



# **CORPORATE GOVERNANCE: A GUIDE FOR DIRECTORS**

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Good corporate governance is about 'intellectual honesty' and not just sticking to rules and regulations, capital flowed towards companies that practised this type of good governance.

MERVYN KING

## WHAT YOU NEED TO KNOW ABOUT BEING A DIRECTOR

Duties, responsibilities and personal liability of directors, prescribed officers and committee members under the Companies Act, No 71 of 2008.

### Introduction

- 1.1 Since the commencement of the Companies Act, No 71 of 2008 (the '2008 Act') many directors will have questioned whether they have a deep enough understanding and appreciation of what is expected of them in the context of leading their organisations, and some have even questioned whether being a director remains advisable, in the light of perceived increases in the obligations resting on them in their capacity as director, and indeed in the potential personal liability which they may face should things go wrong.
- 1.2 In this document, we seek to answer some pressing questions that many company directors have raised.
- 1.3 This document provides a brief summary of the relevant provisions of the 2008 Act in relation to directors' duties, responsibilities and personal liability. This is, however, not intended to be exhaustive. This summary is consequently not a substitute for reading and, where appropriate, seeking advice on, the detailed provisions of the 2008 Act.
- 1.4 We also recommend that any decisions or actions being considered on a review of these provisions be taken or not taken only after consulting appropriately qualified legal advisors.

## Overview

- 2.1 The duties of directors of companies in South Africa have, at times, been an uncertain area of company law, mainly because this area of company law has until recently been contained in the South African common law and, for the most part, not codified in any statute. The previous Companies Act, No 61 of 1973 (the '1973 Act') followed the English law to a very large extent and did not attempt to codify the law relating to directors' duties, instead leaving this to be developed by the courts. The cases decided over the many years have not always been perfectly consistent with one another in this respect.
- 2.2 These duties are vital because they play a major role in ensuring the promotion of corporate governance ethics and principles. In reality, much of company law is ultimately about corporate governance.
- 2.3 Some of the early drafts of the 2008 Act made substantial attempts at codifying most of the duties of directors, but the 2008 Act as ultimately enacted contains provisions dealing more with directors' general duties that are comparable to the common law duties of directors.
- 2.4 To fully appreciate the provisions relating to directors under the 2008 Act, one must have regard, not only to the codified directors' duties

as contained in the 2008 Act, but also to the common law and the relevant provisions of the Companies Regulations, 2011 (the 'Regulations') promulgated under the 2008 Act, which we refer to herein where necessary. Case law decided under the 2008 Act has confirmed that the Act contains only a partial, and not a full, codification of all directors' duties and responsibilities (eg *Kensal Rise Investments (Pty) Limited v Marchant* (2014)). Previously there was a debate on this aspect.

- 2.5 As discussed in more detail later in this document, these duties and liabilities are also applicable to prescribed officers and members of board committees or audit committees of companies. This is irrespective of whether or not they are members of the board of the company, and would therefore include (non-director) officers co-opted to such committees. This document also discusses who 'prescribed officers' are.
- 2.6 It is worth noting that whilst these duties have existed for decades in our law (in terms of case law which developed under the 1973 Act and even long before then), there continues to be a renewed interest in the study and understanding of these duties, mainly for the following reasons:
  - 2.6.1 in some instances the 2008 Act is stricter than the common law insofar as directors' duties are concerned, and since statutory law overrides common law in the case of inconsistency, it is important to understand how the 2008 Act has made certain duties more stringent or onerous than before;

- 2.6.2 now that various duties have been codified, there is a discernible trend which has been borne out in practice through the cases that have been decided since the commencement of the 2008 Act, that they are more accessible and readily enforceable in the sense that aggrieved shareholders and other stakeholders of a company may more easily and readily rely on the statutory causes of action created by the 2008 Act instead of having to base their causes of action on complex and sometimes conflicting case law; and
- 2.6.3 most importantly, breaches of the duties are now coupled with numerous and far-reaching personal liability provisions in the 2008 Act, in s77 (liability to the company), s218(2) (liability to any third parties for any contraventions of the 2008 Act) and elsewhere. Whilst personal liability was always a possibility under the 1973 Act and the common law, the 2008 Act has introduced statutory remedies which in our view may make it easier to pursue claims against directors who have breached their duties. Case law continues to develop regarding whether a third party (eg a creditor) should be able to use s218(2) to sue a director personally for damages and losses suffered by the creditor as a result of a director's breach of fiduciary duties or the company's reckless or fraudulent trading in contravention of s22. Whilst the matter is yet to be settled at the top echelons of our judiciary, it seems this

remains a possibility for now, this despite the fact that traditionally directors owe a legal duty only to the company and not to third parties (*Rabinowitz v Van Graan and Others (2013)*, but compare with *De Bruyn v Steinhoff (2020)*, which largely maintained the traditional position). This potentially increases the scope of directors' personal liability in respect of provisions of the 2008 Act which place obligations or prohibitions on the company.

- 2.6.4 It has however been settled that, despite section 218(2), shareholders cannot sue directors for indirect, "reflective loss", namely loss they suffer as a result of a devaluation of their shares by virtue of damages or loss suffered by the company as a result of the conduct of its directors – it is the company, as "proper plaintiff", which must sue the directors for damages (*Hlumisa Investment Holdings (RF) Ltd and Another v Kirkinis and Others (2020)*).
- 2.7 It is for the above reasons that this document also addresses the personal liability of directors under the 2008 Act.

## A DIRECTOR'S DUTIES AND LIABILITIES

### Am I subject to a director's duties and liabilities?

- Am I a *de jure* or *de facto* director?
- Am I a prescribed officer?
- Am I a board committee member?

### 3.1 Who is a director?

- 3.1.1 In terms of s1 of the 2008 Act, a director means a member of the board of a company, as contemplated in s66, or an alternate director of a company and includes any person occupying the position of a director or alternate director, by whatever name designated. 'Alternate directors' are commonly found in the context of closely held companies, but are not limited to those scenarios. An alternate director is a person elected or appointed to serve, as the occasion requires, as a member of the board of a company in substitution for a particular elected or appointed director of that company. Often a director will have a right in terms of a shareholders agreement to appoint an alternate.
- 3.1.2 What is worth noting from the definition of 'director' is that not only *de jure* appointed/ elected directors are covered, but also *de facto* and so-called 'shadow' directors who are not on the board yet factually occupy a position in the company which is on equal footing with *de jure* directors.

- 3.1.3 However, for purposes of the sections of the 2008 Act dealing with directors' duties, responsibilities and personal liability, a 'director' is defined to further include:
- 3.1.3.1 a prescribed officer; and
- 3.1.3.2 a person who is a member of a committee of a board of a company, or an audit committee, irrespective of whether the person is also a member of the company's board.
- 3.1.4 This means that, for purposes of the sections in question, prescribed officers and members of committees are treated in the same way as directors, irrespective of whether or not these persons are members of the board of directors. This adopts and codifies the trend which was developing in the cases decided under the 1973 Act where non-director senior officers and executives of a company were held to have the same common law fiduciary duties as directors.

### 3.2 Who is a prescribed officer?

#### Definitions

- 3.2.1 Under regulation 38 of the Regulations, a 'prescribed officer' is defined as a person who:
- exercises general executive control over and management of the whole, or a significant portion, of the business and activities of the company. (In our view, an example of this would be someone in the position of a General Manager or the head of a significant division of the company); or



- regularly participates to a material degree in the exercise of general executive control over and management of the whole, or a significant portion, of the business and activities of the company. (In our view, an example of this would be a person who is not a director but is a member of the company's executive or management committee. It should, however, be noted that the test is a purely factual one and will depend on the structure of each company).

