



COMMONWEALTH  
Climate and Law Initiative



# Directors' Liability and Climate Risk: *South Africa - Country Paper*

By Christine Reddell

*April 2018*



SMITH SCHOOL OF ENTERPRISE  
AND THE ENVIRONMENT





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## About the Commonwealth Climate and Law Initiative

The Commonwealth Climate and Law Initiative (CCLI) is a research, education, and outreach project focused on four Commonwealth countries: Australia, Canada, South Africa, and the United Kingdom. CCLI is examining the legal basis for directors and trustees to take account of physical climate change risk and societal responses to climate change, under prevailing statutory and common (judge-made) laws. In addition to the legal theory, it also aims to undertake a practical assessment of the materiality of these considerations, in terms of liability, and the scale, timing, probability of this and the potential implications for company and investor decision-making.

Australia, Canada, South Africa, and the UK, despite only producing 6% of current annual global GHG emissions, account for 13% of global coal reserves and 11% of global oil reserves. Their stock exchanges also have 27% of all listed fossil fuel reserves and 36% of listed fossil fuel resources. They each have large and highly developed financial systems and account for 23% of the global pension assets and contain within the G20 the 8th, 5th, 14th, and 4th largest stock markets by market capitalisation respectively.

The significant commonalities in the laws and legal systems of each of the four countries makes the initiative's work and outcomes readily transferable. They each operate a common law legal system. Their corporate governance laws are based on common fiduciary principles. Whilst their laws may differ at the margins, legal developments and judicial precedents are influential in each others' jurisdictions.

The core research findings are contained in the national legal papers for the four jurisdictions. These have been complemented by conferences in Australia (August 2016), Canada (October 2017), South Africa (January 2018) and the UK (June 2016). The national legal papers are organised by jurisdiction and follow a uniform structure to facilitate the creation of a subsequent comparative paper, which will aim to identify the strengths, weaknesses, opportunities and threats in each jurisdiction.

These papers represent a lead up to the creation of a White Paper that identifies policy recommendations for directors' associations and financial regulators in relation to the proper implementation and enforcement of directors' fiduciary laws in each of the observed jurisdictions. Moreover, the comparative work will be used to design an actionable framework for directors to integrate climate change issues into governance practice. This paper will be made available to the public at large and aim at creating a broad discussion among all targeted stakeholders.



## About the Author

**Christine Reddell** is an attorney at the Centre for Environmental Rights (CER), a non-profit organisation and law clinic based in Cape Town, South Africa, that seeks to advance the realisation of environmental rights by providing support and legal representation to civil society organisations and communities, and by engaging in legal research, advocacy and litigation to achieve strategic change. Christine works in the Corporate Accountability and Transparency Programme at the CER, a team dedicated to improving transparency and accountability around the detrimental impacts of polluting corporates on South Africa's environment and people. Christine holds a BA, LLB and LLM (Marine and Environmental Law) from the University of Cape Town. Before joining the CER, Christine practiced at both dedicated marine, and environmental, law firms.

### *Acknowledgements*

We would like to thank the KR Foundation, the Children's Investment Fund Foundation, and the Ivey Foundation for their support of CCLI.

The authors would also like to recognise critically important guidance and feedback from the CCLI Advisory Board and representatives from CCLI founder and partner organisations, specifically: Ben Caldecott (University of Oxford), Kim Schumacher (University of Oxford), Alice Garton (ClientEarth), Alexia Staker (ClientEarth), David Cooke (ClientEarth), Tracey Davies (Centre for Environmental Rights), Jessica Fries (Accounting for Sustainability), Professor Cynthia Williams (Osgoode Hall), Professor Janis Sarra (University of British Columbia), and Sarah Barker (MinterEllison).

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# 1. Introduction

## 1.1. Climate change as a material financial risk

There is increasing recognition globally that climate change poses various financial risks to companies, particularly those operating within certain sectors or in certain regions. The Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD) categorises climate-related risks into two major types – *transition* risks and *physical* risks.<sup>1</sup> Transition risks are those financial and reputational risks occasioned by the transition to a lower-carbon economy, whereas physical risks are those risks to a company's premises, operations, supply chain, transport needs, and employee safety occasioned by shifts in climate patterns.<sup>2</sup> Included in the TCFD's categorisation of *transition* risks, are what the Bank of England, in its seminal report to the insurance industry on climate-related risks, described as *liability* risks, which could arise out of the potential exposure of companies to legal liability as a result of the company's contribution to climate change, its failure to manage physical and transitional risks, or its inaccurate, misleading or fraudulent reporting of climate change risks.<sup>3</sup>

South Africa is particularly vulnerable to the financial risks associated with climate change. Despite South Africa's abundance of renewable energy sources, South Africa's electricity grid, tightly controlled by state-owned utility Eskom, is fed almost entirely by electricity generated from coal-fired power stations (90% of South Africa's electricity).<sup>4</sup> If South Africa is to meet its commitments under the Paris Agreement, the country must urgently transition away from this reliance. In theory, the prospects for this transition are excellent, given South Africa's abundant and feasible renewable energy alternatives which are in fact cheaper than coal.<sup>5</sup> However, the current political environment means that a timely transition is under threat.

South Africa's Nationally Determined Contribution (NDC), which is rated by the Climate Action Tracker as "highly insufficient" and inconsistent with holding warming to below 2°C,<sup>6</sup> records that South Africa's greenhouse gas (GHG) emissions will peak from 2020-2025, and thereafter plateau and then decline from 2035. There is a very real risk of stranded GHG intensive assets in South Africa, given that South Africa will need to plan for, and introduce more regulations and increasingly strict NDCs, to curb its national GHG emissions to meet its global commitments.

South Africa is also particularly vulnerable to the physical impacts of climate change. Mean annual temperatures in South Africa have increased by at least 1.5 times the global average over the past five decades, and extreme rainfall events have also increased in frequency.<sup>7</sup> The western parts of South

<sup>1</sup> FSB, *Recommendations of the Task Force on Climate-related Financial Disclosures*, June 2017, at page 5.

<sup>2</sup> *Ibid*, at page 5 and 6.

<sup>3</sup> Bank of England Prudential Regulation Authority, *The Impact of Climate Change on the UK Insurance Sector*, September 2015, available at:

<http://www.bankofengland.co.uk/prad/ Documents/supervision/activities/pradefra0915.pdf>.

<sup>4</sup> Lucy Baker, *Post-apartheid electricity policy and the emergence of South Africa's renewable energy sector*, at page 1. See also: <http://ieefa.org/south-africas-state-utility-company-self-styled-extinction/>.

<sup>5</sup> <https://www.dailymaverick.co.za/article/2016-10-18-comparative-analysis-the-cost-of-new-power-generation-in-south-africa#.WfclHGICziU>.

<sup>6</sup> <http://climateactiontracker.org/countries/southafrica.html>.

<sup>7</sup> WIREs Climate Change 2014, 5:605–620. doi: 10.1002/wcc.295, available at:

<http://onlinelibrary.wiley.com/doi/10.1002/wcc.295/pdf>.



Africa have experienced downward trends in rainfall, and certain characteristics of seasonal rainfall such as duration, dry spell frequencies, and rainfall intensity have changed. Increasing frequencies in dry spells have also been accompanied by an increasing trend in daily rainfall intensity, which results in various physical risks, such as increased run-off and erosion.<sup>8</sup>

This paper considers the potential legal duties of company directors in South Africa to assess, manage and report on the financial risks associated with climate change. These duties are owed to the company, which includes the collective body of shareholders. In South Africa, these obligations stem originally from the common law, but have recently been codified into our Companies Act 71 of 2008 (Companies Act). Although directors are the focus of this paper, the legal duties of other key participants in the financial services system, insofar as they differ, are also considered.

Given the scientific consensus on climate change, and the risks associated with climate change, it is likely that various categories of climate-related risks would be considered “foreseeable” by a Court.<sup>9</sup> The foreseeability of these risks, and the ever-increasing data and accuracy of data pointing to these risks, may require that directors take steps to assess, mitigate and report on these risks as they would be required to do for any other foreseeable risks to the company.

