TRANSPARENCY IN CORPORATE GOVERNANCE: EXTENT OF DIRECTORS DUTY TO DECLARE INTEREST IN COMPANY'S TRANSACTIONS

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Abstract

The realization that the directors occupy important position in corporate governance, and as business men and women, cannot be prevented from having dealings with the company, demand a close scrutiny of corporate transactions in which they are directly or indirectly involved or have an interest to ensure that such interest is not placed above their duty to the company. One of the ways in which the law strives to achieve this balance is by imposing a duty on the director to disclose to the board any interest he has in company's transactions. This requirement which was previously governed by the common law and the company's articles, is presently increasingly finding a place in companies statutes in different jurisdictions. The paper examines, through a comparative analysis, the provisions on the duty of the director to disclose interest in company's transactions in South Africa and United Kingdom with the aim of discovering the extent to which the statute in both jurisdictions upholds the common law prescriptions. The paper argues that the need for transparency in corporate governance and the preservation of the distinct legal personality of the company demand that the duty to disclose interest should be upheld even in those cases of companies run by a sole director.

Keywords: Corporate Governance, Transactions, Directors Duties

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1 Introduction

One of the keys to corporate success is ensuring transparency on the part of those entrusted with the management of the corporation. The company as a creation of statute, acts through its human agency. The directors conspicuously stand out as galvanizers of the company's objects. When performing the functions vested in them on behalf of the company, they are regarded as agents of the company. They are also the custodians of the company's assets which they hold on trust for the benefit of the company and the shareholders. As agents and trustees, the directors occupy fiduciary position towards the company, which invariable brings to bear certain equitable obligations on the part of the directors. One of such important equitable obligation is that directors must always disclose any interest they have in transactions involving the company. This fiduciary obligation is presently codified in the companies' statutes in different jurisdictions.[16] Attention is however focused in this work specifically on the provisions contained in the Companies Acts of the United Kingdom and South Africa respectively. It is intended to comparatively appraise those provisions with a view to discovering the extent they guarantee transparency in the directors dealings with the company.

2 Statutory antecedent to duty to disclose interest

At common law the equitable principle which imposes a duty on the director to refrain from placing himself in a position in which his interest conflicts or may conflict with his duty to the company nor benefit from corporate opportunities is limited by the exception that the director may so benefit where there is a full and frank prior disclosure by the director of his interest to the general meeting. Disclosure

[16] For instance, ss 177 and 182 of the UK Companies Act of 2006, s 175 of the South African Companies Act 71 of 2008.

to the board is insufficient even if the director refrains from attending and voting at the meeting because the company is entitled to the unbiased voice and advice of every director.[17] The rule was so strictly enforced that no question is asked or allowed to be asked as to the fairness or unfairness of the transaction.[18] This rule is founded on the obligation by the director, as a component of his duty, to pass to the company every information which would be beneficial to the company, and not to withhold that information for the furthering of the collateral interest of the director.[19]

Statutory recognition was first given to this equitable principle in section 29 of the UK Joint Stock Companies Act of 1844 which disqualified any director in breach of the equitable duty and required him to vacate office. That provision was, however, sandwiched in the optional table in the 1856 Act[20] which obviously impacted on its effectiveness as it was excluded at the option of the directors who saw in the provision an impediment to a free flow of business transactions in which the directors had interest. The practical implication of including such provision in the article could be seem in the pronouncement of Lord Upjohn in *Boulting v Association of Cinematography, Television & Allied Technicians*[4] where the judge, while accepting in principle that the company is entitled to the undivided loyalty of its directors, recognized that,

> the person entitled to the benefit of the rule may relax it, provided he is… *sui iuris* and fully understands not only what he is doing but what his legal rights are, and that he is in part surrendering them. Thus, the company may in its articles of association permit directors to be interested in contracts with the company. It may go further, and articles may validly permit directors to be present at board meeting and even to vote when proposed contracts in which they are interested are being discussed; provided of course, that they make full disclosure of their interest.

The pervasiveness of such articles with the attendant flouting by directors of their fiduciary duties brought about legislative intervention. Statutory provision requiring directors to declare their interests in any contract or proposed contract with the company was restored by section 149 of the UK Companies Act, 1929 which later became section 199 of 1948 Act. The amended version of that provision contained in section 317 of the UK Companies Act of 1985 has undergone further modifications in sections 177 and 182 dealing with a director's interest in proposed and existing transactions and arrangement respectively under the 2006 UK Companies Act with different consequences applying to a breach of either provision.

Similar provisions under the South Africa law were initially elaborately set down in sections 234 to 241 of the Companies Act 61 of 1973 which is now repealed and replaced with section 75 of the Companies Act 71 of 2008.

3 Exploring the statutory components of the duty

Section 177(1) of the UK Companies Act provides that '[i]f a director of a company is in any way, directly or indirectly, interested in a proposed transaction or arrangement with the company, he must declare the nature and extent of that interest to the other directors'. The provision, though concisely captured, is significantly expansive as it does not only bite when the director is personally interested in any transaction or arrangement with the company, but even in those cases where the interest of the director could be described as indirect such as where the present company is dealing with another company in which the director is a shareholder.

