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**A South African perspective on the advantages and disadvantages of codification of directors' duties.**

**By**

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**Submitted in partial fulfilment of the requirements for the**

**Degree of**

**Masters of Laws (LLM)**

**In**  
UNIVERSITY  
OF  
JOHANNESBURG  
**Commercial law**

**At the**

**University of Johannesburg**

**SUPERVISOR: Professor Kathleen van der Linde**

**February 2016**

**DECLARATION**

I, Fanuel Nkomo hereby declare that this research submitted to the University of Johannesburg for the purpose of attaining the Master of Laws (LLM) degree is my own work. Where I have written someone else's work I have acknowledged by way of referencing. This work has not been submitted for any other degree or examination at any other university.

Signed by.....

Signature.....

Day of February 2016



## **Abstract**

Directors play an important role in a company. A company will succeed or collapse through directors depending on how well they carry out their duties. In order to protect companies many jurisdictions have adopted the approach of codification of the director's duties. Some countries have adopted complete codification of directors' duties and others have adopted what is said to be partial codification of directors' duties. The Companies Act has partially codified some of the directors' duties in South Africa.

Codifications have got advantages and disadvantages, this research will provide a brief comparison of United Kingdom approach with the South African approach. It will conclude by exposing that a partial codification approach is suitable to follow in terms of South African company law.



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## **1. Introduction**

### **1.1 Research background**

Directors play an important role in a company.<sup>1</sup> A company will succeed or collapse under directors depending on how well they carry out their duties.<sup>2</sup> In order to protect companies many jurisdictions have adopted the approach of codification of the directors' duties.<sup>3</sup> Some countries have adopted complete codification of directors' duties and others have adopted what is said to be partial codification of directors' duties. Section 75-77 of the Companies Act has codified some of the directors' duties in South Africa.<sup>4</sup>

Codification of directors' duties can be said to be a vital tool that informs the directors of their duties that are owed to the company.<sup>5</sup> Codification also put measures in place to help the company to bring actions against the directors for the damage and loss suffered by the company.<sup>6</sup> This will be resulting from the directors' act or omission to perform their duties.<sup>7</sup> Clarity and legal certainty is brought by as a result of the codification of the directors' duties. The research will show which legal approach is suitable to follow in terms of South African company law.

The advantages and disadvantages of codification of the duties of directors will enable us to evaluate which approach is best suitable for the South African legal system. This is because the advantages and disadvantages give an insight as to what to expect should the legal system adopt a certain approach, whether it is complete codification or partial codification.

### **1.2 Problem statement**

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<sup>1</sup> Mayson French and Ryan *Company Law* (2010) 422.

<sup>2</sup> *Ernest v Nicholls* 1857 6 HL. Also see Coyle *Corporate Governance* (2003) 10.

<sup>3</sup> Section 170(2) of the United Kingdom Companies Act.

<sup>4</sup> Section 76 of the Companies Act 71 of 2008, hereafter the Companies Act.

<sup>5</sup> Section 76 of the Companies Act.

<sup>6</sup> Van der Linde "The personal liability of directors for corporate fault –an exploration" 2008 *SA Merc LJ* 439 442.

<sup>7</sup> Section 165 of the Companies Act, provide for a derivative action by either the shareholder or the stakeholder of the company to bring action against the director on behalf of the company for the damage or loss incurred by the company.

Complete and partial codification of directors' duties, both have advantages and disadvantages. The challenge is to find the approach that will suit the South African legal system. Through complete codification, some of common law principles might be lost in the process. Partial codification on the other hand will not be able to resolve legal uncertainty; this is because the statute and common law co-exist.

The South African legal system has the common law foundations and its company law is mainly based on English law.<sup>8</sup> If complete codification is adopted flexibility in the approach will also be compromised, this is because common law principles provide flexibility, but a single simplified codification might not necessarily suit the South African legal system. Complete codification has a tendency of restricting the development of the law.<sup>9</sup>

Perfect codification may not be practically achievable, this is because common law principles have developed over a long period of time and codifying them could produce conflicting or unwanted results.<sup>10</sup> The post resignation duties of directors in South African law are not codified and are mainly regulated by the common law principles. This creates a problem as while duties in general have been codified, there is no codified rule relating to post resignation duties and as a result legal uncertainty may be created.

Having stated the disadvantages of complete and partial codification, the question to ask is; whether the South African legal system should adopt complete codification or rather continue with partial codification.

### **1.3 Purpose of study**

The purpose of this research is to evaluate the partial codification of the directors' duties in South African company law. It will briefly consider the position under the United Kingdom Companies Act 2006 in comparative perspective. The United Kingdom was chosen as a comparative jurisdiction because , United Kingdom and South African legal system started with the same common law duties approach

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<sup>8</sup> Gibson *South African Mercantile and Company Law* 2003 287.

<sup>9</sup> Mayson *et al Company Law* 2010 468.

<sup>10</sup> Bouwman "An appraisal of the modification of the director's duty of care and skill" 2009 *SA Merc LJ* 516 522.



pertaining to directors before taking different approaches of complete and partial codification respectively.<sup>11</sup>

## **1.4 Definition of concepts**

In terms of company law certain terms are used to describe a particular concept or person. Important terms used in company law will be defined, these include the term director and fiduciary.

### **1.4.1 Director**

The South African Companies Act 71 of 2008 provides that a director of a company is a member of the board of the company, as contemplated in section 66 or an alternate director of a company and includes any person occupying the position of a director or alternate director, by whatever name designated.<sup>12</sup>

In terms of section 75-77, the meaning of the word director is extended to the purpose of that particular section that the act provides.<sup>13</sup> In terms of the United Kingdom Companies Act the term director is not defined, however section 250 of the act states that the term director includes the person occupying the position of director by whatever name called.<sup>14</sup>

### **1.4.2 Directors and other Fiduciaries**

When directors' duties are codified in terms of company statute, a distinction is made between directors and other fiduciaries whose duties may still be governed by either common law or other legislation. In terms of the common law the directors of the company owe fiduciary duties to the company. In *Phillips v Fieldstone Africa (Pty) Ltd*<sup>15</sup> the court held that, "there is no magic in the term fiduciary duty nor is there a closed list of fiduciary relationships or a comprehensive definition of who a fiduciary is".<sup>16</sup> Mayson, French and Ryan refer to the fiduciary duty as a duty of trust and

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<sup>11</sup> Section 170(2) of the United Kingdom Companies Act 2006.also see Mayson *et al Company Law* 2010 468. They state the disadvantages of complete codification.

