THE DUTY OF DISCLOSURE

BY DIRECTORS OF THEIR INTERESTS IN

COMPANY CONTRACTS

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1. INTRODUCTION

In this examination of the disclosure required of directors when they hold interests in company contracts it is necessary to briefly refer to the general duties to which directors are ordinarily subject.

Parsons, dealing with the director's duty of good faith, argues that the director is a fiduciary and as such must act in good faith viz-a-viz the company of which he is a director. He formulates the principles which make up such duty of good faith as follows:

I. "A director must not place himself or allow himself to be placed in a situation in which he has an interest or duty which conflicts with his duty to act bona fide for the benefit of the company of which he is a director", and

II. "A director must act bona fide for the benefit of the company of which he is a director."

(R W Parsons, "The Director's Duty of Good Faith", (1967) 5 Melbourne Law Review 395 at 397)

Whether the above constitutes a single principle or two independent principles is an entirely separate discussion and it is not intended that such discussion will be dealt with during the course of this work. However, what is intended to be discussed are the points raised in Corkery's succinct observation to the effect that "... the law demands high standards of fidelity and honesty from directors. They must not let their personal interests interfere or compete with their duties to their company. Because they are fiduciary agents of their companies, they may not (either themselves or on behalf of the companies), without appropriate disclosure, enter into contracts in which they have a personal interest that conflicts with, or

may possibly conflict with, the interests of their companies. They also may not make what is termed 'secret profits' - that is, profits gained directly or indirectly through the office of director without the knowledge and sanction of the members." (J F Corkery, Directors' Powers and Duties, 1987 Longman Professional, Adelaide, Australia at 77)

Whilst various duties by which directors are ordinarily bound will be referred to during the course of this work, it is intended that the emphasis of this work will be upon the Duty of Disclosure to which directors are subject when they hold interests in company contracts which conflict or may at some future stage possibly conflict with the interests of their companies, and the effect of waiver clauses upon the required disclosure. It is therefore necessary that particular attention be given to the principle that directors may not place themselves in positions where their personal interests conflict with their duties to their companies, since it is from such situations that the duty of disclosure arises.

2. THE DIRECTOR'S DUTY NOT TO PLACE HIMSELF IN A POSITION WHERE HIS PERSONAL INTERESTS CONFLICT WITH HIS DUTY TO THE COMPANY

"The courts have frequently ruled that one of a director's fiduciary duties is to abstain from putting himself in a position where his duties to his company conflict, or may conflict, with personal interests which he has in the transaction in question." (R R Pennington, Directors' Personal Liability, 1987, BSP Professional Books, London, at 41)

One of the earliest expressions of the above principle was given by Lord Cranworth in the well known and often referred to case of Aberdeen Railway Co v Blaikie Brothers (1854) 1 Macq. 461 (HL) at 471 where he said "... it is a rule of universal application that no one having [fiduciary] duties to be discharged shall

be allowed to enter into engagements in which he has, or can have, a personal interest conflicting, or which possibly may conflict, with the interest of those he is bound to protect."

Similarly, in Imperial Mercantile Credit Association v Coleman 1871 6 Ch 558 at 563 Malins VC held "It is of the highest importance that it should be distinctly understood that it is the duty of directors of companies to use their best exertions for the benefit of those whose interests are committed to their charge, and that they are bound to disregard their own private interests whenever a regard to them conflicts with the proper discharge of such a duty." This view was subsequently approved by the House of Lords.

The viewpoints as expressed in the two cases referred to above found favour with our Appeal Court in the case of Robinson v Randfontein Estates Gold Mining Co. Ltd 1921 AD 168 where Innes C J held at page 177 that "Where one man stands to another in a position of confidence involving a duty to protect the interests of that other, he is not allowed to make a secret profit at the other's expense or place himself in a position where his interests conflict with his duty."

It is submitted that the most clear and concise formulation of the principle presently under discussion was given as early as 1846 by Mr Justice Wayne in the United States case of Michoud v Girod 4 How 503 554, 11 L Ed 1076 1099 (1846) where he argued that "The general rule stands upon our great moral obligation to refrain from placing ourselves in relations which ordinarily excite a conflict between self-interest and integrity. In this conflict of interest the law wisely interposes. It acts not on the possibility that, in some case, the sense of that duty may prevail over the motives of self-interest, but it provides against the probability in many cases, and the danger in all cases, that the dictates of self-interest will exercise a predominant influence, and supersede that of duty."

It is thus clear that irrespective of the manner in which it is stated, the courts have recognised the principle that directors may not place themselves in positions where their personal interests conflict with their duties to their companies. We now turn to briefly examine the nature of such conflict principle referred to in the quotations provided above.

3. THE CONFLICT PRINCIPLE

The test for determining a possible conflict is that of a reasonable man who, in evaluating the facts and circumstances of a particular case, identifies a real possibility of conflict. (Boardman v Phipps [1967] 2 AC 46 123 at 124) In Atlas Organic Fertilizers (Pty) Ltd v Pikkewyn Ghwano (Pty) Ltd 1981 (2) SA 173 (T) at page 198 it was held that such a determination must be approached on a common sense basis.

It is important to distinguish the situation where a director places himself in a conflict situation from that where the director not only places himself in such a situation but actually furthers his own interests at the expense of the company. Both instances involve a breach of some duty owed by the director to the company. However, whilst the former involves a breach of the duty presently under discussion (i.e. the director's duty only to place himself in a position where his personal interests conflict with his duty to his company), the latter involves a breach of the duty not to prefer his own interests over those of the company. Although there is a difference of opinion as to whether these duties can in fact be distinguished (since some writers argue that they indeed constitute two components of a single duty), they have been separately identified purely for the purposes of convenience since it is intended that attention will be focused only upon the duty of a director not to place himself in situations of conflict or

potential conflict because it is precisely from such situations that the duty of disclosure arose.

There is recent authority attacking the view that the conflict principle (as discussed above) imposes a duty upon directors. In the case of Tito v Waddel (No 2) [1977] 3 All ER 129 Meggary J held that the principle does not impose a duty but is merely a rule subjecting fiduciaries to certain consequences if they enter into certain transactions without complying with the necessary formalities which may apply. This approach was followed in the recent judgment of Vinelott J in the case of Movitex Ltd v Bulfield (1986) 2 BCC 99 where it was held that because the conflict rule does not impose a duty on directors, it can be waived in the articles of the company. The articles could therefore be used as a tool to exclude or modify the application of this rule because this would not amount to absolving the directors from the consequences of a breach of a duty (since, according to the cases, the conflict principle does not impose a duty upon directors but merely subjects them to certain consequences which could be dealt with in the articles) which is not permitted by law as will later be seen.

Blackman, however, argues that the conflict principle does in fact impose a duty upon directors, and this must be regarded as the better view since it is accepted in almost all the cases dealing with the issue. Blackman criticises Vinelott's argument that where a director places himself in a conflict position the court will intervene to set aside the transaction without enquiring as to whether any breach of the director's duty to the company occurred on the basis that it is precisely because the director commits a breach of duty by placing himself in a conflict situation that the transaction is voidable, and the duty must therefore be seen to exist.

Whilst it is certainly not contemplated that a detailed list and discussion of the various possible conflict situations is to be provided, it is helpful to give a brief categorisation of the typical conflict situations which may arise and in so doing

raise the issue which forms the main focus of this work; that is the duty of disclosure and the effect of waiver clauses upon such disclosure. This categorisation has been obtained from a thesis titled "The Fiduciary Doctrine and its Application to Directors of Companies" by M S Blackman, University of Cape Town, 1970, at pages 330-331, the typical conflict situations being distinguished into 3 main categories:

1. Where the director has an interest in a transaction which he himself is executing on behalf of the company. This type of situation is often referred to as the conflict situation "properly so-called";

2. Where the director acts for his company and acquires an incidental profit as a result; and

3. Where, although the director has not purported to act for his company, his interests conflict with his duty. Blackman distinguishes this category into two sub-categories:

   3.1 Where the director acts for his own benefit; and

   3.2 Where the director neither purports to act for the company nor for himself.

In order to properly analyse conflict situations, it is useful to distinguish between the rule against "self-dealing" and the rule requiring "fair dealing". In the case of Tito v Waddel (No 2) [1977] 3 All ER 129 referred to above Meggary, whilst conceding that the conflict principle may exist as a single rule, argued that if that is indeed the case then such rule at least comprises two separate and distinct elements which he referred to as the rule against self-dealing and the rule requiring fair dealing. At page 241 of his judgment Meggary said: "I can well see that both rules or both limbs have a common origin in that equity is astute to

prevent a trustee from abusing his position or profiting from his trust: the shepherd must not become a wolf. But subject to that, it seems to me that for all practical purposes there are two rules: the consequences are different, and the property and the transactions which invoke the rules are different. I see no merit in attempting a forced union which has to be expressed in terms of disunity." The distinction between the two rules referred to above has long been recognised by our courts, and we therefore now turn to look separately at these rules:

3.1 The Rule Against Self-Dealing

As early as 1802 Lord Eldon, in the case of Ex Parte Lacy (1802) 6 Ves Jun 626, stated the rule against self-dealing in regard to trustees thus: "The rule I take to be this, not that the trustee cannot buy from his cestui que trust, but that he shall not buy from himself", and in the case of Tito v Waddel (No 2) (cited above) Meggary stated the self-dealing rule in relation to trustees as follows: "If a trustee purchases trust property from himself, any beneficiary may have the sale set aside ex debito justitiae, however fair the transaction." He went on to qualify this by including also the case where a trustee sells trust property to himself, the same consequences to apply irrespective of the fairness of the transaction.

