

THE LIABILITY OF COMPANIES, AND THAT OF DIRECTORS IN THEIR  
PERSONAL CAPACITIES, IN RELATION TO LEGAL WARRANTIES

by

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## DECLARATION

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## **SUMMARY**

This research looks at the need and enforceability of legal warranties that companies include in contracts and/or public displays/notices to limit the company's liability exposure to third parties. It also discusses the liability incurred by a company and that of its directors in their personal capacities (if any) should the legal warranty implemented be found to be unenforceable.

The liability that may be incurred by the company and/or its director/s is dependent on whether the legal warranty which it implemented is enforceable or not and therefore it is important to establish what would constitute an enforceable legal warranty. In order to determine what is likely to constitute an enforceable legal warranty the study looks back at what has previously been deemed to constitute an unenforceable legal warranty. This is done by analysing the common law principles of contract, being the freedom to contract and the sanctity of contract, and its development in accordance with our constitutional dispensation through case law precedents. The provisions of the Consumer Protection Act 68 of 2008 that apply to legal warranties are also analysed in order to determine the anticipated outcome of future case law where the Consumer Protection Act 68 of 2008 may be applicable to a dispute involving legal warranties.

Once what constitutes an unenforceable legal warranty is established, the study will discuss the legal position of a third party, and that of the company, where a third party has suffered damages as a result of the company's acts or omissions and the company is unable to raise a legal warranty as a defence against such liability, as the legal warranty is found to be unenforceable. Thereafter the study will discuss the measures available to the company where the company is found liable to the third party for the aforementioned damages and the company wishes to mitigate its losses in this regard. Such measures shall include director insurance as well as the recovery of such liability against a director, in the director's personal capacity, where the company either does not have director insurance or is unable to enforce the director insurance due to the actions of a director.

In order to determine the director's accountability to the company in this regard an assessment is made of the duties imposed on a director in terms of the common law and Companies Act 71 of 2008 to establish whether such duties are wide enough to include a duty on the director to ensure legal warranties he/she plays a part in implementing are

enforceable.

**Key Terms:** indemnity waivers; enforceability; public policy; juristic personality; company liability; director liability; director duties; director insurance; Companies Act; common law; South Africa.

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## **The liability of companies, and that of directors in their personal capacities, in relation to legal warranties**

### 1) CHAPTER 1: INTRODUCTION

#### *a) Introduction*

South Africa houses a vibrant commercial hub which consists of various corporate entities engaging with natural and/or other juristic persons.<sup>1</sup> For purposes of this research, I am only going to be referring to private companies<sup>2</sup> and public companies<sup>3</sup> (hereinafter referred to as the “company”). A company may, through its directors, wish to limit the liability it may incur during its business engagements by utilising legal warranties, more specifically indemnity waivers.<sup>4</sup> Indemnity waivers are a form of legal warranty and for purposes of this research I will be referring to indemnity waivers.

Whilst companies may want to mitigate their liability in this regard, the law of contracts, as developed in South Africa and the Consumer Protection Act 68 of 2008 (hereinafter referred to as the “Consumer Protection Act”)<sup>5</sup> have identified a number of safeguards that protect third parties from indemnity waivers that are unjust and unfair and thus, unenforceable.<sup>6</sup> If indemnity waivers that a company has put into place are found to be unenforceable, the company may be exposed to the risk of liability that it did not adequately prepare for. Therefore, a company may want to ensure that its indemnity waivers are legally enforceable in order to prevent any unexpected liability and where the indemnity waivers would not be enforceable, to appropriately mitigate its risk in this regard by ensuring it has other measures in place to limit its risk exposure.

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<sup>1</sup> Department of Trade and Industry: ‘why invest in South Africa’ available at: [https://www.thedti.gov.za/trade\\_investment/why\\_invest\\_insa.jsp](https://www.thedti.gov.za/trade_investment/why_invest_insa.jsp). (Last accessed on 17 June 2019).

<sup>2</sup> Private companies are defined in section 1 of the Companies of Act 71 of 2008 as profit companies (which are companies incorporated for the purpose of financial gain of its shareholders) that are not a public, personal liability or state owned company and its memorandum of incorporation prohibits it from offering any of its securities to the public and restricts the transferability of its securities.

<sup>3</sup> Public companies are defined in section 1 of the Companies of Act 71 of 2008 as profit companies that are not state-owned companies, private companies or personal liability companies. Public companies are permitted to offer its securities to the public and there are not restrictions in respect of the transferability of its shares.

<sup>4</sup> Indemnity waivers are contractual terms that exclude, alter or limit the liability that naturally arise from contractual relationships.

<sup>5</sup> The Consumer Protection Act 68 of 2008.

<sup>6</sup> *Naidoo v Birchwood Hotel* 2012 (6) SA 170 (GSI), para 53.



Being that a company operates through its board of directors,<sup>7</sup> the study looks at what measures are available to a company to protect it against the decisions made by its director/s in respect of indemnity waivers and thus limiting its liability to a third party. In order to determine the appropriate measure available to the company the study explores the terms of the common law and the Companies Act 71 of 2008 (hereinafter referred to as the “Companies Act”),<sup>8</sup> to establish whether there is a duty on the director/s to ensure that the indemnity waivers implemented for the benefit of the company are enforceable and whether the director/s may be held personally liable should he/she fail to do so.<sup>9</sup>

*b) Problem Statement*

There is a commercial need for a company to ensure that it has adequately limited its liability exposure by enlisting the protection measures available, such as an indemnity waiver, in order to ensure its ongoing financial stability and sustainability.<sup>10</sup> Being that the decisions of a company are largely made by its board of directors,<sup>11</sup> a company would have to rely on its directors to effectively implement such protective measures.

A company may procure insurance in order to mitigate its risk of liability where its director/s make decisions on its behalf and such decisions materialise to be bad decisions (herein after such insurance shall be referred to as “director insurance”).<sup>12</sup> In this instance the bad decision would be whereby the director/s implement an unenforceable indemnity waiver and as such, did not mitigate the company’s risk accordingly. Should the validity of such insurance be in

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<sup>7</sup> Section 66 (1) of Act 71 of 2008. This section states that except to the extent the Act or memorandum of the company states otherwise, the business and affairs of the company must be managed by the board of directors. Whilst the decisions of the company are usually made by the board of directors and not an individual director, the liability of an individual director or the board of directors will be to the extent that the director/s are found to be in breach of the duties imposed on them in terms of section 76 of the Companies Act. In terms of section 77 (6) of the Companies Act any person who is liable for the same act as another person shall be jointly and severally liable, therefore the board of directors may be held accountable jointly if they are all found to be in breach of the duties imposed on them or a director may be held accountable individually if he/she was acting independently from the board when he/she failed to fulfil the duties imposed on him/her.

<sup>8</sup> The Companies of Act 71 of 2008.

<sup>9</sup> Section 77 (2) (a) and (b) of Act 71 of 2008. This section allows for a director to be liable for being in breach of a fiduciary duty or in delict for failing to fulfil the duties imposed on him/her in terms of section 76 of the Companies Act.

<sup>10</sup> Botha M, ‘Flirting with risk: liability in spite of indemnity’ *STBB Buchanan’s Brief* June 2015 available at: <https://www.stbb.co.za/wp-content/uploads/Buchanans-Brief-Issue-01-2015.pdf>, (last accessed on 24 April 2019).

<sup>11</sup> *See Op. Cit.* Footnote 7.

<sup>12</sup> Section 78 (7) (b) of Act 71 of 2008. This section states that unless the memorandum of the company provides otherwise a company may procure insurance to protect the company against any contingencies or any liability or expenses which the company is permitted to indemnify the director against in accordance with section 78 (5) of the Companies Act. For purposes of this research I will refer to this insurance as “director insurance”.

question due to the actions of the director, being that a director failed to fulfil the duties imposed on him/her in terms of section 76 of the Companies Act<sup>13</sup> (herein after such duties shall be referred to as “director duties”), or should the company have not procured director insurance, the company then has the option to institute a claim against the director/s personally in respect of the director being in breach of the director duties imposed on him/her in his/her capacity as a director.<sup>14</sup>

In order for a director to understand the extent of the duties owing to the company and the personal liability attached thereto, he/she would need to understand what would constitute an unenforceable indemnity waiver, to what extent a company can be held liable in respect of an unenforceable indemnity waiver and whether the director duties imposed on a director in terms of the common law and the Companies Act<sup>15</sup> are wide enough to include a duty on him/her to ensure that the indemnity waivers implemented are enforceable and if so, what the personal consequences of failing to carry out such a duty would be.

It is also important for directors to understand the measures available to them when carrying out their duties to ensure that they make a well-informed decision. Such measures can take the form of legal assistance from company employees<sup>16</sup> or professional services<sup>17</sup> and equipping himself/herself with the necessary knowledge and skills<sup>18</sup> required in order to make an informed decision regarding the enforceability of indemnity waivers. This research also briefly discusses the concept of the business judgement rule<sup>19</sup> and how it is applicable to the director duties imposed on a director.

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<sup>13</sup> Section 76 (3) of the Companies Act 71 of 2008. This section recognises that a director has the following duties: the duty to act in good faith and for proper purpose, in the best interest of the company and with the necessary skill, care and diligence reasonably expected of a person, who is carrying out the same function and who has the same general knowledge, skill and experience.

<sup>14</sup> Section 77 (2) (a) and (b) of the Companies Act 71 of 2008.

<sup>15</sup> Section 76 of the Companies Act 71 of 2008.

<sup>16</sup> Section 76 (5) (a) of the Companies Act 71 of 2008. This section allows for a director to rely on the information, opinion, report or statement of an employee which he/she reasonably believes is competent to give such information, opinion, report or statement.

<sup>17</sup> Section 76 (5) (b) of the Companies Act 71 of 2008. This section allows for a director to rely on legal counsel retained by the company, provided that the director reasonably believes that the legal counsel has the skill and expertise to deal with the matter at hand.

<sup>18</sup> Section 76 (4) (a) of the Companies Act 71 of 2008. This section states that a director would be deemed to have complied with his/her duty to act in the best interest of the company and with the necessary skill, care and diligence if he/she took reasonable, diligence steps to become informed about the matter at hand, did not have a personal interest in the matter and had a rational basis for believing that the decision made was in the best interest of the company.

<sup>19</sup> The business judgement is a rebuttable presumption that a director made decisions in his/her capacity as director in good faith. Such presumption, unless proven otherwise, protects the director from the company or its shareholders for any losses resulting from poor-decisions made by the director in good faith.