<sup>12</sup> Section 1 of the Companies Act.

<sup>13</sup> Section 75-77 of the Companies Act.

<sup>14</sup> Section 250 of the United Kingdom Companies Act.

<sup>15</sup> 2004 1 All SA 150 (SCA).

<sup>16</sup> *Phillips v Fieldstone Africa (Pty) Ltd* 2004 1 All SA 150 (SCA).par 27

confidence. They argue that a fiduciary is someone who acts for or on behalf of another person in a relationship of trust and confidence.<sup>17</sup>

## **2. DIRECTORS' DUTIES IN TERMS OF LEGISLATION AND COMMON LAW**

### **2.1 Introduction**

As a general principle a director owes a fiduciary duty to the company. His paramount duty is to act in good faith and therefore for the benefit of his company.<sup>18</sup> Fiduciary duties were developed in English law on the analogy of trust law.<sup>19</sup> In the case of *Cohen v Segal*<sup>20</sup> the court held that the basic goal of directors is the company's success and collective best interest of the shareholders without other ulterior motives. The directors must consider both the short-term and long-term consequences of their actions for the company.<sup>21</sup> This view may be considered as the enlightened shareholder approach where the directors' look after the interest of the shareholders.<sup>22</sup>

The duties of the directors include the duty of acting in the best interest of the company, the duty to avoid a conflict of interest and the duty of care skill and diligence when acting on behalf of the company.<sup>23</sup> These duties have been codified in terms of legislation in the South African legal system; they are codified in section 75 to 77 of the Companies Act.

### **2.2 The South African Codifications**

In the South African context the Companies Act provide for the duties of directors in terms of section 75-77.<sup>24</sup> According to Idensohn, section 76 of the Companies Act, "lists a number of duties and renders them applicable to all directors, members of board and audit committees and all prescribed officers".<sup>25</sup> Included in the list is a duty not to gain an unauthorised advantage, a duty to act in good faith and for a

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<sup>17</sup> Mayson *et al* *Company Law* 2010 476.

<sup>18</sup> *Phillips v Fieldstone Africa (Pty) Ltd* 2004 1 All SA 150 (SCA).par 22

<sup>19</sup> Cassim FHI, Cassim MF, Cassim R, Jooste, Shev and Yeats *Contemporary Company Law* 2012 460 465.

<sup>20</sup> 1970 3 SA 702 (W).

<sup>21</sup> Cassim *et al* *Contemporary Company Law* 2012 465.

<sup>22</sup> Cassim *et al* *Contemporary Company Law* 2012 466.

<sup>23</sup> Section 76 of the Companies Act.

<sup>24</sup> Section 76 of the Companies Act.

<sup>25</sup> Idensohn "The regulation of shadow directors" 2010 *SA Merc LJ* 320 326.

proper purpose<sup>26</sup> as well as a duty to act in the best interests of the company<sup>27</sup> and a duty to exercise reasonable care, skill and diligence.<sup>28</sup> A person who breaches any of these duties can be held liable in accordance with the principles of the common law for any loss, damages or costs sustained by the company as a consequence of the breach.<sup>29</sup> In her opinion the South African legal system provides satisfactory regulation and accountability as a result of this section.<sup>30</sup>

According to Bouwman the Companies Act provides for the partial codification of directors' duties therefore the common law principles of fiduciary duties are preserved. This results in a great deal of overlap between statutory and common law.<sup>31</sup> This partial codification of directors' duties in terms of the legislation creates what Bouwman calls a "perfect balance", as the common law and the statutory duties as provided by section 76 will co-exist.<sup>32</sup>

Other authors argue that, section 76(2)(a) is the underlying section for directors duty of loyalty and fidelity and the duty of directors not to make a profit out of their positions as directors.<sup>33</sup> They are of the view that the section is wide enough to include both a duty to avoid a conflict of interest and a conflict of duties.<sup>34</sup> Cassidy states that, it can be argued that section 77 of the Companies Act implies that, section 76 is intended to operate along with the common law in accordance with the principles of the common law provision relating to a breach of fiduciary duty.<sup>35</sup>

Bekink argues that, "although the directors' duties have been codified to a great extent in terms of section 76 of the Companies Act, the section does not exclude the common law. Common law duties that are not expressly affected by this section and

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<sup>26</sup> Section 76(3)(a) Companies Act.

<sup>27</sup> Section 76(3)(b) Companies Act.

<sup>28</sup> Section 76(3)(c) Companies Act.

<sup>29</sup> Section 77(2) of the Companies Act. Also see Idensohn "The regulation of shadow directors" 2010 *SA Merc LJ* 320 326.

<sup>30</sup> Idensohn "The regulation of shadow directors" 2010 *SA Merc LJ* 320 326.

<sup>31</sup> Bouwman "An appraisal of the modification of the director's duty of care and skill" 2009 *SA Merc LJ* 509 511. Also see Cassim *et al Contemporary Company Law* 2012 467. and Cassidy "Models for reform: the directors' duty of care in a modern commercial world" 2009 *Stellenbosch Law Review* 370 373.

<sup>32</sup> Bouwman "An appraisal of the modification of the director's duty of care and skill" 2009 *SA Merc LJ* 509 511.

<sup>33</sup> Cassim *et al Contemporary Company Law* 2012 467.

<sup>34</sup> Cassim *et al Contemporary Company Law* 2012 467.

