THE MISFIT

Section 218 (2) of the Companies Act 71 of 2008

by

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The question of whether a breach of a statutory duty should give rise to a civil claim for damages has long vexed legal systems all around the globe. The fear is that an extension of liability to every breach of a statutory duty would open the floodgates to claims the legislature never intended, thus creating the risk of unjust and potentially ruinous claims.

While the approach may differ on how one deals with claims for a breach of a statutory duty from one jurisdiction to another, the end result is much the same. Such claims will only be entertained where the claimant has a direct interest in the subject matter of the contravention and as such can show that the law breaker owes a duty of care beyond the general expectation every citizen has that the laws of the land will be observed and enforced.

It's therefore startling that section 218 (2) of Companies Act, 71 of 2008 (the new act) is drafted in the following terms:

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

It is a section remarkable for both the simplicity of its drafting and the magnitude of its impact. It gives everyone the direct interest referred to above in every contravention of the new act. Once a contravention has been established, all that is required is proof of causation and damages.

Why is it that the legislature has not sought to impose similar standards of care on the State? If one of the aims of the new act is to make companies, especially large and presumably powerful ones, more accountable to the wider public, think what would be achieved if one applied similar standards to the general business of government? And that I fear is the problem.

The consequences are massive.

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- Directors are no longer responsible only to the company. They now owe a general duty to the whole world to ensure that they do not contravene the provisions of the new act. Indeed it is not just directors who owe this duty. It's everyone. Thus bankers, advisors, in fact anyone who has any dealings with a company or the new act must take care to ensure that they do not contravene the new act. The penalty for noncompliance is personal liability for any loss or damage that results from that contravention.
- Company employees are likewise affected insofar as their actions amount to a contravention of the act.
- The possible effects of a failure to exercise proper care are endless. For example, directors are obliged to carry out their duties in good faith and for a proper purpose. A failure to do so is a contravention unless the director can show that he or she has acted honestly and reasonably. Deliberate law breaking will never satisfy this test which means that every director of a company who knowingly allows the company to breach a law or agreement could be personally liable under this section to anyone who suffers a loss as a result.
- The existence of a broad-based duty of care therefore immeasurably complicates the business of managing companies, especially companies which are obliged to operate a social and ethics committee. Directors must in the fulfilment of their fiduciary obligations in terms of section 76 consider a broad range of social and developmental issues in addition to the requirement that the company make a profit in circumstances where they are liable to be second-guessed and even sued by government, trade unions and even the general public on the grounds that the decision is a breach of the standard of conduct a company can expect of its directors.
- It thus gives the commission and indeed the public at large very considerable powers to meddle in the affairs of a company. This could have the consequence of transforming what is meant to be an enlightened shareholder model into one of the frightened director.

The magic of a company lies in the marriage it offers between capital and entrepreneurship in a vehicle run on democratic principles and enjoying perpetual succession. It's this magic that has resulted in companies accounting for over 50% of the world's 100 largest economies when measured by gross

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revenue. A frequent weakness inherent in these companies is that their shares are voted by managers. The voice of the individual shareholder has been lost and with it the checks and balances that are inherent in a functioning democracy. Regrettably their place is all too frequently taken by employed managers operating in a moral vacuum that gives them almost limitless opportunities to plunder the company with little or no risk of retribution if they are caught. Abuse is inevitable and we are increasingly seeing the consequences of that abuse. The temptation to address this by applying fear as a countervailing force is understandable and perhaps even to some extent desirable.

However there must be a balance, as fear is the arch enemy of both entrepreneurship and investment. It is destructive of the appetite for risk that underlies every honest commercial success. Too much fear will drive away entrepreneurs and investors alike, leaving companies in the hand of bureaucrats operating at the expense of the taxpayer and hand-in-glove with government. This is a recipe for disaster if ever there was one.

Care must be taken when curbing the excesses of dishonest managers not to throw the baby out with the bath water. I fear the legislature may well have done so in enacting section 218(2) of the new act in its present form.

One would have thought a step as momentous as this would have been the subject matter of considerable debate but this has not been the case. Although this section was in the 2008 Bill the accompanying explanatory memorandum is silent on the subject of its inclusion. Nor was it discussed in the 2004 White Paper "South African Company Law for the 21st Century". It has also received scant attention from those who have written on the act. This is very surprising given the considerable attention that has been given to the manner in which director's duties and the liabilities that flow from a failure to perform these duties are dealt with in the new act. Section 218(2) of course cuts across much of what is said in those sections and what is set out elsewhere in the act. One wonders, for example, why it is necessary to have section 77(3) given that section 218(2) is part of the statute.

The section is also unique to South Africa. It is not even part of the Company Law of the People's Republic of China, 2005, which begs the question: do we really mean to frighten potential investors with something as novel and untested as unlimited civil liability for a contravention of a statutory obligation or was this a mistake?

The answer may lie in section 222 which states:

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> *The State, the Commission, the Commissioner, the Companies Tribunal, the Panel, an inspector, or any state employee or similar person having duties to perform under this Act, is not liable for any loss sustained by or damage caused to any person as a result of any bona fide act or omission relating to the performance of any duty under this Act, unless gross negligence is proved.*

Section 9 (1) of the Constitution says that everybody is equal before the law. This is clearly not the case if section 218(2) is applied literally. Section 222 absolves the state for the most part from liability under the new act while extending the limits of that liability for everyone else. It in effect places the state above the ordinary law of the land. That is tyranny and tyranny has no place in a constitutional democracy such as ours.

For what it's worth, I think section 218(2) is a mistake. It was in my view, and as Henochsberg has hinted, intended to apply to offences only. It is a misfit that needs to be fixed or removed before it damages the confidence that investors and entrepreneurs must place in the new act if it is to achieve the purpose set out in section 7.

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