*c) Aim of the Research*

The aim of this research is the following:

- i. to establish what constitutes an unenforceable indemnity waiver;
- ii. to determine the liability (if any) of a company and director to a third party where the indemnity waiver is found to be unenforceable;
- iii. to establish the measures available to a company to protect it from the decisions made by its director/s;
- iv. to determine the liability (if any) of director/s, (to a company) who failed to ensure that indemnity waivers that they put into place are enforceable and if so, if he/she may be liable in his/her personal capacity to the company for failing to carry out such a duty and the extent of such liability thereto.<sup>20</sup>

*d) Structure of the Research*

In Chapter 1, I refer to the introduction, legal question, aims and research methodology of this dissertation.

In Chapter 2, I analyses the common law, the Constitution of the Republic of South Africa of 1996 (hereinafter referred to as the “Constitution”),<sup>21</sup> the Consumer Protection Act and various court cases in relation to indemnity waivers to establish the enforceability thereof.

The study then moves on to analyse the common law and Companies Act in relation to:

- i. a company’s and director/s liability to a third party in respect of an unenforceable indemnity waivers, which I set out in Chapter 3;
- ii. measures available to a company in order to protect itself against the decisions of director/s, whether a director incurs any personal liability if he/she fails to comply with his/her duties to the company (if any) and whether, in terms of the director duties imposed on a director, a director may be expected to ensure an indemnity waiver is enforceable, which I set out in Chapter 4.

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<sup>20</sup> Section 77(2) (a) and (b) of the Companies Act 71 of 2008.

<sup>21</sup> The Constitution of the Republic of South Africa, 1996.

*e) Research Methodology*

This research shall comprise of reviewing the applicable laws and case laws referred to above in relation to: indemnity waivers, a company's and director/s liability to a third party in respect of unenforceable indemnity waivers, the measures available to a company in order to protect itself from the decision of its director/s from which liability to third parties may arise, the director's duties to a company and his/her personal liability to the company for failing to fulfil such duties in respect of indemnity waivers. The conclusion provides recommendations supported by the facts, precedents and legislation reviewed during this research.

*(f) Conclusion*

The purpose of Chapter 1 was to introduce the legal question, aims and research methodology of this dissertation as well as to define relevant terms. I also outline the following topics: the enforceability of indemnity clauses (Chapter 2), a company's liability to a third party in the event that an indemnity waiver is deemed unenforceable (Chapter 3), measures available to the company to protect itself against the bad decisions of its directors (Chapter 4) and recommendations on how a director can mitigate against unenforceable indemnity waivers and thus ensure that he/she has complied with his/her duties as a director (Chapter 5).

## 2) CHAPTER 2: UNDERSTANDING INDEMNITY WAIVERS AND THE ENFORCEMENT THEREOF

### (a) *Introduction*

In this chapter, it will be explained what an indemnity waiver is and I will discuss the purpose and need of an indemnity waiver. I will also discuss the law of contract that relates to the enforceability of certain provisions within a contract that may be deemed to be against public policy, which was applied by the courts prior to the implementation of the Constitution. I will thereafter discuss the legal changes brought about by the Constitution and the Consumer Protection Act to the law of contract in so far as it relates to the enforcement of an indemnity waiver. Reliance is made on case law that was decided after the promulgation of the Constitution and the Consumer Protection Act.

The reason of discussing the common law is that there may be instances where the Consumer Protection Act may not be applicable,<sup>22</sup> in which case the common law will continue to apply. Therefore, a company and its directors, need to be aware of when and how the common law or the Consumer Protection Act is applicable as well as the impact thereof on the enforceability of indemnity waivers.

### (b) *Indemnity waivers defined*

Indemnity waivers<sup>23</sup> are contractual terms that exclude, alter or limit the liability that naturally flows from contractual relationships.<sup>24</sup> Indemnity waivers may take the form of a clause in a written agreement, a clause displayed on a notice board at the company's premises or a clause on a card provided to a third person by the company wanting to be indemnified.<sup>25</sup> An example of an indemnity waiver can be seen in the case of *Naidoo v Birchwood Hotel*,<sup>26</sup> whereby the following indemnity waiver appeared on the back of the hotels registration card:

*'The guest hereby agrees on behalf of himself and the members of his party that it is a condition*

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<sup>22</sup> Section 5 (2) of the Consumer Protection Act 68 of 2008.

<sup>23</sup> Also referred to as "exemption clause", "indemnity clause", disclaimers or "waivers".

<sup>24</sup> Christelle Kok, *The Effect of the Consumer Protection Act on Exemption Clauses in Standard Contracts*, (unpublished LLM dissertation, University of Pretoria, 2010) 6.

<sup>25</sup> Sheethal Sewsunker, *Contractual Exemption Clauses under the South African Constitution: An Examination of the Potential Impact of Public Policy and Ubuntu of such Provisions* (unpublished LLM dissertation, University of Kwa-Zulu Natal 2012) 12.

<sup>26</sup> *Naidoo v Birchwood Hotel* 2012 (6) SA 170 (GSJ).

*of his/her occupation of the Hotel that the Hotel shall not be responsible for any injury to, or death of, any person or the loss or destruction of or damage to any property on the premises, whether arising from fire, theft or any cause, and by whatsoever cause or arising from the negligence (gross or otherwise) or wrongful acts of any person in the employment of the Hotel*<sup>27</sup>

(c) *The purpose of an indemnity waiver*

The purpose of an indemnity waiver is to limit or exclude the potential liability of a contracting party that flows from a contractual relationship.<sup>28</sup> As mentioned above, in order to ensure the on-going financial stability and sustainability of the company, a company will often utilise indemnity waivers to prevent a third party from recovering any losses or damages from the company in the event that such damages arise from the contractual relationship.<sup>29</sup> For purposes of this research, the third party will hereinafter be referred to as the “consumer”.

(d) *Enforceability of an indemnity waiver*

The purpose of discussing the enforceability of indemnity waivers in this research is to outline what considerations a company, or its directors, may wish to take into account before implementing an indemnity waiver. An indemnity waiver would need to be enforceable in order to serve the desired purpose, which would be to adequately indemnify the company against liability which may result from the contractual relationship with a consumer. The study, therefore discusses the enforceability of indemnity waivers in terms of the common law and the Consumer Protection Act.

aa) *Common law considerations*

The contractual law principles in South Africa were based on the classical theory, being the principle of *Pacta Sunt Servanda*,<sup>30</sup> which comprises of the ideals of the freedom to contract

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<sup>27</sup> Naidoo para 37.

<sup>28</sup> Sheethal Sewsunker, *Contractual Exemption Clauses under the South African Constitution: An Examination of the Potential Impact of Public Policy and Ubuntu of such Provisions* (unpublished LLM dissertation, University of Kwa-Zulu Natal 2012) 12.

<sup>29</sup> Botha M, ‘Flirting with risk: liability in spite of indemnity’ *STBB Buchanan’s Brief* June 2015 available at: <https://www.stbb.co.za/wp-content/uploads/Buchanans-Brief-Issue-01-2015.pdf> (last accessed on 24 April 2019).

<sup>30</sup> This a Latin phrase meaning that an agreement must be honoured. See: Legal Dictionary: *Pacta Sunt Servanda*: <https://legal-dictionary.thefreedictionary.com/pacta+sunt+servanda> (Last accessed 02 October 2019).

and the sanctity of a contract.<sup>31</sup> The *Pacta Sunt Servanda* principle dictates that contracts entered into freely and seriously must be honoured and if necessary, enforced by our courts.<sup>32</sup> Based on this theory, courts would enforce the clauses within a contract despite such clauses being unfair, harsh or oppressive.<sup>33</sup> Courts would only interfere where contracts are not freely entered into (due to duress, misrepresentation or undue influence) or where the terms of such contract are immoral, illegal or against public policy.<sup>34</sup>

The freedom to contract dictates that parties are free to decide who they wish to contract with and what the terms of such contract shall be.<sup>35</sup> The sanctity of contract principle dictates that the obligations established by the parties to an agreement must be honoured because the contract was entered into voluntarily.<sup>36</sup>

Since the introduction of our Constitution in 1996 the principle of *Pacta Sunt Servanda* has been developed in accordance with our Constitution as the Constitution strives to achieve social justice.<sup>37</sup> Furthermore, there has also been a movement towards consumer protection which has assisted in developing the common law and statutory law with the introduction of the Consumer Protection Act in March 2011. The following cases show how the law of contract in South Africa has developed in accordance with the values that underpin the Constitution and outline some important considerations for determining the enforceability of an indemnity waiver.<sup>38</sup>

### ***Barkhuizen v Napier***

In this case, Barkhuizen (“the applicant”) had taken out an insurance policy with a syndicate of Lloyd’s Underwriters of London who was represented in South Africa by Napier (“the respondent” or “the insurer”). The applicant’s vehicle was damaged in a motor vehicle

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<sup>31</sup> Sheethal Sewsunker, *Contractual Exemption Clauses under the South African Constitution: An Examination of the Potential Impact of Public Policy and Ubuntu of such Provisions* (unpublished LLM dissertation, University of Kwa-Zulu Natal 2012) 1-2.

<sup>32</sup> Miranda Pillay, *The Impact of the Pacta Sunt Servanda in the Law of Contract* (unpublished LLM Dissertation, University of Pretoria, 2015) 6.

<sup>33</sup> Christelle, Kok, *The Effect of the Consumer Protection Act on Exemption Clauses in Standard Contracts*, (unpublished LLM dissertation, University of Pretoria, 2010) 8.

<sup>34</sup> Thejane P ‘The doctrine of quasi-mutual assent: has it become the general rule for the formation of contracts? The case of Pillay V Shaik 2009 4 SA 74 (SCA)’, *PERJ* (2012) (15) (5) 525.

<sup>35</sup> Miranda Pillay, *The Impact of the Pacta Sunt Servanda in the Law of Contract* (unpublished LLM Dissertation, University of Pretoria, 2015), 6.

<sup>36</sup> Miranda Pillay, *The Impact of the Pacta Sunt Servanda in the Law of Contract* (unpublished LLM Dissertation, University of Pretoria, 2015), 6.

<sup>37</sup> The Preamble to the Constitution of the Republic of South Africa, 1996.

