

Directors' Co-liability for Delicts

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1 Introduction

It is an established principle of company law that a company is a separate legal entity and that as a general rule, incorporation confers the benefit of limited liability on its shareholders and directors (see *Salomon v A Salomon & Company Ltd* [1897] AC 22 (HL)). This principle, together with the 'identification' or 'alter ego' theory, which ascribes the directing mind and will of the person acting on behalf of the company to the company itself (see, eg, *Lennard's Carrying Company Ltd v Asiatic Petroleum Company Ltd* [1915] AC 705 (HL) at 713; *HL Bolton (Engineering) Co Ltd v TJ Graham and Sons Ltd* [1957] 1 QB 159 (CA); *Tesco Supermarkets Ltd v Natrass* [1972] AC 153 (HL); *Meridian Global Funds Management Asia Ltd v Securities Commission* [1995] 2 AC 500 (PC)), lead to the sometimes problematic conclusion that a person acting on behalf of a company will, in principle, not incur liability personally and that a prejudiced third party must look to the company for recourse (for further authorities on the point, see Louis de Koker 'Die Aanspreeklikheid van Direkteure vir Delikte Gepleeg in Ampsverband' 2002 *Tydskrif vir die Suid-Afrikaanse Reg* 18 at 20 et seq).

But the principle that everyone should answer for his delictual acts, is equally established. Where it is sought to hold a director delictually liable, these two principles need to be balanced (on the difficulties involved in doing so, see John H Farrar 'The Personal Liability of Directors for Corporate Torts' (1997) 9 *Bond LR* 102). It is particularly difficult to do this where the director may be co-liable with the company for the infringement of intellectual property rights (see *Mentmore Manufacturing Co Ltd v National Merchandising Manufacturing Co Inc* ((1979) 89 DLR (3d) 195 (Fed Ct App) at 202; De Koker op cit at 22).

2 English Law

English case law generally follows either the identification or the agency approach to establish a director's tortious liability. The identification approach holds that if a director can be identified with the company, the director should be regarded as acting as the company itself. Therefore, a director is usually exempted from personal liability for his acts. The agency approach, which seems to be the favoured approach in recent cases, views directors as agents of the company when they carry out their functions for it and suggests that their liability should be assessed accordingly (see Chris Noonan & Susan Watson 'Directors' Tortious Liability – *Standard Chartered Bank* and the Restoration of Sanity' 2004 *J of Business Law* 539 at 540-1). The mere fact that a person is a director of a limited liability company does not by itself render him liable for torts committed during the period of his directorship (see *Rainham Chemical Works Ltd (in liquidation) & Others v Belvedere Fish Guano Company Ltd* [1921] 2 AC 465 (HL) at 476; *British Thomson-Houston Company Ltd v Sterling Accessories Ltd* (1924) 41 RPC 311 (ChD) at 317; *Prichard & Constance (Wholesale) Ltd v Amata Ltd & Others* (1924) 42 RPC 63 (ChD) at 73). It does not matter how small the company is, or how powerful the particular director's control over its affairs (*Evans & Sons Ltd v Spritebrand Ltd & Another* [1985] 1 WLR 317 (CA) at 329).

A director, or other officer or employee of a company, can be held personally liable for tortious acts committed during the course of his employment only if he committed, authorised (see *Mancetter Developments Ltd v Garmanson Ltd* [1986] 1 All ER 449 (CA) at 452 and 454), or participated in the act constituting the tort himself; if he, when carrying out his duties for the company, assumed a personal liability, thereby creating a special relationship between the plaintiff and himself (see *Fairline Shipping Corporation v Adamson* [1975] QB 180 (ChD)); or if he procured or induced another, the company, to commit the tort (*Standard Chartered Bank v Pakistan National Shipping Corporation & Others (No 2)* [2000] 1 FSR 218 (CA), discussed by Noonan & Watson op cit 539, at 233-4; *Wah Tat Bank Ltd & Another v Chan Cheng Kum* [1975] AC 507 (PC); *CBS Songs v Amstrad* [1988] AC 1013 (HL) at 1058). Such liability is not automatic. The inference to be drawn depends largely on the facts of each case and may involve the making of a policy decision (*Performing Right Society Ltd v Caryl Theatrical Syndicate Ltd* [1924] 1 KB 1 (CA) at 9 and 15; *Hoover Plc v George Hulme (Stockport) Ltd* [1982] FSR 565 at 596-7; *White Horse Distillers Ltd & Others v Gregson Associates Ltd & Others* [1984] RPC 61 (Ch) at 91; *Evans & Sons v Spritebrand Ltd* supra).