## 1.2. Brief overview of relevant fiduciary precepts

In South Africa, the general duties of directors fall into two categories – fiduciary duties of good faith, honesty and loyalty (which involve an element of trust); and the duty to exercise reasonable care, skill and diligence, which is not a fiduciary duty and instead centres on the issue of competence.

The fiduciary duties of directors, which have been partially codified in the Companies Act, are mandatory and apply to all companies. These duties are set out in section 76 of the Companies Act, and in particular sub-sections (3)(a) and (b), which provide that:

- (3) *Subject to subsections (4) and (5), a director of a company, when acting in that capacity, must exercise the powers and perform the functions of director-*
- (a) *in good faith and for a proper purpose; [and]*
  - (b) *in the best interests of the company;*

...

The duty to act in good faith depends largely on honesty, which is a subjective inquiry requiring subjective awareness of wrongdoing.<sup>10</sup> There are, however, limits to the subjective test, and the

<sup>8</sup> Niang, I., O.C. Ruppel, M.A. Abdrabo, A. Essel, C. Lennard, J. Padgham, and P. Urquhart, 2014: Africa. In: *Climate Change 2014: Impacts, Adaptation, and Vulnerability. Part B: Regional Aspects. Contribution of Working Group II to the Fifth Assessment Report of the Intergovernmental Panel on Climate Change* [Barros, V.R., C.B. Field, D.J. Dokken, M.D. Mastrandrea, K.J. Mach, T.E. Bilir, M. Chatterjee, K.L. Ebi, Y.O. Estrada, R.C. Genova, B. Girma, E.S. Kissel, A.N. Levy, S. MacCracken, P.R. Mastrandrea, and L.L. White (eds.)]. Cambridge University Press, Cambridge, United Kingdom and New York, NY, USA, pp. 1199-1265, at page 1209.

<sup>9</sup> Noel Hutley SC and Sebastian Hartford-Davis, *Climate Change and Directors Duties*, Memorandum of Opinion to Minter Ellison for the Centre for Policy Development and Future Business Council, 7 October 2016, available at: <https://cpd.org.au/wpcontent/uploads/2016/10/Legal-Opinion-on-Climate-Change-and-Directors-Duties.pdf>.

<sup>10</sup> Cassim et al, *Contemporary Company Law*, 2<sup>nd</sup> edition, at page 524.



absence of reasonable grounds for believing that a director is acting in the interests of the company may form the basis for finding a lack of good faith.<sup>11</sup>

What exactly constitutes “a proper purpose” is not defined in the Companies Act, but at common law, it has been taken to mean that directors must exercise their powers according to the objective purpose for which that power was given to them, and not for ulterior purposes – which is an objective enquiry.<sup>12</sup> As indicated above, the duty to exercise reasonable care, skill and diligence is not a fiduciary duty. It is a duty which speaks to the competence of a director and it is based on delictual liability for negligence. This duty has been formulated by the South African courts in largely subjective terms, based on the skill and experience of the particular director.<sup>13</sup> Claims for compensation are limited to delictual damages only.<sup>14</sup> This duty has also been partially codified in the Companies Act – in section 76, subsection (3)(c):

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

### 1.3. *Relationship between statutory and common law duties*

As mentioned above, the Companies Act, which was assented to by the President of South Africa on 8 April 2010, and became effective from 1 May 2011, has partially codified the fiduciary duties of directors and the duty to exercise reasonable care and skill, duties which previously existed in the common law only.

The codification of these duties in the Companies Act has not resulted in an exhaustive list of duties, and the common law principles continue to apply – with the effect that there is now a great deal of overlap between the two. Section 77 of the Companies Act, which deals with the liability of directors, specifically preserves the application of the common law, by providing, in sub-sections (2)(a) and (b), that:

- (2) *A director of a company may be held liable-*
- (a) *in accordance with the principles of the common law relating to breach of a fiduciary duty, for any loss, damages or costs sustained by the company as a consequence of any breach by the director of a duty contemplated in section 75, 76(2) or 76(3)(a) or (b); or*

<sup>11</sup> *Gething v Kilner* [1972] 1 WLR 337 at 342.

<sup>12</sup> *Extrasure Travel Insurance Ltd v Scattergood* [2003] 1 BCLC 598 (ChD) at 613.

<sup>13</sup> Cassim et al (note 10) at page 555.

<sup>14</sup> <http://www.mondaq.com/southafrica/x/214918/Directors+Officers/The+Standard+of+Directors+Conduct>.



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



## 2. Acting in good faith and in the best interests of the company

### *2.1. Loyalty duties framework*

The fiduciary duties of directors in South Africa are based on loyalty, good faith and the avoidance of conflicts of interest.<sup>15</sup> These duties are largely derived from English law – a position which has been acknowledged by the South African courts on many occasions.

The duty to act in good faith entails that a director exercise independent judgment, but also that he or she acts within the limits of his or her authority (since section 76(3)(a) of the Companies Act couples the duty of good faith with the duty to exercise powers for a proper purpose).<sup>16</sup>

Evaluating whether or not a director has acted in good faith is a subjective test, but South African courts have imposed limits – relying on the construct of what a “reasonable man” would do.<sup>17</sup>

The meaning of ‘proper purpose’ is not defined in the Companies Act, but is taken to mean that directors must not act for ulterior purposes outside the scope of their objective powers.

The common law principle that a director must act in the best interests of the company is codified in section 76(3)(b) of the Companies Act. The way in which this duty is phrased in the Companies Act removes any doubt that the duty is owed to the company – i.e. the duty is enforceable only by the company. However, at common law, there is extensive authority for the view that “company”, in this context, refers to more than just the legal entity, but rather includes the collective interests of present and future shareholders.<sup>18</sup>

The duty to avoid a conflict of interest has been heavily influenced by trust law in South Africa.<sup>19</sup> Company directors are under a fiduciary duty to avoid placing themselves in a position in which their company duties conflict with their personal interests.

### *2.2. Application of loyalty duties in climate risk context*

Determining whether a fiduciary duty exists, and if so, whether it has been breached, requires applying the general principles to the facts in each particular case. The Supreme Court of Appeal has specifically acknowledged that there is no “closed list” of fiduciary duties, and that there is room for development of the law outside of established categories.<sup>20</sup>

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<sup>15</sup> Cassim et al (note 10) at page 509.

<sup>16</sup> Cassim et al (note 10) at page 524.

<sup>17</sup> Cassim et al (note 10) at page 524 – 525.

<sup>18</sup> Cassim et al (note 10) at page 515.

<sup>19</sup> Cassim et al (note 10) at page 534.

<sup>20</sup> *Volvo (Southern Africa) (Pty) Ltd v Yssel* (247/08) [2009] ZASCA 82; 2009 (6) SA 531 (SCA); [2009] 4 All SA 497 (SCA); [2010] 2 BLLR 128 (SCA) (20 August 2009), at para 16.



The fundamental fiduciary duty of company directors is to act in the best interests of the company as a whole, which includes the collective body of shareholders.<sup>21</sup> It is for the directors to decide what is in the best interests of the shareholders, but they must act fairly between the shareholders. Other stakeholder interests have not received formal legal recognition in the Companies Act. However, governance codes, and in particular the King Report on Corporate Governance in South Africa<sup>TM</sup> (King Report), emphasise the importance of other stakeholder interests, and require company directors to have regard to wide-ranging social, economic and environmental concerns.

The duty to act in good faith and in the best interests of the company depends largely on honesty. A director is protected from allegations of a breach of duty by the ‘business judgment rule’, which was brought into South African law under the Companies Act (section 76(4)). In terms of the rule, a director is not considered to have breached his or her duties if that director took reasonably diligent steps to become informed about the matter; had no conflict of interest in relation to the matter or complied with the rules on conflict of interest; and had a rational basis for believing - and did believe - that the decision was in the best interests of the company.

