

# Liability within company groups

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## 1 Introduction

In *Bank of Tokyo Ltd v Karoon*<sup>1</sup> the court held that the law does not involve itself with economics but with the law. This view was confirmed by the English appeal court in *Adams v Cape Industries plc*.<sup>2</sup> These views were expressed within the context of company groups and the possibility of holding companies liable for the acts of a subsidiary. However, company groups are commercial realities. The law, however, in many respects does not give effect to this commercial reality but instead still has as its point of departure the doctrines of separate juristic personality and limited liability. In *DHN Food Distributors Ltd v Tower Hamlets London Borough Council*, *Bronze Investments Ltd v Tower Hamlets London Borough Council* and *DHN Food Transport Ltd v Tower Hamlets London Borough Council*<sup>3</sup> the relevant court recognised the economic reality of the group, but this view was rejected in the *Adams* case.

South African law also follows the separate juristic personality doctrine as its point of departure. Locke<sup>4</sup> convincingly argues that the supreme court of appeal in *Consolidated News Agencies (Pty) Ltd (in liquidation) v Mobile Telephone Networks (Pty) Ltd*<sup>5</sup> watered down the separate juristic personality doctrine in this specific matter within the context of a group of companies and the relevant provisions of the Insolvency Act 24 of 1936.<sup>6</sup> Locke argues that the separate juristic personality of the individual companies within the relevant group of companies was relaxed not on the basis of piercing of the corporate veil, but on the basis of a (commercially) purposive interpretation of statutes.<sup>7</sup>

If one accepts that company groups are commercial realities, it could quite easily be accepted that the board of directors of the holding company will give instructions to the (board of the) subsidiary company which may at face value be detrimental to the subsidiary company. This begs the question of who will be exposed to liability to the subsidiary company where the subsidiary suffers damages due to the instructions which the holding company issued to its representatives on the board of the subsidiary. If one ignores the possibility of joint and several liability, two possible wrongdoers could be identified, and therefore, two possibilities could exist for the subsidiary to recover damages from. In the first instance, the more obvious possibility would be to hold the directors of the subsidiary company liable for breach

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<sup>1</sup> 1987 AC 45.

<sup>2</sup> 1990 Ch 433.

<sup>3</sup> 1976 1 WLR 852.

<sup>4</sup> Locke “The approach of the supreme court of appeal to the enterprise reality in company groups” 2012 *Stell LR* 476.

<sup>5</sup> 2010 3 SA 382 (SCA).

<sup>6</sup> s 26 and 33 respectively.

<sup>7</sup> Locke (n 4) 477 485-489.

of their fiduciary duty for not acting in the best interest of the company when they followed the instructions of the holding company. The less obvious possibility in terms of current South African company law would be to hold the holding company liable for the damages which the subsidiary suffered due to the instructions which the holding company issued to the board of the subsidiary.

This article will therefore explore these two opposing possibilities for liability and the possible success of each within the current company law framework in South Africa. A comparative study will be done with German law which provides for liability for the holding company in the given situation. In respect of the position of the directors of the subsidiary, the provisions of the relevant company law legislation in Australia and New Zealand will also be considered. This article will have a narrow focus in respect of the relevant fiduciary duties of the directors of the subsidiary company and will not look at the provisions of section 76(2)(a)(ii) of the Companies Act 71 of 2008 (the act). Instead the focus will be more on the duty to act in the best interest of the company and specifically to act independently and not at the behest of one's appointer.

This article will firstly focus on the possible liability of the holding company by considering the German law as well as considering the concept of shadow directors in the South African law. The article will then investigate the relevant fiduciary duties of the directors of the subsidiary and any possible defences which they may raise against allegations that they were in breach of their fiduciary duty to act in the best interest of the subsidiary company.

## 2 Holding company liability

### 2.1 The German *Aktiengesetz*

The discussion of the German law in respect of the possible liability of the holding company is largely based on the doctoral dissertation of Stevens.<sup>8</sup>

Different acts regulate different companies in German company law. In some cases there may be some overlapping where the courts have taken principles from the *Aktiengesetz* ("AG") and applied them to the *Gesellschaft mit beschränkter Haftung* ("GmbH").

Section 308 of the *AG* allows a holding company to give instructions to the subsidiary company, even if they are detrimental to the subsidiary company, as long as there is a domination agreement (*Beherrschungsvertrag*) in terms of section 291 of the *AG*. The controlling company is entitled to give directions to the dependent company if a domination agreement is in place.<sup>9</sup> These directions may also be prejudicial to the dependent company in the absence of a contrary provision in the enterprise agreement. As long as these directions are to the benefit of the controlling company or other companies within the group, the dependent company has to comply with these directions. The board of the dependent company may not refuse to follow the directions of the controlling company because they believe that the directions are not to the benefit of the controlling company or of other companies within the group structure.<sup>10</sup>

<sup>8</sup> Stevens *The External Relations of Company Groups in South African Law: A Critical Comparative Analysis* (2011 dissertation Stellenbosch) 112-137.

<sup>9</sup> Altmeppen in Kropff and Semler *Münchener Kommentar Aktiengesetz* (2006) 781.

<sup>10</sup> s 308(1) and s 308(2).

In the absence of a domination agreement, the *AG* provides that the holding company may not issue directives to the dependent subsidiary to engage in activities detrimental to its business or to take any business decisions which would be detrimental to the subsidiary, unless the detriment is remedied by the holding company.<sup>11</sup> If the detriment is not remedied during the financial year in which it was caused it has to be made good at the end of that financial year. Should this not be done the subsidiary will have a claim for the harm that it suffered against the holding company.<sup>12</sup> But what does harm mean?

The German *Bundesgerichtshof*, in the *MPS* case,<sup>13</sup> had to decide whether there was any liability for the holding company or the directors of the holding company in terms of sections 311 and 217, 318 of the *AG*. In this case the subsidiary lent money to the holding company without obtaining security.

The loan was for an indefinite period and the holding company was solvent and liquid at the time of the loan. The holding company for a few years paid off the loan including interest to the subsidiary. The subsidiary went insolvent and the liquidator attempted to recover the harm/damages from the holding company, *MPS*. The question before the court was whether there was any harm for the subsidiary by following the directives of the holding company to provide the loan on the given terms and without a date of termination of the agreement. However, the loan could also be cancelled on one month's notice by the subsidiary.

The court first of all considered what "harm" would mean in the context of the case and section 311 of the *AG*. It stated that harm meant "any reduction or concrete endangerment of the financial standing (assets and liabilities) and the profitability (income) position of the company without consideration of how / in so far as to quantify / the quantifiability of the stated impairment/damage as a result of the dependency."<sup>14</sup> As mentioned before, section 311 of the *AG* has to be read with section 317 of the *AG* which provides that if the holding company does not make good the harm suffered by the subsidiary company, that the holding company and its management board will be jointly and severally liable for damages which the subsidiary suffered.

## 2.2 Defence available to the holding company and its board of directors and interpretive difficulties

The holding company is, however, relieved of this duty to make good any damages to the subsidiary company if a reasonable and diligent<sup>15</sup> business manager of an independent company would have undertaken the same business or issued the same business decisions.<sup>16</sup>

The statutory agents, *ie* the directors of the holding company, are also jointly liable with the holding company for the envisaged damages.<sup>17</sup> The board of directors can also be held liable, over and above the liability envisaged in section 317 of the

<sup>11</sup> s 311(1) and Emmerich and Habersack *Aktien- und GmbH-Konzernrecht* (2003) 501-504.

<sup>12</sup> s 311(2).

<sup>13</sup> BGHZ II ZR 102/07 01-12-2008.

<sup>14</sup> BGHZ II ZR 102/07 8: "Jede Minderung oder konkrete Gefährdung der Vermögens- und Ertragslage der Gesellschaft ohne Rücksicht auf Quantifizierbarkeit, soweit die genannte Beeinträchtigung als Abhängigkeitsfolge eintritt."

