Why South African law on directors' delinquency is open to abuse

By Rehana Cassim

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For the first time in South African company law, courts have the power to declare directors delinquent. This remedy was introduced as part of the overhaul of South Africa's corporate law regime in 2011. It is an innovative remedy available to shareholders and other stakeholders to hold company directors accountable. The newly-adopted delinquency order sets out to raise standards of good behaviour expected of directors. It also protects the public from incompetent and dishonest directors.

The delinquency clause seeks to raise standards of good behaviour expected of directors. Shutterstock

To be declared delinquent, a director must be guilty of serious misconduct. There must be a gross abuse of the director's position, gross negligence, wilful misconduct or a breach of trust. Gross abuse is not a trivial misdemeanour. A gross abuse would be if a director exploits company information or takes a business opportunity that should have been given to his company.

Other examples of conduct which have resulted in delinquency orders are failing to refund money to the South African Revenue Service; taking financial benefits and unlawfully excluding a shareholder from the benefits to which he is entitled; allowing a company to trade knowing that it is insolvent; failing to prepare annual financial statements or not holding annual general meetings for several years; and taking bribes of millions of Rands in exchange for turning a blind eye to the looting of municipal, stokvel and pension funds at VBS Mutual Bank.

A host of things aren't enough for a delinquency order. These include poor decision-making, ordinary commercial misjudgement or a misguided reliance on incorrect professional advice.

A delinquency order will ban a person from being a director for at least seven years, or even for a lifetime in very serious cases. His name is put on a public register of disqualified directors. Even though a delinquency order will not send a director to jail, it carries a stigma and reputational damage.

Conditions may be imposed on a delinquency order, such as ordering the director to go for remedial education or to do community service. After three years he may apply to court for the order to be suspended and suspended with an order of probation. But he may face challenges in convincing a court of his rehabilitation.

In my research I have found that courts do not make enough use of these kinds of conditions when declaring directors delinquent. Courts should impose appropriate conditions on the delinquency order to protect the public from a recurrence of the conduct and to enhance the director's rehabilitation.

Who can apply for a delinquency order?

In addition, I found that South Africa's remedy is open to abuse. This is because the country's law, unlike the UK or US, has a much wider definition of who can act.

For example, it allows employee representatives or trade unions the right to apply for a delinquency order. The company secretary and a prescribed officer can also apply for a delinquency order. And it gives one director or a single shareholder the power to bring delinquency proceedings. There is nothing to stop a disgruntled director or shareholder from doing so. There is a great deal of potential for any of these people to put directors under pressure by exercising this right, or by threatening to exercise it.

In contrast, in the US a single director or shareholder cannot apply to court for an order to remove a director. Instead, the application must be brought derivatively by the board of directors or a shareholder – that is, in the company's name, and not in their personal name. A derivative action allows a person to bring an action on behalf of a company to protect the company's legal interests from parties allegedly causing harm to the company.

South Africa has gone in completely the opposite direction. A court has ruled that delinquency applications cannot be brought derivatively (in the company's name), but must be brought by a single shareholder, in the shareholder's name.

In my research, I have found that abuse could be controlled much more effectively if shareholders or directors could bring delinquency proceedings derivatively.

The advantage of derivative procedures is that they have a good faith requirement. The derivative proceeding does not mean that the application is brought by a group. It means that the application is brought in law by the company, and not by the individual shareholder or individual director.

This safeguard is missing when delinquency applications are brought by a director or shareholder in their own name. So frivolous or vexatious delinquency applications may not be screened out and must be fully litigated in court. This could take years to be finalised.

Even before a delinquency application is argued in court, it could affect the directors' reputation and also the company's share price, especially if the company is listed on a stock exchange.

For example, the share price of Old Mutual, the second-largest insurer in South Africa which is listed on various stock exchanges, has dropped drastically recently. This is partly due to publicity of the unprecedented move by the former CEO, Peter Moyo, to have all 14 non-executive directors on the board declared delinquent and thus banned from being directors.

The reason for Moyo's application is that he believes the board did not properly handle his termination of employment as the CEO of Old Mutual, in June 2019. Old Mutual has said that it dismissed Moyo because of a conflict of business interest.

The Companies Act makes no provision for the collective declaration of delinquency of an entire board, which has never been done. To succeed with this unusual application, Moyo must prove that there are valid grounds to declare every single board member delinquent, and that there is enough evidence to support these grounds.

In another case a disgruntled shareholder applied to declare delinquent four directors of Lewis Group, a public listed company. Arguments were made to the court that the shareholder was acting in bad faith, and that his application was vexatious and frivolous. The court agreed and found that the application had no merit. But, the bad publicity given to Lewis Group while the matter was pending had a negative effect on its share price.

Caution against abuse

These cases show the extent of the power conferred on one director or a single shareholder to bring delinquency proceedings against directors. It is important to guard against the abuse of delinquency applications, especially since the Companies Act has no safeguards to protect against such abuse. This remedy must be used responsibly and sensibly by those with the power to use it.

ABOUT THE AUTHOR

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