3.2.2 It will be demonstrated later in this document that the concept of a 'related person' sometimes comes into play in relation to directors' duties, particularly in the context of disclosure and recusal in relation to personal financial interests under s75 of the 2008 Act. It is also a concept which is important in the context of financial assistance given by a company under s44 and/or 45 of the 2008 Act. A related person is defined as follows:

An individual is related to another individual if they:

- are married, or live together in a relationship similar to marriage; or
- are separated by no more than two degrees of natural or adopted 'consanguinity' (blood relationship) or 'affinity' (marriage);

An individual is related to a juristic person (a juristic person is an entity such as a company, close corporation, trust or foreign corporation) if the individual directly or indirectly controls the juristic person;

A juristic person is related to another juristic person if:

- either of them directly or indirectly controls the other, or the business of the other;
- either is a subsidiary of the other; or
- a person directly or indirectly controls each of them, or the business of each of them.

For purposes of s75 of the 2008 Act (dealing with personal financial interests), when used in reference to a director, 'related person' has the meaning set out above, but also includes a second company of which the director or a related person is also a director, or a close corporation of which the director or a related person is a member.

3.2.3 '**Control**' is determined in terms of s2(2) of the 2008 Act.

With regard to 'prescribed officers', the following observations may be made:

3.3.1 it is interesting to note that the initial draft of the Regulations which were published by the Department of Trade and Industry for comment in 2010, listed categories of persons who were deemed to be prescribed officers, but in any event there was still a 'catch-all' provision therein (which was substantially similar to the current definition in regulation 38) which was intended to capture those persons who did not fall within the listed categories yet nevertheless exercised significant influence over the management and administration of the whole or a significant portion of the business and activities of the company. The final Regulations, however, do not contain such a list, and it is now therefore a purely factual test as set out in 3.2.1 above; and

3.3.2 the list contained in the initial draft may, at best, be resorted to as a rough guide indicating who the lawmaker regarded as prescribed officers within a company, although that notion in itself may be debatable. The specific persons listed were as follows:

- 3.3.2.1 a person who has general executive authority over the company (such as a President, Chief Executive Officer, Managing Director, Executive Director or similar office holder) by whatever title the office is designated;
- 3.3.2.2 a person who has general responsibility for the financial management of the company (such as a Treasurer, Chief Financial Officer, Chief Accounting Officer, or similar office holder) by whatever title the office is designated;
- 3.3.2.3 a person who has general responsibility for the legal affairs of the company (such as a General Secretary, General Counsel or similar office holder) by whatever title the office is designated; and
- 3.3.2.4 a person who has general managerial authority over the operations of the company (such as a Chief Operating Officer or similar office holder) by whatever title the office is designated.

3.4 Apart from what is stated above, there are as at the date hereof no other guidelines made available by the Regulations or any practice notes. Indeed, it would probably be very difficult for the relevant authorities to prescribe any guidelines in this regard as companies are structured and organised in a variety of ways, particularly in terms of tiers of governance and reporting structures.

3.5 It is interesting to note that the term 'manager' under the 1973 Act was a concept not very different in substance to that of a prescribed officer under the 2008 Act. A manager was defined in the 1973 Act as 'any person who is a principal executive officer of the company for the time being, by whatever name he may be designated and whether or not he is a director.' Case-law under the 1973 Act held that a manager in the ordinary sense is someone who, either alone or with others, is vested, in whole or in part, with the control and administration of the affairs of the company. Managers were those persons 'who are in a position of real authority, the decision-makers within the company who have the power and the responsibility to decide corporate policy and strategy'.

3.6 One should also bear in mind that the Regulations now specifically contemplate persons who are in charge of 'significant portions' of a company's business, and not only those who are in charge of, or have a significant influence in respect of, the company as a whole. The concept of prescribed officer is a more expansive and refined one than that of 'manager' under the 1973 Act.

## A COMMON QUERY:

### Are company secretaries 'prescribed officers'?

This essentially depends on the facts of each case and may vary from company to company.

As emphasised earlier, there is no specific list set out in the 2008 Act or the Regulations stating which categories of officers would be prescribed officers. Some commentators make reference to the (fairly extensive) statutory duties of a company secretary which are set out in s88 of the 2008 Act and argue that a company secretary is indeed, and necessarily, a prescribed officer. However, when one looks at the duties in question, it is debatable whether these alone are sufficient to label a company secretary a prescribed officer.

In Australian law, the concept of 'officer' contained in their Corporations Act has often had to be interpreted by the courts of Australia. Its statutory definition is very similar to that of a prescribed officer under the 2008 Act. In the Australian case of *Shafron v Australian Securities and Investments Commission* (2012), the High Court of Australia remarked as follows in relation to the position of 'General Counsel and Company Secretary' that was held by a particular officer within the company (Mr Shafron):

*"The expression 'company secretary' is not a term of art. The responsibilities of company secretaries can vary from company to company, within companies, and over time. They have tended gradually to wax over many decades. From Mr Shafron's behaviour in practice, it may be inferred that his responsibilities were much more than mere administrative duties. He advised the board on substantive matters, particularly in respect of James Hardie Industries Ltd's exposure to asbestos litigation. He was one of its three most senior executives."*

## ULTIMATE RESPONSIBILITY FOR MANAGEMENT (SECTION 66)

- Do I know and am I correctly applying:
  - the business judgment and the reliance rule
  - codified and common law directors' duties
  - my delegated functions and responsibilities
  - King IV
- the limitations to my powers I must take special care when dealing with:
  - intersections between my own and the company's financial interests
  - granting of financial assistance by the company to certain connected persons and entities
- Am I a board committee member?

4.1 The 2008 Act expressly spells out the management role and authority of directors in that it stipulates in s66(1) that *"The business and affairs of a company must be managed by or under the direction of its board, which has the authority to exercise all of the powers and perform any of the functions of the company, except to the extent that this Act or the company's memorandum of incorporation provides otherwise."* The effect of s66(1) is that where a board does not directly manage the business of the company (ie is not an operational board), and has delegated the day to day management to full time directors and other officers, the board is nevertheless still ultimately accountable for the conduct of the business of the company.

- 4.2 Therefore, unless limited in some way by the 2008 Act or the company's MOI, the company must be run by or under the direction of its board, and the board has all the authorities and powers to do so. This was always typically the case because a company's articles of association would invariably have vested this power in the board – it is now a statutory duty and function of the board under the 2008 Act.
- 4.3 Directors' duties are primarily categorised under s75 and s76, which respectively deal with a director's personal financial interests and the prescribed standard with which a director's conduct is required to comply.
- 4.4 The personal liability of directors is dealt with in s77 and s218(2). There are however other sections which indirectly have implications for director liability; this document touches on those provisions where appropriate.





## THE BUSINESS JUDGEMENT RULE

5.1 Before embarking on a discussion of directors' duties and personal liability under the 2008 Act, which at times may appear to be quite daunting, a brief overview of the so-called 'business judgement rule' is necessary (at least to address some fears, at the outset, that have been expressed in the market that the onerous nature of these duties and liabilities may stifle decision-making and risk-taking by directors). This rule is essentially a deeming provision which states that a director shall be deemed to have fulfilled certain of his duties if he complied with a number of requirements set out in s76(4) of the 2008 Act. The 2008 Act has adopted the statutory business judgement rule from jurisdictions such as the US, however courts in South Africa had already developed a similar rule prior to the 2008 Act (now that the rule is codified in legislation, it may arguably be more accessible and certain, as is the case with directors' duties and responsibilities). The purpose of the rule is, essentially, to ensure that decision-making and measured risk-taking in a business enterprise are not stifled or paralysed by the spectre of personal liability.

- 5.2 Recent case-law has also indicated that if the board can demonstrate that it acted in accordance with the business judgement rule, it greatly minimizes the possibility of a shareholder successfully claiming under the oppression remedy in s163 of the 2008 Act (see *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd* (2014)).
- 5.3 The business judgement rule provides that a director acted in the best interests of company, and with the requisite degree of care, skill and diligence in respect of a particular matter if that director:
- 5.3.1 took reasonably diligent steps to become informed about that matter;
  - 5.3.2 had no material personal financial interest in that matter or, if he did, followed the requisite disclosure and recusal provisions contained in s75 of the 2008 Act (which we discuss in the following section); and
  - 5.3.3 had a rational basis for believing and did believe, the decision to be in best interests of company.
- 5.4 The purpose of the business judgement rule is to prevent directors being held liable, with the benefit of hindsight, for honest errors of judgement.