<sup>15</sup> *ordentlicher und gewissenhafter*.

<sup>16</sup> s 317(2).

<sup>17</sup> s 317(3). According to Emmerich and Habersack (n 11) the statutory agent is the agent of the holding company who is responsible for the management of a company, usually the board of directors (594).

AG, for the failure of the holding company to remedy the detrimental directives which it issued to the subsidiary company by the end of the financial year. Like the holding company, the board of directors has a defence in the form of the reasonable and diligent business manager defence.<sup>18</sup> This means that if a reasonable and diligent business manager would have acted in the same way there will be no liability. The burden of proof is on the board of directors to show that they acted as reasonable and diligent business managers.<sup>19</sup> The supervisory board of directors is also liable if it firstly fails to consider the report of the auditor in respect of the detrimental business relations between the holding company and the subsidiary company, and if it secondly fails to report the conclusions of the auditor's report to the shareholders meeting.<sup>20</sup>

Kropff highlights a number of problems with the relevant provisions. The first problem is that it may be difficult to establish whether a specific business decision or transaction stemmed from a directive of the holding company or whether the decision was made by the board of directors of the subsidiary company.<sup>21</sup> The nature of a group of companies is such that some of the directors will often serve simultaneously on the boards of several companies within the group. Even if there are no directors in common on the boards of the holding company and the subsidiary company, it could still be difficult to determine whether the subsidiary acted at the behest of the holding company. It is easily conceivable that the subsidiary company may, on its own initiative, engage in activities to promote the interests of the group independently, despite the detriment to itself. The nature of a group of companies is furthermore such that cooperation between the various companies is inevitable in respect of planning, production, information technology and the like.<sup>22</sup> Furthermore, the information to determine whether a harmful business decision was due to the directives of the holding company falls within the knowledge of the management of the holding company and the subsidiary company. It may be difficult for the minority to provide the requisite proof that the subsidiary company acted at the behest of the holding company.<sup>23</sup>

The second problem according to Kropff is the determination of what qualifies as a detrimental transaction or decision.<sup>24</sup> The German legislature addresses this question by providing that one should ask whether a reasonable and diligent<sup>25</sup> business manager of an independent company would have undertaken the same business transaction or made the same business decision under the circumstances.<sup>26</sup>

It can also be asked whether there must be damages for the protective measures to become operative. The logical answer would probably be that the holding company would only have to indemnify the subsidiary company should the latter suffer loss due to the directives of the holding company. Kropff argues that there can be harm or detriment without damages being suffered. He provides the example of a subsidiary company which engages in a risky venture which necessitates a higher *quid pro quo*. Even if there is an eventual advantage to the subsidiary company it

<sup>18</sup> s 317(2).

<sup>19</sup> s 318(1).

<sup>20</sup> s 318(2) read with s 314.

<sup>21</sup> Altmeppen (n 9) 772.

<sup>22</sup> Altmeppen (n 9) 772.

<sup>23</sup> Antunes *Liability of Corporate Groups: Autonomy and Control in Parent-Subsidiary Relationships in US, German and EU Law: An International and Comparative Perspective* (1994) 348.

<sup>24</sup> Altmeppen (n 9) 772.

<sup>25</sup> *ordentlicher und gewissenhafter*.

<sup>26</sup> s 317(2) of the *Aktiengesetz*. See also the *MPS* case (n 13).

was a detrimental transaction when it was entered into. If the subsidiary company acted at the behest of the holding company the provisions of the *Aktiengesetz* would become operative.<sup>27</sup>

Antunes<sup>28</sup> identifies the quantification of the harm which the subsidiary company suffered due to the directives of the holding company as problematic. The first issue again concerns how the management of an independent company would have acted under those circumstances. Would they have entered into the transaction? If so, would it have been on the same terms, with the same contracting party and at the same price?<sup>29</sup> What if the answer to some of the questions is “yes” and “no” to others? Is there still liability? Can a person determine a causal link between the specific offending term which the management of an independent company would not have accepted and the eventual harm that was suffered? The quantification of damages could in some circumstances be easy but in other cases very difficult. In a situation like the one under discussion the added problem lies in determining whether the management of an independent company would have acted differently. Once that complex question is determined, the extent of the loss has to be proved. This can make the whole exercise very complicated and difficult for minority shareholders or creditors of the subsidiary company, with the added complication of a lack of information.

### 2.3 Conclusion

The main principle to distil from the *AG* is probably that there is an attempt by the German legislature to ensure the independence of the subsidiary. It also attempts to prevent the holding company or its board from exercising undue pressure on the subsidiary to engage in risky behaviour. The punishment of having to make good any harm, or, in the absence thereof, to be liable for damages, seems to be adequate protection for the subsidiary company. Problematic, however, are the following: what harm is and how harm is to be determined; and when the harm has to be made good, especially in longer-term contracts where there is no harm in the first few years of the contract as was the case in the *MPS* decision?

The principles from the relevant provisions of the *AG*, however, appear to be sound. The German legislature allows the holding company to give instructions to the subsidiary, even if they are to the detriment of the subsidiary company on condition that a domination agreement is in place. If there is none, the holding company may not issue detrimental instructions. If it does, it has to make good the harm that the subsidiary suffers and if it does not, it and its directors are liable for the damages suffered by the subsidiary.

The question which arises within the South African context is whether the current law provides for any possibilities akin to the German provisions. In this respect the issue of piercing the corporate veil will not be addressed. Instead the focus will be on whether it could be argued that the holding company acted as a shadow director of the subsidiary and on that basis would have the same fiduciary duties as the directors of the subsidiary company.

<sup>27</sup> Altmeyden (n 9) 827 and see also Antunes (n 23) 352.

<sup>28</sup> Antunes (n 23) 353.

<sup>29</sup> Antunes (n 23) 353.

## 2.4 The position of shadow directors and nominee directors

In respect of shadow directors the question will be posed whether the holding company could be considered to be a shadow director of the subsidiary company and would thus be covered by the fiduciary duties of directors.

The UK Companies Act 2006 (“the UK act”) defines shadow directors as follows in section 251:

“(1) In the Companies Acts “shadow director”, in relation to a company, means a person in accordance with whose directions or instructions the directors of the company are accustomed to act.

(2) A person is not to be regarded as a shadow director by reason only that the directors act on advice given by him in a professional capacity.

(3) A body corporate is not to be regarded as a shadow director of any of its subsidiary companies for the purposes of—

Chapter 2 (general duties of directors),

Chapter 4 (transactions requiring members’ approval), or

Chapter 6 (contract with sole member who is also a director),

by reason only that the directors of the subsidiary are accustomed to act in accordance with its directions or instructions.”

Does a shadow director differ from a *de facto* director? A *de facto* director is a person who acts as a director but who is not formally appointed as a director.<sup>30</sup> In *Revenue and Customs Commissioners v Holland; Re Paycheck Services 3 Ltd*<sup>31</sup> the question which the court had to answer was whether Holland was a *de facto* director of 42 companies which the revenue service alleged were associated companies for revenue purposes. If Holland was indeed a *de facto* director of all the companies, it would have had an impact on possible liability in terms of the applicable tax legislation, insolvency legislation and the UK Companies Act. The revenue service did not argue that Holland was a shadow director because the insolvency act did not provide for a remedy against a shadow director, but it did provide a remedy against an officer of the company.<sup>32</sup> It must be borne in mind that the case was still also decided in terms of the 1986 Companies Act which allowed a company to be a director of another company subject to certain conditions. In this case the sole director of the 42 companies was a company of which Mr and Mrs Holland were the sole directors. Lord Collins held that the test to determine whether a person was a *de facto* director and the test whether a person was a shadow director could overlap with each other. The two tests were therefore not mutually exclusive. A shadow director was essentially not held by the company to be a director and remains mainly out of sight and in the background, whereas the *de facto* director is held in most cases to be a director and he also tends to act as if he is one.<sup>33</sup>

The act prohibits a juristic person from being a director.<sup>34</sup> This would include acting as *de facto* director. The mere fact that a juristic person may not act as a director in terms of the act does not however mean that it factually cannot act as such. Whether it is possible to argue that the holding company acts as a shadow director is a difficult issue. As an analogy one could use the liability in terms of

<sup>30</sup> Cassim, Cassim, Cassim, Jooste, Shev and Yeats *Contemporary Company Law* (2012) 408-409.

