DIRECTORS' FIDUCIARY DUTIES AND THE COMMON LAW: THE COURTS FITTING THE PIECES TOGETHER

Mthimunye-Bakoro v Petroleum Oil and Gas Corporation of South Africa (SOC) Limited (12476/2015) [2015] ZAWCHC 113; 2015 (6) SA 338 (WCC) (4 August 2015)

> "In short, the hermeneutic's task is not one of algebraic or purely logical precision, but a much broader endeavour aimed at moral or ethical interpretations and at the constant evaluation and implementation of tradition and community ..." (Goodrich *Reading the Law* (1986) 155).

1 Introduction

The partial codification of directors' duties in section 76 of the Companies Act (71 of 2008, hereinafter "the Act") is not a comprehensive statement of directors' duties. Section 158 of the Companies Act requires of a court to develop the common law as necessary to improve the realisation and enjoyment of the rights created in the Act. In a partial codification the common law is still applicable to the extent that it has not been excluded. The courts can develop the duties and even create new duties as opposed to complete codification where the courts may refer to the common law when interpreting the statutory duties, but cannot create new duties (see also Delport (ed), Vorster, Burdette, Esser and Lombard *Henochsberg on the Companies Act 71 of 2008 Volume 1 Service Issue 10* (May 2015) 290(4)).

Partial codification allows the courts to do ground-breaking work. It allows for the development of the law in a way that would be relevant to the demands of modern company and commercial law. On the other hand it can be argued that creating new duties amounts to judicial law-making, contravenes the principle of *iudicus est ius dicere non dare* and is inconsistent with the principle of separation of powers. In *Mthimunye-Bakoro v Petroleum Oil and Gas Corporation of South Africa (SOC) Limited* (*supra* 2 par 15 www.saflii.org) Davis J indicated that the case raised important questions with regard to the common-law duties of directors, the purpose of those duties and the relationship between the common law and the Companies Act (71 of 2008). The court's decision confirms the importance of considering the facts and circumstances of each case in order to determine whether resolutions taken at meetings are valid. This case is a discussion and analysis of the judgment of the Western Cape High Court. Reliance on the statutory provisions and the common law allowed Davis J to avoid an

extremely strict construction of the meaning of "personal financial interest". The case includes some comments on judicial law-making but does not propose to be a detailed discussion of this matter. The case concludes with a recommendation to amend section 75(5) and 71(4) of the Companies Act (71 of 2008).

2 Facts

The applicant, Mthimunye-Bakoro, was an executive director and the Chief Financial Officer of a state-owned company, Petroleum Oil and Gas Corporation of South Africa (SOC) Ltd (first respondent). The Petroleum Oil and Gas Corporation of South Africa (SOC) Ltd is a subsidiary of Central Energy Fund (SOC) Ltd and reports directly to the Department of Energy. The first respondent is a public entity as contemplated in the Public Finance Management Act (1 of 2009) (2 par 5 and 25). The company had eight non-executive directors and two executive directors. The applicant and the Group Chief Executive Officer were the executive directors (4 par 5).

During December 2014 it came to the attention of the board of directors that the company was expected to declare a substantial loss of several billion rands (R14.89 billion) for the financial year ending March 2015 (4 par 10−25).

The board of directors commenced an investigation into the reasons for the company's poor performance. It wanted to determine whether the poor financial performance could be attributed to the poor performance of the applicant (5 par 5). From the investigation the board concluded that the financial losses were in part attributed to the applicant's conduct (5 par 10−15).

On 18 June 2015 the non-executive directors of the first respondent held a board meeting to consider a resolution to suspend the applicant and the Group Chief Executive Officer. Notice convening the meeting was only sent to the non-executive directors. The applicant and the Group Chief Executive Officer did not attend the board meeting where their suspension was considered. At this meeting it was decided to suspend the applicant and the Group CEO on full pay pending the outcome of the investigation (10 par 20 and 11 par 10).

The applicant claims that the meeting of 18 June 2015 and any decisions taken at that meeting were invalid and unlawful because the executive directors were excluded from participation in the board meeting (14 par 15−20). The applicant relied on the decision in *South African Broadcast Incorporation Limited v Mpofu* ([2009] 4 ALL SA 169 (GSJ)) and the provisions of the King Report on Corporate Governance to motivate that the majority directors were not entitled to exclude the applicant from the board meeting unless the exclusion could be justified. The applicant claimed that a company is entitled to the "collective wisdom of all the directors present at meetings and not merely those of the majority". Her contention was that principles of corporate governance does not allow the exclusion of minority directors from board meetings or from voting at board meetings even if the directors in question are perceived to have a conflict of interest. It was

argued that exclusion of a director from a meeting prevented that director from fulfilling her obligations imposed by the Act (11 par 15 and 15 par 5).