<sup>38</sup> *Barkhuizen v Napier* 2007 (7) BCLR 691 (CC) 135 para 35.

accident and being that the vehicle was listed on the insurance policy, the applicant submitted a claim to the respondent for the damages to his vehicle in the amount of R 181 000.00.<sup>39</sup> The respondent repudiated the claim as the applicant had been using the vehicle for business use and not for private use as it was insured for.<sup>40</sup>

Two years later the applicant instituted action in the High Court of South Africa and served a summons on the respondent in respect of the claim. The respondent raised a special plea in that the applicant was not entitled to issue a summons as in terms of the policy entered into between the parties there was a clause which read as follows:

*'if we reject liability for any claim made under this policy we will be released from liability unless summons is served... within 90 days of repudiation.'*<sup>41</sup>

The applicant responded to the special plea to say that the enforcement of such clause would be deemed unconstitutional as it infringes on his right in terms of section 34 of the Constitution<sup>42</sup> and that the clause is against public policy as it prescribes an unreasonably short time to institute action.<sup>43</sup>

The High Court considered whether section 34 of the Constitution could be limited in terms of section 36 (1) of the Constitution and held that such limitation was not reasonable and justifiable and as such, the clause was not enforceable.<sup>44</sup>

The matter was taken on appeal where the Supreme Court of Appeal upheld the appeal and dismissed the decision of the High Court on the basis that whilst it accepted that the common law of contract is subject to constitutional consideration, the principle of *Pacta Sunt Servanda* should be applied and being that there was no evidence that the parties did not enter into the clause freely and voluntarily, the clause is enforceable and is not in contravention of section 34 of the Constitution.<sup>45</sup>

Whilst the High Court and the Supreme Court of Appeal deliberated on the first argument, being that the clause was unconstitutional in terms of section 34 of the Constitution, they did

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<sup>39</sup> *Barkhuizen* para 1-3.

<sup>40</sup> *Barkhuizen* para 2.

<sup>41</sup> *Barkhuizen* para 3.

<sup>42</sup> In terms of section 34 of the Constitution, everyone has the right to have their dispute heard by a court or where appropriate an independent or impartial tribunal or forum.

<sup>43</sup> *Barkhuizen* para 5.

<sup>44</sup> *Barkhuizen* para 10.

<sup>45</sup> *Barkhuizen* para 17



not deliberate on public policy as this was foreshadowed in the pleadings.<sup>46</sup>

Both the High Court and the Supreme Court of Appeal only considered the direct application of section 34 of the Constitution. The matter was then taken to the Constitutional Court, where the Constitutional Court held that the proper approach when determining contractual terms in accordance with constitutional challenges would be to determine whether the clause was contrary to public policy as evidenced by the constitutional values set out in the Bill of Rights.<sup>47</sup> The Court further remarked that the proper approach would be to consider whether the particular clause was harmful to all of the values that underline the South African constitutional democracy as given expression to in section 34 of the Constitution, and thus deemed to be contrary to public policy.<sup>48</sup>

Ngcobo J then went on to define public policy as follows:

*‘What public policy is and whether a term in a contract is contrary to public policy now may be determined by reference to the values that outline or constitutional democracy as expressed by the Bill of Rights. Thus a term in a contract that is inimical to the values enshrined in our constitution is contrary to public policy.’<sup>49</sup>*

Ngcobo further held that:

*‘Any laws that is inconsistent with the constitution is invalid. No law is immune from constitutional control. The common law is no exception. And courts have a constitutional obligation to develop the common law, including the principles of law of contract, so as to bring it in line with the values that underlie our Constitution. When developing the common law of contracts, courts are required to do so in a manner that “promotes the spirit, purport, and objects of the Bill of Rights... Courts are equally empowered to develop the rules of common law to limit a right in the Bill of Rights “provided that the limitation is in accordance with section 36 (1).’<sup>50</sup>*

In summary, the Constitutional Court held that public policy must be determined in accordance with the values and constitutional democracy as set out in the Bill of Rights and the common law is not only subject to constitutional control but should also be developed in a manner which promotes the spirit, purport and objects of the Bill of Rights. Furthermore,

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<sup>46</sup> *Barkhuizen* para 8.

<sup>47</sup> *Barkhuizen* para 30.

<sup>48</sup> *Barkhuizen* para 36.

<sup>49</sup> *Barkhuizen* para 29.

<sup>50</sup> *Barkhuizen* para 31.

a court is empowered to develop the common law to limit a right in the Bill of Rights provided such limitation is in accordance with section 36 (1) of the Constitution.

The Constitutional Court held that it would be contrary to public policy to enforce a time limitation clause that does not afford a person adequate and fair opportunity to seek judicial redress<sup>51</sup> and that the requirement of an adequate and fair opportunity to seek judicial redress needs to be consistent with the notions of fairness and justice which inform public policy.<sup>52</sup>

The Constitutional Court then held that the test to determine fairness of the clause would be dependent on whether the clause is reasonable or unreasonable. If the clause is unreasonable it will not be fair to enforce, however if the clause is reasonable, there will be a further qualifying factor, being that of whether the clause should be enforced under case specific circumstances.<sup>53</sup> Thus the Constitutional Court had to weigh up the rights afforded to individuals to contract freely and voluntarily and that of the right of an individual to seek judicial redress.<sup>54</sup>

The Constitutional Court found that the clause was reasonable as the applicant would have known the defendant and had all the necessary details to serve the summons at the time of the repudiation of the claim and knew what the cause of action was. The only question remaining was why the summons was not served within 90 days and if such reasons would render the enforcement of such clause to be against public policy.<sup>55</sup> The applicant did not provide any reasoning as to why it was unable to serve the summons within the 90 days required and as such, the court could not deliberate on this point and the appeal was dismissed.<sup>56</sup>

Whilst the Constitutional Court was unable to rule on the fairness of the enforceability of the clause it did confirm the following important principles:

- i. A court may not enforce a clause if it is against public policy and that public policy is determined in accordance with the values and constitutional democracy that is set

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<sup>51</sup> *Barkhuizen* para 51.

<sup>52</sup> *Barkhuizen* para 52.

<sup>53</sup> *Barkhuizen* para 56.

<sup>54</sup> *Barkhuizen* para 55.

<sup>55</sup> *Barkhuizen* para 63.

<sup>56</sup> *Barkhuizen* para 85.

out in the Bill of Rights.<sup>57</sup>

- ii. The common law shall be developed in a manner which promotes the spirit, purport and objects of the Bill of Rights and any limitation of a right set out therein needs to be reasonable and fair in accordance with section 36 (1) of the Constitution.<sup>58</sup>
- iii. It would be contrary to public policy to enforce a time limitation clause that does not afford a person adequate and fair opportunity to seek judicial redress<sup>59</sup> and the requirement of an adequate and fair opportunity to seek judicial redress must be consistent with the notions of fairness and justice which inform public policy.<sup>60</sup>
- iv. The test for fairness is, firstly to determine whether the clause is unreasonable and if the clause is reasonable then, secondly to determine whether enforcing the clause in light of the circumstances will be deemed contrary to public policy.<sup>61</sup>

### ***Naidoo v Birchwood Hotel***<sup>62</sup>

In this case Naidoo (“the plaintiff”), who was a guest at the hotel, was injured when the gate at the entrance of the hotel fell on him causing him serious bodily injuries. The plaintiff sued the hotel for the damages incurred by him in respect of his injuries.<sup>63</sup> The court found that the hotel was negligent in failing to ensure the gate was safe and that its staff failed to adequately notify the plaintiff of the anticipated danger.<sup>64</sup> The hotel argued that even if it was deemed to be negligent there were indemnity disclaimers in place which exempted it from liability in respect of the damages suffered by the plaintiff.<sup>65</sup> For purposes of this research I will only be discussing the defendant’s reliance on the disclaimer which appeared on the back of the hotel registration card and not the disclaimers which were allegedly located around the hotel premises.<sup>66</sup>

Whilst the plaintiff confirmed that he saw the disclaimer on the back of the registration card,

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<sup>57</sup> *Barkhuizen* para 35.

<sup>58</sup> *Barkhuizen* para 35.

<sup>59</sup> *Barkhuizen* para 51.

<sup>60</sup> *Barkhuizen* para 52.

<sup>61</sup> *Barkhuizen* para 56.

<sup>62</sup> *Naidoo*.

<sup>63</sup> *Naidoo* para 1.

<sup>64</sup> *Naidoo* para 27.

<sup>65</sup> *Naidoo* para 5.

<sup>66</sup> *Naidoo* para 6.

he admitted to not reading it<sup>67</sup> and as such, the court had to determine whether the clause was contractually binding and if there was *quasi* mutual consent.<sup>68</sup> The court held that the doctrine applicable to so called ticket cases<sup>69</sup> would be applicable here and therefore the party alleging that there was *quasi* mutual consent, had to demonstrate that it took reasonably sufficient steps to bring the terms of the disclaimer to the other party's attention. If the party did take such reasonable steps, it would be entitled to assume that the other party's continuation on entering the premises, notwithstanding the disclaimer, would be a confirmation of him/her assenting to the terms of the disclaimer.<sup>70</sup> The court further held that when contracting out of liability, it must be done in clear and unequivocal terms which are clearly visible.<sup>71</sup>

The court found that the clause was straightforward and that even if the plaintiff did not read the disclaimer he conceded that he ought to have reasonably known what it could have said and as such, consensus was reached and the clause was deemed to be contractually binding.<sup>72</sup>

The court then had to determine whether the enforcement of such a clause was against public policy. The court followed the test for fairness as applied in the *Barkhuizen v Napier* 2007 (5) SA 323 (CC) case, and thus took into account whether the clause itself was objectively reasonable and whether it should be enforced under the circumstances.<sup>73</sup>

The court found that whilst it was of the view that exemption clauses which exclude liability and that had the effect of denying the claimant judicial redress would objectively deem such a clause unreasonable, it noted that it was not in a position to deliberate on this point as this question was not argued by the parties before the court. The court did deliberate on the second element of the test which was to assess whether the disclaimer should be enforceable under the case specific circumstances. The court held that the plaintiff does not take his own life into his hands when leaving a hotel and that to deny him judicial redress for injuries that came about due to the negligence of the hotel would be against the notions of justice and

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<sup>67</sup> *Naidoo* para 38.

<sup>68</sup> The principle of *quasi* mutual asset is where it is assumed that the signatory, by signing the document, signifies that he intends to be bound by it.

<sup>69</sup> Ticket cases are defined as cases where the terms and conditions are found on a ticket and the purchaser is assumed to have assented to such conditions once he or she purchases the ticket.

<sup>70</sup> *Naidoo* para 39.

<sup>71</sup> *Naidoo* para 40.

<sup>72</sup> *Naidoo* para 38.

<sup>73</sup> *Naidoo* para 49.

fairness.<sup>74</sup> Thus the court held that the plaintiff's claim succeeds.<sup>75</sup>

This case sets out the following principles to consider when implementing indemnity waivers:

- i. For *quasi* mutual consent to be established and thus for an indemnity waiver to be contractually binding, the person entering in to the indemnity waiver should be made aware that it is an indemnity waiver and the indemnity waiver should be in clear and unequivocal terms.<sup>76</sup>
- ii. Where the enforcer of the indemnity waiver has been negligent in relation to bodily injury or death, it would be deemed against the notion of justice and fairness to enforce such an indemnity waiver and deny the plaintiff judicial redress.<sup>77</sup>

### ***Mercurius Motors v Lopez***<sup>78</sup>

In this case the Lopez ("the respondent") delivered his vehicle to Mercurius Motor's ("the appellant") premises for a service.<sup>79</sup> The respondent's vehicle was stolen from the premises. The respondent wanted to hold the appellant liable however, the appellant claimed that they could not be held liable as there was an indemnity clause in the deposit contract that the respondent had signed.<sup>80</sup> The court *a quo* held that the clause in the deposit contract was drafted in such a manner that it did not draw the respondent's attention to such clause and that it misled the respondent as it was unclear and confusing and thus was not enforceable.<sup>81</sup> The matter was taken on appeal to the Supreme Court of Appeal.