The decision of the Canadian Federal Court of Appeal in *Mentmore Manufacturing Co Ltd v National Merchandising* (supra) has been influential in several English decisions. An action for patent infringement had succeeded against a company, but had failed against the company's main shareholder and president, who had allegedly directed the infringement. The Court agreed with the trial judge that the fact that the president, as director, had imparted the practical, business, financial and administrative policies which resulted in the

assembling and selling of the infringing goods, did not itself suffice to give rise to personal liability. The kind of participation that would give rise to such liability was that degree and kind of personal involvement by which the director or officer made the tortious act his own. The circumstances of each case would determine its outcome, but at least a knowing, deliberate, wilful quality to the participation was required (see at 203). In *Whitehorse Distillers v Gregson Associates* (supra at 91), the Court summarised the principles of the *Mentmore* decision: a court will have to consider the circumstances in each case, and must be satisfied not only that the director has committed or directed the tortious act or conduct, but that he has done so deliberately or recklessly and in such a way as to make it his own act or conduct, as distinct from one of the company. It is unnecessary for him to know, or have the means of knowing, that the act or conduct is likely to be tortious. The facts in each case must be considered broadly to see whether, as a matter of policy requiring the balancing of the two principles of limited liability and answerability for tortious acts or conduct, they call for the director to be held liable.

The Court in *Mentmore* referred to *Reitzman & Another v Grahame-Chapman & Derusit Ltd* ((1950) 67 RPC 178 (Ch)); *Oertli AG v EJ Bowman (London) Ltd* ([1956] RPC 341 (Ch)); *Yuille v B&B Fisheries (Leigh) Ltd & Bates* ([1958] 2 Lloyd's Rep 596 (Adm Div)) and *Wah Tat Bank Ltd v Chan Cheng Kum* (supra) in support of this statement. However, in *Evans & Sons Ltd v Spritebrand Ltd* (supra at 326) the Court of Appeal regarded it as doubtful whether any of these decisions actually supported a proposition that a knowing, deliberate, wilful quality to the participation would in all cases be an essential condition precedent to the personal liability in question (see at 326).

The authorities are clear that a director of a company should not automatically be identified with the company for purposes of the law of tort. Commercial enterprises and ventures are not to be discouraged by subjecting a director to such onerous potential liabilities. In every case where it is sought to make a director (co-)liable for his company's torts, it is necessary to examine carefully what part he personally played in respect of the act or acts complained of. In the case of careless or negligent conduct by company directors, for example, where services were rendered by the company or advice given, a special relationship between the company and the director is not enough to establish personal liability for the director. The director should have assumed personal responsibility for the accuracy of the advice or the provision of the services, and it must be shown that the plaintiff had relied on that assumption (see Ross Grantham & Charles Rickett 'Directors' "Tortious" Liability: Contract, Tort or Company Law?' (1999) 62 *Modern LR* 133 at 134-5; *Williams v Natural Life Health Foods Ltd* [1998] 1 WLR 830 (HL)). In the latter decision, Steyn LJ indicated that reliance encompassed both a reliance in fact and that such reliance had to be reasonable (see also Susan Watson & Andrew Willekes 'Economic Loss and Directors' Negligence' 2001 *J of Business Law* 217).

The approach taken in English law amounts to the development of a set of company-law rules that take precedence over the general principles of the

law of tort in order to hold directors co-liable with the company for tortious acts (see also *De Koker* op cit at 35; *Grantham & Rickett* op cit at 139). The director will be liable only when he is found to have committed a specific tort, or to have been sufficiently involved in the company's torts as a joint tortfeasor. The English Chancery Division recently considered the principles drawn from earlier authorities in *Koninklijke Philips Electronics NV v Princo Digital Disc GmbH & Another* ([2004] 2 BCLC 50 (ChD, Patents Court)). This decision is discussed next, and then the means of establishing a director's liability as a joint tortfeasor with the company is considered with regard to South African law.

3 *Koninklijke Philips Electronics NV v Princo Digital Disc GmbH*

The claimant, Koninklijke Philips Electronics NV ('Philips'), brought an action against the defendants, Princo Digital Disc GmbH ('Princo Digital') and its managing director, alleging that they were jointly liable for one of their customer's infringements of the claimant's recordable compact discs ('CD-Rs') in the United Kingdom. The primary issue for determination by the Court was whether the director had been sufficiently involved in the company's torts.

