Illicit outflow of capital from South Africa eliminated by statutory duties placed on directors

Kukama v Lobelo and Others (GSJ) (unreported case no 38587/2011, 12-4-2012) (Tshabalala J)

By Muhammad Patel

In this article a simple illustration is first given of the concepts of semi-privatisation and privatisation. Secondly, common law duties and fiduciary duties of directors under the Companies Act 71 of 2008 (the Act) are discussed. Lastly, the case of *Kukama v Lobelo and Others* (GSJ) (unreported case no 38587/2011, 12-4-2012) (Tshabalala J) is cited in terms of the far-reaching ramifications on directors in light of deterring directors from engaging in illicit outflow of capital activities

In discussing illicit outflow of capital activities, with specific focus on South Africa, the spot light is shone upon directors. This article is relevant to legal practitioners working off a set of facts which raises questions over a director/s delinquency. This article further encourages legal practitioners to apply the provisions of the Companies Act 71 of 2008 (the Act) cited herein. Lastly, legal practitioners are recommended to study the *Kukama* case when assessing director/s delinquently and expand on the Judgment of this precedent setting case when preparing/drafting papers. In light of the sixth Thabo Mbeki Africa day, it is crucial to highlight a recent study by the Global Financial Integrity (GFI) entitled *Illicit Financial Flows from Africa: Hidden Resource for Development* (www.gfintegrity.org), which estimated total illicit outflows from the African continent across the span of 39 years at around $ 1,8 trillion. Further, the top five countries with the highest outflow measured were: Nigeria ($ 89,5 billion), Egypt ($ 70,5 billion), Algeria ($ 25,7 billion), Morocco ($ 25 billion), and South Africa ($ 24,9 billion). Furthermore, the African Union High Level Panel on Illicit Financial Flows from Africa, headed by the former South African President, Thabo Mbeki, recently issued a report stating that Africa loses around $ 60 billion annually due to illicit financial outflows. The report has also established that most illicit financial flows are facilitated through trade mispricing.

Illicit outflow comprises of trade mispricing, bulk cash movements and smuggling, among other *modus operandi*, all of which are formed to move money out of Africa with the object of avoiding taxes.

The debate surrounding the issue of semi-privatisation and privatisation, pro---vides for interesting legal analysis in light of the illicit outflow of capital by directors under the Act.

Semi-privatisation

An interesting and relevant example of semi-privatisation can be found in South Africa in regard to Eskom, the 'main' electricity provider of South Africa. Semi-privatisation is best illustrated in terms of a public-private partnership (PPP).

A PPP is defined as 'a contractual arrangement between a public sector institution and a private party in which the private party performs an institutional function or uses state assets and assumes substantial financial, technical and operational risk in the design, financing, building and or operation of the project, in return for a benefit' (Ivan Grobbelaar *The privatisation of the electricity industry in South Africa* (unpublished LLM thesis, University of Pretoria, October 2010) 72).

A PPP is beneficial for governments such as South Africa as it limits risks and prevents the illicit outflow of capital as witnessed in cases of full privatisation because the state is privy to the operations conducted under a PPP.

Privatisation

Privatisation is the transfer of assets to the private sector rather than a transfer merely of activities. (OECD 'Privatisation in the 21st Century: Summary of Recent Experiences' *www.oecd.org*) Privatisation is not an evil proposition if appropriate checks and balances are put in place. These checks and balances consist of carefully drafted legislation in company and tax law respectively.

Common law and statutory fiduciary duties on directors

The common law in South Africa places on directors fiduciary duties. Some of these duties are –

- to act in the best interests of a company;
- prevent a conflict of interest;
- act within the limitations of power; and
- exercise powers for the purpose for which they were conferred and maintain an unfettered discretion.

In the South African context the Act makes provision for directors' statutory duties. Section 76 of the Act lists the statutory fiduciary duties of directors. A few sub-sections of this provision are s 76(2)(*a*) of the Act – which create a statutory duty on a director to avoid a conflict of interest and s 76(3)(*a*) of the Act – which places on directors a duty to act in good faith and for a proper purpose.

In light of the above provisions, directors will refrain from running companies fraudulently because they would be aware that if they breach their statutory fiduciary obligations they may face civil or even criminal liability.

Director's liability for breaching fiduciary duties

If directors breach their statutory duties they would be held liable under s 77 of the Act. A provision to be considered also is s 218(2) of the Act which reads: 'Any person who contravenes any provision of this Act is liable to any other person for any loss or damage suffered by that person as a result of that contravention'. This subsection makes provision for civil liability if one suffers any loss or damage and is wide enough for one to institute action against a director or anyone else that acts inappropriately by taking part in illicit outflow of capital schemes.

In addition, consideration is to be given to corporate governance in the form of the King III report. One of the key principles of the report is 'social transformation and redress', which would 'give rise to greater opportunities, efficiencies, and benefits, for both the company and society' (Corporate Governance King III report *www.pwc.co.za/en/king3/*, accessed 31-8-2014). If the King III report is applied then multinational corporations would have a duty to contribute positively to society.

Case law

The *Kukama* case is a precedent setting case in which the first order of delinquency against a director was made in terms of s 162 of the Act. It is not necessary to discuss the facts of the case but rather some provisions of the Act as highlighted in the case.

Section 162(5)(*c*)(i) of the Act reads: ‘A court must make an order declaring a person to be a delinquent director if the person – (*c*) while a director – (i) grossly abused the position of director’. My view is that a director grossly abuses his position by participating in illicit outflow of capital activities.

A finding of delinquency against a director has far-reaching effects. This is because under s 69(8)(*a*) of the Act, a director can be disqualified if he or she is found delinquent under s 162 of the Act. The time period in which a director will be disqualified for grossly abusing his or her position under s 162(6)(*b*)(i), is to be decided by a court, by factoring in conditions limiting the application of the declaration to one or more particular categories of companies and under s 162(6)(*b*)(ii), a period of seven years from the date of a court order, or such longer period as determined by the court at the time of making the declaration, subject to subs 11 and 12 in terms of the Act.

It is common knowledge that multinational corporations operate in South Africa and that parastatals such as Eskom may soon be semi-privatised. Further, many private entities carry out business in South Africa and the provisions in the Act reflect that we have done what is necessary insofar as deterring directors from carrying out illicit outflow of capital activities.

Conclusion

Regardless of whether directors act in a semi-privatised or privatised entity they will face civil or even criminal liability if found guilty in participating in illicit outflow of capital activities. Directors in South Africa must take heed of their statutory fiduciary duties under the Act and be mindful not to be pronounced delinquent as in the *Kukama* matter.

The far-reaching effect of the *Kukama* case is that apart from disqualification a director may face a more severe sentence at a courts discretion. The only problem that may be encountered in enforcing the provisions of the Act and the common law is in situations where the companies involved in illicit financial outflows are not domiciled in South Africa, as South African company law will not be applicable to such companies. However, it is quite common for the mispricing that leads to illicit financial outflows to be facilitated by a South African subsidiary of a multinational company, which means that the South African company law will be applicable to such a subsidiary, as the company is neither an external nor a foreign company in that context. Finally, the African countries that suffer most of the illicit financial outflows should consider adopting similar company law rules as the ones applicable in South Africa and should, in particular, consider extending ‘standing rules’ to empower those acting in ‘the public interest’ with right of action in company law in order to protect the interests of the companies concerned.

Muhammad Patel *LLB (Wits) Postgraduate Diploma in Law HDip in Corporate Law (Wits)* is a candidate attorney at Moore Attorneys in Johannesburg.