

And we dare to ask again – whose right is it to enforce a director's fiduciary duties?

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The Companies Act

It goes without saying that a director is the mind and sounding board of a company. In terms of **section 66 of the Companies Act 71 of 2008** (Companies Act), the business and affairs of the company must be managed by or under the direction of its board of directors. The board of directors has the authority to exercise all the powers and perform any of the functions of the company, except to the extent that the company's memorandum of incorporation and the Companies Act provide otherwise.

Added to the fact that a director is the primary custodian of the company's business and affairs, including the company's finances, it is the harsh reality that monies lent and advanced by creditors for a particular purpose are unlawfully and wrongly misappropriated or mismanaged by a specific director or the board in its totality.

In circumstances where a company has been placed under liquidation, the creditor's remedies against that director are clear through **Section 424 of the Companies Act 61 of 1973** (Old Companies Act), read with the transitional provisions contained in Regulation 9 of the regulations to the Companies Act.

Section 424 of the Old Companies Act does provide a relief for an aggrieved party i.e creditor, as it provides that any person who knowingly participates in carrying on the business of the company in the manner prohibited therein, is personally liable for any for any loss or damage suffered by that person.

Where a company is still trading or has not been wound-up because it is not chronically ill but financially distressed as a result of the unlawful and/or wrongful conduct of a director, the position is not as clear and requires some further debate. Can a creditor whose claim is at a risk of either being compromised or restructured pursue a civil and monetary claim against a director who acted unlawfully and/or wrongfully for the loss or harm caused? Put differently, does a creditor of a trading company have the right to enforce a claim against a director for breach for fiduciary duties.

There can be no doubt that interested persons such as creditors and shareholders whose investments are negatively affected by the unlawful and/or wrongful actions of the relevant director. Although dealing with shareholders, in the recent case of *Ryan and Others vs Groenendaal and Others* (12142/2022) [2022] ZAGPJHC 309 (*Ryan*), **the court found that a director may owe fiduciary to someone other than the company should a special factual relationship be found**. The *Ryan* case has allowed us to explore this possibility within our corporate governance jurisprudence.

The fiduciary duties

The purpose of the Companies Act is to "encourage transparency and high standards of corporate governance..." and also, "encourage the efficient and responsible management of companies". Section 22 of the Companies Act states that a company must not carry on its business recklessly, with gross negligence, with intent to defraud any person or for any fraudulent purpose. Section 218 the Companies Act provides

that any person who contravenes any provision of the Act is liable to any other person for any loss or damage suffered by that person, as a result of that contravention.

In *Howard v Herrigal and Another NO 1991 (2) SA 660 (A)* the court acknowledged that at common law, by virtue of accepting an appointment as director, the relevant person becomes a fiduciary in relation to the company and as such, is expected to exhibit the utmost good faith towards the company in all that he/she does on behalf of the company. The fiduciary duties form part and parcel of the characteristics of a director and cannot be ignored or avoided.

Our courts are of the view that the directors of a company owe fiduciary duties to the company and not the members (which can be interpreted to include creditors). According to the Honourable Judge Unterhalter in *De Bruyn v Steinhoff International Holdings NV and Others 2022 (1) (SA) 442 (GJ) (De Bruyn)*, the question on breach of fiduciary duties should be answered in the context that a legal relationship exists between the directors and the company.

The Salomon principle

This principle is supported by the Salomon principle which expresses that a company has its own legal personality, in other words, it is separate from its shareholders.

This golden rule however has appeared to have left shareholders, creditors and the like with little to no direct recourse should directors breach their fiduciary duties. They simply, per our court's decisions, lack the necessary legal standing. We say this because in *Hlumisa Investment Holdings (RF) Limited and Another v Kirkinis and Others 2019 (4) SA 569 (GP) (Hlumisa)*, the court noted that

"[e]ven if the plaintiffs can advance a claim for a breach of section 76 under section 218(2) they must show that section 218(2) has altered the common law to allow a reflective loss. This would be a drastic departure from a core principle of company law."

The enforcement right (or the "*action for wrongs*") against the directors therefore lies with the company and not "any person" as section 218 seems to suggest and as the Supreme Court of Appeal found in *Hlumisa*. Similarly, in *Ryan*, Honourable Judge Siwendu accepted Judge Unterhalter's comment that it is generally accepted that the legal relationship between a director and the company does not give rise to such fiduciary duties being owed to the shareholders of the company or any other party such as a creditor.

The golden rule

This seems to be the golden rule when debating the issue regarding civil liability against directors who may have acted improperly or unlawfully.

In *Ryan*, Mr Bryan James Groenendaal (Mr Groenendaal) argued that the applicants do not have locus standi and that they have no *prima facie* right to the relief they seek because our law recognises a clear distinction between the directors and the shareholders. Although Judge Siwendu accepted Judge Unterhalter's comments in *De Bruyn*, she declined the invitation not to entertain the application on the basis that the applicants lack the necessary *locus standi*.

Judge Siwendu rejected the proposition that Mr Groenendaal, as a sole director should not be restricted from having a "*free reign and unfettered access and use of the bank account*" belonging to the company which was the subject of the proceedings.

In granting the interdict in favour of the applicants, Judge Siwendu noted that the court in *De Bruyn* recognised that although the golden rule is that a fiduciary duty is owed to the company, ***in certain instances directors may owe fiduciary duties to shareholders where a special relationship exists.***

The types of special factual relationships, according to the court, is not a closed list. Importantly, the court noted that from inception, there has been an overlap in the roles between the shareholders and the directors. Further, the court held that given the special factual relationship of the SPV, the pending litigation, the risk and the financial exposure of Afrendev and the applicants are likely to suffer, it is pragmatic and fitting to grant the applicants requisite standing to protect their interest in the subject company.

The confirmation that a special factual relationship may be a ground to pursue a civil claim against a director who may have violated his fiduciary duty may be a relief for persons other than the company to pursue. Notwithstanding the decision in the *Ryan* case, the position remains blurry for creditors.

Should a court be faced with a claim for damages by a creditor against a director for the breach of fiduciary duties, it will be exciting to see how our courts will interrogate the principles laid out in *Hlumisa*, *De Bruyn* and *Ryan*. Will the court look for funding terms and conditions which establish a special factual relationship, the director's conduct prior funding and after funding?

The legal and, to some extent, non-legal relationship between the creditor and the company and its directors? It is definitely not a tick boxing exercise. It will be interesting to see how our courts deal with this issue moving forward and the development of the law in this regard.