A further board meeting was held on 13 July 2015 to reconsider the decisions taken at the 18 June 2015 meeting. Both the applicant and the Group CEO were given notice of this meeting and both attended (18 par 15−20). At the July meeting, the meeting noted that the applicant was conflicted regarding the issues on the agenda (19 par 5). The chair referred to section 75(4) and (5) of the Companies Act and invited the applicant to make representations. After making the representations the applicant was asked to excuse herself from the meeting. No further debate on the issue of her conflict of interest took place after her representations. After being excused from the meeting the board resolved to confirm the suspension. (19 par 10−20). Applicant further claimed that she was wrongly excused from the meeting of 13 July 2015 without her being able to participate in any proper debate on whether she was actually conflicted in the matters to be decided (23 par10−25).

3 Issue

The court had to determine the following issues, namely:

(1) Was the relief sought by the applicant in respect of the 18 June 2015 meeting moot, in light of the meeting and the decisions taken at the meeting of 13 July 2015?

(2) Would the decision to suspend the applicant at the 18 June meeting be valid if the court found that the relief was not moot or if the court was of the opinion that it was necessary to consider the issue?

(3) Was the meeting and the decision to suspend the applicant on 13 July 2015 valid?

4 Finding

The court held that the meeting of 13 July 2015 was valid and dismissed the application with costs. The court said that in terms of the common law a director may not place herself in a position where her personal interests conflict with that of the company. Davis J said that when a board considers a decision of preliminary suspension of a person as an employee and a director one cannot argue that the director in question is not conflicted (38 par 20−25). The court said, correctly so, it is submitted, that to interpret the no-conflict rule under the common law as permitting a director to participate in a decision to suspend her was an incorrect interpretation of the law (38 par 20−25). The common-law principle of conflict of interest must be interpreted by courts on a common sense basis (34 par 15).

5 Analysis and discussion

The issue in the case revolved around the justification for the exclusion of the applicant from the board meeting that considered a decision to suspend her on full pay as employee and chief executive director. The judgment

confirms that "the job of fitting the pieces together is mainly left to the judiciary, whose task it is to combine the old with the new, to decide in relation to a given set of facts just how much the legislature, when formulating the new legal rule, intended to change the existing legal order". (Roux "Continuity and Change in a Transforming Legal Order: The Impact of Section 26(3) of the Constitution on South African Law" 2004 121(2) *South African LJ* 466; and Sunstein "Justice Scalia's Democratic Formalism" 1997 107 *Yale LJ* 529).

When a matter is required to be determined in terms of the Act a court must develop the common law as necessary to improve the realisation and enjoyment of rights established by the Act (s 158(a)). Important in the interpretation of the provisions of the Companies Act is section 5 that provides the Act must be interpreted and applied in a manner that would achieve the purposes of the Act set out in section 7. Of relevance to this discussion are two of these purposes, namely to promote and encourage transparency and high standards of corporate governance as appropriate, given the significant role of enterprises within the social and economic life of the nation (s 7(b)(iii)) and to encourage the efficient and responsible management of companies; and s 7(j)).

In *Peninsula Eye Clinic (Pty) Ltd v Newlands Surgical Clinic* ((21325/11) [2013] ZAWCHC 156; 2014 (1) SA 381 (WCC); [2014] 1 All SA 592 (WCC) (22 October 2013) par 37), the court held that whilst having regard to the provisions of section 5 and 7 of the Act the statute should be construed purposively in a manner that would effectively address such generally recognised needs and considerations unless clearly excluded by the language (see also *Zoneska Investments (Pty) Ltd t/a Bonatla Properties (Pty) Ltd v Midnight Storm Investments* 386 Ltd [2012] 4 All SA 590 (WCC) 596−597; *Kubyana v Standard Bank of South Africa Ltd* [2014] ZACC 1 par 18; *Wary Holdings (Pty) Ltd v Stalwo* (Pty) Ltd [2008] ZACC 12 par 61; *Mistry v Interim Medical and Dental Council of South Africa* [1998] ZACC 10 par 17−18; *S v Zuma* [1995] ZACC 1 par 17−18; and *Investigating Directorate: Serious Economic Offences v Hyundai Motor Distributors (Pty) Ltd: In re Hyundai Motor Distributors (Pty) Ltd v Smith NO* [2000] ZACC 12 par 23−24 and 26).