<sup>35</sup> Cassidy "Models for reform: the directors' duty of care in a modern commercial world" 2009 *Stellenbosch Law Review* 373 376.

those duties not in conflict with the section will continue to apply”.<sup>36</sup> In terms of section 77(2)(a) a director will be held liable in accordance with the principles of the common law relating to a breach of his fiduciary duty as in terms of section 76(3)(a).<sup>37</sup> In terms of section 77, a director of a company can be held liable to the company for any financial losses incurred by the company as a result of the director having acted outside their powers.<sup>38</sup>

### **2.3 Duty to act in good faith and in the best interest of the company**

The duty to act in the best interest of the company is the main fiduciary duty of a director under the common law and as well as under the act.<sup>39</sup> Section 76(2)(b) provides for the duty of disclosure of any information that a person obtains as a director.

According to the Companies Act, a director of a company, when acting in that capacity he or she must exercise the powers and perform the functions of director in the best interest of the company.<sup>40</sup> This fiduciary duty is owed to the company alone and therefore only the company can enforce the duties against the director who has breached them.<sup>41</sup>

Originally at common law, the directors of a subsidiary company did not owe any fiduciary duty to the holding company or to a group of companies. Section 76(2)(a)(i) and (ii) of the Companies Act modified this situation, a duty is also now seen as being owed by directors to the subsidiary company.<sup>42</sup>

### **2.4 Duty to avoid a conflict of interest**

The Companies Act in section 75 provides for preventative measures for a director to avoid a conflict of interest with regards to the company. The director has to inform

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<sup>36</sup> Bekink “Indemnification and aspects of directors’ and officers’ liability insurance in terms of section 78 of the Companies Act 71 of 2008” 2011 *SA Merc LJ* 88 99.

<sup>37</sup> Section 72(2) of the Companies Act.

<sup>38</sup> Section 77 of the Companies Act.

<sup>39</sup> Section 76(2) of the Companies Act. Also see Cassim *et al Contemporary Company Law* 2012 465.

<sup>40</sup> Section 76(3) of the Companies Act.

<sup>41</sup> Section 165 of the Companies Act. Also see *Phillips v Fieldstone Africa (Pty) Ltd* 2004 1 All SA 150 (SCA). In *Prudential Assurance Co Ltd v Newman Industries Ltd* (1982) CH 204 the court held that the shareholders could not personally recover damages from the directors because it was not them, but the company in which they held the shares that had suffered damage.

<sup>42</sup> Section 76 of the Companies Act.

the board or shareholders, of any personal financial interests he or she has in a contract which is to be entered into by the company.<sup>43</sup> Directors are fiduciaries of the company as a result they are not supposed to put themselves in a position where their interests and duties will be in conflict with the duties that they owe to the company as in terms of section 76(3) of the Companies Act.<sup>44</sup> This rule is a specific preventative measure that seeks to prevent any attempt by a person who is either an alternate director, prescribed officer or a person who is either a member of the committee of the board of the company to exploit a company interest for their own benefit.<sup>45</sup> The section will prevent a director from approving or entering into any agreement on behalf of the company if he or she has a personal financial interest regarding that certain transaction.<sup>46</sup>

#### 2.4.1 No-profit rule

Section 76(2)(a)(i) provides that a director of the company must not use his or her position as director to either use information or gain an advantage using such position as director other than for the company benefit. Profits made by a director by reason of him or her being director and in the course of his or her office term as director must be disgorged.<sup>47</sup> The rule will apply even if the company could not itself have made the profit.<sup>48</sup> In *Regal (Hastings) Ltd v Gulliver*<sup>49</sup> the court held that the fact that the profits made by the defendants were not made at the expense of the company was irrelevant to the directors' duty to account. The liability to account rose from the mere fact of the profit having been made.<sup>50</sup> Other authors argue that profits are not only confined to money but, includes every gain or advantage obtained by a director.<sup>51</sup>

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<sup>43</sup> Section 75 of the Companies Act. In terms of section 75(7), a decision by the board or agreement approved by the board is valid despite any personal financial interest of a director or person related to the director, if it was approved in the manner contemplated in the section or has been ratified by an ordinary resolution of the shareholders.

<sup>44</sup> Havenga "Directors in competition with their companies" 2004 SA Merc L J 270 275.

<sup>45</sup> Section 75 of the Companies Act.

<sup>46</sup> Section 75 of the Companies Act. Also see *Sibex Construction (SA) (Pty) Ltd v Injectaseal CC* in this case the court referred to the dictum in the *Canadian Aero Service Ltd v O'Malley case*, where it held that "Persons in position of trust may be less tempted to place themselves in a position where duty conflicts with interest if the courts recognised and enforced the strict ethic in this area of the law."

<sup>47</sup> Cassim *et al Contemporary Company Law* 2012 487.

<sup>48</sup> Cassim "Da Silva v CH Chemicals Pty Ltd: fiduciary duties of resigning directors" 2009 South African LJ 61 64.

<sup>49</sup> *Regal (Hastings) Ltd v Gulliver* (1967) 2 AC 134.

<sup>50</sup> *Regal (Hastings) Ltd v Gulliver* (1967) 2 AC 134.

<sup>51</sup> Cassim *et al Contemporary Company Law* 2012 487.

In the case of *Phillips v Fieldstone (Africa) (Pty) Ltd*<sup>52</sup> the court reaffirmed that the no-profit rule and conflict of interest not only extends to actual conflict of interest but, also to situations in which there is a real sensible possible conflict. In *Da Silva v CH Chemicals Pty Ltd*<sup>53</sup> the court held that, if the director is found as not having exploited the corporate opportunity the court must look at whether he or she did not breach the no-profit rule.

#### **2.4.2 Corporate opportunity rule**

Section 76(2) provides for a duty not to exploit a corporate opportunity of the company by a director. This duty entails that the director cannot use any information that he acquired as a director or try to gain an advantage for personal gain, pertaining to the opportunity that belongs to the company. One can assume that the Act implies that if the opportunity became known to the director by virtue of his office then it must be presumed to be a company opportunity.