<sup>31</sup> 2010 UKSC 51.

<sup>32</sup> s 212 of the UK Insolvency Act 1986.

<sup>33</sup> See Keay *Directors’ Duties* (2014) 21 § 2.33. It must also be borne in mind that s 155(1) of the UK Companies Act 2006 provides that at least one director has to be a natural person.

<sup>34</sup> s 69(7)(a).

section 424 of the 1973 Companies Act, where it was provided that any person who knowingly conducts the business of the company recklessly, or was party to the reckless conduct of business, could be held liable. The question could be posed whether the holding company could be “a person” which could knowingly be a party to the subsidiary conducting its business recklessly as well.

The question therefore arises whether a holding company could knowingly be a party to the reckless conduct of business by its subsidiary, especially in a case where the latter company incurs debt at a stage when it is technically insolvent. The requirement of “knowingly” should be easily ascertainable in those cases where the same directors of the holding company sit on the board of the subsidiary. In light of the fact that the holding company is the sole or majority shareholder it would be extremely rare for these directors not to be aware of the financial situation of the subsidiary or the manner in which the business of the subsidiary is being conducted. The greater its shareholding in the subsidiary and the smaller the group, the more easily the holding company will satisfy the “knowingly” test.

The more problematic aspect may be the “party to the reckless conduct of business” test. Mere awareness of the reckless conduct of business would probably not suffice: it would have to be shown that the holding company was party to the reckless conduct of business. It is submitted that some form of participation in the conduct of the business of the subsidiary may be required. In *Powertech Industries Ltd v Mayberry*<sup>35</sup> the court held that in order to hold the auditor of the relevant company liable it had to be shown that:

“To be a ‘party’ to the conduct of a company’s business requires an association with it in a common pursuit. That is the ordinary meaning of the word as it is used in the statute. ... A ‘party’ to the carrying on of a company’s business is one who has joined with the company in a common pursuit. Generally this would include its directors and managers, all of whom are acting in common pursuit of the company’s business ... The section does not extend to those who, while carrying on their own business, incidentally enable the company to carry on its business.”<sup>36</sup>

On the basis of this statement of the court in the *Powertech* case, a plausible case may be instituted against the holding company since inevitably there would be a common pursuit. The concept of directing minds may be important here since the holding company will inevitably appoint the majority, if not all, of the directors of the subsidiary company. Can the actions of the directors, appointed by the holding company, be the actions of the holding company? Are the directors who serve on the board of the subsidiary the directing minds of the holding company?

In *Lennard’s Carrying Co Ltd v Asiatic Petroleum Co Ltd*<sup>37</sup> the house of lords held that:

“[A] corporation is an abstraction. It has no mind of its own any more than it has a body of its own; its active and directing will must consequently be sought in the person or somebody who for some purposes may be called an agent, but who is really the directing mind and will of the corporation, the very ego and centre of the personality of the corporation.”<sup>38</sup>

The “directing mind” doctrine is therefore in essence there to attribute the acts and the mental state of the persons who control a company to that company.<sup>39</sup> This

<sup>35</sup> 1996 2 SA 742 (W).

<sup>36</sup> 749D-G.

<sup>37</sup> 1915 AC 705, 1914-1915 All ER 280 (HL).

<sup>38</sup> 283.

<sup>39</sup> Blackman, Jooste and Everingham *Commentary on the Companies Act* (RS 4 2007) 4-123.

doctrine of the directing mind is not limited to criminal liability but also applies to delictual liability.<sup>40</sup> The question therefore is whether the holding company is the directing mind of the subsidiary. An argument could certainly be made that the holding company directs the operations of the subsidiary. It is submitted, however, that a blanket statement to this effect cannot be made. The mere fact that the holding company may appoint all or the majority of the directors of its subsidiary could imply that the directors who are appointed are the directing minds of the holding company itself, at least in those cases where the directors are the sole shareholders of the holding company. In cases where they are not in control of the holding company and they are appointed by the holding company, the argument may still be made that the holding company is the directing mind of the subsidiary.<sup>41</sup> However, this could become a “chicken and egg” argument. It would also be plausible to argue that the directors of the holding company direct and make decisions for the holding company and that they make the decisions for the holding company, and that it is not the company which is the directing mind of the subsidiary but the directors of the holding company.

When one considers the *Holland* case in respect of shadow directors, it is clear that where a company could have a corporate director the court would not easily read into this that the natural persons controlling the corporate director would necessarily be held to be *de facto* directors of the company. It could then also be argued that the corporate director would be the directing mind of the company. By analogy where a shadow director is not allowed in law, the point of departure should therefore be that a corporate person should be viewed to be the directing mind of the company only in exceptional cases. The question in such an instance would be who the directing minds are. The only possible answers would be either the board of the subsidiary company, or the board of the holding company.

In light of the above discussion it is doubtful that the holding company could incur liability for any harm suffered by the subsidiary unless it is done on the basis of veil piercing. Any German-style liability would therefore have to be legislated for. In the next part the liability of the directors of the subsidiary company will be discussed in the context of following instructions which were issued to them by the holding company as controlling shareholder.

### 3 *Liability of nominee directors on the board of the subsidiary*

#### 3.1 The position of nominee directors

In *S v De Jager*<sup>42</sup> the court referred to the concepts “nominee”, “tool”, “stooge” and “dummy” as synonymous. In *S v Shaban*,<sup>43</sup> Hiemstra J said in respect of “puppet” directors within the context on a fraud being perpetrated on the Registrar of Insurance, essentially consisting of pretending that one company was independent from another:

“A nominee is a lawfully elected director, put on the board by a shareholder who controls sufficient voting power for the purpose. He goes to a meeting and acts in the way his principal wants him to ... The Companies Act knows directors and through practice the concept of nominees has arisen, but they are still lawfully elected directors whose functions as such are not a hollow pretence. Our

<sup>40</sup> 4-123.

<sup>41</sup> See also *Intramed (Pty) Ltd (in liquidation) v Standard Bank of SA Ltd* 2005 1 All SA 460 (W).

<sup>42</sup> 1965 2 SA 616 (A).

<sup>43</sup> 1965 4 SA 646 (W).

law does not know the complete puppet who pretends to take part in the management of a company whilst having no idea what it is to which he puts his signature. It is utterly foreign to the basic concepts of our law and the courts will punish it as fraud.<sup>44</sup>

The court clearly here distinguishes the nominee director from a puppet. A puppet is a mere facade, whereas a nominee director is apparently a proper director. However, the court strangely mentioned the term “complete puppet”, which seems to indicate that there could be a difference between a “puppet” and a “complete puppet”. As Du Plessis<sup>45</sup> correctly points out, the formulation of the court of what a nominee director is, is not correct.

A director owes a duty to act in the interest of his company and not in the interest of his appointer.<sup>46</sup> With reference to the *Shaban* case, the *De Jager* case and *Robinson v Randfontein Estates Gold Mining Co Ltd*,<sup>47</sup> Du Plessis asked whether it would be possible to hold nominators personally liable in law. In the first two cases the nominators were criminally prosecuted for fraud, and Du Plessis also acknowledges that the *Robinson* case was an extreme case of manipulation.<sup>48</sup> With reference to company groups he also acknowledged that it would be difficult to take action against the nominator, since the holding company would be in control of the board of the subsidiary and the board of the holding company could be the same as the subsidiary board.<sup>49</sup> In his article Du Plessis argued for the liability of nominators of directors, especially in the context of the group situation, but also acknowledged the difficulty in achieving this, even if one used the concept of a shadow director.<sup>50</sup> Since the article by Du Plessis, the question is whether we are any closer to imposing liability on the nominator.