This has always been the position at common law as witnessed in the pronouncement of Lord Selbourne in *Exparte Forder*[21] where he emphasised that trustees are not allowed to exercise their powers for their

[17] See *Benson v Heathorn* (1842) IY & CCC 326 per Knight-Bruce VC at 342-342; *Gray v New Augarita Porcupine Mines Ltd* [1952] 3 DLR 1 (PC) per Lord Radcliffe at 14.
[18] *Aberdeen Railway Co v Blaikie Bros* (1854) 1 Macq HL 461 per Lord Cranworth LC at 472. In *Gray v New Augarita Porcupine Mines Ltd* [1952] 3 DLR 1 (PC) at 14 Lord Radcliffe referring to the decisions in *Parker v McKenna* LR 10 Ch App 96; *Costa Rica Railway v Forwood* [1901] 1 Ch 746 observed that a trustee who is accountable is not the less accountable if he shows that the transaction impugned is both reasonable and fair. See also *Tito v Waddell (No.2)* [1977] Ch 106 per Megarry VC.
[19] See Derek French, Stephen Mayson & Christopher Ryan, *Mayson, French & Ryan on Company Law 30th ed* (Oxford: Oxford University Press 2013) p 511.
[20] See Table B Article 47 UK Companies Act 1856.
[4] (1963)2 QB 606 at 636.
[21] (1881) 25 Sol. Journ 720.

own benefit or for the benefit of anyone so connected with them. Defining the boundaries of such connection as would impact on a director's interest has not been an easy one, not even with all the flexibilities of the courts of equity, as what a relationship may appear in form is not always same in substance. In *Newgate Stud Co & Anor v Penfold & Anor*[22] Richards J observed that 'if a director causes his company to enter into a transaction with a close relation, or a spouse or other partner, there is a significant risk that the director will be compromised by a desire to favour the other party'. In realisation of the propensity of the directors to protect such extended interests, equity throws its searchlight beneath the surface, and applies its doctrines to cases where, although in form a trustee has not sold to himself, in substance he has.[23] Beneath the surface scrutiny enables the courts to ascertain the validity of transactions in which the directors have used 'fronts'[24] to further their personal interests. Such transactions would usually appear fair on the surface, but the real interests involved are discovered with hard facts and evidence.[25]

The reference to 'transaction or arrangement' is meant to obviate the difficulties or limitations associated with the defining of 'contract' as witnessed under the old law.[26] While 'transaction' could be explained as involving the exchange of goods and services, and for monetary value, a binding contract for short, 'arrangement' certainly demands something less. It conjures some element of give and take,[27] it arouses the incidences of moral, rather than legal obligation to act, an honourable understanding which is not legally enforceable[28] and thus does not have contractual effect.[29] A transaction actually starts where arrangement stops. The use of both terms in the provision and separating them with the disjunctive 'or' is an indication that the obligation to disclose interest could arise even where there is no intention, and indeed no obligation, on the part of the company to execute its own part of the bargain.

The South Africa Companies Act of 2008, section 75(5), adopted a more familiar pattern in expressing the scope of the director's obligation to disclose interest in proposed company's dealings. The provision states that '[i]f a director of a company… has a personal financial interest 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 [must disclose the interest]'. The reference to 'a matter to be considered' ensures that whatever controversy that could arise in the interpretation of 'transaction or arrangement' as under the English law is avoided. More importantly is that the scope of the provision is extended to every subject matter of discussion at the meeting of the board that bears some financial implications. What constitutes 'personal financial interest' is explained in section 1 of the Act as a direct material interest of that person, of a financial, monetary or economic nature, or to which a monetary value may be attributed.[30]

The reference to 'direct material interest' seems somewhat restrictive when compared with the UK Companies Act which refers to 'direct or indirect' interest. But the obligation to disclose interest does not end with the personal financial interest of the director, it extends to the personal financial interests of related persons which is known to the director, and by so doing, the provision incorporates the disclosure of indirect financial interests even without the specific mentioning of such interest.[31] In *Cowan de Groot Properties Ltd v Eagle Trust*[32] Knox J had while relying on *Transvaal Lands Co v New Belgium* (*Transvaal*) *Land and Development Co*[33] observed that a conflict between a duty as trustee for others on

[22] [2004] EWHC 2993 (Ch) para 240.
[23] *Tito v Waddell (No 2)* [1977] Ch 106 at 240 per Sir Robert Megarry VC.
[24] 'Front' is defined by the Nigerian Court of Appeal in *Onyekwulunne v Ndulue* [1997] 7 NWLR (pt.513) 250 at 280 as the apparent or nominal leader behind whom the real powerful man works anonymously.
[25] See Anthony O Nwafor & Gloria C Nwafor, 'Breach of Duty: Power of Shareholders to Ratify Directors Fraudulent Dealings' [2014] Vol 10 Issue 2 *Corporate Board: Role, Duties and Composition* 32.
[26] See s 317(1)(5) of the UK Companies Act 1985.
[27] *Re NFU Development Trust Ltd* [1973] 1 All ER 135 at 140.
[28] *Re British Basic Slag Ltd's Agreements* [1963] 2 All ER 807 at 815; *Re Austin Motor Co Ltd's Agreements* [1957] 3 All ER 62 at 69.
[29] *Murray v Leisureplay Plc* [2004] EWHC 1927 (QB) para 106; *In re Duckwari Plc* [1999] Ch 253.
[30] This however does not include any interest held by a person in a unit trust or collective investment scheme in terms of the Collective Investment Schemes Act, 2002 (Act No. 45 of 2002), unless that person has direct control over the investment decisions of that fund or investment. See s 1 SA CA 2008.
[31] See F.H.I. Cassim 'The Duties and Liability of Directors' in F.H.I. Cassim, M.F. Cassim, R. Cassim, R. Jooste, J. Shev and J. Yeats (eds.), *Contemporary Company Law* (Juta & Co Ltd: Cape Town, 2011) p. 516 where the writer observed that the director's interest must be a 'direct' material interest and not an indirect one. However, since the interest of a person related to the director and who is known by the director to hold a personal financial interest falls within the scope of section 75(5), the omission of the word 'indirect' may not be of significance in practice.
[32] [1992] 4 All ER 700 at 764.
[33] [1914-15] All ER Rep 987.

the one hand and a duty as a director on the other constitutes just as 'significant' a conflict of interest as does a conflict between a personal interest and a duty as a director.