As indicated during the explanation of the facts, the applicant relied on the *Mpofu* decision and the provisions of the King III report on Corporate Governance. There is no statutory requirement that companies in South Africa have to comply with the King III and the Code of Corporate Practices. Compliance with King III and the Code of Corporate Practices is only compulsory for companies listed on the Johannesburg Stock Exchange (par 7.F.5 to 7.F.6 and par 8.63(a) of the JSE Listing Requirements; and Cassim *et al Contemporary Company Law* 2ed (2012) 474). Certain issues of corporate governance have been incorporated into the act and have legal force.

The provisions of the act is the primary source of law. The courts first task would always be to ascribe the legal meaning to the words of the act and then to apply that meaning to the situation before the court (Devenish "Fundamental Concepts and the Historical Roots of the Interpretation of Statutes in South Africa" 1991 24(1) *De Jure* 77 81). The language used in

King III distinguishes between principles that have legal force through the use of the word "must" and principles that will result in good corporate governance through the use of the word "should" (King III report on Corporate Governance Institute of Directors 2009: Introduction and background (par 12) language, gender and terminology (17)). If the courts were to adopt a principle that has no legal force (indicated in King by the use of the word "should"), it could be argued that the courts are developing the common law or even creating new duties for directors. If new duties are created by the courts it can be argued that the courts are engaging in judicial law-making. Incorporation by the courts of principles of the Code into the law could be said to promote the development of the South African economy and high standards of corporate governance (see s 7(b)(iii)). A counter-argument to the courts creating new duties is that it is the task of the legislature to engage into policy making and legislation and not that of the courts.

It might be argued that judicial law-making contravenes the principle of separation of powers and the maxim *iudicis est ius dicere non dare*. None of these principles are however applied strictly in South Africa. The Constitutional Ctatourt in *Certification of the Constitution of the Republic of South Africa* (1996 (CCT 23/96) [1996] ZACC 26; 1996 (4) SA 744 (CC); 1996 (10) BCLR 1253 (CC) (6 September 1996) par 108) held that there is no universal model for separation of powers and that a constitutional dispensation cannot reflect a complete separation of powers (par 109). In *De Lange v Smuts* ((CCT26/97) [1998] ZACC 6; 1998 (3) SA 785; 1998 (7) BCLR 779 (28 May 1998) par 60). Ackerman J said that over time South Africa will develop its own unique model of separation of powers. A balance must be maintained between the legislature and the judiciary (*Du Plessis v De Klerk* (CCT8/95) [1996] ZACC 10; 1996 (3) SA 850; 1996 (5) BCLR 658 (15 May 1996) par 181). Sachs J on behalf of the Constitutional Court in *Du Plessis v de Klerk* (*supra* par 181) held that:

> "The Constitution contemplates a democracy functioning within a constitutional framework, not a 'dikastocracy' within which Parliament has certain residual powers. The role of the courts is not effectively to usurp the functions of the legislature, but to scrutinize the acts of the legislature. It should not establish new, positive rights and remedies on its own. The function of the courts, I believe, is, in the first place, to ensure that legislation does not violate fundamental rights, secondly, to interpret legislation in a manner that furthers the values expressed in the Constitution, and, thirdly, to ensure that common law and custom outside of the legislative sphere is developed in such a manner as to harmonise with the Constitution."

What would constitute an appropriate balance remains unclear. It is true that parliament should in an ideal world be best placed to react when new legal rules are needed but similarly the situation might arise where the courts are well placed to develop such rules. Legislation is drafted in general terms and it is accepted that the legislature cannot provide for all eventualities that may occur in future.