The Supreme Court of Appeal held that:

- i. The appellant's employees failed to act in a manner as expected of a reasonable person in the safekeeping of the keys of the vehicle, which led to the theft of the vehicle and as such, the appellant was deemed to have acted negligently;<sup>82</sup>

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<sup>74</sup> *Naidoo* para 53.

<sup>75</sup> *Naidoo* para 54.

<sup>76</sup> *Naidoo* para 40.

<sup>77</sup> *Naidoo* para 53.

<sup>78</sup> *Mercurius Motors v Lopez* (2008) (3) SA 572(SCA).

<sup>79</sup> *Mercurius* para 1.

<sup>80</sup> *Mercurius* para 7.

<sup>81</sup> *Mercurius* para 23.

<sup>82</sup> *Mercurius* para 36.

- ii. A reasonable person would expect that, upon delivery of his/her vehicle to the depository, the depository would take reasonable care of the vehicle;<sup>83</sup>
- iii. Not only did the exemption clause undermine the very purpose of a deposit contract but the clause was not legible and was not clearly brought to the attention of the person signing it.<sup>84</sup>

For the reasons stated above, the Supreme Court of Appeal held that appellant was negligent and that the indemnity clause was unenforceable. As such, the appeal was dismissed.<sup>85</sup>

This case sets out the following principles to consider when implementing indemnity waivers:

- i. The court refused to enforce the indemnity clause as the clause was not brought to the signatory's attention and the clause itself was not clear and was confusing which is deemed to have misled the signatory.
- ii. Where a clause in a contract undermines the purpose of the contract, it may not be enforced.

Further to the point (ii) above, it is noted that where the very purpose of the contract is undermined by the indemnity waiver, it is questionable as to whether the parties reach a level of consensus on the terms of the contract and whether each party have the necessary autonomy required to enter into the agreement freely and voluntarily.<sup>86</sup>

*bb) Consumer Protection Act<sup>87</sup>*

The Consumer Protection Act was introduced in 2011 and was a welcomed movement towards consumer protection.<sup>88</sup> Whilst the Consumer Protection Act does not forbid indemnity waivers it does provide a number limitations specific to indemnity waivers.

The Consumer Protection Act will not be applicable and a consumer shall not be entitled to

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<sup>83</sup> *Mercurius* para 33.

<sup>84</sup> *Mercurius* para 33.

<sup>85</sup> *Mercurius* para 38.

<sup>86</sup> Naude T and Lubbe G 'Exemption clauses- a rethink occasioned by Afrox Healthcare BPK v Strydom' *SALJ*, volume 122, issue 2, 2005, 462-463.

<sup>87</sup> The Consumer Protection Act 68 of 2008.

<sup>88</sup> Christelle Kok, *The Effect of the Consumer Protection Act on Exemption Clauses in Standard Contracts*, (unpublished LLM dissertation, University of Pretoria, 2010) 4.

rely upon the provisions therein, if the consumer is: the State,<sup>89</sup> a juristic person whose asset value or annual turnover, at the time of the transaction, equals or exceeds the threshold value determined by the minister,<sup>90</sup> which is currently two million rand,<sup>91</sup> or the transaction between the company and the consumer constitutes a credit agreement under the National Credit Act 34 of 2005.<sup>92</sup> For purposes of this Chapter 3, the consumer referred to will be deemed to not fall within any of these categories and the Consumer Protection Act shall be applicable.

In terms of section 48 of the Consumer Protection Act a company may not require a consumer to waive any rights, assume any obligations or waive any liability of the supplier on terms that are unfair, unreasonable or unjust. Furthermore, a company cannot impose such terms as a condition for it to enter into the contract with a consumer.<sup>93</sup> Regulation 44 sets out a list of contract terms which are *prima facie* unlawful terms, thus deemed not to be fair and reasonable. This is known as the “Grey List”.<sup>94</sup> If a company tries to enforce a contract term on the “Grey List” it will have to persuade a court that such term is not unfair or unreasonable.<sup>95</sup>

Regulation 44 (3) (a) of the Consumer Protection Act Regulations states that contractual terms that exclude liability for bodily injury or death, caused by negligence, are deemed to be unreasonable, unjust and unfair unless a company is able to persuade a court otherwise. Therefore, an indemnity waiver which provides for this may be deemed to be unenforceable by a court. This provision is similar to the position the court held in the case of *Naidoo v Birchwood* as set out above.

In terms of section 49 of the Consumer Protection Act, where there is a clause in an agreement that limits the risk of the company, places an obligation on the consumer to assume risk or requires the consumer to indemnify the company, such clause must be brought to the consumer’s attention in writing, in plain language<sup>96</sup> and in a manner that is likely to attract the attention of an ordinary alert consumer under the circumstances.<sup>97</sup> The consumer must

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<sup>89</sup> Section 5 (2) (a) of the Consumer Protection Act 68 of 2008.

<sup>90</sup> Section 5 (2) (b) of the Consumer Protection Act 68 of 2008.

<sup>91</sup> Government Gazette No 34181, dated 1 April 2011.

<sup>92</sup> Section 5 (2) (d) of the Consumer Protection Act 68 of 2008.

<sup>93</sup> Section 48 (1) (c) of the Consumer Protection Act 68 of 2008.

<sup>94</sup> Glover G *Kerr’s Law of Sale and Lease* (2014) 4 ed LexisNexis 129.

<sup>95</sup> Regulation 44 of Act 68 of 2008.

<sup>96</sup> Section 49 (3) of the Consumer Protection Act 68 of 2008.

<sup>97</sup> Section 49 (4) of the Consumer Protection Act 68 of 2008.

be given adequate opportunity to comprehend and consider the clause prior to engaging in the activities set out in the agreement.<sup>98</sup> These provisions are similar to the position held in the cases of *Naidoo v Birchwood*<sup>99</sup> and *Mercurius Motors v Lopez*<sup>100</sup> set out above, being that the requirements for *quasi* mutual consent would be for the clause to be brought to the consumer's attention in clear unequivocal terms.

In terms of section 51 the Consumer Protection Act a company must not make an agreement subject to any term or condition if the general purpose or effect of the term or condition is to defeat the purpose or policy of the Consumer Protection Act, mislead or deceive the consumer or subject the consumer to fraudulent conduct.<sup>101</sup> One of the purposes of the Consumer Protection Act is to promote compliance with the Bill of Rights as provided for in the Constitution in the application of company law.<sup>102</sup> This is the same position held in the case of *Barkhuizen v Napier*,<sup>103</sup> being that a court may not enforce a clause which is against public policy and public policy must be determined in accordance with the Bill of Rights as set out in the Constitution.

In terms of section 52 of the Consumer Protection Act, if a company fails to ensure it complies with the provisions of the Consumer Protection Act, a court may declare the contract or part thereof, unenforceable.<sup>104</sup>

*e) Conclusion*

Where the Consumer Protection Act is applicable, the courts will rely on the provisions therein when justifying their decisions as to whether an indemnity clause is enforceable or not. Where the Consumer Protection Act is not applicable the common law and constitutional considerations will be applied by the court.

Whether the Consumer Protection Act or common law applies the following general principles remain the same:

- i. If an indemnity waiver is deemed to be against public policy, which is determined

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<sup>98</sup> Section 49 (5) of the Consumer Protection Act 68 of 2008.

<sup>99</sup> *Naidoo*.

<sup>100</sup> *Mercurius*.

<sup>101</sup> Section 51 (1) of the Consumer Protection Act 68 of 2008.

<sup>102</sup> Section 7 of the Consumer Protection Act 68 of 2008.

<sup>103</sup> *Barkhuizen*.

<sup>104</sup> Section 52 of the Consumer Protection Act 68 of 2008.



by a court by establishing whether the clause is consistent with the Bill of Rights as set out in the Constitution, then it is likely to be unenforceable.

- ii. In the event that an indemnity waiver excludes the company's liability for bodily injury or death caused negligently by the company, it shall be deemed unreasonable, unjust and unfair unless a company is able to persuade a court otherwise. If an indemnity waiver is deemed to be unreasonable, unjust or unfair it will be deemed to be against public policy and will likely be unenforceable.
- iii. In order for it to be deemed that *quasi* mutual consent existed between the consumer and the company, the indemnity waiver must have been brought to the consumer's attention in unequivocal and clear terms. If a company fails to do this, it is likely that the indemnity waiver will not be enforceable.
- iv. The indemnity waiver must not undermine the nature of the contract entered into between the parties as this may be seen by the courts as one or both of the parties lacking the necessary autonomy to enter into an agreement freely and voluntarily.

### 3) CHAPTER 3: THE LIABILITY OF COMPANIES AND DIRECTORS TO CONSUMERS IN RELATION TO LEGAL WARRANTIES

#### a) *Introduction*

In this Chapter 3, I explore a company's ability and authority to enter into agreements with consumers which amount to or include indemnity waivers. I discuss the company's and director's liability to a consumer where the consumer has suffered damages as a result of his or her engagements with the company through a contractual relationship as well as the cause of action available to the consumer for the recovery of such damages. The company's liability in this regard could depend on the availability of an indemnity waiver and its enforceability.

#### b) *The actions, authority and liability of a Company*

Whilst the actions and decisions of a company are mostly made by its board of directors,<sup>105</sup> both private and public companies are juristic persons who have a separate juristic personality from its board of directors.<sup>106</sup> This means that the actions or omissions done by the board of directors of the company will be seen to be done by the company and unless exceptional circumstances exist,<sup>107</sup> the company may be liable for any losses suffered by a consumer in respect of the decisions made by the board of directors on behalf of the company.

Unless the company is unable to exercise certain powers in its capacity or unless otherwise provided for in the company's Memorandum of Incorporation, a company has the power and capacity of a natural person.<sup>108</sup> Therefore a company, through its board of directors, may enter into agreements in its own name,<sup>109</sup> defend any action in its own name<sup>110</sup> and may be liable to the consumer directly should it be found that it was due to the acts or omissions of

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<sup>105</sup> Section 66 (1) of the Companies Act 71 of 2008. (*Op. Cit.* Footnote 7).

<sup>106</sup> Cassim et al, *Contemporary Company Law* (2012) 2 ed Juta, 31.