Corkery, in commenting upon the application of the rule against self-dealing to the office of director, argues that the rule prohibits a director from acting on behalf of his company in any contract between his company and himself, and also prohibits a director from acting on behalf of his company in any contract between his company and a third party in which he has an interest which conflicts or may possibly conflict with the interests of his company. He goes on to say that: "As Fiduciaries, directors must not use

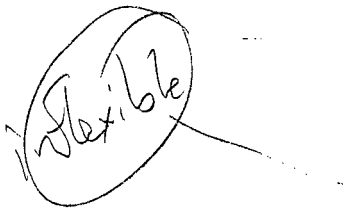
their power to deal with themselves for their own advantage. The potential for abuse is clear and the law is firmly against such practices. The director has a duty to use his knowledge and skill for the benefit of his company when he is involved in company affairs. He must seek the best bargain when negotiating contracts for the company. The company cannot be guaranteed his best efforts when he has a conflicting interest." (J F Corkery, Directors' Powers and Duties, 1987, Longman Professional, Adelaide, Australia, at page 77-78)

This principle had already been applied to the office of director as far back as 1887 when Sir Richard Baggalay, in the case of North-West Transportation Co Ltd v Beatty (1887) 12 App Cas 589, held at page 593 that "... a director of a company is precluded from dealing, on behalf of the company, with himself, and from entering into engagements in which he has a personal interest conflicting, or which possibly may conflict, with the interests of those whom he is bound by fiduciary duty to protect ... ." Baggalay's views seem to have been influenced by a very similar argument of Lord Cranworth which was raised in the case of Aberdeen Railway Co v Blaikie Brothers (1854) 1 Macq 461 at 473.

It is interesting to note, however, that this rule has been watered down over the years so as to allow for the possibility of determinations as to the fairness of the contract to influence the courts' decisions when pronouncing upon the legal status of such contracts, particularly as a result of legal developments in this regard in the United States of America.

In Aberdeen Railway Co v Blaikie Brothers (1854) 1 Macq 461 Lord Cranworth, when dealing with the principle under discussion,

stated at page 472 and in no uncertain terms 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 ...", and in Movitex Ltd v Bulfield (1986) 2 BCC 99 Vinelott J, when commenting upon the decision in Hickley v Hickley (1876) 2 ChD to the effect that the court has a discretion to refuse to set aside a contract entered into in breach of the rule against self-dealing if satisfied that such contract was fair and honest, relied upon the dictum of Lord Cranworth cited in this paragraph in holding at page 99 that "... it is in my judgment inconsistent with cases of the highest authority which show that such a sale is voidable, even if a trustee claims to show that he gave full value or more than full value for the property: So inflexible is the rule that no enquiry on the subject is permitted."



Be that as it may, Pennington argues that "Despite the House of Lords ruling in ... Aberdeen v Blaikie Bros (1854), later judicial decisions show that it is not necessarily a breach of a director's fiduciary duties for him to enter into a contract with his company ... if the contract is a fair one ... and if the contract is entered into for the purpose of the company's legitimate business ...". Pennington continues by saying that "There is no English authority to this effect, but there is ample American authority, which would probably be followed by an English court. "(R R Pennington, Directors' Personal Liability, 1987, BSP Professional Books, London, at 75)

It is respectfully submitted that the English courts (and hence our courts), although mindful of the developments in the United States of America in this regard, in the absence of any indigenous authority in favour of a determination as to the fairness of a

contract, will not yet approve such an approach until such time as the question is placed before the courts in such a manner as to require a re-evaluation. At this point the American developments will no doubt be consulted, and such developments will therefore be dealt with in detail later in this work in view of the impact which they will have upon the legal status of contracts entered into without proper disclosure, but where the result is fair.

Before the discussion turns to the rule requiring fair-dealing, it is important to mention that the rule against self-dealing does not require that a director holds a beneficial interest in the transaction in question. Hence Blackman submits that "It is not necessary for a director to have a beneficial interest in the transaction, it being sufficient if he has a duty in conflict with his duty to the company." (M S Blackman, The Fiduciary Doctrine and its Application to Directors of Companies, PhD Thesis, UCT, 1970 at 337) Authority for this view can be found in the case of Transvaal Lands Company v New Belgium (Transvaal) Land and Development Company [1914] 2 Ch 488 at page 503 where it was held that whenever a director "... has an interest as a shareholder in another company or is in a fiduciary position towards and owes a duty to another company which is proposing to enter into engagements with the company of which he is a director, he is in our opinion within the rule. He has a personal interest within this rule or has a duty which conflicts with his duty to the company of which he is a director. It is immaterial whether this conflicting interest belongs to him beneficially or as a trustee for others ...".

It must be further noted that the extent of any benefit is irrelevant to the determination of whether a director falls foul of the rule. Corkery relies on the case of Todd v Robinson (1884 - 1885) 14

QBD 739 as authority for the view that even a mere nominal benefit accruing to a director as a shareholder was sufficient to regard him as interested in a company transaction. (J F Corkery, Directors' Powers and Duties, 1987, Longman Professional, Adelaide, Australia, at 78) Furthermore, it was held in Transvaal Lands Co v New Belgium (Transvaal) Land and Development Co [1914] 2 Ch 488 that the validity or invalidity of a transaction "... cannot depend upon the extent of the adverse interest of the fiduciary agent ...", whilst in Movitex Ltd v Bulfield (1986) 2 BCC 99 Vinelott J stated that "While the interest of the fiduciary may be so small that it can as a practical matter be disregarded, if the interest is sufficiently large to be capable of influencing the fiduciary's mind, the strict rule applies." It is submitted that the opinion expressed in the Movitex case is the position currently applied in our law since, as will later be seen, directors are not under a duty to disclose interests of a trivial or inconsequential nature.

3.2 The Rule Requiring Fair Dealing

In Tito v Waddel (No 2) [1977] 3 All ER 129 at page 228 Meggary V-C stated the rule requiring fair dealing in the following manner: "If a trustee purchases his beneficiary's interest, the beneficiary may have the sale set aside unless the trustee can establish the proprietary of the transaction, showing that he had taken no advantage of his position and that the beneficiary was fully informed and received full value." The "requirement" that the beneficiary must receive full value must not be construed as an invocation of notions of fairness into the determination. It is merely used to emphasize that the transaction must be entered into at arms-length.

Blackman argues that this rule requiring fair dealing does not constitute an absolute bar against contracts between a director and his company. However, if a director wishes to enter into a contract with his company, or has an interest in a third party who wishes to enter into a contract with his company, he must make full disclosure to his company and transact with it at arms-length. Furthermore, as has been discussed, the rule against self-dealing will bar the director from acting on behalf of his company in such a transaction.

4. THE DUTY OF DISCLOSURE

The introductory discussions having been completed, we now turn to deal with the main focus of this work being the duty of disclosure to which directors having an interest or a potential interest in their company's contracts are subject.

Professor Blackman categorises the general principle that a director is under a duty not to place himself in a position where his personal interests conflict with his duty to his company into five independent duties which he lists as follows:-

1. The duty to disclose any interest in a company contract;

2. The duty to account for secret profits;

3. The duty to account for corporate opportunities;

4. The duty not to misuse confidential information; and

5. The duty not to compete with the company of which he is a director.

As indicated above, we are presently concerned with the first such independent duty being the director's duty to disclose any interest in contracts held or to be entered into by the company of which he is a director. In this regard it is important to emphasize that the duty of disclosure is subject to both common law rules and statutory provisions, each having their own distinct characteristics and consequences for failing to comply adequately therewith. The nature of the required disclosure, and the consequences for failing to comply adequately therewith will therefore be dealt with separately in the case of the common law requirements on the one hand, and the statutory requirements on the other hand.

4.1.1 DISCLOSURE IN TERMS OF THE COMMON LAW

"Since the fiduciary nature of a director's position requires him to avoid conflicts between his personal interests and his duty to the company, a contract or transaction which produces such a conflict is, on general equitable principles, liable to be rescinded or avoided by the company. The only effective safe-guard for a director who desires to protect himself against the possibility of rescission in these circumstances is to disclose his interest under the general (common) law, to the shareholders, or, if the articles of association contain an appropriate provision, to the board of directors". (B H McPherson, "Duties of Directors and the Powers of Shareholders", The Australian Law Journal, Volume 51, July 1977, 460 at 465)

In terms of the common law a director is under a duty to disclose to the shareholders in general meeting the nature of any direct or indirect personal interest he may have in the transaction to which the company is or may be a party (presupposing that the articles of association of the company do not provide otherwise). Gower

argues that disclosure to the board of directors alone is insufficient since this would, if permitted, allow for "reciprocal self-interest" or "misplaced loyalty" among the fellow directors which could adversely affect their business judgment and dampen their enthusiasm to get the best possible deal for their company. Gower therefore states that: "It hardly seems over-cynical to suggest that disclosure to one's cronies is a less effective restraint on self-seeking than disclosure to those for whom one is a fiduciary." (L C B Gower, Principles of Modern Company Law, 4th ed., 1979, Stevens and Sons, London at 587)

The need for adequate disclosure is thus made clear, and many arguments have been proposed in an attempt to define the degree of disclosure required. However, no precise formula exists to determine the extent of detail that is called for when a director declares his interest in a company contract, and in this regard the words of Vinelott J in Movitex v Bulfield (1986) 2 BB 99 at page 99 are most helpful: "The duty to declare the nature of his interest must ... impose on a director the duty to disclose full information as to the nature of any transaction which it is proposed to enter into. The disclosure must be such that the other director or directors can see what this interest is and how far it goes."