Section 66(1) of the Companies Act (71 of 2008) provides that the business of a company must be managed by or under the direction of the board of directors (see also *South African Broadcasting Corporation Ltd v Mpofu* (A5021/08) [2009] ZAGPJHC 25; [2009] 4 All SA 169 (GSJ) (11 June 2009) par 30). Generally the board of directors will act through resolutions

taken at board meetings. It is possible, except where the MOI provides otherwise, that directors may adopt written resolutions on matters that could be voted on by the board (s 74). However, when a board of directors meeting is being held, the prescribed formal requirements have to be complied with for the meeting and it's decisions to be valid. Section 73 of the Act and the MOI of a particular company prescribe the formal requirements for board meetings. No board meeting may be convened without notice to **all** (author's own emphasis) the board members (s 73(4)(b)). The MOI of the company may determine the form and time for giving notice of meetings (s 73(4)). A matter at a board meeting may only be put to a vote provided a quorum is present (s 73(5)(b)). In the absence of a provision to the contrary in the MOI, a quorum would be a majority of the members of the board (s 73(5)(b)).

The implications of the exclusion of directors from board meetings was raised in a number of decisions. In *Novick v Comair Holdings Ltd* (1979 (2) SA 116 (W) 128D), Colman J giving the judgment of the court said:

> "I was referred to the authorities which hold that the company is entitled to the benefit of the collective wisdom of all the directors present at a meeting, and not merely to that of a majority. The minority, it is said, is entitled to all relevant information, and to an opportunity of stating its views, even though it may ultimately have to submit to a majority decision … The legal basis for this defence was the well-known doctrine that directors of a company are under a duty to use their voting powers for the benefit and in the interests of that company and not of any other person."

In *Transcash SWD (Pty) Ltd v Smith* ((1994) 1 All SA 163 (C)) the court recognized, as a basic democratic principle of company law, that the minority (a factual minority of the members of the board of directors) must be allowed the opportunity to participate in a debate or a discussion of the board with the aim of convincing the majority to adopt the minority view (see also *Robinson v Imroth* 1917 WLD 159 171−172). In *Transcash* reliance was placed on the common-law principle that a director is not entitled to participate in a decision where she was conflicted. The court cautioned against excluding directors merely because of a perceived conflict of interest. In that decision the judge held (par 174(1)) that a director should be entitled to exercise her rights as a director until she has been validly removed. *In South African Broadcasting Corporation Ltd v Mpofu* ((A5021/08) [2009] ZAGPJHC 25; [2009] 4 All SA 169 (GSJ) (11 June 2009) 14), the court held (par 32) that a board meeting must consist of all the board members. It is respectfully submitted that this is incorrect. In terms of section 73(4)(b) no board meeting may be held if **notice** (author's own emphasis) was not given to **all directors** (author's own emphasis). A board meeting may proceed provided a quorum is present (a factual majority of the members of the board (s 73(5)(b)). The Act does not require all directors to be present. The facts in each of these cases distinguish them from the case under discussion. In the decisions referred to above meetings were not properly convened (insufficient or no notice was given) or directors were not allowed to make representations at the meetings or there was no quorum at the meeting.

Directors' duties are partially codified in the Companies Act 71 of 2008. (Delport (ed), Vorster, Burdette, Esser and Lombard *Henochsberg on the*

Companies Act 71 of 2008 Volume 1 Service Issue 10 290(3)). In terms of the common law, directors stand in a fiduciary position towards the company and must avoid the situation where their personal interests conflict with that of the company (*Robinson v Randfontein Estate Gold Mining Co Ltd* 1921 AD 168 177). King III provides that it is not sufficient to merely table a register of interests at board meetings. The Chairperson of the board **must** (author's own emphasis) ask affected directors to recuse themselves from discussions and decisions in which they have a conflict, unless they are required to provide specific input, in which event they should not participate in the decision making (Principle 2.16 par 40.6 of the King III report on Corporate Governance Institute of Directors 2009 35). Section 75 and 76 of the Companies Act deal specifically with directors duties. Section 75(5) of the Companies Act provides that:

> "If a director of a company, other than a company contemplated in subsection (2)(b) or (3), has a **personal financial interest** (author's own emphasis) in respect of a matter to be considered at a meeting of the board or knows that a related person has a personal financial interest in the matter, the director:
> (a) must disclose the interest and its general nature before the matter is considered at the meeting.
> (b) must disclose to the meeting any material information relating to the matter and known to the director.
> (c) may disclose any observations or pertinent insights relating to the matter if requested to do so by the other directors.
> (d) If present at the meeting must leave the meeting immediately after making any disclosure contemplated in paragraph (b) or (c).
> (e) must not take part in the consideration of the matter except to the extent contemplated in paragraph (b) and (c).
> (f) while absent from the meeting in terms of the subsection
> (i) is to be regarded as being present at the meeting for the purposes of determining whether sufficient directors are present to constitute the meeting and
> (ii) is not to be regarded as being present at the meeting for the purpose of determining whether the resolution has sufficient support to be adopted and
> (g) must not execute any document on behalf of the company in relation to the matter unless specifically requested or directed to do so by the board."