<sup>107</sup> These exceptional circumstances shall be where a director or shareholder are in breach of their duties to the company in terms of the Companies Act, 2008 or where a court decides to pierce the corporate veil. There is no set list of instances whereby the court may pierce the corporate veil however in the textbook of *Contemporary Company Law* (2012) 2 ed Juta, the authors discuss instances where courts have pierced the corporate veil. These instances include: where the separate legal personality of a company was used: (i) as a device by a director to evade his/her fiduciary duty and (ii) to overcome a contractual duty. For purposes of this research "exceptional circumstances" shall only be the exceptional circumstances where the directors are in breach of the director duties imposed on them in terms of the Companies Act, 2008.

<sup>108</sup> Section 19 (1) (b) of the Companies Act 71 of 2008.

<sup>109</sup> Cassim et al, *Contemporary Company Law* (2012) 2 ed Juta, 40.

<sup>110</sup> Cassim et al, *Contemporary Company Law* (2012) 2 ed Juta, 29.

the company that caused the consumer's damages.<sup>111</sup>

c) *Cause of action for a claim against the company or director*

A consumer's claim against a company in respect of damages suffered due to the acts or omissions of a company may be based on the common law *aquilian* action<sup>112</sup> for a delictual claim or a claim based on an infringement of the Consumer Protection Act<sup>113</sup> (if applicable) or a claim based on breach of contract if there was a contract between the company and consumer whereby the company undertook to indemnify the consumer against the damages suffered by the consumer.

Where the company has put in place certain indemnity waivers, it may raise such indemnity waivers as a defence to a claim for damages by a consumer, as was done in the case of *Naidoo v Birchwood Hotel*.<sup>114</sup> Should the indemnity waiver be found to be unenforceable the company may be held liable for the damages suffered by the consumer.<sup>115</sup>

In the case of *Naidoo v Birchwood Hotel*,<sup>116</sup> which has been discussed in detail above, a delictual claim was brought by the plaintiff,<sup>117</sup> who claimed that the defendant (the Hotel – Company) had been negligent in taking adequate steps to prevent the incident occurring, causing damages to the plaintiff.<sup>118</sup> As a defence, the defendant relied on the tacit contractual agreement it entered into with the plaintiff: first, being that the plaintiff had sight of the indemnity notices that appeared on the defendant's premises;<sup>119</sup> and secondly on the informed agreement whereby the plaintiff agreed to the terms on the back of the registration card by signing it (the terms included a provision which indemnified the defendant against any damages suffered by the plaintiff whilst on the defendant's premises).<sup>120</sup> This case is an

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<sup>111</sup> Section 19 (2) (b) of the Companies Act 71 of 2008.

<sup>112</sup> The *aquilian* action is a common law remedy for delictual liability whereby a plaintiff can claim the damages suffered by it if it can prove the following elements were present: the plaintiff suffered damages or a loss, there was conduct (an act or omission) by the defendant which was wrongful, there was a link between the conduct of the defendant and the damages/loss caused to the plaintiff and there is fault or blameworthiness on the part of the defendant. (See Delpont P *New Entrepreneurial Law* (2014) 1 ed LexisNexis, chapter 6, 143-144..

<sup>113</sup> Section 69 of the Consumer Protection Act 68 of 2008. This section states that the consumer must first try resolve the dispute with the company with the assistance of the Tribunal, Ombudsman or Consumer Court, failing resolution through these channels, the consumer may then approach a court which has the necessary jurisdiction.

<sup>114</sup> *Naidoo*.

<sup>115</sup> *Naidoo* para 53.

<sup>116</sup> *Naidoo* para 12.

<sup>117</sup> *Naidoo* para 7.

<sup>118</sup> *Naidoo* para 4.

<sup>119</sup> *Naidoo* para 12.

<sup>120</sup> *Naidoo* para 6.

example of the basis on which an action can be brought as well as a possible defence a defendant may rely upon if an indemnity waiver is in place.

In the aforementioned case,<sup>121</sup> the claim was brought against the company, being the Birchwood Hotel and that it was the company who was ordered to pay the proven damages.<sup>122</sup> The reason for this is that, as mentioned above,<sup>123</sup> the company has a separate legal personality and therefore the action was brought against the company directly.

The separate legal personality of a company does not allow a director or the board of directors to escape liability in instances where exceptional circumstances exist.<sup>124</sup> Should a director or the board of directors be found to be in breach of its director duties, the company may have a claim<sup>125</sup> against the individual director or the board of directors to the extent that they are found to be in breach of the director duties imposed on them in terms of the Companies Act.<sup>126</sup>

Where exceptional circumstances exist, there may be a second option available to a consumer being that it may have an opportunity to recover its damages directly from the director or board of directors instead of the company. Whilst the Companies Act does not specifically mention instances where a director or board of directors may be liable personally to a consumer, section 218 (2) of the Companies Act<sup>127</sup> states that any person who contravenes the Companies Act is liable to any other person for any loss or damages suffered by that person due to the contravention.<sup>128</sup> For purposes of this chapter 3, I am going to focus on the consumer's right of recovery from the company and not that of the director.

An example of the above bears reference to the case of *Naidoo v Birchwood Hotel*,<sup>129</sup> where the court held that property owners are required to ensure that their property does not pose any hazards to the public<sup>130</sup> and that the property should be well maintained and functioning properly at all times.<sup>131</sup> The duty to manage the business and affairs of the company is that

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<sup>121</sup> *Naidoo*.

<sup>122</sup> *Naidoo* para 54.

<sup>123</sup> *Op. Cit.* Footnote 106.

<sup>124</sup> See *Op. Cit.* Footnote 107 regarding the exceptional circumstances.

<sup>125</sup> Section 77 (2) (a) or (b) of the Companies Act 71 of 2008.

<sup>126</sup> Section 76 (3) of the Companies Act 71 of 2008.

<sup>127</sup> Section 218 (2) of the Companies Act 71 of 2008.

<sup>128</sup> Section 218 of the Companies Act 71 of 2008.

<sup>129</sup> *Naidoo*.

<sup>130</sup> *Naidoo* para 24.

<sup>131</sup> *Naidoo* para 25.

of the board of directors.<sup>132</sup> Therefore, if the board of directors or a director who had been allocated the duty to ensure the property was safe and well maintained (for example a “managing director”)<sup>133</sup> failed to carry out his/her duties in accordance with the director duties imposed on him, he/she may be personally liable to the plaintiff for the damages suffered by the plaintiff under section 218 of the Companies Act. The director’s personal liability to the plaintiff, or that of the board of directors, whichever may be applicable, would depend on whether the director or board of directors carried out the respective director duties imposed on it/him/her by the Companies Act.

*d) Conclusion*

As is seen above, a company, through its board of directors, has the authority to enter into contracts and/or indemnity waivers in its own name. A consumer may, if it has suffered damages due to the act or omissions of the company, institute action for the recovery of such damages against the company as the company has a separate legal personality to its board of directors and unless exceptional circumstances exist, the consumer will only be entitled to recover such damages from the company and not to the directors personally.

If a court deems an indemnity waiver to be enforceable, the company’s liability towards the consumer may be extinguished in full or partially. If the indemnity waiver is found to be unenforceable the company may be liable to the consumer for all quantified damages suffered by the consumer as a result of the conduct of the directors.

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<sup>132</sup> Section 66 (1) of the Companies Act 71 of 2008.

<sup>133</sup> Cassim et al *Contemporary Company Law* (2012) 2 ed Juta, chapter 10, 413.

#### 4) CHAPTER 4: MEASURES AVAILABLE TO COMPANIES TO LIMIT THEIR LIABILITY TO CONSUMERS WHERE WAIVERS ARE FOUND TO BE NOT ENFORCEABLE

##### a) *Introduction*

In this chapter I look at the measures that are available to the company in order to limit its liability to consumers, if it is found that the indemnity waiver implemented by the company is not enforceable. The first measure that I discuss in this chapter which is available to the company, is director insurance<sup>134</sup> in terms of section 78 of the Companies Act.<sup>135</sup> Where a company is unable to rely on such insurance as a result of the director failing to carry out the director duties imposed on him/her as director<sup>136</sup> or such insurance not being in place, then the next measure discussed is the availability to the company of an option to recover from the director, in the director's personal capacity, the losses the company suffered as a result of it being liable to a consumer in respect of the unenforceable indemnity waiver.

##### b) *Director insurance*

In terms of section 78 (5) of the Companies Act, a company may indemnify a director in respect of any liability arising during the time the director holds office. In terms of the section 78 (7) (b) of the Companies Act a company may procure director insurance<sup>137</sup> in order to protect the company against any contingencies, including any amount payable by the company to a director in accordance with indemnity provided in section 78 (5).<sup>138</sup> This section is limited in that if the director has not fulfilled his/her duties which are owing to the company in terms of the Companies Act, then such insurance cover may be void and a director or company may not have access to benefits thereof.<sup>139</sup> Should this happen, the company would not be able to call on the insurance to indemnify the director and or company and may have to resort to the next measure available to it (which would be to hold the director

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<sup>134</sup> Section 78 (7) (b) of the Companies Act 71 of 2008.

<sup>135</sup> Section 78 of the Companies Act 71 of 2008.

<sup>136</sup> These duties include the duty to act in good faith, for proper purpose, in the best interest of the company and in a manner which the reasonable person would have acted. These duties are discussed in more detail in this chapter four.

<sup>137</sup> Section 77 (7) (b) of the Companies Act 71 of 2008.

<sup>138</sup> Section 78 (7) (b) (ii) of the Companies Act 71 of 2008.

<sup>139</sup> Section 78 (2) of the Companies Act 71 of 2008.

personally liable for failing to fulfil the director duties imposed on him/her in his/her capacity as a director) in order for it not to absorb the damages that arose due to the failure of the director to comply with his/her director duties.

c) *Director duties and his/her liability to the Company.*

A director may be liable to the company in delict through the *aquilian* action (which has largely been codified in section 77 of the Companies Act), for breach of the statutory provisions within the Companies Act or for breach of contract if a contract existed between the company and director.<sup>140</sup> For the purposes of this research I will only be discussing the breach of a statutory provision of the Companies Act and shall exclude breach of contract.

Section 77 (2) of the Companies Act states that a director of a company may be held liable in accordance with the common law for any loss, damages or costs incurred by the company as a result of:

- i. The director failing to act in accordance with his/her fiduciary duties to act in good faith and/or in the best interest of the company.<sup>141</sup>
- ii. The director being liable in delict for failing to comply with his/her duty to have acted with the degree of care, skill and diligence that may be reasonably expect to be carried out by a person carrying out the same function and having the same general knowledge, skill and experience.<sup>142</sup>

Therefore, it is likely that should a director fail to act in accordance with the director duties imposed on him/her in terms of the Companies Act when either making the decision to implement an indemnity waiver or voting with the board of directors on whether the company shall implement the indemnity waiver, he/she may be held personally liable to the company for any losses or damages suffered by the company as a result of an unenforceable indemnity waiver.

