EVALUATION OF GOVERNANCE CHALLENGES ASSOCIATED WITH THE EXERCISE OF FIDUCIARY DUTIES BY THE BOARD MEMBERS OF THE STATE-OWNED ENTITIES

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Abstract

There are fundamental challenges encountered by the non-executive directors (board members) of state-owned entities in a course of exercise of fiduciary duties. These challenges are, inter alia, conflict of interests, failure to uphold the fundamental principles of corporate governance, lack of necessary skill and competencies, and this impact on the ultimate performance of the company. The article seeks to evaluate the potential challenges encountered by board members of state-owned entities in the course of exercise of their fiduciary duties. The results indicate that failure to comply with fiduciary duties may have drastic effects on a state as a shareholder and may lead to a decline in corporate governance of state-entity. The article will make a brief reference to fiduciary duties in terms of common law, the Companies Act, PFMA and King IV, secondly examine potential challenges and thirdly conduct a comparative approach with the international instruments with the aim of making recommendations/best practices. The article makes reference to various case laws dealing with fiduciary duties, journal articles, internet sources and textbooks, common law and legislations.

Keywords: Governance, Fiduciary Duties, Board Members, Common Law, Directors, Companies Act, PFMA

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1. INTRODUCTION

In terms of the common law, the director stands in fiduciary capacity which requires directors to exercise powers bona fide and for the benefit of the company. In the process of exercising fiduciary duties, a director should display reasonable care and skill (Du Plessis, 1993; Havenga, 1997; Cilliers et al., 2000). The directors owe fiduciary duty to the company as a whole and as a separate legal entity (Blackman, Jooste & Everingham, 2002; Cilliers et al., 2000). It is mandatory for directors to comply with the fiduciary duties (Cassim, 2011). The fiduciary duties apply to executive and non-executive directors, alternate directors, ex officio directors, shadow directors, nominee directors. The fiduciary duties also apply to senior managers/employees of the company (Volvo (Southern Africa) (Pty) Ltd v Yssel, 2009).

The executive directors and non-executive directors of the state-owned entities (also referred to as “state-owned companies” or “SOEs”) undoubtedly stand in a fiduciary capacity. A non-executive director is a member of a company’s board of directors while the executive director is part of the executive team of a company and involved in the
day-to-day management of the company. There is no distinction between executive and non-executive directors for the purpose of fiduciary duties (Howard v. Herrigel, 1991). The directors owe fiduciary duty to the company as a whole and as a separate legal entity (Blackman et al., 2002; Cilliers et al., 2000).

The Public Finance Management Act 1 of 1999 (hereafter “PFMA”) prescribes the standard of conduct required for directors. The Companies Act 71 of 2008 (hereafter the “Companies Act” or the “Act”) codified some of the common law duties of directors (partial codification). In fact, the provisions of the Companies Act apply to the state-owned company except where the Minister of Trade and Industry has granted exemption (section 9 of the Companies Act of 2008) (Coetzee & Van Tonder, 2016). The King IV report on corporate governance for South Africa 2016 (King IV report) also provides recommended practices that should be considered by state-owned entities (IoDSA, 2016). The Protocol on Corporate Governance in the Public Sector was established to realise the King Code. The Protocol, inter alia, seeks to amplify and inculcate the principle of King Code, provide guidance on the board, etc. (Department of Public Enterprises (South African Government), 2002).

There are challenges encountered by the non-executive directors of state-owned entities in a course of exercise of fiduciary duties. These challenges are, inter alia, conflict of interests, failure to uphold the fundamental principles of corporate governance, lack of necessary skill and competencies. The aforementioned classical examples demonstrate the governance challenges on the state-owned companies.

The purpose of this article is to evaluate the potential challenges experienced by the board members of the state-owned entities in the course of exercise of fiduciary duties.

The structure of this paper is as follows: Section 2 reviews the relevant literature. Section 3 analyses the methodology that has been used to research on fiduciary duties by the board members of the state-owned entity. Section 4 discusses key obligations imposed on board members (fiduciary duties) in terms of common law, the Companies Act and PFMA, King IV. Section 5 identifies potential challenges. Section 6 presents the best practices/recommendations, followed by the conclusion in Section 7.

2. LITERATURE REVIEW

The article considers the literature on the fiduciary duties of directors since they are relevant and significant in achieving the purpose of the research. The sources on fiduciary duties emphasise that once a person occupies the position of director he/she stands in a fiduciary capacity in which he/she owes fiduciary duty to the company as a whole. In this regard, reference is made to the sources as (Blackman et al., 2002; Cilliers et al.; 2000).