What the court referred to as 'significant' in that case cannot be different, and indeed is synonymous with the term 'material' as used in section 1 of the South African Companies Act.[34] The materiality or significance of financial interest cannot be an issue for the director. The company is in a better position to decide on what it deems 'material' in the sense that the disclosure of the interest would have affected the company's decision in the matter. In most cases, however, it would be for the court to determine based on available evidence. The preservation of the director's integrity as imposed by his fiduciary status, demands that every interest in the subject matter be declared even as a cautionary measure.

Where the interest is merely indirect, it must be shown that the director has knowledge of the existence of such interest to invoke the duty of disclosure. But knowledge as used in the provision is not restricted to subjective or actual knowledge. Section 1 of the Act elevates knowledge to the level of objectivity by extending it to imputed knowledge, so that a director cannot deny knowledge when he ought reasonably to have known.[35]

Knowledge is actual when it is proved that the person knows, or imputed; when it is inferred from the surrounding circumstances.[36] The basis for imputed knowledge was explained by Williams as follows:

> In either event there is someone with actual knowledge. To the requirement of actual knowledge there is one strictly limited exception. Men readily regard their suspicions as unworthy of them when it is to their advantage to do so. To meet this, the rule is that if a party has his suspicion aroused but then deliberately omits to make further enquiries, because he wishes to remain in ignorance, he is deemed to have knowledge.[37]

The 'deemed knowledge' is what Lord Scott of Foscote referred to in *Manifest Shipping Co Ltd v Uni-Polaris Co Ltd*[38] as blind-eye knowledge' which implies a suspicion that the relevant facts do exist and a deliberate decision to avoid confirming that they exist. In *Morris & Ors v Bank of India*[39] Patten J reiterated this judicial position where he stated that 'knowledge includes deliberately shutting one's eyes to the obvious'. A similar position was adopted by the South African court in *jeNO and others v Mitsui & Company Ltd and others*[40] where Wunsh J held that if a person has a suspicion that something unlawful is happening and deliberately shuts his or her eyes to what is going on, he or she has knowledge.[41]

This type of knowledge is in Canada referred to by the courts as 'wilful blindness'. In *R v Briscoe*[42] Charron J explained that the doctrine of wilful blindness imputes knowledge to a person whose suspicion is aroused to the point where he or she sees the need for further inquiries, but deliberately chooses not to make inquiries. Pink J observed in *R v Jorgensen*[43] that 'a finding of wilful blindness involves an affirmative answer to the question, did the accused shut his eyes because he knew or strongly suspected that looking would fix him with knowledge'. And when such an answer is in affirmative, it amounts to what Doherty J described in *R v Duong*[44] as 'deliberate ignorance'.[45] A director would accordingly not

[34] A term defined by the Act as implying 'significant in the circumstances of a particular matter, to a degree that is— *(a)* of consequence in determining the matter; or *(b)* might reasonably affect a person's judgment or decision-making in the matter'. See s 1 SA CA 2008.

[35] See s 1 of the SA CA 2008 which provides that '"knowing", "knowingly" or "knows", when used with respect to a person, and in relation to a particular matter, means that the person either—*(a)* had actual knowledge of that matter; *(b)* was in a position in which the person reasonably ought to have—(i) had actual knowledge; (ii) investigated the matter to an extent that would have provided the person with actual knowledge; or(iii) taken other measures which, if taken, would reasonably be expected to have provided the person with actual knowledge of the matter'.

[36] See *Valantine v Bangla TV Ltd* [2009] EWHC (Ch) 632 para 53 where Jeremy Cousins QC sitting as Deputy Judge inferred knowledge from admissions made in the witness statement.

[37] G. Williams, *Criminal Law: The General Part*, 2nd edn (Stevens & Sons Ltd: London, 1961) p. 157.

[38] [2003] 1 AC 469 para 116 (HL).

[39] Sub nom *Re Bank of Credit and Commerce International SA (No.14)* [2003] EWHC 1868 (Ch), [2004] 2 BCLC 236 para 11. See also *Re Bank of Credit and Commerce International SA (No.15)* [2004] EWHC 528 (Ch), [2004] 2 BCLC 279 para 13.

[40] [1996] 3 All SA 353 (W) at 401. See also *Frankel Pollak Vinderine Inc v Stanton* [1996] 2 All SA 582 (W).

[41] 'Knowledge' is similarly defined in section 1 of SA CA 2008.

[42] [2010] SCC 13, [2010] 1 SCR 411 (CanlII) para 21. See also *R v Jorgensen* [1995] 4 SC 55 (SCC), *R v Sansregret* 1985 CanLII 79 (SCC), [1985] 1 SCR 570.

[43] [1995] 4 SC 55 (SCC) para 10.

[44] 1998 CanLII 7124 (ON CA), (1998) 124 C.C.C. (3d) 392 (Ont. CA) at 402 para 23.

escape liability by claiming not to know of the existence of the personal financial interest of a related person when he ought reasonably to have known.[46]

In both jurisdictions, disclosure of interest is not limited to proposed transactions, it extends to those other transactions in which the company has acquired material interest.[47] The provisions anticipate the dynamics of commercial transactions and directors relationships with their companies. The companies' interests vary as much as those of the directors and their appointments. Directors are not appointed at the same time, some could be appointed while the company has already acquired interest in the transaction. Such directors must therefore inform the company of their interests in the transaction to guide the company's future dealings.