The untenable situation could arise where a director acted in the interest of the holding company (of which he is also a director), but to the detriment of the subsidiary of which he is also a director. When the holding company gives instructions to the subsidiary company, it effectively gives the instructions to the board of the subsidiary to decide and implement the instructions. The holding company, in terms of section 3 of the act, will naturally control the board of the subsidiary and have “nominee” directors in place.

How do foreign jurisdictions deal with issues like nominee directors on the boards of subsidiary companies? The ancillary question is to what extent directors on the subsidiary board may fetter their discretion, especially in the context of the holding company subsidiary company relationship. Oddly, the duty of a director to exercise his discretion in an unfettered manner has not been explicitly inserted into section 76 of the act. The closest would probably be section 76(3)(b), which provides that a director must act in the best interest of the company.<sup>51</sup>

Keay mentions that the duty to act in an unfettered manner is breached even if the director had no intention of benefiting from the agreement with the other party to whom he bound himself.<sup>52</sup> There has been some movement away from the common

<sup>44</sup> 651F-652A.

<sup>45</sup> Du Plessis “Nominee directors versus puppet, dummy and stooge directors: reflections on these directors and their nominators or appointers” 1995 *TSAR* 310.

<sup>46</sup> Du Plessis (n 45) 312.

<sup>47</sup> 1921 AD 168.

<sup>48</sup> Du Plessis (n 45) 314-315.

<sup>49</sup> Du Plessis (n 45) 315.

<sup>50</sup> Du Plessis (n 45) 319-321.

<sup>51</sup> Cassim *et al* (n 30) 529.

<sup>52</sup> Keay (n 33) 184-185.

law position abroad. Whether these are merely exceptions to the facts at hand or whether the judiciary is actively moving away from a strict interpretation is difficult to gauge. In *Thorby v Goldberg*<sup>53</sup> the directors of a company sought to declare a contract void for illegality based on the fact that the contract contained a provision in terms of which they bound themselves to exercise their discretion in a certain manner in the future. The case should however be treated with circumspection. Kitto J said the following:

“There are many kinds of transactions in which the proper time for the exercise of the directors’ discretion is the time of the negotiation of a contract, and not the time at which the contract is to be performed. A sale of land is a familiar example. Where all the members of a company desire to enter as a group into a transaction such as that in the present case, the transaction being one which requires action by the board of directors for its effectuation, it seems to me that the proper time for the directors to decide whether their proposed action will be in the interests of the company as a whole is the time when the transaction is being entered into, and not the time when their action under it is required. If at the former time they are bona fide of opinion that it is in the interests of the company that the transaction should be entered into and carried into effect, I see no reason in law why they should not bind themselves to do whatever under the transaction is to be done by the board.”<sup>54</sup>

Menzies J stated the following in respect of the facts:

“While I wish to guard against being understood as deciding that a director of a company can in an ordinary case bind himself to exercise his power as a director in a particular way, I have not in this case found any ground for objection to the directors of the company committing themselves, as I think they did, to act as set out in the agreement . . . . All the shareholders were party to the agreement and what the directors undertook to do was what all the shareholders committed themselves to ensure that they did.”<sup>55</sup>

And finally Owen J stated:

“For all that appears from the plea, the directors of the Company may, before the execution of the agreement, have given proper consideration to the desirability of entering into it and decided that it was in the best interests of the Company that it should be made. If so, it would be impossible to argue that they had, by executing the document, improperly fettered the future exercise of their discretion. In fact they would already have exercised it and, in the absence of an allegation that they had done so improperly, the suggested defence could not be sustained.”<sup>56</sup>

It would appear, especially after considering the example that Kitto J gave, that directors may determine how they will decide on a matter in the future, but that they should have exercised their discretions independently when making this determination. Imagine that the directors enter into a contract of sale for land on a certain date and this agreement is beneficial for the company at that date. The directors will then also in this contract give an undertaking that they will do everything to effect transfer at the relevant time in the future. The contract then becomes disadvantageous to the company between the date of signing the contract and the date of transfer. The directors at the date of transfer now allege that they have fettered their discretions when they signed the contract of sale and allege that the contract is therefore unlawful. This is certainly not possible, since the directors

<sup>53</sup> 1964 112 CLR 597.

<sup>54</sup> 605-606.

<sup>55</sup> 610.

<sup>56</sup> 617-618.

at the date of signing the contract of sale already applied their independent minds to the agreement and the fettering of their future conduct was merely a logical consequence of the agreement. It is also important to bear in mind, when looking at the words of Menzies J, that all the shareholders were aware of the agreement and were also signatories to the agreement. The shareholders therefore consented to the possibility of the directors fettering their discretion in respect of a very specific matter. There was therefore no undertaking to vote in a certain way in respect of uncertain matters or upon the instructions of a certain individual.

In *Fulham Football Club Ltd v Cabra Estates plc*<sup>57</sup> the underlying issue was the development of Craven Cottage, which served as the home of Fulham Football Club. The club leased the property from its ultimate holding company, Vicenza via Cabra Estates, which was the subsidiary of Vicenza. Vicenza wanted to develop the property. The local council opposed the development and submitted an alternative development and issued a compulsory purchase order. Initially the directors of Fulham supported the local council but prior to the public inquiry in respect of the compulsory purchase order, the directors of Fulham contractually undertook to support the appeal of Vicenza against the compulsory purchase order and simultaneously support the application by Vicenza for the development of Craven Cottage. The relevant authority rejected the compulsory purchase order but also rejected Vicenza's appeal. Subsequent to this public inquiry, Vicenza lodged a new planning application and a public inquiry had to be held. At this stage the directors of Fulham changed their minds and held the belief that the development would not be in the best interest of Fulham. Vicenza informed Fulham of the new public inquiry and that it was required to write a letter of support of the development. The directors of Fulham alleged that the undertaking to support the application was a breach of their fiduciary duty not to fetter their discretion. The court dealt with a number of issues, including an interpretation of the undertaking by the directors *ie* whether the undertaking, although for seven years, was only in respect of the initial compulsory purchase order and appeal by Vicenza or whether it extended to any new application to develop Craven Cottage. The crucial issue was however the undertaking where the directors did not only rely on a breach of their fiduciary duties but also on legislation which, *inter alia*, prohibited giving false evidence amongst others.

The court in the *Fulham* case rejected the arguments by the directors of Fulham. Although the court acknowledged that directors should act in good faith and in the best interest of the company, this did not necessarily mean that they could not contractually bind themselves to the future exercise of their discretions. The effect of not allowing such a contractual undertaking would be that a company could lose out on a commercially beneficial contract. Neill LJ referred with approval to the Australian case of *Thorby v Goldberg* and rejected two English cases, *John Crowther Group plc v Carpets International plc*,<sup>58</sup> and *Rackham v Peek Foods Ltd*,<sup>59</sup> where the respective courts held that such undertakings were unlawful. Neill LJ mentioned that neither case referred to the *Thorby* case and that they should be understood within the specific factual context. According to the court in the *Fulham* case, the cases did not lay down a general rule that directors can never give an undertaking in respect of the future exercise of their fiduciary powers.<sup>60</sup>

<sup>57</sup> 1994 1 BCLC 363; 1992 BCC 863.

<sup>58</sup> 1990 BCLC 460.

<sup>59</sup> 1990 BCLC 895.

<sup>60</sup> the *Fulham* case (n 57) par 393.

