

# **“NO CONFLICT” DUTY OF COMPANY DIRECTORS**

**BY**

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## CHAPTER 1

### 1.1 INTRODUCTION

Company directors play critical roles not only in the commercial life of their companies but also in the overall economic wellbeing of whole nations. As members of the board of directors, they are the think-tanks of their companies and are entrusted with directing the company's decision-making process as well as overseeing the management of companies.

It is now settled law that directors owe fiduciary duties to companies in whose boards they serve. The Companies Act<sup>1</sup> has extended the directors' fiduciary duties and the duty of care and skill to subsidiary companies as well.<sup>2</sup> Breaches of duties by directors have become a major concern in South African corporate law. Even more disturbing, is the realisation that many directors in South Africa appear to have a very limited understanding of their fiduciary duties and their duty of care and skill. This leads to inadvertent breaches of duties by directors owing to insufficient knowledge of what the law requires of them. Apart from this problem, greed for riches appears to be the main driving force behind directors' breach of duties in general (the "no-conflict" duty in particular).

These problems in corporate law motivated me to undertake this research in order to gain a better understanding of what the law requires in as far as directors' duties are concerned. The intention of this research is to ascertain and extract general legal principles that regulate directors' conduct.

The research has a specific focus on the "no-conflict of interest" duty of company directors. Chapter 1 deals with the concept of "company director" as well as directors' duties. Chapter 2 covers the "no-conflict" duty in detail. Chapter 3 discusses directors' liability for breach of fiduciary duties as well as liability for breach of the duty of care and skill. Chapter 4 is the comparative law section. In this chapter, I discuss some legal provisions from the United Kingdom (UK) Companies Act of 2006 which may clarify identified uncertainties in our law. Chapter 5 concludes the research. Here, recommendations for the improvement of South African law will be made if any.

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<sup>1</sup> Companies Act 71 of 2008

<sup>2</sup> See section 76(2)(a)

## 1.2 THE CONCEPT OF “COMPANY DIRECTOR”

### 1.2.1 Common Law

At common law a person's appointment as director is complete on his appointment to the office by those having the authority to do so and his acceptance or consent to such appointment.<sup>3</sup> This is the formal method by which a person can become a director of a company. It is apparent that a positive act by some organ of the company is required here to effect the appointment.<sup>4</sup> This positive act may be the voting by members to appoint a person a director or the co-opting of a new director by existing directors of the company. Directors falling under this category are referred to as *de jure* directors. An alternate director<sup>5</sup> may be classified under this category as well. The reason for this view is that an alternate director can only be nominated by a *de jure* director or by the board. Secondly, the said nomination must be permitted by the constitution of the company.

The articles of association of a company may authorise a class of shareholders, debenture holders or an institutional creditor to appoint a director. Such authorisation may also be contained in the shareholders' agreement. Directors who are appointed in this manner are referred to as nominee directors. A director is in that capacity [nominee] not the servant or agent of the shareholder who votes for or otherwise procures his appointment to the board.<sup>6</sup> He must exercise independent judgment.

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<sup>3</sup> HS Cilliers *et al Corporate Law 3<sup>rd</sup> ed* (2000) 118, and authorities cited there.

<sup>4</sup> See, in general N Grier *UK Company Law* (1998) 344

<sup>5</sup> An alternate director is a person who only acts temporarily on behalf of a director who has nominated the alternative to act on the board in the absence of the nominator.

<sup>6</sup> *Fisheries Development Corporation of SA Ltd v Jorgensen* 1980 (4) SA 156 (W) at 163

In direct contrast to the formal method, the informal methods by which a person can become a director require no positive act by any organ of the company. A case in point here is a *de facto* director.<sup>7</sup> *De facto* directors are, legally speaking, not directors, although they are treated as directors. There is no consensus among legal commentators on the question of whether or not fiduciary duties should be imposed on *defacto* directors.<sup>8</sup> The better view is that a *defacto* director has placed himself in a fiduciary position and, therefore, should bear the consequences and responsibilities of that position.<sup>9</sup> Thus both *de jure* and *de facto* directors occupy a fiduciary position towards the company. Idensohn,<sup>10</sup> mentions a convincing argument by Noonan and Watson regarding the fiduciary position of *de facto* directors. They argue that *de facto* directors willingly assume the position, functions and appearance of properly appointed *de jure* directors. Treating them in the same way as *de jure* directors gives effect to substantive reality and brings form into line with function. I support this view.

Puppet directors and shadow directors have no legal recognition in South African law. In *SvShaban*,<sup>11</sup> the court stated that our law does not know the complete puppet who pretends to take part in the management of a company whilst having no idea what it is to which he puts his signature. Such conduct is punishable as fraud.<sup>12</sup>

A director qua director is not an employee of the company with the result that he has no right to the ordinary benefits of employees and is not entitled to the usual rights flowing from a contract of service.<sup>13</sup> The fact that a person is appointed as a director does not *ipso facto* entitle him to claim remuneration.<sup>14</sup> A director may enter into a service contract with his company, which contract, entitles him to a salary or other remuneration. In the capacity of an employee of the company, he must carry out the instructions of the company's board of directors. In his capacity as a director, he is a member of the board of directors of that company.

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<sup>7</sup> A *defacto* director is a person who claims to act and purports to act as a director, without having been so appointed either validly or at all [Re *Hydrodam (Corby) Ltd* [1994] BCC 161 at 162-163]

<sup>8</sup> For a detailed exposition, see Michele Havenga *Fiduciary Duties of Company Directors with Specific regard to corporate opportunities* [LLD thesis, University of South Africa (1995)] 307-309

<sup>9</sup> *ibid*

<sup>10</sup> K Idensohn "The Regulation of Shadow Directors" (2010) 22 *SA Merc LJ* 326 – 339 at 335

<sup>11</sup> *S v Shaban* 1965 (4) SA 646 (W) at 651-652

<sup>12</sup> *ibid*

<sup>13</sup> *ibid*

<sup>14</sup> HS Cilliers *et al Corporate Law* 3<sup>rd</sup>ed (2000) 138

## 1.2.2 Companies Act 71 of 2008

The concept 'director' as defined in the Companies Act 71 of 2008, means a member of the board of a company, as contemplated in section 66, or an alternate director of a company and includes any person occupying the position of a director or alternate director, by whatever name designated.<sup>15</sup> The phrase, "includes any person occupying the position of a director or alternate director, by whatever name designated" may be interpreted as being intended merely to cover the situation where management of a company is conducted by persons described as say, governors or managers rather than directors.<sup>16</sup> The term 'director' as envisaged in section 66 refers to: (a) persons who become directors as a result of a positive act by some organ of the company to appoint the person as a director. (b) persons who become directors pursuant to a direct appointment by any person who is named in or determined in terms of, the Memorandum of Incorporation.<sup>17</sup> (c) *ex-officio* directors and those who act in that capacity.<sup>18</sup>

A person becomes entitled to serve as a director of a company when he has delivered to the company a written consent to serve as its director.<sup>19</sup>

For purposes of section 69 of the Act, director' includes an alternate director, and –

(a) a prescribed officer; or

(b) a person who is a member of committee of a board of a company, or of the audit committee of a company. It may be argued that this definition of "director" in section 69 materially differs from the definition of 'director' in section 1 of the Act. The definition in section 1 does not expressly include prescribed officers and members of a committee of a board of the company. A board committee (except an audit committee) may include persons who are not directors of the company.<sup>20</sup> This shows that the meaning of 'director' is to be derived from the words of the Act as a whole and varies according to the context in which it is found. Clearly, the definition of 'director' in section 1 is not exhaustive.

<sup>15</sup> Section 1

<sup>16</sup> AJ Boyle *et al Boyle & Birds' Company Law* 7<sup>th</sup> ed. (2009) 540 [on a similar provision of the UK Companies Act 2006]

<sup>17</sup> Section 66 (4) (a) (i)

<sup>18</sup> Section 66 (4) (a) (ii) read together with section 66 (5) (b) [see section 1 for the definition of "*ex-officio director*"]

<sup>19</sup> Section 66 (7) (b)

<sup>20</sup> See section 69(1); section 72 (2) and section 77 (1) (b)

The concept of 'director' under the Companies Act is wider than the Common law concept of director. Persons who were not regarded as directors at common law [prescribed officers] are now deemed to be directors for the purposes of the Act. Prescribed officers are deemed to be directors by various provisions which are scattered throughout the Act.<sup>21</sup> A person is a 'prescribed officer' of the company for all purposes of the Act if that person-<sup>22</sup>

(a) exercises general executive control over and management of the whole, or a significant portion, of the business and activities of the company, or (b) regularly participates to a material degree in the exercise of general executive control over and management of the whole, or a significant portion, of the business and activities of the company.

From the above provisions, It is worth noting that the definition of 'prescribed officer' is restricted to persons who perform, designated functions within the company and therefore excludes shadow directors because they are not operating within the company but "lurk in the shadows and pull the strings".

Incorporators of a company are also regarded as directors. Each incorporator of a company is a first director of the company, and serves until sufficient other directors to satisfy the minimum requirements of the Act are first appointed or nominated.<sup>23</sup> As directors of a company, incorporators owe fiduciary duties and the duty of care and skill to the company just like other directors. The fact that they are incorporators does not in any way, make their duties less onerous.

It is unclear whether the term 'director', as defined in the Act, encompasses the concept of 'shadow director'. Cassim argues that, even though the Act does not explicitly define the concept of a shadow director, the definition of a 'director' in section 1 of the Act is wide enough to include a shadow director because of the phrase 'occupying the position of a director'.<sup>24</sup> I respectfully disagree. As already discussed above, this phrase may be construed as being intended merely to cover those directors who were formally appointed to the positions of directors (including those whose appointment is legally defective) but who are called by other names by the company (eg governors). That said, one can argue that shadow directors are not included.

