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have formed (see Christie *op cit* at 387ff; *George v Fairmead (Pty) Ltd* 1958 (2) SA 465 (A); *Horty Investments (Pty) Ltd v Interior Acoustics (Pty) Ltd* 1984 (3) SA 537 (W); *Nasionale Behuisingskommissie v Greyling* 1986 (4) SA 917 (T)).

Similarly, in order to determine whether an instrument is complete and regular on its face (a requirement which can be included in the broad requirement that a holder in due course must take an instrument in good faith), the judgment of the reasonable person taking the instrument with due care must be employed. Just as good faith underlies the law of contract, so it underlies holdership in due course. And since it is the reasonable person who acts in good faith, it is her judgment which must be employed to determine holdership in due course.

On this basis the decision in *Sappi Manufacturing* seems correct. A reasonable person reading the bill would probably have concluded that De Villiers and Vlok signed as indorsers on behalf of Sappi. It is to be hoped that whenever the regularity of a bill or indorsements upon it are in question, the judgment of the reasonable person will be applied as the relevant criterion.

Competing with the Company — When Does a Director Breach His or Her Fiduciary Obligation?

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1 Introduction

It is generally accepted that the paramount duty of directors, individually and collectively, is to exercise their powers bona fide in the best interests of the company. This fiduciary principle leads to the question as to the extent to which competition between a director and his or her company is permissible. The problem is clouded by the fact that both the nature of the competition and the position of the particular director may vary considerably (see generally Michele Kyra Havenga *Fiduciary Duties of Company Directors with Specific Regard to Corporate Opportunities* (unpublished LLD thesis, University of South Africa, 1995); SJ Naudé *Die Regsposisie van die Maatskappydirekteur met Besondere Verwysing na die Interne Maatskappyverband* (1970) 135; SJ Naudé 'Mededinging deur 'n Direkteur met sy Maatskappy' (1970) 87 *SALJ* 193). This is illustrated by the recent decision of the Supreme Court of New South Wales in *Rosetex Company Pty Ltd v Licata* (1994) 12 ACSR 779 (SC NSW).

2 The Decision in *Rosetex v Licata*

In *Rosetex v Licata* the plaintiff company in receivership brought proceedings against its former controlling director and certain other companies which commenced trading with former customers of the plaintiff after it had ceased to trade. Before its receivership, the plaintiff company, Rosetex, traded in importing bedspreads and doonas from Pakistan in a raw state, performing the finishing work on the raw product in Australia, and then selling the finished product to retailers. Rosetex went into receivership on 15 July 1993. On 22 July, the receiver conducted a receiver's closing-down sale and soon afterwards dismissed all the company's staff. Thereafter the company was not permitted to trade.

The first defendant, Licata, was the controlling director of the plaintiff company prior to its going into receivership. The second and third defendants were the son and son-in-law of the first defendant. They effectively controlled the companies cited as fourth and fifth defendants, one of which was incorporated after Rosetex went into receivership. The sixth and seventh defendants were retailers who had purchased products from the fourth and fifth defendants. It was conceded that the first defendant had assisted these companies in their project and that the first defendant was a person who, before the receivership, was involved with marketing the same products for the plaintiff.

The plaintiff company relied on subsecs 232(5) and (6) of the Australian Corporations Law 1989. These subsections provide as follows:

'(5) An officer or employee of a corporation or a former officer or employee of a corporation, must not, in relevant circumstances, make improper use of information acquired by virtue of his or her position as such an officer or employee to gain, directly or indirectly, an advantage for himself or herself or for any other person or cause detriment to the corporation.

(6) An officer or employee of a corporation must not, in relevant circumstances, make improper use of his or her position as such an officer or employee, to gain, directly or indirectly, an advantage for himself or herself or for any other person or cause detriment to the corporation.'

Young J confirmed that a person who is a director of a corporation remains the director even after the company goes into receivership (see also *Hawkesbury Development Co Ltd v Landmark Finance Co Ltd* [1969] 2 NSW 782 (SC NSW); *Re Geneva Finance Ltd* (1992) 7 WAR 496 (SC WA) at 508-509). However, this does not imply that their fiduciary duties are the same as the fiduciary duties in respect of a company which is not in receivership. On the evidence before the Court, his Lordship thought that the plaintiff was not entitled to relief against any of the defendants based on a breach of any duty not to compete with it (see at 783). The Court further held that the concept of 'information' in s 232 denoted the sort of information which equity would protect by injunction if a director used it in breach of his or her fiduciary duties. 'Improper' use of that information should be considered on much the same basis as a breach of fiduciary duty under the general law. It followed that as there was no breach of duty in casu, there was also no

infringement of section 232(5) (at 784). The proceedings were accordingly dismissed.