According to the Act the concept director has an extended concept.<sup>54</sup> In *Volvo (Southern Africa) (Pty) Ltd v Yssel*<sup>55</sup> the court had to decide on the instance in which a fiduciary duty will exist. The court held that, “whether a particular relationship should be regarded in law as being one of trust will depend upon the facts of the particular case”.<sup>56</sup> The court further found that, it was the position to which Yssel was appointed, rather than the nature of the contractual relationship that defined what Volvo could expect of him. His position to the company was found not to be the one to give him an opportunity to self- enrich himself but, for the interest of the company as he was a senior employee.

Besides corporate opportunity being provided in section 76(2), common law also provides for it.<sup>57</sup> According to the corporate opportunity rule, it does not matter whether the opportunity came to the director as director.<sup>58</sup> He or she is prohibited from using any contract, contact, information and any other opportunity that properly

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<sup>52</sup> *Phillips v Fieldstone Africa (Pty) Ltd* 2004 1 All SA 150 (SCA).par 35

<sup>53</sup> *Da Silva v CH Chemicals* 2008 SA 620 (SCA).par 56

<sup>54</sup> Section 75(1) of the Companies Act.

<sup>55</sup> *Volvo (Southern Africa) (Pty) Ltd v Yssel* 2009 82 (SCA).

<sup>56</sup> *Volvo (Southern Africa) (Pty) Ltd v Yssel* 2009 82 (SCA) par 19

<sup>57</sup> Section 76(2) of the Companies Act.

<sup>58</sup> *Phillips v Fieldstone Africa (Pty) Ltd* 2004 1 All SA 150 (SCA).par 39

belongs to the company.<sup>59</sup> This is because the opportunity belongs to the company and if the directors are to divert the opportunity for their own benefit; this will be a breach of the fiduciary duty owed to the company.<sup>60</sup>

In the case of *Da Silva v CH Chemicals*,<sup>61</sup> the court acknowledged the corporate opportunity rule by stating that “A consequence of the rule is that a director is in certain circumstances obliged to acquire an economic opportunity for the company if it is acquired at all”. Such an opportunity is said to be a ‘corporate opportunity’ or one which is the property of the company. In the case of *Robinson v Randfontein Gold Mining Co Ltd*<sup>62</sup> the court held that, the confidence of the director to the company involved a duty to protect the interests of the company. Since the company had a definite interest in acquiring the farm for itself therefor, it was said to be actively pursuing the opportunity.<sup>63</sup> Havenga argues that, a corporate opportunity is one that the company is actively pursuing or one that can be said to fall within the company existing or prospective business activities. This opportunity will be considered as the corporate opportunity.<sup>64</sup>

Havenga further argues that the duty not to exploit an opportunity arises from the fiduciary relationship that exists between the director and the company.<sup>65</sup> The opportunity involved is supposed to be for the benefit of the company. According to Beuthin the director is not supposed to personally benefit from the company opportunity that is supposed to benefit the company.<sup>66</sup> The no-profit rule and the corporate opportunity rule prohibit the director from gaining an advantage of the company for his or her own benefit.<sup>67</sup>

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<sup>59</sup> Cassim *et al Contemporary Company Law* 2012 487.

<sup>60</sup> *Da Silva v CH Chemicals* 2008 SA 620 (SCA).

<sup>61</sup> *Da Silva v CH Chemicals* 2008 SA 620 (SCA), par 18

<sup>62</sup> *Robinson v Randfontein Estates Gold Mining Co Ltd* (1921) AD 168. page 177

<sup>63</sup> *Robinson v Randfontein Estates Gold Mining Co Ltd* (1921) AD 168. page 177

<sup>64</sup> Havenga “Corporate opportunity: A South African update” 1996 *SA Merc LJ* 42 43. see also Cassim MF “*Da Silva v CH Chemicals Pty Ltd: fiduciary duties of resigning directors*” 2009 *South African LJ* 61 64.

<sup>65</sup> Havenga “Corporate opportunity: A South African update” 1996 *SA Merc LJ* 42 43

<sup>66</sup> Beuthin “Corporate opportunity and the non-profit rule” 1978 *SA LJ* 450 458.

<sup>67</sup> Beuthin “Corporate opportunity and the non-profit rule” 1978 *SA LJ* 450 458.

## 2.5 Duty to act for a proper purpose

The duty to act for a proper purpose is provided in section 76(3) of the Companies Act.<sup>68</sup> This duty is still available in terms of common law.<sup>69</sup> Proper purpose is not defined in terms of the Companies Act, however in terms of the common law principles it means that directors must exercise their powers for the objective purpose for which the power was given to them and not for other ulterior purpose or motive.<sup>70</sup> In the case of *Hogg v Cramphorn Ltd*<sup>71</sup> the court found that the primary purpose behind the allotment of shares in this instance had not been to raise share capital required for the company but, to ensure that the directors retained control of the company and as a result the court held that the power to issue shares is a fiduciary power. In this case the powers of the directors' were exercised for an improper purpose.<sup>72</sup> This provision is bound to create uncertainty as it is not really clear as to what the proper purpose entails since the Act does not define it.

## 2.6 Duty of care skill and diligence

The duty of care, skill and diligence which in terms of the Companies Act is provided in section 76(3)(c)(i) and (ii).<sup>73</sup> Under section 76(3)(c)(ii) the act provides for a subjective test in determining the liability of the director as his or her general knowledge is considered.<sup>74</sup> Recent South African courts are using both the subjective and objective test in determining the liability of the director. Section 76(4) contain a provision that may be likened to the American business judgment rule which seeks to exclude the directors' liability if he or she had acted with the informed knowledge and as well as having taken diligent steps in approving a transaction which he or she believed was in the best interest of the company.

According to Havenga the business judgement rule in United States of America was developed to protect honest directors from risks in their unsuccessful decisions. She

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<sup>68</sup> Section 76(3) of the Companies Act.

<sup>69</sup> Cassim *et al Contemporary Company Law* 2012 487.