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<sup>21</sup> See generally section 69 (1) ; section 75 (1); section 76 (1); section 77 (1) and section 78 (1)

<sup>22</sup> Regulation 38 (1) of the Companies Regulations 2011

<sup>23</sup> See section 67. On the minimum number of directors prescribed for different types of companies, see section 66

<sup>24</sup> FHI Cassim *et al Contemporary Company law 2<sup>nd</sup> ed.* (2012) 410

## 1.3 DUTIES

### 1.3.1 Fiduciary duties

Much of the content of directors' duties was developed by way of analogy with rules governing legal relationship comparable to that between a director and his company.<sup>25</sup> In order to understand or explain the nature of the legal relationship that exists between the company and its directors, various terms have been used to describe this relationship. Directors are sometimes referred to in company law sources as trustees and as agents of the company.<sup>26</sup>

In certain respects, the director is a trustee and there is no doubt that many of his duties developed from the law of trusts, but he is certainly not a full trustee, not least because his very function is an entrepreneurial one and he may properly take risks with the company's funds which a trustee in the strict sense cannot.<sup>27</sup> In South African law, trust property vests in the trustee, not in his personal capacity, but in his official capacity as a trustee. This is because a trust is not a juristic person. On the other hand, a company is a juristic person and owns its assets. The effect of this is that it is confusing to describe directors as "trustees" in our law since directors are not owners of the company assets.

In *Ferguson v Wilson*<sup>28</sup> the court, referred to the position of directors as "merely agents of a company." The use of the analogy of the agent to explain the company- director relationship may, to a certain extent, be appropriate when dealing with the company's external conduct (i.e. dealing with the outside world). While many similarities have been drawn between the legal position of directors and that of agents, there are fundamental differences as well.<sup>29</sup> Most importantly; directors have wider powers than ordinary agents as they are not subject to much control by their companies acting through shareholders in general meeting. Under the Companies Act 71 of 2008, directors now have original powers conferred by section 66 (1) of the Act. In terms of the Act the board has original powers and not delegated authority. Thus the position of directors is fundamentally different from that of agents.

<sup>25</sup> AJ Boyle *et al* *Boyle & Birds' Company law* 7<sup>th</sup> ed. (2009) 586

<sup>26</sup> See *Ferguson v Wilson* (1886) 2 Cha App 77 at 89-90; and *Sibex Construction (SA) Ltd v Injectaseal CC* 1988 (2) 54(T) at 65

<sup>27</sup> AJ Boyle *et al* *Boyle & Birds' Company law* 7<sup>th</sup> ed. (2009) 587; see also Michele Havenga *Fiduciary Duties of Company Directories with specific regard to corporate opportunities*. [LLD thesis, University of South Africa (1995)] 11-16

<sup>28</sup> *Ferguson v Wilson* (1866) 2 Cha App 77 at 89-90

<sup>29</sup> For a detailed discussion, see Michele Havenga *Fiduciary Duties of Company Directories with specific regard to corporate opportunities*. [LLD thesis, University of South Africa (1995)] 17-19; see also *Re Forest of Dean Coal Mining Co* (1878) 10 ChD 450



In *Cohen v Segal*,<sup>30</sup> the court held that directors occupy a position peculiar to themselves. In that case, the court made it clear that use of analogies of agents, trustees or managing partners is not indicative of all the powers and responsibilities of directors. Legal commentators refer to directors as '*fiduciaries sui generis*' which indicates the uniqueness of the director's office.

It has long been accepted in common law that directors owe two broad categories of duty to the company, namely: a fiduciary duty and a duty of care and skill. The fiduciary duties are undoubtedly based on loyalty, good faith and avoidance of conflicts of interests and duty.

The paramount duty of directors, individually and collectively, is to exercise their powers *bona fide* in the best interests of the company.<sup>31</sup> It is generally accepted that all other fiduciary duties emanate from this overarching fiduciary duty. A consideration of various subdivisions of fiduciary duties is helpful in trying to ascertain what each category entails. Traditionally, the following categories have been identified:

(a) The duty to act *bona fide* in the interest of the company as a whole.

This duty requires directors to act in good faith in the interests of the company as a whole and not for some other collateral purpose. The phrase "interests of the company as a whole" refers to the interests of the general body of shareholders.

On the directors' duty to act *bona fide* in the interests of the company as a whole, the court in *Re Smith & Fawcett Ltd*<sup>32</sup> made it clear that a subjective test is applied to determine whether or not a director acted in breach of this duty. The subjective test focuses on the state of mind of the director in question. If the court is of the opinion that the directors acted lawfully and *bona fide* in what they consider to be the interests of the company, then the court will not interfere with their decision. Courts are generally not prepared to second guess the merits or otherwise of the business decisions of directors which are made honestly.<sup>33</sup> This may appear to be too modest a standard for directors' conduct. However, the court in *Teck Corporation Ltd v Millar*<sup>34</sup> cautioned that the courts will consider whether there are reasonable grounds for the director's belief. If there are not, that will justify a finding that the director's conduct was actuated by an improper purpose, and therefore is not in the interest of the company.

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<sup>30</sup> *Cohen v Segal* 1970 (3) SA 702 (W) 706

<sup>31</sup> JT Pretorius *et al Hahlo's South African Company Law through the cases 6<sup>th</sup> ed* (1999) 279

<sup>32</sup> *Re Smith & Fawcett Ltd* [1942] Ch 304 at 306

<sup>33</sup> *see Hogg v Cramphorn* [1967] Ch 254 at 268

<sup>34</sup> *Teck Corporation Ltd v Millar* (1973) 33 DLR (3d) 288 at 315-316

Where directors resign from the company *en masse* in circumstances akin to abandoning the company, they will be in breach of this duty. This was the case in *Minister of Water Affairs and Forestry v Stilfontein Gold Mining Co Ltd*.<sup>35</sup> In that case, the court found directors to be in breach of their fiduciary duty to act in the interest of the company. It was held that they could not be allowed to abandon the company on the basis that it was convenient for them to do so.

Where a breach of this duty is alleged, facts of the case must be considered carefully and then the general principles of law as already discussed, must be applied to given facts to determine whether or not a breach of duty has occurred.

(b) The duty to exercise powers for proper purpose.

The “proper purpose” duty entails in the first instance that the director must not exceed the limitations of his own authority and must not exceed the limitations (capacity) of the company.<sup>36</sup>

This duty applies to the exercise of any of the director’s powers. The fundamental principle is that transactions “for objects and purposes foreign to, or inconsistent with, the memorandum of association are *ultra vires* of the corporation itself.”<sup>37</sup> This common law principle ensures that directors obey the constitution of the company and that they exercise their powers to further the objects stated therein. In terms of common law principles, directors’ acts which are beyond the company’s powers are null and void. Such acts cannot be ratified by the company. Where directors exceed the limitations placed on their authority, by common law, statutes or the company’s constitution they will be in breach of this duty unless the company ratifies the transaction in question. Furthermore, the “proper purpose” duty requires directors to exercise powers for the purpose for which the powers were conferred on them. Directors are under an obligation to exercise their powers to achieve the objects of the company that are stated in the memorandum of incorporation and articles of association.<sup>38</sup>

This duty is often breached by directors in cases where they issue shares for a purpose other than to raise capital for the company. It is an established principle of common law that shares are issued to raise capital for the company. However, it must be noted that raising capital may not be the sole purpose for which shares can be issued. Where the directors’ power to issue shares is exercised for other purposes, it is the dominant or substantial purpose which is crucial in determining whether or not the powers were exercised for a proper purpose. The case of *Howard Smith Ltd v Ampol Petroleum Ltd*.<sup>39</sup> is authority for these views.

<sup>35</sup> *Minister of Water Affairs and Forestry v Stilfontein Gold Mining Co Ltd* (2006) (5) SA 333 (W)

<sup>36</sup> PA Delpont *et al Henochsberg on the Companies Act 71 of 2008* (2011) [ electronic version] 296 (1) and authorities cited there.

<sup>37</sup> *ibid*

<sup>38</sup> see *Rolled Steel Products (Holdings) Ltd v British Steel Corporation* [1982] 3 All ER 1057 (Ch)

<sup>39</sup> *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] 1 All ER 126 (PC) 1135-1136; see also, *Automatic Self –Cleansing Filter Syndicate Co Ltd v Cunningham* [1906] 2 Ch

(c) The duty to avoid conflicts of interest.

The duty to avoid a conflict of interest is undoubtedly the core duty of a fiduciary. Directors have a strict obligation in their capacity as fiduciaries, to observe this duty. One would expect directors to have a deeper and clearer understanding of the obligations placed on them by the “duty to avoid a conflict of interest.” However, this is not the case. Seemingly, this is the most violated duty by directors, especially in South Africa. This duty is discussed in detail in the next chapter.

The above mentioned common law fiduciary duties are now partially codified in the Companies Act 71 of 2008 [section 76(a) and (b)]. However, the Act extends the duties to cover a wholly-owned subsidiary and a subsidiary of the holding company. This indicates a shift from the common law position.

### **1.3.2 Duty of care, skill and diligence**

Apart from fiduciary duties, common law imposed a further duty on company directors, namely, a “Duty of care and skill.” In sharp contrast to directors’ onerous duties of good faith and loyalty, the common law historically pitched a very low standard of care and skill required of directors. Reasons for such a low standard will not be dealt with in this work. For a detailed discussion, see articles by McLennan<sup>40</sup>; Bekink<sup>41</sup>; and also Bouwman<sup>42</sup>.

In the early cases (on this duty), directors had to be “culpably” or “grossly” negligent before they could be held in breach of the duty. In *Lagunas Nitrate Co v Lagunas Syndicate Ltd*<sup>43</sup> the court held that their [directors] negligence must not be the omission to take all possible care; it must be more blamable than that. It was made clear by the court that their negligence must be in a business sense culpable or gross. An error of judgment or imprudence is insufficient to hold a director liable for breaching this duty. *Re Brazilian Rubber Plantations and Estates Ltd*<sup>44</sup> is supportive of this view.

