

Section 75 introduced significant changes to Companies Act

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In the interest of ensuring that the integrity of board decisions are not compromised by directors' personal financial interests, section 75 of the Companies Act 71 of 2008, has introduced some significant changes to the provisions of its predecessor, the Companies Act 61 of 1973 (the old Companies Act).



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The changes were probably deemed necessary by the legislature due to a number of cases in South Africa where conflicted directors have deliberately withheld material information from the rest of the board to the prejudice of the company and its shareholders.

A case in point is *S v Gardiner and Another* 2011 (4) SA 79 (SCA) where two chief executive officers were held to have breached their duty to disclose personal financial interests in certain contracts with the company by failing to disclose those personal financial interests to the board of the company. The court held that the two accused had deliberately and fraudulently withheld information from the board of directors and convicted the two accused of fraud.

The most noteworthy changes that have been introduced by section 75 of the Companies Act are the following:

- under the old Companies Act, a conflicted director was prohibited from voting on a matter or agreement in which he/she was interested after making a disclosure but he/she could attend the meeting and participate in the deliberations of the matter or agreement at the discretion of the board. This is in stark contrast to section 75 of the Companies Act which provides that a conflicted director is not only required to recuse himself/herself from voting on a matter where he/she has a conflicting interest, but must also recuse himself/herself from the relevant meeting and may not take part in the consideration of the matter except to disclose the interest and its general nature or any material information relating to the matter; and
- the Companies Act clearly contemplates that non-disclosure by a director of a personal financial interest in a matter or contract before the board renders any decision by the board in relation to the matter or a transaction or agreement approved by the board invalid, and that such decision, agreement or matter can be validated only if ratified by an ordinary resolution of shareholders or declared valid by the courts.

Against this background, we unpack below the provisions of section 75 of the Companies Act which deal with the management of conflicts of interests and a director's duties to the company he/she serves with regards disclosure of a director's personal financial interests.

In terms of section 75 of the Companies Act a director's obligation to disclose a personal financial interest arises in respect of:

- a matter to be considered at a meeting of the board in which he/she has a personal financial interest or in which he/she knows that a related person has a personal financial interest; or
- any personal financial interest acquired by a director in an agreement or matter, in which a company has a material interest or knows that a related person has acquired a personal financial interest in the matter after the agreement or matter has been approved by the company (our emphasis). It should be noted that the disclosure required in terms of this section relates to a personal financial interest in relation to an existing contract or matter which has been approved by the board; and requires a director to disclose his or her personal financial interest in an existing contract or a related person's personal financial interest in an existing contract - regardless of whether such personal financial interest is material to him/her so long as it relates to a matter in which the company has a material interest.

When used in the context of section 75, the term "related person" not only includes a director's spouse, parents, children and siblings, but also includes a juristic person if the director directly or indirectly controls the juristic person or a second company of which the director or a related person is also a director; or a close corporation of which the director or a related person is also a member.

Knowledge of related person's interests

Although no disclosure is required in terms of section 75 in circumstances where a director has no knowledge of a related person's interests, it should be borne in mind that, for purposes of section 75, a director is regarded as having actual knowledge of a related person's interests if he/she was in a position in which he/she reasonably ought to have known of the related person's interests.

The test set out in the Act for determining whether a director had actual knowledge of a particular matter is whether, objectively, the director was in a position in which he/she reasonably ought to have:

- had actual knowledge;
- investigated the matter to an extent that would have provided the person with actual knowledge; or
- taken other measures which, if taken, would reasonably be expected to have provided the person with actual knowledge of the matter. Accordingly, to the extent that a director does not know of a related person's interests, he/she is required to conduct an investigation into the related person's interests and acquaint himself/herself of such interests.

The term "personal financial interest" is defined in 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, but 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 45 of 2002), unless that person has direct control over the investment decisions of that fund or investment". In this regard, it is important to note that:

- the nature of interest that requires disclosure in terms of section 75 of the Act applies to matters of "a financial, monetary or economic nature, or to which a monetary value may be attributed";
- such interest is strictly restricted to an interest which is "direct and material" in relation to the director or the director's

related person. The term "material" is defined in the Act as, "when used as an adjective, means significant in the circumstances of a particular matter, to a degree that is of consequence in determining the matter or might reasonably affect a person's judgment or decision-making in the matter".

The test set out in the Companies Act for determining whether or not a person has a personal financial interest is essentially a test of "materiality" or "significance". The test involves an enquiry as to what extent the interest held by a director or a director's related person is material or significant to the director concerned or the related person concerned, in the context of a particular matter.

Lack of clarity

The definition of the term "material" as set out in section 1 of the Act has been criticised for lack of clarity and consequently, being open to various interpretations. Our view is that the "materiality" and "significance" tests are tests which depend on the facts and circumstances of a particular case. In this context, the tests should not be used in vacuo but should be applied to a particular set of facts or circumstances in order to achieve the correct results.

Section 75 of the Act is applicable not only to members of the board but also alternate directors, prescribed officers, and members of board committees. "Prescribed officers" refers to persons who exercise or regularly participate to a material degree in the exercise of general executive control over and management of the whole of, or a significant portion of, the business of a company; for example, chief executive officers, chief financial officers, general counsel and the like.