Both the *Thorby* and the *Fulham* cases dealt with contractual undertakings in respect of the future exercise of fiduciary powers by the directors of the respective companies. Blackman argues that the *Thorby* case was incorrectly decided because the court confused the personal undertaking of the directors with the transaction entered into on behalf of the company. The time that the contract is entered into is crucial according to Blackman; *ie* that would be the time to determine whether the directors believe that they are acting in the best interest of the company.<sup>61</sup> More difficult, however, is the position of nominee directors where the manner of exercising their discretion would be less overt and probably more implied due to their relationship with their appointers. The appointees will probably feel under the moral obligation and compelled to exercise their discretions in favour of their appointers. This is especially the case in the relationship between the holding company and its subsidiary where the holding company would be able to appoint the majority of the board.

The English law appears to be settled that nominee directors have to act in good faith and in the best interest of their own companies.<sup>62</sup> In New Zealand the position appears to be more flexible. In *Berlei Hestia (NZ) Ltd v Fernyhough*,<sup>63</sup> an Australian company held only 40% of the shares in the New Zealand company but could appoint three of the six directors. There was no provision in the articles for a casting vote. The New Zealand company started competing with the Australian company and among other things also denied the three Australian directors access to the premises and books of the New Zealand company. The Australian directors and company sought an interdict to compel the company to provide access to the Australian directors. The New Zealand company alleged, or were fearful, that the Australian directors would gain access to confidential information which they would share with their nominating company.

The court held that the situation which arose was more of a partnership than a proper company. For example, the Australian company was entitled to a 40% dividend of the annual profit after tax. The court then stated:

“Notwithstanding that the Australian directors are the nominees of the Australian company, they nevertheless have responsibilities to the whole body of shareholders. But despite the width of that proposition, there have been attempts to bring this theoretical doctrine of undivided responsibility into harmony with commercial reality, upon the basis that when articles are agreed upon whereby a specified shareholder or group of shareholders is empowered to nominate its own directors, then there may be grounds for saying that in addition to the responsibility which such directors have to all shareholders as represented by the corporate entity, they may have a special responsibility towards those who nominated them. Such a view proceeds on the basis that the articles were so constructed with the intent and belief that the institution of such a special responsibility towards one class of shareholders was conducive to the interests of the company as a whole. The stage has already been reached, according to some commentators, where nominee directors will be absolved from suggested breach of duty to the company merely because they act in furtherance of the interests of their appointors, provided that their conduct accords with a bona fide belief that the interests of the corporate entity are likewise being advanced.”<sup>64</sup>

<sup>61</sup> Blackman *et al* (n 39) 2 OS 2002 8-110.

<sup>62</sup> See *Scottish Co-operative Wholesale Society Ltd v Meyer* 1959 AC 324; *Lindgren v LandP Estates Ltd* 1968 Ch 572; *Re Neath Rugby Ltd* 2009 EWCA 291; Keay (n 33) 191 § 7.32.

<sup>63</sup> 1980 2 NZLR 150.

<sup>64</sup> the *Berlei Hestia* case (n 63) par 54-56.

The above quote should be understood within the context of the facts of the case. The facts indicated more a position of a partnership with a partnership agreement than a company with articles of association. Even then the articles of association conferred specific powers to the directors and the shareholders could not interfere. The deadlock that existed in this case could therefore not be broken by the 60% New Zealand shareholders since they bound themselves contractually (through the articles) to vest all the relevant powers for this case in the board of directors.

In *Dairy Containers Ltd v NZI Bank Ltd*,<sup>65</sup> the Auckland high court confirmed the reasoning in the *Berlei Hestia* case. The court confirmed that commercial realities should be taken into account when assessing the fiduciary duties of nominee directors on the boards of the subsidiary company. The court also considered the Australian cases of *Re Broadcasting Station 2GB*<sup>66</sup> and *Levin v Clark*,<sup>67</sup> where the New South Wales courts twice confirmed that commercial realities would be taken into account in the determination of to whom the directors owed a duty. The Australian courts subsequently followed these two earlier decisions in *Re News Corporation Ltd*<sup>68</sup> and *Canwest Global Communications Corporation v Australian Broadcasting Corporation*.<sup>69</sup> The Auckland high court, with reference to the *Berlei Hestia* decision, stated:

“Mahon J referred to attempts to bring the theoretical doctrine of undivided responsibility into harmony with commercial reality on the basis that, when articles are agreed upon in which a specified shareholder is empowered to nominate its own directors, there may be grounds for saying that, in addition to the responsibility which such directors have to all shareholders as represented by the corporate entity, they may have a special responsibility towards those who nominated them.

On the basis of these decisions, nominee directors need not necessarily approach company problems with an open mind and they may pursue their appointer’s interests provided that, in the event of a conflict, they prefer the interests of the company. In such circumstances the breadth of the fiduciary duty has been narrowed by agreement amongst the body of shareholders. In other words, the incorporators have agreed upon an adjusted form of fiduciary obligation.”<sup>70</sup>

Although it appears that all these cases accept that a nominee director may put the interests of his nominator above the interests of the company of which he is a director, the cases should also be understood within their own contexts. In these cases the articles or the subsidiaries allowed for such a fettered discretion as mentioned in the above quote. Whether these cases necessarily set out a new legal position is doubtful and it could be argued that they were very facts-specific.

Ahern<sup>71</sup> mentions that the concept of nominee directors is difficult to describe but when discussing the case law and the context of her article refers to the directors appointed either by controlling shareholders or other bodies to serve their interest. Ahern argues that there are three lines of cases which have developed in respect of the position of nominee directors and their fiduciary duties. She distinguishes the absolutist approach, the corporate primacy approach and the attenuated duty

<sup>65</sup> 1995 2 NZLR 8.

<sup>66</sup> 1964-1965 NSW 1648.

<sup>67</sup> 1962 NSW 686.

<sup>68</sup> 1987 70 ALR 419.

<sup>69</sup> 1997 24 ACSR 405.

<sup>70</sup> the *Dairy Containers* case (n 65) par 215.

<sup>71</sup> Ahern “Nominee directors’ duty to promote the success of the company: commercial pragmatism and legal orthodoxy” 2011 *Law Quarterly Review* 118. See also generally Redmond “Nominee directors” 1987 *University of New South Wales Law Journal* 194.

approach.<sup>72</sup> *Fisheries Development Corporation of South Africa Ltd v Jorgensen*<sup>73</sup> and *Scottish Co-operative Wholesale Society Ltd v Meyer*<sup>74</sup> would be examples of the absolutist approach in terms whereof the courts held that a director has a duty only towards the company of which he is a director to the exclusion of any interest of another, including his/her appointer.<sup>75</sup> In the *Fisheries Development* case the court stated:

“The director’s duty is to observe the utmost good faith towards the company, and in discharging that duty he is required to exercise an independent judgment and to take decisions according to the best interests of the company as his principal. He may in fact be representing the interests of the person who nominated him, and he may even be the servant or agent of that person, but, in carrying out his duties and functions as a director, he is in law obliged to serve the interests of the company to the exclusion of the interests of any such nominator, employer or principal. He cannot therefore fetter his vote as a director, save in so far as there may be a contract for the board to vote in that way in the interests of the company, and, as a director, he cannot be subject to the control of any employer or principal other than the company.”<sup>76</sup>

The court therefore essentially states that the commercial reality that directors are appointed by others must yield to the strict rule that the duty to the company must be obeyed and not the interest or loyalty to the appointer.

