessed on 5 February 2019).
[128] AGSA *Consolidated General Report on National and Provincial Outcomes 2017-2018* at 106 available at *https://www.agsa.co.za/Reporting/PFMAReports/PFMA2017-2018.aspx* (accessed on 5 February 2019).
[129] AGSA *Consolidated General Report on National and Provincial Outcomes 2017-2018* at 110 available at *https://www.agsa.co.za/Reporting/PFMAReports/PFMA2017-2018.aspx* (accessed on 5 February 2019).
[130] AGSA *Consolidated General Report on National and Provincial Outcomes 2017-2018* at 115 available at *https://www.agsa.co.za/Reporting/PFMAReports/PFMA2017-2018.aspx* (accessed on 5 February 2019).
[131] AGSA *Consolidated General Report on National and Provincial Outcomes 2017-2018* at 115 available at *https://www.agsa.co.za/Reporting/PFMAReports/PFMA2017-2018.aspx* (accessed on 5 February 2019).

irregular expenditure of the Denel Group, South African Airways and South African Express is included in the AGSA report.[132]

The PFMA refers to the exercise of reasonable care in the definition of fruitless wasteful and irregular expenditure.[133] It fails to identify guidelines in determining when reasonable care has been exercised by a director of a SOC, or factors that should be considered in determining whether reasonable care has been exercised. Furthermore, the AGSA in its 2014 Guidelines on Fruitless and Wasteful Expenditure (which aims to provide clarity on the interpretation of matters related to fruitless and wasteful expenditure in s 1 of the PFMA)[134] states that reasonable care means applying due diligence (careful application, attentiveness and caution).[135]

The PFMA and the 2014 guidelines by the AGSA do not expressly propose that the expertise and knowledge of persons should be taken into account when determining whether reasonable care was exercised. This omission by the PFMA and 2014 Guidelines on Fruitless and Wasteful Expenditure indicates an objective test applicable to the reasonable care required to be exercised in the PFMA due to the legislature failing to explicitly include any subjective elements that should be taken into account. Consequently the reasonable care required to be exercised is comparable to the care a cautious and ordinary person in the same or similar circumstances of a director of a SOC would have exercised.

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[132] AGSA *Consolidated General Report on National and Provincial Outcomes 2017-2018* at 113 available at https://www.agsa.co.za/Reporting/PFMAReports/PFMA2017-2018.aspx (accessed on 5 February 2019).
[133] S 1 Public Finance Management Act.
[134] Office of the Accountant-General *Guideline on Fruitless and Wasteful Expenditure* (2014) 1 available at *http://www.treasury.gov.za/legislation/pfma/guidelines/Guideline%20on%20Fruitless%20and%20Wasteful%20Expenditure%2027%20May%202014.pdf* (accessed on 15 February 2019).
[135] Office of the Accountant-General *Guideline on Fruitless and Wasteful Expenditure* (2014) 1 available at *http://www.treasury.gov.za/legislation/pfma/guidelines/Guideline%20on%20Fruitless%20and%20Wasteful%20Expenditure%2027%20May%202014.pdf* (accessed on 15 February 2019).

3.4.2 The breach of a director's duty of care, skill and diligence as a consequence of the failure to prevent fruitless, wasteful and irregular expenditure in terms of the Public Finance Management Act 1 of 1999.

Directors of a SOC have a duty to act with a degree of care, skill and diligence that may be reasonably expected of a person carrying out the functions of that director.[136] In determining the degree of care, skill and diligence expected of a reasonable person in the position of the director the general knowledge, skill and experience of the director is taken into account.[137] This results in a director having a dual objective/subjective duty of care, skill and diligence in the Act.[138] In addition to the duty of care, skill and diligence in the Companies Act, it has been established that a director of a SOC also have a duty to exercise reasonable care and due diligence in preventing fruitless and wasteful expenditure,[139] including the duty of utmost care in protecting the assets of the SOC.[140] Therefore the Companies Act and the PFMA requires directors of SOCs to fulfil their functions at least equivalent to that which is expected of a reasonable person in his position[141] and to exercise reasonable care.[142]

The PFMA does not directly state that directors of SOCs have to exercise reasonable care in preventing fruitless and wasteful expenditure. Instead, fruitless and wasteful expenditure is defined as expenditure which is a result of the failure to exercise reasonable care.[143] In addition, directors are required to take appropriate and effective steps to prevent fruitless and wasteful expenditure.[144] In other words, directors' of SOCs are required take appropriate and

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136 S 76(3)*(i)* Companies Act

138 See discussion in 3.3.2
139 S 1 & 51(1)*(b)(ii)* Public Finance Management Act.; Office of the Accountant-General *Guideline on Fruitless and Wasteful Expenditure* (2014) 1 available at *http://www.treasury.gov.za/legislation/pfma/guidelines/Guideline%20on%20Fruitless%20and%20Wasteful%20Expenditure%2027%20May%202014.pdf* (accessed on 15 February 2019).
140 S 50*(a)* Public Finance Management Act.
141 S 76(3)*(c)* Companies Act.
142 S 1 & 51(1)*(b)(ii)* Public Finance Management Act.
143 S 1 Public Finance Management Act.
144 S 51(1)*(b)(ii)* Public Finance Management Act.

effective steps to exercise reasonable care, the failure of which resulting in fruitless and wasteful expenditure.

The failure by directors of SOCs to take appropriate and effective steps to exercise reasonable care to prevent fruitless and wasteful expenditure in the PFMA may result in directors contravening their duty of care, skill and diligence in the Companies Act. The potential contravention of the duty of care, skill and diligence in the Companies Act is dependent on whether a director of a SOC exercised a degree of care that a reasonable person would in his position by considering his knowledge, skill and experience. This includes whether the director met the requirements of the statutory version of the BJR[145] in order to have complied with his duty of care, skill and diligence.

The subjective inquiry in the duty of care, skill and diligence in the Companies Act takes into account the knowledge, skill and experience of the director.[146] It elevates the duty of a director to exercise a degree of care expected of a reasonable person with the knowledge, skill and experience that the director possess. The potential contravention of the duty of care, skill and diligence as a result of a director of a SOC failing to exercise reasonable care in preventing fruitless and wasteful expenditure is more likely when the director of the SOC possesses knowledge, skill and experience superior to that of a reasonable person in his position. This is attributed to the elevated duty of care, skill and diligence resulting from the knowledge, skill and experience possessed by the director of the SOC.

If it is established that a director does not possess knowledge, skill or experience higher than a reasonable person, he has a duty to exercise a degree of care, skill and diligence equivalent to that of a reasonable person with his knowledge, skill and experience. The contravention of the duty of care, skill and diligence as a result of a director of a SOC failing to prevent

[145] S 76(4) Companies Act.
[146] S 76(3)*(c)(ii)* Companies Act

fruitless and wasteful expenditure is also probable even where a director of a SOC is only required to exercise a degree of care, skill and diligence that a reasonable person would in his position. There is a similarity between the two standards, namely the duty to exercise 'reasonable care' in the PFMA[147] and the duty to exercise 'a degree of care, skill and diligence required from a reasonable person' in the Companies Act.[148] Both standards consist of objective elements, requiring directors of SOCs to exercise care cautiously to the extent that an ordinary person would in the same or similar circumstances. Therefore the contravention of the duty to exercise reasonable care to prevent fruitless and wasteful expenditure as a result of the failure to exercise caution to the extent that an ordinary person would simultaneously result in a director of a SOC contravening his duty to act with a degree of care, skill and diligence expected of a reasonable person.

