CORPORATE DIRECTORS' DUTY OF CARE, SKILL AND DILIGENCE UNDER THE NEW ZIMBABWEAN COMPANIES AND OTHER BUSINESS ENTITIES ACT

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ABSTRACT

The new Zimbabwean Companies and Other Business Entities Act [Chapter 24:31] *introduced far reaching changes to the corporate regulatory landscape in Zimbabwe. Significantly, COBE brought under the statutory purview, directors' duties that were largely regulated under the common law. However, this statutory codification of duties previously regulated by common law has raised questions as to whether the legislature has altered the standard expected of company directors in the execution of their duties. This article sought to analyse the impact of legislative intervention on directors' duty of care, skill and diligence as laid down under common law and developed through judicial interpretation. The article argued largely that the new law, by codifying a previous common law duty, modified the common law standard of care and skill expected of a company director's conduct and in the process places a rather higher standard on directors as opposed to those required under common law.*

Key words: Companies and Other Business Entities Act [*Chapter 24:31*]; director; duty of care, skill and diligence; common law duty of care; standard of care

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1.0 INTRODUCTION

In February 2020 Zimbabwe enacted a new law, the Companies and Other Business Entities Act (COBE),[4] to regulate companies and other businesses. COBE which repealed the old Companies Act[5] and Private Business Corporations Act,[6] introduced far reaching changes to the corporate regulatory landscape in Zimbabwe. One aspect that witnessed material changes is the regulation of company directors' duties. Traditionally company directors' duties have been largely governed by common law as interpreted through judicial decisions.[7] The new law brought this crucial aspect of corporate law under statutory purview.

COBE codified the standard of company directors in Zimbabwe in Part IV. Section 54 obliges every director of a company to exercise their functions towards the company in good faith, in the best interest of the company and with diligent care, skill and attention.[8] It is further provided that in discharging this duty, a director can rely on information, opinions, reports or statements (including financial statements) of independent auditors or legal practitioner or experts or employees of the company provided that the director concerned reasonably believe the reliability and competence of such information, opinion, report or statement[9] and only upon making a proper inquiry should there be a need for such an inquiry.[10]

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4 The Companies and Other Business Entities Act [*Chapter 24:31*] (hereinafter 'the Act') was gazette in the Government Gazette Extraordinary of 15 November 2019 in General Notice 2073/2019.

5 [*Chapter 24:03*].

6 [*Chapter 24:11*].

7 I Esser & JJ Du Plessis 'The Shareholder Debate and Directors' Fiduciary Duties' (2007)19 *SA MercLJ* 346.

8 S 54 (1).

9 S 54 (2)

10 S 54 (3)

Section 54 also codified the business judgment rule.[11] This rule exempts a director from liability if he/she takes reasonable diligent steps to be aware of the matter that is subject to decision making on behalf of the company in circumstances where the concerned director has no personal financial interests or has declared such interest in addition to having a rational basis to believe that the decision involved is in the company's best interest.[12]

The codification of traditional common law directors' duties brings clarity to directors' responsibilities and accountabilities towards the company and other stakeholders. This is critical in the face of demands being placed on the conduct of company directors to observe and promote good corporate governance. The role of company directors in ensuring corporate viability and survival has come under increasing spotlight in an environment characterized by corporate viability challenges and publicized corporate failures attributed to a volatile operating environment and corporate governance challenges in equal measures. The new law comes with the backdrop of the need to promote effective corporate governance as a universally acceptable modern-day management standard. It is thus not surprising that the Act expressly provides for the role of directors in promoting good corporate governance.[13]

Section 54 combines the director's standard of care, skill and diligence and fiduciary duties in one single test. It is with this in mind that this paper analyses the nature and extent of codified director's duty of care and skill with a

11 S 54 (4).

12 *Ibid.* (a),(b),(c). See generally, *In re The Walt Disney Co. Derivative Litigation*, 906 A. 2d 27 (Del. June 8, 2006).

13 S218.

view to assess how the codification impacted on the same duty as provided under common law. To advance this objective, the paper will largely adopt a comparative approach to the elements of the duty of care, skill and diligence under COBE and as is under common law. The paper will argue that although the statutory codification has the effect of modifying the common law standard of care and skill, such modification largely made additions relating to the standard of directors' conduct which are now a steep higher without subtracting anything from the common law elements of the duty as was proposed in *re City Equitable Fire Insurance Co*[14] and approved in *Fisheries Development Corporation of South Africa Ltd v Jorgensen v AWJ Investments (Pty) Ltd and others*[15] and *Gomwe and Another v Associated Newspapers of Zimbabwe (Pvt) Ltd*.[16] The paper will also demonstrate that the codification, given the background of the Act, that is, the corporate governance movement, places a rather higher standard on directors as opposed to those required common law.

1.1 COBE and director's duty of care, skill and diligence

COBE codified the standard of director's conduct in section 54 of Part IV. Section 54 provides that every director or officer of a company owes a duty of care towards the company. It provides that:

> (1) […] every director or officer of the company has a duty to perform as such in good faith, in the best interests of the registered business entity, and with the care, skill, and attention that a diligent business person would exercise in the same circumstances.

14 [1925] 1 Ch 407.

15 1980(4) S 156(W) 437.

16 2001(2) ZLR 415 (H).