Guidance is not given in the Companies Act as to what constitutes “*reasonably diligent steps to become informed about the matter*”, but it has been suggested that the matter should be considered in the context of the *Lex Aquilia* (patrimonial loss), and that the matter can be addressed by asking what public policy would demand in each individual case.<sup>22</sup> The question is therefore informed in line with the general principles of the South African law of delict, and by applying the wrongfulness test. The basic question is then whether, in light of the legal convictions of the community and the circumstances of the case, the director acted in a reasonable or unreasonable manner.

In the global climate risk context, it is clear that the approach to fiduciary duty is being carefully scrutinised. For example, the United Nations, in a report on fiduciary duties, has concluded that “[f]ailing to consider long-term investment value drivers, which include environmental, social and governance issues, in investment practice is a failure of the fiduciary duty”.<sup>23</sup> The establishment of the industry-led TCFD, and the TCFD’s publication of recommendations for voluntary disclosures of climate-related financial risks, is also strong evidence of a shifting approach in the international community. In the South African context, the King Report, although it does not prescribe specific climate risk related interventions or reporting requirements, does reflect a more nuanced understanding that environmental and social considerations must guide business decisions if these decisions are to “*create value in a sustainable manner*”<sup>24</sup>. In this context, it is clearly conceivable that a director’s failure to consider climate risks that pose a foreseeable and material financial risk to the business, could constitute (based on the legal convictions of the international and South African community) a failure to take reasonable steps to become informed about the matter, and hence a failure to act in the best interests of the company.

As to what constitutes a “rational belief” on the part of the director, there is once again no specific guidance in the Companies Act. It has been suggested that, in order to have a “rational belief”,

<sup>21</sup> Cassim et al (note 10), at page 515.

<sup>22</sup> Linda Muswaka, *Shielding Directors against Liability Imputations: The Business Judgment Rule and Good Corporate Governance*, [2013] SPECJU 2, at page 29.

<sup>23</sup> United Nations Global Compact et al, *Fiduciary Duty in the 21<sup>st</sup> Century*, 2015, at page 9.

<sup>24</sup> King IV Report on Corporate Governance for South Africa 2016, p 4.



directors must be independent with respect to their actions, and in a position to base their decisions on the merits of the matter rather than being governed by extraneous considerations or influences.<sup>25</sup> In the climate risk context, if a director has obtained expert advice on climate risks, but then fails to adjust the operations of the business to incorporate the advice received, or to explain why adjustments are not needed, because the director is driven by short-term profits or short-term commitments made by the company, then the rationality of the director's belief that he or she was acting in the best interests of the company could be called into question.

Another important factor in the South African context, which goes to the proper interpretation of the nature and scope of fiduciary duties, and also to what constitutes "reasonably diligent steps", or a "rational basis" for a belief, is the Constitution and the Bill of Rights. The legal landscape has changed significantly in South Africa with the adoption of the Constitution, which requires a reconsideration of company responsibilities.<sup>26</sup> This is a potential game-changer in the climate risk context. In South Africa, the Constitution is the supreme law of the Republic, and courts are required, when interpreting any legislation or when developing the common law, to promote the spirit, purport, and objects of the Bill of Rights.<sup>27</sup> Included in our Bill of Rights is an environmental right which provides that everyone has the right "to have the environment protected for the benefit of present and future generations..." What constitutes a company's "best interests" is a general term which, if interpreted so as to promote the Bill of Rights, may reasonably extend beyond shareholder profit maximisation, to embrace socially and environmentally responsible board decisions which will benefit the company and its shareholders over long-term horizons.<sup>28</sup>

### 2.3. Loyalty conclusion

The legal landscape has changed significantly in South Africa and internationally. It is clear that climate risk considerations are increasingly influencing what can be said to constitute the "legal convictions" of the community. This will have a significant impact on how fiduciary duties are interpreted. What it means to act in "good faith", and in the "best interests" of the company, are legal constructs which develop over time.

The existence and nature of fiduciary duties are not cast in stone. In *Ghersi v Tiber Developments (Pty) Ltd*,<sup>29</sup> the court recognised that "the ambit of the duty can change from time to time", and that "[t]he existence of...a [fiduciary] duty and its nature and extent are questions of fact to be adduced from a thorough consideration of the substance of the relationship and any relevant circumstances which affect the operations of that relationship".<sup>30</sup> The substance of a relationship between parties is something which does not exist in isolation from society, and is rather something which develops over time to suit modern conditions.<sup>31</sup>

<sup>25</sup> Muswaka (note 22), at page 31.

<sup>26</sup> Minal Ramnath, *Interpreting Directors' Fiduciary Duty to Act in the Company's Best Interests Through the Prism of the Bill of Rights: Taking Other Stakeholders into Consideration*, *Speculum Juris* Volume 27, Issue 2 (2013). Also see: Constitution of the Republic of South Africa, 1996, section 8(2) and 39(2).

<sup>27</sup> Constitution of the Republic of South Africa, 1996, section 39(2).

<sup>28</sup> Ramnath (note 26) at page 113.

<sup>29</sup> 2007 (4) SA 536 (SCA) at para 9.

<sup>30</sup> At para 9 (quoting *Phillips v Fieldstone Africa (Pty) Ltd and Another* 2004 (3) SA 465 (SAC) at 477H). See also: Ramnath (note 26), at page 102.

<sup>31</sup> Ramnath (note 26) at page 102.



It is within this context that director liability for the failure to consider climate risks could arise within the existing legal framework in South Africa. A court faced with whether the failure on the part of a director to consider climate risk is a breach of the fiduciary duties under section 76(3)(a) and (b) of the Companies Act, must consider evolving business norms and the recognition globally of the financial risks of climate change, as well as the constitutional obligation to ensure that the environment is protected for the benefit of present and future generations.

## 3. Competence (due care and diligence)

### 3.1. Due care and diligence duties framework

Section 76(3)(c) of the Companies Act imposes a less subjective standard of care on directors than was the case under the common law.<sup>32</sup> Section 76(3)(c)(i) and (ii) require a director to exercise the degree of skill and diligence that may reasonably be expected of a person “*carrying out the same functions*” as those carried out by the director, and “*having the general knowledge, skill and experience of that director*”. While this does impose objective limits, the test is not entirely objective – it will be influenced by the size and nature of the company, and the position and responsibilities of the particular director.<sup>33</sup>

The knowledge, skill, and experience of the director must also be taken into account. If the director is more experienced or knowledgeable, his or her conduct will be judged against this higher subjective standard. A director cannot hide behind his or her lack of knowledge though, since the wording of section 76(3)(c)(i) and (ii) makes it clear that there is a prescribed minimum standard with which all directors are required to comply. The subjective standard is taken into account only when it increases or improves the objective standard expected of a reasonable director.<sup>34</sup>

A director can be held liable in delict for damages if he or she fails to observe his or her duties of care and skill. As is the case with the fiduciary duties discussed above, the Companies Act has imported the ‘business judgment rule’ as a defence to be used by directors in relation to such claims.<sup>35</sup>

### 3.2. Application of due care and diligence duties laws in climate risk context

The leading case in South Africa on the duty of care and skill is *Fisheries Development Corporation of South Africa Ltd v Jorgensen*.<sup>36</sup> Amongst other things, in this case the court set out the difference between what is expected of executive, versus non-executive, directors. While the court noted the differences, it did not provide any guidance on how to apply different tests.<sup>37</sup> The court emphasised that considerable weight is placed on the nature of the company’s business and any particular obligations assumed or assigned to the particular director. The court also considered the delegation of duties, noting that, in the absence of grounds for suspicion, directors are justified in trusting that company officials perform their duties honestly. Directors are also entitled to rely on the information and advice of management; however they should not accept information blindly.<sup>38</sup> Apart from the *Fisheries Development* case, there appears to be very little case law in South Africa dealing specifically with the duty of care and skill.<sup>39</sup>

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<sup>32</sup> Cassim (note 10), at page 558.

<sup>33</sup> Cassim (note 10), at page 559.

<sup>34</sup> Cassim (note 10), at page 560.

<sup>35</sup> Section 76(4) of the Companies Act.

<sup>36</sup> 1980 4 SA 156 (W).

<sup>37</sup> Richard Stevens, *The Legal Nature of the Duty of Care and Skill: Contract or Delict?*, PER / PELJ 2017(20) – DOI, at page 4.