The Companies Act 71 of 2008 codified some of the common law fiduciary duties. Therefore, both common law fiduciary duties and those contained in the Companies Act are considered because the Companies Act does not exclude common law. In fact, the common law applies to the extent that is not inconsistent with the Act (Delport, 2014; Coetzee, 2016; Delport, Vorster, Esser, Lombard, & Burdette, 2011).

The article analyses and makes reference to various case laws in which the court developed jurisprudence on fiduciary duties. The critical cases such as Da Silva and others v. C H Chemicals (Pty) Ltd (2008); Robinson v. Randfontein Estates Gold Mining Co Ltd (1921); Howard v. Herrigel (1991); Fisheries Development Corporation of SA Ltd v. Jorgensen (1980) that deal with fiduciary duties are considered.

The legislation in which the fiduciary duty of board members of a state-owned entity is codified namely the Public Finance Management Act 1 of 1999 is considered. Journal articles on the fiduciary duties are considered as they played a significant role in explaining the fiduciary duties, comparison between common law and the Companies Act.

The article analyses and makes reference to the King IV report because it, inter alia, provides guidance on good governance including the fiduciary duties. It is essential to comply with King IV as failure to do so may attract liability on basis of a breach to fiduciary duty of skill if not care (Delport, 2014; De Villiers NO and another v. BOE Bank Limited, 2003; Minister of Water Affairs and Forestry v. Stilfontein Gold Mining Company Limited and others, 2006). King IV also provides recommended practices that should be considered by state-owned entities.

At present, there are potential gaps in the current legal framework because the principles of corporate governance some contained in King IV are not mandatory. They may be ignored as they do not have the status of subordinate legislation and do not have the force of law. It will be recommended that that the principles of corporate governance to the extent that they are applicable to the state-owned entity, should be entrenched in founding legislations in order to be applicable to the state-owned entities. This will undoubtedly minimise the decline in corporate governance of state-entities. This research is relevant and significant because in instances non-compliance or breach of fiduciary duties has contributed to the decline of corporate governance of the state-owned entities in South Africa.

The article also considers the international instruments such as the World Bank toolkit for state-owned enterprises (Arrobbio et al., 2014) and OECD’s Professionalising boards of directors of state-owned enterprises: Stocktaking of national practices (OECD, 2018) to the extent that they recommend and provide for best practices on state-owned entities.

3. RESEARCH METHODOLOGY

The article seeks to evaluate the potential challenges encountered by board members of state-owned entities in the course of exercise of their fiduciary duties. The article will make a brief reference to fiduciary duties in terms of common law, the Companies Act and PFMA with a view to identify key obligation on board members, secondly examine potential challenges encountered by board members and thirdly conduct comparative approach with the international instruments with the aim of making recommendations/best practices which may assist to avoid a decline in corporate governance by the
4. FIDUCIARY DUTIES (KEY OBLIGATIONS IMPOSED ON DIRECTORS)

In terms of Law Dictionary, a fiduciary is “a person holding the character of a trustee, or a character analogous to that of a trustee, in respect to the trust and confidence involved in it and the scrupulous good faith and candor which it requires” (Featuring black's law dictionary free online legal dictionary). In Daniels v. Anderson (1995) it was stated that “a person who accepts the office of the director of a particular company undertakes the responsibility of ensuring that he or she understands the nature of the duty a director is called upon to perform...” (p. 665). In other words, a director stands in fiduciary relation and should avoid conflict of interest between his and that of the company (Blackman, 1970; Havenga, 1995). In Howard v. Herridge (1991) Goldstone J. stated that “at common law, once a person accepts an appointment as a director, he becomes a fiduciary in relation to the company and is obliged to display the utmost good faith towards the company in his dealings on its behalf...” (p. 678). The fiduciary duty does not replace other duties that directors owe to the company (Blackman et al., 2002, p. 8-39).

The exercise of fiduciary duty is part of corporate governance which is defined by Du Plessis and colleagues as “the process of controlling management and of balancing the interests of all internal stakeholders and other parties who can be affected by the corporation’s conduct in order to ensure responsible behaviour by corporations and to achieve the maximum level of efficiency and profitability for a corporation” (Du Plessis, Hargovan, Bagaric & Harris, 2011, p. 6-7). The board represents the shareholders and in principle is the accounting authority of the company. In the case of R v. Kritzinger (1971) the court stated that “a company is an artificial person which cannot read a written or hear a spoken representation. It reads or hears a representation through the eyes or ears of, inter alios, its directors acting in the course of their duty, and “board” is a collective term used to designate the directors when they act together in the course of their duty to the company. Prima facie, therefore, an allegation that a representation was made to a board of a company is an allegation that the representation was made to the company through the medium of its directors” (p. 59).