> (2) In performing that duty, the manager, officer or director as the case may be referred to in subsection (1) may rely on information, opinions, reports or statements (including financial statements) of independent auditors or legal practitioners or of experts or employees of the registered business entity whom the person reasonably believes are reliable and competent to issue such information, opinions, reports or statements.
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> (3) Subsection (2) applies only if the person makes proper inquiry where the need for inquiry is indicated by the circumstances, and has no knowledge that such reliance is unwarranted.
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> (4) A person who makes a business judgment acting as stated in subsection (1), (2) and (3) fulfills the duty under this section with respect to that judgment if that person—
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> (a) does not have a personal interest as defined in section 56 ("Transactions involving conflict of interest") in the subject of the judgment; and
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> (b) is fully informed on the subject to the extent appropriate under the circumstances; and
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> (c) honestly believes when the judgment that it is in the best interests of the company or corporation.

Despite being headed as 'duty of care and business judgment rule', section 54 combines directors' common law fiduciary duties of acting in good faith[17] and in the best interest of the company[18] with the duty of care and skill. This implies that the statutory codification applies in addition to the common law stipulation rather than being

17 S54(1)

18 *Ibid.*

applied to substitute them.[19] This construction entails that jurisprudence developed prior to the enactment of COBE that developed the common law principles are still applicable and will be used to interpret the statutory provisions. The common law principles relating to the duty will thus be referred to under appropriate sections of this discussion.

1.2 Application of section 54 to the duty

Section 54(1) provides that every director or officer of the company has a duty to act with care, skill and attention to towards the company. Section 2(1) of COBE defines a director as to include 'any person occupying the position of director or alternate director of a company, whatever his or her title.' This formalistic definition relates more to the position that one finds himself/herself in. This entails that a director is any person who performs the managerial functions of the company.[20] An officer of the company is defined as to mean 'an officer appointed by the company's board of directors' and includes managers and secretaries[21] who are responsible for management and operations of the company's activities except for those activities within the exclusive jurisdiction of the board of directors.[22]

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19 Deloit 'Duties of Directors' 2013.p.23. Available at https://www2.deloitte.com/content/dam/Deloitte/za/Documents/governance-risk-compliance/ZA_DutiesOfDirectors2013_16042014.pdf,(accessed 20 April 2022).

20 Powertech Industries Ltd v Mayberry and another 1996 (2) SA 724 (W), 746B.In this case NUGENT J quoted the English case of Caparo Industries p/c v Dickman and others [1989] 1ALL ER 798 (CA), 804 a-c where in reference to the role of an auditor it was held that 'the responsibility for day –to-day management of the company is delegated to directors.' See also Levy v Central Mining and Investment Corporation Ltd 1955(1) SA 141 (A) where the court described the board of directors as the 'directing mind and will' of the company. See further HS Cilliers, ML Benade, JJ Hening & JJ Du Plessis Corporate Law 2ed (1992)133; WA Jourbert (founding ed) The Law of South Africa (LAWSA) 4(1) 'Companies' (by MS Blackman) (1995) para 161; JS McLennan 'Directors' Duties and Misappropriation of Company Funds' (1982) 99 SALJ 394,408.

21 S 2(1).

22 S221(3).

The import of section 54(1) is that the directors' duties, including that of care and skill also apply to managers and officers of the company who are not themselves, strictly speaking, directors but occupy managerial positions within the company. These officers have powers to bind the company and as such are required to exercise a reasonable degree of care and skills whenever they transact to bind the company. It is submitted that by extending the duty of care and skill to officers of the company, the legislature placed a burden on persons concerned to be aware of their responsibilities as well as on the company to conscientise them of their obligations.

1.2.1 Elements of the duty under the Act

(a) Attending to company's affairs

Section 54(1) provides that every director has a duty to exercise his/her functions towards the company with care, skill, and attention. Generally, a company director is expected to attend to the affairs of the company. In *Re City Equitable Fire Insurance Co* it was held that a director's duty of care and skill largely depends on the nature of the company's business and any other obligations undertaken or assigned to him.[23] The question then arises as to what extent is a director expected to attend to the company's affairs? In answering this question a distinction is often made between an executive director and a non-executive

23 At 427. See also *Wolpert v Uitzigt Properties* 1961(2) SA 257 (W) 267; *Fisheries Development Corporation of South Africa* (note 15 above) 165.

director.[24] An executive director is obliged to devote his/her full attention to the affairs of the company for which he/she is entitled to a salary and other benefits.[25] A non-executive director is not obliged to give continuous attention to the affairs of the company for his/her duties are of intermittent nature to be performed at periodical board meetings and for which he/she is entitled to board fees.[26] Whereas there is no such distinction made in terms of the law, this distinction exists in practice. In *CyberScene Ltd*[27] it was held that a director stands in a fiduciary relationship to the company even if he/she is a non-executive director. The implication of the absence of the legal distinction is that the duty applies to all directors. Based on this construction and given that COBE does not provide for any distinction, it is accordingly submitted that the duty applies to all the types of directors.

The common law position relating to the duty to attend to company's affairs was pronounced in *Re City Equitable Fire Insurance Co.* where the court proposed that in performing his functions as such, a director is not required to give continuous attention to the company's affairs.[28] Within the context of the distinction between executive and non-executive directors, this proposition thus suggests that

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24 *Howard v Herrigel and another NNO* 1991 (2) SA (A) 678 A-B where in reference to company's statutory liabilities in terms of section 424 of the then South African Companies Act 61 of 1973 GOLDSTONE JA opined that 'it is unhelpful and even misleading to classify company directors as 'executive' or 'non-executive' for purposes of asserting their duties to the company…' The court further rejected this distinction as baseless in law for nowhere is it provided for be it at common law or statute. See also Institute of Directors in Southern Africa 'The King Report on Corporate Governance 2002 'King II' chapter 6, Para 11 (all principles applying to executive directors apply to non-executive directors as well).

25 *Gomwe* (note 16 above). See also See *Fisheries Development Corporation of South Africa* (note 15 above) 165.