- 5.5 The business judgement rule is supplemented with the 'reliance rule', in s76(4)(b) and (5) of the 2008 Act. The reliance rule provides that, in exercising his functions as such, a director is entitled to rely on others (such as employees, committees or advisors of the company) reporting to him, as well as opinions and information provided to him.
- 5.6 In basic terms, reliance is well founded if the director reasonably believed that the persons advising or reporting to him merit confidence. This rule is of course necessary and pragmatic because in certain companies, especially large organisations, it simply cannot be expected of every director to be constantly involved in every aspect of the management of the company. However, the age-old adage that a director may 'delegate' but not 'abdicate' is as important as ever. The 2008 Act specifically refers to this concept in, for instance, s72(3) which provides that the creation of a committee by the board (which may be tasked with implementation and oversight of any aspect), delegation of any power to a committee, or action taken by a committee, does not alone satisfy or constitute compliance by a director with the required duty of a director to the company.
- 5.7 A delegation, and its extent, is a function of the board's powers and will in itself be judged against the directors' fiduciary duties and duty of care, skill and diligence.

## DIRECTORS' PERSONAL FINANCIAL INTERESTS (SECTION 75)

- Disclosure
- Before meeting
- Before a matter is considered
- Conduct at meeting
- Subsequent acquisition of personal interest
- Exceptions
- Approval by board or shareholders

- 6.1 Section 75 is certainly one of the most significant sections of the 2008 Act. Any director, prescribed officer or committee member of a company would be well advised to carefully consider this section and to seek professional advice thereon in any particular circumstances, if needs be. This of course applies to any of the duties in the 2008 Act, but s75 is particularly intricate in some parts.
- 6.2 Because of the intricacy of s75, this part deals with s75 on a fairly high-level with a view to setting out the essentials of that section.
- 6.3 Section 75 deals with those situations in which a director (again, in the wide sense as described in paragraph 3.1.3 above) must disclose his personal financial interests, as well as those of related parties, in any matter to be considered by the board of the company. The director must then recuse himself from the decision and he may not vote on that matter.
- 6.4 Some preliminary points ought to be made:
- 6.4.1 The requirement for directors and other officers of the company to disclose personal interests is not new. Similar provisions were contained in the 1973 Act.

- 6.4.2 However, what is important is that the 2008 Act has made almost every aspect of the disclosure provisions more stringent. The consequences of non-compliance with these provisions are also more severe than would have been the case previously.
- 6.4.3 This is how the 2008 Act is more stringent in this regard:
- 6.4.3.1 all direct, material personal financial interests of directors must now be disclosed in respect of any matter considered by the board of the company, whether or not the matter is significant to the company. Previously, disclosure was only required where there was a personal interest in a 'contract of significance' in relation to the business of the company. The focus in s75 is on the materiality of the matter to the director or his related persons, rather than to the company. (In one sense the 2008 Act may be narrower than the 1973 Act as the former refers only to 'financial interests' and the latter to any 'interests', but in practice it is more often than not financial interests which are of concern);
- 6.4.3.2 a director must also disclose interests of parties related to that director. Previously, 'indirect' interests were covered but that criterion was vague, and would not necessarily have covered interests held by relatives, or of companies in which relatives have an interest or directorship, which s75 now covers. Director's duties are expanded to apply not only where a director has an interest in a matter, but also where a director knows, or ought to have known after reasonable enquiry, that a related person to the director has an interest in a matter. As

a result, directors are required to consider the interests of a potentially wide range of persons and entities connected to them, including any other companies of which the relevant persons are also directors (for purposes of s75, 'related person' includes a second company of which the director or a related party is a director, irrespective of whether or not the director controls that second company or has any economic or proprietary interest therein);

- 6.4.3.3 the duties in s75 apply not only to directors, but also to prescribed officers and committee members, in an unqualified manner. Therefore, reference to 'directors' in respect of the s75 duties must be read as including all these relevant persons. Under the 1973 Act, officers other than directors were hit by the disclosure provisions only if they were the ones to execute the contract on behalf of the company;
- 6.4.3.4 critically, s75 now provides for disclosure and recusal from the meeting. A problematic 'gap' under the previous law was that although the director had to disclose his personal interest, he could still deliberate and vote on the matter if the MOI (then still referred to as the 'memorandum and articles of association') of the company permitted him to do so (and this was quite a common clause found in articles of companies). This raised serious questions as to whether such a director could, in all honesty, exercise an unfettered discretion in the best interests of the company. Now, a director must disclose and recuse, irrespective of what is stated in the company's MOI; and

6.4.3.5 perhaps even more critically, failure to comply with the steps in s75 leads to voidness (ie invalidity) not only of the board resolution, but also of the ensuing transaction, unless the shareholders ratify it or an application is successfully made to court to validate the resolution and the transaction. This may not be a problem if there are only a handful of shareholders in a closely-held private company that are happy to ratify (and can do so swiftly), but it would be a major and expensive problem in the context of, say, a listed company with thousands of shareholders.

## 6.5 Disclosure

### 6.5.1 Disclosure before a meeting

A director may disclose any personal financial interest in advance, by delivering to the board, or to the shareholders (in the case of a company which has only one director), a written notice setting out the nature and extent of that interest, to be used generally for the purposes of s75 until changed or withdrawn by further written notice from that director.

#### Note:

An up-front, general disclosure of interests is not in itself enough.

A director must also recuse himself from a board meeting at which a matter is to be considered in which the director, or any person related to that director, has a personal financial interest.

A common query is: What if the director honestly did not know that a person related to him had a personal financial interest in the matter, and this is why the director failed to comply with s75? After all, one does not necessarily know where all one's related persons hold shares and directorships.

In this regard, it should be noted that insofar as interests of related persons are concerned, s75 provides that a director must disclose (and recuse) where he knows that a related person has a personal financial interest in the matter. However, in terms of the 2008 Act, the words 'knows', 'knowing' or 'knowingly' are defined terms and include not only actual, subjective knowledge, but also capture situations where a director ought reasonably to have known about the issue after due enquiry.

## 6.5.2 Disclosure before matter is considered

If a director of a company has a personal financial interest in respect of a matter to be considered at a meeting of the board, or knows (see the note above as to what the word 'knows' means in the 2008 Act) that a related person has a personal financial interest in the matter, the director:

- 6.5.2.1 must disclose the interest and its general nature before the matter is considered at the meeting;
- 6.5.2.2 must disclose to the meeting any material information relating to the matter, and known to the director; and
- 6.5.2.3 may disclose any observations or pertinent insights relating to the matter if requested to do so by the other directors.

## 6.6 Conduct at meeting where s75 applies

6.6.1 If a director, who has a personal financial interest is present at the meeting, he must:

- 6.6.1.1 leave the meeting immediately after making any disclosure contemplated above;
- 6.6.1.2 not take part in the consideration of the matter, except to the extent contemplated in paragraphs 6.5.2.2 and 6.5.2.3 above.

6.6.2 Such director, while absent from the meeting, is to be regarded as being present at the meeting for the purpose of determining whether sufficient directors are present to constitute the meeting, and is not to be regarded as being present at the meeting for the purpose of determining whether a resolution has sufficient support to be adopted. Therefore, the company still has a valid quorum and may still pass valid resolutions despite his absence.

6.6.3 Such director must also not execute any document on behalf of the company in relation to the matter unless specifically requested or directed to do so by the board. Practically, the authorising resolution of the board should preferably include a specific reference to that director by name as the authorised agent and signatory for the company.

#### 6.7 Subsequent acquisition of interest

If a director of a company acquires a personal financial interest in an agreement or other matter in which the company has a material interest, or knows that a related person has acquired a personal financial interest in the matter, after the agreement or other matter has been approved by the company, the director must promptly disclose to the board, or to the shareholders in the case of a company with only one director, the nature and extent of that interest, and the material circumstances relating to the director or related person's acquisition of that interest.