The requirement of disclosure of interest is however not absolute as there are instances where the statute condones non-disclosure. Under the South African law, for instance, section 75(2) of the Companies Act does not require disclosure where the decisions generally affect all the directors in their capacity as directors. Although administratively, it seems quite sensible not to insist on disclosure when all the directors are equally interested in the company's transaction as there would be none to decide on the fate of the other, but there is everything wrong in foreclosing the need for a disclosure simply on the ground that the directors with interest also constitute the board. The directors are not synonymous with the company. The need for disclosure does not exists for the protection of the company and the creditors. There is always another organ, and indeed a superior organ, of the company that could act where the directors could not because of existing interest. That organ is the general meeting which consists of the body of the shareholders. If the decision which generally affects all the directors is as such that the financial interest of the company is also affected, then disclosure should be made to the shareholders at the general meeting as they as a body are the principal of such directors. The same could also be said of the common law position where the directors could be exempted from disclosure if all the directors knew of each other's interest in the agreement being discussed by the board a situation described as 'technical non-declaration'.[48] The courts have commendably declined to extend this, rather absurd statutory leverage to sole directors. In *Neptune (Vehicle Washing Equipment) Ltd v Fitzgerald*[49] Lightman J declined to accept that a sole director of the company could evade the provision of section 317 of the UK Companies Act of 1985 (now s 177 of 2006 Act) simply on account of being the only director. The judge was not swayed by the argument that as the law required declarations of interests to be made at the meeting of the board, a sole director of the company cannot constitute a meeting. On the contrary, as held by the court:

> The sole director may hold a meeting attended by himself alone or he may hold a meeting attended by someone else, normally the company secretary. When holding the meeting on his own, he must still make the declaration to himself and have the statutory pause for thought, though it may be that the declaration does not have to be out loud, and he must record that he made the declaration in the minutes. The court may well find it difficult to accept that the declaration has been made if it is not so recorded. If the meeting is attended by anyone else, the declaration must be made out loud and in the hearing of those attending, and again should be recorded. In this case, if it is proved that the declaration was made, the fact that the minutes do not record the making of the declaration will not preclude proof of its making. In either situation the language of the section must be given full effect: there must be a declaration of the interest.

Such declaration even in those unique circumstances, as observed by Lightman J, ensures the existence of records of interest which could serve as a point of reference should the transaction be subjected to scrutiny sometime in the future. It affords valuable information as to the existence of any interest and its disclosure which enhances accountability and ensures protection for shareholders and creditors of the company against self-dealing by the director.

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[45] A description preferred by D. Stuart, *Canadian Criminal Law: A Treatise*, 5th ed. (Scarborough, Ontario,Thomson Carswell, 2007) at 241 where the author stated that the expression 'deliberate ignorance' seems more descriptive than 'wilful blindness', as it connotes 'an actual process of suppressing a suspicion'.

[46] For more discussion on the concept of imputed knowledge, see Anthony O Nwafor, 'Fraudulent Trading and the Protection of Company Creditors: the Current Trend in Company Legislation and Judicial Attitude' [2013] 42(4) *Common Law World Review* 297 at 316-319.

[47] See s 75(6) SA CA 2008, s 182 UK CA 2006

[48] See *Lee Panavision v Lee Lighting* [1992] BCLC 22 (CA).

[49] [1995] 3 All ER 811 at 818.

An overlooked factor in these vital considerations is that the company as a juristic person could survive the sole director, even if such director is also the sole shareholder of the company. The succeeding members, and if the company goes into liquidation, the liquidator, could ask questions on the fairness of transactions involving self-dealing where disclosures are not made and fully recorded in the company's book. The South African Companies Act provision in section 75(2)(b) does not seem to have taken these factors into consideration while exempting from the declaration of interests, a sole director who is also the sole shareholder of the company. The UK Companies Act of 2006 does not bear any specific provision in this regard. However, it has been suggested that since both sections 177 and 182 require disclosure to be made to the board, a sole director of a private company need not make any disclosure, and it seems from the views as expressed that it does not matter that such a sole director may not be the only shareholder of the company.[50] Indeed, the UK Attorney General Lord Goldsmith was quoted as describing any suggestion that a sole director of a private company should declare interest to himself as a "nonsense".[51] Perhaps that could be said from a literal reading of sections 177 and 182 of the UK Companies Act which require disclosure to be made by the interested director to the 'other directors'. There would not be 'other directors' in a company that is run by a sole director. But if the term 'other directors' is given its true meaning as referring to the 'board of directors' then some 'sense' could be deduced from the 'nonsense'. Section 154(1) of the UK Companies Act, like the section 66(2)(a) of the South African Act, creates room for the private company to function with a sole director. The sole director invariably constitutes the board. If the board should meet at all to transact the business of the company,[52] then a sole member board could constitute a meeting. Any disclosure that is required by law to be made to the meeting of the board must therefore be made by the sole director to himself.

Rules of law apart, there is so much sense in the suggestion that a sole director should, for all practical purposes, be seen to have made a disclosure of interest even if it is to himself, if the distinct personality of the company must be preserved. The directors must be made to conduct their individual affairs in such a manner as would distinct them from those of the company even if it seems artificially so as is the concept of legal personality of the company itself. This is what transparency and fairness demand especially for the company which can only act through the directors.

The South African Companies Act of 2008 deviates significantly from the UK approach by providing in section 75(3) that the sole director who is not also the sole holder of the beneficial interests of all the securities of the company should disclose his interest to the shareholders at the general meeting. This will obviously apply to every company as what matters is the number of shareholders and not number of directors as such. But the gap still remains in section 75(2)(b) to the extent that it exempts a sole director who is also the sole shareholder from disclosing his interest in the company's transaction.