Blackman suggests that when a director wishes to contract with his company, or, if he has an interest in any contract to be entered into by it, he must take the following steps in order to ensure that he entirely shakes off his relationship with the company and acts openly and in good faith, so as to make certain that any such dealings are conducted at arms-length:

1. He must reveal his identity and his part in the transaction;

2. He must disclose his interest in the contract;

3. He must correct any material misstatements which he might have made in the negotiations or otherwise which would affect the company's decision to enter into the contract;

4. He must answer fully and truthfully any questions put to him concerning matters having a bearing upon the contract and the company's decision to enter into it;

5. He must disclose any and all information which is likely to influence the company's decision, and which he knows (or surmises) that those acting on behalf of the company do not possess; and

6. He must disclose any and all profits he is likely to make for which, had it not been for his disclosure, he would be accountable. This would obviously also include commissions and indirect profits.

Previously it was mentioned that disclosure must be made to the members in general meeting provided that the articles of association of the company do not provide otherwise. The power to sanction such contract then rests with the general meeting (or any other organ specified in the articles), which sanction is given by the passing of an ordinary resolution, unless disclosure was made to all

the members and their unanimous approval obtained in which case the necessity that a general meeting be called may be obviated. In the case of North-West Transportation Co v Beatty (1877) 12 AC 589 (PC) it was held that an interested director may vote in his own interests on his shares in the company except where this would constitute a fraud on the minority.

On the basis of the aforesaid it is submitted that disclosure, in terms of the common law, must be made to the general meeting of shareholders unless the articles provide otherwise, or unless the unanimous approval of all shareholders is obtained. The extent of disclosure required is uncertain, and in this regard it is submitted that the disclosure must be such that the general meeting or board of directors, whichever is the case, are made aware as to the nature of the interest and how far such interest extends so as to permit them to make an informed decision as to whether the contract ought to be rescinded. In this regard it is recommended that Blackman's suggestions be strictly adhered to.

4.1.2 CONSEQUENCES OF BREACHING THE COMMON LAW DISCLOSURE REQUIREMENTS

The most elementary statement of the common law legal position to be applied where a director has failed to make proper disclosure can be found in the judgment of Lord Denning M R in the case of Hely-Hutchinson v Brayhead Ltd, [1967] 3 All ER 98 (CA) at page 103 where he stated that "Non-disclosure does not render the contract void or a nullity. It renders the contract voidable at the instance of the company and makes the director accountable for any secret profit which he has made. If he discloses his interest, the contract is not voidable, nor is he accountable for

profits. But if he does not disclose his interest, the effect of the non-disclosure is: "... the contract is voidable and he is accountable for secret profits." The position is supported by both Gower and Pennington, and has not been challenged by any of the leading decisions on the point.

Pennington, relying upon the case of Transvaal Lands Co v New Belgium (Transvaal) Land and Development Co. (1914) as authority, argues further that "... if the contract was made with a third person such as another company, and the director had an interest in that person, such as holding shares in it, the company may rescind only if the third person was aware of the director's interest at the time the contract was made." (R R Pennington, Directors' Personal Liability, 1987, BSP Professional Books, London, at 76)

Earlier the relevance of the fairness of such a contract was briefly discussed, and reference was made to the view expressed by Pennington that the English Courts will be influenced by the American Developments in this regard, although there is still no English authority to support the argument that the fairness of the contract should be allowed to affect its validity. However, it is interesting to note that when dealing with the fairness of such contracts within the realm of the common law consequences for breaching the necessary disclosure requirements, Pennington states that "The fairness or otherwise of the contract is not a relevant matter in deciding whether the company may rescind a contract, and the company may rescind even though the contract is perfectly fair in respect of its terms and the consequences it will entail". (R R Pennington, Directors' Personal Liability, 1987, BSP, Professional Books, London, at 76) It is difficult to reconcile these conflicting viewpoints but perhaps what is intended is a distinction between Pennington's assessment of how the position in England will be influenced at some future date by developments

in the United States of America, and his assessment of the legal position which prevails in England at this present point in time.

As previously mentioned, it was held in the case of Aberdeen Railway Co v Blaikie Brothers (1854) 1 Macq 461 that the legal position as stated above will be unaffected by notions of fairness and reasonableness. This was extended to encompass all situations, irrespective of whether or not the company would otherwise have acquired a profit. It is important to emphasize, however, that the fact that a company has been deprived of a profit by a director will not automatically entitle such company to recover such profit since it was held in Burland v Earle (1902) (PC) that such profit can only be recovered once the contract has been rescinded by the company. Thus if the company is unable or refuses to rescind such contract, it cannot compel the director to account to it for these profits. This is, of course, subject to the director not having been guilty of breaching his fiduciary duties. Where these duties have been breached, the director will be accountable for all profits so obtained irrespective of whether the company has rescinded the contract or not.

Rescission of the contract is effected by the passing of an ordinary resolution by the shareholders in general meeting to such effect. In this regard I refer once again to the decision of North-West Transportation Co v Beatty (1877) 12 AC 589 (PC) where it was held that an interested director may vote on his shares in the company in his capacity as shareholder at such general meeting, provided that no fraud on the minority is committed in so doing. The board of directors lacks the necessary power to take a decision as to whether the company is to apply for the rescission of a contract in which a director holds an interest, and in this regard Gower's caveat regarding "disclosure to one's cronies" is once again emphasized.

What must, however, constantly be borne in mind is that many of these principles may be waived or their effect reduced by the company's memorandum or articles of association. The extent to which the memorandum or articles may be used to dilute the effect of the common law (and later statutory) disclosure requirements indeed forms a major component of this work, and it is imperative that the limitations of the utilisation of waiver clauses in the articles and memoranda, especially with regard to statutory requirements, be examined. Corkery, commenting on the effect of such waiver clauses upon the common law principles discussed above, argues that the articles may be drafted in such a manner so as to

"... circumvent the common law disclosure requirements, ... permit directors to be interested in contracts with the company, ... allow them to be present at board meetings, and even to vote when contracts in which they are interested are at issue." (J F Corkery, Directors' Powers and Duties, 1987, Longman Professional, Adelaide, Australia, at 79)

The scope for abuse resulting from the insertion of such waiver clauses in the memorandum or articles thus becomes clear. They permit directors to contract with their companies or to be interested in contracts to which their companies are party, and then reduce the protection normally afforded to shareholders by diluting the degree of disclosure normally required of interested directors and transferring some of the powers of control ordinarily held by the shareholders in general meeting to the board of directors. This results in an anomalous situation in that the very directors who may be party to "sensitive dealings" are then called upon to decide whether the company may validate such transactions. Although the standard waiver clauses normally insist upon full disclosure being made by the interested director as to the nature and extent of his interests in company transactions, it is very common that such disclosure is to be made to the board of directors, and not to the general meeting, which has the

effect that this small amount of protection is virtually negated (especially when one is dealing with a board of directors accustomed to making concessions in order to accommodate each others' interests).

However, Pennington demonstrates that waiver clauses cannot be utilised in order to abuse shareholders without limitation since "... the memorandum or articles cannot relieve a director from liability for a breach of his fiduciary duties by the director inducing or permitting his company to enter into a contract which is unfair or harmful to it without warning the board of that fact. If such a contract is made with the director, or is made with a third person who is aware of the director's breach of duty, the company can rescind the contract and claim compensation from the director for any loss it sustains from his breach of duty. This is so even though the company's memorandum or articles permit directors to contract with the company or to be interested in contracts made with it." (R R Pennington, Directors' Personal Liability, 1987, BSP Professional Books, London, at 77 -78)

It is thus apparent that with the modern day norm being to insert such waiver clauses in the articles and memoranda, shareholders are being placed at increased risk at the hands of unscrupulous directors. Of course directors may never be contracted out of their fiduciary duties, but the procedural protection normally afforded to the shareholder may be reduced having a similar effect. It has become almost standard procedure for attorneys to include the customary waiver clauses in the articles and memoranda of newly formed companies. However, "... in the absence of express provision in the company's articles, the only effective step is to make full disclosure to the members of the company and to have the contract entered into or ratified by the company in general meeting." (L C B Gower, Principles of Modern Company Law, 4th ed., 1979, Stevens &

Sons, London, at 585) Unfortunately, Gower's point seems nowadays to be of academic interest only.