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<sup>40</sup> JS McLennan “Duties of Care and Skill of Company Directors and Their Liability for negligence (1996) 8 SA Merc LJ 94-102

<sup>41</sup> M Bekink “An Historical Overview of the Director’s Duty of Care and Skill: From the Nineteenth Century to the Companies Bill of 2007” (2008) 20 SA Merc LJ 95-116

<sup>42</sup> N Bouwman “An Appraisal of the Modification of the director’s duty of Care and Skill” (2009) 21 SA Merc LJ 509-534

<sup>43</sup> *Lagunas Nitrate Co v Lagunas Nitrate Syndicate Ltd* [1899] 2 Ch 392

<sup>44</sup> *Re Brazilian Rubber Plantation and Estates Ltd* [1911] 1 Ch 425

*Re City Equitable Fire Insurance Co Ltd*<sup>45</sup> is instructive on the earlier common law position concerning the duty of care and skill. It was held that:

(a) A director need not exhibit in the performance of his or her duties a greater degree of skill than may reasonably be expected from a person of his or her (the particular director's) knowledge and experience. Where the director is a professional, the standard will be of a reasonably competent member of that profession.

(b) A director is not bound to give continuous attention to the affairs of the company. A director's duties are of an intermittent nature to be performed at periodic board meetings and at meetings of any committee of the board upon which he or she happens to be placed. A director is not bound to attend all meetings although he or she ought to attend whenever, in the circumstances, he or she is reasonably able to do so.

(c) In respect of all duties that, having regard to the exigencies of business and the articles of association, may properly be left to some other official, a director is, in the absence of grounds for suspicion, justified in trusting that official to perform such duties honestly.

The principles enunciated in *Re City Equitable Fire Insurance Co Ltd* case, above, were reaffirmed in *Fisheries Development Corporation of SA Ltd v Jorgensen*.<sup>46</sup> Since then; courts developed common law and shifted towards a stricter construction of the duty.

The new test was applied by the court in *Re D'Jan (of London) Ltd*.<sup>47</sup> New prominence was given to the objective test. In the *Daniels*<sup>48</sup> case, the court indicated that a more objective standard was appropriate. In that case, it was held that it is no longer appropriate to evaluate a director's conduct with outdated subjective tests applied in outdated precedents. These cases clearly point to a departure from a low, largely subjective, standard of care and skill which was required in earlier court decisions.

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<sup>45</sup> *Re City Equitable Fire Insurance Co. Ltd* [1925] 1 Ch 407

<sup>46</sup> *Fisheries Development Corporation of SA Ltd v Jorgensen* 1980 (4) SA 156 at 163

<sup>47</sup> *Re D'Jan (of London) Ltd* [1994] 1 BCLC 561

<sup>48</sup> *Daniels t /as Deloitte Haskins & Sells v AWA Ltd* (1995) 37 NSWLR 438

The common law duty of care, skill and diligence is now codified in the Companies Act 71 of 2008 (hereafter the Companies Act).<sup>49</sup> It is submitted that the provisions of section 76(3) (c) are a reflection, not of the largely subjective standard of care and skill applied in earlier court decisions<sup>50</sup>, but a reaffirmation of the current position at common law.<sup>51</sup> The two legs of the test for recklessness (ie the objective standard and the subjective standard) are maintained in the Act. The objective leg of the test weighs the director's conduct against conduct that may reasonably be expected of a person carrying out the same functions as those carried out by the director.<sup>52</sup> However, a director who is a chartered accountant is expected to display a higher level of skill with regard to financial matters than a reasonable person who does not hold himself out as having financial acumen.<sup>53</sup> It can be argued that the objective standard is now the minimum standard below which no company director's conduct should fall.

The subjective leg of the test<sup>54</sup> takes into consideration the knowledge, skill and experience of that director in deciding whether or not a breach of the duty has occurred. It is submitted that a company director cannot rely on his actual low level of knowledge, skill and experience to circumvent or undermine the objective standard. This view is supported by Cassim<sup>55</sup> who argues that the subjective standard of skill, knowledge and experience is taken into account only when it increases or improves the objective standard of care or skill of a reasonable director. Directors must comply with both standards in order to satisfy the requirements of the duty of care, skill and diligence.

*Re D'Jan (of London)*<sup>56</sup> is a typical example of a breach of this duty. In that case, a director of a company failed, before signing it, to read an insurance proposal form that had been filled out by the company's insurance broker. The court found this to be a breach of his duty of care, skill and diligence

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<sup>49</sup> See section 73(c) of the Companies Act 71 of 2008

<sup>50</sup> *Re City Equitable Fire Insurance Co. Ltd* [1925] 1 Ch 407 reflects the earlier position at common law

<sup>51</sup> The current position at common law is reflected in cases such as *Re D'Jan (of London) Ltd* [1994] 1 BCLC 561; and *Daniels t/as Deloitte Haskins & Sells v AWA Ltd* (1995) 37 NSWLR 438

<sup>52</sup> See section 76(3) (c) (i)

<sup>53</sup> See in general *Re Brian D Pierson (contractors) Ltd* [2001] BCLC 275; and also *Dorchester Finance Co Ltd v Stebbing* [1989] BCLC 498 (Ch)

<sup>54</sup> Section 76(3) (c) (ii) applies the subjective standard

<sup>55</sup> Cassim *et al Contemporary Company Law 2<sup>nd</sup> ed.* (2012) 560

<sup>56</sup> *Re D'Jan (of London) Ltd* [1994] 1 BCLC 561

## CHAPTER 2

### NO- CONFLICT OF INTEREST

#### 2.1 Common Law

##### Introduction

The “no-conflict” duty of company directors extends not only to actual conflicts but also to those which are a real sensible possibility.<sup>1</sup> Courts have adopted a very strict stance in enforcing this duty.<sup>2</sup> A view has been advanced that one reason for the ‘strict ethic’ in this area of law is that fiduciary duties are meant to be prophylactic and preventative.<sup>3</sup> A question which then arises is: how does a court determine that a director is in breach of this duty? A common sense approach is followed here and the determination is done by assessing whether a reasonable person would when considering the relevant facts and circumstances of the case think that there was a real possibility of conflict.<sup>4</sup> The director’s *bona fides* or lack thereof is irrelevant in determining whether or not the duty has been breached.

##### 2.1.1 Secret Profit

Where one man stands to another in a position of confidence involving a duty to protect the interests of that other, he is not allowed to make a secret profit at the other’s expense or place himself in a position where his interests conflict with his duty.<sup>5</sup> Directors must avoid placing themselves in situations where their personal interests clash with their fiduciary duties to the company. Their personal interests must be subordinated to those of the company.

Where a director makes any profits by reason of his office, he is liable to account to the company for such profits. In *Regal (Hastings) Ltd v Gulliver*<sup>6</sup> it was stated that the rule requiring directors to account for the profits they have made while standing in a fiduciary relationship does not depend on fraud, or absence of *bonafides*, or upon such questions or considerations as whether the profit would or should otherwise have gone to the [company]. The court held that the liability arises, from the mere fact that the profit was made. This means that once proof is adduced that a director made profit contrary to his fiduciary duty, all the above mentioned considerations become irrelevant.

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<sup>1</sup> *Phillips v Fieldstone Africa (Pty) Ltd* [2004] 465 (SCA)

<sup>2</sup> See *Aberdeen Railway Co v Blaikie Bros* (1854) Mcq 461 at 471

<sup>3</sup> FHI Cassim *et al Contemporary Company Law* 2<sup>nd</sup> ed (2012) 534

<sup>4</sup> M Havenga “Director’s exploitation of corporate opportunities and the Companies Act 71 of 2008” (2013) 2 TSAR 257 -268 at 257-258 and authorities cited.

<sup>5</sup> *Robinson v Randfontein Estates Gold Mining Co Ltd* [1921] AD 168 at 177

<sup>6</sup> *Regal (Hastings) Ltd v Gulliver* [1942] 1 All ER 378

The court decision in the *Regal (Hastings)* case has been criticised on the grounds that the claim was wholly unmeritorious. Davies and Worthington<sup>7</sup> argue convincingly that recovery by the company benefited only the purchasers, who in this way received an undeserved windfall resulting, in effect, in a reduction in the price which they had freely agreed to pay. An equitable principle was, in effect, taken to an unfair and inequitable conclusion.<sup>8</sup> Despite the difficulties arising from the inequitable effect (in that particular case) of the *Regal (Hastings)* decision, our courts continue to apply the legal principles laid down by the court in that case. *Phillips v Fieldstone Africa (Pty) Ltd*<sup>9</sup> reaffirmed the legal principles enunciated in the *Regal (Hastings)* case. It was also pointed out that only the free consent of the principal after full disclosure will suffice as a defence where a fiduciary is accused of breaching his trust.

More recently, in *Dorbyl Ltd v Vorster*<sup>10</sup>, the court referred with approval, to the legal principles enunciated in *Regal (Hastings v Gulliver; Robinson v Randfontein Estates Gold mining Co Ltd; and Phillips v Fieldstone Africa (Pty) Ltd*. In the *Dorbyl* case, a paid executive director of the company, who played a very active role in the restructuring of the *Dorbyl* Group received profits in the form of joining fees, share allocation and proceeds of the resale of shares without the knowledge of his company. The court, after considering the legal principles laid down in the above mentioned cases, held that the director was in breach of his trust. The director in question was ordered to return the profits to the company. Such profits are deemed to have been made for and on behalf of the company and therefore must be disgorged.