#### 6.8 Exceptions

The above provisions do not apply if the decision in question affects all of the directors of the company in their capacity as directors, or a class

of persons (unless the only members of that class of persons are the directors or persons related or inter-related to them) or where there is only one director and one person holds all of the beneficial interests of all of the issued securities of the company. For example, if the director is also a shareholder and stands to benefit from a dividend contemplated to be declared by the company, s75's application may be excluded (and therefore he is allowed to participate in the board meeting) if it can be said that a whole class of persons (ie all the shareholders of the company) stand to benefit equally, and not just the director in question.

#### Question:

- There can conceivably be scenarios where all the directors of the board are prevented by s75 from voting on a matter (and the exceptions in s75 do not apply). What must the company then do in order to properly authorise the matter?
- Section 75 does not specifically deal with this possibility, but it does provide that where one is a sole director (but not the sole shareholder) and one is conflicted in terms of s75, the matter must be approved by the shareholders of the company by ordinary resolution (see below). The same principles should arguably apply where there is more than one director and they are all conflicted in terms of s75, ie the matter must be voted on and approved by the shareholders. After all, s75 is for the benefit of the shareholders of the company and it is there to ensure that directors act in a non-conflicted manner in the best interests of the general body of shareholders.

#### 6.9 Approval by board

A decision by the board, or a transaction or agreement approved by the board, is valid despite any personal financial interest of a director, only if:

- 6.9.1 it was approved following disclosure of that interest in the manner contemplated in s75; or
- 6.9.2 despite having been approved without disclosure of that interest, it has subsequently been:
  - 6.9.2.1 ratified by an ordinary resolution of the shareholders following disclosure of that interest; or
  - 6.9.2.2 has been declared to be valid by a court.



## STANDARDS OF DIRECTORS' CONDUCT (SECTION 76)

- 7.1 Directors, prescribed officers and members of board committees and audit committees of companies would be well advised to read s76 of the 2008 Act, as this contains their core, overarching duties and responsibilities under company law.
- 7.2 Many of the common law duties and liabilities of directors have now been codified in s76 of the 2008 Act. However, not all common law duties of directors have been codified by the 2008 Act, and to this extent they are still alive and well. As the focus of this document is on directors' duties and responsibilities under the 2008 Act, we do not delve into the common law duties in any detail.

- 7.3 Section 76 provides that a director must not
- 7.3.1 use his position of director or any information obtained whilst acting in his capacity as director to gain an advantage for himself or any another person other than the company or a wholly-owned subsidiary of the company. This obligation speaks to two important aspects of directors' duties:
- 7.3.1 the 'no secret profit' and 'corporate opportunity' rules, which state that a director may not appropriate business opportunities and benefits of the company for his personal benefit, as these arose out of his position as director and, therefore, he is deemed to have acquired these as agent and fiduciary for the company; and
- 7.3.2 confidentiality in respect of board proceedings. The information and deliberations in the board process often encompass information which is highly confidential to the company and may harm its interests if divulged without authority. Such information may only be used for the benefit of the company or a wholly-owned subsidiary.
- 7.4 A director may also not knowingly cause harm to the company or its subsidiary.
- 7.5 A director must inform the board at the earliest practicable opportunity of any information of which he is aware, unless the director:
- 7.5.1 reasonably believes the information is immaterial to the company or generally available to the public or is known to other directors; or
- 7.5.2 is bound not to disclose such information by a legal or ethical obligation of confidentiality.

### Example:

- Any corporate opportunity or information within the line of business of the company must be communicated by the director to the board. An exception in s76 is where there is a legal obligation on the director not to disclose that information.
- An example of this is where a director of a company happens to come across inside information (as contemplated in the Financial Market Act) in respect of listed securities of another company (and the director knows such information is inside information), he would be committing an offence if he disclosed that inside information to a third party, such as co-directors of the first company. He is, in terms of the Financial Market Act, prohibited (subject to certain narrow exceptions) from disclosing inside information even though such information may be of use to his company (because, for instance, the second company is a competitor).
- The only defence to this offence is if he can demonstrate that it was necessary to make the disclosure in the course of his employment or profession, and the disclosure was made in circumstances unrelated to any dealing in securities.
- What exactly is contemplated by 'ethical' obligations of confidentiality in s76 has yet to be interpreted by the courts. Presumably professional ethics are envisaged here. The problem however is that ethics is a rather subjective topic, so it will be very interesting to see how courts deal with this aspect on a case-by-case basis.

7.6 A director of a company, when acting in that capacity, must exercise the powers and perform the functions of director:

7.6.1 in good faith and for a proper purpose. A 'proper purpose' means that the powers given to directors must be exercised for the purpose for which they were granted. Many of the cases which dealt with this duty under the common law concerned the power of directors to issue fresh shares of the company – such power must not be used for an ulterior motive such as entrenching control of the company or thwarting bona fide takeover offers;

7.6.2 in the best interests of the company. ('Company', in this context, is understood to mean the shareholders of the company as a whole.) Linked to this duty is the common law duty to exercise an unfettered discretion. In this regard, in practice the question often arises as to whether decisions of previous boards are binding on a 'new board' of the company. The new board is obliged to act in the best interests of the company and with an unfettered discretion – if it believes that policies and decisions adopted by the previous board are no longer in the best interests of the company, steps must be taken to reconsider the issue. Of course, if the previous decisions were acted on by the company and it subsequently entered into binding agreements, the company cannot now set aside that contract with a third party. If, however, the previous board's decision has not as yet resulted in the company being bound to third parties, there is nothing preventing a new board from reversing those decisions and adopting a new course of action; and

7.6.3 with the degree of care, skill and diligence that may reasonably be expected of a person:

7.6.3.1 carrying out the same functions in relation to the company as those carried out by that director; and

7.6.3.2 having the general knowledge, skill and experience of that director.

### What role does king iv play in the context of directors' duties under the 2008 act?

It is also worth mentioning that there is a growing trend in South African case-law to refer to the principles outlined in the King Report on Governance for South Africa, 2016 ('King IV') and its predecessors King II (2002) and King III (2009), as a yardstick against which directors' conduct and diligence is measured. Accordingly, it may be safely stated that there is a growing expectation (although not fully crystallised in law as yet) that all directors, including independent non-executive directors, especially those of large companies, acquaint themselves with King IV and ensure that they understand what is expected of them under King IV.

The case of *Minister of Water Affairs and Forestry v Stilfontein Gold Mining Co Ltd* (2006) concerned a mining company where all the directors resigned en masse in light of various environmental legal problems that hit the company. The judge referred to King II and noted that the directors' conduct in so resigning did not match up to what is expected by King II.

In the context of state-owned companies, the case of *SABC v Mpofu* (2009) had this to say:

*"The King Report on Corporate Governance for South Africa 2002 deals with public sector enterprises. The first appellant is a public company and is a public sector enterprise as defined in terms of the Public Finance Management Act No 1 of 1999. Companies and their Boards are required to measure up to the principles set out in the Code. King recommends that public enterprise should try and apply the appropriate principles set out in the Code. The Code sets out principles and does not determine detailed conduct. The conduct of public enterprises must be measured against the relevant principles of the Code and must adhere to best practices."*

This was echoed by the high court in *OUTA and Others v Myeni* (2020).