3 The Fiduciary Duty not to Compete

It is submitted that the issue of competition by a director and his or her company is more complex than may at first glance be apparent from the decision in *Rosetex v Licata*. Young J acknowledged the range of opinions varying from a total prohibition on competition between director and company, to a total disregard of any such prohibition (see at 782). This was described as a problem caused by the changing attitudes to the role of company directors. And, warned the Court, care must be taken in not ruling out practices which are acceptable, namely, a well-known citizen being on the board of more than one charitable organisation even though the organisations may compete for funds. The Court did not have sufficient evidence before it to indicate any breach of the director's fiduciary obligation, and the decision was therefore straightforward. But had the case been stronger, the outcome might well have been different (see at 784).

There are various approaches to the issue of competition between a director and his or her company (Havenga *op cit* at 381ff). Under English law, unless the articles of association provide otherwise and subject to any contract between a director and his or her company, it has traditionally been accepted that competition between a director and his or her company is not prohibited *per se* (see LCB Gower *Gower's Principles of Modern Company Law* 5 ed (1992) 571; Robert R Pennington *Company Law* 6 ed (1990) 587; *London & Mashonaland Exploration Co Ltd v New Mashonaland Exploration Co Ltd* [1891] WN 165 (ChD), approved in *Bell & Another v Lever Brothers Limited & Others* [1932] AC 161 (HL) at 195). But more recent decisions suggest that mere competition is a breach of duty, and illustrate that it will almost inevitably lead to other breaches of duty (see Gower *op cit* at 572; *Hivac Limited v Park Royal Scientific Instruments Limited & Others* [1946] Ch 169, [1946] 1 All ER 350 (CA); *Thomas Marshall (Exports) Ltd v Guinle* [1979] Ch 227, [1978] 3 All ER 193 (Ch D)). It has in fact been suggested that the decision in *Mashonaland Exploration* was incorrect (see Michael Christie 'The Director's Fiduciary Duty not to Compete' (1992) 55 *Modern LR* 506). The recent recommendation by the Cadbury Committee (on the Report by this Committee generally, see Sir Adrian Cadbury 'Restoring Trust and Confidence in the Corporate System' (1992) 3 *International Company & Commercial LR* 403; Janet Dine 'The Governance of Governance' (1994) 15 *Company Lawyer* 73) in this regard is that the majority of the non-executive directors of a company should be free from any business or other relationship which could materially interfere with the exercise of their independent judgment (*Report by the*

Committee on the Financial Aspects of Corporate Governance (1992) par 4.12).

The considerable danger of the misuse of confidential information has been pointed out in other Commonwealth countries (see *Abbey Glen Property Corp v Stumborg* (1976) 65 DLR (3d) 235 (SC Alb) at 278 (Canada); *Berlei Hestia (NZ) Ltd v Fernyhough* [1980] 2 NZLR 150 (SC NZ) at 161 (New Zealand)). American law recognises that directors also have independent interests to advance. The general rule, therefore, is that directors may engage in independent business but that if such business competes with that of the corporation, equitable limitations apply (see generally Harry G Henn & John R Alexander *Laws of Corporations and Other Business Enterprises* 3 ed (1983) 628; *Lincoln Stores, Inc v Grant et al* 34 NE 704 2d (SC Mass) at 709; *Tovrea Land & Cattle Company v Otto H Linsenmeyer et al* 412 P2d 47 (SC Ariz) at 57).

Under South African law, the position of a director who participates in rival companies is uncertain. The traditional view, similar to that in English law, is that unless the articles provide otherwise and subject to any contract between a director and his or her company, the director is not precluded from becoming a director, officer or employee of a rival company (see HS Cilliers, ML Benade, JJ Henning, JJ du Plessis & PA Delpont *Corporate Law* 2 ed (1992) 138; *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168 at 216). The rule is subject to qualifications: the director may not subordinate the interests of the company to those of the other venture (see WA Joubert (ed) *The Law of South Africa* vol 4 (1982) par 229), or disclose confidential information to the rival company, and the corporate personality of the rival company may, in certain circumstances, be disregarded. In the *Robinson* decision, the Court indicated that it would disregard the legal personality of a company if it was being used to circumvent the fiduciary relationship between a director and his or her company. The transaction between the director and a subsidiary company of the company of which he was a director, was treated as if it were a breach of duty between the director and his or her own company (see Naudé (*Maatskappydirekteur*) op cit at 136n2). Another instance where corporate personality may be disregarded, is where the director formed the competing venture himself with the purpose of competing with his or her company (Naudé ('Med-edinging') op cit at 194. On the disregarding of the corporate entity by the courts generally, see Cilliers et al op cit at 11ff; *Botha v Van Niekerk & 'n Ander* 1983 (3) SA 513 (W) especially at 521D-F).