The requirement of declaration at the meeting of the board is no longer indispensable as the law now provides other alternatives which could be by notice in writing or general notice.[53] Whichever method adopted must be deliberated upon at the board meeting and duly recorded in the company's minutes book as evidence of such declaration.[54] An open declaration of interest at meeting of the board remains the most transparent and viable option from the company's perspective. Lightman J in *Neptune's case*[55] set down three cogent reasons why this option should be preferred by the company, namely: First, all the directors should know or be reminded of the interest; Second, the making of the declaration should be the occasion for a statutory pause for thought about the existence of the conflict of interest and of the duty to prefer the interests of the company to their own; Third, the disclosure or reminder must be a distinct happening at the meeting which therefore must be recorded in the minutes of the meeting. The second reason seeks to channel the minds of the directors on the right course. As fiduciaries and trustees of the company's assets and powers they must place the interest of the company above any personal interest of the directors and any decision taken at the moment must be transparently seen as furthering the company's purpose.

[50] See Marcus Haywood, 'Duty to Declare Interest in Proposed Transaction or Arrangement' in Simon Mortimore QC (ed), *Company Directors, Duties, Liabilities and Remedies* (Oxford, Oxford University Press, 2009) p.330.
[51] See also Lloyd Tamlyn, Declaration of Interest in Existing Transaction or Arrangement' in Simon Mortimore QC (ed), *Company Directors, Duties, Liabilities and Remedies* (Oxford, Oxford University Press, 2009) p.380.
[52] See s 73 SA CA 2008, Table A Reg 88 UK CA 2006.
[53] See ss184 and 185 of the UK CA 2006, s 75(4) SA CA 2008.
[54] Sec 73(6) SA CA 2008, s 248 UK CA 2006.
[55] [1995] 3 All ER 811 at 817.

4 Extent of interest to be disclosed

The materiality of a disclosure depends on what is actually disclosed and its relationship with the transaction in question. Business interests are usually personal in nature and most directors would prefer to shield information relating to such interests from others, but that is exactly what their fiduciary status prohibits when conducting the affairs of the company. Unless compelled by the law, not many of these directors would willingly disclose their interests in company's transactions, and in situations where they deem fit to disclose such interests, the information relayed would hardly be of any assistance in enabling the company take an informed decision on the matter. The common law courts are fully aware of this trend and had insisted long before the statutory intervention that where there is an obligation to disclose interest, such disclosure must be sufficiently detailed as would give a true picture of what the interest actually is. In *Imperial Mercantile Credit Association v Coleman*[56] Lord Chelmsford declared that the director's declaration of interest must enable his colleagues to be 'fully informed of the real state of things'. In *Gray v New Augarita Porcupine Mines*[57] Lord Radcliffe stated that there is no precise formula that will determine the extent of detail that is called for when a director declares his interest or the nature of his interest. The amount of detail required is determined by the nature of the contract or arrangement and the context in which it arises, but that it is simply not enough for a director to say 'I must remind you that I am interested and to leave it at that'. This strengthens Lord Cairns statement in *Coleman's case*[58] that if it is material to their judgment that they should know not merely that he has an interest, but what it is and how far it goes, then he must see to it that they are informed. Similarly, in *Neptune's case*[59] Lightman J while construing section 317 of the UK Companies Act of 1985 held that the requirement is for a full and frank declaration by the director, not of an interest, but of the precise nature of the interest he holds, and when his claim to the validity of a contract or arrangement depends upon it, he must show that he has in letter and spirit complied with the section and any article to like effect.

The above decisions emphasize the need for a disclosure of interest to be as such as would enable the board to take an informed decision on the matter. The paucity of the information supplied to the board was the basis for the criticism of the director by Lord Radcliffe in *Gray's case* where he said:[60]

> A director who wishes to keep for himself the benefit arising from some deal with his company has to establish that he has satisfied all necessary conditions…. But it seems fairly plain that in this case Gray made no such disclosure as was required. He came to the meeting under very heavy liabilities towards the company: he has been making large profits out of his transactions in the shares that he had allotted to himself, he had been making liberal use of the company's funds for his own purposes. He left the meeting with all those liabilities extinguished for a secured payment of $18,765, a sum which charged him with the equivalent of no more than his ostensible issue price for the shares and which ignored altogether the benefits that he may have obtained from the use of the company's funds.

This criticism depicts the amount of information which a director must disclose to have a safe dealing with the company. *Gray's case* is a clear illustration of the manner of dealings often witnessed in most private companies where the directors, whether out of ignorance or sheer indifference, usually do not draw any distinction between their private affairs and those of the company. This could go on for as long as business is smooth and profits are made by the company, but once debts are incurred, the interest of the creditors would intrude and the manner of the conduct of the affairs of the company by the directors would be subjected to judicial scrutiny. The directors in such cases would always be required to account for every unjustified profits.