4.2 STATUTORY DISCLOSURE

Earlier in this work it was mentioned that the duty of disclosure is subject to both common law rules and statutory provisions, each having their own separate consequences. Since the common law rules have been dealt with above, it now remains to deal with the statutory disclosure requirements.

Blackman argues that in practice the common law duties placed upon directors who were involved in company contracts were felt to be too onerous. It thus became the norm to insert provisions in the memorandum or articles waiving compliance with certain of the common law rules, or reducing their effect to varying degrees. Alarmed by the growing ambit of such clauses, the legislature intervened and in 1939 section 70 quin of the 1926 Companies Act was introduced requiring a minimum degree of disclosure, notwithstanding the degree of disclosure required under the articles. The section was re-cast in 1952 and some twenty years later, following on the recommendations of the Van Wyk De Vries Commission, sections 234-241 were included in the Companies Act of 1973, and it is these sections which are presently in force.

This group of sections deals with the duty of a director (or an officer in certain circumstances) to disclose any direct or indirect material interest in contracts entered into or proposed to be entered into with the company, the recording thereof in minutes and in a special register, and the inspection and supervision of such requirements. The sections differ to section 70 quin which they replaced in that section 70 quin has now been divided into 8 sections, and section 70 (9) quin has been discarded. The company is now required to keep a register of interests which must be available for inspection. Henochsberg suggests that these sections

"... can have no application to the director of a one-man company which has only one director, though it will apply as regards the disclosure of the interests of an "officer" authorised to enter into contracts in terms of sub-section (2)(b)". (Henochsberg on the Companies Act, 3rd ed., The Hon A Milne (editor), 1975, Butterworths, Durban, at 413)

"The important point is that the operation of these sections does not affect the voidability of contracts entered into by a director with his company: in the absence of an exclusion clause or approval of the general meeting the common law rule that the contract is voidable at the option of the company still applies notwithstanding compliance with the disclosure requirements of the Act." (Cilliers and Benade Company Law, 4th ed., 1982, Butterworths, Durban, at 347)

In this regard Gower, commenting on the old English section 199 (which has since been replaced and which was similar to our section 234), argued that the section "... has of itself no validating effect on the contract even if it is fully complied with. It is purely negative in its operation, limiting the ambit of any exclusion clause in the articles." (L C B Gower, Principles of Modern Company Law, 4th ed., 1979, Stevens & Sons, London, at 588)

Hence compliance with the requirements of sections 234-241 does not absolve the director from full compliance with the general equitable rule, unless provided for in the articles. The sections merely prescribe a minimum degree of disclosure in order to restrict the effect of waiver clauses in the articles.

The position in England is currently governed by section 317 of the Companies Act of 1985, which is similar in effect to our corresponding legislation referred to above. As Pennington says: "The equitable rule enabling a company to rescind contracts in which its directors are interested is supplemented by two statutory provisions: The first obliges a director who has a direct or indirect interest in a contract or proposed contract with his company, or in a transaction or

arrangement entered into or proposed to be entered into with it, to disclose the nature of his interest at the first board meeting at which the proposed contract, transaction or arrangement is considered, or, if his interest did not then exist, to disclose it at the first board meeting held after his interest arises, whether the contract, transaction or arrangement has by then been entered into or is still only a proposal (Companies Act 1985, sections 317 (2) and (5)). There is also a more general obligation imposed on a director to disclose his interest in a contract, transaction, or arrangement in all cases, and this covers contracts etc. which are not made or approved by the board, but are entered into by individual directors or executives of the company under powers delegated to them by the board. Presumably disclosure must be made by the interested director at the first board meeting after his interest arises (sections 317 (1) and (5))." (R R Pennington, Directors' Personal Liability, 1987, BSP Professional Books, London, at 78)

In Australia the common law is supplemented by section 228 of the code which requires that a director having an interest in a contract or proposed contract of the company, whether direct or indirect, shall declare the nature of such interest at a meeting of directors. Thus the position is similar to that of English Law, and English precedent is relied upon in Australia as authority in this area of law (as is the case in South Africa). We now turn to look more in depth at the various statutory procedural requirements, and at the consequences for failing to comply therewith.

4.2.1 STATUTORY PROCEDURAL REQUIREMENTS

4.2.1.1 When must disclosure be made?

Section 234 (1) of our Companies Act No 61 of 1973 ("the Act") provides that a director who is in any way, whether directly or indirectly, materially interested in a contract of

his company, which has been or is to be entered into, or becomes interested in such a contract after it has been entered into, shall declare his interest and full particulars thereof as provided in the Act.

In terms of Section 235 such declaration is ineffective unless it is made at or before the first meeting of directors at which the question of confirming or entering into the contract is first considered, and is read out to the meeting (or each director present states in writing that he has read such declaration).

Henochsberg argues that "Since section 235 is one very easily complied with, the declaration of interest should be made as promptly as possible so that the directors may decide whether or not to approve of a proposed contract in which a declarant has an interest or whether or not to confirm such a contract already entered into." (Henochsberg on the Companies Act, 3rd ed., The Hon. A Milne (ed.), 1975, Butterworths, Durban, at 416)

The position in England is similar to that of our law. Pennington, commenting upon sections 317 (1) and (5) of their Companies Act of 1985 (which replaced their 1948 act), argues that disclosure "Presumably ... must be made by the interested director at the first board meeting, after his interest arises." (R R Pennington, Directors' Personal Liability, 1987, BSP Professional Books, London, at 78) This viewpoint is similar to the sentiments expressed in Henochsberg (referred to above), who, it is submitted, are making the same point. Likewise, a similar view is also

expressed by Corkery commenting upon the Australian position. He states that disclosure must be made "... as soon as practicable after the relevant facts have come to (the director's) knowledge." (J F Corkery, Directors' Powers and Duties, 1987, Longman Professional, Adelaide, Australia, at 80)

All these authorities thus appear to be making the point that disclosure is to take place at the first meeting of directors (board meeting) held after the interest arises, only Pennington being brave enough to blatantly express such a view (albeit with the caveat that this must "presumably" be seen to be the position).

4.2.1.2 Who must disclose?

It will be noted that section 234 (1) requires disclosure to be made by those directors materially interested in company contracts. The requirement of materiality is also to be found in section 228 (2) of the Australian Code and previously existed in the United States of America until it was eliminated by the Securities Exchange Act Release No 7804 of 1966. It did not exist in the old English Companies Act of 1948 upon which our act is based, nor did it exist in section 70 quin of our old Companies Act of 1926. No definition of the word "materially" has been offered either in the legislation itself or by any of the respected authorities on company law. It is defined in the Oxford English Dictionary as "important, of much consequence, or of serious or substantial import", and it is therefore respectfully submitted

that it has been inserted merely to preclude a trivial interest from the operation of the section, since it is submitted that the word "interested" in itself and seen within the context of directors' duties of disclosure (which section 234 (1) specifically deals with) is wide enough to ensure that the Act embraces all situations where directors hold or may hold interests in company contracts not being of a trivial nature. It is therefore to be regarded as restricting rather than broadening the ambit of the section.

Support for such a view can be found when consulting Gower's comments on the meaning of the word "interested" as appears in section 199 of the old English Companies Act of 1948. Gower argues that the word does not preclude directors merely because they hold no immediate or pecuniary interest in the contract. He argues that the draftsmen of the 1948 Act did not intend that a restrictive interpretation be placed upon the meaning of the word "interested", and in support thereof points out how widely section 199 was framed ("... any director who is in any way, whether directly or indirectly, interested in a contract or proposed contract ..."). (L C B Gower, Principles of Modern Company Law, 4th ed., 1979, Stevens & Sons, London, at 588) Since our section 234 (1) adopts the same wording, albeit with the inclusion of the word "materially", it is thus submitted that the word "interested" is to be widely interpreted so as to embrace all directors' interests in contracts or proposed contracts of whatsoever nature, with the exception of interests of an inconsequential nature. All directors holding such interests will therefore fall within the

ambit of the section, and will be required to comply therewith.

4.2.1.3 What must be disclosed?

Section 234 (1) is directive in nature in that it states that a director having an interest in an existing or future company contract shall declare his interest and full particulars thereof as provided for in the Act. Corkery submits that the director must not only declare that he has an interest, but also specify what that interest is. (J F Corkery, Directors' Powers and Duties, 1987, Longman Professional, Adelaide, Australia, at 79 - 80) Gower, commenting on section 199 of the English Companies Act of 1948, supports this view. He agrees that "It is not sufficient to disclose merely that one is interested - the nature of the interest (as the section itself says) must also be disclosed." To this Gower, in relying upon the case of Imperial Mercantile Credit Association v Coleman (1873) LR 6 HL 189, adds that disclosing the nature of the interest "... normally involves disclosing the exact extent of the profit which the director will make as a result of the contract." (L C B Gower, Principles of Modern Company Law, 4th ed., 1979, Stevens & Sons, London, at 587)

Blackman, however, points out that section 234 itself limits the extent of disclosure required in that section 234 (3)(a) specifies that a general notice in writing given by a director to the directors to the effect that he is to be regarded as interested in any contract which may be entered into

between his company and another company or firm specified in such notice of which the director has stated that he is a member, shall be deemed to be a sufficient declaration of interest in relation to any contract or proposed contract entered into between the company and such specified company or firm (subject to two conditions not relevant for present purposes), and it is submitted that Blackman is correct in this regard. However, since the sub-section will only apply when a director is a member of the company or firm with which his company transacts and has disclosed fully the extent of such interest (as required in terms of sections 234 (3) (a) (i) and (ii)), the sub-section will rarely apply and, when it is applicable, it should not pose a threat to shareholders since, having been made aware of such interest in advance, they ought to bear such interest in mind at all times.