26 *I bid.* See also *In Re City Equitable Fire Insurance Co.Ltd* (note 14 above) 408.

27 *CyberScene Ltd & others v iKiosk Internet and Information (Pyt) Ltd* 2000 (3) SA 806 (C).

28 *Re City Equitable Fire Insurance Co.Ltd* (*note* 14 above) 429: *Re Brazilian Rubber Plantations and Estates ltd* [1911]1 Ch 425, 437. See also *Gomwe* (note 16) 415.

companies are run by executive directors and their non-executive counterparts are not obliged to continuously attend to the company's affairs.[29] However, a director is expected to attend periodic board meetings as well as any meetings of any board committee to which he/she is placed.[30] Although the nature of a non-executive director's duty is intermittent, periodically performed and whenever the need arise,[31] he/she is expected to execute his duties with a degree of care and skill expected of a person of his caliber whenever is in attendance.[32]

In *Fisheries Development Corporation of South Africa*, it was held that 'the extent of a director's duty of care depends to a considerable degree on the nature of the company's business and any particular obligations assumed by or assigned to him.'[33] In in *re City Equitable Fire Insurance Co. Ltd*, the court further proposed that a director is not bound to attend all board and committee meetings although ought to attend whenever in the circumstances is reasonable able to do.[34] This proposition is largely premised on the distinction between executive and non-executive directors and applies to the former. This makes it an outdated proposition[35] considering that modern companies employ full time executive directors.[36] It is

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29 *Ibid*.

30S ee *re City Equitable Fire Insurance Co.Ltd* (note 14 above) 408 and 427. See also *Wolpert v Uitzigt Properties* (note 23 above); Fisheries *Development Corporation of South Africa* (note 15 above) 165.

31 *Re City Equitable* (*note* 14 above) 429; *Fisheries Development Corporation of South Africa* (note 15 above)165;

32 *Ibid*.

33 Per MARGO J at 165; see also *Re City Equitable Fire Insurance Co.Ltd* (note 14 above), 427; *Wolpert (*note 23 above) 267.

34 At 408.

35 J S McLennan 'Duties and Skill of Company Directors and Their Liability for Negligence' (1996) 8 *SA Merc LJ* 94, 97.

36 *Ibid*. See also LCB Gower *Gower's Principles of Modern Company Law* 5ed (1992) 587 who noted that the proposition 'is directed to holders of non-executive directorships and the idea that they ought to attend meetings is merely "a pious hope."

submitted that the requirement that directors are not bound to give continuous attention to the company's affairs unless so specifically required to do reveals the laxity of the common law degree of care and skill and is not contemplated under section 54(1).

(b)The standard of care and skill

Section 54(1) provides that every director of a company must perform his/her duties 'with the care, skill, and attention that a diligent business person would exercise in the same circumstances'. This provision provides the standard of conduct that a director is measured against in determining whether or not he/she would have discharged of his/her duty of care and skill towards the company. The standard is thus whether a director has conducted him/herself is a manner 'that a diligent business person would exercise in the same circumstances.'

The question that needs to be answered is who is 'a diligent business person?' It is submitted that this is nothing more than an adaptation of the tradition reasonable person test applied in law. The concept of a reasonable person owes its roots from the Roman Law concepts of *bonus paterfamilias* or *diligent paterfamilias* which literally translates to 'the good father of the family' and 'the diligent father of the family' respectively.[37] Practically, these concepts translate into a reasonable person or diligent person.

A reasonable person has been described as an ordinary, normal, average person who is 'of ordinary knowledge and

37 See CR Snyman Criminal Law (4th ed.,2002) 214. See also R Ahmed 'The Standard of the Reasonable Person in Determining Negligence- Comparative Conclusions' (24) *P.E.R/PELJ* 2021, 1-55, 4; M Moran *Rethinking the Reasonable Person: An Egalitarian Reconstruction of the Objective Standard* (2003) 33; Artosi A "Reasonableness, Common Sense, and Science" in G Bongiovanni, G Sartor and C Valentini (eds.,) *Reasonableness and Law* (Springer Dordrecht 2009) 69-78,69.

intelligence.'[38] A reasonable person is neither an extremely and exceptionally cautious and talented nor underdeveloped or recklessly takes chances.[39] He/she thus is somewhat between these two polar. This in turn makes the reasonable person test an objective criterion.[40] Any personal qualities and characteristics of the person are disregarded[41] for considering them renders the test subjective.[42]

Section 54(1) refers to a diligent business person in the same circumstances as the director concerned. This formulation is thus a modified version of the ordinary person implied by the reasonable person test. A diligent business person is not just any person but one with business qualities. This however does not tilt the formulation of the reasonable person or diligent person test. In *S v Meyer* [43] it was held that the true test in cases involving persons of specialized knowledge is not merely a reasonable person in the same circumstance but rather 'whether he/she exhibited that degree of care and skill which may reasonably be expected of a competent person.'[44] It follows therefore that the legislature in formulating section 54(1) contemplated a standard more than that expected of a normal reasonable person.

In interpreting the same requirement under the common law duty of care and skill, MAGO J in *Fisheries Development Corporation of South Africa Ltd* stated that in performing

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38 *S v Mbombela* 1933 AD 269, 273. See also generally G Feltoe *A Guide to the Zimbabwean Law of Delict* (2012) 13; J Neethling and JM Potgieter *Law of Delict* (8 th ed., 2020) 169-176.

39 Snyman (note 37 above) 214.

40 *Ibid.*, 215; Felote (note 38) 13.