The culmination of these decisions are now found in the details adopted in the statutory provisions that demand the disclosure of interest by the directors. While under the English Act, the director must declare the nature and extent of his interest either in a proposed or existing transaction or arrangement, [61] the South African law goes a step further by demanding that the interest to be disclosed by a director in a proposed matter must include the general nature of the interest, any material information relating to the

[56] (1873) LR 6 HL 189 at 201.
[57] (1952) 3 DLR (PC) 1 at 14.
[58] (1873) LR 6 HL 189 at 205.
[59] [1995] 3 All ER 811 at 817.
[60] (1952) 3 DLR (PC) 1 at 14.
[61] SS 177(1) and 182(1) UK CA 2006.

matter that is known to the director, and any observations or pertinent insights relating to the matter if requested to do so by the other directors.[62] Where the interest is in an existing matter, the disclosure must include the nature and extent of the interest, and the material circumstances relating to the director or related person's acquisition of that interest.[63] It is not in doubt that the South African statutory provisions are *ex facie* more stringent in their demands for disclosure of interest from the directors than the English counterpart. However, the practical intendment of those provisions in both jurisdictions may not be different for as stated by Lord Radcliffe in *Gray's case*, there is no precise formula that will determine the extent of detail that is called for when a director declares his interest or the nature of his interest, the amount of details must depend on what each case demands.[64] Where the company is run by a sole director, the court's concern is even greater, and hence its scrutiny of the transaction even closer,[65] to determine the extent of detachment of private from corporate interest.

The influence which a director with interest in the transaction could exert on the decision-making process must not be overlooked. The South Africa statute has adopted a precautionary measure by enacting that an interested director must leave the meeting after disclosing his interest. His exit shall not however, affect the quorum for the board meeting.[66] The provision ensures that the voting process is fair and devoid of influence.[67] The exercise of voting powers at board meeting is purely administrative in nature, it is a status vote and has nothing to do with shareholding. It does not therefore deny the director of his right to protect his interest as could be done by virtue of his shareholding.[68] While the power as shareholder is personal, the power as director is a power of trust held by the director on behalf of and for the benefit of the company, hence the need for the director to subordinate his interest to that of the company when exercising his power as a director. This is what the deprivation of the right to vote at board meeting entails. The mandatory nature of this requirement under the South African law is certainly preferred to the optional provisions under the English model articles.

5 Effect of failure to disclose interest

It should perhaps be noted that there is no prophylactic statutory provisions against director's interest in company's transactions. All that the law requires is that whenever such interest exists, the director must disclose it to the board. Once disclosure is made in the statutorily prescribed manner,[69] the transaction would be unimpeachable.[70] This effect was pronounced upon by Lord Wilberforce in *Hely –Hutchinson v Brayhead*[71] while dealing with similar provisions in the company's articles and section 199 of the UK Companies Act of 1948 where he said:

> It seems to me what that means is this, that if the statutory disclosure is made, then a director's contracts with a company are exempted from the normal consequences which would follow under the general law where one person who is in a fiduciary position enters into a contract with a person to whom he owes the fiduciary duty; and there is also the second consequence, that the person in the fiduciary position does not have to account for any profit.

[62] S 75(5) SA CA 2008.
[63] S 75(6) SA CA 2008.
[64] (1952) 3 DLR (PC) 1 at 14.
[65] See *Neptune (Vehicle Washing Equipment) Ltd v Fitzgerald (NO 2)* [1995] BCC 1000 at 1017 per Steinfeld QC (sitting as a deputy judge of the High Court).
[66] See s 75(5)(d-f). Cf arts 13, 14 and 16 of the UK Model articles for companies SI 2008/3229 which do not only disqualify the interested director from voting, but also exclude him from being counted towards the quorum for the resolution. This could have adverse effect on company's business where it is unable to obtain a quorum. It is sufficient that the interested director is not allowed to vote at the meeting where his interest is being considered.
[67] Lord Buckmaster had emphasized in *Cook v Deeks* [1916] AC 554 at 568 that even supposing it not to be *ultra vires* of a company to make a present to its directors, it appears quite certain that directors holding a majority of votes would not be permitted to make a present to themselves. See *also Menier v Hooper's Telegraph Works* (1874) L.R.9 Ch App 350.
[68] See *North – West Transportation Co .Ltd v Beatty* (1887) 12 App Cas 589; *Att- Gen for the Dominion of Canada v The Standard Trust Co. of New York* [1911] AC 498 (PC); *Re Express Engineering Works Ltd* [1920] 1 Ch 466 (CA).
[69] Mummery LJ in *Gwembe Valley Development Co Ltd v Koshy* [2003] EWCA Civ 1048 para 59 observed that informal disclosure made piecemeal or proof of knowledge of individual board members does not comply with the formal requirements of disclosure of interest which would involve an opportunity for consideration of the matter by the board as a body. See also *Guinness v. Saunders* [1988] 1 WLR 863 at 868D-H (CA), *Neptune v Fitzgerald* [1995] 1 BCLC 352 at 358h-360c.
[70] See s 75(7) SA CA 2008, s 180(1)(b) UK CA 2006.
[71] [1967] 3 All ER 98 at 106.

The general law referred to in this decision is the principles of common law and equity under which a person in a fiduciary position is not allowed to profit from such relationship at the expense of the beneficiary. It is long accepted that the directors stand in fiduciary relationship with the company and hold the company's property and power as trustees. They are not therefore allowed at common law to benefit from the trust property. This common law position was buttressed by the decision in *Bray v Ford*[72] where Lord Herschell said:

> It is an inflexible rule of a court of equity that a person in a fiduciary position, such as the respondent's, is not, unless otherwise expressly provided, entitled to make a profit; he is not allowed to put himself in a position where his interest and duty conflict. It does not appear to me that this rule is, as has been said, founded upon principles of morality. I regard it rather as based on the consideration that, human nature being what it is, there is danger, in such circumstances, of the person holding a fiduciary duty being swayed by interest rather than by duty, and thus prejudicing those whom he was bound to protect. It has, therefore, been deemed expedient to lay down this positive rule. But I am satisfied that it might be departed from in many cases, without any breach of morality, without any wrong being inflicted, and without any consciousness of wrongdoing.