The secret profits in question are not limited to monetary gain but include any gain or advantage acquired by a director while standing in a fiduciary relationship. While such additional advantages are frequently referred to as secret profits, the rule applies equally even if the advantage was obtained openly, in good faith and in no way at the expense of the company.<sup>11</sup>

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<sup>7</sup> PL Davies and S Worthington *Gower and Davies' Principles of Modern Company Law* 9<sup>th</sup>ed (2012) 593

<sup>8</sup> FHI Cassim *et al Contemporary Company Law* 2<sup>nd</sup>ed (2012) 537

<sup>9</sup> *Phillips v Fieldstone Africa (Pty) Ltd* [2004] (3) SA 465 (SCA)

<sup>10</sup> *Dorbyl v Voster* [2011] (5) SA 575 (GSJ)

<sup>11</sup> HS Cilliers *et al Corporate Law* 3<sup>rd</sup>ed (2000) 142

The view above, finds support in *Canadian Aero Service Ltd v O'Malley*<sup>12</sup> where Laskin J, held that there may be situations where a profit must be disgorged, although not gained at the expense of the company, on the grounds that a director must not be allowed to use his position as such to make a profit even if it was not open to the company, as for example, by reason of legal disability to participate in the transaction. A pattern of “strict ethic” in this regard is clearly discernible from these cases.

### **Corporate opportunities**

Under the common law, the exploitation of a so-called “corporate opportunity” is also a specific instance of conflicting interests and profit-making by a director. Here the profit is not necessarily made by virtue of the director’s position in the company.<sup>13</sup> The duty applies whether or not the director used his position as such, or confidential information, to pursue the opportunity in question. A director is duty-bound to act in the interest of the company in developing opportunities that are made available to it. If an opportunity is acquired for the director’s own benefit rather than for the company, it is said that the director usurped or expropriated the corporate opportunity.<sup>14</sup> The rule applies equally where the said opportunity is appropriated for the benefit of a third party. If it is acquired by the director, not for the company but for himself, the law will refuse to give effect to the director’s intention and will treat the acquisition as having been made for the company.<sup>15</sup> The company has a right to claim such an opportunity from the delinquent director.

The most difficult aspect of the corporate opportunities rule is determining whether an opportunity which has arisen qualifies as a corporate opportunity or not. The classification is crucial because a director’s liability depends on it. Where a director pursues an opportunity which is regarded as corporate opportunity, the director will be in breach of duty, consequently, liability will follow. On the other hand, directors are at liberty to pursue, for themselves, those opportunities which do not fall under “corporate opportunities”. The rationale here is that directors are not under a general duty to relay to the company every money-making idea they have or every prospect of making money that they identify.

<sup>12</sup> *Canadian Aero service Ltd v O'Malley* [1973] 40 DLR (3d) 371

<sup>13</sup> M Havenga “Directors’ exploitation of corporate opportunities and the Companies Act 71 of 2008” (2013) 2 *TSAR* 257-268 at 258

<sup>14</sup> M Havenga “Directors’ exploitation of corporate opportunities and the Companies Act 71 of 2008” (2013) 2 *TSAR* 257-268 at 258-259

<sup>15</sup> *Da Silva v CH Chemicals (Pty) Ltd* [2008] ZASCA 110 at 17



As already acknowledged above, identifying specific criteria to be applied in the identification of corporate opportunities presents challenges for academics and courts alike. Various tests have been applied in determining whether or not a corporate opportunity was expropriated. The tests range from the exceptionally wide approach to the narrowest approach. The widest test requires a director to pass on to the company any opportunity of which he becomes aware, regardless of the nature of the opportunity, whilst the narrowest approach requires a director to report only those opportunities to which the company has a legal right.<sup>16</sup> In between these two extremes lies a number of tests that have been applied by the courts. For a detailed exposition of these tests see Havenga's article.<sup>17</sup> It can be argued that the law lacks clarity with regard to the criteria which must be used to determine whether or not an opportunity is a corporate one. A consideration of selected cases to illustrate the application of the corporate opportunity rule will now follow.

In *Canadian Aero Services Ltd v O'Malley*<sup>18</sup> two directors of the company diverted for their personal benefit, a maturing business opportunity which, at the time was pursued by their company. The court found that the two had resigned from their positions as directors of the company before forming their own company which tendered for the same contract that was pursued by Canadian Aero Services (their former principal). The court held that their resignation had been prompted by a desire to acquire the opportunity for themselves. It was their position with the company rather than a 'fresh' initiative which led them to the opportunity which they later acquired.<sup>19</sup> Factors such as the nature of the corporate opportunity, its ripeness, its specificity and the director's or managerial officer's relation to it were listed as some of the considerations which a court takes into account in determining a director's breach of the corporate opportunity doctrine. The directors in question were held to be in breach of fiduciary duty. The court made it clear that their fiduciary duty had survived their resignation in the circumstances of that particular case.

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<sup>16</sup>R Cassim "Post-resignation duties of Directors: The application of the fiduciary duty not to misappropriate corporate opportunities" (2008) 4 SALJ 731-753 at 734 and authorities cited.

<sup>17</sup> M Havenga "Corporate Opportunities: A south African Update (Part1)" (1996) 8 SA Merc LJ 40-55 at 43-46

<sup>18</sup> *Canadian Aero Service Ltd v O'Malley* [1973] 40 DLR (3d) 371

<sup>19</sup>L Sealy and S Worthington *Sealy's Cases and Materials in Company Law* 9<sup>th</sup>ed (2010) 365

The widest approach alluded to earlier, was adopted in cases such as *Regal (Hastings) Ltd v Gulliver*<sup>20</sup>, and in *Bhullar v Bhullar*.<sup>21</sup> In both these cases, directors did not divert for their benefit opportunities which were being actively pursued by their companies. There was no suggestion in *Bhullar* that the directors had used their position in the company to bring the opportunity to maturity and then divert it for themselves, as in *Can aero* [Canadian Aero Services Ltd case]. For this reason, the decision can be seen as affecting a significant extension of the criteria for identifying a corporate opportunity.<sup>22</sup> In this case, the company's board had decided, before the opportunity arose, not to acquire any more properties. The decision was then reversed after the opportunity arose. In the *Regal (Hastings)* case, the company would not itself have been able to exploit the business opportunity due to lack of funds. Davies and Worthington argue that it could be said that it was the directors who decided that the company could not afford the opportunity who were the ones who later took it themselves and that such behavior is necessarily suspect.<sup>23</sup> In both these cases directors were held to be in breach of fiduciary duty.

In *Atlas Organic Fertilizers (Pty) Lt v PikkewynGhwano (Pty) Ltd*<sup>24</sup> the managing director resigned from the company. While still serving out his period of notice under his employment contract, he sabotaged the company's chances of obtaining long-term, favorable raw material contracts which he subsequently acquired for himself. The court held this to be a breach of fiduciary duty by the director.

A survey of South African court decisions shows that in earlier cases the courts did not use the term "corporate opportunity" as such, preferring to apply the secret profit doctrine in resolving matters which fall under the "corporate opportunity" category. The first South African, case in which the "corporate opportunity" rule was applied is *Spieth v Nagel*.<sup>25</sup> On the facts of that case, a director was interdicted from exploiting a commercial opportunity created in breach of fiduciary duty.

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<sup>20</sup> *Regal (Hastings) Ltd v Gulliver* [1942] 1 All ER 378

<sup>21</sup> *Bhullar v Bhullar* [2003] 2 BCLC 241 (CA)

<sup>22</sup> PL Davis and S Worthington *Gower and Davies' Principles of Modern Company Law* 9<sup>th</sup>ed (2012) 597

<sup>23</sup> PL Davis and S Worthington *Gower and Davies' Principles of Modern Company Law* 9<sup>th</sup>ed (2012) 597-598

<sup>24</sup> *Atlas Organic Fertilizers (Pty) Ltd v Pikkewyn Ghwano (Pty) Ltd* [1981] 2 SA 173 (T)

<sup>25</sup> *Spieth v Nagel* [1997] 3 All SA 316 (W)

Subsequent cases such as *Cyberscene Ltd v i-Kiosk Internet and Information (Pty) Ltd*<sup>26</sup> ; *Movie Camera Company (Pty) Ltd v Van Wyk*<sup>27</sup>; and *Da Silva v CH Chemicals (Pty) Ltd*<sup>28</sup> applied the “corporate opportunity” rule.

In the *Cyberscene Ltd* case, directors of the company were precluded from exploiting a corporate opportunity which rightfully belonged to *Cyberscene Ltd*. The facts of the case were that the directors while still holding their positions as such in *Cyberscene Ltd*, set up a business in direct competition with their company. They replicated the entire business of *Cyberscene Ltd* using its assets and goodwill. They made a presentation to the *City of Tygerberg* (a prospective client of *Cyberscene Ltd*) to sell a product which was a replica of *Cyberscene*’s product. The court refused to give effect to the directors’ intention to exploit for themselves a maturing business opportunity which rightfully belonged to *Cyberscene Ltd*. The directors in question were held to be in breach of their fiduciary duty.

The approach generally adopted by South African courts has been the “line of business test”, which requires the opportunity to correspond with the existing and prospective interests or activities of the company, or to be closely associated with it.<sup>29</sup> In addition, the company must, in the circumstances of the case, be seen to be actively pursuing the opportunity or placing reliance on directors to acquire it for the company. It can be argued that if an opportunity falls outside these parameters, the directors may be free to acquire it for themselves. However, they must first overcome the obstacles imposed by the “no secret profit” rule. In the *Da Silva* case the court explained that the circumstances in which the secret profit and corporate opportunity rules apply frequently overlap, but differ in important respects. The distinction was held to lie in the fact that when a corporate opportunity is expropriated, it is deemed to be at the expense of the company whereas the secret profit is not necessarily made at the expense of the company, but obtained as a result of the director’s office.

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<sup>26</sup> *Cyberscene Ltd v i-Kiosk Internet and Information (Pty) Ltd* [2000] 3 SA 806 (C)

<sup>27</sup> *Movie Camera Company (Pty) Ltd v Van Wyk* [2003] 2 All SA 291 (C)

<sup>28</sup> *Da Silva v CH Chemicals (Pty) Ltd* [2008] ZASCA 110

<sup>29</sup> R Cassim “Post –resignation Duties of Directors: The application of the fiduciary duty not to misappropriate corporate opportunities” 2008 (4) SALJ 731 – 753 at 734 and authorities cited there; see also *Da Silva v CH Chemicals (Pty) Ltd* [2008] ZASCA 110 at 19

The above cases serve to highlight the stance of the South African courts with regard to expropriation of corporate opportunities by company directors. It is impossible and unwise to lay down any conclusive guidelines which are to be applied in assessing whether or not one is dealing with a corporate opportunity which rightfully belongs to the company.<sup>30</sup> Facts of each case must be weighed against the applicable legal principles to resolve questions of expropriation of corporate opportunities.