The second defendant, Kuo, was the managing director of the first defendant, Princo Digital, a wholly owned subsidiary of a Taiwanese company, Princo Corporation. Kuo was in charge of Princo Digital's day-to-day operations. The defendants admitted that Princo Digital had imported into the United Kingdom, and kept and disposed of there, the type of CD-Rs that the Court had, in a previous matter before it, held to have infringed the patent in suit (see at 54 in par [9]). Kuo had been responsible for the decision to import the infringing CD-Rs into the United Kingdom and for the cultivation of Aventi Ltd ('Aventi') as a customer. Kuo was alleged to be jointly liable with Princo Digital as an importer from its owner Princo Corporation. Kuo's evidence was that although policy (and CD-Rs) came from Princo Corporation in Taiwan, he ran the business on a day-to-day basis, leaving much of the work of communicating with his English customers, who included Aventi, to his assistant, Ms Huang. He accepted that his job was to develop the European market. He took orders from Aventi, he signed invoices and he arranged for the supply of stock to the United Kingdom, all in the ordinary course of business (see at 52 in par [4]). When Aventi was later sued for infringement by Philips in the United Kingdom, Kuo, on Princo Digital's behalf, indemnified Aventi against liability for royalties. The potential exposure was substantial. Kuo also agreed, on Princo Digital's behalf, to fund Aventi's defence. While the indemnity was in place, Aventi were content to continue trading in infringing CD-Rs, and Kuo was willing for Princo Digital to continue to supply them (see at 52 in par [5]).

The trading activities relied upon in the case pleaded against Kuo were his negotiation of an exclusive supply agreement for CD-Rs with a Mr Dobson of Aventi; a visit by Ms Huang at the instance of Kuo to Dobson to show him samples of infringing CD-Rs; telephoning Aventi with a view to negotiating further sales, or instructing Ms Huang to make such calls; the importation by

Princo Digital itself into the United Kingdom, evidently at the instance of Kuo and his personally signing invoices. The other activities relied on concerned the indemnity given to Aventi, and the offsetting of its legal costs, paid by Kuo, against invoice price of CD-Rs supplied to Aventi (see at 52 in par [3]).

On the facts, the Court had no doubt that Kuo's activities extended beyond participation in board meetings. As the business manager of the company, he was responsible for fostering Aventi as a customer, and it was his decision to provide the indemnity to his client. Ms Huang was responsible for most of the dealings with Aventi, but she had been instructed by Kuo and acted under his supervision and control (see at 56 in par [18]).

The Court (at 52 in par [6]) agreed with the Court of Appeal's exposition of four principles in *MCA Records Inc v Charly Records Ltd* ([2003] 1 BCLC 93 (CA) at 116-7 in pars [48] -[53]). Briefly, they are the following:

- First, it is a logical consequence of the proper recognition of the company as a separate legal person that a director will not be treated as liable with the company as a joint tortfeasor if he does no more than carry out his constitutional role in the governance of the company, that is, by voting at board meetings. Equally, a shareholder will not be held accountable as a joint tortfeasor if he does no more than exercise his power of control through the constitutional organs of the company, for example, by voting at general meetings and by exercising the powers to appoint directors.
- Secondly, there is no reason why a person who happens to be a director or the controlling shareholder of a company should not be liable with the company as a joint tortfeasor if he is not exercising control through the constitutional organs of the company and the circumstances are such that he would be liable if he were not the director or controlling shareholder.
- In the third place, at least in the field of intellectual property, liability as a joint tortfeasor may arise where the individual 'intends and procures and shares a common design that the infringement takes place' (*CBS Songs v Amstrad* supra at 105).
- And fourthly, liability may arise irrespective of whether or not there is a separate tort of procuring an infringement of a statutory right, actionable at common law. It is not necessary to prove the making of an express direction or procurement to establish a director's liability for his company's tortious activities in unlawfully copying recordings and issuing them to the public (*MCA Records v Charly Records* at 104).

The Court in *Koninklijke Philips Electronics v Princo Digital Disc* regarded the need to show, on normal principles, that the director was a joint tortfeasor with the company as the essential part of the analysis. The relevant question here was whether Kuo, the director, had been sufficiently involved in the company's torts, bearing in mind that the whole of the company's course of trading, so far as the CD-Rs were concerned, was potentially infringing (see at 54 in par [7]). The fact that a person was an officer of the company was not regarded as a factor in fixing his liability, save to the extent that it afforded him

the opportunity to participate in the company's acts to the extent necessary to impose on him liability as a joint tortfeasor. In this case Kuo did not carry out the infringing acts personally, but he was aware of them and the provision of indemnities against liability for royalties and for the costs of litigation suggested that he was willing to encourage them. The Court rejected the argument advanced by the defence, namely that unless Kuo was sufficiently involved in a particular importation into the United Kingdom or a particular disposal of a batch thereafter, he could not be held liable as a joint tortfeasor in respect of that batch. Kuo was not a director who was substantially removed from the day-to-day conduct of the business of the company, but was the one who instructed Ms Huang and controlled her actions. He had also decided the basis upon which Avanti was to do business, and to have a warehouse in the United Kingdom some seven months after termination of the licence. It was also he who had decided to encourage Avanti to continue as a customer even after Philips complained and had offered an indemnity with the intention to encourage future importations (see at 57 in par [21]).