It is these rules that are now incorporated in the companies statutes to determine the effects of the failure by the director to disclose interest in company transactions. A distinction is made in the English law between proposed and existing transactions in applying the consequences of non-disclosure. Section 183 of the UK Companies Act of 2006 merely prescribes criminal consequences which is actualized by the imposition of fine. Justification for criminal sanction in this situation was proffered by the Lord Goldsmith at the parliamentary debate on the bill where he stated that because the transaction is already concluded by the company as at the time of the breach of section 182 by the director, the validity of the transaction could not be questioned and as such there can no longer be 'any other civil consequences'.[73] There is certainly no question as to the validity of the transaction which was entered by the company before the breach of section 182 by the director, but there is certainly a question as to whether the director should be allowed in equity to retain the profits accruing to him from his breach of duty arising from a failure to disclose interest in such transaction. In *Hely-Hutchinson's case*, Lord Denning MR had emphasised that when a director fails to disclose his interest, the effect is the same as nondisclosure in contracts *uberrimae fidei*, or nondisclosure by a promoter who sells to the company property in which he is interested.[74] In those circumstances, the person must be compelled in equity to disgorge the proceeds of the ill-gotten benefits even when the transaction is unimpeachable. It does not seem to be a relevant consideration that the profit was made in a proposed or an existing transaction.

The consequences of nondisclosure of interest in proposed transaction or arrangement are stated in section 178(1) of the UK Companies Act to be the same as would apply in the corresponding common law and equitable principles. A similar approach is adopted in the South Africa Companies Act which provides in section 77(2)(a) that 'a director of a company may be held liable in accordance with the principles of the common law relating to the breach of a fiduciary duty, for any loss, damages or costs sustained by the company as a consequence of any breach by the director of a duty contemplated in section 75'. Section 75 of the Act covers the disclosure requirements in both proposed and existing matters, as such there is no distinction in the application of the common law and equitable principles in those circumstances as under the English law. Lord Pearson in *Hely-Hutchinson's case* proffered the most illustrative effect of this provision while dealing with a similar subject matter under section 199 of the UK Companies Act of 1948 where he said:

> If a director *makes or is interested* in a contract with the company, but fails duly to declare his interest, what happens to the contract? Is it void, or is it voidable at the option of the company, or

[72] [1896] AC 44 at 51-52. See also Sir John Stuart VC in *Barrett v. Hartley* (1866) L.R. 2 Eq. 789 at 796 who emphasised that a trustee who greatly benefits his *cestui que* trust by performing his duties is not entitled to say to him that he will not give him his property, or proceed to execute the trust, unless he be paid a bonus. In *Aberdeen Railway Co. v. Blaikie Bros.* (1854) 1 Macq. HL 461 at 471-472 Lord Cranworth LC stated that so strictly is this principle adhered to, that no question is allowed to be raised as to the fairness or unfairness of a contract so entered into. It obviously is, or may be, impossible to demonstrate how far in any particular case the terms of such a contract have been the best for the interest of the *cestui que* trust which it was possible to obtain. It may sometimes happen that the terms on which a trustee has dealt or attempted to deal with the estate or interests of those for whom he is a trustee have been as good as could have been obtained from any other person - they may even at the time have been better. But still so inflexible is the rule that no inquiry on that subject is permitted.

[73] Hansard, HL Col GC338 (9 February 2006).

[74] [1967] 3 All ER 98 at 103. See also *Re Cape Breton Co*; *Burland v Earle* ([1902] AC 83 per Lord Davey at 99.

> is it still binding on both parties, or what? … I think that the answer must be supplied by the general law, and the answer is that the contract is voidable at the option of the company, so that the company has a choice whether to affirm or avoid the contract, but the contract must be either totally affirmed or totally avoided and the right of avoidance will be lost if such time elapses or such events occur as to prevent rescission of the contract.[75]

The correctness of this decision was affirmed by the House of Lords in *Guinness v Saunders*[76] where Lord Goff emphasized that a '[c]areful study of the decision…merely served to reinforce my natural expectation that the case was rightly decided'. There is much to say about the distinction between when a director makes a profit or is merely interested in the company's transaction especially in the light of the existing distinction on the consequences of a breach of the duty under sections 182 and 177 of the UK Companies Act respectively. Lord Wilberforce had in a concurring decision in *Hely-Hutchinson*, observed that the normal consequences which follow from a contract made by a person in such a fiduciary position are that the contract may be voidable at the instance of the company and that in certain cases a director may be called on to account for profits which he has made out of the transaction.[77] The inference here is that the avoidance of the contract does not invariably lead to an obligation to account for profit as the director might not have made any profit from the contract. The right of the company to 'void' the transaction is therefore simply predicated on the existence and nondisclosure of interest by the director. But there could be situations where rescission is no longer possible as indicated by Lord Pearson, and a profit has been made by the director from his breach of duty. The separation of the right of the company to rescind the transaction from the right to demand an account for profit made by the director, ensures that even in those instances where rescission is not tenable, the obligation to demand an account for the unjust profit made by the director from the transaction is never lost by the company. Hence the suggestion by Lord Goldsmith that the criminal penalty imposed by section 183 for a breach of section 182 of the UK Companies Act brings the matter to an end does not find justification in the common law principles.