<sup>70</sup> Cassim *et al Contemporary Company Law* 2012 487.

<sup>71</sup> *Hogg v Cramphorn Ltd* 1967 Ch 254

<sup>72</sup> *Hogg v Cramphorn Ltd* 1967 Ch 254. Also see *Howard Smith v Ampol Petroleum Ltd* 1974 A C 821. The court stated that it was unconstitutional for directors to use their fiduciary powers over the shares of a company for the purpose of destroying an existing majority or creating a new one.

<sup>73</sup> Section 76 of the Companies Act.

<sup>74</sup> Havenga "The business judgment rule-should we follow the Australian example?" 2000 *SA Merc LJ* 32 33



argues that business growth requires risks to be taken.<sup>75</sup> According to Cassidy the duty of care is in section 76(3)(c) marks the first statutory incorporation of the South African directors' duties.<sup>76</sup> Section 76 of the Companies Act provides for the partial codification of the directors' duties in terms of this section, a director may not use information that he or she gained in the office of the director to gain a personal advantage or to use this information for self-enrichment.<sup>77</sup> At common law, a director was required in the performance of his duties to exercise the care and skill that may be expected of a person with his or her knowledge and experience.<sup>78</sup>

According to Robert Baxt, "in the 1800 and early 1900 low expectations were placed on directors'. At this time the concept of negligent director required something grosser or more culpable than a negligent director in the modern sense".<sup>79</sup> This test was seen to be subjective as it only looked at the skill that the director held at that given moment and it was the one expected of him to exercise.<sup>80</sup> Directors are liable for negligence in the performance of their duties to the company for any loss incurred or caused to the company by their incompetence and carelessness. Havenga argues that, "South African company law recognises that a director must exercise his or her powers and carry out his or her office in good faith and for the benefit of the company. In so doing the director must exercise the required degree of care and skill". This type of care will depend on the nature of the business.<sup>81</sup>

In *Fisheries Development Corporations of South African Ltd v Jorgensen*<sup>82</sup>, the court held that, "a director's duty of care depends to a considerable degree on the nature of the company business that is assigned to the director". Other authors are of the

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<sup>75</sup> Havenga "The business judgment rule-should we follow the Australian example?" 2000 *SA Merc LJ* 31 33

<sup>76</sup> Cassidy "Models for reform: the directors' duty of care in a modern commercial world" 2009 *Stellenbosch Law Review* 373 374.

<sup>77</sup> Section 76 of the Companies Act.

<sup>78</sup> Cassim *et al Contemporary Company Law* 2012 506. They argue that, a corporate opportunity is one that the company is actively pursuing or one that can be said to fall within the company existing or prospective business activities.

<sup>79</sup> Baxt "*Company and Securities Law Journal*" 2015 298. Also see *Daniels v Anderson* where the court held that care and skill mean different things. It was further held that skill refers to the knowledge and experience, the technical competence of a director.

<sup>80</sup> Cassim *et al Contemporary Company Law* 2012 550. Also see *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168 the court ruled that the company was entitled to claim from Robinson the profit he had made on the basis that, he stood in a position of confidence in relation to the company.

<sup>81</sup> Havenga "The business judgment rule-should we follow the Australian example?" 2000 *SA Merc LJ* 32 33.

<sup>82</sup> *Fisheries Development corporation of South African Ltd v Jorgensen* 1980 4 SA 156 (W)

opinion that directors owe a duty to their company to take reasonable care in performing the functions of the office that they are assigned to as directors'. They further argue that, the standard of care is measured by the care that an ordinary man might be expected to take in the circumstances upon his own behalf.<sup>83</sup> On the other and McLennan argues that, "it will ultimately be a question of reasonableness. In conducting the affairs of the company the director must act reasonably".<sup>84</sup>

## 2.7 Post resignation duties of directors'

In terms of South African law there are no codified duties of directors after they have resigned from the office of directorship, therefore the common law rules will apply.<sup>85</sup> In *Da Silva and Others v CH Chemicals (Pty) Ltd*<sup>86</sup> the court referred to foreign law cases and stated that the director will not be able to escape liability should he resign and later exploit a company opportunity. It was further held that unless if the opportunity is not of such a kind or if it is an opportunity which although is falling within the scope of the company's business activities only arose after his resignation or was one which he was unaware prior to his resignation.<sup>87</sup> The director is at liberty in the absence of contractual restraints of trade to exploit the opportunity if it was not belonging to the company.<sup>88</sup>

Cassim has listed some of the instances in which the director of the company will be held liable to the company after he or she resign and later, it is found that they exploited the company corporate opportunity.<sup>89</sup> She state that a director will be accountable if he or she resigned to personally take up a maturing business opportunity that the company was actively pursuing and the director later pursue an

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<sup>83</sup> Redmond "Corporations and Financial Markets Law" 2013 428.

<sup>84</sup> McLennan "Duties of care and skill of company directors' and their liability for negligence". 1996 *SA Merc LJ* 94 102.

<sup>85</sup> Cassim *et al Contemporary Company Law* 2012 467.

<sup>86</sup> *Da Silva and Others v CH Chemicals (Pty) Ltd* 2008 6 SA 620 (SCA).par 18

<sup>87</sup> *Da Silva and Others v CH Chemicals (Pty) Ltd* 2008 6 SA 620 (SCA).par 20

<sup>88</sup> *Da Silva and others v CH Chemicals (Pty) Ltd* 2008 6 SA 620 (SCA). See also Cassim "Post resignation duties of directors: The application of the fiduciary duty not to misappropriate corporate opportunities" (2008) *South African LJ* 73. She argues that, the leading authorities suggest that a former director will in certain circumstances continue to owe fiduciary obligations to the company and that it would be appropriate to hold him accountable for the appropriation of corporate opportunities which occur after his resignation.