In order for a director of a SOC to be protected by the statutory version of the BJR, the director is required to have taken reasonable diligent steps to be informed about the matter, have no financial interest in the matter and have a rational basis for believing he acted in the best interest of the SOC.[149] A director will not be protected by the BJR for the contravention of the duty of care, skill and diligence as a consequence of the failure to prevent fruitless and wasteful expenditure. This is due to the overlap between the requirement that a director should take reasonable diligent steps in order for the BJR to find application[150] and a director's duty in the PFMA to exercise reasonable care to prevent fruitless and wasteful expenditure.[151] It cannot be said that a director failed to exercise reasonable care to prevent fruitless and wasteful expenditure requiring the exercise of due diligence but at the same time

[147] S 1 Public Finance Management Act.
[148] S 76(3) Companies Act.
[149] See discussion in 3.3.3
[150] S 76(4)*(a)(i)* Companies Act.
[151] Office of the Accountant-General *General Guideline on Fruitless and Wasteful Expenditure* (2014) 1 available at *http://www.treasury.gov.za/legislation/pfma/guidelines/Guideline%20on%20Fruitless%20and%20Wasteful%20Expenditure%2027%20May%202014.pdf* (accessed on 15 February 2019).

took reasonable diligent steps in terms of s 76(4)*(a)(i)* of the Companies Act for purposes of complying the requirements of the statutory version of the BJR.

A director of a SOC is also required to take appropriate and effective steps in preventing irregular expenditure, which is expenditure by a SOC that contravenes the PFMA and other legislation providing for procurement procedures.[152] This duty entails that directors of SOCs should mitigate potential non-compliance with legislation and regulations which are relevant and applicable to procurement procedures by SOCs. This is akin to the expectation of natural and juristic persons to ensure that they are compliant with the law, which is also expected of a reasonable person when conducting the affairs of those natural and juristic persons. Therefore the duty of care, skill and diligence in the Companies Act may be contravened by a director of a SOC where he fails to take appropriate and effective steps to prevent the contravention of the PFMA or other legislation providing procurement procedures.[153]

This is more likely where a director of a SOC has the knowledge, skill or experience which points to the conclusion that a reasonable person with the particular knowledge, skill and experience that the director of the SOC possesses should be aware and informed of the fact that the law which was contravened. This position puts forward that directors are required to exercise care, skill and diligence in the strategic management and governance of the SOC as well as requiring directors of SOCs to ensure the operations and conduct of SOC's comply with the law.

[152] S 1 Public Finance Management Act.

3.5 CONCLUSION

The Companies Act requires directors of SOCs to act in good faith, for a proper purpose, in the best interest of the company and with the degree of care, skill and diligence expected of a reasonable person. The degree of care, skill and diligence expected of a reasonable person is akin to a reasonable person fulfilling the same position in the company as that fulfilled by the director and with his knowledge, skill and experience. This confirms an objective/subjective duty of care, skill and diligence in the Companies Act which is in contrast with the subjective duty of care in terms of the common law. The effect of this contrast is a marginally more stringent duty of care, skill and diligence in the Companies Act due to the inclusion of an objective reasonable person inquiry. The subjective inquiry takes into consideration the knowledge, skill and experience of the director which is used to determine the degree of care, skill and diligence expected of a director where it is greater than that of a reasonable person in the position of the director. The subjective inquiry can only increase the degree of care, skill and diligence required to be exercised by a director. As a result directors cannot justify their contravention of the duty of care, skill and diligence based on the lack of knowledge, skill and experience being less than that of a reasonable person in the position of the director of the SOC.

In relation to the duty of care, skill and diligence in the Companies Act, the BJR establishes a presumption that a director of a SOC discharged his duty of care, skill and diligence. This is dependent on a director of a SOC taking reasonable diligent steps to become informed about the matter,[154] having no financial interest in the matter[155] and having a rational basis for believing he acted in the best interest of the SOC.[156] The BJR restricts an already undemanding duty of care, skill and diligence in the Companies Act to the requirements of

[154] S 76(4)*(a)(i)* Companies Act.
[155] S 76(4)*(a)(ii)* Companies Act.
[156] S 76(4)*(a)(iii)* Companies Act.

the BJR. This mitigates efforts made by the Act for a more stringent duty of care, skill and diligence and to encourage high standard of corporate governance.[157]

The PFMA requires directors of SOCs to take effective and appropriate steps to prevent fruitless, wasteful and irregular expenditure which is defined as expenditure made in vain and which would have been avoided had reasonable care been exercised.[158] Reasonable care refers to the exercise of due diligence. A director's duty of care, skill and diligence and the duty to prevent fruitless and wasteful expenditure require directors of SOCs to exercise due diligence and a degree of care expected from a reasonable person.

Where a director fails to exercise reasonable care and due diligence in taking effective and appropriate steps to prevent fruitless and wasteful expenditure he simultaneously contravene the duty of care, skill and diligence in the Companies Act. Furthermore the requirements of the BJR will not be complied with in order for it to be concluded that directors fulfilled their duty of care, skill and diligence in the Companies Act. The failure to exercise reasonable care cannot result in a director taking reasonable diligent steps in order for a director to be protected by the BJR. The rationality requirement in the BJR will also not be met; rationality refers to whether a reasonable person would view the conduct of the director to be in the best interest of the company.[159] Unreasonable conduct by a director of a SOC for failing to exercise reasonable care to prevent fruitless and wasteful, expenditure cannot be viewed by a reasonable person to be in the interest of the SOC.

The duty to prevent irregular expenditure requires a SOC to comply with the PFMA and other legislation. Directors of SOCs have a duty to take appropriate and effective steps to prevent irregular expenditure which requires them to prevent non-compliance with the PFMA

[157] S 7*(a)(b)(iii)* Companies Act.
[158] S 1 Public Finance Management Act.
[159] Cassim F *et al Contemporary Company Law* 2 ed (2012) 564.

and other legislation providing for procurement procedures. The failure to comply with the PFMA and other legislation may result in the contravention of the duty of care, skill and diligence by a director of a SOC.

The analysis provided in this chapter is foundational to the legislative mechanisms to hold directors of SOCs personally liable for the contravention of the duty of care, skill and diligence resulting from the failure of directors of SOCs to prevent fruitless and wasteful expenditure.

The subsequent chapter examines the legislative mechanisms brought in terms of the Companies Act to hold directors of SOCs personally liable for the contravention of their duty of care, skill and diligence. These legislative mechanisms are at the centre of the objective of this thesis which aims to, amongst other things, identify and expound on legal mechanisms in the Act to hold directors of SOCs personally liable for fruitless, wasteful and irregular expenditure.

CHAPTER: 4 THE LIABILIY OF DIRECTORS OF STATE OWNED COMPANIES: AN ANALYSIS OF SECTION 83 OF THE PUBLIC FINANCE MANAGEMENT ACT 1 OF 1999 AND SECTION 77 (2) (b) AND 218 (2) OF THE COMPANIS ACT 71 OF 2008.

4.1 INTRODUCTION

Companies are juristic persons requiring agents to act on its behalf. Generally these agents will be the directors of the company who have the authority to represent the company.[1] Representation from a legal perspective means the power to enter into contracts or performing functions on behalf of the company. As long as the directors have acted within their scope authority, they will bind the company and not incur liability towards the company or any third party with whom they contracted.