41 *Mbombela* supra 38 at 272-274

42 Synman (note 37 above) 215.

43 *S v Meyer* 1971 4 SA 178 R 183 E-G

44 At 183 E-G

his/her duty of care and skill, a director need not 'exhibit special business acumen or expertise, or singular ability or intelligence or even experience in the business of the company.'[45] The court then held that a director is only required to exercise a reasonable degree of care and skill in executing his duties.[46]

In *City Equitable Fire Insurance Co. Ltd*, ROMER J stated that a director need not exhibit in the performance of his duties, 'a greater degree of skill than may be reasonably expected from a person of *his/her* knowledge and experience.'[47] It is submitted that this negative formulation plainly put, means that a company director is not required to have any special qualifications.[48] The COBE Act[49] does not prescribe any qualifications except for disqualifications.[50] In principle a director is not required to have any expertise in the business of the company in which he/she is appointed director.[51] However if his/her appointment is based on his/her expertise then he/she is expected to bring forth such for the company's benefit.[52]

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45 Per MARGO J in *Fisheries Development Corporation of South Africa Ltd* (note 15 above) 166. Similarly, the court in *Re Brazilian Rubber Plantations and Estates Ltd* (note 28 abve) 437 ,it was stated that 'a director may undertake the management of a rubber company in complete ignorance of anything connected with rubber, without incurring responsibility for the mistakes which may result from such ignorance…'

46 *Ibid.*

47 *Re City Equitable Fire Insurance Co. Ltd* (note 14 above) 428. With writers' emphasis italicized. See also *Fisheries Development Corporations of South Africa Ltd* (note 15 above) 165.

48 *Fisheries Development Corporation of South Africa* (note15 above) 166. See also *In re Brazilian Rubber Plantations and Estates Ltd* (note 28 above)436 where NEVILLE J stated that a director is' bound to bring any special qualifications to his office.' See also McLennan (note 35 above) 96.

49 Companies and Other Business Entities Act [*Chapter 24:31*].

50 See sections 218 and 219 of the Act.

51 See *re Brazilian Rubber Plantations and Estates Ltd* (note 28 above) 437.NEVILLE J stated that, '…he might undertake the management of a rubber company in complete ignorance of everything connected with rubber…' see also G Morse (principal ed) *Palmer's Company Law* 25ed (loose leaflet update) (1995) 2, 8.408.

52 *Ibid.*

A director ought to exercise his/her duties of care and skill with a reasonable degree expected from him/her having regard to his/her knowledge and experience.[53] This objective standard applied in *Re Brazilian Rubber Plantations and Estates*[54] and adopted in *re City Equitable Fire Insurance Co. Ltd*[55] and expressed in *Norman Theodore Goddard*[56] has an element of subjectivity.[57] This subjective element implies that a 'director might thus pray in aid his or her deficiencies'[58] since he would be 'obliged only to do as much as could be expected from someone as incompetent and foolish as he happens to be.'[59]Under common law, a director is expected to act 'with such care as is reasonably to be expected from him, having regard to his knowledge and experience'.[60] Reasonableness of care is 'measured by the care an ordinary man might be expected to take in the same circumstances on his own behalf.'[61]

It is submitted that this 'minimum and irreducible objective standard,'[62] popularized in many decisions,[63] is inadequate in determining the degree of care and skill directors owe to

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53 *Ibid.* See also *In re City Equitable Fire Insurance Co.Ltd* (note 14 above) 428. Cf. *Norman v Theodore Goddard* [1991] BCLC 1028.The court holding that a director of a property company was not to be a tax expert, employed an objective test being that care that may reasonably be expected of a person carrying out those functions.

54 Note 28 above, 437. See also Dwight [1907] *Yale LJ* 33, 35 and further *In re Denham and Co* (1884) 25 ChD 752,767.

55 Note 14 above, 428. See also *Lagnus Nitrate Co. v Lagnus Syndicate* [1899]2 Ch 392,435 and *re Brazilian Rubber Plantations and Estates Ltd* (note 28 above) 437.

56 Note 51 above, 1028.

57 See *Re D'Jan of London Ltd* [1994]1BCLC 561.

58 V Finch 'Company Directors: Who Cares About Skill and Care?' (1992) (55) *Modern Law Review* 179,200.

59 Mackenzie 'A Company Director's Obligations of Care and Skill' [1982] *JBL* 460,461.

60 Par NEVILLE J in *re Brazilian Rubber Plantations and Estates Ltd* (note 28 above) 437.

61 *Ibid.*

62 A Hicks 'Directors' Liability for Management Errors' (1994) 110*LQR* 390,392.

63 See *Fisheries Development Corporation of South Africa* (note 15 above) 166; *re Brazilian Rubber Plantations and Estates* (note28 above) 437; *re City Equitable Fire Insurance Co. Ltd* (note 15 above)428 and *Norman v Theodore Goddard* (note 53 above) 1028

their companies.[64] Under common law, a director's knowledge and experience may be less than that may be reasonably expected of a person who carries out the director's functions.[65] This interpretation, it is argued, is the one that the legislature contemplated when formulating the standard is section 54(1), that is, a diligent business person in the same circumstances as the director. It is submitted that a director must only be held liable for negligence having regard to his own knowledge and experience.[66] The statutory formation of this duty correctly reflects the modern commercial fact that nowadays a company director, particularly of a listed company, is often a highly skilled professional with considerable business experience.[67] Thus a partly objective and partly subjective test is contemplated.[68] Riley argued that by adopting the subjective standard a director 'would be liable only where she herself was capable, given the person she is, of avoiding failure.'[69] Plausible as this might appear, this has the potential of discouraging experts from taking up directorships.[70] Hence directors should be judged on the functions they undertake to perform without fearing that

64 Mayson, French & Ryan *Mayson, French and Ryan on Company Law* 15ed (1998-99)485. The court in *Daniels (formerly practicing as Deloitte Haskins & Sells) v Anderson* (1995) 37 NSWLR, 438 affirmed the position and called for a stricter and objective standard for directors. The court held that '…it is no longer appropriate to judge directors' conduct by the subjective texts that were applied in outdated precedents….whatever may have been the position in the past, directors are no longer ornaments or figureheads…'

65 *Ibid*.