According to Ahern the corporate primacy approach is an approach that attempts to reconcile, or at least recognise, that there could be conflicting interests at stake for a nominee director and that an act may serve both the interest of the appointer and the company. However, if there is conflict and the conflict between the two interests cannot be reconciled, the interest of the appointer must yield to the interests of the company.<sup>77</sup> In *Re News Corporation Ltd*<sup>78</sup> the court, with reference to *Re Broadcasting Station 2GB Pty Ltd*,<sup>79</sup> stated:

“As was pointed out in the *Broadcasting Station* case, it would make the position of a nominee or representative director an impossibility to require that he approach each company problem with a completely open mind. It is both realistic and not improper to expect that such directors will follow the interests of the company which appointed them, subject to the qualification that they will not so act if of the view that their acts would not be in the interests of the company as a whole. In my opinion, it may be assumed that the nominee directors of NTHL will act in such a way. Such an assumption does not, however, lead to the assumption they will act in breach of their fiduciary duty as directors.”<sup>80</sup>

The attenuated approach is based on a contractual premise, namely that the shareholders of the company may agree that directors may act in the interest of the appointer.<sup>81</sup> The New Zealand case of *Berlei Hestia*, although not a holding company subsidiary company relationship, but essentially a joint venture, gave cognisance and recognition to the articles of association.<sup>82</sup> In *Re Neath Rugby Ltd*:

<sup>72</sup> Ahern (n 71) 129-137.

<sup>73</sup> 1980 4 SA 156 (W).

<sup>74</sup> (n 62).

<sup>75</sup> Ahern (n 71) 129.

<sup>76</sup> the *Fisheries Development* case (n 73) 163E-G.

<sup>77</sup> Ahern (n 71) 131.

<sup>78</sup> the *News* case (n 68).

<sup>79</sup> the *Broadcasting Station* case (n 66).

<sup>80</sup> the *News* case (n 68) 437.

<sup>81</sup> Ahern (n 71) 133.

<sup>82</sup> the *Berlei Hestia* case (n 63).

*Hawkes v Cuddy*<sup>83</sup> Hawkes and Cuddy were both 50% shareholders of Neath. Cuddy was disqualified from acting as a director of Neath (for reasons not important to this case) and he appointed Mrs Cuddy as director and the 50% share was actually registered in her name. Neath and Swansea would together form a new club, Ospreys. Neath and Swansea would each hold 50% of the shares in Ospreys. Cuddy was the nominated director from Neath on the board of Ospreys. Hawkes alleged that he suffered unfairly prejudicial conduct by Mr Cuddy because Cuddy put the interests of Ospreys above the interests of Neath, who appointed Cuddy to the board of Ospreys. In terms of the agreement between Mr Cuddy and Hawkes, when they established Neath and then subsequently Neath's interests in Ospreys, Cuddy was to consult with Hawkes on matters concerning Neath.

“In my judgement, the fact that a director of a company has been nominated to that office by a shareholder does not, of itself, impose any duty on the director owed to his nominator. The director may owe duties to his nominator if he is an employee or officer of the nominator, or by reason of a formal or informal agreement with his nominator, but such duties do not arise out of his nomination, but out of a separate agreement or office. Such duties cannot however, detract from his duty to the company of which he is a director when he is acting as such. The duty, if any, owed by Mr Cuddy to Mr Hawkes depended entirely on the agreement between them. There was evidence, referred to at paragraph 19 of the judgment, that Mr Cuddy accepted that he was to ‘look after the Region and Neath’s interests in the Region’. This is, however, a very vague formulation for a legal duty, and particularly so when Mr Cuddy’s overriding duty to Ospreys when acting as a director of that company is borne in mind. That duty [to Ospreys] was overriding.”<sup>84</sup>

It initially appears that the court accepted the corporate primacy approach with the above statement. However, the court then states the following:

“In addition, as mentioned above, there was no evidence that the other shareholder of Osprey, i.e. Swansea, had agreed to any dilution of Mr Cuddy’s fiduciary duties to the company so as to justify his putting the interests of Neath ahead of those of Osprey when making decisions as a director of the latter. It would not have been sufficient to show that the other director of Osprey, i.e. Mr Blyth, had agreed to such a dilution.”<sup>85</sup>

The above statement implies that the shareholders of Ospreys could have agreed that their directors may put the interests of the individual constituent clubs (Swansea Neath respectively) before the interests of Ospreys.<sup>86</sup>

The *Fulham* case discussed above also appears to recognise and accept the possibility that nominee directors may contractually agree in advance to serve the interests of their appointers. There was however a caveat that in the *Fulham* case the undertaking by the directors was given at a stage that it would be in the best interest of the subsidiary company. When the development a few years later would not be in the interest of the subsidiary company, they were bound by their earlier undertaking. The *Fulham* case is probably not authority for the proposition that a director may contractually put the interests of his appointer above the interests of the company. The *Fulham* case dealt with a very specific undertaking given at a time when the undertaking was in fact in the interests of the company. Also, the juristic act to which the exercise of discretion pertained had been completed at that (much) earlier stage, whereas the development project itself was merely a consequence of

<sup>83</sup> (n 62).

<sup>84</sup> the *Neath* case (n 62) par 32, 33 and 35.

<sup>85</sup> par 44.

<sup>86</sup> Ahern (n 71) 136-137.

that act. A reading of the *Berlei Hestia* case shows that the issue dealt more with a joint venture and the *Neath* case's facts are also very specific.

This highlights the important difference between a contract concluded between an appointor and a director, and one concluded by the company itself (through its director/s) with a third. Whether a contractual arrangement which provides that directors may act in the interest of their appointers is enforceable is doubtful, even if this arrangement is provided for in the memorandum of intent of a company in the light of the nature of fiduciary duties of directors. The purpose here is not to discuss the contractarian view that the imposition of fiduciary duties is a result of bargaining by the contracting parties.<sup>87</sup> DeMotte on the other hand argues that fiduciary duties stem from equity and that contract law is not an appropriate tool to analyse fiduciary duties.<sup>88</sup> The fact that duties of directors have also been codified to an extent that fiduciary duties now also have a legislative component and that it cannot be subject to bargaining, or at least to limited bargaining which is subject to acting always in the best interest of the company and not the appointer.

Subsequent to the Australian and New Zealand cases cited above, the respective legislatures made amendments to the respective Companies Acts. The Australian Corporations Act<sup>89</sup> provides in respect of wholly owned subsidiaries that directors may prefer the interests of the holding company. The Corporations Act provides that

“A director of a corporation that is a wholly-owned subsidiary of a body corporate is taken to act in good faith in the best interests of the subsidiary if:

- (a) the constitution of the subsidiary expressly authorises the director to act in the best interests of the holding company; and
- (b) the director acts in good faith in the best interests of the holding company; and
- (c) the subsidiary is not insolvent at the time the director acts and does not become insolvent because of the director's act.”<sup>90</sup>

The Corporations Act has therefore followed commercial reality in acknowledging that a director stands in an unenviable position when it comes to exercising his discretion where there is a divergence between the interests of the holding company and the interests of the subsidiary company. The Australian legislature has however only restricted the common law rule that directors owe a duty to their own company in the given defined circumstances and subject to the subsidiary being a wholly owned subsidiary. There will still be tension for directors where they have to exercise their discretion in those situations where the interests of the holding company and the interests of the subsidiary clash.

The New Zealand Companies Act<sup>91</sup> goes further than the Australian Corporations Act. The New Zealand Act provides:

“Duty of directors to act in good faith and in best interests of company

- (1) Subject to this section, a director of a company, when exercising powers or performing duties, must act in good faith and in what the director believes to be the best interests of the company.
- (2) A director of a company that is a wholly owned subsidiary may, when exercising powers or performing duties as a director, if expressly permitted to do so by the constitution of the company, act in a manner which he or she believes is in the best interests of that company's holding company even though it may not be in the best interests of the company.

<sup>87</sup> See Ahern (n 71) 138-141 and the authorities discussed there.

<sup>88</sup> DeMotte “Beyond metaphor: an analysis of fiduciary obligation” 1988 *Duke LJ* 879 879-880.

<sup>89</sup> Corporations Act 2001.

<sup>90</sup> s 187 of the Corporations Act.

<sup>91</sup> 105 of 1993.

(3) A director of a company that is a subsidiary (but not a wholly owned subsidiary) may, when exercising powers or performing duties as a director, if expressly permitted to do so by the constitution of the company and with the prior agreement of the shareholders (other than its holding company), act in a manner which he or she believes is in the best interests of that company's holding company even though it may not be in the best interests of the company.