## LIMITATIONS ON DIRECTORS' POWERS (SECTIONS 65 AND 66)

- 8.1 As discussed earlier, in terms of s66(1) of the 2008 Act, the business and affairs of a company must be managed by or under the direction of its board, which has the authority to exercise all of the powers and perform any of the functions of the company, except to the extent that the 2008 Act or the company's MOI provides otherwise. The board's obligation to manage, or direct the management of, the company's business and affairs is now a statutory requirement. Previously, the board obtained its powers in this regard from the company's constitution – it was, in that sense, 'delegated' authority from the shareholders. It is now coupled with statutory force.
- 8.2 As is noted from the proviso at the end of s66(1), the 2008 Act provides for flexibility in the overall management structure, hierarchy and division of powers within a company (this was always the case under the common law – the principle is now codified). Whereas typically the board manages (or exercises control over management of) all aspects of the business and affairs of a company, with shareholder approval being required only in cases of fundamental matters pertaining to the existence and structure of the company, the proviso in s66(1) allows this default position to be moulded and customised for each company's particular requirements. In closely held private companies, for instance, the shareholders often wish to limit or retain certain managerial powers which would ordinarily have vested in the board, and thus the MOI of such a company can accordingly provide that the exercise of certain managerial functions will not be within the board's domain but must be decided on by the shareholders, for example borrowings or capital expenditure above certain thresholds.
- 8.3 As was the case under the 1973 Act, in numerous instances in the 2008 Act there are limitations on the powers of directors in that shareholder approval is required in order for a company to conclude certain transactions or engage in certain corporate actions.
- 8.4 Section 65(11) of the 2008 Act sets out instances in which a special resolution of shareholders is required for certain matters (this means approval by an enhanced majority of shareholders – generally 75%, but now capable of adjustment in the MOI). A special resolution is required to:
- 8.4.1 amend the company's MOI to the extent required by s16(1)(c) and s36(2)(a);
  - 8.4.2 ratify a consolidated revision of a company's MOI, as contemplated in s18(1)(b);
  - 8.4.3 ratify actions by the company or directors in excess of their authority (as a result of the company's capacity being restricted), as contemplated in s20(2);
  - 8.4.4 approve an issue of shares or grant of rights in the circumstances contemplated in s41(1);
  - 8.4.5 approve an issue of shares or securities as contemplated in s41(3);
  - 8.4.6 authorise the board to grant financial assistance in the circumstances contemplated in s44(3)(a)(ii) or 45(3)(a)(ii);
  - 8.4.7 approve a decision of the board for re-acquisition of shares in the circumstances contemplated in s48(8);
  - 8.4.8 authorise the basis for compensation to directors of a profit company, as required by s66(9);
  - 8.4.9 approve the voluntary winding up of the company, as contemplated in s80(1);
  - 8.4.10 approve the winding up of a company in the circumstances contemplated in s81(1);
  - 8.4.11 approve an application to transfer the registration of the company to a foreign jurisdiction as contemplated in s82(5); or
  - 8.4.12 approve any proposed fundamental transaction, to the extent required by Part A of Chapter 5.
- 8.5 Ordinary resolutions of shareholders are required to appoint auditors and audit committee members (s90 and 94).
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## REMOVAL OF DIRECTORS (SECTION 71)

### What happens if i don't get it right?

- When can I be removed as a director?
- Can I acquire personal liability?
- Can I be declared a delinquent/under probation director?
- Business rescue aspects

9.1 Section 71 of the 2008 Act provides that a director may be removed in one of three ways: by way of an ordinary shareholders resolution, a board resolution (at a board meeting) or by the Companies Tribunal. In comparison, s220 of the 1973 Act only provided for removal by way of an ordinary shareholders resolution.

9.2 In the case of removal by the board or by the Companies Tribunal the procedure to be followed depends on the number of directors on the board. In the case of three or more directors, a board resolution will suffice, whereas in the case of two or less directors, the Companies Tribunal must determine the removal of the director on application by a shareholder or director.

9.3 Section 71(3) allows any shareholder (or any director, for that matter – the remedy is not limited to shareholders) of a company, regardless of the size of his shareholding or influence in the company, to allege that a particular director is disqualified or ineligible to be a director, or has become incapacitated and will not regain capacity within a reasonable time, or has been negligent or derelict in carrying out his functions as a director. An allegation made at an annual general meeting, for instance, would presumably suffice. The board must then call a meeting of directors to determine the matter. Interesting to note is that there is no specific protection in s71 against vexatious or frivolous allegations made by the shareholder – the board must, regardless of the merit in the shareholder's allegation, still at the very least convene a meeting to determine the matter. Presumably, however, there may always be recourse to courts if it can be shown that there is abuse of process by a shareholder.

9.4 The beleaguered director is given an opportunity to make representations at the board meeting, and if he is removed he will be entitled to recourse to the court to review the determination to remove him. Conversely, should the director not be removed by the board, the directors who voted in favour of the removal of the director in question, or the aggrieved shareholder who initially laid the complaint, will likewise have recourse to the court.

9.5 Companies will probably find it very difficult, if possible at all, to minimise the effect of this by way of the MOI, as it is an unalterable provision of the 2008 Act. Agreements amongst directors to vote in a particular way are notoriously difficult to enforce due to the fundamental duty in law on directors to exercise an unfettered discretion. Attempts to reach agreement amongst shareholders not to make allegations under s71(3) could prove to be futile in light of the new anti-avoidance mechanisms in s6 of the 2008 Act. The mechanism in s71(3) addresses serious issues relating to shareholder protection, and one would be hard pressed to argue that a shareholder can waive his right to allege that a director is, for instance, disqualified in law due to being convicted of an offence involving dishonesty.

9.6 Shareholders, however, need not have a reason in order to remove a director using S71(1), which provides that "*Despite anything to the contrary in a company's Memorandum of Incorporation or rules, or any agreement between a company and a director, or between any shareholders and a director*", a director may be removed by an ordinary shareholders resolution after the director has been given the opportunity to make representations. It was held in *Amoils v Fuel Transport (Pty) Ltd* (1978), that shareholders are bound to vote in a manner agreed in a shareholders agreement. The 2008 Act still presents the possibility of a shareholders agreement validly binding shareholders not to vote in favour of the removal of certain directors.



## LIABILITY OF DIRECTORS AND PRESCRIBED OFFICERS TO THE COMPANY (SECTION 77)

### 10.1 When Directors may be held liable:

10.1.1 Directors may, under s77, be held liable for any loss, damages or costs sustained by the company, in the following instances:

10.1.1.1 in accordance with the common law principles relating to breach of fiduciary duties, as a consequence of any breach by the director of the fiduciary duties as contained in the provisions of s75 (personal financial interests) and 76 (standards of conduct); or

10.1.1.2 in accordance with the common law principles relating to delict, as a consequence of any breach by the director of his duty of care, skill and diligence as contained in s76 (standards of conduct) or of any provisions of the 2008 Act or the company's MOI. Delict is similar to the law of torts which one encounters in other jurisdictions and deals with claims for civil damages as a result of negligence.

10.1.2 Section 77(3) in addition sets out statutory grounds on which a director may be held personally liable to the company for any loss or damage suffered by the company from the exercise of his or her functions as director, which grounds include:

10.1.2.1 acting in the name of the company, signing anything on behalf of the company or purporting to bind the company or authorising the taking of any action by or on behalf of the company despite knowing that he or she lacked authority;

10.1.2.2 acquiescing in the company's carrying on of its business in circumstances prohibited by s22 of the 2008 Act. Section 22 refers to trading recklessly, with gross negligence or the intent to defraud or for fraudulent purposes. Section 22 also provides that the Companies and Intellectual Property Commission can direct a company to cease trading if it is unable to pay its debts as and when they become due and payable in the normal course of business i.e. under commercially insolvent circumstances. If the company nevertheless continues to trade under such circumstances, it is in contravention of s22;

10.1.2.3 being party to an act or omission by the company despite knowing that it was calculated to defraud creditors, employees or shareholders of the company, or had a fraudulent purpose;

10.1.2.4 signing, consenting or authorising the publication of materially false financial statements or a prospectus or written statement for the public offer of shares that contains an untrue statement or a statement to the effect that a person had consented to be a director of the company, when no such consent had been given despite knowing that the statement was false, misleading or untrue, as the case may be, but the provisions of s104(3) apply to limit the liability of a director in these instances; or

10.1.2.5 being at a meeting and failing to vote against certain corporate finance/corporate capital decisions of the company despite knowing that such transactions were unauthorised. In most instances these types of transactions require shareholder approval or compliance with the solvency and liquidity test and fairness and reasonableness, or a combination of these. The type of transactions envisaged in s77(3) are:

10.1.2.5.1 issuing of unauthorised shares or securities;

10.1.2.5.2 granting options despite knowing that the shares or securities are unauthorised;

10.1.2.5.3 providing financial assistance either to a director or for the acquisition of securities despite knowing that this is inconsistent with the 2008 Act or the company's MOI;

10.1.2.5.4 approving an unauthorised distribution;

10.1.2.5.5 the company acquiring its own shares or shares of the company contrary to the 2008 Act or the company's MOI; or

10.1.2.5.6 any unauthorised allotment of shares by the company in contravention of the public offering provisions in Chapter 4 of the 2008 Act.