### Corporate information

The legal principles discussed under the corporate opportunity doctrine above, are equally applicable to situations where company directors use, for their personal benefit, information which they acquired in their capacity as directors. *Magnus Diamond Mining Syndicate v MacDonald and Hawthorne*<sup>31</sup> provides a clear example of a case where directors were proscribed from benefiting from unlawful use of such information. In that case, directors got information about diamondiferous land and in competition with their company, purchased it for themselves. The court found that they were in breach of their fiduciary duty and ordered them to transfer the said land to the company. In this situation the directors are deemed to have made the acquisition for the company and therefore they cannot keep it for their personal benefit.

*In Sibex Construction (SA) (Pty) Ltd v Injectaseal CC*<sup>32</sup> directors who had submitted a tender for work to Sasol and Natref on behalf of Sibex, resigned and formed a close corporation (*Injectaseal CC*). The directors then used Sibex's confidential information to prepare tenders (on behalf of *Injectaseal CC*) for work to Sasol and Natref. These two companies were Sibex Construction's main clients. The court granted a provisional interdict against *Injectaseal CC* after making a finding that the directors breached their fiduciary duties towards Sibex Construction.

Company directors are duty-bound to pass information on corporate opportunities to their companies. They cannot guard such information for their own personal gain.

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<sup>30</sup> *Movie Camera Company (Pty) Ltd v Van Wyk* [2003] 2 All SA 291 (C)

<sup>31</sup> *Magnus Diamond Mining Syndicate v MacDonald and Hawthorne* [1909] ORC 65

<sup>32</sup> *Sibex Construction (SA) Pty Ltd v Injectaseal CC* [1988] 2 SA 54 (T)

The case of *Industrial Development Consultants Ltd v Cooley*<sup>33</sup> discussed earlier is instructive on these matters. The argument that the company could not or would not have been able to take up the opportunity is of no consequence in determining the director's breach of duty. Equally irrelevant, is the argument that the director learnt of the opportunity in his private capacity. In the above case, Cooley was ordered to account to his former company for the profits he made. The rationale here was to deny Cooley from benefiting personally as a result of information he acquired while working as a director of *Industrial Development Consultants Ltd*.

### **Contracts between a Director and the Company**

Since a director entering into a contract with his company will find his interests conflicting with those of the company, the rule is that such a contract is not void, but voidable at the option of the company.<sup>34</sup> Common law rules preclude a director from having an interest in a contract or contracting with the company unless such is permitted by an "exclusion clause" in the articles.

Where the articles do not contain such a clause, authorisation must be sought from the general meeting of shareholders after full disclosure by the director(s) concerned. Shareholders' approval or ratification must not constitute a fraud on the minority shareholders. Directors are duty-bound to disclose to the company any interest they have in a contract to which the company is a party. This is confirmed in *Robinson v Randfontein Estates Gold Mining Co Ltd*<sup>35</sup> where the court held: There is only one way by which such transactions can be validated, and that is by the free consent of the principal following upon a full disclosure by the agent. In *Novick v Comair Holdings Ltd*<sup>36</sup> the court mentioned some guidelines which must be observed where directors have interests in the contracts in which their companies are involved.

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<sup>33</sup> *Industrial Development Consultants Ltd v Cooley* [1972] 2 All ER 162

<sup>34</sup> HS Cilliers *et al Corporate Law* 3<sup>rd</sup>ed (2000) 143

<sup>35</sup> *Robinson v Randfontein Estates Gold Mining Co Ltd* [1921] AD 168

<sup>36</sup> *Novick v Comair Holdings Ltd* [1979] 2 SA 116 (W)

The guidelines may be summarised as follows:

- directors who are involved must act in good faith and openly
- they must make full disclosure to the company
- directors have a duty to correct any material misstatements they might have made in negotiation or otherwise, which might influence the company's decision to enter into the transaction.
- directors are under a duty to answer truthfully, any questions on matters which would or might have a bearing upon the contract.
- Directors have a duty to reveal, unasked, any information they know which is unknown to those acting for their company, if it is information likely to influence the company's decision to contract.

It is submitted that directors may avoid liability if they follow the above mentioned guidelines. A discussion of the “no – conflict “duty under statutory law will now follow.

## **2.2 Companies Act 71 of 2008**

### **2.2.1 Secret Profits**

The common law principles on the “no conflict” of interest duty of directors, discussed earlier in this chapter will still be of relevance in interpreting the relevant statutory provisions. The Act does not exclude common law.<sup>37</sup> Section 158 (a) of the Act provides that when determining a matter brought before it in terms of the Act, or making an order contemplated in the Act, a court must develop the common law as necessary to improve the realisation and enjoyment of rights established by the Act.

Directors' fiduciary duties are regulated under section 76 of the Act. The term “director” in this section has an extended meaning as discussed in Chapter 1 of this work. Section 76 (2) provides:

A director of a company must-

- (a) not use the position of a director, or any information obtained while acting in the capacity of a director-
  - (i) to gain an advantage for the director, or for another person other than the company or a wholly-owned subsidiary of the company ; or
  - (ii) to knowingly cause harm to the company or a subsidiary of the company ; and

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<sup>37</sup> See section 77(2) (a) and (b)

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

Section 76(2) (a) above, may be viewed as a restatement of the common-law no profit rule. One material difference is the extension of the fiduciary duty to subsidiaries of the holding company. Directors' fiduciary duties did not extend to subsidiary companies under common law. Cassim<sup>38</sup> is of the view that section 76(2) (a) (i) and (ii) is wide enough to apply to the "no profit" rule and the corporate opportunity rule as well as the post-resignation duties of directors. The learned authors suggest that the two rules are encapsulated in section 76(2) (a) (i) and (ii). Havenga<sup>39</sup> disagrees. According to Havenga, the provision covers corporate situations only partially. She argues that neither of the limitations [contained in section 76(2) (a)] applies to the appropriation of corporate opportunities under the common law rule, and also that the section does not provide for the situation where a former director takes up an opportunity after his resignation from office. In her view, section 76 (2) (b) partially covers the corporate opportunity situations. In addition to this argument, Havenga is of the view that the stipulation that harm must be caused "knowingly" also potentially excludes some corporate opportunity situations.

The two positions discussed above reveal uncertainty in the law. It remains to be seen how the courts will interpret these sections.

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<sup>38</sup>FHI Cassim *et al Contemporary Company Law 2<sup>nd</sup>ed* (2012) 551

<sup>39</sup>M Havenga "Directors' exploitation of corporate opportunities and the Companies Act 71 of 2008" 2013 (2) *TSAR* 257-268 at 265-266

## 2.2.2 Contracts between directors and the company

Under the Act, directors are required to disclose personal financial interests<sup>40</sup> in respect of a matter to be considered at a meeting of the board<sup>41</sup> [future contracts]. This requirement applies equally where a director knows that a related person<sup>42</sup> has a personal financial interest in the matter. The director must disclose the interest and its general nature<sup>43</sup> before the matter is considered at the meeting of the board and must disclose any material information relating to the matter which is known to him.<sup>44</sup> Section 75 (5) (c) allows the director discretion to disclose any observations or pertinent insight relating to the matter if requested to do so by the other directors. Disclosure is not required in situations specified in section 75 (2). The concerned director must leave the meeting immediately after making the required disclosure (if he was present at the meeting). He must not take part in the consideration of the matter. Presumably, this is to prevent the director in question from influencing the decision of the board on the matter. It is not clear what the procedure will be if the directors are all interested in the same way. Possibly, the matter will have to be submitted to the general meeting of shareholders for consideration. The conflicted director is not allowed to execute any document on behalf of the company in relation to the matter unless requested to do so by the board.

In respect of existing contracts or agreements, prompt disclosure must be made by a director who acquires a personal financial interest after, or who knows that a related person has done so after the agreement /matter has been approved by the company. The said disclosure must be made to the Board or to the shareholders in certain situations.<sup>45</sup> The nature and extent of the interest, and the material circumstances relating to the director or related person's acquisition of the interest must be disclosed.

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<sup>40</sup> "Personal financial interest" means a direct material interest of that person of a financial, monetary, or economic nature or to which economic value may be attributed [see section 1]. The test of "material interest" is subjective because it depends on the personal circumstances of the person concerned.

<sup>41</sup> Section 75 (5)

<sup>42</sup> "Related person" has the meaning contemplated in section 2(1)

<sup>43</sup> Section 75 (5) (a)

<sup>44</sup> See section 75(5) (b)

<sup>45</sup> If a person is the only director of a company, but does not hold all of the beneficial interests of all of the issued securities of the company, disclosure must be made to shareholders [see generally, section 75 (3)]



Notwithstanding any personal financial interest of a director or person related to a director, the board's approval of a transaction or agreement is valid if it was approved in terms of section 75 or ratified in terms of section 75 (7) (b)(i) (if approval was made without prior disclosure). A court, on application by any interested person, may declare valid a transaction or agreement that had been approved by the board, or shareholders, as the case may be, despite the failure of the director to satisfy the disclosure requirements of section 75.<sup>47</sup> It can be argued that the disclosure requirements of section 75 are a modification of the position at common law. Common law required that conflicts of interest be disclosed to the general meeting of shareholders and not to the Board. Arguably, this was meant to preclude "mutual back-scratching" by directors. At common law, shareholders were the only organ of the company which had power to approve, following full disclosure, or to ratify transactions (where the company was a party) in which directors had conflicts of interests.