In order to fully understand the company's right to recover damages from a director in the directors personal capacity, I will define: (aa) what a director is, (bb) a director's authority

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<sup>140</sup> Emmanuel Lekgau, *Fiduciary Duties of a Nominee Director* (unpublished, LLM dissertation, University of Pretoria, 2016), 32.

<sup>141</sup> Section 77 (2) (a) of the Companies Act 71 of 2008.

<sup>142</sup> Section 77 (2) (b) of the Companies Act 71 of 2008.

to act on behalf of a company, (cc) the director duties imposed on a director by the Companies Act<sup>143</sup> and (dd) to what extent a director may be personally liable to a company should it fail to carry out the director duties imposed.

*aa) The term “director” defined*

The term “director” is defined as a member of the board of directors of a company as contemplated in section 66 of the Companies Act and includes a person occupying the position of director or alternative director by whatever name designated.<sup>144</sup> Section 66 of the Companies Act recognises directors who are appointed in terms of the company’s Memorandum of Incorporation or by shareholders as well as *ex officio* directors,<sup>145</sup> alternative directors<sup>146</sup> and *de facto* directors.<sup>147</sup> For purposes of section 76 and section 77 of the Companies Act, the term “director” will also include prescribed officers and any person who is a member of a committee of the company.<sup>148</sup>

A prescribed officer is defined in Regulation 38 (1) of the Companies Act Regulations as any person who exercises general control and management over the business activities of the company or regularly participates to a marginal degree in the general executive control and management of the company.<sup>149</sup>

Therefore any person who is appointed as a director in terms of the Memorandum of Incorporation or by the shareholders, or falls within the definition of *ex officio* director, alternative director, *de facto* director, prescribed officer, or any person who is a member of the board of directors of the company, may be held personally liable to the company to the extent that he/she failed fulfil the director duties imposed on him/her.

*bb) The director’s authority to act on behalf of a company*

Except to the extent that the Companies Act or the company’s Memorandum of Incorporation provides otherwise, a company’s business and affairs must be managed by its

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<sup>143</sup> The Companies Act 71 of 2008.

<sup>144</sup> Section 1 of the Companies Act 71 of 2008.

<sup>145</sup> *Ex officio* directors are people who are directors as a consequence of the office they hold.

<sup>146</sup> Alternative directors are persons who serve as a director as and when an occasion occur.

<sup>147</sup> *De facto* directors are persons who are not formally appointed as directors however, they perform the function of a director and as such, they will be deemed to be *de facto* directors.

<sup>148</sup> Section 76 (1) and 77 (1) of the Companies Act 71 of 2008.

<sup>149</sup> Regulation 38 (1) of the Companies Act Regulations.



board of directors.<sup>150</sup> Directors are appointed by persons who are entitled to a vote in the director appointment process, these persons may be the incorporator/s of the company, the shareholders, a person named in the memorandum of incorporation or other stakeholders.<sup>151</sup> Unless otherwise provided for in the company's Memorandum of Incorporation, the appointment of a director is done by a series of votes and is confirmed by a resolution.<sup>152</sup>

Upon appointment, the board of directors will generally be tasked with managing the business affairs of the company<sup>153</sup> which may include the task of entering into contracts on behalf of the company. Individual directors do not have the authority to enter into contracts on behalf of the company unless this authority is specifically delegated to them by the board of directors.<sup>154</sup> The obligations of a director and the right of recourse a company may have against a director, which is highlighted in this research, would therefore be applicable to the individual director as well as the board of directors to the extent that the director/s are found to be in breach of the director duties imposed on a director in terms of the Companies Act. Section 77 (6) of the Companies Act<sup>155</sup> states that a person liable under section 77 of the Companies Act<sup>156</sup> is jointly and severally liable with any other person who is or may be liable for the same act. Therefore, the board of directors may be liable jointly and severally liable should they all be found to be in breach of the director duties imposed on a director in terms of the Companies Act when making a decision on behalf of a company.

*cc) The partial codification of the common law director duties*

Prior to the implementation of the Companies Act,<sup>157</sup> the common law and subsequent case law thereto, provided guidance on what was expected from directors with regards to their duties to a company. These duties have now been partially codified in the Companies Act and in order to understand the basis upon which the Companies Act was drafted, I will discuss the applicable common law in so far as it related to director duties.<sup>158</sup>

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<sup>150</sup> Section 66 of the Companies Act 71 of 2008.

<sup>151</sup> Cassim et al *Contemporary Company Law* (2012) 2 ed Juta, chapter 12, 423-425.

<sup>152</sup> Cassim et al *Contemporary Company Law* (2012) 2 ed Juta, chapter 12, 424.

<sup>153</sup> Section 66 of the Companies Act 71 of 2008.

<sup>154</sup> Deloitte: 'Duties of Directors' available at:

[https://www2.deloitte.com/content/dam/Deloitte/za/Documents/governance-risk-compliance/ZA\\_DutiesOfDirectors2013\\_16042014.pdf](https://www2.deloitte.com/content/dam/Deloitte/za/Documents/governance-risk-compliance/ZA_DutiesOfDirectors2013_16042014.pdf). (Last accessed on 11 August 2019).

<sup>155</sup> Section 77 (6) of the Companies Act 71 of 2008.

<sup>156</sup> Section 77 of the Companies Act 71 of 2008.

<sup>157</sup> The Companies Act 71 of 2008.

<sup>158</sup> Itumeleng Lesofe, *Implications of the Partial Codification of the Director's Duties under the New Companies Act* (unpublished LLM dissertation, University of Pretoria, 2015), 26.

The purpose of such partial codification was to create clear guidelines on what the director's duties are and to have such guidance accessible, particularly to directors. The partial codification also raised the standards of corporate governance and offers protection to companies and its shareholders as now both the company and the directors are aware of what duties are placed on a director.<sup>159</sup>

The Companies Act does not stand to replace the common law but to run parallel with it and to the extent that the common law does not conflict with the Companies Act, it shall still be applicable.<sup>160</sup>

*dd) Duties imposed on a director*

In terms of the common law there are two sets of duties imposed on a director, the fiduciary duties<sup>161</sup> and the non-fiduciaries duties.<sup>162</sup> The fiduciary duties comprise of the primary duty to act in good faith, which is a subjective overarching duty requiring the director to act honestly whilst carrying out his/her powers as director.<sup>163</sup> The fiduciary duties have been partially codified in section 76 (3) (a) and (b) of the Companies Act. The non-fiduciary duty comprises of the duty to act as a reasonable person and has been partially codified in section 76 (3) (c) of the Companies Act.<sup>164</sup> Section 76 (3) is cited below for ease of reference:

*'76.3 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 proper purpose;*

*(b) In the best interest of the company;*

*(c) With the degree of care, skill and diligence reasonably expected of a person-*

*i. carrying out the same functions in relation to the company as those carried out by that director*

*ii. having the general knowledge, skill and experience of that director.*<sup>165</sup>

Another notable consideration is the introduction of the business judgement rule which is a concept that originated in the United States of America which deals with the decision making

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<sup>159</sup> Cassim et al *Contemporary Company Law* (2012) 2 ed Juta, chapter 12, 507-508.

<sup>160</sup> Delport P *New Entrepreneurial Law* (2014) 1 ed LexisNexis, chapter 6, 140.

<sup>161</sup> Cassim et al *Contemporary Company Law* (2012) 2 ed Juta, chapter 12, 509.

<sup>162</sup> Cassim et al *Contemporary Company Law* (2012) 2 ed Juta, chapter 12, 509.

<sup>163</sup> Delport P *New Entrepreneurial Law* (2014) 1 ed LexisNexis, chapter 6, 141.

<sup>164</sup> Coetsee L 'Advantages and disadvantages of partial codification of directors duties in South African Companies Act, 71 of 2008' *Journal for Judicial Services*, (2016) 41 (2) 10.

<sup>165</sup> Section 76 (3) (c) of the Companies Act 71 of 2008.

process of directors and prevents a court from interfering with the honest and reasonable business decisions of directors.<sup>166</sup> The business judgement rule has since been incorporated into the Companies Act under section 76 (4) and acts as an aid for directors where it has been alleged that such director has breached his/her duty to act in the best interest of the company in accordance with section 76 (3) (b) or with reasonable diligence and care when performing his/her duties as director in accordance with section 76 (3) (c). Note that this section 76 (4) is set out below with reference to only section 76 (3) (b) and section 76 (3) (c) of the Companies Act as it does not apply to the duty to act in good faith or with proper purpose as required in terms of section 76 (3) (a) of the Companies Act.<sup>167</sup>

The director duties in terms of the Companies Act and the common law influences, as well as the codification of the business judgement rule are set out below in order to fully understand when a director would be in breach of his/her duties owing to the company and thus possibly liable to the company for any losses the company suffers in regards to such breach.

### **Fiduciary Duties: Section 76 (3) (a) and the common law:**

Section 76 (3) (a) of the Companies Act requires a director to perform his/her functions and exercise his/her powers in good faith and for proper purpose. This section codifies the common law duties imposed on a director to act in good faith which is the overarching duty from which the duty to act for proper purpose, in the interest of the company, with independent judgment, and to avoid a conflict of interest, flow.<sup>168</sup> Should a director subjectively act in good faith but objectively breach one of the subsequent duties, whether in common law or in terms of the Companies Act, he/she may be found to be in breach of the duty to act in good faith.<sup>169</sup>

The common law legal principle to determine whether a director complied with his/her fiduciary duty of good faith was established in the English case of *RE Smith & Fawcett Ltd*,<sup>170</sup> being that a director must have acted in good faith and in a manner which he/she believed

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<sup>166</sup> Cassim et al, *Contemporary Company Law* (2012) 2 ed Juta, chapter 12, 563.

<sup>167</sup> Section 76 (a) of the Companies Act 71 of 2008.

<sup>168</sup> Cassim et al, *Contemporary Company Law* (2012) 2 ed Juta, 523.

<sup>169</sup> Delpont P, *New Entrepreneurial Law* (2014) 1 ed LexisNexis, chapter 6, 140.