### For example:

In terms of s44 of the 2008 Act, a company requires, *inter alia*, the approval of its shareholders by special resolution before it may provide financial assistance to any person for purposes of the acquisition of its own shares. Failure to comply with s44 renders the provision of that financial assistance void, meaning that the contract in terms of which the financial assistance is given (for instance, a loan agreement) is not legally valid or enforceable.

This effectively means that the company cannot enforce the loan that it provided to the third party to acquire the company's shares. It may at best have to claim under unjustified enrichment, which can sometimes be a very difficult cause of action and may result in the company recovering less than what it could have under the contract of loan.

If a director knows, or ought to have known, that the company was not in compliance with s44 because, for instance, the company did not obtain a special resolution of its shareholders, approving the financial assistance, and that director failed to vote against the resolution, that director may find himself being liable to the company for the loss it has suffered, and costs incurred, as a result of being unable to recover the funds (or a portion thereof) and interest that it had disbursed in terms of the aforementioned loan contract.

## 10.2 Solvency and liquidity test (s4 of the 2008 Act)

10.2.1 The 'solvency and liquidity test' features quite prominently in the 2008 Act.

10.2.2 The test is not a test which the Companies Act requires a company to generally satisfy at all times – it is applied when a company proposes implementing certain corporate actions (distributions, share repurchases), providing financial assistance under certain circumstances (under s44 and/or 45 of the 2008 Act) or implementing a merger and amalgamation transaction under s113 of the 2008 Act.

10.2.3 The solvency and liquidity test is contained in s4 of the 2008 Act. It reads as follows:

- (1) For any purpose of this Act, a company satisfies the solvency and liquidity test at a particular time if, considering all reasonably foreseeable financial circumstances of the company at that time:
  - (a) the assets of the company, as fairly valued, equal or exceed the liabilities of the company, as fairly valued; and
  - (b) it appears that the company will be able to pay its debts as they become due in the ordinary course of business for a period of:
    - (i) 12 months after the date on which the test is considered; or
    - (ii) In the case of a distribution contemplated in paragraph (a) of the definition of 'distribution' in s1, 12 months following that distribution.

(2) For the purpose contemplated in subsection (1):

- (a) any financial information to be considered concerning the company must be based on:
  - (i) accounting records that satisfy the requirements of s28; and
  - (ii) financial statements that satisfy the requirements of s29;
- (b) subject to paragraph (c), the board or any other person applying the solvency and liquidity test to a company:
  - (i) must consider a fair valuation of the company's assets and liabilities, including any reasonably foreseeable contingent assets and liabilities, irrespective of whether or not arising as a result of the proposed distribution, or otherwise; and
  - (ii) may consider any other valuation of the company's assets and liabilities that is reasonable in the circumstances; and

(c) unless the Memorandum of Incorporation of the company provides otherwise, when applying the test in respect of a distribution contemplated in paragraph (a) of the definition of 'distribution' in s1, a person is not to include as a liability any amount that would be required, if the company were to be liquidated at the time of the distribution, to satisfy the preferential rights upon liquidation of shareholders whose preferential rights upon liquidation are superior to the preferential rights upon liquidation of those receiving the distribution.

10.3 The solvency and liquidity test becomes particularly pertinent when a company happens to go into winding up proceedings or business rescue under Chapter 6 of the 2008 Act. It is then that the liquidator or business rescue practitioner of the company, as the case may be, has the opportunity to set aside any irregular dispositions or disbursements that were made by the company prior to going into winding up or business rescue, and in many instances he will investigate whether certain distributions, financial assistance and similar corporate actions or transactions made by the company complied with the solvency and liquidity test.

## 10.4 Absolution by a Court from liability

- 10.4.1 Section 77 of the 2008 Act contains provisions similar to s248 of the 1973 Act in that in any proceedings against a director, other than for wilful misconduct or wilful breach of trust, the court may relieve a director from any liability if it appears to the court that:
- 10.4.1.1 the director is or may be liable, but has acted honestly and reasonably; or
  - 10.4.1.2 having regard to all the circumstances of the case, including those connected with the appointment of the director, it would be fair to excuse the director.
- 10.4.2 A director who has reason to apprehend that a claim may be made alleging that the director is liable, other than for wilful misconduct or wilful breach of trust, may apply to a court 'pre-emptively' for relief, and the court may grant relief to the director on the same grounds as if the matter had come before the court in terms of paragraph 10.4.1 above.
- 10.5 Claims under s77 must be brought within three years of the act or omission giving rise to liability.
- 10.6 Another important aspect to bear in mind with regard to s77 is that it creates so-called 'joint and several' liability of directors where there is more than one wrongdoer, ie where for instance two or three directors breached their duties which resulted in the same loss. Joint and several liability means that the company can sue any one director and recover the full amount of the loss or damages from him, and that director will then have to claim a contribution from his co-wrongdoers. Joint and several liability is not the norm in the law of damages; therefore, the regime created in s77 is quite exceptional in this regard.

## OTHER PROVISIONS IN THE ACT WHERE A DIRECTOR MAY BE HELD LIABLE (SECTIONS 19 AND 40)

### 11.1 Personal liability companies (S19)

- 11.1.1 Section 19 of the 2008 Act codifies the fundamental consequence of the separate legal personality of a company: a person is not, solely by reason of being a director of a company, liable for any liabilities or obligations of the company, except to the extent that the 2008 Act or the company's MOI provides otherwise.
- 11.1.2 However, if a company is a personal liability company (these are companies whose names end with the suffix 'Incorporated' or 'Inc.', and are used primarily by professional firms such as attorneys), the directors and past directors of the company are jointly and severally liable, together with the company, for any debts and liabilities of the company as are or were contracted during their respective periods of office.
- 11.1.3 The recent case of *Dracotas v Van Der Elst and Others* (2015) confirmed that it is no defence to the directors that they did not know of the contract that was concluded or that the debts and liabilities were incurred outside of the company's normal course of business.

### 11.2 Consideration for shares (S40)

- 11.2.1 In terms of s40, the board of directors must determine the consideration for and the terms on which shares will be issued. The board's determination as to the adequacy of consideration for any shares cannot be challenged, other than on the basis that there has been a breach of fiduciary duties or the duty of care, skill and diligence (s76 as read with the personal liability provisions of s77(2)).



11.2.2 What 'adequate' consideration is, is not stated by the 2008 Act. It only goes so far as to give a definition for 'consideration', which means 'anything of value given and accepted in exchange for any property, service, act, omission or forbearance or any other thing of value, including:

11.2.2.1 any money, property, negotiable instrument, securities, investment credit facility, token or ticket;

11.2.2.2 any labour, barter or similar exchange of one thing for another; or

11.2.2.3 any other thing, undertaking, promise, agreement or assurance, irrespective of its apparent or intrinsic value, or whether it is transferred directly or indirectly'.

11.2.2.4 The concept of 'adequate consideration' was essentially imported from the US corporate law, and there is much case law and literature in that jurisdiction on this subject. Ultimately, it is a commercial, business judgement to be taken by the board.

### 11.3 Veil piercing (s20(9))

11.3.1 Under s20(9), a court may pierce the corporate veil if there has been abuse or fraud in the use of a company. In such cases, a court may hold a director or shareholder personally liable (ie the court ignores the separate legal personality of the company).

11.3.2 Case-law under the 2008 Act has confirmed that now that the remedy has been codified it is no longer a 'remedy of last resort' as was the case under the common law predating the 2008 Act (Ex Parte: Gore NO and Others (2013)).