Prior to the commencement of the Companies Act a directors' authority to act on behalf of the company was a delegated authority which stemmed from the company's articles of association. The Companies Act authorises the board to manage the business and affairs of the company, as a consequence the directors are no longer dependant on delegated powers from the shareholders. The authority is a statutory one, arising *ex lege* and is subject only to the provisions of the Act and the company's MOI.[2]

The position in South African company law regarding the personal liability of directors since the commencement of the Companies Act has changed. What used to be liability under common law principles has now become a statutory liability. Section 77 of the Companies Act sets out this liability which includes a director's liability for a breach of the duty of care,

[1] S 66 Companies Act.
[2] S 66 Companies Act.

skill and diligence,[3] this is the focus of this chapter. The grounds in the Companies Act which may result in a director being held personally liable is aimed at promoting accountability, transparency, higher standards of corporate governance, as well as the efficient and responsible management of companies. Additionally these grounds may also operate as equilibrium to mitigate and create a balance between the extensive legislative authority and powers bestowed on directors to manage the company in terms of s 66 of the Companies Act and compliance by directors with their duties and the provisions of the Act.

Section 83[4] provides that:

> *(1) The accounting authority for a public entity commits an act of financial misconduct if that accounting authority wilfully or negligently:*
> *(a) fails to comply with a requirement of section 50, 51, 52, 53, 54 or 55; or*
> *(b) makes or permits an irregular expenditure or a fruitless and wasteful expenditure*
> *(2) If the accounting authority is a board or other body consisting of members, every member is individually and severally liable for any financial misconduct of the accounting authority.*
> *(3) An official of a public entity to whom a power or duty is assigned in terms of section 56 commits an act of financial misconduct if that official wilfully or negligently fails to exercise that power or perform that duty.*
> *(4) Financial misconduct is a ground for dismissal or suspension of, or other sanction against, a member or person referred to in subsection (2) or (3) despite any other legislation.*

Section 77(2)*(b)*[5] provides that:

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

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[3] S 77(2)*(b)(i)* Companies Act.
[4] Public Finance Management Act.
[5] Companies Act.

Section 218 reads:[6]

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

The objective of this chapter is to analyse s 83 of the PFMA, s 77(2)*(b)* and s 218(2) of the Companies Act by examining the requirements that have to be met for the successful application of these sections. Although the primary focus of this chapter is to examine a director's liability for breaching his duty of care, skill and diligence in terms of s 77(2)*(b)(i)* and s 218(2), the personal liability of a director due to a breach of a provision in the Companies Act or a clause of the companies MOI will also be addressed. The nature of an application in terms of s 77(2)*(b)(i)* of the Companies Act as well as any limitations, difficulties and uncertainties which could arise in the application of this section.

The potential effect of s 218(2) of the Act in relation to the liability of directors for the breach of their duty to act with care, skill and diligence will also be examined by identifying the scope, limitations and uncertainties which could arise in the application of this section. The ultimate aim of this chapter in analysing s 77(2)*(b)* and s 218 of the Act is to identify the relation between these two sections as well as to determine whether s 218(2) can be utilised to hold a director liable for breaching his duty of care, skill and diligence.

4.1 AN EXAMINATION OF SECTION 83 OF THE PUBLIC FINANCE MANAGEMENT ACT 1 OF 1999

Section 83 of the PFMA provide that directors of SOC's may be held personally liable for financial for failing to prevent irregular expenditure, fruitless and wasteful expenditure and expenses expenditure not complying with the operational policies of the public entity

[6] Companies Act.

provided in section 51(1)*(b)(iii)* of the PFMA, or their failure to prevent fruitless wasteful and irregular expenditure.

Directors of SOCs may also be held personally liable for any conduct which results in the intentional or negligent commission or authorisation of fruitless and wasteful or an irregular expenditure. This includes persons to whom powers and duties have been assigned or delegated to by directors of SOCs.[7] The liability provided for in section 83 of the PFMA should be interpreted to avoid any inconsistency between this section and any provision in the Companies Act, however where an inconsistent interpretation is unavoidable then the provisions of the PFMA prevail.[8]
Proceedings which aim to hold a director of a SOC liable in terms of section 83 of the PFMA should include an investigation, heard either in terms of legislation, conditions of appointment or employment applicable to the director of the SOC including any regulations prescribed by the Minister in terms of section 85 of the PFMA. If it is alleged that a director of a SOC committed financial misconduct, then treasury should ensure that the relevant executive authority investigates the matter, if the allegations are confirmed a disciplinary hearing should be held in terms of any applicable agreements.[9]

The investigation may be conducted by an official that is not employed by the SOC at the direction of treasury[10] who may further issue reasonable requirements relating to the performance of the investigation.[11]

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[7] See section 56 of the PFMA.
[8] Section 5(4)*(b)(i)(ee)* of the PFMA
[9] Reg 4.1.3 Treasury Regulations issued in terms of Section 76 of the PFMA
[10] Reg 4.1.4*(a)* Treasury Regulations issued in terms of Section 76 of the PFMA
[11] Reg 4.1.4*(b)* Treasury Regulations issued in terms of Section 76 of the PFMA

4.2 AN EXAMINATION OF SECTION 77(2)*(b)* OF THE COMPANIES ACT 71 OF 2008.

The application of s 77(2)*(b)* of the Companies Act is limited to circumstances where a director is found to have breached the duty of care, skill and diligence in the Act.[12] In order for liability to ensue in terms of s 77(2)*(b)(i)* as a result of a director breaching s 76(3)*(c)* of the Companies Act, a director should have contravened his duty of care, skill and diligence. The determination as to whether the director breached this duty will encompass the objective and subjective inquiry contained in s 76(3)*(c)* as well as the requirements provided for in s 76(4) and (5).[13] A distinction is made between whether the director has in fact breached his duty of care, skill and diligence in terms of s 76(3)*(c)* of the Companies Act and whether a director can be liable for the breach of this duty in terms of s 77(2)*(b)(i)*. This distinction recognises the constraints on s 77(2)*(b)* of the Companies Act as a result of the formulation and nature of the duty of care, skill and diligence.[14]

4.2.1 The scope and limitations of a director's personal liability in terms of s 77(2)*(b)(i)* of the Companies Act 71 of 2008.

Section 77(2)*(b)(i)* of the Companies Act refers to loss, damages or costs sustained by the company due to a director breaching his duty of care, skill and diligence. This means that any claim in terms of s 77(2)*(b)(i)* is limited to loss, damage or cost sustained by the company alone, excluding loss or damage sustained by any internal or external stakeholders of the company. Section 77(2)*(b)(i)* endorses the position that directors only owe the duty of care, skill and diligence to the company. However, certain stakeholders are not precluded from

[12] The examination of s 77 (2) *(b)* of the Act in this chapter is mainly based on the supposition that the director has in fact breached his duty of care, skill and diligence because the determinations as to whether the duty of care, skill diligence was breached by the director was dealt with in 3.3 of this thesis and do not form part of the substance of this chapter.
[13] See 3.3
[14] This is coupled with the countering effect of the statutory business judgement rule BJR (even though it is not named as such) in s 76 (4) and (5) of the Act which results in an undemanding duty of care, skill and diligence that might limit the applicability and effectiveness of s 77 (2) (b).

utilising a derivative action provided for in s 165 of the Companies Act which enables them to either request the company to institute a claim in terms of s 77(2)*(b)* or to institute such a claim in the name of and on behalf of the company.