The fiduciary duties of directors are contained in the Companies Act, PFMA, common law, founding legislations of SOEs, King IV and the Protocol on Corporate Governance in the Public Sector which are discussed below.


It should be noted that some of the common law fiduciary duties have been expanded and codified in the Companies Act. Section 76 of the Companies Act prescribes the standard of conduct expected from a director (Mongalo, 2016). The Companies Act does not exclude common law. In fact, the common law applies to the extent that is not inconsistent with the Companies Act (Delport, 2014; Coetzee, 2016 p. 401-409). In terms of the common law and the Companies Act a director has the following duties:

1. A director must exercise his/her powers and perform functions in the best interest of the company (section 76(3) (b); Da Silva and others v. C H Chemicals (Pty) Ltd (2008); Visser Sitrus (Pty) Ltd v. Goede Hoop Sitrus (Pty) Ltd and others (2014); Fisheries Development Corporation of SA Ltd v. Jorgensen (1980). In fact, the fiduciary duty to exercise powers bona fide in the best interests of the company is considered to be the paramount duty (Pretorius, Delport, Havenga & Vermaas, 1999; Coetzee & Van Tonder, 2014). As a principle, the company must be used for profit maximisation in favour of shareholders. However, the pluralist approach indicates that in certain instances the directors can ignore the interests of shareholders in favour of the interests of stakeholders while the enlightened shareholder approach states that the interest of another stakeholder should be taken into account if it promotes interests of shareholders (Delport, 2014 p. 141-421). This is a common law duty which was codified in the Companies Act;

2. A director must exercise his/her powers for the purpose for which they were conferred. For instance in Piercy v. S Mills & Co (1920) shares were issued to prevent the election of additional directors with the result that the directors will be a minority. The court held that the powers were improperly exercised (Cilliers et al., 2000; S v. Hpek, 1973; Hogg v. Cramphorn, 1967; Howard Smith Ltd v. Ampol Petroleum Ltd, 1974; Punt v. Symons & Co Ltd, 1903; Bidle, 2019; Tjio, 2016; Nolan, 1998). Interesting, in the matter between CDH Invest NV v. Petrotank South Africa (Pty) Ltd and others (2019) the Supreme Court of Appeal confirmed the decision of Gauteng Division of the High Court, Johannesburg in finding that the resolution of March 31, 2014 was invalid because the three Petrotank directors who signed the resolution (i.e., the CDH nominees on Petrotank’s board/appellant) had violated their fiduciary duty. The court considered that compliance with their fiduciary duty required that the power to increase the authorised shares be exercised in good faith and the best interests of the company (a subjective test) and for a proper purpose (an objective test). The court stated that the CDH nominees’ conduct failed on both legs of subjectivity and objectivity. On the first leg, the court found that motivation for impugned resolution was a devious misrepresentation because it failed to offer any justification for increasing the authorised shares to 1 000 000. Secondly, the resolution was in any event irrational, having regard to the proclaimed purpose of correcting the error in the MOI (para 13). It is submitted that the powers should be exercised for the purpose intended provided that such powers are exercised appropriately within the ambit/parameters of the law. Directors should, therefore, refrain from utilising the delegated powers for the ulterior motive which may have the effect of breaching this duty and thus put the company into disrepute or susceptible to litigation by the aggrieved parties.
3. A director should observe the limitation of powers of the company as well as his/her own authority to act on behalf of the company. In other words, a director should not exceed the limitation of powers. This is a common law duty but section 20(5) and (6) appears to be supporting common law duty.

4. A director must maintain and exercise an unfettered discretion. In other words, a director must consider the interests of the company in an objective manner (Cilliers et al., 2000; common law).

5. A director has a legal duty to avoid conflicts of interests arising between his/her own and that of the party he serves (Cilliers et al., 2000; Robinson v. Randfontein Estates Gold Mining Co Ltd, 1921). As such a director may not use the information obtained as director for personal gain (Regal (Hastings) Ltd v. Gulliver, 1942; Magnus Diamond Mining Syndicate v. Macdonald & Hawthorne, 1909; Industrial Development Consultants Ltd v. Cooley, 1972; Atlas Organic Fertilizers (Pty) Ltd v. Pikkewyn Ghowo (Pty) Ltd, 1981; Sibex Construction (SA) (Pty) Ltd v. Injectaseal CC, 1988; CyberScene Ltd v. i-Kiosk Internet and Information (Pty) Ltd, 2000). A director must disclose the nature and extent of the conflict of interest (section 75). Section 75 also describes the conflict of interest.