<sup>89</sup> Cassim "Post resignation duties of directors: The application of the fiduciary duty not to misappropriate corporate opportunities" 2008 *SA LJ* 70 73.

opportunity which their company is unable to take without the company having finally abandoned the opportunity.<sup>90</sup>

She further argues that directors' will be liable if their resignation is prompted or influenced by a desire to acquire the opportunity for their own benefit after resignation.<sup>91</sup> In the case of *Cyber Scene Ltd and Others v I-Kiosk Internet and Information Pty Ltd*<sup>92</sup>, the court held that the common law fiduciary duty continues to exist even after the appointment has ceased. It further held that, it does not matter if the director pursued the opportunity while still a director or after he resigned nor that the company would have not been able to obtain the opportunity.

## 2.8 Conclusion

Partial codification of the directors' duties in the Companies Act shows that not much is lost through the compression of case law; this is due to the fact that the Companies Act has codified some of the fiduciary duties of directors in section 75-77. These include the duty to act in good faith and in the best interest of the company and avoiding the conflict of interest, the duty to act for a proper purpose, the duty not to exploit the corporate opportunity, no profit rule as well as the duty of care skill and diligence. The Companies Act also retains objective and subjective elements contained in the common law duties of directors.<sup>93</sup> According to Bouwman, the Companies Act does not expressly provide that the statutory provisions relating to duties of the directors do not substitute the common law provisions.<sup>94</sup>

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<sup>90</sup> Cassim "Da Silva v CH Chemicals Pty Ltd: fiduciary duties of resigning directors 2009 *S A LJ* 58 61. She also state that even if the company could not take an opportunity the director will not be exempted.

<sup>91</sup> Cassim "Post resignation duties of directors: The application of the fiduciary duty not to misappropriate corporate opportunities" 2008 *South African LJ* 70 73.

<sup>92</sup> *Cyber Scene Ltd and Others v I-Kiosk Internet and Information Pty Ltd* 2000 3 SA 806 (C), par

<sup>93</sup> Bouwman "An appraisal of the modification of the director's duty of care and skill" 2009 *SA Merc LJ* 509 511.

<sup>94</sup> Bouwman "An appraisal of the modification of the director's duty of care and skill" 2009 *SA Merc LJ* 506 511.

### **3. UNITED KINGDOM DIRECTORS' DUTIES IN TERMS OF THE COMPANIES ACT 2006**

#### **3.1 The United Kingdom Codifications**

The United Kingdom Companies Act codifies the directors' duties in terms of section 170 up to section 181.<sup>95</sup> The act provides for the equitable principle of fiduciary duties and the common law duty of negligence.<sup>96</sup> Mayson, French and Ryan state that as the directors duties are codified in terms of the United Kingdom Companies Act in the above sections, the courts will continue to develop the equitable principle of fiduciary duties and the common law duty of negligence as they apply other than to the company directors.<sup>97</sup> They argue that the traditional formulation expressing the duty of good faith requires directors to act bona fide for the benefit of the company as a whole.<sup>98</sup> Codification of the directors' duties in the United Kingdom was recommended by law commission and the Scottish law commission.<sup>99</sup>

The approach relating to directors duties in United Kingdom differs from the one in South Africa in that the statutory duties are based on and apply in place of common law rules in the United Kingdom.<sup>100</sup> Before the Companies Act in the United Kingdom was enacted, the law on directors duties was derived from various common law rules and it was also self-regulated by other certain codes that where applicable to the rules.<sup>101</sup>

#### **3.2 Codified post resignation duties of directors'**

The United Kingdom legal systems provide for the post resignation duties of the directors when they are no longer acting or performing the duties that they were

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<sup>95</sup> Section 170 of the United Kingdom Companies Act. Also see *Shuttle worth v Cox* 1927 1 CH 154 the court stressed that the best interests of the company is not assessed by the court itself, instead the test is whether a reasonable man would have regarded the act of the directors to be in the best interest of the companies.

<sup>96</sup> Mayson *et al Company Law* 2010 432.

<sup>97</sup> Mayson *et al Company Law* 2010 468. Also see *Greenhalgh v Ardene Cinemas Ltd* 1950 2 All ER 1120. The Court stated that the phrase "company" as a whole does not mean the commercial entity as distinct from the incorporators. It means the shareholders or incorporators as a general body. In this case the shareholders should have sued derivatively and not personally, as directors owe their fiduciary duties to the company and not its shareholders.

<sup>98</sup> Mayson *et al Company Law* 2015-2016 488.

<sup>99</sup> Mayson *et al Company Law* 2010 433.

<sup>100</sup> Section 170 of the United Kingdom Companies Act.

<sup>101</sup> Bouwman "An appraisal of the modification of the director's duty of care and skill" 2009 SA *Merc LJ* 509 511.

previously doing in the office of directorship.<sup>102</sup> One can argue that, this approach of codifying the duties of directors after office will help curb some of the malpractices and mischievous deeds that, the person who was a director in a company suddenly resigns in order to gain or use the opportunity that he may know that it belonged to the company.<sup>103</sup>

Section 170(2) of the United Kingdom Companies Act provides a provision that informs directors or any person who once held the office of directorship about the liability that will be placed on such a particular person. If the director ceases to be a director he or she will be subject to the directors' duty of not exploiting information or any opportunity belonging to the company that he or she might have acquired at the time of holding office as director.<sup>104</sup> This serves to show that former directors will not rely on the defence that they have ceased to be company directors and as a result that duty has stopped applying to them. This can be seen as a good piece of legislation to codify directors' duties even post resignation as a director may seek to exploit the company opportunity.

In the United Kingdom case of *CMS Dolphin Ltd v Simonet*<sup>105</sup> the court held that a director will not be able to avoid liability for relying on the defence that he had resigned before he took the opportunity that the company was actively in pursuit of thereof to himself. This case set a precedent in United Kingdom relating to post resignation duties of directors as they can be held liable for exploiting the company opportunity after resignation. The Companies Act 2006 of United Kingdom provides for codified duties of directors just as it was held in the *CMS Dolphin Ltd* case. As a result directors will not avoid liability for relying on the defence of resignation. In order for the opportunity to be considered as a corporate opportunity, it must be within the scope of the company business activities which the director may have concealed to his company at the time that he was holding office of directorship.<sup>106</sup>

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<sup>102</sup> Section 170(2) of the United Kingdom Companies Act.