It is thus clear that what must be disclosed by a director having an interest in a contract or proposed company contract is:

(a) that he has such an interest, and

(b) the nature and extent of such interest, but he is not required to provide all the material facts concerning such interest (except insofar as the extent of the profit which he will make as a result of the contract is to be regarded as an important element of the nature of such interest). (L C B Gower, Principles of Modern Company Law, 4th ed., 1979, Stevens and Sons, London, at 587)

It is difficult to define the elements which constitute the "nature" of a director's interest in such a contract, but Vinelott J, commenting upon the degree of disclosure required in order to adequately disclose the nature of one's interest, argued that "The disclosure must be such that the other directors can see what this interest is and how far it extends." (Movitex v Bulfield, (1986) 2 BCC 99 at 99)

It is submitted that given the difficulties associated with defining "the nature of an interest", Vinelott's comments should be developed into a legal test of general application, the object being to advise the (board of) directors fully as to all the relevant facts pertaining to such interest in order that they may be placed in a position where they can make an informed decision as to whether the contract ought to be rescinded or avoided. Should they not be placed in such a position, it will be inferred that the nature of the interest had not been fully disclosed, and the interested director will then not be regarded as having complied with the appropriate statutory requirements, which will expose him to the consequences for failing to disclose properly in accordance with the applicable act.

4.2.1.4 To whom must disclosure be made?

In terms of section 235 (1) of the Act no declaration of interest by a director under section 234 shall be of any effect unless it is made at or before the meeting of directors at which the question of confirming or entering into the

contract is first taken into consideration. Section 235 (2) provides further that if for any reason it is not possible for a director to make any such declaration at or before a particular meeting of directors, he may make it at the first meeting of directors held thereafter at which it is possible for him to do so, and shall in that event state the reasons why it was not possible to make the declaration at such particular meeting.

Section 235 was previously discussed within the context of when disclosure must be made but, in addition to providing such information, the section also attempts to specify to whom disclosure must be made. The key words in this regard are that disclosure, in order to constitute proper disclosure in terms of the Act, must be made "... at or before the meeting of directors at which the question of confirming or entering into the contract is first taken into consideration ..." (from section 235 (1)). Most of these words pertain to when disclosure must be made, and this aspect has (as indicated) been dealt with above. However, on closer inspection it is clear that the section also directs to whom disclosure is to be made, albeit in such a manner as to lead to possible differences in its interpretation.

Both sections 235 (1) and (2) require disclosure to be made to a "meeting of directors", and this then raises the obvious question: What constitutes a meeting of directors in terms of the section? Since no definition of a meeting of directors is provided in the definition section of the Act, the question has been left to the courts for their interpretation and decision. Unfortunately, our courts have been silent on the

point, and we are therefore left to rely upon the interpretation provided by the English Courts and authorities for guidance.

Gower, commenting upon the old section 199 of the English Companies Act of 1948, argues that in contrast with the basic equitable principle of the common law which requires that disclosure be made to the general meeting unless the unanimous consent of all members to enter into the contract has been obtained, the disclosure required in terms of the section "... is not to the general meeting but to the board." Nevertheless Gower puts forward an argument (which argument has often been referred to above) to the effect that disclosure to the board is an obviously less effective restraint on self-seeking than disclosure to the shareholders for whom one is a fiduciary. (L C B Gower, Principles of Modern Company Law, 1979, Stevens & Sons, London, at 587)

Irrespective of these arguments (which it is submitted are not without merit), we now have authority for the view that the section requires that disclosure be made to the board of directors. Such authority has been provided in the recent case of Guiness Plc v Saunders [1988] 1 WLR 863 (CA) where the court was called upon to interpret the meaning of section 317 (1) of the present English Companies Act of 1985. A director, who was also acting as a consultant to Guiness in a possible takeover bid, made disclosure of his interest and the profits he would derive therefrom to a sub-committee of the board of directors. The section directs that disclosure shall be made "... at a meeting of the directors

of the company ...", the director arguing that the disclosure to the sub-committee was sufficient to satisfy the act's requirements since the section did not specify that such meeting had to be a meeting of the board. The Court of Appeal, per Fox L J, held at page 868 that the section "... imposes an obligation to make a disclosure to a meeting of the board of directors duly convened. Section 317 (1) requires a disclosure to a meeting of directors. These words ... cannot be satisfied by a disclosure to a sub-committee of the directors. It is simply not what the section says. Nothing in the articles can alter that. Section 317 (1) is a statutory requirement and its provisions are mandatory."

It is submitted that whilst the result of the judgment in this regard is to be applauded for safeguarding the interests of shareholders, the legal validity of Fox's argument has to be questioned. Perhaps he could have placed a stronger emphasis upon the meaning of a "meeting of directors" and given more cogent arguments as to how these words could not possibly be interpreted to mean anything other than the board of directors? Be that as it may, our courts will no doubt follow the decision of Guiness v Saunders, and we can therefore safely argue that disclosure is to be made to the board of directors since our section 235 also refers to a "meeting of directors" as is the case in section 317 of the English Act.

At this point it is worth mentioning that section 236 prevents the possibility that a resolution of the board of directors is used in order to circumvent the procedure provided in sections 234 and 235 of our Act. Section 236 provides that

notwithstanding any provision in the articles of a company permitting the taking of a resolution by way of a written resolution signed by directors, no such resolution which concerns contracts or proposed contracts referred to in section 234 shall be valid unless the provisions of that section and section 235 are complied with.

4.2.1.5 Notice of meeting to discuss contract

Section 238 (1) of the Act specifies that if a director of a company is in any way, whether directly or indirectly, materially interested in a contract or proposed contract which is placed before the company at any meeting thereof for confirmation or authorisation, the notice convening any such meeting shall state the full particulars of the interest in such contract of the director concerned. The meaning of this section depends almost entirely upon the interpretation of the crucial section 234 (1) which has been discussed above, in that all the key concepts contained in section 234 (1) such as the meaning of "materially interested", and "declare his interest and full particulars thereof" are repeated in this section. If it can be accepted that the interpretation of these concepts will be drawn from the interpretations given to them as they appear in the more important section 234 (1), then section 238 (1) reads rather literally to mean that: (a) all meetings convened for the purpose of discussing a contract in which a director has an interest shall be convened by means of a notice, (b) such notice to state fully the particulars of the interest held by the director in such contract.

It is submitted that the notice will have to contain the same degree of disclosure as is required to be made in terms of section 234 (1) (since the phrases "interest" and "full particulars" are repeated in both sections), and in this regard you are referred to the discussion concerning the degree of disclosure required which appears under the sub-heading "What must be disclosed?" above. The effect, it is submitted, is thus to ensure that the required disclosure is comprehensively stated in the notice in its totality, so that the notice constitutes a documented written recordal of such disclosure rather than a summation thereof which would be open to abuse, subsequent uncertainty, and manipulation.

At this point I wish briefly to refer once again to section 234 (3) which provides for a different sort of a notice called a "general notice" which is not to be confused with the notice referred to in section 238 (1). The general notice allows a director who is a member of another company or firm to give to the directors of his company a written notice advising of such membership and the extent thereof, and indicating that he is to be regarded as interested in any contract entered into between the entities. This dispenses with the need to give notice in terms of section 238 (1) every time the two entities transact, since section 234 (3)(a) deems such a notice to be a sufficient declaration of interest provided that the nature and extent of the director's interest is indicated in the notice, and at the time of transacting the director's membership interest did not exceed that which is stated (in the notice). Cilliers and Benade point out that "The general notice must ... be brought up to date as

circumstances change otherwise contracts entered into after such a change will not be covered. As the general notice lapses at the end of each financial year it must be renewed annually." (Cilliers and Benade, Company Law, 4th ed., 1982, Butterworths, South Africa, at 348)

Similar provisions appear in the English Companies Act of 1985 (in the form of sections 317 (3) and (4)), and in section 228 (4) of the Australian Code. These sections have been inserted with the obvious intent that directors having shares in other entities with which their companies transact on a regular basis shall not be forced to comply with all the formalities of the Act in the case of each separate transaction (of which there may be many).

4.2.1.6 Interests to be recorded in minutes

In terms of section 239 (1) every declaration of interest made under sections 234, 235 and 237 (1) shall be recorded in the minutes of the meeting of directors at which the declaration is made, and where the interest is that of an officer in terms of Section 237 (2), his interest must be recorded in the minutes of the first meeting of directors held after the date of the declaration of interest. Section 239 (2) requires that the minute recording the declaration must be read out at the next meeting of directors unless copies of the minutes of the previous meeting were circulated to the directors. Just as is the case with regard to sections 234 (4), 237 (5) and 238 (2), failure to comply with the section leads to a criminal offence (section 239 (3)). The contents of

section 239 are directive in nature and since no problem exists in its interpretation no further discussion thereof is required.