6. A director must not use the position of director or any information obtained to gain advantage as a director or for another person or knowingly cause harm to the company including subsidiary (section 76(2)(a) (Symington and others v. Pretoria-Oos Privaat Hospital Bedryfs (Pty) Ltd (2005); Crainleigh Precision Engineering Ltd. v. Bryant and another (1966); Olifants Tin “B” Syndicate v. De Jager, 1912).

7. A director is bound to communicate to the board any information that comes to his attention and this should be done at "earliest predictable opportunity" (section 76(2) (b); Kukama v. Lobelo JDR, 2012).

8. A director must exercise his powers and perform functions with the degree of care, skill and diligence that may be expected from a person carrying out the same function and having the general knowledge, skill and experience of the director (section 76(3)(a) (Stevens & De Beer, 2016; Mupangavanhu, 2016; Stevens, 2017).

4.2. PFMA

Section 50 of PFMA contains fiduciary duties of accounting authorities. The PFMA refers to the board as accounting authorities. In terms of PFMA "accounting authority" means a board or other controlling body or if there is no controlling body, the accounting authority will be chief executive officer or the other person in charge of the public entity (sections 1 and 49 of PFMA).

The directors of a public entity have the following fiduciary duties:

1. A director is required to exercise the utmost care in ensuring reasonable protection of the assets and record of the public entity.

2. A director must act with fidelity (faithfulness, loyal, support), honesty, integrity and in the best interests of a public entity in dealing and managing the affairs of a public entity.

3. If requested, a director must disclose to the executive authority or legislature all material facts that may influence the decision or actions of the executive authority or legislature. Executive authority refers to Minister (Cabinet member), Member of Executive Council of Province, Member of Provincial Executive Council (section 1 of PFMA).

4. A director must seek measures to prevent any prejudice to the financial interests of the state.

5. A director is prohibited to act in any way inconsistent with his/her responsibilities or use the position or privileges obtained in that capacity for personal gain to improperly benefit another person.

6. A director is required to disclose "direct or indirect personal or private business interest" that a spouse, a partner, a close family member may have in a matter before the accounting authority (South African Government, 1909, section 50(3)). In this matter, the affected director must be withdrawn from the proceedings when that particular matter (interests) are considered unless the accounting authority decides the interests of the member in the matter are trivial or irrelevant.

4.3. King IV

King IV also provides for fiduciary duties of directors. Although King IV is not a law, it applies to companies. Furthermore, the court has stated in the case of Minister of Water Affairs and Forestry v. Stilfontein Gold Mining Company Limited and others (2006, para 16.7) that "practising sound corporate governance is essential for the well-being of a company and is in the best interests of the growth of this country's economy especially in attracting new investments. To this end, the corporate community within South Africa has widely and almost uniformly accepted the findings and recommendations of the King Committee on Corporate Governance". In fact non-compliance with King IV may attract liability for breach of fiduciary duty of skill if not care (Delport, 2014, p. 146; De Villiers NO and another v. BOE Bank Limited (2003); Minister of Water Affairs and Forestry v. Stilfontein Gold Mining Company Limited and others (2006). In South African Broadcasting Corporation Ltd and another v. Mpoja (2009) the full bench approved certain principles of corporate governance relying on, inter alia, King Code.

In terms of King IV, a governing authority should serve as the focal point and custodian of corporate governance in the state-owned entity (principle 6 of sector supplement on state-owned entities). According to King IV, it is a natural consequence of fiduciary duties emanating from the fact that accounting authority is entrusted with assets and assets other than its own (principle 6 of sector supplements on SOEs). The accounting authority of the SOEs must have the "right balance of knowledge, skills, experience, diversity and independence for it to discharge its governance role and responsibilities objectively and effectively" (principle 7 of King IV on SOEs sector supplements). The King IV also provides that directors should always act in the best interest of SOE (principle 16 of sector supplements on SOEs). In so far as independence is concerned the court in PPWAWU National Provident Fund v. Chemical Energy Paper Printing Wood and Allied Workers Union (2007, para 27) stated that directors must exercise independent judgment regardless of the views of those who appointed them (company).
4.4. Protocol on Corporate Governance in the Public Sector

This protocol was established to realise the King Code. It seeks to amplify and inculcating the principle of King Code and not to supersede or conflict with King Code (Protocol on Corporate Governance in the Public Sector by the Department of Public Enterprises, 2002 p. 3-4). The Protocol states that the board should always comprise individuals that have integrity and accountability, competencies, skills, experience and expertise.