Although the Court conceded that the case fell 'near the line', Kuo's close involvement with the day-to-day actions of the company, and his independent authority in respect of those actions, together with the factors mentioned above, satisfied it that he had worked sufficiently to bring about the continued importations into the United Kingdom of the CD-Rs in question and that he was liable as a joint tortfeasor with Princo Digital (see at 57 in par [23]). He had knowledge of the transactions and had been sufficiently bound up in the first defendant's acts to make him liable.

The indemnities were considered relevant only in as far as they indicated his encouragement of future importations. In other respects they were normal actions for a seller of goods to undertake. Kuo was held liable as a joint tortfeasor with Princo Digital.

4 South African Law

As in other Commonwealth jurisdictions, it is trite that directors who breach their common-law obligations to act with care and skill may incur delictual liability (see, eg, *Fisheries Development Corporation of SA Ltd v Jorgensen* 1980 (4) SA 156 (W); *Du Plessis NO v Phelps* 1995 (4) SA 165 (C) at 170B). It is equally well established that where a director's fiduciary obligation has been breached, the usual action is *sui generis*, but that the claimant may, in appropriate circumstances, elect to institute a claim in delict. In *Cohen NO v Segal* (1970 (3) SA 702 (W)), for example, the claimant chose to do this (see also Michele Havenga 'Breach of Directors' Fiduciary Duties: Liability on What Basis?' (1996) 3 SA Merc LJ 366 and authorities cited there).

The principles regarding directors' liability for delicts where the company is also delictually responsible, have received less attention (for an early commentary, see JJ du Plessis & JJ Henning 'Die Deliktuele Aanspreeklikheid van Persone wat as Maatskappyorgane Optree' (1989) 52 *Tydskrif vir*

Hedendaagse Romeins-Hollandse Reg 540; see also the more recent, incisive article by De Koker op cit).

In *Body Corporate of Greenwood Scheme v 75/2 Sandown (Pty) Ltd* (1999 (3) SA 480 (W)), the Court found a director liable under s 424 of the Companies Act 61 of 1973 for defective repairs and renovations done to common property in a sectional-title scheme. The Court did not equate s 424 liability with delictual liability (see at 488I where Wepener AJ held that 'the purpose of s 424(1) was to supplement the common law and to simplify the evidential requirements of a delictual claim which might be difficult if not impossible to prove'; section 424 is, moreover, not the appropriate remedy in such an instance, as is argued convincingly by De Koker op cit at 35n67). This view seems to be supported by the decision of the Supreme Court of Appeal in *L & P Plant Hire BK v Bosch* (2002 (2) SA 662 (SCA)). There the Court held that the intention of the corresponding s 64 of the Close Corporations Act 69 of 1984 was, except possibly in the case of fraud, not to render the members of a close corporation liable as co-principal debtors with the corporation, but rather to protect creditors against possible prejudice as a result of the business of the corporation being carried on recklessly or with gross negligence. Where the corporation was able to meet the creditor's claim despite any such negligent or reckless conduct, the creditor would not be entitled to proceed under s 64 (see at 677C-678E; on s 424 generally, see *Howard v Herrigel* 1991 (2) SA 660 (A); *Ex parte De Villiers & Another NNO: In re Carbon Developments (Pty) Ltd (in liq)* 1993 (1) SA 493 (A); *Philotex (Pty) Ltd v Snyman* 1998 (2) SA 138 (SCA)). Section 424 should therefore not be regarded as an appropriate means of vesting delictual liability.

Lifting the corporate veil may lead to delictual liability in certain circumstances, but this rule of company law also does not provide a principled basis for establishing such liability. Policy considerations determine whether the veil will be disregarded in the particular circumstances. A court will, in the exercise of its discretion whether or not to pierce the veil, consider various factors, but there is a general reluctance to do so (see *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* 1995 (4) SA 790 (A); *Hülse-Reutter v Gödde* 2001 (4) SA 1336 (SCA) at 1346A-C; see also Du Plessis & Henning op cit at 551 who indicate that it cannot be deduced from either case law or from instances where the veil has been disregarded as a result of statutory provisions, that the corporate veil will always be pierced in order to found delictual liability).