66 *Re D'Jan of London Ltd* (note 57 above).

67 See F. Cassim, J Cassim , R Jooste et al, *Contemporary Company Law* 2 ed. (2012) 558.

68 See CA Riley 'The Company Directors' Duty of Care and Skill: The Case for an Onerous but Subjective Standard' (1999)62*The Modern Law Review* 697 for arguments for the subjective test.

69 *Ibid.*, 700.

70 See also PC Sorensen 'Discretion and its Limits- An Analytical Framework for Understanding and Applying the Duty of Care to Corporate Directors' (1988) 66 *Wash ULQ* 533,573 who argued for not imposing an onerous standard on the basis that it will stifle entrepreneurship and discourage non-executive directors.

their qualifications might prejudice them.[71] This standard confirms what Finch described as showing that 'common law operates to give directors a remarkable freedom to run companies incompetently.'[72] Thus by doing very little directors actually do no wrong at all.[73] This strengthens the call for an onerous standard.[74]

Section 54(1) refers to a diligent business person in the same circumstances as those of the director concerned. The legislature provided a customized test to cater for the individual qualities of the directors. The standard thus carries both objective and subjective elements. The objective element is denoted by the 'diligent business person' through which a director's conduct is measured against a person conducting the same functions as that of the concerned director which functions are promoting the interests of the business. Any business person would ideally make decisions that promote the best interests of the business. The subjective element is denoted by the phrase 'in the same circumstances.' This implies that the concerned director's conduct is measured against that of a person of the same knowledge, skill and experience as that of the director.[75]

The Act retained the standard proposed in *Lagnus Nitrate*[76] quoted with approval in *re City Equitable Fire Insurance Co. Ltd*[77] and *Fisheries Development Corporate of South Africa Ltd*.[78] Essentially this test is partly subjective and

71 Finch (note 58 above)203.

72 *Ibid.*, 179.

73 Riley (note 67 above) 700.

74 Finch (note 58bove) 202. See also Sorensen (note 69 above) 573.

75 Deloit (2013) (note 19 above).

76 Note 55 above, 435.

77 Note 14 above, 428.

78 Note 15 abive,166.

partly objective. The first leg contemplates a minimum objective standard, that is, to perform the duty 'with the care, skill, and attention that a diligent business person would exercise in the same circumstances.'[79] Critics[80] often point to the fact that traditional reference to a 'reasonable person' shows the laxity of the duty more so that a reasonable person's standards can be far less than a director's.[81] It is argued that a partly subjective and partly objective test in the Act had addressed this shortcoming. The subjective element account for the actual position occupied by the director in the company.[82] It is submitted that this potentially extends the liability of a director particularly in that should he/she possess certain skills or experience he is expected to apply them.[83]

It has been illustrated that just as the case under common law, [84] the codified standard is largely objective with a subjective element. This double-pronged quality of the standard raises the question as to the extent of application of the standard of conduct to the company directors? In other words, who is bound and to what extent? Given that the Act does not provide a distinction on the types of directors and specifically refers to 'every director,' it can be argued that all directors are bound by the standard regardless of whether one is an executive or non-executive director. The standard of conduct applies equally to all directors of the company.[85] However, this assertion ignores the fact that directors do not possess the same skills and

79 S 54(1).

80 See generally Riley (note 67 above) 697.

81 See Myson et al (note 64 above) 485.

82 McLennan (note 35 above) 101.

83 *Ibid*.

84 Common law on test being both objective and subjective.

85 Deliot (2013) (note 19 above).

experience. This variance in skills and experiences then require that logically the standard be applied differently to corporate directors. In *Fisheries Development Corporation Ltd of South Africa,* it was confirmed that the test applies differently to different types of directors.[86] This however does not mean that directors will have different duties towards the company. They still owe the same duty of care and skill towards the company but only that by inserting the subjective element to the test, the legislature intended the measurement against the standard of conduct to account for personal circumstances of each director.[87]

(c)Reliance upon company officials and others

Section 54(2) provides that:

> (2) In performing that duty, […]director […]may rely on information, opinions, reports or statements (including financial statements) of independent auditors or legal practitioners or of experts or employees of the registered business entity whom the person reasonably believes are reliable and competent to issue such information, opinions, reports or statements.

The above provision codified the common law element of the duty of care and skill where the director was deemed to have discharged of his/her duty if had he/she reasonably relied on 'information, judgment and advice of the company management unless there are proper reasons for querying such.'[88] At the core of this common law proposition is the indispensable element of human trust in

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86 See *Fisheries Development Corporation of South Africa* (note 15 above) 437.

87 Deloit (2013) (note 19 above).

88 *Re National Bank of Wales Ltd* [1899]2 Ch 629,673 and appeal as *Dovey v Cory* [1901] AC 477,485,492. See also *In re City Equitable Fire Insurance* (note 14 above) 429-430; *Huckerby v Elliot* [1970]1 ALL ER 189[QB] 193-94. This was also echoed in *Fisheries Development Corporation of South Africa* (note 15 above) 166.

business.[89] For convenience, a director is expected to delegate to some company officials such duties that he/she personally cannot perform.[90] However he/she ought to exercise such delegation with caution[91] but not 'suspicious of dishonesty.'[92]

In *re City Fire Equitable Insurance Co. Ltd* it was held that reliance on such information, judgment or advice can be necessitated by the company's constitutive documents or circumstances.[93] However, a director cannot just blindly accept such information, judgment or advice without any reasonable belief on the truth thereof.[94] He/she can only be justified, in the absence of fraud and dishonesty, to trust and rely upon such official to perform such duties as honestly delegated.[95] Although delegation shows a lighter duty of care and trust as contrasted to the heavy duties of loyalty, it has been argued that a director may not be indifferent or a dummy in relying on others.[96]

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89 *Ibid.*

90 *Fisheries Development Corporation of South Africa* (note 15 above) 166. See also *Re City Equitable Fire Insurance* (note 14 above) 452.