The protocol is intended to provide guidance to the public sector including the achievement of socio-politico-economic objectives of the Government (Department of Public Enterprises (South African Government), 2002, p. 4). The Protocol states that the board should always comprise individuals that have integrity and accountability, competence, relevant and complementary skills, experience and expertise (Department of Public Enterprises (South African Government), 2002). The protocol also states that the board should act in the best interest of the SOE and shareholder (Department of Public Enterprises (South African Government), 2002, p. 27).

5. FIDUCIARY DUTIES (KEY OBLIGATIONS IMPOSED ON DIRECTORS)

The Public Protector released a report on February 2014 entitled “When Governance and Ethics Fail”. The investigation by Public Protector concerns various corporate governance failures in the management of the affairs of SABC by its board, financial mismanagement at the SABC, undue interference by the Minister and the Department of Communications on SABC, the issue regarding salaries (Public Protector South Africa, 2014). The SABC is a public broadcaster and the state is the sole shareholder (state-owned entity).

Pertinent to this research, one of the issues investigated by the Public Protector was whether there were systemic corporate governance failures at the SABC and the causes thereof (page 3 of Executive Summary). The Public Protector made finding that governance failures at SABC are as a result of “symptomatic of pathological corporate governance deficiencies at the SABC, including failure by the SABC board to provide strategic oversight to the National Broadcaster as provided for in the SABC board Charter and King III Report” (Public Protector South Africa, 2014, p. 20-21; IoDSA, 2009). It should be noted that King IV replaced King IV in it’s entirely (IoDSA, 2016, p. 38). The Public Protector also made finding that “the executive Directors (principally the GCEO, COO and CFO) failed to provide the necessary support, information and guidance to help the board discharge its fiduciary responsibilities effectively…” (Public Protector South Africa, 2014, p. 21). Consequently, the Public Protector made remedial action to the board that, inter alia, disciplinary action be instituted against officials and all monies are recovered which were irregularly spent through unlawful and improper actions from the appropriate persons (Public Protector South Africa, 2014 p. 22-24).

On February 22, 2011, the Public Protector issued a report where it investigated the alleged improper procurement of the lease of office accommodation for the South African Police Service (SAPS) in the Sanlam Middestad building in the Pretoria Central Business District. The complaints were related to the alleged non-compliance with the requirements of section 217 of the Constitution of the Republic of South Africa (South African Government, 1996) (the Constitution) by the SAPS and the Department of Public Works, and the alleged improper involvement the National Commissioner of the SAPS in the procurement of two buildings which is Pretoria and Durban. Section 217 of the Constitution provides for the minimum test for valid tender and contracts. It provides that contracts for goods or services in a public sector must be “in accordance with a system which is fair, equitable, transparent, competitive and cost-effective”.

The Public Protector made findings that, inter alia, “the decision of the DPW to proceed with the implementation of the lease agreement in the face of considered legal advice from two senior counsel to the contrary, particularly the opinion that on November 22, 2010 under the leadership of the current Minister of Public Works, was in breach of its fiduciary duties and the requirements of good governance in terms of the PFMA and amounted to maladministration” (Public Protector South Africa, 2011, p. 14, 90). Consequently, the Public Protector made remedial action that, inter alia, the National Treasury should urgently review the purported lease agreement between the DPW and Roux Property Fund (Pty) Ltd in order to determine if the contract can be terminated forthwith. The Public Protector also made remedial action that DPW must ensure that appropriate measures are implemented in order to prevent a recurrence of contraventions of the relevant procurement legislation and prescripts (Public Protector South Africa, 2011, p. 13-15).

The board members of state-owned entities do not appreciate the cardinal corporate governance rules (Thabane & Snyman-Van Deventer, 2018). The root cause for this challenge may that some of the principles of fiduciary duties are not codified in the specific legislations or founding legislations of state-owned companies. Some directors may be aware of the principles applicable and yet disregard those principles especially in case of conflict of interests.

Lack of necessary skills and competencies appears to be one challenge in the board. In fact, the Companies Act of 2008 requires a director to exercise his/her powers and perform functions with the degree of care, skill and diligence that may be expected from a person carrying out the same function and having the general knowledge, skill and experience of the director (section 76(3) (c). Failure to comply with section 76(3)(a) attract liability in which a director may be held liable for breach of fiduciary duties in accordance to section 77 of the Companies Act (section 77 provides that, inter alia, a director will be liable for any loss, damages or costs sustained by the company in case he/she breaches the fiduciary duties (Blue Farm Fashion Limited v Kapitrade 6 (Pty) Ltd and others, 2018). In terms of the Business Judgment Rule, the director will escape liability if he/she taken reasonable diligent steps to be informed about the matter, had
no material personal financial interest in the matter and reasonably believed that the decision in question was in the interest of the company (section 76(4)). This rule was made to protect directors from incurring liability in case of an error in judgement or business decision which turns to be a poor decision (Cassim, 2011; Davis et al., 2013, p.124-125; Delport et al., 2011; Mupangavanhu, 2019; Mupangavanhu, 2019).