<sup>170</sup> *RE Smith & Fawcett Ltd* [1942] CH 304 at 306. Available at: <https://publications.parliament.uk/pa/ld199900/ldjudgmt/jd000720/equite-1htm> (Last accessed 10 February 2020) and <https://swarb.co.uk/in-re-smith-and-fawcett-ltd-ca-1942/> (Last accessed 07 May 2019).

to be in the best interest of the company and not what the court would deem to be in the best interest of the company. There are however limits to this subjective test, being that there must have been a rational basis upon which the director relied upon when making the decision.<sup>171</sup> This principle was later confirmed in the South African case of *Visser Citrus (Pty) Ltd v Goede Hoop Citrus (Pty) Ltd and Others*,<sup>172</sup> where the court had to consider whether the director had acted in good faith, in accordance with section 76 (3) (a) of the Companies Act. The court confirmed that the test to determine whether a director acted in good faith was whether the director, after taking reasonable and diligent steps to become informed, subjectively believed that his/her decision was in the best interest of the company and such belief had a rational basis.<sup>173</sup>

The second requirement of section 76 (3) (a) is that a director must act for proper purpose, the Companies Act does not however define proper purpose. In the case of *Visser Citrus (Pty) Ltd v Goede Hoop Citrus (Pty) Ltd and Others* the court held that the test to determine “proper purpose” in terms of section 76 (3) (a) of the Companies Act was objective in that one had to ascertain the actual purpose of the power exercised and one must then determine whether the actual purpose falls within the purpose for which the power was conferred.<sup>174</sup>

Therefore, when one considers section 76 (3) of the Companies Act in respect of a director who has implemented an indemnity waiver on behalf of a company or has voted in favour of such implementation,<sup>175</sup> one would need to consider whether the director took reasonable steps to become informed about the enforceability of an indemnity waiver under the circumstances and whether the director had a rational basis upon which he/she believed that the enforcement of the indemnity waiver was in the best interest of the company. In addition to this one would also need to consider whether the director’s actions are aligned to the purpose for which the powers were conferred on him/her, and if it is found that the director did not act in accordance with the “proper purpose” requirement, a director may be in breach of his/her fiduciary duty to the company.

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<sup>171</sup> Cassim et al, *Contemporary Company Law* (2012) 2 ed Juta, 524.

<sup>172</sup> *Visser Citrus (Pty) Ltd v Goede Hoop Citrus (Pty) Ltd and Others* (15854/2013) [2014] ZAWCHC 95;

<sup>173</sup> *Visser* para 74.

<sup>174</sup> *Visser* para 80.

<sup>175</sup> A director may implement an indemnity waiver by having the board of directors authorise: (i) an indemnity notice to be displayed on company property, (ii) an indemnity provisions in a contract, or (iii) an indemnity provision on the back of a card which is received by third parties on entry to the company premises. If the director is already provided with the necessary authority to make such decisions on behalf of the board, he/she will not have to seek authorisation from the board prior to implementation.

### **Fiduciary Duties: Section 76 (3) (b) and the common law:**

In terms of section 76 (3) (b) a director is required to act in the best interest of the company. A director would be deemed to have fulfilled his duty in this regard if he/she complied with the provisions of section 76 (4) (a), being:

- i. the director took reasonable steps to become informed about the matter;
- ii. the director did not have a personal material or financial interest in the matter; and
- iii. the director has a rational basis for believing that the decision made was in the best interest of the company.

The duty to take reasonable diligent steps to become informed about indemnity waivers and having a rational basis upon which the director believed that the implementation of an indemnity waiver is in the best interest of the company, have already been discussed above with regards to the duty to act in good faith. The duties imposed on a director do not exist independently from each other and as such, the requirements for each duty may overlap.<sup>176</sup>

Whilst a director will have to consider what is in the best interest of the company (and that of the shareholders and external stakeholders) he/she must take caution to do so independently and not on an instruction from such shareholders or external stakeholders.

The duty to exercise independent judgment was a requirement of common law as confirmed in the case of *Fisheries Development Corporation of SA v AWJ Investments*,<sup>177</sup> where the court held that the basic principle was that it is the director's duty to exercise an independent judgement and to take decisions in the best interest of the company.<sup>178</sup> A director must therefore exercise his/her powers with independent discretion in the best interest of the company and must not allow himself/herself to be used as a "puppet" by shareholders. The reason for this is to allow directors to consider the affairs of the company in an objective and unbiased manner.<sup>179</sup> This duty is not specifically set out in the Companies Act, however it is seen by some commentators as a requirement of the duty to act in good faith and as such, is

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<sup>176</sup> Delport P, *New Entrepreneurial Law* (2014) 1 ed LexisNexis, chapter 6, 140.

<sup>177</sup> *Fisheries Development Corporation of SA v AWJ Investments* 1980 (4) SA 156 (W) 163.

<sup>178</sup> Cassim et al, *Contemporary Company Law* (2012) 2 ed Juta, 527.

<sup>179</sup> Cassim et al, *Contemporary Company Law* (2012) 2 ed Juta, 528.

still applicable.<sup>180</sup>

### **Non-Fiduciary Duties: Section 76 (3) (c) and the common law:**

In addition to the fiduciary duties set out above, a director also has a duty to exercise reasonable care and skill which is a non-fiduciary duty. This non-fiduciary duty was established in common law and is now partially codified in terms of section 76 (3) (c) of the Companies Act.<sup>181</sup> In terms of the common law, the cause of action for breach of the duty to exercise reasonable care and skill is based on the *aquilian* or delictual action as the director would be seen to be negligent if he/she failed to comply with his duty of care and skill.<sup>182</sup> In order for an action for *aquilian* or delictual liability to succeed the elements of delict needs to be present.<sup>183</sup>

Based on the precedent set<sup>184</sup> in *Fisheries Development Corporation of SA v AWJ Investments*,<sup>185</sup> in order for a court to determine if the director acted with the necessary care and skill at common law, it would need to consider a dual test which comprises of a subjective test, being that the court would need to consider the director's skill, experience and ability and determine if he/she acted with the necessary skill under the circumstances and then the objective test where the court would need to consider whether a "reasonable person" (with the same skill, experience and ability under the same circumstances) would have acted with the same level of care.<sup>186</sup>

The common law position was critiqued for being out dated and not applicable in our modern world.<sup>187</sup> Therefore the Companies Act, whilst still maintaining a subjective approach, as it takes into consideration what the director's general knowledge, skill and experience, offers a more objective test where the director will be measured against a person who would perform the same functions as the director in the company. The comparison to a person

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<sup>180</sup> Cassim et al, *Contemporary Company Law* (2012) 2 ed Juta, 529.

<sup>181</sup> Emmanuel Lekgau, *Fiduciary Duties of a Nominee Director* (unpublished, LLM dissertation, University of Pretoria, 2016), 17.

<sup>182</sup> Cassim et al *Contemporary Company Law* (2012) 2 ed Juta, chapter 12, 554.

<sup>183</sup> *See Op. Cit.* Footnote 112 regarding the elements of the *aquilian* action.

<sup>184</sup> The test for negligence was established in the case of *Fisheries Development Corporation of SA v AWJ Investments* where the court followed the decision held in the English case *Re City Equitable Fire Insurance Co Ltd*, the test being that a director is required to use the degree of care that an ordinary man might be expected to take in the circumstances and the ordinary person against which the director will be measured must exhibit the same skill and knowledge as the director. Therefore, a director is only expected to display the level of care and skill they are capable of.

<sup>185</sup> *Fisheries Development Corporation of SA v AWJ Investments* 1980 (4) SA 156 (W).

<sup>186</sup> Cassim et al *Contemporary Company Law* (2012) 2 ed Juta, chapter 12, 555-156.

<sup>187</sup> Cassim *Contemporary Company Law* (2012) 2 ed Juta, chapter 12, 558.

performing the same function, with the same expected general knowledge, skill and experience as the director, allows for an executive director to be accountable at an executive director level and a non-executive director to be held accountable at a non-executive level.<sup>188</sup>

Therefore in order to determine if a director has complied with his/her duty in terms of section 76 (3) (c), one would need to determine whether the director acted with the level of care, skill and diligence that would be expected from a reasonable person performing the same function as the director. Section 76 (3) (c) requires the reasonable person to be a person with the same general knowledge, skill and experience as expected of the director in question. For example, if the director is an attorney with 10 years' experience in contract law, it would be expected that a person with that level of experience would most likely be aware of what constitutes an enforceable indemnity waiver. This would have an impact on determining whether a director with 10 years of experience in contract law should have been aware of what constitutes an enforceable indemnity waiver and if he/she should have avoided or advised the board of directors to avoid the implementation of an indemnity waiver which would have been unenforceable.

In terms of section 76 (4) a director would be deemed to have fulfilled his duty in terms of section 76 (3) (c) if he/she complied with the provisions of section 76 (4) (a), being:

- i. the director took reasonable steps to become informed about the matter;
- ii. the director did not have a personal material or financial interest in the matter; and
- iii. the director has a rational basis for believing that the decision made was in the best interest of the company.

*ee) Codification of the Business Judgement Rule*

As mentioned above, the business judgement rule has been partially codified in section 76 (4) of the Companies Act. If it is alleged that a director acted in a manner that was not in the best interest of the company or that he/she lacked the necessary care, skill and diligence when implementing an indemnity waiver, in order for a director to rely on section 76 (4), he/she would have to show that:

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<sup>188</sup> Cassim *Contemporary Company Law* (2012) 2 ed Juta, chapter 12, 559.

- i. he/she made an informed decision to implement or vote in favour of implementing the indemnity waiver;<sup>189</sup>
- ii. he/she did not have a material or financial interest in the decision made to implement the indemnity waiver and if he/she had, it was appropriately disclosed in accordance with the relevant provisions of the Companies Act;<sup>190</sup> and
- iii. he/she has a rational basis upon which he/she believed the decision to implement the indemnity waiver was in the best interest of the company.<sup>191</sup>

*ff) Case study – English law*

Currently there is no case law in South Africa which speaks specifically to a director being liable to its company under section 77 (2) of the Companies Act in respect of indemnity waivers. Section 5(2) of the Companies Act 2008 does however state that to the extent appropriate, a court interpreting or applying the provisions therein, may consider foreign law. Therefore, the below case may have relevance to the topic of this research in that it shows a United Kingdom High Court's view's on whether a director who knew its actions were not in good faith or in the best interest of the company, would be personally liable for the damages suffered by the company.

In the English case of *Antuzis & Ors -v- DJ Houghton Catching Services Ltd & Ors*,<sup>192</sup> the court had to decide whether the director and company secretary of the company, who may have been in breach of their statutory duties to the company under the United Kingdom's Companies Act,<sup>193</sup> could be held personally liable for damages caused by the them for allowing the company to be in breach of contract.

The Court had to consider certain sections of the Companies Act, 2006, being section 172<sup>194</sup>

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<sup>189</sup> Section 76 (4) (a) (i) of the Companies Act 71 of 2008.

<sup>190</sup> Section 76 (4) (a) (ii) of the Companies Act 71 of 2008.

<sup>191</sup> Emmanuel Lekgau, *Fiduciary Duties of a Nominee Director* (unpublished, LLM dissertation, University of Pretoria, 2016), 37.

<sup>192</sup> *Antuzis & Ors -v- DJ Houghton Catching Services Ltd & Ors* [2019] EWHC 843.

