

CORPORATE & COMMERCIAL ALERT

29 JUNE 2022



CLIFFE DEKKER HOFMEYR

INCORPORATING
KIETI LAW LLP, KENYA

IN THIS ISSUE

Sharing board members across group companies is not always a good idea

It is trite that a company's board is the controlling mind behind every action taken by a company. In orchestrating the company's affairs, board members must act in the best interests of the company and may not participate in decisions which further their own personal financial interests.



FOR MORE
INSIGHT INTO
OUR EXPERTISE
AND SERVICES

Sharing board members across group companies is not always a good idea

It is trite that a company's board is the controlling mind behind every action taken by a company. In orchestrating the company's affairs, board members must act in the best interests of the company and may not participate in decisions which further their own personal financial interests.

However, when two group companies contract with each other where board members serve on both entities, this potential conflict of interest becomes unavoidable. The increasing frequency of this occurrence has necessitated a closer look at the disclosure and recusal requirement in section 75(5) of the Companies Act 71 of 2008 (Companies Act) and how these procedural aspects are to be dealt with.

SECTION 75(5) OF THE COMPANIES ACT

In summary, section 75(5) of the Companies Act provides that, if a director of a company has a "personal financial interest" in a matter to be considered at a meeting of the board, or knows that a "related person" has a personal financial interest in the matter, that director must recuse him/herself from a meeting where the matter is to be decided.

Section 1 of the Companies Act defines "personal financial interest", when used with respect to any person, as "a direct material interest of that person, of a financial, monetary or economic nature, or to which a monetary value may be attributed". This will often be the case for both parties to commercial contracts.

Importantly, section 75(1)(b) of the Companies Act provides that a "related person", when used in reference to a director, has the meaning set out in section 1, but also includes a second company of which the director or a related person is also a director".

It is an all too common occurrence that certain members of the board of company A also serve as members on the board for its sister company B (common directors). In this situation, section 75(1)(b) prevents these common directors from voting

as regards agreements between company A and company B, as company B would be considered "related" to company A. This section applies notwithstanding that such board members themselves may derive no direct personal financial benefit from the proposed transaction to be approved, and there is no carve-out in section 75 regarding intra-group transactions, even where wholly-owned subsidiaries are concerned. This would be even more problematic where the boards of both company A and company B are constituted entirely by common directors (so-called "mirror boards"), leaving no unconflicted directors to pass a decision once all recusals have been made.

Although practically challenging, the underlying rationale of section 75(1)(b) is that a director of two companies owes a fiduciary duty to

Sharing board members across group companies is not always a good idea

CONTINUED

both companies and must act in their respective interests. In theory there is a concern around divided loyalties where a director of two companies deliberates on a decision in terms of which both companies have a material financial interest, as the furtherance of one company's interest may be to the detriment of the other. For instance, in the context of one group company deciding whether to stand as guarantor or surety for another group company's bank debts, or deciding whether to purchase property from another group company, the concern of the legislature is that the common director is tempted to push through a decision of the first company (guarantor, purchaser) when actually it is the second company's (borrower, seller) interests he truly has at heart. This goes to the root of the common law position that a director must always avoid a conflict of interest.

POSSIBLE SOLUTIONS

Section 75(7) of the Companies Act provides that a decision by a board is valid despite any personal financial interest of a director or related person only if:

- (a) *"it was approved following disclosure of that interest in the manner contemplated in this section; or*
- (b) *despite having been approved without disclosure of that interest, it:*
 - i. *has subsequently been ratified by an ordinary resolution of the shareholders following disclosure of that interest; or*
 - ii. *has been declared to be valid by a court in terms of subsection (8)."*

Section 75(7) provides three scenarios where a decision may be valid notwithstanding a personal financial interest of a director or related person in three instances.