A company secretary plays a significant role in guiding the board. It is submitted that lack of capacity in the office of company secretary may also affect the SOE as there is a danger of a board taking the decision that is inconsistent with the Companies Act, founding legislations of that particular entity, principles of corporate governance. Furthermore, the lack of necessary skill and competency may also affect the performance of SOE. It should be noted that a company secretary plays a significant role and it was submitted that company secretary is qualified as "prescribed officer" because the company officer is actually the chief administrative officer of the company (Delport et al., 2011; Havenga, 2013; Cassim et al., 2012, p. 418).

Failure by the director to declare an interest that he/she has on the matter that is before the board is one of the potential challenges. This may occur even at the stage when a director is appointed thereby fails to declare a secret profit or the fact that he/she is a director of a private company or even non-disclosure or partial disclosure in case of executive directors. This is evident from the Public Service Commission (PSC) Report on the management of the financial disclosure framework. The PSC scrutinised all the financial disclosure forms for the 2016/17 financial year and the forms revealed that 1 943 senior management service (SMS) members in both the National and Provincial Departments have directorships in public and private companies and only 721 (37%) disclosed such information (Public Service Commission, 2018).

The Presidential Review Committee on state-owned entities found that the quality of the board and executive recruitment for state-owned entities was inadequate (see report of the Presidential Review Committee of state-owned entities (South African Government, 2013). The Presidential Review Committee found that there is no clear legislative framework for selection, appointments and induction of board (Presidential Review Committee, 2013, vol. 2.101). In this regard, there was no single legislation governing recruitment, procedures and processes. The founding legislation of SOE/Memorandum of Incorporation will grant the executive authority the power to appoint or dismiss the board, CEO and board chairperson whereas the Protocol on Corporate Governance in the Public Sector that the board should appoint one its member as chairperson as such there is a conflict with founding legislation/Memorandum of Incorporation (Presidential Review Committee, 2013, vol. 2.101). The Presidential Review Committee found that the Handbook for the Appointment of Persons to Boards of State and State-Controlled Institutions, which was approved by Parliament on September 17, 2008 did not standardise on how roles are performed and “there is no clarity in terms of who does what and when” (Presidential Review Committee, 2013, vol 2.108) (in May 2010 former President Zuma established PRC to, inter alia, investigate whether SOEs are responding appropriately to the developmental state. The PRC was tasked to review SOEs and provide recommendations/reforms. Their terms of reference included “governance matters”.

World Bank toolkit for state-owned enterprises provides that “contrary to good practice, however, SOE boards are often composed of government, political, and stakeholder representatives with limited commercial or financial knowledge or experience, who are therefore unsuited to exercising the kind of responsibility increasingly required of SOE boards”. It further provides that “such problems often stem from the lack of clear policies or guidelines for nominating and appointing qualified members to SOE boards — even when such nominations and appointments are covered by SOE legislation and by the companies’ constitutional documents” (World Bank toolkit provides a framework for the corporate governance of SOEs. It focuses on commercial SOEs where the government has significant control such as full, majority, or substantial minority ownership on the entity 2014 (Arrobbio et al., 2014, p. 163).

6. BEST PRACTICES/RECOMMENDATIONS

The state as shareholder directly or through the National Assembly should appoint fit and proper board members after following sound due-diligence the process (Thabane & Snyman-Van Deventer, 2018). The process of appointment must be transparent.

The World Bank provides that “in addition to minimum requirements for education and experience, industrial, financial, business, legal, and corporate governance skills, as well as private sector backgrounds and experience, are carrying more weight. Other skills such as integrity, ability to add value, and critical faculty are also important” (Arrobbio et al., 2014, p. 170).

In China directors are required to have “good character” as one of the required qualifications (OECD, 2018, p. 14).