<sup>103</sup> Mayson *et al* *Company Law* 2010 432.

<sup>104</sup> Section 170(2) of the United Kingdom Companies Act.

<sup>105</sup> *CMS Dolphin Ltd v Simonet* 2001 EWHC CH 415.

<sup>106</sup> *CMS Dolphin Ltd v Simonet* 2001 EWHC CH 415.

### 3.3 Conclusion

The United Kingdom legal system saw it very wise to follow this approach of codification. Codification of directors' duties post resignation can be said to be a better method of approach. This is because; better regulation of directors' duties will be exercised. Codifying post directors resignation duties will prevent directors from any attempt to exploit company opportunities that arose when they were still in the office as directors. Codification of post resignation of directors' duties can be said to be a better approach because legal certainty is preserved.

## **4. ADVANTAGES AND DISADVANTAGES OF COMPLETE CODIFICATION**

### 4.1 Advantages of complete codification

Bouwman has listed some of the advantages of codification of directors' duties. She states that they improve clarity, simplicity and legal certainty to make the law more accessible to directors.<sup>107</sup> She further argues that common law fiduciary duties are complicated and inaccessible.<sup>108</sup> Codification makes the law accessible to others, including shareholders and stakeholders in order for them to identify breach of duty and to deter directors from misconduct as it could be easily detected.<sup>109</sup> She is of the view that codification makes the regulation of directors duties fit contemporary needs better and as well as that, codification helps to update the common law principle that may be out-dated.<sup>110</sup>

Through codification of the directors' duties a more authoritative statement of what those duties are is made clear on statute.<sup>111</sup> Bouwman further argues that the other reason for codification is to present an opportunity for the legislature to rectify and resolve some of the conflicting judicial decisions on the fiduciary duties.<sup>112</sup> Much time and effort to ascertain what the law requires from directors when there is a dispute

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<sup>107</sup> Bouwman "An appraisal of the modification of the director's duty of care and skill" 2009 *SA Merc LJ* 509 521.

<sup>108</sup> Bouwman "An appraisal of the modification of the director's duty of care and skill" 2009 *SA Merc LJ* 511 521.

<sup>109</sup> Cassim *et al Contemporary Company Law* 2012 508. She also state that codification of directors' duties will also enable directors to know what their fiduciary duties are.

<sup>110</sup> Bouwman "An appraisal of the modification of the director's duty of care and skill" 2009 *SA Merc LJ* 511 522.

<sup>111</sup> Mayson *et al Company Law* 2015-2016 477.

<sup>112</sup> Cassim *et al Contemporary Company Law* 2012 508.

that needs to be resolved will be reduced as a result of duties being known through statute.<sup>113</sup>

#### **4.2 Disadvantages of complete codification**

Mayson, French and Ryan state that perfect codification cannot be practically achievable; this is because the common law principles have developed over a long period of time and to try to codify them may not bring in wanted results. Therefore reducing all these principles to a single codification mechanism will almost be practically impossible.<sup>114</sup> The other disadvantage for complete codification is that it could lead to over simplification of the common law principles. In this way some common law principles that are important for the development of the law may be lost.<sup>115</sup> Bouwman states that oversimplified principles of common law in codification will not be appropriate to assist with complex legal cases.<sup>116</sup> She further argues that “flexibility will be compromised. In the modern competitive business environment, the common law provides the necessary flexibility”.<sup>117</sup>

It has been said that the other disadvantage of complete codification is that in other instances when an aspect of codified law has been contained in statute, it is incentive for people to find and identify gaps that they may explore to their advantage to avoid compliance. This is not the same as if it is just being interpreted from the common law perspective.<sup>118</sup> Another disadvantage that codification of the rules has is that the statutory codification will have to be tested in a legal case while the common law rules have been applied tried and tested over a long period of time.<sup>119</sup> As a result of complete codification flexibility is mostly compromised due to the fact that its application to certain principles will be limited.<sup>120</sup> Mayson, French and

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<sup>113</sup> Bouwman “An appraisal of the modification of the director's duty of care and skill” 2009 *SA Merc LJ* 511 522.

<sup>114</sup> Bouwman “An appraisal of the modification of the director's duty of care and skill” 2009 *SA Merc LJ* 511 522.

<sup>115</sup> Cassim *et al Contemporary Company Law* 2012 508.

<sup>116</sup> Bouwman “An appraisal of the modification of the director's duty of care and skill” 2009 *SA Merc LJ* 509 511.

<sup>117</sup> Cassidy “Models for reform: the directors' duty of care in a modern commercial world” 2009 *Stellenbosch Law Review* 373.

<sup>118</sup> Bouwman “An appraisal of the modification of the director's duty of care and skill” 2009 *SA Merc LJ* 509 511.

<sup>119</sup> Cassim *et al Contemporary Company Law* 2012 466.

<sup>120</sup> Bouwman “An appraisal of the modification of the director's duty of care and skill” 2009 *SA Merc LJ* 509 511.

Ryan state that codification risks losing adaptability of certain legal principles in exchange for legal certainty and accessibility of fixed statutory wording.<sup>121</sup>

### **4.3 Conclusion**

As it has been shown above, codification of the directors' duties has got many advantages and disadvantages. It is up to the legislature to weigh out the option in order to choose an appropriate approach. If the advantages outweigh the disadvantages then the complete codification approach will be a suitable method. However the disadvantage may lead to the redundant of the law and to difficulties that may lead to the overall disregard of the common law foundations that its legal system is based on, then a much better approach should be followed which may include partial codification.