4.2.1.7 Register of interests to be kept

Section 240 of the Act requires that every company shall keep at its registered office a register of interests in its contracts in respect of which declarations of interest have been made. The section was included as a result of the recommendations of the Van Wyk De Vries Commission. It has been argued that although no time limit has been set within which entries must be made in the register, they should be made as soon as possible after the declaration of interest has been made. (Henochsberg on the Companies Act, 3rd ed., The Hon A Milne (ed), 1975, Butterworths, Durban, at 420)

4.2.1.8 Duties of the Auditor

The final section of the portions of the Act dealing with disclosure requirements, section 241, requires that the auditor of any company shall satisfy himself that the register of interests in contracts has been kept as required by section 240, and that every declaration of interest recorded therein has been minuted as required by section 239. This section was also introduced as a result of the recommendations of the Van Wyk De Vries Commission. Its contents are self-

explanatory, and accordingly do not warrant any further discussion.

4.2.1.9 Effect of the disclosure provisions upon the common law rules

Both sections 234 (5) and 237 (4) provide that nothing in sections 234 and 237 respectively shall be taken to prejudice the operation of any rule of law restricting a director/officer of a company from having an interest in contracts with the company. The common law rule being referred to is that which prohibits directors from entering into contracts in which they have or may have a conflicting interest with their companies, and prevents directors from profiting from such transactions should they indeed transact under such circumstances. Such contracts are voidable at the option of the company, unless authorised by its articles.

It is not intended to re-embark upon a discussion of the common law principles applicable to such situations for this has received attention above. However, the point to be made is that "A company may, by its articles, make provision whereby, in effect, it waives its rights under the common law, but it cannot relieve a director of his duty to make the disclosure required (by section 234 and 237 respectively). A contract between a company and a director or his firm, or a company in which he is interested as a director or shareholder ... is voidable at the option of the company, unless sanctioned by the articles, expressly or by necessary implication, and made in conformity therewith."

(Henochsberg on the Companies Act, 3rd ed., The Hon. A Milne, 1975, Butterworths, at 415)

It is thus clear that the articles may, as previously stated, be used to limit the effect of the common law rules. However, they cannot be used to reduce the degree of disclosure required under the sections of the Act dealing with disclosure and presently under discussion. Gower remarks of section 199 of the English Companies Act of 1948, which contained an identical provision to that of section 234 (5), that the section "... has of itself no validating effect on the contract even if it is fully complied with. It is purely negative in its operation, limiting the ambit of any exclusion clause in the articles... . If such contracts are to be valid this can only be as a result of ratification in general meeting after full disclosure, or as a result of an exclusion of the general rule under a provision in the articles." (L C B Gower, Principles of Modern Company Law, 4th ed., 1979, Stevens & Sons, London, at 588) The point is therefore that section 234 - 241 do not themselves affect the common law rules. These rules are affected only by waiver clauses which do not involve a breach of a director's fiduciary duties.

4.2.2 CONSEQUENCES OF FAILING TO DISCLOSE IN ACCORDANCE WITH THE SECTIONS

Cilliers and Benade, dealing with the consequences of directors' failure to disclose their interests in company contracts as required under sections 234 - 241 of our Act, argue that the "Failure by a director to disclose his interest in these types of contract constitutes

an offence (e.g. section 234 (4)) and the contract may be voidable if the conduct of the director is not provided for in the articles, while the profits may be recoverable from the director." (Cilliers and Benade, Company Law, 4th ed., 1982, Butterworths, South Africa, at 348) However, the learned authors fail to provide a detailed argument in order to substantiate such an assertion. The absence of such an argument can also be noted in the works of Henochsberg, and we are therefore required to look to the English authorities in order to obtain the legal justification for such a view.

Gower, commenting upon section 199 of the old English Companies Act of 1948 (now section 317 of the Companies Act of 1985), argues that the effect of failing to disclose in accordance with such section renders the defaulting director guilty of an offence and liable to a fine, "but over and above this, a breach of its provisions automatically removes any protection afforded by the exclusion clauses in the articles and brings the basic equitable principle into operation; in other words, the contract is voidable by the company and any profits made by the interested directors are recoverable. But failure to comply with the section does not make the contract void, it merely becomes voidable under the general equitable principle and if it is too late to rescind it is fully enforceable against the company." (L C B Gower, Principles of Modern Company Law, 4th ed., 1979, Stevens and Sons, London, at 586 to 587)

The point that Gower is making is that failure to make the disclosure required by the statute brings the basic equitable principle into operation by removing any protection which may have been granted to the defaulting director in the articles by means of exclusion clauses which are aimed at waiving compliance with certain requirements of the common law. The contract will then

not be void, but will be voidable at the instance of the company (unless full disclosure has been made to the general meeting of shareholders), and any profits made by the interested director will then be recoverable.

Pennington, also commenting upon section 199 of the old 1948 English Act, puts forward a very similar view to that of Gower, albeit not as succinctly. He argues that "... a director who fails to make proper disclosure of his interests is liable to a fine, but the contract in which he is interested is not thereby avoided, nor does the company have a right to rescind it merely because of the director's failure to make disclosure. Because of his fiduciary relationship a contract made by a director with his company is voidable by it in equity." (R R Pennington, Company Law, 4th ed., 1979, Butterworths, London, at 543) The point which Pennington infers but does not specifically state is that the principles of equity are brought into operation since any possible protection afforded by the exclusion clauses found in the articles is negated because of the interested director's failure to disclose as required by the statutory provisions dealing with disclosure.

Baker, commenting on Gower's views as aforesaid (as reflected in The Principles of Modern Company Law, 3rd ed., London, 1969), argues that according to such view "... although a company may by its articles exclude the operation of the equitable principle which renders voidable a contract in which a director has an interest which he has failed to disclose to the general meeting and renders the director accountable to the company for any profit arising from the contract, a breach of section 199 (1) will deny the director the right to rely on such an article." (C D Baker, "Disclosure of Directors' Interests in Contracts", The Journal of Business Law, 1975, 181 at

181) Succinctly put, Baker is understanding Gower's argument to mean that when the statutory disclosure requirements are not complied with, the interested director loses the right to rely on the exclusion clauses contained in the articles. The basic equitable principle is then revived, and the interested director is then dealt with in terms thereof.

It will be noted that the sections make no mention of the civil consequences for failing to comply with their provisions, but Gower cites the cases of Hely-Hutchinson v Brayhead Ltd [1967] 3 All ER 98 (CA) and Imperial Credit Association v Coleman (1873) L R 6 HL 189 as authority in support of his argument. In the former case the Court of Appeal was called upon to decide whether contracts entered into between the parties were voidable for the reason that at the time of contracting the plaintiff was a director of the defendant company and had failed to disclose such interest at the relevant board meeting of the directors as required by Article 99 of the company's articles of association (which required that disclosure be made in accordance with section 199 - which required disclosure to the board). It was the unanimous decision of the court that these contracts were all voidable. However, the court did not follow Gower's argument that voidability flowed inevitably from the Plaintiff's breach of section 199, but instead relied on the effect of non-disclosure on the interpretation of Article 99.

Article 99 was interpreted by the court to mean that the contracts could not be avoided by the company under the general equitable principle, provided that the director properly disclosed his interests in such contracts to the board of directors of such company as required by such article. Since the exclusion of the general equitable principle was, by virtue of Article 99, made dependent

upon proper disclosure being made as required by section 199, the director's failure to make the required disclosure brought the general equitable principle into operation thus rendering the contract voidable in terms of the common law (since the common law requires that disclosure be made to the general meeting of shareholders, which was not done). Lord Pearson was quite specific about the lack of the civil effect of section 199 (1), and argued that "... it is not contended that section 199 in itself avoids the contract. The section merely creates a statutory duty of disclosure and imposes a fine for non-compliance; but it has to be read in conjunction with Article 99." This prompted Baker to argue that "... the judgment of the Court of Appeal appears to countenance the possibility that had the article made its exclusion of the general equitable principle independent of the requirement of disclosure to the board under section 199 being observed, voidability would not have ensued in the event of a failure to disclose." (C D Baker, "Disclosure of Directors' Interests in Contracts", The Journal of Business Law, 1975, 181 at 183)

In Imperial Credit Association v Coleman (1873) LR 6 HL 189 the articles of the company required a director to vacate his office if he was concerned with or participated in the profits of any contract with the company without declaring his interest at a meeting of directors. Coleman persuaded the company to purchase certain railway debentures at a commission of 1,5%, without disclosing that he was being paid an additional commission of 5% by the railway company. Although Coleman had disclosed that he had an interest in the contract (to the tune of 1,5%) the Court, in finding that there was insufficient disclosure to obtain the protection of the articles, held Coleman liable to account to the company for the commission he had received. The Court did, however, state that had proper

disclosure been made to a meeting of the directors as required in terms of the company's articles, the articles would have protected Coleman not only against the vacation of his office, but also against the application of the general equitable principle.