91 Riley (note 67) 386.

92 Lord DENNING in *Formento (Sterling Area) Ltd v Selsdon Fountain-Pen Co. Ltd and Others* (1988)1 ALL ER 11(HL)23 quoted by BOSHOFF J in *Tonkwane Sawmill Co.Ltd v Filmmaker* 1975(2) SA 435,455(in respect of auditor's role).

93 *In re City Equitable Fire Insurance* (note 14 above) 425.

94 *Fisheries Development Corporation of South Africa* (note 15 above) 166.

95 *In re City Equitable Fire Insurance* (note 14 above) 452. See also *Re National Bank of Wales Ltd* (note 87 above).

96 Gower (note 36 bove) 602 et seq.

A director who relied upon untrue expert advice cannot be held liable thereupon.[97] However, relying on an expert must not be used as a shield of culpable ignorance or failure to understand the company's affairs.[98] It is submitted that a diligent director would use his/her knowledge and experience to consider the advice and make a sound judgment in the interest of the company.[99]

In its wisdom, the legislature took on board this common law element of the director's duty of care and skill. Section 54(2) allows a director to 'rely on information, opinion, reports or statements (including financial statements) of independent auditors or legal practitioners or of experts or employees of the registered business entity whom the person reasonably believes are reliable and competent to issue such information, opinions, reports or statements.'

For the avoidance of doubt, section 54(2) clarifies what the director can rely on from others and from whom. A director can 'rely on information, opinions, reports or statements (including financial statements)' and from 'independent auditors or legal practitioners or of experts or employees.' However, this reliance is qualified. A director can only rely on any such person mentioned (independent auditors, legal practitioner, experts and employees) when the director

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97 See *Norman v Theodore Goddard* (note 53 above) 1048.Where Mr. Q who was a chartered surveyor, was a director of a property company. The shares in the company were principally assets of a trust administered by Theodore Goddard, a leading firm of solicitors. Mr. Q relied on the advice of a partner in the firm that tax would be saved if the company's surplus cash were to be lent to on deposits to a company which the latter claimed was controlled by the firm. Factually the company was controlled by that partner and it was one of the mechanisms he used to steal money from trust funds administered by the firm. The court held that by relying on an expert that tax was going to be saved. Mr. Q was not liable for negligence.

98 Gower (note 36 above) 602.

99 See *Fisheries Development Corporation of South Africa* (note 15 above) 166. MARGO J said, 'obviously a director exercising reasonable care would not accept information and advice blindly. He would accept it, and he would be entitled to rely on it, but he would give it due consideration and exercise his own judgment in the light thereof.'

reasonably believes the reliability and competency of the person so relied upon. The director thus cannot blindly rely on the information, opinion, and report of statement of the said person.[100] Subsection 3 of the same section obliges a director who relies on such to make a proper inquiry where there is need for such inquiry as dictated by circumstances.

In relying on advice from others, a director thus has a responsibility to give due consideration to such and thereupon exercise his/her own judgment. In *Australian Securities and Investments Commission* v *Healey* (*Centro* case),[101] the court held liable all non-executive directors of the company for approving financial statements without noticing certain omissions and errors therein after having solely relied on management (employees) and external advisers. The found that:

> All directors must carefully read and understand financial statements before they form the opinions which are to be expressed … Such a reading and understanding would require the director to consider whether the financial statements were consistent with his or her own knowledge of the company's financial position. This accumulated knowledge arises from a number of responsibilities a director has in carrying out the role and function of a director. [102]

The *Centro* case raises questions as to the extent to which directors can rely on others (independent auditors, the audit committee and the company's own finance team).

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100 *Ibid.*

101 [2011] FCA 717. In this case the non-executive Chairman, 6 other non-executive directors and the Chief Finance Officer of the Centro Property Group 'Centro' faced allegations by the Australian Securities and Investments Commission that they had contravened provisions of the Australian Corporations Act 2001 particularly having approved the consolidated financial statements of Centro which incorrectly reflected substantial short-term borrowings s 'non-current liabilities.' Similar provisions requiring the board of directors to approve the financial statements are also contained in the Zimbabwean statute. See generally s183.

102 *Ibid.*, at 17 and 18.

The answer to this is that the directors can still rely on these persons but such reliance must not take away the directors' responsibilities to give any advice from these persons due consideration and thereupon exercise own judgement. Directors cannot in the name of relying on others, blindly accept advice and rubber stamp positions for this will amount to dereliction of the duty of care towards the company. In case of financial statements, directors are expected to exercise their own judgment before they approve the financial statements. This entails that even if they rely on the audit committee of the board of directors and the company's own finance team, they cannot however transfer (ceded, delegate or assign) their legal liability to such committee or team.[103]

Section 54(2) makes specific reference, *inter alia*, to financial statements as well as independent auditors and employees of the company. This entails that a director is entitled to accept and rely on the opinion or judgment, information and advice of the management relating to financial issues of the company contained in the financial statements. However, a director cannot rely on such information, opinion, report or statement if there exist any proper reasons not to.[104] In *Fisheries development Corporation of SA Ltd*[105] it was also held that a director:

> [i]s not expected to examine entries in the company's books... Obviously, a director exercising reasonable care would not accept information and advice blindly. He would accept it, and he would be entitled to rely on it, but he would give it due consideration and exercise his own judgment in the light thereof. [106]

103 Deliot (2013(note 19 above).

104 See note 99 above.

105 *Ibid.*

106 *Ibid.*, 166.