<sup>38</sup> *Fisheries Development Corporation of South Africa Ltd v Jorgensen* (note 29), at paras 165g-166e.

<sup>39</sup> Stevens (note 37), at page 8.



In academic circles, the test for a director's duty of care and skill has been criticised as having a relatively low threshold.<sup>40</sup> The Companies Act has, to some degree, sought to rectify this, by imposing a less subjective and more demanding standard than the common law.<sup>41</sup> However, the Companies Act also introduces the business judgment rule in relation to this duty, which has the effect of softening the duty.

It is clear that overlapping considerations apply in respect of the fiduciary duties and the duty of care and skill, particularly given that the business judgment rule applies to both.<sup>42</sup> In the climate risk context, breach of section 76(3)(c) may therefore occur in similar circumstances to those discussed in relation to sections 76(3)(a) and (b) – i.e. where climate risk poses foreseeable and material financial risks to the company and the directors have not considered that risk, or where directors have assessed climate risks, but then fail to exercise reasonable care and skill in managing those risks. For example, it is widely accepted by the scientific community that climate change will result in a greater frequency of extreme weather events (physical risks). Directors can, and arguably should, conduct forward planning to deal with these events, especially in instances where their business is particularly affected by these risks (for example, located in a floodplain, or in a water-scarce area but reliant on significant volumes of water). Similarly, where directors fail to adequately supervise delegated duties relating to climate change risks, or where directors blindly rely on advice without using their own judgment, or without giving the advice their due consideration, it is likely that they could be considered to have breached their duty of care and skill (as set out in the *Fisheries Development* case referred to above).

Liability for the breach of a director's duty of care and skill takes place in accordance with the common law relating to delict for any loss, damages or costs sustained by the company as a consequence of the breach of duty (section 77(2)(b) of the Companies Act). In the climate risk scenario, this will require proof of actual loss, and a causal link between, for example, a director's negligence in failing to foresee, adapt or mitigate certain effects of climate change that result in financial loss to the company (an example of this might be where a company relies on heavy rainfall for crop production and does nothing to mitigate, or plan for a future in which the particular area suffers from severe drought, which leads to financial loss as a result of lower crop yields).

A unique aspect of the Companies Act is that while this duty, and the fiduciary duties, are owed to the company, section 218(2) of the Companies Act provides that “[a]ny 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”.<sup>43</sup> This opens up the possibility for claims by other stakeholders, and by shareholders directly.<sup>44</sup> This could be particularly useful in the climate risk context, where the impacts of climate risk affect a large number of different stakeholders.

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<sup>40</sup> Jean Kanamugire and Terence Chimuka, *The Directors' Duty to Exercise Care and Skill in Contemporary South African Company Law and the Business Judgment Rule*, *Mediterranean Journal of Social Sciences*, Vol 5 No 20, September 2014, at page 72. See also: D Botha and R Jooste, *A Critique of the Recommendations in the King Report Regarding a Director's Duty of Care and Skill*, (1997), 114 SALJ at 76.

<sup>41</sup> *Ibid*, at page 73.

<sup>42</sup> Monray Marsellus Botha, *The Role and Duties of Directors in the Promotion of Corporate Governance: A South African Perspective*, *Obiter*, 2009, at page 710.

<sup>43</sup> Own emphasis.

<sup>44</sup> *Ibid*, at page 714. Also see: Cassim (note 10), at page 582.



As with fiduciary duties, the duty to exercise reasonable skill and care evolves with the values of society and what is considered to be the industry norm, or 'best practice', at any given time. In the South African context, the King Report, and the Constitution and Bill of Rights, are of particular relevance in this regard.

### *3.3. Competence conclusion*

Insofar as South African courts have considered the duty of care and skill, they have relied on English judicial precedent, and set a very high threshold for finding that a director has breached one or more of his or her duties.<sup>45</sup>

While the Companies Act "upgrades" the duty of care and skill and imposes a less subjective standard, the introduction of the business judgment rule acts to soften that duty.<sup>46</sup>

There is a shortage of judicial precedent in relation to this duty in South Africa, particularly with regard to the Companies Act formulation. While this makes it difficult to assess whether particular climate risk-related scenarios would found successful claims, it also leaves the door open for the development of this area of law.

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<sup>45</sup> Kanamugire and Chimuka (note 40), at page 72.

<sup>46</sup> Ibid, at pages 73-74.



## 4. Director duties in environmental legislation

In addition to the director duties imposed by the Companies Act, there are also certain director duties in South Africa's framework environmental legislation – the National Environmental Management Act 107 of 1998 (NEMA).

Section 49A of NEMA sets out various offences, including, that a person is guilty of an offence if that person –

- (e) unlawfully and intentionally or negligently commits any act or omission which causes significant pollution or degradation of the environment or is likely to cause significant pollution or degradation of the environment;*
- (f) unlawfully and intentionally or negligently commits any act or omission which detrimentally affects or is likely to detrimentally affect the environment;*

Section 34(7) of NEMA sets out clearly that “*any person who is or was a director of a firm at the time of the commission by that firm of an offence under any provision in Schedule 3 [which includes section 49A of NEMA] shall himself or herself be guilty of the said offence and liable on conviction to the penalty specified in the relevant law...if the offence in question resulted from the failure of the director to take all reasonable steps that were necessary under the circumstances to prevent the commission of the offence: Provided that proof of the said offence by the firm shall constitute prima facie evidence that the director is guilty under this subsection*”.

These provisions in NEMA could apply in the climate risk context where a director's failure to recognise and take steps to mitigate the company's contribution to climate change results in significant pollution or degradation of the environment, or detrimentally affects the environment. In this context, the director is liable for the harm to the environment, as opposed to the harm to the company (as is the case with the company law provisions discussed above). However this approach would encounter significant difficulties in relation to causation and attribution.



## 5. Duty of disclosure

### 5.1. Disclosure and reporting requirements

Corporate disclosures can reveal whether or not directors have complied with their general duties. Disclosures, which are subject to separate legal requirements, can also be said to create additional duties in the climate risk space – with their own consequences for any failure to apply these requirements.

This section of the report considers the various disclosure and reporting requirements in South Africa which are relevant to the issue of climate risks. The limitations of formal corporate disclosures as a mechanism for accountability must be kept in mind when assessing these requirements.

#### *i. Financial statements must not be false or misleading or incomplete*

With regard to the preparation of financial statements, section 29(2) of the Companies Act sets out that:

- (2) *Any financial statements prepared by a company, including any annual financial statements of a company as contemplated in section 30, must not be-*
  - (a) **false or misleading in any material respect;** or
  - (b) **incomplete in any material particular, subject only to subsection (3).**
- (3) *A company may provide any person with a summary of any particular financial statements, but-*
  - (a) *any such summary must comply with any prescribed requirements; and*
  - (b) *the first page of the summary must bear a prominent notice-*
    - (i) *stating that it is a summary of particular financial statements prepared by the company, and setting out the date of those statements;*
    - (ii) *stating whether the financial statements that it summarises have been audited, independently reviewed, or are unaudited, as contemplated in subsection (1)(e);*
    - (iii) *stating the name, and professional designation, if any, of the individual who prepared, or supervised the preparation of, the financial statements that it summarises; and*
    - (iv) *setting out the steps required to obtain a copy of the financial statements that it summarises. (Own emphasis).*

Any failure to disclose material issues that could impact on a company's financial position would be considered a contravention of section 29(2) of the Companies Act. Climate change impacts, such as those associated with rising global temperatures, or policy and legislative changes aimed at transitioning to a lower-carbon economy, can, depending on the industry and environment in which the company operates, materially affect the financial position of a company. Failure to disclose this as a material issue in the company's financial statements could render the financial statements "incomplete" in a material respect, or "false and misleading". Similarly, companies that overstate the extent to which climate risks can be managed could be said to be providing "false or misleading" information.