The Protocol states that “the board should, on an annual or such other regular basis as the circumstances of the SOE may determine, review its size, mix of skills, expertise and experience and other qualities in order to measure its performance levels in relation to the requirements of the shareholder. In this regard, the performance of the entire board, the chairperson, the Chief Executive Officer and each individual director should be assessed” using key performance indicators (Department of Public Enterprises (South African Government), 2002, p. 19-20). It is submitted that it is essential to engage in this process as it would assist the board to assess and determine if there is a decline in the performance and the shareholder will implement necessary measures because the board acts as shareholder representative in managing the business and affairs of the SOE (see section 66(1) of the Companies Act; Delport, 2014 p. 103-106). This process will also assist in reducing or preventing the decline in low performance which may have effect on the finances of the SOE. It is also recommended that external service of monitoring and evaluating board members...
should be considered where appropriate and the shareholder to be furnished with the report.

The office of the company secretary should also be strengthened with the necessary support to discharge its responsibilities (e.g., capacity) as the company secretary play a critical role in advising the board on corporate governance. The company secretary is charged with the responsibility of guiding the board on their powers, making them aware of the laws relevant to the SOE, report non-compliance with the MOI, etc. (section 88(2) of the Companies Act). The role of the company secretary is often underestimated but it submitted that sufficient/adequate capacity in the office of the company secretary will reduce the extent of non-compliance with the laws and procedures including governance principles. The company secretary advises the board and would have discharged his/her duties should the board disregard the advice of the company secretary. A board member who disregards advices of the company secretary may run a risk of attacking liability of the basis of duty of care if not a duty of skill (section 20(7) of the Companies Act). A shareholder who is not satisfied/agrieved may institute action for piercing the corporate veil (section 209 of the Companies Act) to hold company directors personally liable. A shareholder is entitled to institute a claim against any person who intentionally, fraudulently or due to gross negligence causes the company to engage in conduct that is inconsistent with the Companies Act or MOI (section 206(6)). Therefore if the court grant order for piercing the corporate veil, it cuts the protection afforded by limited liability in terms of the statute (Salomon v. Salomon & Co Ltd, 1897; Cape Pacific Ltd v. Lubner Controlling Investments (Pty) Ltd and others, 1995; Robinson v. Randfontein Estates Gold Mining Co Ltd, 1921), In the case of Knoop NO and Others v. Birkenstock Properties (Pty) Ltd and Others (FB) (unreported case No. 7095/2008) (2009) the court stated that “the corporate veil may be pierced where there is proof of fraud or dishonesty or other improper conduct in the establishment or the use of the company or the conduct of its affairs and, in this regard, it may be convenient to consider whether the transactions complained of were part of a “device”, “stratagem”, “cloak” or a “sham” (p. 4-6) (Shipping Corporation of India Ltd v. Evulmon Corporation and another, 1993, paras 43-44; Ex parte Gore NO and other NNO, 2013).

It is also imperative for the board to clearly understand the role and mandate of the particular SOE in which they serving. This requires support from the office of the company secretary to ensure that directors during the induction process are provided with guidance on the mandate of the SOE, their powers and responsibilities. The OECD guideline provides that SOE guideline indicates that appointed directors receive a minimum level of induction training where they are informed about their responsibilities and liabilities and this should take place within the first month of appointment and prior to the first board meeting (OECD, 2018, p. 22). The World Bank toolkit for state-owned enterprises also encourages board induction as it assists new director for the circumstances of a particular SOE (Arrobbio et al., 2014, p. 205).

The founding legislation of SOEs should be amended to clarify the role of directors, appointment and removal of the board. During the process of amendment, the principle of common law, the Companies Act, King IV report and other applicable regulatory principles to the SOE should be considered. In other words, governance principles should be considered when amending the founding legislations and be incorporated into founding legislation of the state-owned entity so that they can have a force of law.

In the SABC matter, it is evident that corporate governance deficiencies were a result of failure to provide oversight to SABC as required by, inter alia, King III. The Public Protector also explicitly states that governance failures were a result of GCEO, COO and CFO for failing to provide information to the board to exercise fiduciary duties. As indicated above, the principles of King IV are not mandatory and may be ignored. Therefore governance deficiencies may decline if principles of corporate governance in King IV are mandatory and entrenched in subordinate legislations of state-owned entities. The SOE directive also strengthens this recommendation because when principles of governance are mandatory to both executive and non-executive directors (board), the ultimate decision-maker which is the accounting authority (board) will be able to arrive at appropriate decisions that are in the best interest of the state-owned entity. In other words, this may also protect the board in the instances where the executive directors fail to provide information to the board such as in this case, which the information would have enabled the board to make a proper decision. Consequently, by failing to provide such information, the executive directors would have automatically breached the mandatory principles of corporate governance /fiduciary duties.