A derivative action in terms of the Companies Act replaces any rights afforded to persons in terms of the common law to bring any legal proceedings on behalf of the company.[15] It permits shareholders, directors, prescribed officers and representatives of the company's employees to serve a demand on the company to institute or continue legal proceedings or take any steps to protect the rights afforded to the aforementioned parties.[16]

A demand in terms of s 165 may be for the company to institute legal proceedings in terms of s 77(2)*(b)* of the Companies Act in order to hold a director liable for the breach of his duty of care, skill and diligence. The company may respond to such a request within 15 days after it was served with the demand by approaching the court to set it aside on the grounds that the demand is frivolous or vexatious.[17] The company may also initiate or continue legal proceedings as well as take any steps contemplated in the demand.[18] If a company refuses to fulfil a demand for a derivative action then the company is required to serve a notice on the person who brought the demand stipulating the refusal.[19]

The court may also grant leave to a party who made a demand for a derivative action to institute or continue legal proceedings in the name of or on behalf of the company. Only in exceptional circumstances may the aforementioned parties who are entitled to serve a demand on the company approach the court to institute or continue legal proceedings in the name of and on behalf of the company without serving such a demand.[20] It is important to note that

[15] S 165(1) Companies Act.
[16] S 165(2) Companies Act.
[17] S 165(3) Companies Act
[18] S 165(4)*(b)(i)* Companies Act.
[19] S 165(4)*(b)(ii)* Companies Act
[20] S 165(5) Companies Act.

even though an action is brought derivatively to institute a claim in terms of s 77(2)*(b)(i)* of the Act, the loss, damages or costs must still have been sustained by the company and not by the persons who is acting in the name of and on behalf of the company.

The common law principles relating to the law of delict is recognised as the basis upon which a director can be held liable for the breach of the duty of care, skill and diligence in terms of s 77(2)*(b)(i)* of the Companies Act. In order for a director to breach a duty of care, skill and diligence it must first be determined what the duty is as well as the test to be applied in determining whether this duty has been breached.[21] Therefore, in addition to proving that a director in fact breached his duty of care, skill and diligence the company or a person instituting a derivative action to hold a director in terms of s 77(2)*(b)(i)* must also prove the necessary requirements for delictual liability.

The following elements have to be proven in order to hold a director liable in terms of s 77 (2)*(b)(i)* of the Act:

- Harm or loss[22]
- Conduct[23]
- Causation[24]
- Fault[25]
- Wrongfulness[26]

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[21] See 3.3.2
[22] Loubser M et al *The Law of Delict in South Africa* 2 ed (2012) 45; Neethling, Potgieter & Visser *Law of Delict* 6 ed (2010) 212.
[23] Loubser M et al *The Law of Delict in South Africa* 2 ed (2012) 63; *Jooste v Minister of Police* 1975 (1) SA 349 (E).
[24] *Minister of Finance and others v Gore NO* 2001 (1) SA 111 (SCA0 para 32; *International Shipping Company Co (Pty) v Bentley* 1990 (1) SA 680 (A) 65-66; *Minister of Safety and Security v Van Duivenboden* 2002 (6) SA 431 (SCA) para 25.
[25] Loubser M et al *The Law of Delict in South Africa* 2 ed (2012) 103; *Weber v Santam Versekeringsmaatskappy Bpk* 1983 (1) SA 381 (A) para 403, 410-411; *Minister of Justice v Hofmeyr* 1993 (3) SA 131 (A).
[26] *Le Roux v Dey* 2011 SA 274 (CC) para 22; Loubser M et al *The Law of Delict in South Africa* 2 ed (2012) 140-141.

4.2.2 Potential hurdles and uncertainties in the application of s 77(2)*(b)* of the Companies Act 71 of 2008.

Section 77(2)*(b)* of the Companies Act restricts the basis upon which a director can be held liable for a breach of the duty of care, skill and diligence, a provision of the Act and the company's MOI to delictual claims. The restriction to delictual claims has the potential to create uncertainties and difficulties in the application of s 77(2)*(b)* by specifically providing for the application of the law of delict where a provision in the MOI was breached. A company's MOI serves as a contract which applies by operation of law. It binds the company and each shareholder,[27] the shareholders amongst themselves[28] as well as the company and each director.[29] In other words s 77(2)*(b)* contains an irregularity whereby the law of delict finds application if a contractual clause (in the MOI) is breached. In order to correct this irregularity it is argued that s 77(2)*(b)(iii)* of the Companies Act should be amended in order for it not to make reference to the law of delict as the remedy to hold a director liable for breaching a provision of the companies MOI. Section 77(2)*(b)* of the Companies Act may blur the distinction between the duty of care, skill and diligence and the common law delictual principles by specifically providing for the application of the law of delict where the duty of care, skill and diligence has been breached.

The English law of tort[30] regulates the liability of civil wrongs and recognises the duty of care as a requirement to prove negligence by a defendant. Where a duty of care is not established in English law of tort, liability cannot ensue even though the defendant was at fault and caused loss to the plaintiff. The duty of care in English law of tort refers to taking reasonable steps to avoid conduct or omissions which could have reasonably been foreseen to possibly

[27] S 15(6)*(a)* Companies Act.
[28] S 15(6) Companies Act.
[29] S 15(6)*(c)(i)* Companies Act.
[30] Which is the equivalent to the law of delict in South Africa

injure your neighbour.[31] A neighbour refers to an individual who is directly and closely connected to, and affected by the conduct or omission which should have been reasonably avoided.[32] Therefore in order for a duty of care to be established in terms of English law of tort, it has to be foreseeable that the conduct of the defendant will result in loss to the plaintiff. There should also be proximity between the defendant and the plaintiff; further, it must be fair, just and reasonable to impose a duty of care on the defendant.[33]

South African law of delict does not explicitly provide for a delictual remedy or any specific requirements for liability to ensue where a duty of care is established. However, South African law of delict require negligence to be proven; the test for negligence requires a consistent level of care on the part of all legal subjects.[34] It is therefore argued that this may be the equivalent to the duty of care in English tort law. Furthermore the duty of care in English law of tort is similar to the test for negligence which comprises of a foreseeability and preventability test in determining whether a person was negligent. This test may be equally applied to directors who are found to have breached their duty of care, skill and diligence.

One of the developments of the Companies Act is the new duty of care, skill and diligence which has been introduced by s 76(3)*(c)* of the Act comprising of an objective/subjective test previously not recognised by the common law.[35] This results in a difference between the duty of care, skill and diligence in the common law and in the Companies Act.[36] The duty of care, skill and diligence in terms of the common law is a purely subjective duty; this is apparent in

[31] *Donoghue v Stevenson* [1932] AC 562.
[32] *Donoghue v Stevenson* [1932] AC 580.
[33] *Caparo v Dickman* [1990] 2 AC 605.
[34] Loubser M et al *The Law of Delict in South Africa* 2 ed (2012) 117.
[35] See 3.3.2
[36] See 3.3.1 & 3.3.2

both English and South African case law.[37] The anomaly with Roman Dutch law principles, specifically the law of delict, used to hold a director liable for a breach of the duty of care, skill and diligence founded in English law would not find application in relation to the duty of care, skill and diligence in the Companies Act. The elimination of the aforementioned anomaly with the introduction of a objective/subjective duty of care, skill and diligence in s 76(3)*(c)* and s 77(2)*(b)(i)* of the Companies Act that recognise the application of the law of delict as the basis for liability where this duty has been breached, can be considered a development of South Africa company law.