Does non-disclosure render the contract void? Section 75 is silent on this issue. It is submitted that common law principles should apply here since the section does not expressly exclude common law. In terms of common law, non-disclosure does not render the contract void but voidable at the instance of the company. In *Hely-Hutchinson v Brayhead Ltd*<sup>48</sup> [English case] the court dealt with this question in respect of a similar section in the UK Companies Act. Lord Denning explained that when a director fails to disclose his interest, the effect is the same as non-disclosure in *contracts uberrimaefidei* [ie the contract is voidable]. For a different approach on the "void ability" issue, see Delpont's arguments in *Henochsberg*.<sup>49</sup>

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<sup>47</sup> See section 75(8)

<sup>48</sup> *Hely-Hutchinson v Brayhead Ltd* [1968] 1 QB 549

<sup>49</sup> PA Delpont et al *Henochsberg on Companies Act 71 of 2008(2011)* [electronic version] 284 and 286

## CHAPTER 3

### LIABILITY

This chapter will discuss directors' liability for breach of fiduciary duties and the duty of care and skill. The first part will deal with liability under common law while the second part will focus on liability under the Companies Act 71 of 2008.

#### 3.1 Common Law

For some time there has been debate among South African legal commentators regarding the legal basis of the action for breach of fiduciary duties. Some commentators like JJ Du Plessis sought to base it on the Aquilian action while others<sup>1</sup> endorsed the *sui generis* action. It is now generally accepted that liability for breach of fiduciary duties is *sui generis*. In *Robinson v Randfontein Estates Gold Mining Co Ltd*<sup>2</sup> the court confirmed that the cause of action for breach of trust is neither delictual nor contractual in nature but *sui generis*.

This view was reaffirmed in *Cohen v Segal*<sup>3</sup> where the court held that in our law the action based on breach of trust is *sui generis*.

If as a result of a director's breach of his fiduciary duty the company suffers a loss or the director is benefited thereby, the amount of such loss or benefit may be recovered by the company and the transaction concerned may be set aside.<sup>4</sup> At common law, an aggrieved company and other parties with legal standing can have recourse to one or more of the following remedies:

- (a) interdict
- (b) rescission of contracts
- (c) a right to claim damages
- (d) a right to claim profit or benefit obtained through a breach of fiduciary duty
- (e) proprietary remedy of constructive trusteeship
- (f) restoration of property misapplied

The remedies in question depend to a greater extent, on the nature of the duty involved in each case. A discussion of remedies in respect of various breaches of directors' duties will now follow.

#### **(a) expropriation of corporate opportunities.**

In the event of a threatened breach of duty, the company may apply for an interdict to restrain the director (s) from usurping a corporate opportunity<sup>5</sup>.

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<sup>1</sup> For example JT Pretorius, PA Delpont, M Havenga and M Vermaas. For a detailed exposition of the debate and legal principles advanced in support of each position, see M Havenga "Breach of Directors' Fiduciary Duties: Liability on what basis?" (1996) 8 SA Merc LJ 366-376

<sup>2</sup> *Robinson v Randfontein Estates Gold Mining Co Ltd* [1921] AD 168

<sup>3</sup> *Cohen v Segal* [1970] 3 SA 702 (W)

<sup>4</sup> PA Delpont *et al Corporate Law* 3rd ed (2000) 140

<sup>5</sup> The remedy was invoked in cases such as *Spieth v Nagel* [1997] 3 All S 316 (W); and *Sibex Construction (SA) (Pty) Ltd v Injectaseal CC* [1998] 2 SA 54 (T)

An interdict is equally effective where the breach is taking place and the company wishes to restrain the director (s) from continuing to exploit the corporate opportunity. The proprietary remedy of constructive trusteeship is also applicable here. The company can claim the property acquired in breach of duty from the errant director as in *Magnus Diamond Mining Syndicate v MacDonald and Hawthorne*<sup>6</sup>. In that case, directors who, in breach of their fiduciary duty, acquired a corporate opportunity for themselves were ordered to transfer the land in issue to the company and to account for their profits. It is clear that in the circumstances of the case, the court deemed the acquisition to have been held in trust for the company. If it is no longer possible for the company to claim the property for example, where such property has been disposed of, directors can still be made to account for any profits made by them as a result of their breach of duty.<sup>7</sup> Directors may also be liable for damages for any loss suffered by the company consequent to a breach of duty by directors.<sup>8</sup> Where damages are claimed, the company must prove the causal connection between the said breach and the alleged loss.

#### **(a) misuse of corporate information**

Corporate information includes the company's confidential information. However, it must be noted that the information exploited need not be confidential to qualify as corporate information. It suffices if the information is closely connected to the company such that the exploitation thereof constitutes a conflict of interest. Havenga argues the remedies for misuse of confidential information are damages, an interdict to restrain the director and delivery up but not an account of profits.<sup>9</sup> This view is endorsed. It is however, submitted that an accounting of profits is indeed a remedy in situations where the information exploited does not constitute that company's confidential information as such, but falls under "corporate information". In *Industrial Development Consultants v Cooley*<sup>10</sup>, a director who exploited corporate information for his personal benefit was held liable to account to the company (*Industrial Development Consultants*) for his profits. Similarly, directors were ordered to account for profits in other cases such as *Magnus Diamond Mining case*; and in *Robinson v Randfontein Estates Gold Mining*, discussed above.

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<sup>6</sup> *Magnus Diamond Mining Syndicate v MacDonald and Hawthorne* (1909) ORC 65

<sup>7</sup> Cases where directors were made to account for profits include:

*Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134;

*Robinson v Randfontein Estates Gold Mining Co Ltd* [1972] AD 168;

*Industrial Development Consultants Ltd v Cooley* [1972] 2 All ER 162; and

*Magnus Diamond Mining Syndicate v MacDonald and Hawthorne*, note 6 above

<sup>8</sup> see *Du Plessis v Phelps* [1995] 4 SA 165 (C)

<sup>9</sup> M Havenga "Corporate Opportunities: A South African update (Part 2)" (1996) 8 SA Merc LJ 233-251 at 245

<sup>10</sup> *Industrial Development Consultants v Cooley*, note 7 above

Liability for exploitation of corporate information overlaps with liability for expropriation of corporate opportunities. Exploitation of corporate information inevitably leads to expropriation of a corporate opportunity.

### **(b) breach of the duty not to make secret profits**

Liability of directors for breach of duty here does not depend upon proof of mala fides but on the mere fact that the profit was made by the director contrary to his fiduciary obligations to the company.<sup>11</sup> A director who makes profit (s) by reason of his office is liable to account to the company for such profits. This principle is backed by a rich body of case law.<sup>12</sup> The “no secret profit” rule also covers bribes. Directors are accountable to the company for any bribes they receive whilst occupying a fiduciary position. The aggrieved company may claim damages instead of a disgorgement of profits. Where the claim is for damages the company must prove that it suffered a loss as a result of the director’s breach of duty. *Symington v Pretoria – OosPrivaat Hospital Bedryfs (Pty) Ltd*<sup>13</sup> acknowledged that a breach of fiduciary duty can in principle give rise either to a claim for disgorgement of profits or to a claim for damages.

### **(c) breach of the duty to disclose interest in contracts**

Unless otherwise provided in the articles of the company, a director is precluded from having interest in a contract with the company. A contract to which the company is a party and in which a director has conflicting interest is voidable at the instance of the company<sup>14</sup> for failure to disclose a conflict of interest. It should be noted that such a contract is not void but voidable.<sup>15</sup> The company may lose the right to rescind where restitution is not possible; where the rights of *bonafide* third parties intervene or where the company delays unreasonably in exercising its right to rescind. A director who breaches the duty is liable to account to the company for any benefit he gained. If the company suffered a loss as a result of entering into the contract, the errant director is liable for damages.

<sup>11</sup> See *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134

<sup>12</sup> See for example, *Regal (Hastings) Ltd v Gulliver*, note 11 above; *African Claim and Land Co Ltd v Langermann* [1905] (TS ) 494; *Robinson v Randfontein Estates Gold Mining Co Ltd* [1921] AD 168;

*Dorbyl v Vorster* [2011] 5 SA 575 (GSJ), *Canadian Aero Services Ltd v O’ Malley* [1973] 40 DLR (3d) 371; and *Transvaal Cold storage Co Ltd v Palmer* [1904] TS

<sup>13</sup> *Symington v Pretoria – OosPrivaat Hospital Bedryfs (Pty) Ltd* [2005] ZASCA 47 at 27

<sup>14</sup> See for example *Hely Hutchinson v Brayhead Ltd* [1968] 1QB 549

<sup>15</sup> See discussion in paragraph 2.2.2 of Chapter 2

#### **(d) breach of duty not to exceed limitation of powers**

At common law, limitation of powers relates to two situations: (i) limitation on the authority of directors (ii) limitation on the capacity of the company. These limitations are found in the company's articles.

Where an act or decision of the directors is beyond their constitutional capacity as set out in the company's constitution (and subject to claims of ostensible authority), it is void i.e. of no effect.<sup>16</sup> However, where directors enter into a transaction with a *bona fide* third party who is not aware of the directors' non compliance with an internal requirement (Turquand situation), the company will be bound to the transaction. While the company cannot escape liability in such a case, the director concerned would have acted in breach of a fiduciary duty and would have incurred liability to the company for any loss suffered.<sup>17</sup> This liability arises from the director's breach of trust.

If directors enter into transactions beyond the capacity of the company and make payments in that regard, they will be in breach of their fiduciary duty. The company may require the errant directors to replace the money paid in breach of duty.

#### **(e) breach of the duty to exercise powers for the purposes for which they were conferred.**

If directors exercise powers for an improper or ulterior purpose, they will be in breach of the duty. Transactions entered into in breach of duty are voidable at the instance of the company. It is conceivable that the company may suffer a loss where the transaction involves *bona fide* third parties, because in that situation, the Turquand rule will deny the company the right to void the transaction.

In the event that the company suffers a loss consequent to directors' breach of duty, the delinquent directors will be liable for the loss.<sup>18</sup> In a claim for damages, the causal connection between the loss and the directors' conduct must be established. Where the company institutes a delictual action, all the elements of delict must be proved.