The import of both *Fisheries Development Corporation of SA Ltd* and the *Centro* case on section 54(2) and (3) is that directors are generally allowed to accept and rely on information, opinion, reports or statements (including financial statements) from other persons for as long as the directors concerned have reason to believe that such person is competent and the information, opinion , report or statements is credible. This then requires the absence of doubt or mistrust in the person so relied upon.

1.3 The business judgment rule

A significant statutory modification made to the common law director's duty of care and skill is the insertion of the business judgment rule. This rule is a doctrine derived from US courts' interpretation and application of corporate law principles as a defence for business executives (directors) when faced with charges of breaching of their duties particularly acting in a manner that potentially prejudices the company. The rule is derived from the principle that company directors are motivated in their conduct by a bona fide *(good faith)* desire to advance the interests of the company.[107] The business judgment rule is given statutory effect in section 54(4) which provides that:

> (4) A person who makes a business judgment acting as stated in subsection (1), (2) and (3) fulfills the duty under this section with respect to that judgment if that person—
>
> (a) does not have a personal interest as defined in section 56 ("Transactions involving conflict of interest") in the subject of the judgment; and

107 *Gimbel v Signal Cos.* 316A. 2d 599, 608 (Del.Ch.1974). The directors act in the best interests of the company as required by the shareholders who places them in control/management of the company.

(b) is fully informed on the subject to the extent appropriate under the circumstances; and
(c) honestly believes when the judgment is made that it is in the best interests of the company or corporation.

The provision avails the business judgment rule as a defence to any director who having no personal financial interest in the transaction forming part of the decision,[108] took reasonable diligent steps to learn about the transaction or matter that forms part of the decision and having no any personal financial interest in such a transaction or matter.[109] Additionally, the defence is only available where the concerned director honestly believes in the judgment, that is, that it is in the best interest of the company.[110]

The codification of the business judgment rule is a welcome development for it is recognition of two critical aspects of modern-day corporate decision business practices, *viz* risk taking and risk exposure. Both the company directors and interested parties are beneficiaries of the rule. Company directors can take risks in company management and rely on the rule should the risks fail to transform into meaningful returns for the business.[111] Interested parties including shareholders can show that the directors' conduct in transacting failed to meet the requirements of a sound business judgement hence prejudicial to the company.

It is submitted that the codification of the business judgment rule has a significant implication to a company

108 s54(4)(a)
109 s54(4)(b)
110 s54(4)(c).
111 Deloit (2013) (note 19 above) 4.

director's relationship with the company's stakeholders. The rule is derived from the principle that company directors are motivated in their conduct by a bona fide *(good faith)* desire to advance the interests of the company.[112] An interested party, be it a shareholder, creditor or any party who can establish substantial interest in the company can thus challenge the director (board)'s decision. The party making such a challenge must, on a balance of probabilities, prove that; (a) the directors in reaching their decisions, breached any of the elements of their fiduciary duties, that is, either acted in bad faith, did not show loyalty to the company, or breached a duty of care towards the company and (b) adduce sufficient evidence to prove (a) above.[113]

Although section 54(4) does not expressly provided for the criterion set out above, it is submitted that the provision can be construed to imply the same. This is because section 54(4) makes reference to the absence of a personal interest in the transaction forming part of the decision as well as taking steps to familiarise oneself with the circumstances surrounding the subject matter of the decision. These aspects thus imply a combination of duties specified under sections 54 and 195.[114].

Section 54(4) presents the business judgment rule as a defence available to diligent directors for having made sound business decisions that are motivated by benefiting the company. However, it is submitted that the business judgment rule can only be a basis of holding the same directors liable for damage suffered by a party with

112 *Gimbel v Signal Cos.* (note 107 above).

113 See *re The Walt Disney Co. Derivative Litigation* (note 12 above).

114 Section 195 provides for the general functions and responsibilities of directors.

substantial interest in the company even if that party fails to prove a breach of fiduciary duty and that of care and skills contemplated under section 54. In *re The Walt Disney Co. Derivative Litigation*[115] the court granted remedies against the company directors despite the claimant failing to prove on a balance of probabilities that the directors had breached their fiduciary duties after it was proven that the transaction in question was biased and constituted a waste of the company's resources such that no business person of ordinary and sound judgement could conclude that the company had received adequate consideration therefrom.

The codification of the business judgement rule thus presents both challenges and opportunities for company directors. Challenges in that it can be used as a basis to hold them liable should their conduct fail short of that of a business person of ordinary and sound judgement, and opportunities in that it enables them to take reasonable risks and exposure with the constant fear of unnecessary personal exposure to liabilities. It is submitted in the overall scheme of things that the benefits of the rule far out-weighs the risks for even the challenges implicit in the exposure to personal risks are determined using a rather objective standard of a businessperson of ordinary and sound judgement.