4.3 AN EXAMINATION OF SECTION 218 (2) OF THE COMPANIES ACT 71 OF 2008.

The extensive wording of s 218(2) of the Act indicates that any person (including directors) may be liable to any other person for loss or damage suffered due to the contravention of a provision in the Companies Act. This provision *prima facie,* extends the liability of directors to creditors and other external stakeholders of the company by providing a general remedy to any person for loss or damaged suffered as a consequence of contravening the Companies Act.[38] This section applies in addition to any right or remedy a person may have in terms of the common law or statue to hold any person (including directors) liable for loss or damage suffered due the contravention of the Act.[39]

Section 218(2) of the Act does not provide a common law remedy as a basis for liability resulting from a contravention of the Act. Instead on the face of it, any person can institute a claim in terms of s 218(2) of the Act provided that such a person has a direct interest in the

[37] *Re Brazilian Rubber Plantation & Estates Ltd* [1911] Ch 425 (CA); *Re City Equitable Fire Insurance CO Ltd* [1925] Ch 407; *Fisheries Development Corporation* 1980 4 SA 156 (W) 1980 (4) SA 156 (W).
[38] *Chemfit Fine Chemicals (Pty) Ltd v Maake* 2017 JDR 1473 (LP) para 30.
[39] S 218(3) Companies Act.

legal claim and the person must have suffered loss or damages due to a contravention of the Act.

An extensive interpretation of s 218(2) would alter the common law position that directors owe their fiduciary duties[40] and the duty of care, skill and diligence to the company.[41] It will also be in conflict with s 77(2)*(b)(i)* of the Act which only provides the company with the ability to hold a director liable for this duty. The section provides that where a director breached his duties in terms of s 76(3) of the Act, he may be held liable by any person who suffered any loss or damages resulting from the breach of this duty. This could not have been the intention of the legislature with the inclusion of s 218(2) in the Act to depart from this well-recognised and entrenched principle of South African company law. However, in order for a plaintiff to hold any person liable in terms of s 218(2), the following should be proven; first, that a provision of the Act had been contravened. Secondly, that damage or loss has been suffered by the plaintiff, and lastly, that there is a causal link between the contravention of the Companies Act and the damage or loss suffered by the plaintiff.

The meaning of 'contravention' in s 218(2) is not limited to provisions in the Companies Act which constitute an offence when it is not complied with; it also includes any provision in the Act which does not constitute an offence.[42] Furthermore, an extensive interpretation of s 218(2) of the Companies Act may constitute an alternative to a derivative action in s 165 of the Companies Act to hold a director liable for the contravention of his duty of care, skill and diligence as provided for in s 77(2)*(b)(i)* of the Act, this also could not have been intended by the legislature when drafting s 218(2) of the Act.

[40] *Howard v Herrigel NO* 1991 (2) SA 660 (A) at 678.
[41] *Re Brazilian Rubber Plantation & Estates Ltd* [1911] Ch 425 (CA) 436-7.
[42] *Chemfit Fine Chemicals (Pty) Ltd v Maake* 2017 JDR 1473 (LP) para 30.

The current formulation and wording of s 218(2) of the Act cannot be correct based on an extensive interpretation of s 218(2). It conflicts with the foundational company law principles and certain provisions of the Companies Act. It has the potential to open the floodgates for frivolous and trivial claims against directors and other company agents for damages and losses as a result of breaching their duties in the Act which are owed to the company, or due to their failure to fulfil an obligation stemming from a provision in the Companies Act.

4.3.1 The scope and limitations of a director's personal liability in terms of s 218(2) of the Companies Act 71 of 2008.

Liability in terms of s 218(2) of the Companies Act is not limited to the company such as in s 77(2)*(b)(i)* of the Companies Act. A plaintiff is not required to explicitly rely on s 218(2) in his particulars of claim in order for it to find application; instead it must be evident from the facts that s 218(2) of the Companies Act finds application.[43]

In order to institute a claim in terms of s 218(2) of the Companies Act, such a claim must be in conjunction with the relevant provision which is alleged to have been contravened; such as s 76(3)*(c)* of the Companies Act where it is alleged that the duty of care, skill and diligence was breached. In the case of *Sanlam Capital Markets (Pty) Ltd v Mettle Manco (Pty) Ltd and Others*[44] the plaintiff claimed from the directors of Mettle Manco (Pty) Ltd (the first defendant), a sum of R 98 243 807.00 which it lost as a funder of a debt securitisation scheme. The plaintiff alleges that the lost was incurred as a result of misrepresentations by the directors of the first defendant. The plaintiffs further contended that the misrepresentation by the directors of the first defendant is in breach of s 76(3)*(c)* of the Act because the directors 'owed a duty of care to the plaintiff requiring the directors not to make the

[43] *Blue Farm Fashion Limited v Rapitrade 6 (Pty) Ltd and Others* (22288/2014) [2016] ZAWCHC 35 para 21.
[44] [2014] 3 All SA 454 (GJ).

representations to it unless the representations were correct in all material respects'.[45] The plaintiffs claim was based on s 76(3) and s 218(2) of the Companies Act in dismissing an exception raised by the respondents relating to their liability in terms of the aforementioned sections. Vally J held that s 218(2) of the Companies Act imposes liability on any person who contravened the Act, and where the contravention caused harm to another person.[46]

The decision by Vally J to dismiss an exception raised by the defendants is based on an extensive interpretation of s 218(2) of the Act and therefore flawed. Even though s 218(2) of the Act is drafted in wide terms the application of this section is restrictive.[47] Where s 218(2) is utilised to hold a director liable for the breach of the duty of care, skill and diligence then s 77(2)*(b)(i)* of the Companies Act must be considered[48] which specifically provides for requirements and limitations relating to the liability of directors in relation to this duty.[49] Section 77(2)*(b)(i)* of the Companies Act refers to the common law as the basis upon which to hold a director liable for the breach of his duty of care, skill and diligence.

The common law maxim *'generalia specialibus non derogant'* stipulates that where a provision provides for general liability then it does not derogate a provision that provides for specific liability.[50] Therefore s 77(2)*(b)(i)* of the Companies Act provides for specific liability which take precedence over s 218(2) providing a general liability provision in the Act. Even though s 218(2) of the Act is capable of an extensive interpretation such an interpretation is too far a departure from the limited liability principle established in company law.[51] Furthermore, the legislature would have explicitly provided for the exclusion of the common law or any provision in the Act relating to a directors liability if the intention was for s 218(2)

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[45] *Sanlam Capital Markets (Pty) Ltd v Mettle Manco Pty Ltd and Others* [2014] 3 All SA 454 (GJ) 7.
[46] *Sanlam Capital Markets (Pty) Ltd v Mettle Manco Pty Ltd and Others* [2014] 3 All SA 454 (GJ) 42.
[47] *Hlumisa v Kirkinis* 2018 ZAGPPHC 676 26.
[48] *Hlumisa v Kirkinis* 2018 ZAGPPHC 676 40.
[49] See 4.2.1
[50] *Hlumisa v Kirkinis* 2018 ZAGPPHC 676 30.
[51] *Hlumisa v Kirkinis* 2018 ZAGPPHC 676 31.

of the Act to replace or have preference over the common law or any other provision in the Act.[52]

A directors' duty of care, skill and diligence is subject to the common law proper plaintiff rule, a director can only be held liable by a person to whom he owes a duty such as the company. In order for a director to be held liable for the breach of the duty of care, skill and diligence the company must have suffered damages or loss. In order to identify the proper plaintiff, a duty must be owed to a person and the person who is owed this duty must have suffered loss due to the breach of this duty.[53] However, the proper plaintiff rule does not find application where a derivative action is brought in terms of s 165 of the Companies Act to hold a director liable for a duty[54] which he owes to the company[55] this is provided for in s 165(1) of the Act.