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<sup>16</sup> PL Davies and S Worthington *Gower and Davies' Principles of Modern Company Law* 9<sup>th</sup>ed (2012) 532

<sup>17</sup> HS Cilliers *et al Corporate Law* 3<sup>rd</sup>ed (2000) 144 and authorities cited there.

<sup>18</sup> *Atlas Organic Fertilizers (Pty) Ltd v PikkewynGhwano (Pty) Ltd* [1981] 2 SA173 (T)

### (f) breach of duty of care and skill

A director who does not observe his duties of care and skill towards his company, is liable to it in delict for damages.<sup>19</sup> To succeed in a delictual action, the company must prove all the elements of delict. Liability may also be based on breach of contract in an appropriate case where there is a contract between the errant director and the company.

## 3.2 Companies Act 71 of 2008

Liability of directors and prescribed officers is dealt with in section 77 of the Act. For purposes of liability under the section, “director” has an extended meaning.<sup>20</sup>

A director may be liable in accordance with the principles of common law relating to breach of a fiduciary duty, for any loss, damages or costs sustained by the company as a consequence of any breach (by the director) of the following duties:

- (a) duty to disclose personal financial interests in transactions where the company is a party.<sup>21</sup>
- (b) a duty to avoid a conflict of interest<sup>22</sup>
- (c) a duty to act in good faith and for a proper purpose<sup>23</sup>
- (d) the duty to communicate to the board any material corporate information (except where the director is under a legal or ethical obligation of confidentiality)<sup>24</sup>
- (e) a duty to act in the best interests of the company<sup>25</sup>

When one reads the liability provisions of section 77 (2) (a) together with the standards of conduct prescribed in section 76 (2) (a) and (b) as one must, a view is formed that liability seems to be imposed only for loss, damages or costs sustained by the company consequent to a breach of fiduciary duties highlighted above. It is not clear what the position is in situations where there is a proven breach of fiduciary duty but no loss, damages or costs sustained by the company as was the case in *Regal (Hastings) Ltd v Gulliver*.<sup>26</sup>

<sup>19</sup> HS Cilliers *et al Corporate Law* 3<sup>rd</sup> ed (2000) 148; and authorities cited there. See also, *Du Plessis v Phelps* [1995] 4 SA 165 at 170; M Havenga “Breach of Directors’ Fiduciary Duties: Liability on what basis?” (1996) 8 SA Merc LJ at 370; and *Fisheries Development Corporation of SA Ltd v Jorgensen* [1980] 4 SA 156 (W) at 166

<sup>20</sup> See Chapter 1, paragraph 1.2.2, above, for a discussion of this concept.

<sup>21</sup> See section 75

<sup>22</sup> See section 76 (2) (a) although this section does not use the term “conflict” of interests the wording points to it.

<sup>23</sup> See section 77 (2) (a) and 76(3) (a)

<sup>24</sup> See section 76 (2) (b)

<sup>25</sup> See section 76 (3) (b) and 77(2) (a)

<sup>26</sup> *Regal (Hastings) Ltd v Gulliver* [1942] 1 All ER 378

Cassim<sup>27</sup> suggests that the fact that the company has not incurred any loss nor suffered any damage may not be relevant to section 76(2) (a) (i) and (ii). I respectfully disagree with this view on the grounds that it appears to be inconsistent with the express provisions of section 77 (2) (a) in terms of which liability is predicated on the said considerations.

Delpoort<sup>28</sup> is of the view that liability for any benefit (irrespective of or even in the absence of damage to the company) is not covered by section 77(2) (a). Delpoort argues further that it is not clear whether common law remedies pronounced in the cases cited, [e.g. *Regal (Hastings) Ltd v Gulliver* (1967)2 AC 134] will apply. In his view the wording of section 77 (2) (a) seems to exclude a director's liability for a benefit in circumstances where the breach of duty does not result in the company incurring costs or a loss. This seems to be a better view. However, it is submitted that this technical oversight in the drafting of the section should not be viewed as indicating the legislature's desire to depart from the common law position.

A director of a company may be held in accordance with the principles of the common law relating to delict for any loss, damages or costs sustained by the company as a consequence of any breach by the director of-

- (i) a duty of care, skill and diligence<sup>29</sup>
- (ii) any provision of the Act not otherwise mentioned in section 77 <sup>30</sup>
- (iii) any provision of the company's Memorandum of Incorporation.<sup>31</sup>

Section 77 (2) (b) confirms that for purposes of liability for breach of duty of care, skill and diligence, the common law principles in this regard are applicable. In other words, a director's liability under the Act for breach of the duty is the same as was discussed under common law above and therefore will not be repeated here.

At common law the general rule is that the company is the proper plaintiff to sue a director for any breach of fiduciary duty. The position seems to be different under the Companies Act. It is argued that section 20 (6) empowers a shareholder of the company to institute a personal action to claim damages in the event of a breach of any fiduciary duty or a breach of the duty of care, skill and diligence.

<sup>27</sup> FHI Cassim *et al Contemporary Company law* 2<sup>nd</sup>ed (2012) 550

<sup>28</sup> P Delpoort *et al Henochsberg on the Companies Act 71 of 2008 Vol 1* (2011) [loose leaf 2014 update] 301

<sup>29</sup> Section 77 (2) (b) (i) read with section 76 (3) (c)

<sup>30</sup> See section 77 (2) (b) (ii)

<sup>31</sup> See 77 (2) (b) (iii)

Section 77(9) of the Act empowers the court to relieve the director, either wholly or partly from any liability stated in section 77 as long as the conduct giving rise to liability does not constitute willful misconduct or willful breach of trust. It appears the court has power to pardon a director for breaching fiduciary duties or the duty of care and skill if it appears to the court that –

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

It is argued that these provisions cover situations like the *Regal (Hastings) v Gulliver*<sup>32</sup> case. It is further argued that had the case been decided under the Companies Act 71 of 2008, the directors in *Regal (Hastings)* would probably have been relieved from liability by the court.

Having regard to the above discussion of the provisions of section 77 (9), it can be argued that the section modifies the common law position. At common law, directors could not be relieved by the court, of liability for breaching fiduciary duties and the duty of care, skill and diligence. The considerations mentioned in section 77 (9) were of no relevance. Only the company's shareholders in a general meeting could resolve to relieve the director of liability after full disclosure by the errant director. Alternatively, the company's articles could exclude liability for breach of duty as was the case in *Re Brazilian Rubber Plantation*.<sup>3</sup>

The practice by companies of excluding directors' liability for breach of duty by inserting exclusion clauses in the articles in derogation of the strict common law rules is expressly cancelled by the Act. Section 78(2) provides: Any provision of an agreement, the Memorandum of Incorporation or rules of a company, or a resolution adopted by a company, is void if it purports to relieve a director of fiduciary duties, a duty of care, skill and diligence or liability contemplated in section 77.<sup>34</sup> Liability of a director in terms of section 77 is joint and several with any person who is or may be held liable for the same act.<sup>35</sup>

Apart from imposing liability for breach of fiduciary duties and the duty of care and skill, the Act also imposes liability for "specific actions" (specific actions liability) as outlined in section 77(3) – (5). "Specific –actions" liability falls outside the scope of this research and therefore will not be discussed here.

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<sup>32</sup> *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134 (HL)

<sup>33</sup> *Re Brazilian Rubber Plantation and Estates Ltd* [1911] 1 Ch 425 (CA) at 440

<sup>34</sup> See section 78(2)

<sup>35</sup> See section 77(6)



## CHAPTER 4

### COMPARATIVE LAW

#### 4.1 Introduction

The fiduciary doctrine as a legal concept originated in England from the rules of equity. This underscores the influence of English company law in any research on company directors' fiduciary duties. Apart from this fact, South African company law is based on English law. It is therefore not surprising that many English company law rules have been readily accepted in South African company jurisprudence. This is not to imply that our law is a carbon copy of English Law. Although the two systems share the same common law heritage in this area, statutory provisions have pushed them apart. However, English law is still an important source of reference in the development of our company law. This is why England (United Kingdom (UK)) has been selected for comparative study.

This chapter will consider the legal provisions of the UK regarding the “no conflict” duty of company directors. A comparison will be made with the corresponding provisions in the South African Company Law. For reasons of length restriction, only those statutory provisions which may contribute to the improvement of South African law with regard to the regulation of conflict of interests will be discussed.

#### 4.2 United Kingdom (UK)

The general duties of company directors are codified under the Companies Act 2006. They are located in Chapter 2 (sections 171 to 177) of the Act under the heading “General Duties of Directors”. The primary reason for codification was to make the rules accessible. Common law rules and equitable principles have been put in a single statutory scheme that now regulates this area of law.

The general duties are based on certain common law rules and equitable principles as they apply in relation to directors and have effect in place of those rules and principles as regards the duties owed to a company by a director.<sup>1</sup> It is clear here that the general duties replace the common law principles on which they are based. A consequence of this is that any allegation of breach of duty by the director needs to be identified as a breach of one or more of the general duties set out in the statutory scheme in so far as the statutory statement preserves the common law duties.<sup>2</sup>

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<sup>1</sup> Section 170 (3) of the Companies Act of 2006

<sup>2</sup> See PL Davies and S Worthington *Gower and Davies' Principles of Modern Company Law* 9<sup>th</sup>ed (2012) 504

It is submitted that the UK position in this respect is different from the position in South African company law, where the common law duties and principles are preserved.

Section 170 (4) of the UK Companies Act 2006 states:

The general duties shall be interpreted and applied in the same way as common law rules or equitable principles, and regard shall be had to the corresponding common law rules and equitable principles in interpreting and applying the general duties.

The meaning of the above section is not clear. It appears that section 170 (4) read together with section 170 (3) is to the effect that actions against directors will have to be based on breach of some statutory provision, not breach of related common law rules and equitable principles.<sup>3</sup> However, case law will remain relevant to the interpretation of the statutory duties. In comparison, South African Companies Act<sup>4</sup> has allowed common law duties to exist parallel to statutory duties with the effect that directors are required to comply with both the statutory duties and common law fiduciary duties.