Baker, commenting on the above case, once again points out that he cannot see how the court's decision could be construed as advancing Gower's arguments. He argues that aside from the fact that the case was decided before section 199 came into existence, it merely serves to support the ratio of Hely-Hutchinson v Brayhead to the effect that where the articles make their exclusion of the general equitable principle conditional upon observance of the requirement of disclosure to the board of directors, failure to disclose will allow the equitable principle to be invoked by the company. Baker goes on to ask what the intended effect of section 199 viz-a-viz exclusionary provisions in the articles is, and submits that "... in terms of actual intent it is as certain as anything can be that Parliament intended section 199 to have no civil consequences of any kind." (C D Baker, "Disclosure of Directors' Interests in Contracts", The Journal of Business Law, 1975, 181 at 184) He argues further that although many statutory provisions are construed as having civil effect where this is not expressly stated (and therefore section 199's silence concerning civil consequences which it may have cannot be regarded as conclusive proof that it bears no civil consequences), it is a considerable extension of this to argue, as Gower does, that a statutory prohibition upon certain conduct (i.e. failure to disclose an interest in a contract) results in the contract becoming voidable, not because of the breach of the statutory provisions itself, but because of the consequent revival of a principle of equity. Baker submits that his argument gains further credibility when regard is had to the possibility that the company,

for whose protection the equitable principle operates, may have excluded it without qualification in its articles. Furthermore, Baker points out that it is difficult to reconcile the view that section 199 (1) has civil consequences with section 199 (5) (our section 234 (5)) which provides that nothing in section 199 shall be taken to prejudice the operation of any rule of law restricting directors of a company from having any interest in contracts with the company.

Baker concludes by saying that "... even if ... a director has complied with his obligations under section 199 (1), this does not in itself mean that the contract is valid since the company's articles may not have excluded the general equitable principle either unconditionally or conditionally upon disclosure to the board of directors. But if section 199 (1) has an invalidating effect (i.e. a breach of it renders the contract voidable whatever the articles of the company say), it is difficult to explain why the articles become relevant to the issue of validity when section 199 (1) has been observed. Even if such a result may be defended on its merits, it seems difficult to believe that its complications could have been intended by Parliament." (C D Baker, "Disclosure of Directors' Interests in Contracts", The Journal of Business Law, 1975, 181 at 185 - 186)

Responding to Baker's criticisms of Gower's views, Blackman argues that our courts will in all likelihood follow the views expressed by Gower, both because of his great authority and also because it avoids the anomalous consequences which would follow Baker's argument (a criminal sentence coupled with possible voidability of the contract depending upon the construction of the company's articles of association). Moreover, as is evident from the opening remarks made at the beginning of this section, Cilliers and Benade

appear to support Gower's views (although their viewpoint is widely cast and no specific reference to Gower is made).

In searching for some authority in support of Gower's views, Blackman refers to sections 234 (5) and 237 (4) which provide that nothing in these sections shall be taken to prejudice the operation of any rule of law restricting directors/officers of a company from having an interest in contracts with the company. These sections have been dealt with above and it is not intended that they be revisited. However, it is submitted that they were intended to deal with a separate issue as previously discussed, and cannot be relied upon to support Gower's views. In fact, certain of the commentary referred to when these sections were dealt with above was obtained from the works of Gower himself, who failed to suggest that the inclusion of these sections (identical sections are to be found in the English Act) may be relied upon in support of his arguments concerning the consequences of failing to disclose in accordance with the sections.

Blackman also refers to the recent case of Guiness PLC v Saunders [1988] 1 WLR 863 (which has been briefly referred to above) in support of Gower's arguments. The facts, which are once again briefly stated in such a manner so as to accommodate the issue presently under discussion, were as follows: Guiness, acting through three of its directors, launched a takeover bid for Distillers plc. One of these three directors, a certain Mr Ward, was also a partner in a Washington firm of attorneys. Some four months later, the bid having been successful, a company registered in Jersey submitted an invoice in the amount of 5,2 million Pounds to Guiness being for services rendered in respect of the bid. The sum was paid by Guiness and it was later conceded that it had been received for and

on behalf of Ward. After a Department of Trade and Industry investigation had led to a change of management at Guiness, the new management team instituted an Application for Summary Judgment against Ward in order to recover the aforestated commission (remuneration had been agreed at 0,2% of the ultimate value of the bid). Recovery was claimed on the grounds that Ward had received the payment in breach of his fiduciary duty as a director in that he had failed to disclose his interest in the agreement to the board of directors of Guiness as required by section 317 (1) of the (present) Companies Act of 1985. (Note that Ward was cited as second defendant). The case was taken from the court of first instance to the Court of Appeal, and finally to the House of Lords.

In the court of first instance Browne-Wilkinson J granted the application for judgment based upon his interpretation of section 317 (which is almost identical to our section 234). The court held that section 317 intended that disclosure be made to a duly constituted and convened board meeting, and this function could not be delegated to a committee of the board (as had been the case). The articles of association only entitled a director to retain profits from contracts entered into with the company where there had been full disclosure in accordance with section 317. Since disclosure had not been made to a duly constituted and convened board meeting, Section 317 had not been complied with and the money was therefore to be returned.

Article 100 (A) of the company's articles of association provided that an interested director had to declare the nature of his interest at a meeting of the directors in accordance with the statutes; in terms of Article 100 (B) an interested director would not be liable

to account to the company for any profits realised from such contracts; whilst Article 100 (D) allowed directors to receive remuneration for professional services as if they were not directors.

The decision of the court of first instance was confirmed by the Court of Appeal where Fox L J held at page 869 that "... the purpose of section 317 (1) is not to destroy the power to relax the general rule by the articles but to impose a binding safeguard upon that power. In my opinion, a provision such as article 100 (D) must be read in the light of section 317 (1) to which it is always subject - and, for that matter to article 100 (A), which gives effect, or perhaps more accurately, draws attention to the statute. The interest of a director under any contract to which article 100 (C) or (D) applies must be disclosed in accordance with section 317 (1)." (Guiness Plc v Saunders [1988] 1 WLR 863 at 869) Fox L J went on to conclude that section 317 (1) must be regarded as imposing a duty which has consequences in civil law in addition to the imposition of a fine.

Blackman argues that although Fox's judgment may not be the model of clarity, it does appear to be the same argument as that of Gower, which Blackman states as follows:

(a) in the absence of an exclusionary provision in the articles, disclosure must be made to the general meeting and failure so to disclose will render the transaction voidable, even if disclosure is made in terms of the section (to the board of directors);

(b) if an exclusionary provision in the articles requires the disclosure required by the section, then failure so to

disclose will, of course, render the transaction voidable; and

(c) if the articles provide for a less onerous disclosure than that required by the section, failure to disclose as required by the section will render the transaction voidable, i.e. any exclusionary clause that does not at least require the disclosure required by the section is ineffective.

Fox's judgment caused Prentice to comment that "... although the reasoning of Fox L J is shaky, the result is to be welcomed; there is no reason in principle why a breach of section 317 should not have civil consequences. There has been a much too great a reluctance on the part of the courts to attach civil consequences to the breach of statutory provisions which provide merely for a criminal sanction. This, in relation to the Companies Act of 1985, greatly attenuates its effectiveness." (D D Prentice, "Director's Duty to Disclose Interest in Contract with Company", Commentary on Company Law, 1988, All ER, Annual Review, 34 at 35)

Whilst the sentiments expressed by Prentice and others may be meritorious in respect of the motives from which they are born, it is submitted that no authority exists for such a view. It is too simplistic to suggest that such issues may be answered from a common sense basis. The intention of Parliament must be given effect to, and it is hence required that the sections be properly interpreted.

The Guiness saga did not end at this point, since Ward took Fox's decision on appeal to the House of Lords where the appeal was

dismissed, albeit on the basis of considerations different from those which found favour with the court below. These considerations are of crucial importance given that the House of Lords judgment must be regarded as the most recent authority dealing with the civil consequences of failing to disclose in accordance with the section.

Two judgments were delivered by Lords Templeman and Goff in the House of Lords. It is important to bear in mind that the court's decision viz-a-viz the consequences of a director failing to disclose an interest in a company contract in accordance with the sections must be regarded as obiter since the court found that no contract existed between Ward and Guiness. This was because Ward had contracted with a committee of the board of directors, and not with the duly constituted and convened board. Ward argued that the contract was valid since article 2 defined the board as encompassing inter alia "any committee authorised by the board to act on its behalf". Moreover, article 110 gave the directors leave to establish any committees, fix their remuneration, and delegate to any committee any of the powers and discretions vested in the board. However, in rejecting Ward's arguments, Lord Templeman held that although the articles permitted the board to grant special remuneration to any director serving on any committee, this could not have been intended to allow any committee to grant special remuneration to a director, whether a member of the committee or not. Article 110 did not enable the board to delegate the power of deciding directors' remuneration. This power was vested in the board alone.