Section 218(2) of the Companies Act is not intended to replace the common law in relation to the liability of a director for breaching his duty of care, skill and diligence. Section 218 (2) of the Act is a provision which provides general liability and only finds application where the Act fails to provide a specific form of liability for the contravention of any provision in the Act. The contravention of the Act must have caused loss or damage to a person who would generally have recourse for the contravention for that specific provision in the Companies Act. Section 218(2) of the Act cannot be used to hold a director liable for the breach of his duty of care, skill and diligence such a claim must be brought within the ambit and meet the requirements of s 77(2)*(b)(i)* of the Companies Act.

[52] *Hlumisa v Kirkinis* 2018 ZAGPPHC 676 45.
[53] *Hlumisa v Kirkinis* 2018 ZAGPPHC 676 70.
[54] See 4.2.1
[55] *Hlumisa v Kirkinis* 2018 ZAGPPHC 676 72.

4.3.2 The possible consequences of the application s 218(2) Companies Act 71 of 2008.

The manner in which s 218(2) of the Act has been drafted could *prima facie*, open the floodgates for frivolous and trivial claims by persons that have been adversely affected by the conduct or decision of any person (including directors), specifically where the conduct or decision of a director breaches his duties in the Companies Act.

The State, CIPC, commissioner of the CIPC, the company's tribunal including a panel or inspector of the tribunal and an employee of the state is exempted from any liability which might arise in terms of s 218(2) of the Act.[56] The exemption is subject to the aforementioned persons and institutions acting in good faith and not with gross negligence.[57] Where the decisions and conduct of directors affect a vast majority of individuals, such as in the instance of directors of SOCs, the potential amount of claims in terms of s 218(2) of the Act would be even greater. Regardless of the fact that plaintiffs would first have to prove that a duty was breached by a director. It would entail determining what the duty is and the test to be applied in determining when the duty is breached. A plaintiff will also be required to provide a causal link between the specific duty that was breached and the loss or damage actually suffered by the plaintiff due to the breach.

The intention of the legislature in drafting s 218(2) of the Companies Act was not to bestow extensive liability on any person (including directors) who contravenes the Act as well as for claims in terms of this section to be available to any person. However, based on the wording and the manner in which s 218(2) of the Act was drafted, it is subject to an extensive interpretation. It is argued that in order to avoid the extensive interpretation of s 218(2) it should be amended to reflect the true intention of the legislature, which is to provide general

[56] S 222 Companies Act.
[57] S 222 Companies Act.

liability for the contravention of the Companies Act where specific liability is not provided for in the Act.

4.4 CONCLUSION

The duty of care, skill and diligence is owed by directors to the company alone, this is evident in s 77(2)*(b)(i)* of the Companies Act which only affords the company the right to hold director liable for the breach of his duty of care, skill and diligence where the company has suffered any loss, damages or costs. Nonetheless, a derivative action to hold a director liable for the breach of his duty of care, skill and diligence is not excluded, provided the requirements of s 165 of the Companies Act have been complied with. A derivative action is still limited to any loss, cost or damages sustained by the company. Furthermore s 77 (2)*(b)(i)* of the Act recognises the law of delict as the applicable remedy in order to hold a director liable for the breach of his duty of care, skill and diligence. In addition to proving that the duty of care, skill and diligence was breached, harm, conduct, causation, fault and wrongfulness must be proven in order to hold a director liable in terms of s 77(2)*(b)(i)* of the Companies Act.

Reference to the law of delict in this section is fitting because the negligence requirement (under fault) in the law of delict requires a certain degree of care to be exercised. This degree of care can be equally applied to directors in determining whether they should be held liable for the breach of the duty of care, skill and diligence. The anomaly in South African company law, where Roman Dutch law principles (delict), is used to hold a director liable for a duty derived from English law (the duty of care), does not exist in relation to the duty of care, skill and diligence in the Companies Act. The duty of care, skill and diligence in s 76(3)*(c)* is not a duty derived from the English law duty of care or even based on English and South African

case law.[58] Instead the legislature introduced a new objective/subjective duty of care, skill and diligence in the Companies Act which is dissimilar to the subjective common law duty of care. Section 77(2)*(b)* of the Companies Act is not without fault, despite this section correctly making reference to the law of delict as the basis for liability due to the breach of the duty of care, and skill. Section 77(2)*(b)* incorrectly refers to the law of delict as the basis for liability where a provision in the MOI is breached.[59]

Section 218(2) of the Companies Act is drafted in extensive terms, ostensibly providing any person with the *locus standi* to hold a director liability for the contravention of any provision in the Act provided they has suffered loss or damages which was caused by the contravention of a provision in the Act. Even though s 218(2) is drafted in wide terms it should be applied restrictively because the application of the extensive interpretation of s 218(2) of the Act is in conflict with the common law and s 77(2)*(b)(i)* of the Companies Act.[60] Where legislation provides for specific and general liability provisions then the provision providing for specific liability takes precedence over the provision providing for general liability.[61] In order to hold a director liable for the breach of the duty of care, skill and diligence the specific provision providing for liability which is s 77*(2)(b)(i)* of the Act should be applied. Hence s 218(2) of the Act cannot be relied on to hold a director liable for any damages or loss resulting from a breach of his duty of care, skill and diligence. It is a general remedy which only finds application where the Act failed to identify a specific remedy in the Act to attribute liability.

An extensive interpretation and application of s 218(2) of the Act will result in unintended consequences such as directors and other company agents being exposed to trivial and frivolous claims from persons who they do not know or never even heard of. In order to avoid

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[59] See 4.2.2
[60] See 4.3.1
[61] See 4.3.1

these consequences, it is argued that s 218(2) of the Act must be restrictively applied. Nonetheless, in order to provide certainty and consistency in the interpretation and application of s 218(2) the legislature should amend this section to explicitly provide that its application is subject to the common law and any provision in the Act providing for any form of specific liability.

The subsequent and final chapter to this thesis provides a conclusion to the main research questions as well as sub-inquires. Recommendations are made in the final chapter in relation to the research conducted and outcome of this thesis. Further research required within the area of corporate law relating to the personal liability of directors of SOCs is highlighted with the aim of encouraging future research which could not be covered in this thesis and is not within the scope of the research question and sub inquiries.

CHAPTER: 5 CONCLUSION AND RECOMMENDATIONS

5.1 CONCLUSION

The main objective of this chapter is to provide a conclusion to this research; recommendations are made in order to identify areas for further research which is related to, but not within the scope of the research question. The research question of this thesis explores whether directors of SOCs can be held personally liable for fruitless, wasteful and irregular expenditure,[1] in answering this question several sub-inquiries are examined.[2] The objective in answering the research question is to promote good corporate governance practices in South African SOCs by elevating the standards of accountability, responsibility and transparency in the governance of SOCs. This is of paramount importance because South African SOCs has a critical role to play in the progressive realisation of socio-economic rights.[3] Furthermore the elevation of the aforementioned standards will contribute to either, minimising or eradicating fraud, corruption, and other forms of maladministration in South African SOCs.