It is recommended that SOEs should strengthen their evaluation and monitoring processes to ensure that their systems/controls are able to detect a director of SOE who also serves as a director of a private company. Furthermore where applicable SOE should consider restraint of trade provision in which director of SOE is precluded from occupying a position in a private sector that is a competitor of that particular SOE. The restraint of trade will in principle restricts a director’s right to carry on their trade or profession that is the same of the former employer for a particular period (eg year). In Reddy v. Siemens Telecommunications (Pty) Ltd (2006, para 10), the court stated that “the substantive law as laid down in Magna Alloys is that restraint is enforceable unless it is shown to be unreasonable, which necessarily casts an onus on the person who seeks to escape it” (Magna Alloys & Research (S.A.) (Pty) Ltd. v. Ellis, 1984).

It should be noted that the Presidential Review Committee recommended that the government should develop a framework for the appointments of SOEs board and the rules of selection of candidates should be defined. The Presidential Review Committee also recommends that the process of recruitment, selection and appointment should be subjected by public彭福ing as part of the pre-determined objectives of SOE (South African Government, 2013, p. 111).
OECD guidelines for state-owned enterprises recommends that “mechanisms should be implemented to avoid conflicts of interest preventing board members from objectively carrying out their board duties and to limit political interference in board processes” (OECD, 2018, p. 8).

7. CONCLUSION

The fundamental challenges encountered by the board of state-owned entities are *inter alia*, conflict of interests, failure to uphold the fundamental principles of corporate governance, lack of necessary skill and competencies. The Public Protector in conducting the investigation on SABC explicitly made finding, *inter alia*, that governance failures were a result of group chief executive officer (GCED), chief operations officer (COO) and chief financial officer (CFO) for failing to provide information to the board to exercise *fiduciary duties*. Pertaining to Department of Public Works, the Public Protector made finding, *inter alia*, that the decision of the department to proceed with the implementation of the lease agreement was in breach of its *fiduciary duties and the requirements of good governance* in terms of the PFMA, and that decision amounted to maladministration.

It is submitted that failure to comply with fiduciary duties will have drastic effects on a state as a shareholder and may lead to a decline in corporate governance of the state-owned entity. Consequently, the other stakeholders of the entity may be affected and while the state as a shareholder will suffer the ramifications.

Although a King IV is not a law but it recommended that the principles of corporate governance some of which are contained in King IV should be incorporated in subordinate legislation and in this regard they will have a force of law. Consequently, this will certainly assist in reducing a decline in corporate governance by the state-owned entity resulting from a breach of fiduciary duties. In the alternative, the state as a shareholder should always consider the principles of corporate governance in amending the governance related documents such as Memorandum of Incorporation or Shareholder Compact/Agreement.

The state should appoint fit and proper board members with necessary skills and competencies. Upon acceptance of appointment by board members, a company secretary should proceed to coordinate the process of induction. The role of company secretary should not be under-estimated by the board members because company secretary is charged with a significant role of guiding the board on their powers, making them aware of the laws relevant to the SOE, report non-compliance with the MOI, etc. (section 88(2) of the Companies Act). This will ensure that the board members understand the role and mandate of the particular SOE in which they are serving. The above process will undoubtedly reduce the extent of non-compliance with the laws and procedures. Failure to comply with the laws and procedures by the board, the aggrieved party including the shareholder may also bring an action of piercing the corporate veil (section 209(9) of the Companies Act) in which the company directors will be personally liable. In fact, a shareholder may institute a claim against any person who intentionally, fraudulently or due to gross negligence causes the company to engage in conduct that is inconsistent with the Companies Act or MOI (section 20(6). When the court pierces the corporate veil, it strips or cuts the protection afforded by Limited Liability in terms of the statute and the director will be personally liable (*Salomon v. Salomon & Co Ltd*, 1897; *Cape Pacific Ltd v. Lubner Controlling Investments (Pty) Ltd and others*, 1995; *Robinson v. Randfontein Estates Gold Mining Co Ltd*, 1921).

The shareholder should on the other hand regularly assess the performance of the board as this will assist in detecting any decline in the performance of the state-owned entity. The founding legislation of SOEs should be amended to clarify the role of directors, appointment and removal of the board. During this process, consideration should be made principles of common law, the Companies Act, King IV report and other applicable regulatory principle to the SOE.

It is envisaged that the article will contribute in the knowledge and research pertaining to governance challenges associated with the exercise of fiduciary duties by the board members of the state-owned entities and to other employees who have fiduciary responsibilities, as it examines the potential challenges and provides recommendations in order to reduce a decline in corporate governance of the state-owned-entity.

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