(4) A director of a company that is carrying out a joint venture between the shareholders may, when exercising powers or performing duties as a director in connection with the carrying out of the joint venture, if expressly permitted to do so by the constitution of the company, act in a manner which he or she believes is in the best interests of a shareholder or shareholders, even though it may not be in the best interests of the company.<sup>92</sup>

Sections 131(3) and 131(4) go further than the Australian equivalent in the Corporations Act by extending the boundaries of acting in the interests of the holding company. In the defined circumstances a director of a subsidiary may put the interests of the holding company above the interests of his own company.

### 3.2 Directors having to act in the best interest of the company

Where does this leave the South African law? When one considers the Australian and New Zealand legislation, which give effect to the commercial realities facing nominee directors on the boards of subsidiary companies, and when one considers the attempt by the German legislature to partially give effect to this reality but simultaneously having a stick in the form of section 311 and section 317 of the *AG*, the question arises as to what end the act could protect a director who serves as a nominee of the holding company on the board of the subsidiary company and who wants to serve the interests of the holding company above the interests of the subsidiary.

Section 76(3)(b) of the act provides that a director of a company must exercise his powers in the best interests of the company. Could a director conceivably argue that he served the interests of the company where he acts for the benefit of the holding company but it appears at face value to be detrimental to the subsidiary company? This could probably only be argued in terms of the business judgement rule. Section 76(4)(a)(iii) of the act provides that a director will have satisfied his duty to act in the best interests of the company if, among other things, he “made a decision, or supported the decision of a committee or the board, with regard to that matter, and the director had a rational basis for believing, and did believe, that the decision was in the best interests of the company”. Is it possible for a director to state that he had a rational basis, and believed that he acted in the best interests of the subsidiary company where he followed an instruction from the holding company which was advantageous for the holding company but detrimental to the subsidiary company? To answer this question the judgment in *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd*,<sup>93</sup> which dealt with the question whether the directors acted in the best interests of the company, will be tested against analogous case law from the Insolvency Act.

The *Visser Sitrus* case dealt with the question whether the directors of Goede Hoop Sitrus acted in the best interest of the company by refusing to consent to the transfer of the shares which Visser Sitrus held in the company to a fellow shareholder, Mouton Sitrus. From the facts it appeared that the board was concerned that Mouton Sitrus was becoming too powerful and that their increased shareholding would not

<sup>92</sup> s 131.

<sup>93</sup> 2014 5 SA 179 (WCC).

be in the interests of the company for various reasons. The court had to therefore consider whether the board had a rational basis for believing that, and that it did indeed believe, that it was in the best interests of the company to refuse the transfer.

The court stated:

“Section 76(4) makes clear that the duty imposed by s 76(3)(b) to act in the best interests of the company is not an objective one, in the sense of entitling a court, if a board decision is challenged, to determine what is objectively speaking in the best interests of the company. What is required is that the directors, having taken reasonably diligent steps to become informed, should subjectively have believed that their decision was in the best interests of the company and this belief must have had ‘a rational basis’. The subjective test accords with the conventional approach to directors’ duties...”<sup>94</sup>

The court then further stated: “Section 76 requires the *bona fide* assessment of the directors to have a rational underpinning. This requirement has been articulated less frequently in the conventional statement of directors’ duties, but is not necessarily an innovation.”<sup>95</sup>

The court in the *Visser Citrus* case appears to state that the rationality test is subjective in nature, yet the analysis of a decision’s rational basis appears far more objective in nature. The court uses the principles of administrative law for clarity regarding the rationality test, considering specifically the jurisprudence surrounding s 6(2)(f)(ii) of the Promotion of Administrative Justice Act 3 of 2000, and the legality principle in this field in general.<sup>96</sup> Ultimately, it appears that the application of s 76(4) reduces the standard of conduct required for adherence to s 76(3)(b) and (c), as rationality is a less onerous standard of conduct than reasonableness.<sup>97</sup> The implication is that a director’s belief in the confluence of the best interests of the appointing and subsidiary entities need not have been one a reasonable director with the same knowledge, skill and experience as the director in question would have held, but merely one which bears a rational relationship to the basis for that belief.

Can a belief that acting in the best interest of the holding company or the group is also in the best interest of the subsidiary company (despite *prima facie* detriment to that company) have a rational basis?

This section will attempt to draw analogies from the law of insolvency case law dealing with allegations that dispositions by a subsidiary to its holding company were dispositions without value. The counterargument in the following cases was that the subsidiary received value in the form of the financial stability of the group. The purpose of the section will therefore be to determine whether the board of the subsidiary company could rationally argue that it acted in the best interest of the company despite the *prima facie* detriment.

In *Goode, Durrant & Murray Ltd v Hewitt & Cornell NNO*<sup>98</sup> Fannin J said the following about an inter-group cession agreement, which was attacked as a disposition without value under the Insolvency Act 24 of 1936:

“In this case, as I have said, the Company is one of a group of companies, and it guaranteed the obligation of another member of the same group as a result of financial pressure upon that fellow member, and on the parent company. On those facts, it seems to me impossible at this stage to say

<sup>94</sup> the *Visser Citrus* case (n 93) par 74.

<sup>95</sup> par 75.

<sup>96</sup> par 74.

<sup>97</sup> For a fuller and more detailed discussion of the impact of the *Visser Citrus* case and the effect of s 76(4), see Stevens and De Beer “The duty of care and skill and reckless trading: remedies in flux?” 2016 *SA Merc LJ* 250.

<sup>98</sup> 1961 4 SA 286 (N).

that no ‘value’ was given for there are many important benefits which such a transaction might bring to the Company, such as, for example, the continued financial stability of the whole group of companies.”<sup>99</sup>

By stating that the value of the transaction was situated in the financial stability of the group, the court in effect held that a debtor could show that value in terms of the Insolvency Act need not be received by it as the direct beneficiary, but that value could be received indirectly through the benefit to the rest of the group.

However, *Langeberg Koöperasie Bpk v Inverdoorn Farming & Trading Company Ltd*,<sup>100</sup> like the *Goode, Durrant* case, dealt with dispositions in terms of the Insolvency Act<sup>101</sup> within the context of a group of companies. In this case the respondent stood surety for the obligations of its holding company, Standard Finance Corporation of South Africa Ltd. Upon the liquidation of the respondent the appellant attempted to prove a claim against the respondent. The liquidator averred, *inter alia*, that the grant of the suretyship constituted a disposition without value under the Insolvency Act that should be set aside. The appellant relied on the judgment in the *Goode, Durrant* case, namely that the suretyship gave value to the group of companies of which the respondent was part.

Beyers JA, in delivering the majority judgment, mentioned that the respondent was a member of a group of companies, but that it nevertheless had a personality of its own. He further held that when a court has to consider whether a particular transaction is or is not in the interests of such a company, it would be prudent to bear in mind the remarks of Centlivres CJ in *R v Milne and Erleigh*,<sup>102</sup> namely that:

“There is no *persona* which is the group, and there are no interests involved except the interests of the companies and the interests of the controllers. This is not mere legal technicality. No doubt it may be convenient to talk of the interests of the group, but no one could seriously think of the group as having interests distinct from those of the companies and controllers. The fact that in a group bargaining between companies may often be non-existent, because the controllers decide, does not support the idea of a single *persona* with single interests. No business man would be deceived into thinking that in a group there is, in effect, a pooling of assets and a right in the controllers to deal with assets belonging to the companies without regard to their respective interests. Those interests must be adjusted by the controllers as honest boards would agree to do if there were no group, i.e. on fair and reasonable lines, having regard to the circumstances of each transaction.”<sup>103</sup>

The court *a quo* in the *Langeberg* case had held, after observing that the *Goode, Durrant* case was decided on exception, that:

“After considering the evidence and the arguments adduced thereon I can come to only one conclusion, and that is that this was an extraordinary transaction by which a farming company mortgaged the whole of its assets to assist another company to meet its debts. By undertaking this liability the Board achieved nothing beneficial to the Company, the advantage sought was remote and illusory, and in the result the Company was impoverished and forced into liquidation. To describe the disposition as one for value is to ignore the facts.”<sup>104</sup>

The appellate division was not persuaded that the findings of the court *a quo* were incorrect. It is important to note, however, that the court held that it was

<sup>99</sup> 291.