- (a) Firstly, where the conflicted director makes the appropriate disclosure and recuses him/herself in accordance with section 75(5). Practically, this will only be possible where, following the common directors' recusal, there are sufficient directors remaining who may vote on the matter.
- (b) Secondly, where the decision has subsequently been ratified by an ordinary resolution of the shareholders following disclosure of that interest. As regards group entities whose boards consist entirely of common directors, the only option is for all of the directors to disclose their personal financial interests, and thereafter refer the resolution to the company's shareholder for ratification. It does not seem obvious that this falls within section 75(7)(b)(i), as the latter appears to only deal with situations of non-disclosure (whether inadvertent or mala fide) by the conflicted director, but should pass muster under common law principles.

Sharing board members across group companies is not always a good idea

CONTINUED

Thirdly, where the decision has been declared to be valid by an order of court.

In the second scenario, there is no authority to suggest that this remedial provision will not apply where the counterparty to a transaction is also the very shareholder of the company seeking to ratify. Shareholders are not bound by conflict-of-interest rules and can vote their shares in their absolute discretion. In other words, where the counterparty is a holding company, it is acceptable for that

holding company to ratify actions “to be taken” or actions “already taken” by the subsidiary seeking approval.

CONCLUSION

Section 75(5) is problematic for group companies wishing to contract with each other where directors serve on both entities. Common directors must adhere to these provisions or face possible liability for a breach of their fiduciary duties. Although section 75(7) provides remedies for these procedural obstacles, obtaining

shareholder approval for each decision taken or to be taken at board level may be slow and administratively cumbersome. Consequently, group companies may consider avoiding this overlap in management by ensuring mirror boards are not pervasive throughout the group, and that there are sufficient “independent” board members on each company board.

**JUSTINE KRIGE AND
LAYEN PETERSEN**

2021 WINNERS OF M&A DEAL FLOW 2021

2021

1st by M&A Deal Flow.
2nd by General Corporate Finance Deal Flow.
2nd by BEE Deal Value.
3rd by General Corporate Finance Deal Flow.
3rd by BEE Deal Flow.
4th by M&A Deal Value.

2020

1st by M&A Deal Flow.
1st by BEE Deal Flow.
1st by BEE Deal Value.
2nd by General Corporate Finance Deal Flow.
2nd by General Corporate Finance Deal Value.
3rd by M&A Deal Value.
Catalyst Private Equity Deal of the Year.

2019

M&A Legal DealMakers of the Decade by Deal Flow: 2010-2019.
1st by BEE M&A Deal Flow.
1st by General Corporate Finance Deal Flow.
2nd by M&A Deal Value.
2nd by M&A Deal Flow.

2018

1st by M&A Deal Flow.
1st by M&A Deal Value.
2nd by General Corporate Finance Deal Flow.
1st by BEE M&A Deal Value.
2nd by BEE M&A Deal Flow.
Lead legal advisers on the Private Equity Deal of the Year.

DealMakers



OUR TEAM

For more information about our Corporate & Commercial practice and services in South Africa and Kenya, please contact:



Willem Jacobs

Practice Head & Director:
Corporate & Commercial
T +27 (0)11 562 1555
M +27 (0)83 326 8971
E willem.jacobs@cdhlegal.com



David Thompson

Deputy Practice Head & Director:
Corporate & Commercial
T +27 (0)21 481 6335
M +27 (0)82 882 5655
E david.thompson@cdhlegal.com



Sammy Ndolo

Managing Partner | Kenya
T +254 731 086 649
+254 204 409 918
+254 710 560 114
E sammy.ndolo@cdhlegal.com

Roelof Bonnet

Director:
Corporate & Commercial
T +27 (0)11 562 1226
M +27 (0)83 325 2185
E roelof.bonnet@cdhlegal.com

Tessa Brewis

Director:
Corporate & Commercial
T +27 (0)21 481 6324
M +27 (0)83 717 9360
E tessa.brewis@cdhlegal.com

Etta Chang

Director:
Corporate & Commercial
T +27 (0)11 562 1432
M +27 (0)72 879 1281
E etta.chang@cdhlegal.com