It is a criminal offence, in terms of section 29(6) of the Companies Act to be “*party to the preparation, approval, dissemination or publication of any financial statements [including any summary statement]...knowing that those statements...are materially false or misleading*”.<sup>47</sup>

“Knowing” is a term which is defined in section 1 of the Companies Act and means that the person either–

- (a) *had actual knowledge of the matter; or*
- (b) *was in a position in which the person reasonably ought to have-*
  - (i) *had actual knowledge;*
  - (ii) *investigated the matter to an extent that would have provided the person with actual knowledge; or*
  - (iii) *taken other measures which, if taken, would reasonably be expected to have provided the person with actual knowledge of the matter.*

A person who is convicted of an offence relating to false statements is liable “*to a fine or to imprisonment for a period not exceeding 10 years, or to both a fine and imprisonment*”.<sup>48</sup>

In this regard, knowingly providing false, misleading, or incomplete information which understates climate risk, overstates the degree to which these risks can be managed, or completely failing to mention these risks, could constitute an offence in its own right. Disclosures of these sort could also evidence a breach of a director’s fiduciary duties, or duties relating to care and skill (as discussed above).

## **ii. Duty to communicate certain information to the board**

Section 76(2)(b) of the Companies Act states that a director must:

- (b) *communicate to the board at the earliest practicable opportunity **any information** that comes to the director’s attention, unless the director –*
  - (i) *reasonably believes that the information is –*
    - (aa) *immaterial to the company; or*
    - (bb) *generally available to the public, or known to the directors; or*
  - (ii) *is bound not to disclose that information by a legal or ethical obligation of confidentiality. (Own emphasis).*

This is a mandatory duty imposed on directors to convey material information to the board. Commentators on this section have remarked that whilst the requirement is to disclose “any” information, the requirement is sensibly limited to “*relevant corporate information of a sensitive nature*”.<sup>49</sup> This section is also said to impose an ethical duty on directors, requiring them to disclose any information acquired when acting for the company that is likely to influence the company’s decisions. This duty is also considered an integral part of the director’s fiduciary duties of loyalty, good faith, and the avoidance of a conflict of interest.

<sup>47</sup> Section 29(6) of the Companies Act.

<sup>48</sup> Section 216(a) of the Companies Act.

<sup>49</sup> Cassim (note 10), at page 553.



Section 77(2) of the Companies Act provides that a director is liable, “*in accordance with the principles of the common law relating to breach of a fiduciary duty, for any loss, damages or costs sustained by the company*” as a consequence of breaching this duty.

It is unclear whether this section could apply in the context of information relating to climate risks, given that its intention seems to be more in relation to time-sensitive information, and not information concerning long-term risks.

### **iii. King Report on Corporate Governance**

As mentioned above, the King IV Report on Corporate Governance<sup>TM</sup> (King IV Report) is the fourth iteration of the King Report in South Africa. The King Reports each contain a code of corporate practice and conduct for South African companies. The King IV Report was published by the Institute of Directors in Southern Africa NPC in 2016, and replaces the King III Report. Compliance with the King IV Report and the King Code is mandatory for companies listed on the Johannesburg Stock Exchange (JSE). While there is no statutory obligation to do so, all other entities are encouraged to comply.

While the King IV Report only mentions climate change four times (in the introductory paragraphs) and contains no express requirement to report on climate risks, there are other reporting requirements in the King IV Report which indirectly require the disclosure of climate risks where those risks pose a material financial risk to the company.

In particular, Principle 5 of the King Code requires that “[t]he governing body should ensure that reports issued by the organisation enable stakeholders to make informed assessments of the organisation’s performance, and its short, medium and long-term prospects.”<sup>50</sup> The use of the term “stakeholders” as opposed to shareholders is significant, particularly in the context of reporting on climate risks. “Stakeholders” are defined in the King IV Report as “[t]hose groups or individuals that can reasonably be expected to be significantly affected by an organisation’s business activities, outputs or outcomes, or whose actions can reasonably be expected to significantly affect the ability of the organisation to create value over time.”<sup>51</sup>

One of the practices recommended to achieve this principle<sup>52</sup> is that the governing body issue an integrated report at least annually, which is either:

- a) *a standalone report which connects the more detailed information in other reports and addresses, at a high level and in a complete, concise way, the matters that could significantly affect the organisation’s ability to create value; or*
- b) *a distinguishable, prominent and accessible part of another report which also includes the annual financial statements and other reports that must be issued in compliance with legal provisions. (Own emphasis).*

<sup>50</sup> Principle 5 of the King IV Code, at page 48 of the King IV Report on Corporate Governance for South Africa 2016.

<sup>51</sup> King IV Report on Corporate Governance for South Africa 2016, page 17, quoting from the International Integrated Reporting Council, *The Integrated <IR> Framework*, (13 December 2013), at page 33.

<sup>52</sup> The principles are mandatory for listed companies. King IV imposes a “apply and explain” regime. Companies must apply the principles, and explain which practices were followed to achieve the principles.



“Value creation or value creation process” is defined in King IV as “[t]he process that results in increases, decreases or transformations of the capitals caused by the organisation’s business activities and outputs. The value creation process therefore has neutral, positive and negative outcomes”.<sup>53</sup>

It is clear that a wide range of climate change impacts could result in “increases, decreases or transformations” of capitals. It could therefore be argued that South African listed companies must disclose climate risks (and opportunities) in terms of the King IV Report, though the degree to which they do so is extremely varied, given the lack of direct disclosure specifications.

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<sup>53</sup> King IV Report on Corporate Governance for South Africa 2016, page 18, quoting from the International Integrated Reporting Council, *The Integrated <IR> Framework*, (13 December 2013), at page 33.

## 6. Duties applicable to other categories of directors

### 6.1. Specific categories of directors

There are certain additional duties which apply to directors of pension funds, banks and insurance companies, which may also require the consideration of climate change risks.

#### *i. Pension funds*

As long term investors, pension funds are particularly vulnerable to experiencing lower returns over a long-term period as a result of the effects of climate change on investments made. The failure to take into account these climate change risks when making investment decisions could therefore give rise to liability for the trustees managing these funds.

Pension funds in South Africa are governed by the Pension Funds Act 24 of 1956 (Pension Funds Act). The Pension Funds Act prescribes that all pension funds must have a board of at least four board members (50% of whom, the members shall have the right to elect).<sup>54</sup>

The Pension Funds Act sets out specific duties of the board, which include, among other things:

- *take all reasonable steps to ensure that the interests of members in terms of the rules of the fund and the provisions of this Act are protected at all times;*<sup>55</sup>
- *act with due care, diligence and good faith;*<sup>56</sup>
- *avoid conflicts of interest;*<sup>57</sup>
- *have a fiduciary duty to members and beneficiaries in respect of accrued benefits or any amount accrued to provide a benefit, as well as a fiduciary duty to the fund, to ensure that the fund is financially sound and is responsibly managed and governed in accordance with the rules and this Act;*<sup>58</sup>
- *ensure that adequate and appropriate information is communicated to the members and beneficiaries of the fund informing them of their rights, benefits and duties in terms of the rules of the fund, subject to such disclosure requirements as may be prescribed.*<sup>59</sup>

Regulation 28, under section 36 of the Pensions Fund Act, is also of particular relevance in the climate change risk context. Regulation 28 requires that pension funds give consideration “to any factor which may materially affect the sustainable long-term performance of a fund’s assets, including factors of an environmental, social and governance character.” This requirement in Regulation 28 is framed as part of the fiduciary duty of the fund. Regulation 28 clearly requires the consideration of climate-related risks insofar as those risks affect the sustainable long-term performance of the fund’s assets; for instance, where a fund’s assets are likely to be affected by the physical impacts of climate change

<sup>54</sup> Section 7A of the Pension Funds Act.

<sup>55</sup> Section 7C(2)(a) of the Pension Funds Act.

<sup>56</sup> Section 7C(2)(b) of the Pension Funds Act.

<sup>57</sup> Section 7C(2)(c) of the Pension Funds Act.

<sup>58</sup> Section 7C(2)(f) of the Pension Funds Act.

<sup>59</sup> Section 7D(1)(c) of the Pension Funds Act.



(flooding, rising temperatures, etc.) or where a fund controls assets which are likely to be affected by the transition to a low-carbon economy (coal and other extractive industries).