Where two or more companies are trade competitors, it is difficult to envisage one person being a director of more than one of them without subordinating the interests of one of the companies to his or her own interests, thereby breaching his or her fiduciary obligation. There is also the real danger that the director might disclose confidential information. Hence the following warning by Goldstone J in *Sibex Construction (SA)*

(Pty) Ltd & Another v Injectaseal CC & Others (1988 (2) SA 54 (T) (at 67D-E)):

'It would be a most unusual situation which allowed directors or senior officers or managers of one company to act in the same or similar capacity for a rival without actual or potential conflict situations arising with frequent regularity. Even in the case of a non-executive director a similar conflict of interests could arise in circumstances not difficult to imagine.'

Moreover, withholding the information might also be held to be in contravention of the obligation to act in the best interests of the rival company. In some instances competing directorships could, arguably, also form the basis of a member's action for oppressive conduct under s 252 of the Companies Act 61 of 1973. Furthermore, the director may be held liable for unlawful competition (see generally Havenga op cit at 388ff).

I believe that in view of the difficulties facing a person who is director of competing companies, the Companies Act should be amended to prohibit the holding of multiple directorships in companies which are trade competitors for the duration of the director's term of office. Until the Companies Act is amended in this way, I would suggest that the articles (this is probably the easiest solution to the problem: see eg John H Farrar, Nigel E Furey & Brenda M Hannigan *Farrar's Company Law* 3 ed (1991) 420), or separate service contracts (see eg *Hivac Limited v Park Royal Scientific Instruments* supra) should include a clause precluding directors from occupying directorships in competing companies.

4 The Effect of a Company's Liquidation on the Obligation not to Compete

Rosetex v Licata also prompts the question whether a director of a company in liquidation remains precluded from competing with that company. Young J agreed with Cohen J who stated in *Lord Corporation Pty Ltd v Green* ((1991) 9 ACLC 1,094 (SC NSW)) that the real issue was whether the persons who are directors at the time of the winding up continue to owe a fiduciary duty to the company in their dealings with it when it is under the control, not of a board of which they are members, but of a liquidator appointed by the Court. In *Lord Corporation*, which concerned the purchase of a company's property by a director, the Court (at 1,104) based its decision that a director owed a lesser obligation to the company after its liquidation on the philosophy of control underlying the fiduciary principle:

'Directors have a responsibility to act in the best interests of the company and their relationship restricts their dealings with the company not because of any power they actually do wield but because of their potential powers in the company's control. Where a liquidator, acting as an officer of the court, has total responsibility in the company for disposition of its assets, if possible the payment of its debts and the repayment of capital, all discretionary decisions in respect of those assets are reposed in him. The powers of the directors having ceased, so too have their fiduciary powers, that is their capacity to misuse their position which arises from their having control over the company's actions and the dealing with its assets.'

In *Lord Corporation* the Court confirmed that a person who was a director at the time of the winding-up, remains precluded from benefiting, at the expense of the company, from knowledge or information obtained as a director before the liquidation. Such a person would be in much the same position as a director who, after acquiring knowledge in that capacity, resigns as a director and makes a profit from a transaction by using that knowledge at the expense of the company. Directors were held in breach of their fiduciary obligation in similar circumstances in *Industrial Developments Consultants Ltd v Cooley* ([1972] 1 WLR 443, [1972] 2 All ER 162 (Birmingham Assizes)) and in *Canadian Aero Service Ltd v O'Malley et al* ([1974] SCR 592, (1974) 40 DLR (3d) 371 (SC Can)).

Rosetex v Licata concerned not the purchase of a company's asset, but the problem that the company could be affected by the director's competing activities. Although the Court found that the director still owed a fiduciary duty to the company, it considered that this duty had in the circumstances not been breached (see at 783).