Vivien Chaplin

Director:
Corporate & Commercial
T +27 (0)11 562 1556
M +27 (0)82 411 1305
E vivien.chaplin@cdhlegal.com

Clem Daniel

Director:
Corporate & Commercial
T +27 (0)11 562 1073
M +27 (0)82 418 5924
E clem.daniel@cdhlegal.com

Jenni Darling

Director:
Corporate & Commercial
T +27 (0)11 562 1878
M +27 (0)82 826 9055
E jenni.darling@cdhlegal.com

André de Lange

Sector Head: Agriculture, Aquaculture
& Fishing Sector
Director: Corporate & Commercial
T +27 (0)21 405 6165
M +27 (0)82 781 5858
E andre.delange@cdhlegal.com

Andrew Giliam

Director:
Corporate & Commercial
T +27 (0)21 481 6363
M +27 (0)83 359 7069
E andrew.giliam@cdhlegal.com

John Gillmer

Joint Sector Head: Private Equity
Director: Corporate & Commercial
T +27 (0)21 405 6004
M +27 (0)82 330 4902
E john.gillmer@cdhlegal.com

Johan Green

Director:
Corporate & Commercial
T +27 (0)21 405 6200
M +27 (0)73 304 6663
E johan.green@cdhlegal.com

Ian Hayes

Director:
Corporate & Commercial
T +27 (0)11 562 1593
M +27 (0)83 326 4826
E ian.hayes@cdhlegal.com

Peter Hesselting

Director:
Corporate & Commercial
T +27 (0)21 405 6009
M +27 (0)82 883 3131
E peter.hesselting@cdhlegal.com

Quintin Honey

Director:
Corporate & Commercial
T +27 (0)11 562 1166
M +27 (0)83 652 0151
E quintin.honey@cdhlegal.com

Brian Jennings

Director:
Corporate & Commercial
T +27 (0)11 562 1866
M +27 (0)82 787 9497
E brian.jennings@cdhlegal.com

Rachel Kelly

Director:
Corporate & Commercial
T +27 (0)11 562 1165
M +27 (0)82 788 0367
E rachel.kelly@cdhlegal.com

Yaniv Kleitman

Director:
Corporate & Commercial
T +27 (0)11 562 1219
M +27 (0)72 279 1260
E yaniv.kleitman@cdhlegal.com

Justine Krige

Director:
Corporate & Commercial
T +27 (0)21 481 6379
M +27 (0)82 479 8552
E justine.krige@cdhlegal.com

Johan Latsky

Executive Consultant:
Corporate & Commercial
T +27 (0)11 562 1149
M +27 (0)82 554 1003
E johan.latsky@cdhlegal.com

Nkcubeko Mbambisa

Director:
Corporate & Commercial
T +27 (0)21 481 6352
M +27 (0)82 058 4268
E nkcubeko.mbambisa@cdhlegal.com

OUR TEAM

For more information about our Corporate & Commercial practice and services in South Africa and Kenya, please contact:

William Midgley

Sector Head: Commercial Real Estate
Director: Corporate & Commercial
T +27 (0)11 562 1390
M +27 (0)82 904 1772
E william.midgley@cdhlegal.com

Tessmerica Moodley

Director:
Corporate & Commercial
T +27 (0)21 481 6397
M +27 (0)73 401 2488
E tessmerica.moodley@cdhlegal.com

Anita Moolman

Director:
Corporate & Commercial
T +27 (0)11 562 1376
M +27 (0)72 252 1079
E anita.moolman@cdhlegal.com

Wayne Murray

Director:
Corporate & Commercial
T +27 (0)21 405 6018
M +27 (0)79 691 0137
E wayne.murray@cdhlegal.com

Francis Newham

Executive Consultant:
Corporate & Commercial
T +27 (0)21 481 6326
M +27 (0)82 458 7728
E francis.newham@cdhlegal.com

Verushca Pillay

Director:
Corporate & Commercial
T +27 (0)11 562 1800
M +27 (0)82 579 5678
E verushca.pillay@cdhlegal.com