There is a suggestion that if the nondisclosure of interest by the director as required by section 182 causes the company harm, the company could get around the restrictions in section 183 by seeking civil remedies for breach of the directors general duties under sections 171-174 or section 176 or possibly arising from any related breach of the company's articles.[78] The provisions in those sections of the Act can hardly be of any assistance to the company[79] as the equitable duties imposed by those provisions are not predicated on any harm on the company. They arise merely by virtue of the fiduciary status of directors. Moreover, if the company should suffer any harm arising from the breach of section 182, such harm would most likely relate to the profit made by the director which could only be an issue of conflict of interest. Incidentally, section 175 which deals with the issues of conflict of interest, clearly states that its application does not extend to a conflict of interest arising in relation to a transaction or arrangement with the company, thus excluding any relief from being sought under that provision by the company for a breach of section 182.[80] The only option available to the company outside a recourse to the common law is to create civil remedies in its articles which could be enforced by the company against the director as a breach of the company's constitution.[81]

6 Conclusion

One of the consequences of the statutory intervention in the prophylactic common law prohibition of directors from benefiting from company's transaction is the relaxation of the rule which now enables the

[75] [1967] 3 All ER 98 at 109. Emphasis added. Lindley MR had in a much earlier case of *Kaye v Croydon Tramways Co*[1898] 1 Ch 358 at 368 (CA) stated that the general legal consequences of a director being interested in a contract with the company is that he cannot enforce, as against the company, any contract which he has entered into with that personal interest. See also *Great Luxembourg Ry Co v Magnay (No 2)* (1858) 25 Beav 586 at 593, 594); *Re Cape Breton Co* ((1884) 26 ChD 221 at 223, 228, 229, 234); *Transvaal Lands Co v New Belgium (Transvaal) Land and Development Co* ([1914–15] All ER Rep 987 at 990, 991; *Cook v Deeks* ([1916–17] All ER Rep 285 at 290, 291.

[76] [1989] UKHL 2 at 22..

[77] [1967] 3 All ER 98 at 106.

[78] See Lloyd Tamlyn, Declaration of Interest in Existing Transaction or Arrangement' in Simon Mortimore QC (ed), *Company Directors, Duties, Liabilities and Remedies* (Oxford, Oxford University Press, 2009) p.374.

[79] Those sections deal with the Duty to act within powers, Duty to promote the success of the company, Duty to exercise independent judgment, Duty to exercise reasonable care, skill and diligence and Duty not to accept benefits from third parties respectively.

[80] See s 175(3) UK CA 2006.

[81] See Anthony O Nwafor, 'The Unending Debate on the contractual Effect of the Company's Constitution: A Comparative Perspective' [2013] Vol 24 Issue 7 *International Company and Commercial Law Review* 261

directors to benefit from such transactions, provided that their interest, either in a contemplated or existing transaction, is disclosed to the board for consideration accordingly. The relaxation of the common law rule invariably demands that the manner and extent of disclosure of interest by the director be closely scrutinized. Thus, the legislation in both UK and South Africa provide for a full and frank disclosure of, not only interest directly held by the director, but also all indirect interests held by persons connected to the director and the existence of which are known or ought to be known by the director. Although the reference to 'indirect interest' is more pointedly captured in the UK statute,[82] the South African counterpart is no less imperative as the reference to 'related person' as used in the relevant provision[83] portend a similar consequence.

There are, however, a significant difference in both jurisdictions in dealing with the scope of transactions that demand a disclosure of interest. While in the UK provision, interest must be disclosed by the director in any 'transaction or arrangement' which presupposes some level of engagement either directly or indirectly between the company and the director, the South African provision goes a step further by compelling a disclosure once there is in existence any 'personal financial interest in the matter' whether that of the director, or of a related person which is known to the director. The interpretation of 'knowledge' both under the statute[84] and at common law as including imputed knowledge, when combined with the statutory reference to 'a matter to be considered at a meeting of the board' suggests that the reach of the South African provision is quite expansive. A director could be found in breach of that provision even without actual personal knowledge of the existing interest, and which extends to every subject matter that bears some financial connotations which falls to be considered at board meetings.

The need to explain or interpret such technical terms as 'transaction or arrangement' as under the English law is obviated by the simplicity and liberal presentation of the South African provision. The latter would demand some precautionary measure by the director as a breach could occur even before the 'matter' reaches the status of a 'transaction or arrangement'.

The leverage granted to the directors under section 75(2) of the South African statute not to disclose interest where the subject matter of interest generally affects all the directors in their capacity as director does not accord with the distinct legal personality of the company and the real essence of the disclosure requirement which is the protection of the interest of the company and its creditors. The body of the shareholders, or the general meeting as it is usually called, is always there to fill the gap where the directors could not function as a board. It is also this organ of the company that could grant a final absolution to the directors for any breach of duty. Disclosure should therefore be made to the general meeting where the directors could not disclose to themselves because of their vested interests.

The description as 'nonsense' by Lord Goldsmith that a sole director of a private company should make a disclosure of interest to himself as held by Lightman J in *Neptune's case*[85] is a negation of the distinct legal personality of the company. A sole director must not only distinct his personal affairs from those of the company, but must be seen to be doing so, as demanded by transparency and fairness in the conduct of the company's affairs. The fact that companies often survive their founders/directors is a compelling reason for observing such rules of transparency, and for the protection of the interest of the director whose estate could be put in jeopardy in times of liquidation.

The South African provision which requires a sole director that is not also the sole shareholder of the company to disclose interest to the general meeting is more amenable to company operations.[86] But the snag still remains to the extent that the same provision exempts a sole director who is also the sole shareholder of the company from disclosing his interest in company's transactions. It is beneficial to the sole director, the company and its creditors, that the sole director discloses his interest, even if it does not go as far as the 'pausing and pondering at a meeting' as suggested by Lightman J, there should be at least a record of the disclosure of interest in the company's book as evidence of such disclosure and for future references.

[82] See s 177(1).
[83] See s 75(5).
[84] Sec 1 SA CA.
[85] [1995] 3 All ER 811.
[86] See s 75(3).

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