## **5. ADVANTAGES AND DISADVANTAGES OF PARTIAL CODIFICATION**

### **5.1 Advantages of partial codification**

In terms of partial codification the statute and the common law will exist together.<sup>122</sup> In some instances where the statute does not provide for equitable results the common law rules will apply giving better results.<sup>123</sup> According to Bouwman partial codification is a better way to approach codification of directors' duties this is because, partial codification will not stunt the common law growth. She further argues that it is because partial codification embraces the principles that have been developed through the interpretation of legal cases.<sup>124</sup>

The other advantage that is brought by the partial codification system is that it does not lead to the reduction of the common law principles to a simple principle and as a result it allows common law to govern the situations in which the legislation does not provide answers on.<sup>125</sup> Through partial codification, flexibility of the rules is not compromised and the common law rules can still be used in complex legal cases

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<sup>121</sup> Mayson *et al Company Law* 2015-2016 477.

<sup>122</sup> Cassim *et al Contemporary Company Law* 2012 508.

<sup>123</sup> Mayson *et al Company Law* 2015-2016 433.

<sup>124</sup> Bouwman "An appraisal of the modification of the director's duty of care and skill" 2009 *SA Merc LJ* 511 523.

<sup>125</sup> Cassim *et al Contemporary Company Law* 2012 508.



that will provide a legal precedent when applied correctly.<sup>126</sup> Mostly the other advantage is that most of the disadvantages of complete codification will be avoided if a partial codification system is followed.<sup>127</sup>

## **5.2 Disadvantages of partial codification**

The disadvantages of partial codification include the fact that it will not resolve legal uncertainty that directors, shareholders and other stakeholders' experience.<sup>128</sup> There is also no evidence to show that partial codification will reduce time and effort in extracting applicable legal principle as Bouwman puts it.<sup>129</sup>

## **5.3 Conclusion**

Considering the history of the South African legal system, one can say that partial codification is an advantageous approach to follow when it comes to the codification of directors' duties. This is because the common law and the legislation will exist alongside each other.<sup>130</sup> This will help in development and preserving of the common law rules and flexibility of the application will not be compromised. Partial codification will help to inform directors of their duties owed to the company.

## **6. ASSESSMENT OF THE SOUTH AFRICAN LEGAL SYSTEM PERTAINING TO CODIFICATION OF DIRECTORS DUTIES.**

The South African legal system in terms of Companies Act provides for partial codification of the directors' duties. Other legal systems provide complete codification of their directors' duties, example the United Kingdom.<sup>131</sup> In the South African legal system, legislation and the common law co-exist together.<sup>132</sup>

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<sup>126</sup> Bouwman "An appraisal of the modification of the director's duty of care and skill" 2009 SA Merc LJ 509 523.

<sup>127</sup> Cassim *et al Contemporary Company Law* 2012 467.

<sup>128</sup> Bouwman "An appraisal of the modification of the director's duty of care and skill" 2009 SA Merc LJ 511 523.

<sup>129</sup> Bouwman "An appraisal of the modification of the director's duty of care and skill" 2009 SA Merc LJ 511 523. she further state that if the duties of the directors will be partially codified, this will mean that both the codified aspect of the law will be able to exist with the common law rules and in doing so a balance is created.

<sup>130</sup> Cassim *et al Contemporary Company Law* 2012 508.

<sup>131</sup> Mayson *et al Company Law* 2010 468. They state that the statute will override any common law principle in this case.

<sup>132</sup> McLennan "Duties of care and skill of company directors and their liability for negligence" 1996 SA Merc LJ 94 101.

The Companies Act is silent on the directors' duties after they have resigned on whether liability for exploiting a company opportunity can be attached to the director. Although it can be argued that codifying of the directors' duties brings legal certainty as the United Kingdom has done, some authors have argued that complete codifications has many disadvantages and as a result partial codification provides what others call a perfect balance.<sup>133</sup>

Based on the fact that the common law rules and principles will exist together with statutes, partial codification can be said to be a better approach in terms of the South African legal system. Other authors have embraced partial codification and as well argued in favor of it. One may argue that based on the South African legal system it will be much better if both the statute and common law principles that are still applicable exist together. This will help in the further development of the law. It has been said that adopting partial codification will enable to avoid most of the disadvantages of complete codification and as well enable in the development of common law principle that are still applicable. The disadvantages of complete codification outweigh its advantages.<sup>134</sup> Complete codification is also not practically achievable, this is because the common law principles have developed over a long period of time and to try to codify them may not bring in wanted results.<sup>135</sup>

The other reason to embrace partial codification is because; it embraces the principles that have been developed through the interpretation of legal cases.<sup>136</sup>

## **7. Recommendations**

From the above exposition of advantages and disadvantages relating to the codification of the directors' duties, I conclude that it will be a better method for South Africa to have a more balanced approach that allows for both the development of the common law and at the same time bring legal certainty. In terms of the South African

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<sup>133</sup> Bouwman "An appraisal of the modification of the director's duty of care and skill" 2009 *SA Merc LJ* 509 511

<sup>134</sup> Mayson *et al Company Law* 2010 434. The statute will override any common law principle in this case

<sup>135</sup> Bouwman "An appraisal of the modification of the director's duty of care and skill" 2009 *SA Merc LJ* 509 511.

<sup>136</sup> Bouwman "An appraisal of the modification of the director's duty of care and skill" 2009 *SA Merc LJ* 509 511.

legal system, partial codification of directors' duties will be considered as a better approach.

The Companies Act should have provisions that provides for the regulation of directors' duties after they have resigned in order to complement the common law with regards to post resignation duties of the directors. Partially codifying post resignation duties of directors will help mean that most of the disadvantages of complete codification will be avoided and as a result common law principles will be embraced. Bouwman, Cassidy and Mayson, French and Ryan view complete codification as a method that limit the development of the common law principles.

Codification helps to inform the directors of their duties owed to the company; therefore partial codification is a best method for the reason that room will be left for further development of the common law as some of the duties will be codified and others left as the Companies Act has done pertaining to the fiduciary duties owed to the company by a director. This will help in preserving some of the common law principles since the South African legal system has the common law background just like the United Kingdom even though the latter has completely codified fiduciary duties, post resignation duties and as well as the duty of care and skill. Therefor the South African legal system should continue with partial codification approach.

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