Corporate governance, as a field of study, came about as a result of the separation of ownership and control of companies. It aims to provide checks and balances in the governance of companies, as well as to provide a governance structure which promotes the optimum and efficient operation of companies. Consequently various corporate management theories have been established to identify effective ways to manage and mitigate conflict within the governance structures of companies.[4] In examining the various corporate management theories, it is concluded that not a single corporate governance theory is ideal within the South African context.

[1] See 1.2.2.
[2] See 1.2.3.
[3] See 1.3.
[4] See 2.3.

Although the implementation of the Stakeholder Theory is the most appropriate in order for SOCs to address the disparities in South Africa, it can only be implemented when SOCs are financially sustainable. However, this is not the case for majority of South African SOCs. A corporate management theory must be developed which attaches equal importance to all internal and external stakeholders of SOCs. The proposed corporate management theory should integrate all stakeholders into their operation this can be achieved by SOCs recognising and implementing a sustainable balance between their financial and socio-economic objectives.[5]

The DTI initiated a process of reforming South African corporate law in 2004. The process was motivated by the legal and political transition in South Africa from a system of parliamentary sovereignty to constitutional supremacy. This transition called for South African corporate law to be developed in order to be aligned with the new constitutional dispensation.[6] South Africa's reintegration into the global business community and the collapse of South African and international companies motivated the need for a reform of South African corporate law.[7] The objective of the DTI was to change the authoritative and formalistic nature of South African corporate law.

The guidelines for corporate law reform by the DTI resulted in the promulgation of the Companies Act which amongst other things partially codifies directors' duties,[8] enhances transparency and accountability in public companies and SOC's as well as recognising South African companies as a means to address socio-economic problems.[9] Even though there is a legislative framework providing for transparency and accountability in the governance of SOCs, there are still major issues in relation to SOCs being transparent and accountable.

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[5] See2.3.7.
[6] See 2.4.1.
[7] See 2.4.1.
[8] See 3.2.1 & 3.3.2.
[9] See 2.5.

These issues are owed to the improper implementation of the Companies Act by various stakeholders failing to fulfil their supervisory roles such as the State as the shareholder, the board of directors (as well as individual directors) and the company secretaries of SOCs.

The partial codification of directors' duties in the Companies Act includes both fiduciary duties and the duty of care, skill and diligence. These duties equally applies to directors of SOC's and are not in substitution for a directors duties in terms of the common law but rather operates concurrently. The duty of care, skill and diligence in terms of the common law is a subjective duty deriving from the English law duty of care.[10] The duty of care, skill and diligence in the Companies Act is a dual objective/subjective duty requiring a director to exercise a degree of care, skill and diligence akin to the degree that a reasonable person would have exercised. The reasonable person is put in the same position as the director and with the knowledge, skill and experience of the director.[11] The duty of care, skill and diligence in terms of the common law and the Companies Act points to two different duties with each duty having its own test to be applied in order to determine whether the duty was breached.[12]

The result of an objective/subjective duty of care, skill and diligence in the Act is a marginally more stringent duty of care, skill and diligence when compared to this duty in terms of the common law.[13] The subjective element in the duty of care, skill and diligence in the Companies Act only finds application where the knowledge, skill and experience of a director are equivalent to or higher than that of a reasonable person. The test for determining whether a director exercised the required degree of care, skill and diligence is against that of a reasonable person and not a reasonable director. However the knowledge, skill and

[10] See 3.3.1.
[11] See 3.3.2.
[12] See 4.2.2.
[13] See 3.3.2.

experience of the director is taken into account in determining the degree of care, skill and diligence a reasonable person in the same position of the director would have exercised.

In addition to partially codifying directors' common law duties, the Companies Act has also introduced a statutory version of the BJR[14] which does not form part of South African common law. The BJR operates as a standard of review in determining whether a director acted in the best interest of the company and with a degree of care, skill and diligence as required by the Companies Act.[15] The BJR mitigates the objective inquiry in the Companies Act relating to the duty of care, skill and diligence as well as countering the efforts made by the Act in introducing a more stringent duty of care, skill and diligence.[16] Furthermore it is viewed that the BJR is contrary to one of the purposes of the Companies Act which is to encourage transparency and high standards of corporate governance by blurring the distinction between the dual objective/subjective inquiry in the duty of care, skill and diligence in the Companies Act and the requirements that have to be proven in order for the BJR to find application.[17]

The PFMA and the Companies Act finds concurrent application in relation to directors of SOCs. In terms of the PFMA, directors of SOCs have a duty to prevent fruitless, wasteful and irregular expenditure. One of the aims of the PFMA is to secure the transparency, accountability and the sound management of the revenue, expenditure, assets and liabilities of public entities. In order to fulfil this aim directors of SOCs have to prevent fruitless, wasteful and irregular expenditure. The PFMA requires the exercise of due diligence and reasonable care in preventing fruitless and wasteful expenditure.[18] Irregular expenditure is expenditure

[14] Even though it is not referred to as the BJR.
[15] See 3.3.3.
[16] See 3.3.3.
[17] See 3.3.3.
[18] See 3.4.1.

which does not comply with the PFMA or any national or provincial legislation providing for procurement procedures.[19]

Directors of SOCs have the duty to exercise utmost care to ensure the reasonable protection of the assets and records of the SOC. This can be achieved by directors of SOCs successfully preventing fruitless, wasteful and irregular expenditure. According to AGSA, 80 per cent of SOCs failed to comply with legislation relating to procurement and expenditure procedures during the 2017-2018 financial year; this non-compliance frequently increases irregular expenditure by SOCs.[20] The current financial position of South African SOCs includes large sums of money being lost due to fruitless, wasteful and irregular expenditure which is attributed to the lack of accountability, transparency and good corporate governance practices by directors and other senior managers of SOCs as well as their failure to implement recommendations by AGSA.[21]

The Companies Act and the PFMA requires directors' of SOCs to exercise and fulfil their duties at least equivalent to that expected of a reasonable person. It is not explicitly stated in the PFMA that a director of a SOC has to exercise reasonable care in preventing fruitless and wasteful expenditure. However, fruitless and wasteful expenditure is defined in the PFMA as expenditure which arises due to the failure to exercise reasonable care.[22] Therefore, what is indirectly provided for in the PFMA is a duty to exercise reasonable care in order to prevent fruitless and wasteful expenditure, where such expenditure arise it is due to the failure by directors of SOCs to exercise reasonable care. Both the duty of care, skill and diligence in the Companies Act and the duty to prevent fruitless and wasteful expenditure in the PFMA

[19] See 3.4.1.
[20] See 3.4.1.
[21] See 3.4.1.
[22] See 3.4.2.

require the exercise of reasonable care.[23] It is apparent that the failure on the part of a director of a SOC to prevent fruitless and wasteful expenditure could simultaneously constitute a contravention of the duty of care, skill and diligence in the Companies Act. Both of these duties require the exercise of a degree of care at least equivalent to that expected of a reasonable person.[24] However, the aforementioned determination is subject to the statutory BJR in the Companies Act and the effects thereof on the duty of care, skill and diligence in the Act. Additionally, the PFMA requires the exercise of effective and appropriate steps in preventing irregular expenditure. This entails taking effective and appropriate steps in order to ensure that any procurement or expenditure by SOCs is in compliance with the PFMA as well as any other applicable provincial or national legislation.