Under South African law, a director's duties arise once his or her appointment takes effect. If the director has not formally been appointed, the fiduciary relationship commences when he or she starts to act as director (*The Law of South Africa* op cit par 218). The director's termination of office should release him or her from the fiduciary obligation, although in certain circumstances a former director may still be accountable for competitive activities which occurred after the resignation on the basis of the prior fiduciary obligation. For example, where a director's resignation is influenced by the desire to personally acquire an opportunity, or where his or her position with the company rather than a fresh initiative led to the opportunity, he or she remains precluded from taking it (Phillip M Meskin *Henochnberg on the Companies Act* 5 ed (1994) at 472; *Cranleigh Precision Engineering Ltd v Bryant & Another* [1965] 1 WLR 1293, [1964] 3 All ER 289 (QBD); *Magnus Diamond Mining Syndicate v MacDonald & Hawthorne* 1909 ORC 65 at 81-82; *Industrial Development Consultants v Cooley* supra; *Canadian Aero Service v O'Malley* supra at 382; *Island Export Finance Ltd v Umunna & Another* [1986] BCLC 460 (QBD); *Sibex Construction v Injectaseal* supra). Moreover, the fiduciary obligation only applies when the director acts in his or her capacity as director (Havenga op cit at 314, 382).

When a company is wound up by the Court, the directors cease to be directors when the winding-up order is granted and their powers and duties terminate automatically (Cilliers et al op cit at 125; *Volkskas Bpk v Darrenwood Electrical (Pty) Ltd* 1973 (2) SA 386 (T) at 389H-390C; *S v Cope* 1970 (3) SA 605 (T) at 608H-609A; *Attorney-General v Blumenthal* 1961 (4) SA 313 (T) at 315C-D, 318A-C). They retain certain residual powers, such as to effect opposition to confirmation of a provisional order of liquidation and to participate in any proceedings in

relation to such provisional winding-up order (*O'Connell Manthe & Partners Inc v Vryheid Minerale (Edms) Bpk* 1979 (1) SA 553 (T) at 558C-D; *Smulders v Namibia Diamond Mining Co (Pty) Ltd* 1982 (1) SA 549 (SWA) at 552E-G; *Ex Parte G Pagan Enterprises (Pty) Ltd* 1983 (2) SA 30 (W) at 31H-33F; *Wolhuter Steel (Welkom) (Pty) Ltd v Jatu Construction (Pty) Ltd (in provisional liquidation)* 1983 (3) SA 815 (O) at 823E-F). When a company is wound up voluntarily, the liquidation commences on registration of the special resolution authorising the winding-up, and from that time all the powers of the directors cease except in so far as their continuance is sanctioned by the liquidator or the creditors (in the case of a creditors' winding-up) or the company in general meeting (in the case of a members' winding-up) (see s 353(2) read with s 352 of the Companies Act 61 of 1973). The board therefore becomes *functus officio* upon liquidation (see also Gower *op cit* at 763). In the *Blumenthal* decision (*supra* at 318C), the director's position was, in my view correctly, stated in the following terms:

[O]n the granting of a winding up order of a company a director ceases to be a director, officially, functionally and nominally, but the expression "director of a company" in a statute might in its context be used in a special sense to mean or include a person who was a director at the time of the order.'

Under South African law, therefore, former directors of a company in liquidation do not owe the company a fiduciary obligation. They do not remain directors in the normal sense, as was suggested in *Rosetex v Licata* in respect of the Australian law. Neither will their actions usually be regarded as being executed in their capacities as directors. But they may be liable to the company for competitive activities which occurred after the liquidation on the basis of the fiduciary obligation previously occupied. This view supports the principle of 'no power without responsibility' (see JS McLennan 'Directors' Duties and Misapplications of Company Funds' (1982) 99 *SALJ* 394; Michele Havenga 'Company Directors — Fiduciary Duties, Corporate Opportunities and Confidential Information' (1989) 1 *SA Merc LJ* 122 at 124; *Sibex Construction v Injctaseal CC* *supra* at 65F-G).

5 Conclusion

It is submitted that, on the evidence before the Court, the decision in *Rosetex v Licata* was correct and that on similar facts a South African court would have made a similar finding. The decision highlights the potential liability of directors who enter into competitive activities after their office has been terminated. Finally, it is suggested that developments since the decision in *Mashonaland Exploration* call for total re-consideration of the complex issue of competition by directors.