## PERSONAL LIABILITY FOR DEBTS OF THE COMPANY IF THERE WAS RECKLESS OR FRAUDULENT TRADING (SECTION 424 OF THE 1973 ACT)

12.1 Section 424 of the 1973 Act provides as follows:

*"When it appears, whether it be in a winding-up, judicial management or otherwise, that any business of the company was or is being carried on recklessly or with intent to defraud creditors of the company or creditors of any other person or for any fraudulent purpose, the Court may, on the application of the Master, the liquidator, the judicial manager, any creditor or member or contributory of the company, declare that any person who was knowingly a party to the carrying on of the business in the manner aforesaid, shall be personally responsible, without any limitation of liability, for all or any of the debts or other liabilities of the company as the Court may direct."*

12.2 Section 424 will only apply if and when the company is placed in liquidation, because the transitional arrangements contained in Schedule 5 to the 2008 Act provide that Chapter 14 of the 1973 Act (in which chapter s424 is located) only applies in the context of the liquidation and winding up of companies. Therefore, if a creditor of the company were to successfully apply to Court for the liquidation of the company, s424 would come into play. It is one of the most important mechanisms invoked by creditors and/or liquidators of companies in the course of liquidations of companies unable to pay their debts.

12.3 Any person who was knowingly a party to the reckless or fraudulent trading can be held liable for the debts of the company. This would of course include directors and managers of the company.

## APPLICATION TO DECLARE DIRECTOR DELINQUENT OR UNDER PROBATION (SECTION 162)

13.1 In terms of s162 of the 2008 Act, a company, a director, company secretary or prescribed officer of the company, a registered trade union that represents employees of the company or any other representative of the employees of the company, may apply to court for an order declaring a person 'delinquent' or under probation. Basically the grounds relate to breaches of duty and non-compliance with the 2008 Act. The grounds are, however, quite extensive and relate to a wide range of conduct on the part of the director. These are set out in s162.

13.2 Some of the important consequences to note with regard to an order of delinquency or probation include that a director will be barred from acting as a director of a company (or a category of companies) and a court may also order that compensation be payable by a director to persons who were adversely affected by the director's conduct.

## Section 162 delinquency

There have been a number of cases decided in the High Court in terms of s162 where the court declared a director to be a delinquent. One such example is *Kukama v Lobelo and Others* (2012). The case dealt with tax refunds owing to a company which were diverted by the delinquent director into the account of another company in which he had an interest. The court referred to the fiduciary duties imposed by the 2008 Act on directors and did not hesitate to hold the director to be a delinquent in terms of s162. For instance, it held that by utilising the funds destined for the company for the benefit of other companies who are not subsidiaries of the first company, the director inflicted harm upon the company in terms of s162(5)(c)(iii) of the 2008 Act. This was a serious breach of the fiduciary duties he owed to the first company. The court also held that in view of the effect of an order declaring a director delinquent it is not necessary to also order his removal as such due to the automatic inherent effect of such a declaration.

In *Msimang NO and Another v Katuliiba and Others* (2013) the court declared company directors as delinquents for their failure, for a number of years, to maintain the company's statutory books and to have the company's annual financial statements audited. In *OUTA and Others v Myeni* (2020) the court declared the non-executive chairperson a delinquent due to her deliberate and negligent interference with, and frustration of, management's functions, which resulted in vitally important and potentially beneficial transactions being scuppered.

## BUSINESS RESCUE (CHAPTER 6 OF THE 2008 ACT)

### 14.1 Business rescue is defined as meaning

*"proceedings to facilitate the rehabilitation of a company that is financially distressed by providing for: the temporary supervision and management of the company including its business and property; a temporary moratorium on the rights of claimants (creditors) against the company or in respect of property in its possession; the development and implementation, if approved, of a plan to rescue the company by restructuring its affairs, business, property, debt and other liabilities and equity in a manner that maximises the likelihood of the company continuing in existence on a solvent basis or if it is not possible for a company to so continue in existence results in a better return for the company's creditors or shareholders than would result from the immediate liquidation of the company"*, (s128(1)(6)).

14.2 The term 'financially distressed' in relation to a company at any particular time means that: it appears to be reasonably unlikely that the company will be able to pay all of its debts as they become due and payable within the immediately ensuing six months; or it appears to be reasonably likely that the company will become insolvent within the immediately ensuing six months, (s128(1)(f)).

14.3 A company may go into business rescue proceedings voluntarily (by way of a board resolution) or an application may be made to court to place the company in business rescue.

14.4 Section 129(7) of the 2008 Act provides that if the board of a company has reasonable grounds to believe that the company is financially distressed, but the board has not adopted a resolution placing the company under business rescue proceedings in terms of Chapter 6, the board must deliver a written notice to each 'affected person' (ie any employee, trade unions, shareholder or creditor of the company), setting out the grounds upon which the company is financially distressed and the board's reasons for not adopting a business rescue resolution.

14.5 If the board fails to do this, and a creditor eventually suffers loss in that it is unable to recover its debts, it could be argued by that creditor that had the board sent the required notice under s129(7), the creditor would have been able to assess its position in respect of the debtor at an earlier stage and that because the board failed to send the notice, the creditor was unaware of the debtor's dire financial position and continued to provide credit or funding to the company. The creditor could accordingly hold the members of the board liable in this context, again under s218(2) of the 2008 Act which provides that anyone who contravenes the 2008 Act is liable to compensate any third party that suffered loss as a result of the contravention.

## 14.6 Effect of business rescue proceedings in relation to directors

- 14.6.1 Business rescue proceedings effectively place the company under bankruptcy protection and all claims of creditors against it are suspended. A business rescue practitioner will be appointed and, with the assistance of the directors and management of the company, must prepare a business rescue plan which is submitted and put to creditors (and to shareholders, if it affects their rights) for their vote and approval.
- 14.6.2 The effect of business rescue on directors is set out more fully in s137 which *inter alia* provides that the directors of a company must continue to exercise their functions as such, subject to the authority of the practitioner and they also have a duty to the company to exercise any management function in accordance with the instructions or direction of the practitioner. They remain bound by the requirements of s75 regarding personal financial interests.
- 14.6.3 Importantly, to the extent that a director acts in accordance with the express instructions or directions of the practitioner, and that it is reasonable to do so and complies with s75 (dealing with personal financial interests), the director is relieved from the duties of a director as set out in s76 (standards of directors conduct) and the liabilities set out in s77 (liabilities of directors and prescribed officers) other than s77(3)(a), (b) and (c) (acting in the name of the company knowing that the director lacked the authority to do so; acquiescing in the carrying on of the company's business knowing that it was being conducted recklessly or fraudulently;

being party to any act or omission by the company knowing that the act or omission was calculated to defraud the creditor, employee or shareholder of the company or had another fraudulent purpose).

- 14.6.4 During the business rescue proceedings each director of the company must attend to the requests of the practitioner at all times and provide the practitioner with any information about the company's affairs as may reasonably be required (s137(3)).
- 14.6.5 If during business rescue proceedings one or more directors of the company purport to take any action on behalf of the company that requires the approval of the practitioner, that action is void unless approved by the practitioner.
- 14.6.6 The business rescue practitioner can also remove a director from office if circumstances require and justify it and must report any incidences of reckless trading, fraud or contravention of any law to the appropriate authorities.
- 14.6.7 Section 142 provides for specific duties of co-operation and assistance on the part of directors of a company to assist a business rescue practitioner in particular by delivering all relevant books and financial records that relate to the affairs of the company as may be in such director's possession to the practitioner. The directors must also provide the practitioner with a comprehensive statement of the financial and other affairs of the company containing certain particulars as more fully set out in s142(3).

## DIRECTORS' INDEMNIFICATION AND INSURANCE (SECTION 78)

### What protection does the 2008 act give me?

- indemnification
- Insurance
- Whistle blower protection
- Business judgment and reliance rules

- 15.1 Any provision of an agreement, the MOI or rules of a company, or a resolution adopted, whether express or implied, is void to the extent that it directly or indirectly purports to relieve a director of a duty contemplated in s75 or s76 or a liability contemplated in s77.
- 15.2 The 2008 Act has however extended the scope for insurance and indemnification of directors of a company. The rationale behind this expansion is thought to be a counter-balancing provision against the heightened standards of conduct and accountability coupled with the extensive personal liability provisions. Under the 1973 Act, there were severe restrictions on the ability of a company to indemnify or insure its directors and officers.