<sup>193</sup> The Companies Act 2006, enacted by the Parliament of the United Kingdom (hereinafter referred to as "the Companies Act 2006")

<sup>194</sup> Section 172 of the Companies Act 2006: Section 172 (duty to promote the success of the company), so far as relevant, provides as follows:- "(1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to -(a) the likely consequences of any decision in the long term, (b) the interests of the company's employees,(d) the impact of the company's operations on the community and



which states that a director of a company must act in ways he considers in good faith and would most likely promote the success and benefit of the company and its members and section 174,<sup>195</sup> which states that a director must exercise reasonable care, skill and diligence of a person with the same general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company, and the general knowledge, skill and experience that the director has. You will note that these sections are similar to section 76 (3) of the South African Companies Act.<sup>196</sup>

In this case the claimants were Lithuanian nationals and the defendants were DJ Houghton Catching Services Limited (“the company”), Jacqueline Judge, the sole director of the Company (“the director”) and Darrell Houghton the Company Secretary of the Company (“company secretary”).

The Claimants were employed by the Company as chicken catchers whose employment conditions were exploitative. For example, the Company paid less than the statutory minimum wage<sup>197</sup> and refused to pay them holiday pay<sup>198</sup> and in some instances withheld payment as a form of punishment.<sup>199</sup>

The High Court held that the director and company secretary were not acting *bona fides* or reasonable in relation to the company because they knew that they were not paying the minimum wage and they knew that they were not entitled to withhold the claimants wages or holiday payments and by doing so they induced the company to commit a statutory breach of the claimants employment contracts.<sup>200</sup> The court further held that the director and company secretary did not act in the best interest of the company as they did not hold a honest belief that what they were doing would not result in such breach and as such, they were held personally liable for inducing the company to breach the employment contracts

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the environment (e) the desirability of the company maintaining a reputation for high standards of business conduct, and

<sup>195</sup> Section 174 of the Companies Act 2006: Section 174 (Duty to exercise reasonable care, skill and diligence) provides: - "(1) A director of a company must exercise reasonable care, skill and diligence. (2) This means the care, skill and diligence that would be exercised by a reasonably diligent person with—(a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company, and (b) the general knowledge, skill and experience that the director has."

<sup>196</sup> Section 172 and 174 of the Companies Act, 2006 are similar to section 76 of the Companies Act, 2008 as these sections require a director to act in good faith, in the best interest of the company and in a manner expected of a reasonable person.

<sup>197</sup> *Antuzis* para 85.

<sup>198</sup> *Antuzis* para 101.

<sup>199</sup> *Antuzis* para 91.

<sup>200</sup> *Antuzis* para 125.

that the company had with the claimants.<sup>201</sup>

Whilst this case is not specific to an unenforceable indemnity waiver, it does show that in giving due consideration to the Companies Act 2006, which is similar to the South African Companies Act 2008, a United Kingdom High Court held a director liable for the damages incurred by the company for breach of contract where the director and company secretary acted against the duty to act in good faith and the duty to act in the best interest of the company.

*d) Conclusion*

Should it be alleged that a director has failed to comply with the duties imposed on him/her in terms of section 76 (3) of the Companies Act when implementing an indemnity waiver, a director will have to show that he/she acted in good faith, for proper purpose and in the best interest of the company. In addition to this he/she would also have to show that his/her actions were done with the reasonable care, skill and diligence expected of a person who performs the same functions as the director in the company, having the same general knowledge, skill and experience.<sup>202</sup> Should a director fail to show this, he/she may be held personally liable to the company in terms of section 77 (2) of the Companies Act.

Whilst the Companies Act does provide some measures in the form director insurance, this measures will not be available to the company if the director is found to have acted or omitted to act and such action or omission constitutes wilful misconduct or a wilful breach of trust on the part of the director. The measure will also not be available if the measure purports to relieve the director of a director duty in terms of section 76 of the Companies Act or relieves the director of any liability contemplated in section 77 of the Companies Act.<sup>203</sup> Should this be the case then the next measure available to the company would be to hold the director/s personally liable for any losses suffered by the company.<sup>204</sup>

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<sup>201</sup> *Antuzis* para 132.

<sup>202</sup> Section 76 (3) of the Companies Act 71 of 2008.

<sup>203</sup> Section 78 (2) of the Companies Act 71 of 2008

<sup>204</sup> Section 77 (2) of the Companies Act 71 of 2008.

## 5) CHAPTER 5: CONCLUSION

### *a. The focus of the study*

The focus of this study was to determine:

- i. what constitutes an unenforceable indemnity waiver;
- ii. the liability (if any) of a company and director to a third party where the indemnity waiver is found to be unenforceable;
- iii. the measures available to a company to protect it from the decisions made by its directors, thus being to implement an unenforceable indemnity waiver;
- iv. to determine the liability (if any) of directors who failed to ensure that indemnity waivers that they put into place are enforceable and if so, if they may be liable in their personal capacity to the company for failing to carry out such a duty and the extent of such liability thereto.

The purpose of determining the above was to assist companies, consumer and director/s understand their rights and obligations towards each other when engaging in business relations with one another, in particular where indemnity waivers are concerned.

### *b. The outcome*

#### *aa) The enforceability of indemnity waivers*

As I mention in Chapter 2, whether the Consumer Protection Act or common law applies to indemnity waivers, the following general principles remain the same:

- i. If an indemnity waiver is deemed to be against public policy, which is determined by a court by establishing whether the clause is consistent with the Bill of Rights as set out in the Constitution, then it is likely to be unenforceable.
- ii. In the event where an indemnity waiver excludes the company's liability for bodily injury or death caused negligently by the company, it shall be deemed unreasonable, unjust and unfair unless a company is able to persuade a court otherwise. If an indemnity waiver is deemed to be unreasonable, unjust or unfair it will be deemed to be against public policy and will likely be unenforceable.
- iii. In order for it to be deemed that *quasi* mutual consent existed between the consumer

and the company, the indemnity waiver must have been brought to the consumers attention in unequivocal and clear terms. If a company fails to do this, it is likely that the indemnity waiver will be unenforceable.

- iv. The indemnity waiver must not undermine the nature of the contract entered into between the parties as this may be seen by the courts as one or both of the parties lacking the necessary autonomy to enter into an agreement freely and voluntarily and thus such an indemnity waiver may be unenforceable.

The enforceability of an indemnity waiver would need to be decided on a case by case basis however, the instances where indemnity waivers are likely to be found to be unenforceable, as documented herein, are a guideline to companies and directors as to what to consider when implementing indemnity waivers.

*bb) The liability of a company to third parties (consumers)*

Where a consumer brings a claim against a company for damages that arose as result of the relationship between the company and consumer and the company is proven to have been negligent or at fault, the company would not be able to raise the indemnity waiver as a defence if such indemnity waiver is found to be unenforceable. As I mention in Chapter 3, a company has a separate legal personality to its directors and as such, unless exceptional circumstances exist, where a consumer brings such a claim it will need to be brought against the company. If exceptional circumstances do exist, for example where it is found that a director failed to comply with the director duties imposed on him/her in his/her capacity as director, a consumer may be entitled under section 218 of the Companies Act, to bring a claim directly against a director and hold the director personally liable for the damages suffered by the consumer as a result of the director contravening the Companies Act.

*cc) Measures available to a company*

Where a company is found to be liable to a consumer as referred to above, there are certain measures which offers it protection against such liability. In terms of section 78 of the Companies Act, the company may procure director insurance against certain liabilities that that may arise. This insurance may be limited if a director has been found to be in breach of the duties imposed on him/her in terms of section 76 of the Companies Act.

Should the company be unable to call on the director insurance, it may, in order to recover

its losses, hold the director personally liable, or the board of directors jointly and severally liable if it is shown that such director/s failed to carry out the duties imposed on them in terms of section 76 of the Companies Act.

In order to determine whether a director or the board of directors have fulfilled its duties in terms of the Companies Act one needs to consider whether, when exercising its powers or performing its functions as director or the board of directors, the directors acted in good faith and for proper purpose, in the best interest of the company and with the reasonable care, skill and diligence of a person carrying out the same functions as the director within the company and who has the same general knowledge, skill and experience as the director in question.

*c) Summary*

In summary, whilst indemnity waivers serve a good purpose, being to limit the companies expose to liability and as such, assist in ensuring the ongoing sustainability of the company, such indemnity waivers are required to meet certain requirements before they will be accepted as enforceable. Should an indemnity waiver not be enforceable it may lead to a company being liable to a third party for any damages suffered by that third party as a result of the company's acts or omissions during the business engagements.

It was shown in this study that in order for a company to avoid liability against third parties (consumers) and/or a director or board of directors to avoid personal liability in respect of damages suffered by a company as a result of indemnity waiver being unenforceable the following is recommended:

- i. A director and/or the board of directors must take reasonable diligent steps to become informed about the enforceability of indemnity waivers.
- ii. A director and/or the board of directors must comply with their duties in effecting or implementing indemnity waivers. They should act in good faith, for proper purpose, and in the best interest of the company. It is further recommended that a director takes the following precautions when implementing an indemnity waiver:
  - ensures that the indemnity waiver is consistent with the Bill of Rights and is in line with public policy;
  - where the indemnity waiver indemnifies the company against bodily injury or death caused by the company negligence, the director should ensure that the

reasons for such a provision are valid, fair and reasonable and he/she should keep a written record of these reasons in case he/she or any succeeding director needs to explain the reasoning at a later stage;

- the director of the company should put processes in place to ensure that the indemnity waiver is brought to the customers attention and that a written record of this is kept;
- iii. Companies should have measures in place in cases where their indemnity waivers are unenforceable. These measures include:
- the procurement of director insurance by the company which protects the company against the liability that arose due to the decisions made by the director/s or
  - holding directors personally liable for the decision they make on behalf of a company where it is found that the director/s failed to carry out the decision in accordance with the director duties imposed by him/her in terms of the common law and the Companies Act.

This study addresses the above points and assists companies, third parties and director/s understand their rights and obligations towards each other when engaging in business relations with one another.

## ABBREVIATIONS

<b>CC</b>	Constitutional Court
<b>GSJ</b>	Gauteng High Court, Johannesburg
<b>MERC</b>	Mercantile Law Journal (SA Tydskrif vire Handelsreg)
<b>PERJ</b>	Potchefstroom Electronic Law Journal
<b>SALJ</b>	South African Law Journal
<b>SCA/ ZASCA</b>	Supreme Court of Appeal
<b>ZAWCHC</b>	South Africa: Western Cape High Court

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<i>Barkhuizen v Napier</i> 2007 (7) BCLR 691 (CC) 135.	<i>Barkhuizen</i>

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<i>Mercurius Motors v Lopez</i> (2008) (3) SA 572(SCA).	<i>Mercurius</i>
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<i>Re City Equitable Fire Insurance Co Ltd</i> [1925] CH 407. (United Kingdom)	<i>Re City Equitable Fire</i>
<i>Re Smith &amp; Fawcett Ltd</i> [1942] CH 304 at 306. (United Kingdom)	<i>Re Smith</i>
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