"Personal financial interest" is defined as a direct material interest of that person of a financial, monetary or economic nature or to which a monetary value can be attributed but does not include any interest held by a person in a unit trust scheme or a collective investment scheme, unless that person has direct control over the investment decisions of that fund or investment (s 1 of the Companies Act 71 of 2008). The inclusion of the word "financial" raised the technical argument that if an interest is not financial in nature, the provisions of the section will not be applicable. In this case it was argued that suspension with full pay does not involve a financial interest and therefor section 75 should not apply. It is submitted that such a narrow interpretation of the section will not promote the purposes of the act and constitutes textual literalism.

Procedural due process or the *audi alteram partem* rule is well established in South African law. The principles of natural justice would require granting the applicant the opportunity to state her side of the case prior to any

decision being made. The principles of natural justice does however not make provision for the fact that the applicant must participate in the decision to suspend her. In addition to the principles of natural justice, executive directors are also regarded as employees to whom the labour laws will apply. As an employee, an executive director is entitled to fair labour practices in terms of section 23 of the Constitution of the Republic of South Africa 1996 which includes the right to be heard but not the right to participate in the decision-making about her future.

The court correctly relied on both the provisions of the Act and the common law to determine that the CEO could not participate in a decision regarding her own suspension. The court confirmed that where a meeting was duly convened, that is, proper notice was given, she was allowed to make representations at the meeting of 13 July 2015 prior to being requested to excuse herself. The court held that the decisions taken at the meeting were valid.

When considering the suspension of a director it is useful to consider the provisions of section 71 that provides for removal of directors. Section 71(3) provides that:

> "If a company has more than two directors and a shareholder or director has alleged that a director of the company –
> (a) has become −
> (i) ineligible or disqualified in terms of section 69, other than on the grounds contemplated in section 69(8)(a); or
> (ii) incapacitated to the extent that a director is unable to perform the functions of a director and is unlikely to regain that capacity within a reasonable time; or
> (b) has neglected or been derelict in the performance of the functions of the director,
> the board, **other than the director concerned** (author's own emphasis), must determine the matter by resolution and may remove a director who it is determined to be an ineligible or disqualified, incapacitated or negligent or derelict as the case may be."

When this occurs section 71(4) provides:

> "Before the board of a company may consider a resolution contemplated in subsection (3), the director concerned must be given
> (a) notice of the meeting including a copy of the proposed resolution and a statement setting out reasons for the resolution, with sufficient specificity to reasonably permit the director to prepare and present a response and
> (b) a reasonable opportunity to make a presentation in person or through a representative to the meeting before the resolution is put to a vote."

The intention is clear that when a decision is to be taken that would adversely affect a director, such a director should be allowed the opportunity to make representation to the board prior to the decision being taken. The provision in King III that provides the director in question must be allowed an opportunity to make representations and then be asked to recuse herself and not participate in the decision are in line with the provisions in section 75(5) and 71(4). The court promoted high standards of corporate governance in line with section 7(b)(iii) of the Act when it held that the decision to suspend the applicant was valid.

6 Conclusion

Judicial law-making should not be seen as an invitation to take irrelevant material into account. Only a finding of the Supreme Court of Appeal or ultimately the Constitutional Court on a matter will bind all other lower courts. Till either the Supreme Court of Appeal or the Constitutional Court pronounces on a matter it is possible that courts that are not bound by decisions of other courts could come to different conclusions on the same issue which will contribute to legal uncertainty. It is suggested that the most effective way to deal with the uncertainty within the provisions of the act would be a legislative amendment. The legislature is recommended to amend section 75(5) of the Companies Act (71 of 2008) to read "personal financial interest or any other conflict of interest in respect of a matter to be considered at a meeting of the board". In addition to amending section 75(5), section 71(4) can also be amended to make the procedure provided for in section 71(4) applicable to a situation where the board considers a resolution to suspend a director. The proposed amendments will contribute to clarity and legal certainty. It will also make the statutory statement clearer to directors which is one of the advantages of partial codification.

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