It is forwarded that the duty of care, skill and diligence in the Companies Act is contravened by a director of a SOC where the director fails to take appropriate and effective steps to prevent the contravention of the PFMA, or other legislation providing procurement procedures.[25] This position is fortified by the expectation of reasonable person to ensure that they are compliant with the law. This is even more apparent where a director of a SOC has the knowledge, skill or experience which displays that a reasonable person with that particular knowledge, skill and experience of the director should have been aware or informed of a particular law which was contravened.[26]

The general position is that directors are not personally liable for conduct or decisions within their scope of authority as a director of a company. However, s 77(2)*(b)(i)* of the Companies Act provides for the liability of directors for any loss or damage which results from the

[23] See 3.4.2.
[24] See 3.4.2.
[25] See 3.4.2.
[26] See 3.4.2.

breach of the duty of care, skill and diligence in the Companies Act.[27] The company has the *locus standi* to hold a director liable in terms of s 77(2)*(b)(i)* of the Companies Act because a director owes a duty of care, skill and diligence only to the company. Additionally s 77(2)*(b)(i)* of the Act only makes reference to loss or damage sustained by the company, However, nothing in the section precludes the application of a derivative action in terms of 165 of the Act in order to demand the company to take action in terms of s 77(2)*(b)(i)* of the Act. Therefore all persons eligible to bring a derivative action in terms of the Companies Act may serve a demand on the company in order hold a director liable in terms of s 77(2)*(b)(i).*

Reference is made to the common law specifically the law of delict in s 77(2)*(b)(i)* of the Act as the basis to hold a director liable for breaching his duty of care, skill and diligence. In order for a director to be held liable for the breach of his duty of care, skill and diligence, the necessarily elements for the law of delict must be proven.[28] This is the position even though South African law, of delict unlike its English counterpart, do not provide for a specific delictual remedy which finds application where a duty of care is established. Nevertheless, South African law of delict does require negligence to be proved; the test for negligence requires a consistent level of care on the part of all legal subjects which is akin to the duty of care in English tort law. The test for negligence also comprises of a foreseeability and preventability test in determining whether a person was negligent this test may be equally applied to directors when it is alleged that such a director breached his duty of care, skill and diligence in the Companies Act.[29]

The anomaly in South African corporate law where the law of delict (a Roman Dutch law principle), is used to hold a director liable for the duty of care (an English law duty), does not find application in relation to the duty of care, skill and diligence in the Companies Act. The

[27] See 4.2.1.
[28] See 4.2.1.
[29] See 4.2.2.

duty of care, skill and diligence in the Act is not the same duty as provided for in terms of the common law. In terms of the common law it is a purely subjective duty whereas the Act recognises the duty of care, skill and diligence as a dual objective/subjective duty. It is forwarded that the duty of care, skill and diligence in the Companies Act must be seen as a development in South African corporate law creating a new duty of care, skill and diligence which is distinct and marginally more stringent than the duty in terms of the common law.[30]

Section 77(2) of the Companies Act is not without fault, in providing for the personal liability of a director for breaching a clause in the company's MOI the law of delict is recognised as the basis to hold a director liable for this breach. This cannot be correct whereby the law of delict is utilised to hold a director liable for breaching an agreement (which could constitute a contract operating *ex lege*) such as the companies MOI.

Directors of SOCs may also be held liable for any financial misconduct in terms of section 83 of the PFMA for failing to prevent irregular expenditure, fruitless and wasteful expenditure and expenses expenditure not complying with the operational policies of the public entity. This liability will be as a result of the outcome of an investigated initiated by Treasury in accordance with any application regulations, agreements and reasonable requirements issued by Treasury. The Companies Act introduced a unique and innovative but yet controversial provision in the form of s 218(2) of the Act. When reading s 218(2), it is a widely worded provision providing for an extensive interpretation which could have equally extensive consequences such as unwarranted and frivolous claims against directors by individuals outside of the company.[31] Section 218(2) seemingly provides that any person can hold a director liability for the contravention of any provision in the Act provided they has suffered loss or damages which caused by the contravention of the provision in the Act. This provision

[30] See 4.4.
[31] See 4.3.2.

should be applied restrictedly even though it was drafted in wide terms because an extensive interpretation of s 218(2) will be in conflict with the common law position that directors owe their fiduciary duties and the duty of care, skill and diligence towards the company alone.[32] Section 218(2) will also be in conflict with s 77(2) of the Companies Act which limits the liability of directors for the breach of their fiduciary duties and the duty of care, skill and diligence to loss or damage suffered by the company.

It was not the legislature's intention to depart from established company law principles with the enactment of s 218(2) of the Act. It is forwarded that s 218(2) provides for a general liability provision in the Act and only finds application where the Act fails to provide specific form of liability.[33] A provision providing for specific liability such as s 77(2) of the Act takes precedence over the application of s 218(2). This section cannot be relied on to hold a director liable for the breach of his duty of care, skill and diligence, reliance must be placed on s 77(2)*(b)(i)* and s 165 of the Companies Act where a shareholder, director of the company or any other persons permitted to institute a derivative action in terms of the Act would want to hold a director liable.[34]

Based on the analysis provided for in this thesis the current corporate law legislative framework provides for directors of SOCs to be held personally liable for failing to prevent fruitless, wasteful and irregular expenditure where such a failure result in directors simultaneously breaching their duty of care, skill and diligence in the Companies Act. In order for this liability to ensue SOCs, its board of directors and the State as the shareholder should be committed to enhancing accountability and transparency in the governance of SOCs as well as actively safeguarding good corporate governance practices in SOCs.

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[32] See 4.4.
[33] See 4.3.1.
[34] See 4.3.1.

5.2 RECOMMENDATIONS

Having analysed the potential personal liability of directors of SOCs for failing to prevent fruitless, wasteful and irregular expenditure where such failure results in a director breaching his duty of care, skill and diligence. The general recommendation is that s 218(2) of the Companies Act is amended to explicitly provide that it is a remedy for liability in the Act which is subject to any provision in the Act providing for specific liability. The amendment should also ensure that s 218(2) does not conflict with or contradict any established common law principles relating to South African company law. It is recommended that during the process of amending s 218(2) of the Act in accordance with the aforementioned recommendations the courts should restrictively apply this section regardless of the widely worded manner in which it is drafted.

It is further recommended that s 77(2)*(b)(iii)* of the Companies Act be amended to remove the reference to the law of delict as the recognised basis to hold a director liable for breaching a clause in the company's MOI.

5.3 AREAS FOR FURTHER RESEARCH

The following is identified as areas for further research which is related to but not within the scope of the research question of this thesis.

- The suitability of the BJR in the Companies Act; in order to determine whether it is necessary to have a statutory version of the BJR in the Act considering the affect it has on the duties of directors to act in the best interest of the company and with care, skill and diligence.

- The extent to which a company's MOI constitutes a contract between the company and its shareholders and between the company and its directors. This is aimed at

determining whether the law of contract has any role to play in this type of agreement and if so to what extent. This research should also provide an analysis to determine whether the law of delict can be applied in determining liability for the breach of such an agreement.

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