The findings of two seminal reports by the Trillion Dollar Transformation initiative, a collaborative initiative by Mercer Investment Consulting (Mercer) and the Center for International Environmental Law (CIEL), in relation to the strategies that pension fund trustees should implement to avoid liability for breach of their fiduciary duties, are equally applicable in the South African context (and particularly given Regulation 28). These strategies include:

- **modify plan documents** to reflect climate risks as a potentially material risk factor, and ensure fiduciaries and managers act in accordance with the plan;
- **avoid or minimize investments in assets most vulnerable to climate risk**, such as fossil fuels;
- **engage actively with owned climate-vulnerable companies** to demand information and assess resilience to climate risks;
- **invest strategically in clean energy assets** both as an opportunity for returns and as a hedge against climate risk.<sup>60</sup>

## ii. Banks

The risks associated with climate change are relevant to banks in their investment, financing and asset management capacity.

While South Africa's four biggest banks have all made public commitments to address climate change related risks, they have also all been linked, in terms of their financing, to projects that will fuel climate change.<sup>61</sup>

Section 60(1) of the Banks Act 94 of 1990 sets out that “[e]ach director, chief executive officer and executive officer of a bank owes a fiduciary duty and a duty of care and skill to the bank of which such person is a director, chief executive officer or executive officer.” Section 60(1A) of the Banks Act provides further that each director, chief executive officer, and executive officer of a bank must act *bona fide* for the benefit of the bank, avoid conflicts of interest between his or her own interests and those of the bank, possess and maintain the knowledge and skill that may reasonably be expected of a person holding a similar position, and exercise such care “as may reasonably be expected of a diligent person who holds the same appointment under similar circumstances.”<sup>62</sup>

In addition to the Banks Act, the Financial Advisory and Intermediary Services Act 37 of 2002 (FAIS Act) also imposes certain duties, and applies to all financial entities that provide a financial product, such as banks and insurers. Under the FAIS Act, there are also two codes of conduct that must be adhered to: the General Code of Conduct and the Specific Code on discretionary and administrative financial services providers. Section 2 of the General Code sets out the fundamental principle that “[a]

<sup>60</sup> Trillion Dollar Transformation: Key Findings and Recommendations, available at: <http://www.ciel.org/wp-content/uploads/2016/12/TDT-Findings-Recs-Summary.pdf>.

<sup>61</sup> <https://cer.org.za/news/why-are-sas-banks-facilitating-climate-change>.

<sup>62</sup> Section 60(1A) of the Banks Act. Own emphasis.



*provider must at all times render financial services honestly, fairly, with due skill, care and diligence, and in the interests of clients and the integrity of the financial services industry.*<sup>63</sup>

**iii. Insurers**

Insurers need to consider relatively long-term horizons. In its examination of the impact of climate change on the insurance sector, the Bank of England identified three primary channels through which impacts might be expected to arise: physical risks (e.g. through damage to property from extreme weather conditions); transition risks (e.g. through the repricing of carbon intensive financial assets); and liability risks (e.g. third party liability claims from parties who have suffered loss and damage from climate change).<sup>64</sup>

As with the directors of banks and pension fund trustees, directors' general duties under the Companies Act apply to the directors of insurance firms. The duties imposed by the FAIS Act also apply, along with the codes of conduct published under the FAIS Act.

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<sup>63</sup> Financial Advisory and Intermediary Services Act, 2002 (Act No. 37 of 2002):

General code of conduct for authorised financial services providers and representatives, 2003, Part II.

<sup>64</sup> Bank of England Prudential Regulation Authority, *The Impact of Climate Change on the UK Insurance Sector*, September 2015, available at: <http://www.bankofengland.co.uk/pru/Documents/supervision/activities/pradefra0915.pdf>.

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## 7. Establishing liability

### 7.1. Evidentiary requirements

Section 77(1) to (10) of the Companies Act sets out the requirements for establishing liability of directors and prescribed officers. Section 77 expressly provides that the term “director”, in the context of determining liability under section 77, includes “*an alternate director, and- (a) a prescribed officer; or (b) a person who is a member of a committee of a board of a company, or of the audit committee of a company, irrespective of whether or not the person is also a member of the company’s board.*”

Section 77(2) of the Companies Act sets out that:

- (2) *A director of a company may be held liable-*
  - (a) *in accordance with the principles of the common law relating to breach of a fiduciary duty, for any loss, damages or costs sustained by the company as a consequence of any breach by the director of a duty contemplated in section 75, 76(2) or 76(3)(a) or (b); or*
  - (b) *in accordance with the principles of the common law relating to delict for any loss, damages or costs sustained by the company as a consequence of any breach by the director of-*
    - (i) *a duty contemplated in section 76(3)(c);*
    - (ii) *any provision of this Act not otherwise mentioned in this section; or*
    - (iii) *any provision of the company’s Memorandum of Incorporation.*

It is clear from the wording of section 77, and from both the common law relating to delict and to the breach of fiduciary duties, that a causal link must be established between the director’s breach of duty and the actual loss sustained by the company. In the climate risk context, this means that there must have been a foreseeable and material climate-related risk that the director failed to deal with (or failed to adequately address) in breach of his or her duties, which resulted in the loss complained of.

The liability of a person in terms of section 77 is joint and several with that of any other person who is liable for the same act (section 77(6)). Section 77(8) provides that a person who is liable under section 77 is also jointly and severally liable to pay the costs of all parties incurred in court proceedings to enforce liability.

Section 77 of the Companies Act is supplemented by section 218(2) of the Companies Act, which has a much wider ambit. Section 218(2) sets out that “*[a]ny 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.*” This is potentially a significant provision in the context of establishing liability for the failure to address climate-related risks, since it can be utilised by “any person”. According to Cassim et al, “[t]he deliberate repetition of the word ‘any’ in s 218(2) underscores its wide ambit.”<sup>65</sup>

Section 20(6) of the Companies Act is also relevant in this context. This section provides that:

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<sup>65</sup> Cassim (note 10), at page 582.





- (6) *Each shareholder of a company has a claim for damages against any person who intentionally, fraudulently or due to gross negligence causes the company to do anything inconsistent with-*
- (a) *this Act; or*
  - (b) *a limitation, restriction or qualification contemplated in this section, unless that action has been ratified by the shareholders in terms of subsection (2).*

The obvious disadvantage with bringing a claim in terms of section 20(6) is the high threshold for establishing liability, since the action to which the complaint relates must be shown to have been intentional, fraudulent, or as a result of gross negligence.

### *7.2. Possible defences*

Section 76(4) of the Companies Act is described as having introduced the American-styled “business judgment rule” into South African company law.<sup>66</sup>

According to section 76(4), a director is presumed to have exercised his or her duties in the best interests of the company and with reasonable care, skill and diligence if:

- (i) *the director has taken reasonably diligent steps to become informed about the matter;*
- (ii) *either-*
  - (aa) *the director had no material personal financial interest in the subject matter of the decision, and had no reasonable basis to know that any related person had a personal financial interest in the matter; or*
  - (bb) *the director complied with the requirements of section 75 with respect to any interest contemplated in subparagraph (aa); and*
- (iii) *the director 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.” (Own emphasis).*

Accordingly, if a director is able to show that he or she complied with these three requirements (informed decision; no self-dealing, alternatively, proper disclosure of any personal interest; and rational basis for his or her belief), the decision of the director will fall outside of the scope of judicial review.<sup>67</sup>

Since the business judgment rule is relatively new in South Africa, and borrowed from the United States, it is likely that South African courts will look to foreign case law in interpreting section 76(4).<sup>68</sup> A useful illustration of where the rule was applied is in the American case of *Smith v Van Gorkum*.<sup>69</sup> In this case, the court of first instance ruled in favour of the directors, on the basis that the directors had acted in an informed manner. On appeal, the court reversed the decision, and held that the directors

<sup>66</sup> Cassim (note 10), at page 563; Alewyn Petrus Grove, *Company Directors: Fiduciary Duties and the Duty of Care and Skill*, LLM dissertation, available at: <https://repository.up.ac.za/handle/2263/26667>.