A director who did not commit the delict in question, is not delictually liable simply because of his directorship in the company (see MS Blackman, RD Jooste & GK Everingham *Commentary on the Companies Act* Vol 2 (looseleaf) (2002) at 8-231; see also *Gower & Davies' Principles of Modern Company Law* 7 ed (2003) by Paul L Davies at 170), even if those who committed the delict are also directors. Nor can a director automatically be held delictually liable for a delict committed by the company. It was seen above that a director's co-liability with the company for tortious acts is determined in English law according to

a set of specially developed rules of company law that take precedence over the general principles of the law of tort (De Koker op cit at 35; Grantham & Rickett op cit at 139). In South African law, it seems unnecessary to do this (see also De Koker op cit at 36). The elements of delict, properly applied, will both protect a director against unreasonable attribution of liability and prevent him from escaping from such liability where it should be imposed. The requirement of unlawfulness, in particular, will be important in this regard. Making policy decisions and value judgments are not unusual when applying this criterion. These policy considerations can, to a considerable extent, be extracted from the provisions of the Bill of Rights since it reflects the fundamental legal values accepted in our society (see Michele Havenga 'Directors' Fiduciary Duties under Our Future Company-law Regime' (1997) 3 SA Merc LJ 310 at 313 ; see also Annél van Aswegen 'Policy Considerations in the Law of Delict' (1993) 56 *Tydskrif vir Hedendaagse Romeins-Hollandse Reg* 171; JC van der Walt & JR Midgley *Delict Principles and Cases* Vol I 2 ed (1997) 54-64; *Payen Components SA Ltd v Bovic Gaskets CC* 1994 (2) SA 464 (W) at 474-6).

5 Conclusion

It is accepted in most Commonwealth jurisdictions that the imposition of personal liability on a director for damage caused to a third party while acting on behalf of a company, is restricted by company-law doctrines (see Grantham & Rickett op cit and the authorities cited there). The argument usually advanced in favour of restricting directors' delictual liability is that of limited liability. However, this principle protects the company's shareholders, not the company or its officers (see also Ross Grantham 'Company Directors and Tortious Liability' (1997) 56 *Cambridge LJ* 259 at 260 who argues that the principle of limited liability thus has no bearing where a director is not a shareholder, and that even where, as is common in small companies, directors are also shareholders, it is far from clear why the individual's status as a shareholder should foreclose the normal consequences of other capacities in which that individual acts; see further *Trevor Ivory Ltd v Anderson* [1992] 2 NZLR 517 (NZ CA) at 527 where the latter suggestion was rejected by the New Zealand Court of Appeal). The true reason for restricting a director's liability is rather the principle of corporate personality.

However, there is also agreement that such liability is not excluded entirely. This is important, because from the claimant's point of view, the reality may be that the company has been wound up insolvent and that the only hope of a remedy is if the director can be held personally liable (see Brenda Hannigan *Company Law* (2003) at 86). It is therefore imperative that a principled approach be taken to found such liability.

The decision in *Koninklijke Philips Electronics v Princo Digital Disc* (supra) considered a director's liability, as a joint tortfeasor with the company, in respect of the infringement of a patent. It confirmed the difficulties in attempting to draw up a comprehensive formulation of the principles which may be regarded as prescriptive. The facts of each case will determine its outcome and this may

involve the making of a policy decision. The Court confirmed that liability as a joint tortfeasor would arise where the director's participation or involvement in the wrongful act(s) went beyond the exercise of his constitutional role in the governance of the company. In the field of intellectual property, in particular, liability may arise where the individual 'intends and procures and shares a common design that the infringement takes place' (*CBS Songs v Amstrad supra* at 1058).

I agree with the view expressed by other commentators that no specific rules of company law are required in South African law to regulate the delictual co-liability of directors. The ordinary principles of delict can effectively regulate, and limit, a director's co-liability with the company for delicts committed by the director. The elements of delict, especially the requirement of unlawfulness, will impose their own limitations on such liability. Making policy decisions and value judgments are not unusual when applying this criterion, and the Bill of Rights reflects the legal convictions of the community according to which they are to be made. The decision in *Koninklijke Philips Electronics v Princo Digital Disc* also involved a policy decision (see at 52 in par [6]) and the outcome would arguably not have been different had the case been decided on South African law. But it would, I think, have been based on a more principled approach.