David Pinnock

Joint Sector Head: Private Equity
Director: Corporate & Commercial
T +27 (0)11 562 1400
M +27 (0)83 675 2110
E david.pinnock@cdhlegal.com

Allan Reid

Joint Sector Head: Mining & Minerals
Director: Corporate & Commercial
T +27 (0)11 562 1222
M +27 (0)82 854 9687
E allan.reid@cdhlegal.com

Jess Reid

Director:
Corporate & Commercial
T +27 (0)11 562 1128
M +27 (0)83 571 6987
E jess.reid@cdhlegal.com

Megan Rodgers

Sector Head: Oil & Gas
Director: Corporate & Commercial
T +27 (0)21 481 6429
M +27 (0)79 877 8870
E megan.rodgers@cdhlegal.com

Ludwig Smith

Director:
Corporate & Commercial
T +27 (0)11 562 1500
M +27 (0)79 877 2891
E ludwig.smith@cdhlegal.com

Tamarin Tosen

Director:
Corporate & Commercial
T +27 (0)11 562 1310
M +27 (0)72 026 3806
E tamarin.tosen@cdhlegal.com

Roxanna Valayathum

Director:
Corporate & Commercial
T +27 (0)11 562 1122
M +27 (0)72 464 0515
E roxanna.valayathum@cdhlegal.com

Roux van der Merwe

Director:
Corporate & Commercial
T +27 (0)11 562 1199
M +27 (0)82 559 6406
E roux.vandermerwe@cdhlegal.com

Andrew van Niekerk

Head: Projects & Infrastructure
Director: Corporate & Commercial
T +27 (0)21 481 6491
M +27 (0)76 371 3462
E andrew.vanniekerk@cdhlegal.com

Gasant Orrie

Director:
Corporate & Commercial
T +27 (0)21 405 6044
M +27 (0)83 282 4550
E gasant.orrie@cdhlegal.com

Charl Williams

Director:
Corporate & Commercial
T +27 (0)21 405 6037
M +27 (0)82 829 4175
E charl.williams@cdhlegal.com

Njeri Wagacha

Partner | Kenya
T +254 731 086 649
+254 204 409 918
+254 710 560 114
E njeri.wagacha@cdhlegal.com

Christelle Wood

Director:
Corporate & Commercial
T +27 (0)11 562 1372
M +27 (0)83 498 2850
E christelle.wood@cdhlegal.com

Emma Hewitt

Practice Development Director:
Corporate & Commercial
T +27 (0)11 562 1635
E emma.hewitt@cdhlegal.com

BBBEE STATUS: LEVEL ONE CONTRIBUTOR

Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

PLEASE NOTE

This information is published for general information purposes and is not intended to constitute legal advice. Specialist legal advice should always be sought in relation to any particular situation. Cliffe Dekker Hofmeyr will accept no responsibility for any actions taken or not taken on the basis of this publication.

JOHANNESBURG

1 Protea Place, Sandton, Johannesburg, 2196. Private Bag X40, Benmore, 2010, South Africa.

Dx 154 Randburg and Dx 42 Johannesburg.

T +27 (0)11 562 1000 F +27 (0)11 562 1111 E jhb@cdhlegal.com

CAPE TOWN

11 Buitengracht Street, Cape Town, 8001. PO Box 695, Cape Town, 8000, South Africa. Dx 5 Cape Town.

T +27 (0)21 481 6300 F +27 (0)21 481 6388 E ctn@cdhlegal.com

NAIROBI

Merchant Square, 3rd floor, Block D, Riverside Drive, Nairobi, Kenya. P.O. Box 22602-00505, Nairobi, Kenya.

T +254 731 086 649 | +254 204 409 918 | +254 710 560 114

E cdhkenya@cdhlegal.com

STELLENBOSCH

14 Louw Street, Stellenbosch Central, Stellenbosch, 7600.

T +27 (0)21 481 6400 E cdhstellenbosch@cdhlegal.com

©2022 11257/JUN