<sup>67</sup> Cassim (note 10), at page 565.

<sup>68</sup> Kanamugire and Chimuka (note 40), at page 75.

<sup>69</sup> *Smith v Van Gorkum* 488 A.2n 858 (Del. 1985).



could not successfully invoke the business judgment rule. The court held that the directors had not adequately informed themselves, having listened only to a short presentation of approximately twenty minutes to the board, and thereafter having made the decision based on two hours of consideration. The court held that the decision, which was to sell the company, required more consideration, and that the directors were uninformed as to the intrinsic value of the company.<sup>70</sup>

In addition to the business judgment rule as contained in section 76(4) of the Companies Act, section 77(9) also provides that:

*In any proceedings against a director, other than for wilful misconduct or wilful breach of trust, the court may relieve the director, either wholly or partly, from any liability set out in this section, on any terms the court considers just if it appears to the court that-*

- (a) the director is or may be liable, but has acted honestly and reasonably; or*
- (b) having regard to all the circumstances of the case, including those connected with the appointment of the director, it would be fair to excuse the director.*

Section 77(9) is similar, but not identical to section 248 of the 1973 Companies Act (which it replaced). Section 248 also required that the director must have acted honestly and reasonably. In *Ex parte Lebowa Development Corporation Ltd*,<sup>71</sup> the court held that section 248 of the 1973 Act did not apply to granting relief to a director or officer against a claim by a third party; it only empowered the court to grant relief against a claim by the company itself. The court also held that, in the case of gross negligence, reasonableness may seldom, if ever, be found.<sup>72</sup> It is suggested that these principles will continue to apply to section 77(9) of the Companies Act.<sup>73</sup>

### *7.3. Personal liability and availability of directors and officers liability insurance*

Section 78 of the Companies Act prohibits, subject to certain exceptions, any exemptions or indemnities for directors. The term “director” is used in its extended sense, and includes “*a former director and an alternate director, and (a) a prescribed officer; or (b) a person who is a member of a committee of a board of a company, or of the audit committee of a company, irrespective of whether or not the person is also a member of the company’s board.*”

Section 78(2) provides that a provision in an agreement, the company’s Memorandum of Incorporation, or a resolution of the company, whether express or implied, is void to the extent that it exempts a director of liability under section 75 or 76 (duty to act in the best interests of the company and with due care and skill).

While section 78(2) prohibits certain exemptions or exclusions, section 78(6) prohibits indemnification in certain circumstances. Indemnification is not prohibited in relation to a director’s fiduciary duties and

<sup>70</sup> *Smith v Van Gorkom*, as discussed in Kanamugire and Chimuka (note 40) at pages 75-76.

<sup>71</sup> 1989 (3) SA 71 (T) 107.

<sup>72</sup> *Ibid*, at 109.

<sup>73</sup> Cassim (note 10), at page 579.



duties of due care and skill. This means that a company may indemnify a director in respect of liability arising from the director's negligence.<sup>74</sup>

Section 78(4) provides that a company may advance expenses to a director to defend litigation in any proceedings arising out of the director's service to the company, unless the company's Memorandum of Incorporation provides otherwise.

Companies may purchase and maintain insurance on behalf of a director or prescribed officer against liability incurred in his or her capacity as director or prescribed officer of the company. Insurance policies of this sort may also protect the directors and prescribed officers in the event that the company is not able to honour the indemnification payments it has undertaken.<sup>75</sup> Section 78(7) provides that a company may purchase insurance to protect a director against any liability or expenses for which the company is permitted to indemnify a director. A company may also purchase insurance to protect itself against the expenses it is permitted to advance a director or indemnify a director (section 78(7)(b)).

#### *7.4. Plausible scenarios for how liability risk might emerge*

As set out in the TCFD's final recommendations, some companies and organisations are already affected by risks associated with climate change today, and others are likely to be affected over the medium to longer term. While there is uncertainty in relation to the timing and magnitude of these effects, there is certainty in relation to the existence of risks. Companies and other organisations should be considering how these risks will evolve over time, and what the potential implications will be under different circumstances.<sup>76</sup> Whether these considerations are done through well-established scenario-analysis methods (as recommended by the TCFD), or through other, less formal planning techniques, some form of risk identification, risk assessment and risk management should occur.<sup>77</sup> Director liability for breach of duties could arise at each of these stages.

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<sup>74</sup> Cassim (note 10), at page 576.

<sup>75</sup> Cassim (note 10), at page 577 – 578.

<sup>76</sup> TCFD recommendations, at page 25.

<sup>77</sup> The Bank of England recently described risk management as a three-stage process in these terms. Bank of England, the UN Environment Inquiry and the University of Cambridge Institute for Sustainability Leadership, *Enhancing Environmental Risk Assessment in Financial Decision-Making*, July 2017, at page 7.

## 8. Procedural considerations

### 8.1. *Standing and derivative actions*

As set out above, directors' fiduciary duties, and duties of due care and skill, as set out in section 77 of the Companies Act, are owed to the company. If a shareholder (or other interested party) wishes to seek redress against a director for breach of the duties, a derivative action will have to be instituted (discussed below).

However, as set out above, there are alternative provisions in the Companies Act that could be relied on to found a direct claim by a shareholder (or other party).

Section 218(2) of the Companies Act states that "any person" who has contravened "any provision" of the Companies Act is liable to "any other person" for any loss or damage suffered. Section 20(6) of the Companies Act also provides a possible avenue for direct claims by shareholders. This section provides that "*each shareholder of a company has a claim for damages against any person who intentionally, fraudulently or due to gross negligence causes the company to do anything inconsistent with this Act...*" However, the disadvantage of relying on this provision is that "intention," "fraudulence," or "gross negligence" on the part of the director will have to be shown.

Section 163 of the Companies Act provides a remedy to a shareholder or a director who complains of "oppressive or prejudicial conduct", or conduct that "unfairly disregards" his or her interests. A complaint under section 163 is brought by way of an application to court. On the basis of the definition of "shareholder" in the Companies Act, it appears that only a registered shareholder can bring an application in terms of section 163, and that there is no *locus standi* for a holder of a beneficial interest in any shares.<sup>78</sup> The oppression remedy typically operates to protect minority shareholders (though majority shareholders are not excluded from relying on section 163).

The ambit of the terms "oppressive", "unfairly prejudicial", and "unfairly disregards interests" are undefined. Since the emphasis is on the unfairness of the conduct, a minority shareholder cannot obtain relief merely on the basis that he or she is outvoted – i.e. acts that prejudicially affect shareholders will not entitle them to relief, it must be shown that the conduct is not only prejudicial, but also unfair.<sup>79</sup> The emphasis on fairness requires that considerations such as the expectations of the shareholders are also taken into account. Rationality considerations are also embedded in the notion of fairness – and decisions which therefore ignore, without cause, the interests of certain shareholders, can be said to be unfairly prejudicial.<sup>80</sup>

The unfair disregard of the 'interests' of the applicant in section 163 of the Companies Act did not previously form part of the oppression remedy. Since the term 'interests' is clearly wider than 'rights', it will arguably allow courts to avoid a strict interpretation of the provision. Where the prejudice affects applicants other than in their capacity as shareholders, it could nonetheless be relevant for the

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<sup>78</sup> Cassim (note 10), at page 759.

<sup>79</sup> Cassim (note 10), at page 772.

<sup>80</sup> Cassim (note 10), at page 770 – 771.



purposes of the oppression remedy.<sup>81</sup> This could be particularly relevant in the climate risk context, where the failure to consider climate risks may not always result in a direct, and immediate financial impact, but may affect the shareholders' interests more broadly – for instance, the shareholders may have an interest in forward planning to protect their rights in the future. This is also likely to affect certain shareholders only – i.e. those shareholders expecting returns over the longer term (such as pension funds).