The UK Companies Act expressly extends statutory duties to shadow directors.<sup>5</sup> A shadow director is defined as a person in accordance with whose directions or instructions the directors of the company are accustomed to act.<sup>6</sup> The express imposition of directors' statutory duties on shadow directors eliminates any doubts as to whether shadow directors are subject to these duties. Unlike the UK position, the South African legal position is not clear in this regard. There is debate on whether directors' statutory duties extend to shadow directors or not. An express statutory provision like section 170 (5) of the UK companies Act is desirable in South African law to bring certainty and put to rest the current debate on the subject.

The duty to avoid conflicts of interest is dealt with in section 175 of the UK Companies Act. The section provides:

- (1) A director of a company must avoid a situation in which he has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company.

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<sup>3</sup> L Sealy and S Worthington *Sealy's Cases and Materials in company Law* 9<sup>th</sup>ed (2010) 310

<sup>4</sup> Companies Act 71 of 2008 (SA)

<sup>5</sup> See section 170 (5) of the Companies Act of 2006 (UK)

<sup>6</sup> See section 251 of the Companies Act of 2006 (UK)

- (2) This applies in particular to the exploitation of any property, information or opportunity (and it is immaterial whether the company could take advantage of the property, information or opportunity).
- (3) This duty does not apply to a conflict of interest arising in relation to a transaction or arrangement with the company.<sup>7</sup>

Subsection (4) makes it clear that the duty to avoid conflicts of interest is not infringed if the situation cannot reasonably be regarded as likely to give rise to a conflict of interest<sup>8</sup> or if the matter has been authorised by the directors.<sup>9</sup> From this, it can be said that section 175 (4) offers two defenses to a claim against a director which is based on a conflict of interests.

Section 175 (5) and (6) deal with authorisation of conflicts of interest. It is not intended in this paragraph to deal with the two subsections in detail; suffice it to say that the two subsections modify common law and equitable rules regarding the authorisation of conflicts of interest. Having outlined the provisions of section 175 of the UK Companies Act, it is apposite here to make a comparison with the relevant provisions in South African law.

Section 175 of the UK Companies Act is comparable to section 76 (2) of the South African Companies Act<sup>10</sup> in that they are both directed at dealing with directors' conflicts of interest. Furthermore they both treat the no-profit rule as part of the no-conflict rule. This may be viewed as the statutory adoption of the approach followed by the courts in cases like *Bray v Ford*<sup>11</sup> and *Boardman v Phipps*<sup>12</sup>. It is not clear whether this should be viewed as a rejection of the distinction between the two concepts, which distinction, came out clearly in *Regal (Hastings) Ltd v Gulliver*.<sup>13</sup> However, it must be pointed out that the two sections are drafted differently. There is uncertainty in South African law as to whether section (76) (2) is wide enough to apply to both the 'no-profit' rule and the corporate opportunity rule.<sup>14</sup> This problem does not arise in English law because section 175 (2), cited above, makes it crystal clear that the provisions of section 175 (1), noted above, apply in particular to the exploitation of any property, information or opportunity. It is submitted that a provision like section 175 (2) of the UK Companies Act is required in South African law to eliminate any doubts regarding the scope of section 76 (2).

<sup>7</sup> Conflicts of interest arising in relation to a transaction or arrangement with the company are regulated by section 177 and chapters 3 and 4

<sup>8</sup> See section 175 (4) (a) of the Companies Act 2006 (UK)

<sup>9</sup> See section 175 (5) (b) of the Companies Act 2006 (UK)

<sup>10</sup> Companies Act 71 of 2008 (SA)

<sup>11</sup> *Bray v Ford* [1896] AC 44 at 51-52

<sup>12</sup> *Boardman v Phipps* [1967] 2 AC 46 at 123

<sup>13</sup> *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134 at 153 and 159

<sup>14</sup> See chapter 2 paragraph 2.2.1 above, where this problem is discussed in detail

Section 176 of the UK Companies Act imposes a duty on directors, not to accept benefits from third parties. The section provides:

1. A director of company must not accept a benefit from a third party conferred by reason of<sup>15</sup>
  - (a) his being a director, or
  - (b) his doing (or not doing) anything as director.

A “third party” means a person other than the company, an associated body corporate or a person acting on behalf of the company or an associated body corporate.<sup>16</sup> This duty is not infringed if the acceptance of the benefit cannot reasonably be regarded as likely to give rise to a conflict of interest.<sup>17</sup>

Questions may be raised as to the wisdom of English law in having a standalone section (separate from section 175 which regulates conflicts of interests discussed above) that deals with benefits from third parties. The answer, and it is an important one, is that there is no provision in s 176 for authorisation to be given by uninvolved directors for the receipt of third-party benefits.<sup>18</sup> The risk of such benefits distorting the proper performance of a director’s duties is so high that it is rightly thought to be proper to require authorisation from shareholders in general meeting (even though that turns the rule into a near-ban on the receipt of third-party benefits).<sup>19</sup> From the above arguments it becomes clear that it is important to have a section which specifically deals with benefits from third parties.

Section 176 of the UK Companies Act does not seem to have a counterpart in the South African Companies Act. However it may be argued that this duty is subsumed in section 76 (2) (a) (i) of the Act.<sup>20</sup> If this is correct, then a question which arises is: Does the board have power to authorise one of their number to accept benefits from third parties in South African law? The answer appears to be in the affirmative because section 66 (1)<sup>21</sup> confers authority to the board to exercise all of the powers and perform any of the functions of the company, except to the extent that the Act or the company’s Memorandum of Incorporation provides otherwise. The Act is silent on the matter of benefits from third parties. This creates uncertainty in the law, particularly where the company’s Memorandum of Incorporation is also silent on the matter.

<sup>15</sup> See section 176 (1) of the Companies Act 2006 (UK)

<sup>16</sup> Section 176 (2) of the Companies Act 2006 (UK)

<sup>17</sup> Section 176 (4) of the Companies Act 2006 (UK)

<sup>18</sup> PL Davies and S. Worthington *Gower and Davies Principles of Modern Company Law 9<sup>th</sup> ed* (2012) at 611

<sup>19</sup> PL Davies and S Worthington, note 18 above

<sup>20</sup> *Companies Act 71 of 2008* (SA)

<sup>21</sup> See section 66 (1) of the Companies Act 71 of 2008 (SA)

The risk alluded to earlier in the discussion of section 176 of the UK Companies Act is relevant here, and point to a requirement for shareholder authorisation in general meeting as opposed to board authorisation.

It is submitted that South African law may benefit from having a provision which is equivalent to section 176 of the UK Companies Act. Such a provision will eliminate any idea of mutual back scratching by directors in as far as authorising receipt of third-party benefits is concerned.

Both English law and South African law require declaration of interest by directors in proposed transactions or arrangements with the company. The same rule applies in respect of existing transactions or arrangements with the company. Section 177 of the UK Companies Act imposes a duty to declare interest in existing transaction or arrangement. The duty to declare interest in existing transactions or arrangements is dealt with in section 182 of the Act. It must be noted that while a breach of section 177 attracts civil liability<sup>22</sup>, a failure to declare interest as required under section 182 constitutes a criminal offence<sup>23</sup>. Unlike the English law, South African law does not make a distinction between declaration of interest in proposed transaction and declaration of interest in existing transactions or arrangements in as far as liability is concerned. Failure to declare interest, in either case, only attracts civil consequences.<sup>24</sup> It is not clear whether the difference (between the English approach and the South African position) turns on anything significant.

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<sup>22</sup> See section 178 of the Companies Act of 2006 (UK)

<sup>23</sup> See section 183 of the Companies Act of 2006 (UK)

<sup>24</sup> See section 75 and section 77 of the Companies Act 71 of 2008 (SA)

## CHAPTER 5

### CONCLUSION

This research has shown that company directors are fiduciaries and they owe fiduciary duties to the company<sup>1</sup> and not to individual shareholders. In addition to their fiduciary duties, directors owe a duty of care and skill as well as statutory duties<sup>2</sup>. The Companies Act 71 of 2008 has extended directors; fiduciary duties to subsidiary companies as well.

A breach of any one of the above mentioned duties attracts personal liability for the errant director. A strict ethic is observed by the courts in enforcing directors' fiduciary duties. This is particularly so in respect of the "no-conflict" duty. Liability for breach of fiduciary duties is sui generis in nature.<sup>3</sup> There are various remedies for the company if directors breach their duties. The remedies in question depend on the nature of the duty involved in each case<sup>4</sup>.

The research has also shown that the Companies Act 71 of 2008 has not excluded common law principles that regulate directors' fiduciary duties and the duty of care and skill. The result of this is that directors must know and must comply with both common law rules and statutory provisions in as far as their duties are concerned.

As far as the "no-conflict" duty is concerned, directors are not allowed to make secret profit or to usurp the company's corporate opportunities. In addition, directors have an obligation to disclose their interests in contracts to which their company is a party. A failure to do so renders the contract voidable at the instance of the company.

The research has also identified a number of uncertainties in South African law with regard to the regulation of directors' conduct. Some of the said uncertainties may be eliminated by borrowing certain provisions from other comparable jurisdictions such as the United Kingdom, and incorporating these into our law. See the discussion in Chapter 4 of this research.

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<sup>1</sup>See Chapter 1

<sup>2</sup>See Chapter 1

<sup>3</sup> See discussion in paragraph 3.1

<sup>4</sup>See discussion in Chapter 3

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*Spieth v Nagel* [1997] 3 All SA 316 (W)  
*Symington v Pretoria – OosPrivaat Hospital Bedryfs (Pty) Ltd* [2005] ZASCA 47  
*Transvaal Cold Storage Co Ltd v Palmer* [1904] TS  
*Teck Corporation Ltd v Millar* [1973] 33 DLR (3d) 288

## **LEGISLATION**

Companies Act 71 of 2008 (South Africa)

Companies Act of 2006 (United Kingdom)