1.4 Basis of liability for breach of the duty

The common law basis of liability for directors for breaching their duty of care and skill flows from the relationship between a director and the company being *sui generis*, that is, exclusively arising 'from the circumstances that the director assumes responsibilities for the property

115 906 A. 2d 27 (Del. June 8, 2006).

or affairs of the company.'[116] Where there is breach of the duty, the courts have held that the company is entitled to remedies which are also *sui generis*.[117] It is also possible to base liability upon delict[118] founded on *action legis aquilia*.[119] The company must prove pure economic loss caused by the director's negligent conduct, that is, in breach of his duties of care and skill.[120]

Since the duty of care and skill is owed to the company,[121] it follows that the wrong is also suffered by the company. A shareholder's derivative action could only be sustained in fraud cases.[122] This action is provided for in section 61.[123] This is because directors could not be held liable for 'mere errors of judgment.'[124] However where directors personally

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116 Per LORD BROWNE-WILKINSON in *Henderson v Merret Syndicates Ltd* [1995]2 AC 145,205. See also *Cohen v Segal* 1970 (3) SA 702(W)706(directors of a company occupy a position peculiar to themselves).

117 See *Symington and Others v Pretoria Privaat Hospitaal Bedryfs* 2005(5) SA 550,562C. In an action against a director for appropriating of corporate opportunity, the court held that the company's action is *sui generis*.See also *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168,177-8, 192 and 241-2 regarding the *sui generis* basis for damages .In these cases the company need not necessarily prove that it suffered a loss.

118 Mayson, French & Ryan (note 64 above) 483, para16.2.

119 See generally J Neethling, JM Portgieter & PJ Visser *Law of* Delict4ed (2001)(trans and ed JC Knobel)265.See also *Kohler Flexible Packaging (Pinetown)(Pty) Ltd v Marrianhill Mission Institute* 2000 1 SA 141(D) 144-45(concurrence of the action with a contract where a wrongful culpable conduct(delict) causing of patrimonial damage against a wronged contracting party).

120 See *Dorchester Finance Co.Ltd v Stebbing* [1989] BCLC 498. Dorchester Finance Co. Ltd (DFC) a money lending company with three directors, S, P and H. No board meetings were held. P and H left all the affairs of the company to S. Their only contribution was signing blank cheques on the company's account and leaving them to S to do whatever he deems fit. S then lent company money to companies controlled by himself, his clients or his brother. This he did without complying with any statutory requirements then in force. The loans were unenforceable and the company suffered loses. All the directors were held liable to the company for their negligence.

121 *Fisheries Development Corporation of South Africa* (note 15 above) 163. MARGO J in respect of 'nominee' directors stated that they are at law as directors obliged to serves the interests of the company to the exclusion of individual shareholders.

122 *Pavlides v Jensen* [1956] Ch 565;[1956]2 ALL ER 518. Where directors were alleged to have sold a company's asset at a gross undervalue. Held that they had acted negligently, however in the absence of fraud, as shareholder's derivative action could not be maintained.

123 S61.

124 *Fisheries Development Corporation of South Africa* (note 15 above) 166;*Re City Equitable Fire Insurance Co.Ltd* (note 14 above) 429. See also *Lagnus Nitrate Co* (note 55 above) 435.

benefited from their negligence, an element of dishonesty is present thus a shareholder's derivative action can be maintained.[125] It is submitted that although directors cannot be held liable for errors of judgment, this must not be taken to mean that they must act foolishly so as to 'make a profit of £115 000 odd at the expense of the company.'[126]

Additionally, directors' liability can also be founded on contract.[127] This position is true especially with reference to executive who are usually contracted to the company as employees thereof.[128]

Directors act as a board.[129] This implies a collective element[130] having a potential of extending the liability of an individual director to others.[131] Should directors be held liable jointly and severally as implied by the collective element, it is submitted, this might have dire consequences for even those who are honest as they end up paying for the negligence of others.[132] However, this is rather an extreme generalization for in cases where the entire board was held liable, there were equally at fault.[133] Thus common law

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125 *Daniels v Daniels* [1978] Ch 406,404; [1978]2 ALL ER 89.

126 Per DANCK J in *Pavlides* (note 121 above). Cf *Turquand v Marshall* [1869]4Ch App376; 20 LT 766 where LORD HARTLEY LJ opined that shareholders must put up with foolish or unwise directors.

127 See *Symington and Others v Pretoria Privaat Hospitaal Bedryfs* (note 116 above) 560E-D (in relation to resignation of directors, held that since the relationship is contractual, principles of termination of contract applies). See also JS Naude` *Die Regsposisie van die Maatskappydirektreur* (1970) 156,159-166.

128 *Ibid*. See also Myason et al (note 64 above) 483, para 16.2.

129 The Act refers to the board as directors.

130 See generally McLennan (note 35 above) 100.

131 See Finch (note 58 above) 204.

132 *Ibid*.

133 See for example *re City Equitable Fire Insurance Co. Ltd* (note 14 above); *Pavlides* (note 122 above); *Dorchester Finance Co.Ltd* (note 120 above).

does not contemplate strict vicarious liability in this regard.[134]

1.5 Conclusion

The director's duty of care and skill as formulated under common law and developed through judicial decisions, contemplated a rather lighter standard of conduct. The codification also provides not only clarity thereto but comes with a rather a higher standard with personal liability where directors' conduct fails to meet the prescribed standards. The Companies and Other Business Entities Act [*Chapter 24:31*] did not only confirm common law principles relating to directors' duty of care and skill but provides very clear principles that are intended to encourage directors to act honestly, in good faith and in the best interest of the company with diligent care and skill. This then places a burden to be responsible for their actions as well as being accountable to other stakeholders beyond the traditional shareholders. It has been noted that the higher standards expected of directors must have undesired results of discouraging from taking risks on behalf of the company. However, the codification of the business judgment rule neutralizes this as it allows directors to take risks and exposure without the fear of being held unnecessarily personally liable whilst executing their duties.

134 McLennan (note35 above) 100, (commenting on the Report envisaging the concept of collective responsibility as being a misinterpretation of the *City Equitable* case).