<sup>100</sup> 1965 2 SA 597 (A).

<sup>101</sup> 24 of 1936.

<sup>102</sup> 1951 1 SA 791 (A).

<sup>103</sup> (n 102) 827G-828A as quoted in the *Langeberg* case (n 100) 606.

<sup>104</sup> the *Langeberg* case (n 100) 607C-D.

not unmindful of the possible implications of its conclusion upon the general acceptability to creditors of bonds over the assets of subsidiary companies, when tendered by parent companies as security for the latter's obligations. The court held that if any such bond is attacked as a disposition without value under the Insolvency Act, the enquiry must always be whether, on the facts of the particular case, the mortgaging subsidiary company can fairly be said to have received value for the challenged disposition.

Although the appellate division dismissed the appeal, it would appear that it was more due to the facts at hand than the principle before it. It would appear that Beyers JA and Williamson JA, who wrote the dissenting judgment, tacitly acknowledged that the financial stability of a group of companies may constitute value in terms of the Insolvency Act in appropriate circumstances. This seems to imply that the court could view a group of companies as an economic unit in appropriate circumstances.

The question of value in the context of voidable dispositions under the Insolvency Act was again considered in *Swanee's Boerdery (Edms) Bpk (in liquidation) v Trust Bank of Africa Ltd.*<sup>105</sup> In this decision the court seemingly attempts to qualify the judgments in the *Goode*, *Durrant* and *Langeberg* cases but simultaneously does not reject the notion that the insolvent may receive value for its disposition within the context of a group.<sup>106</sup> Value in this context refers to the financial stability of the group. This case, however, did not involve a group of companies. The only common feature of the companies in this case was that they had the same shareholders, Mr and Mrs Swanepoel. Be that as it may, the court still accepted implicitly that it is conceivable that the financial stability of a group would constitute value within the context of voidable dispositions under the Insolvency Act. The court infers that it would be a question of fact by looking at all the surrounding circumstances.<sup>107</sup>

The problem with analogies is that they have to be understood within context. In this respect it is important to remember that the *Langeberg*, *Goode*, *Durrant* and *Swanee* cases all deal with whether value had been given in the specific circumstances. In these cases it was approached as an objectively determinable factual question, and the subjective intention of the disposer was not important whether the disposers intended it to be for the benefit of the group was not crucial to determine whether there had been value given. What was important was to determine *ex post facto* whether value had been received. Why these cases are important though is the fact that the courts did not reject the arguments of value within the group context, but in those cases where it had been rejected it was a question of fact and not of law. Thus, would a director of a holding company be in breach of his duty to act in the best interest of the company if he follows an instruction from his holding company which is harmful but thought it would be in the best interest of the holding company but also the subsidiary company? If one also considers the argument of Locke that the supreme court of appeal gave a commercially purposive interpretation in the *CNA* case, the argument that the directors may have had a rational basis for believing that they acted in the best (longer-term) interest of the company, despite the *prima facie* shorter-term harm, may be a plausible defence for the relevant directors.<sup>108</sup>

<sup>105</sup> 1986 2 SA 850 (A).

<sup>106</sup> 860B-E.

<sup>107</sup> 860E.

<sup>108</sup> See Locke (n 4).

#### 4 Conclusion

Subsidiary companies could often suffer harm due to the instructions of the holding company. This places the directors of subsidiary companies in a dilemma when they make decisions because more often than not they have to act in the interest of the holding company and to the detriment of the subsidiary company. This is the commercial reality within which they operate. The South African law does not always recognise this commercial reality. The board of the subsidiary may believe that they as nominee directors have to act in the interest of the holding company to avoid possible negative consequences. They may also believe that if they follow the instructions of the holding company they may act in the long-term best interest of the subsidiary company. At the moment the only defence that a director may have against a charge that he did not act in the best interest of his company is that he had a rational belief that he did. This article therefore investigated whether such belief could be justified by considering the dictum in the *Visser Citrus* case, and using case law in the field of insolvency as an illustration that such group-benefits have indeed been judicially recognised in another context. This suggests that, in theory, it would be possible for a director to allege a rational basis for a belief in the materialisation of such benefits.

The article further investigated the unenviable position of nominee directors within the context of the above conclusions. It is suggested that the legislature takes cognisance of the German, Australian and New Zealand Companies Acts, which in some form or another recognise the commercial reality within which the nominee directors operate. All three systems have attempted to give effect to the commercial reality, but also simultaneously attempted to build in sufficient deterrents to avoid abuses, especially the German provisions. It has been shown that no clear analogous position exists in South African law to adopt the German position but that legislative intervention would be needed if, from a policy perspective, liability would be imposed on the holding company. In the light of the separate juristic personality doctrine, it is doubtful whether the German model would suit South African law. The reason for this is its different company law tradition despite the attractive nature of the provisions of *AG* in the context of harmful instructions by the holding company.

#### SAMEVATTING

##### AANSPREKLIKHEID BINNE MAATSKAPPYGROEPE

Een van die grondbeginsels van die maatskappyereg is aparte regs persoonlikheid; ook waar die beherende aandeelhouer 'n ander maatskappy is. Maatskappygroepe is kommersiële werklikhede, maar tradisioneel erken die reg nie die ekonomiese realiteit van maatskappygroepe nie. Dit is enersyds 'n kommersiële werklikheid dat houermaatskappy direkteure in sy filiale aanstel en instruksies aan daardie direkteure sal gee ten opsigte van die bestuur van die filiaal; instruksies wat dikwels nie op die oog af in die beste belang van die filiaal maatskappy is nie. Andersyds het direkteure van die filiaal maatskappy 'n vertrouensplig teenoor die filiaal maatskappy en moet in die beste belang van die filiaal maatskappy optree. Direkteure van filiaal maatskappye bevind hulle dus dikwels in die onbenedenswaardige posisie om te moet kies tussen die gehoorsaming van instruksies van hul aanstellers en hul vertrouenspligte teenoor die filiaal maatskappy.

Hierdie artikel ondersoek die aanspreeklikheid in groepsverband binne die konteks van instruksies wat die houer aan die filiaal gee. Die Duitse *Aktiengesetz* laat in sekere omstandighede toe dat instruksies gegee mag word. Indien hierdie omstandighede egter nie teenwoordig is nie, mag die houermaatskappy nie nadelige instruksies aan die filiaal gee nie. Indien dit sou, mag die houer of sy direksie vir die skade, wat die filiaal ly, aanspreeklik gehou word. Die onderskeie Australiese en Nieu-Seelandse maatskappywetgewing laat breedweg toe dat die filiaal se direksie wel in sekere gevalle in die belang van die houer optree ten spyte van die nadeel aan die filiaal. Hierdie artikel

ondersoek enersyds die moontlikheid of die houermaatskappy as 'n skadu-direkteur beskou kan word en op daardie basis aanspreeklikheid opdoen as analogie tot die Duitse posisie. Tweedens ondersoek die artikel of direkteure van die filiaal, wat prima facie nie in die beste belang van die filiaal optree nie, wel 'n suksesvolle verweer sou kon opper teen 'n klag dat hulle hul vertrouensplig teenoor die filiaal verbreek het. Na aanleiding van die *Visser Sitrus*-saak blyk dit dat daar wel 'n moontlike suksesvolle verweer teen enige klag van 'n vertrouenspligskending geopper sal kan word.