Section 75 (5) of the Act prescribes the following procedure for disclosure of a director's personal financial interest or a director's related person's personal financial interest to be considered at a meeting of the board. The director concerned:

- must disclose the interest and its general nature before the matter is considered at the meeting. The Act does not prescribe the manner of disclosure and, as such, we take it that the disclosure maybe oral or in writing;
- must disclose to the meeting any material information relating to the matter, and known to the director;
- may disclose any observations or pertinent insights relating to the matter if requested to do so by the other directors;
- if present at the meeting, must leave the meeting immediately after making any disclosure as required by the Act; and
- must not take part in the consideration of the relevant matter/s except to the extent contemplated by the Act.

It should be noted that although the conflicted director is required to recuse himself/herself from the meeting of the board at which the matter in question is deliberated:

- he/she is treated as present for the purposes of determining the quorum but absent for the purposes of determining whether the resolution has sufficient support to be passed; and
- he/she must not execute any documents on behalf of the company in relation to the matters unless specifically requested or directed by the board to do so.

As noted above, sections 75 (d) and (e) of the Act prohibit participation in a meeting or voting by a conflicted director on a matter or contract where he/she has a conflicting interest after making a disclosure. This strict requirement for recusal from the meeting was, presumably, introduced by the legislature in order to prevent a conflicted director from participating, influencing or attempting to influence any discussions or decisions by the board in relation to the matter in which he/she was interested or even worse, influencing the members of the board to vote in favour of a contract particularly in instances when it would not be in the best interest of the company to do so.

This is sometimes viewed as draconian on the basis that the other board members or shareholders are not, at their discretion, empowered to condone or permit further participation by a conflicted director in any consideration of the matter in which he/she is interested, as was previously the case in terms of the old Companies Act.

Nature and extent of interest

Section 75 (4) of the Companies Act allows disclosure by a director of any personal financial interest in advance of any conflict of interest arising, by delivering to the board, or shareholders (where the company in question has a single director), a notice setting out the nature and extent of the interest to be used. Section 75 (4) enables a director to disclose all personal financial interest when he is first appointed and at any time whilst he is a director.

There are exceptions to the rules set out in section 75 of the Act. Section 75 of the Companies Act does not apply to a director of a company in relation to:

- decisions that may generally affect all the directors of the company in their capacity as such;
- decisions relating to a class of persons notwithstanding that a director belongs to that class; save in circumstances where the only members of that class are the relevant director or persons related or inter-related to that director. Our view is that the rationale behind this exception is that a company should not be deprived of a director's contributions (by remaining in attendance at a meeting and participating in the deliberations of the matter) where the board has to decide on a matter "that may generally affect ... a class of persons", and one or more directors incidentally happen to fall within that class - unless the whole of the class comprises the relevant director or persons related or interrelated to the director, in which case the definition of "class" would be artificial. In such circumstances, a conflicted director is still obliged to disclose his/her interest, and cannot vote on the matter on which he/she is conflicted, but he/she is not obliged to recuse himself/herself from the meeting or refrain from participating in the board's deliberations of the matter after making the disclosure of his/her personal financial interest;
- a proposal to remove a director from office; or
- the sole director if he/she is also the company's sole shareholder.

Consequences for non-compliance

Legal consequences for non-compliance with the disclosure requirements, set out in section 75 of the Act, are the following:

- a resolution, transaction, matter or agreement approved without proper disclosure in the manner contemplated in section 75 of the Act is invalid unless the invalidity is subsequently cured as set out below;
- a director may face possible claims for damages from the shareholders, the company or even third parties or criminal prosecution for fraud or theft if he/she is held to have deliberately and knowingly withheld material information from the company with regards to his/her personal financial interests in a contract with the company, in order to induce the company to act to its prejudice or potential prejudice.

The effect of non-disclosure by a director of a personal financial interest in a matter or contract before the board is that it renders invalid any decision taken by the board, or any transaction or agreement approved by the board. The question that arises is what remedies are available to the company or third parties who may be affected by an invalid resolution, agreement or transaction as a result of non-compliance with the disclosure requirements set out in the Act.

In this regard, section 75 (7) of the Act, provides that a decision by the board, or a transaction or agreement approved by the board or by shareholders, can be validated despite having been approved without proper disclosure, if it -

- is subsequently ratified by an ordinary resolution of the shareholders following disclosure of that interest; or
- has been declared to be valid by a court.

It is important to note that, if none of the above actions are taken, the resolution and the ensuing agreement or transaction are void.

In the interest of ensuring compliance by the members of the board and prescribed officers with the provisions of section 75 of the Act, the following is recommended:

- mandatory annual or semi-annual disclosure in advance by members of the board and prescribed officers of their

personal financial interests, as well as those of related persons regardless of whether or not such interests give rise to a conflict of interest;

- prior to the commencement of each board meeting, the chairperson of the board should require all directors and prescribed officers to disclose any personal financial interests in relation to any matter on the agenda;
- disclosures of personal financial interests by directors or prescribed officers must be properly and diligently minuted;
- directors and prescribed officers should be advised to take diligent steps to make themselves aware of and have knowledge of the financial interests of their related persons; and
- the board should immediately take steps to rectify any decisions that are taken or contracts approved by the board without proper disclosure, by having them ratified by shareholders of the company.

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