Despite having found that no contract existed between Guinness and Ward, the House of Lords did, however, venture an opinion as to the effect of failing to comply with section 317 (as indicated

above). Lord Goff argued that the decisions in the lower courts were wrongly decided insofar as they concerned section 317 since this section of itself holds only criminal consequences. The court referred to the well known dictum of Lord Pearson in Hely-Hutchinson v Brayhead Ltd [1968] 1 QB 549 (CA) at 594 where he argued that "... it is not contended that section 199 in itself affects the contract. The section (now section 317) merely creates a duty of disclosure and imposes a fine for non-compliance. But it has to be read in conjunction with article 99 ... If a director makes or is interested in a contract with the company but fails duly to declare his interest, ... 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."

The House of Lords held that had a contract existed between Guiness and Ward, it could have been avoided by Guiness on the grounds that Ward had failed to comply with the disclosure requirements laid down in the articles. However, since it was found that no such contract existed, the court did not ponder with any great depth the principles relating to the existence of a civil remedy for contravention of a criminal prescription, an exercise which had led Fox L J in the Court of Appeal to hold that section 317 had civil as well as criminal consequences. Nevertheless, McCormack sums up the findings of the House of Lords viz-a-viz section 317 as follows:

(a) A director is not free to contract with the company of which he is a director. Contracts so made may be

avoided at the option of the company. The right of rescission, however, is exercisable only by virtue of the general equitable principle so that the right may be lost through lapse of time or in the event of restoration of the status quo ante becoming impossible;

(b) A director is, however, free to contract with the company upon obtaining the consent of the company in general meeting, or if there are exempting provisions in the articles of the company and he complies therewith; and

(c) A breach of the duty of disclosure contained in section 317 of the Companies Act of 1985 attracts only the criminal sanctions stated in the section and does not per se entail any civil consequences. Often, however, exempting provisions in the company's articles are framed with reference to section 317 so that compliance with the section means a permission to contract with the company according to the articles. It is quite conceivable that observance of exemption conditions in the company articles will involve a less rigorous procedure than fulfilment of the duty of disclosure set out in section 317. (G McCormack, "The Guinness Saga : In Tom We Trust" (1991), 12, The Company Lawyer, 90 at 92)

As has been previously stated, it is submitted that the decision of the House of Lords, insofar as it concerned the consequences for failing to comply with section 317, must be regarded as obiter. We

are therefore left to rely upon the judgment of Fox L J in the Court of Appeal to the effect that section 317 has both criminal as well as civil consequences, this being the view supported by Gower, Pennington, and Cilliers and Benade as discussed above. This certainly appears to be the most practical interpretation, but it is submitted that there is much merit in the arguments of Baker and the recent House of Lords decision in the Guiness Saga. This recent decision must certainly have attracted the attention of legal draftsmen, and it is hoped that the legislation will be amended to clarify this confusion since the implementation of the House of Lords ratio that section 317 has only criminal consequences may have an extremely negative impact upon the protection afforded to shareholders by the section. Whilst one would dearly like to complacently accept Gower's view, there now exists recent authorative argument to the contrary. We are therefore forced to ask whether the courts will blindly continue to accept that the sections carry both civil and criminal consequences in the face of such recent and eminent authority to the contrary, and the answer to this question it is submitted must be that they will not. The consequences of failing to comply with the statutory provisions concerning disclosure must therefore be regarded as being in a state of flux, and it is hoped that the issue will shortly be resolved.

5. DEVELOPMENTS OF THE FAIRNESS TEST IN THE UNITED STATES OF AMERICA

Earlier in this work, when dealing with the rule against self-dealing, the possibility of determinations as to the fairness of contracts being allowed to influence the courts' decisions with relevance to English and South African law was discussed. It was mentioned that there had been considerable developments in this regard

in the United States of America, and that these developments would receive further attention at a later stage in view of the impact which they will no doubt exercise upon our law.

It is submitted that the introduction of determinations as to the fairness of contracts in which directors have an interest will be a positive step since it will avoid many of the anomalies which result from the present inflexible and formalistic approach and advance the smooth administration of companies. It is interesting to note that whilst English Law (and consequently our law) is still at the stage where this possibility is only being entertained but has certainly not yet been accepted, the United States have allowed notions of fairness to influence their decisions for more than eighty years.

In 1880 the case of Wardell v Union Pacific R R Co 103 V S 651 (1880) clearly stated that the general rule in the United States was that any company contract in which a director had an interest was voidable at the instance of the company without regard to the fairness of such transaction, irrespective of whether such contract was approved by a majority of the disinterested directors. However, as Marsh points out, "... thirty years later this principle was dead. The general rule (by 1910) was that a contract between a director and his corporation was valid if it was approved by a disinterested majority of his fellow directors and was not found to be unfair or fraudulent by the court if challenged; but that a contract in which a majority of the board was interested was voidable at the instance of the corporation or its shareholders without regard to any question of fairness." (H Marsh, "Are Directors Trustees?", The Business Lawyer, (1966), 35, at 39-40)

Marsh is at pains to point out that the cases do not provide a reasoned defence in support of this change in legal philosophy. He argues that "... the only explanation which seems to have been given for this change in position is the technical one that a trustee, while forbidden to deal with himself in connection with the trust property, could deal directly with the cestui que trust if he made full

disclosure and took no unfair advantage." (H Marsh, "Are Directors Trustees?", The Business Lawyer, (1966), 35 at 40)

The above was the argument which originally succeeded in allowing notions of fairness to influence the court's determination. However, Marsh argues further that "... by 1960 it could be said with some assurance that the general rule was that no transaction of a corporation with any or all of its directors was automatically voidable at the suit of a shareholder, whether there was a disinterested majority of the board or not; but that the courts would review such a contract and subject it to rigid and careful scrutiny, and would invalidate the contract if it was found to be unfair to the corporation." (H Marsh, "Are Directors Trustees?", The Business Lawyer, (1966), 35 at 43) Hence in the 1960 case of Shlensky v South Parkway Building Corporation 19 I 11. 2 d (1960) 268 at pages 280 - 281 it was held that "... transactions between corporations with common directors may be avoided only if unfair and that the directors who would sustain the challenged transaction have the burden of overcoming the presumption against the validity of the transaction by showing its fairness."

It is submitted that by placing the onus upon the directors to prove the fairness of such transactions the interests of shareholders are protected, whilst the need for strict formalistic procedures is reduced thus allowing for greater flexibility and more efficient and cost effective administrative procedures within the company. The introduction of these developments into our legal system would therefore be most welcome.

6. CONCLUSION

Whilst it is not intended that the issues already dealt with in this work be re-examined, it is perhaps helpful to isolate the present areas of uncertainty with regard to modern-day disclosure.

It is submitted that although the degree of disclosure required has not been resolved to a state of sufficient clarity, this has been due largely to the practical difficulties associated with defining the extent of the required disclosure. Although it was suggested that a test be formulated in order to accommodate this problem, it is submitted that this lack of clarity does not present major difficulties since it has been dealt with in a consistent manner by the courts and a body of precedent has been developed which can be relied upon for guidance.

What has, however, provided a major cause for concern is the lack of clarity regarding the consequences for failing to disclose in accordance with the statutory provisions, the position being much more consistent with regard to the consequences for failing to comply with the common law requirements.

The present uncertainties flowing from the House of Lords decision in the Guiness case with regard to the consequences for failing to comply with the disclosure provisions of the Act must be seen to have resulted in a most unacceptable state of affairs. This is amplified by the fact that the insertion of waiver clauses in the articles must now be regarded as being a standard practice, and there is therefore an urgent need for certainty insofar as the civil consequences or lack thereof for failing to comply with the statutory provisions of the Act are concerned. This is especially so given the recent increase in commercial crime in our country, and also the growing trend for directors to manipulate their powers to the detriment of shareholders.

The recent Guinness cases and also the criticisms of Baker clearly expose the lack of clarity on the point, and the House of Lords decision has demonstrated that this lack of certainty has extended to the highest judicial authority in England.

It is hoped that attention will shortly be focused upon the issue, and that steps will be taken in order to amend the existing legislation so as to specifically state that

a breach of the disclosure provisions will immediately bring the equitable rule into force. Should this not be done, we may well be left with the situation where a failure to disclose in accordance with the statutory provisions leads to a criminal sanction of minute proportions, whilst the contract in which the interested director is involved is not rendered voidable at the instance of the company depending upon the construction of the company's articles. The sections will clearly then not be accommodating the generally perceived intention of Parliament in enacting them; that being to limit the erosion of the common law rules by waiver clauses designed to accommodate the interests of the director as opposed to those of the shareholder. Should Parliament's intention simply have been to prescribe a minimum degree of disclosure notwithstanding the contents of the articles, and provide a criminal sanction for failing to comply therewith without providing corresponding civil remedies, it is submitted that such a view requires revision in view of the anomalous situations which may result therefrom as indicated above.

Finally, it is submitted that the influence of notions of fairness in the determination as to whether contracts should be regarded as voidable must be seen to be a positive step since the courts will no doubt approach such considerations in a careful and considered manner having the benefit of more than eighty years of United States precedent upon which to rely. The onus of proving the fairness of the contract will always rest upon the interested director, and the smooth administration of companies will thus be thereby advanced without prejudicing the position of shareholders who will be able to rely upon the court's assessment as to the fairness of the transaction.

**Kindly note that unless otherwise stated, all references to the opinions and observations of Professor M S Blackman have been obtained from class notes prepared by him and distributed to his students.*