Section 165 of the Companies Act provides for derivative actions to be brought by shareholders (or others) in order to protect the interests “of the company”. This is distinct from where shareholders enforce their own rights. The derivative action under section 165 is wider than its predecessor with regard to the cause of action, the identity of the wrongdoer, and persons who have legal standing to institute proceedings.<sup>82</sup> Legal standing is extended to shareholders, directors, trade unions, or any “other person” who has been granted permission from the court to bring a derivative action, which permission “*may be granted only if the court is satisfied that it is necessary or expedient to do so to protect a legal right of that other person*”.<sup>83</sup> The approach that the courts will take in this regard remains to be seen, and this could be a key opportunity in the climate risk space.

## 8.2. Remedies

### i. Damages

Section 77 of the Companies Act sets out that a director may be held liable –

- (a) *in accordance with the principles of the common law relating to breach of a fiduciary duty, for any loss, damages or costs sustained by the company as a consequence of any breach by the director of a duty contemplated in section 75, 76(2) or 76(3)(a) or (b);*  
or
- (b) *in accordance with the principles of the common law relating to delict for any loss, damages or costs sustained by the company as a consequence of any breach by the director of-*
  - (i) *a duty contemplated in section 76(3)(c);*
  - (ii) *any provision of this Act not otherwise mentioned in this section; or*
  - (iii) *any provision of the company's Memorandum of Incorporation. (Own emphasis).*

As set out above, since these duties are owed to the company, any claim by a shareholder will need to be brought as a derivative action. The claim is for “*loss, damages or costs sustained by the company*”. If a shareholder brings a derivative action in terms of section 165, any benefit from the proceedings accrues to the company, and not the applicant, since a derivative action is brought on behalf of the company. Since the person who brings the action does not directly gain from the derivative action, the risk of being burdened with legal costs may constitute a strong disincentive to bring a claim.

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<sup>81</sup> Cassim (note 10), at page 762.

<sup>82</sup> Cassim (note 10), at page 777.

<sup>83</sup> Section 165(2)(d) of the Companies Act.



Outside of derivative actions, each shareholder also has a claim for damages against any person who intentionally, fraudulently, or due to gross negligence causes the company to do anything inconsistent with the Companies Act (section 20(6)). Furthermore, any person who contravenes any provision of the Companies Act is liable, under s218(2), to any other person for any loss or damage suffered by that person as a result of the contravention.

**ii. Restraining the company from contravening the Act**

Shareholders also have a statutory right to restrain the company from violating any provision of the Companies Act. Section 20(4) provides that one or more shareholders or directors, or prescribed officers of a company, or a trade union representing employees may apply to the court for an order restraining the company from doing anything inconsistent with the Companies Act.

**iii. Oppressive or prejudicial conduct**

The court has a discretion, under section 163(2) of the Companies Act, to make any interim or final order it thinks fit in relation to such a claim. The open-ended list of remedies included in section 163(2) is much more extensive than under the previous Companies Act, and includes the following remedies:

- (a) *an order restraining the conduct complained of;*
- (b) *an order appointing a liquidator, if the company appears to be insolvent;*
- (c) *an order placing the company under supervision and commencing business rescue proceedings in terms of Chapter 6, if the court is satisfied that the circumstances set out in section 131(4)(a) apply;*
- (d) *an order to regulate the company's affairs by directing the company to amend its Memorandum of Incorporation or to create or amend a unanimous shareholder agreement;*
- (e) *an order directing an issue or exchange of shares;*
- (f) *an order-*
  - (i) *appointing directors in place of or in addition to all or any of the directors then in office; or*
  - (ii) *declaring any person delinquent or under probation, as contemplated in section 162;*
- (g) *an order directing the company or any other person to restore to a shareholder any part of the consideration that the shareholder paid for shares, or pay the equivalent value, with or without conditions;*
- (h) *an order varying or setting aside a transaction or an agreement to which the company is a party and compensating the company or any other party to the transaction or agreement;*
- (i) *an order requiring the company, within a time specified by the court, to produce to the court or an interested person financial statements in a form required by this Act, or an accounting in any other form the court may determine;*
- (j) *an order to pay compensation to an aggrieved person, subject to any other law entitling that person to compensation;*



- (k) an order directing rectification of the registers or other records of a company; or
- (l) an order for the trial of any issue as determined by the court.

### 8.3. Collective actions and litigation funding

The Companies Act contains a unique provision which provides for extended standing in relation to any remedy under the Act, and specifically introduces the possibility of class actions for any matters brought before a court, the Companies Tribunal, the Takeover Regulation Panel, or the Companies Commission in terms of the Companies Act.<sup>84</sup>

Section 157(1) of the Companies Act provides that:

- (1) *When, in terms of this Act, an application can be made to, or a matter can be brought before, a court, the Companies Tribunal, the Panel or the Commission, the right to make the application or bring the matter may be exercised by a person-*
  - (a) *directly contemplated in the particular provision of this Act;*
  - (b) *acting on behalf of a person contemplated in paragraph (a), who cannot act in their own name;*
  - (c) *acting as a member of, or in the interest of, a group or class of affected persons, or an association acting in the interest of its members; or*
  - (d) *acting in the public interest, with leave of the court.*

This provision is new to South African company law and did not form part of the previous Companies Act. In relation to derivative actions, it is specifically clarified in section 157(3) that section 157 does not create a right for any person to commence derivative proceedings other than on behalf of a person entitled to make a demand in terms of section 165(2) of the Companies Act (i.e. a shareholder, director or prescribed officer, trade union or another representative of employees, or a person exercising a particular right that has been granted leave by the court to bring a derivative action).

Despite the opportunities that exist for class actions, the potential costs of bringing an action against directors could still prove prohibitively costly. Third-party funding arrangements for litigation have received recognition in South Africa. The Supreme Court of Appeal, in *Price Waterhouse Cooper Inc. v National Potato Co-operative Ltd*<sup>85</sup> held that an agreement to fund litigation in exchange for part of the proceeds is in keeping with the right of access to justice, and such an arrangement would only constitute an abuse of process if it lacks good faith.<sup>86</sup>

### 8.4. Limitation periods

Proceedings to recover any loss, damages or costs for which a person may be liable in terms of section 77 (fiduciary duties, duty of care and skill) “*may not be commenced more than three years after the act or omission that gave rise to the liability*” (section 77(7) of the Companies Act). This is

<sup>84</sup> Cassim (note 10), at page 827-828.

<sup>85</sup> *Price Waterhouse Coopers Inc and Others v National Potato Co-operative Ltd* (448/2003) [2004] ZASCA 64; [2004] 3 All SA 20 (SCA) (1 June 2004).

<sup>86</sup> See: <https://www.cover.co.za/funding-and-insuring-litigation/>.



potentially problematic given the long lead times between the actual breach of a fiduciary duty and the time at which the climate change consequences of that breach become apparent.





## 9. Conclusion

Climate-related risks to the profitability and long-term sustainability of companies are increasing, as the impacts of climate change become more severe, and the need to transition to low carbon economies becomes more urgent. Fiduciary and other company law duties requiring company directors to act in the best interests of the company are likely to apply in the climate-risk context, given the material financial risks that climate change pose, which are foreseeable, requiring company directors to develop strategies to manage these risks.

While traditional company law provisions for director liability have not yet been applied in climate-risk scenarios, there is scope to test these provisions in this context – particularly given the changing approach to climate change risks globally, which is paving the way for a more robust interpretation and application of laws relating to directors' fiduciary and competence duties.

South Africa, with its heavy reliance on fossil fuels, will need to transition quickly if it is to meet its international climate change obligations. This means that there is a high risk of stranded assets in South Africa, as the country is forced to plan for a future which meets global commitments, and which avoids the worst physical impacts of climate change, to which South Africa is particularly vulnerable. It is clear that climate change mitigation requires forward-looking decision making, and that company directors need to be identifying risks now, to ensure enough lead time to manage risks appropriately.

Good corporate governance practice will require that companies steer their businesses away from climate-related risks, and towards the opportunities that a low-carbon transition provides.



**Oxford Sustainable Finance Programme**

Smith School of Enterprise and the Environment  
University of Oxford  
South Parks Road  
Oxford OX1 3QY

enquiries@smithschool.ox.ac.uk *Email*  
+44 (0)1865 614963 *Telephone*

Founders



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