- 15.3 Subject to the MOI of a company, the company may:
- 15.3.1 advance expenses to a director to defend litigation in any proceedings arising out of the director's service to the company; and
- 15.3.2 indemnify a director for such expenses if the proceedings are abandoned or exculpate the director, or arise in respect of any liability for which the company may indemnify the director.
- 15.4 A company may not indemnify a director in respect of any liability arising:
- 15.4.1 in terms of s77(3) (a), (b) or (c) (see paragraph 14.6.3);
- 15.4.2 from wilful misconduct or breach of trust by the director; or
- 15.4.3 a fine related to an offence committed by the director, except where there was 'strict liability' (namely where negligence or intent did not have to be proven for the conviction).
- 15.5 Other than the specific instances mentioned above, a company may indemnify a director in respect of any liability, including liability arising from the director's negligence. A company may also purchase insurance to protect a director or the company against any liability in respect of which the company is permitted to indemnify a director.

- 15.6 By way of illustration of the type of insurance that is available in the market, Bekink ('Indemnification and Aspects of Directors' and Officers' Liability Insurance in terms of S78 of the Companies Act, No 71 of 2008 (2011) 23 SA Merc LJ 88') notes that a typical Lloyds 'D&O' (directors and officers) insurance policy usually contains two parts. They are commonly known as Side A and Side B cover. Side A provides cover for the individual director (as the insured), for instance where a director has negligently entered into a contract with a third party on behalf of the company which the company is not able to honour. Side B offers reimbursement to the company itself (as the insured) to the extent that the company has indemnified the director for any claim made against the director. However, it should be observed that with Side B cover the company is not indemnified in its own right, but is reimbursed as a result of incurring expenses due to claims made against the director. Some policies offer in addition what is referred to as Side C or 'corporate/entity' cover. This type of insurance provides cover for both directors' and company liability, in instances where the company faces primary or vicarious liability for the acts and defaults of its directors.



15.7 The scope and limitations for directors' and officers indemnification and insurance under the 2008 Act may be summarised as follows:

Who is protected by the indemnity or insurance	Who suffers loss/who is plaintiff	Type of protection	Limits/extent of protection
DIRECTOR	Company	Indemnity given by company	Cannot indemnify for: <ul style="list-style-type: none"> <li>• conduct in 15.4</li> <li>• fine (unless strict liability)</li> </ul>
DIRECTOR	Company	Insurance taken out by company	Policy cannot insure for: <ul style="list-style-type: none"> <li>• conduct in 15.4</li> <li>• fine (unless strict liability)</li> </ul>
DIRECTOR	Third party	Indemnity given by company	Cannot indemnify for wilful misconduct or wilful breach of trust
DIRECTOR	Third Party	Insurance taken out by company	Policy cannot insure for wilful misconduct or wilful breach of trust
DIRECTOR	Company or third party	Indemnity for legal defence costs	Can advance for any legal proceedings. Director can be indemnified if: <ul style="list-style-type: none"> <li>• case is abandoned or he successfully defends; or</li> <li>• if he loses, but case was not related to conduct in 15.4</li> </ul>
DIRECTOR	Company or third party	Insurance for legal defence costs	Policy can cover director's legal costs if: <ul style="list-style-type: none"> <li>• case is abandoned or he successfully defends; or</li> <li>• if he loses, but case was not related to conduct in 15.4</li> </ul>
COMPANY	Third party, or loss is suffered by company itself	Insurance taken out by company protecting itself	Any contingency can be covered

15.8 Two points should be borne in mind in relation to the indemnification and insurance of directors:

15.8.1 the first is the potential application of the s45 of the 2008 Act. It is arguable that certain forms of indemnification or insurance may amount to 'financial assistance' given by a company to its directors as contemplated in s45 of the 2008 Act. In this regard, a company should ensure that it has its s45 approvals in place (including a special resolution of shareholders) before entering into certain indemnification or insurance arrangements. Under the 1973 Act, only loans and security provided to directors were regulated (s226) – indemnities and insurance would probably not have been covered before. But the provision in s45 of the 2008 Act is now wider and includes any form of financial assistance, whether by way of loan, guarantee or otherwise; and

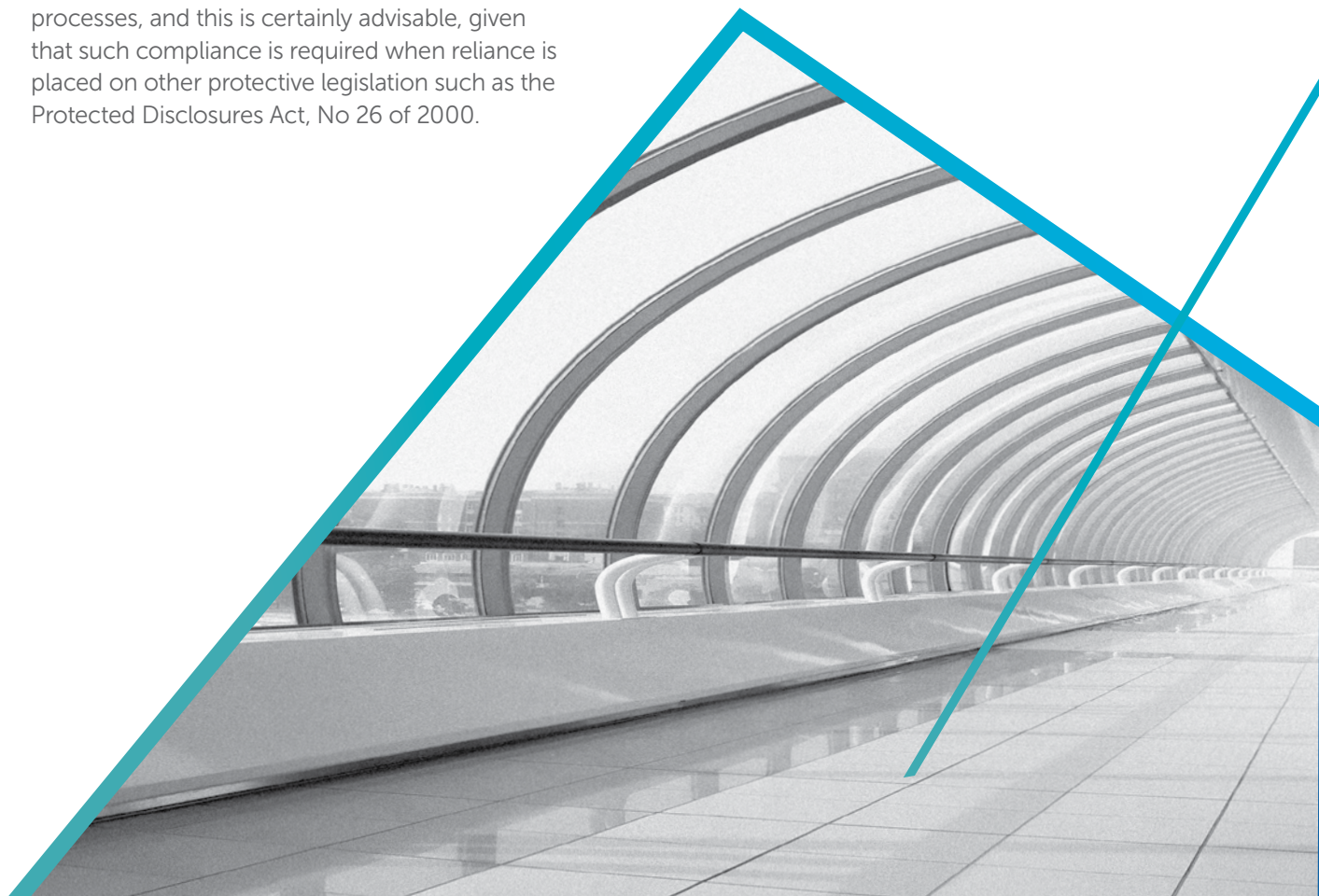
15.8.2 the second point relates to the company's insurer's right of subrogation. Before a company goes ahead and indemnifies its directors in respect of a particular breach of duty, consideration must be given to whether the company should first consult its insurers before giving such an indemnity. Insurers have a right of subrogation once they have covered the insured company, which means the insurer can proceed, in the company's name, against the culpable director that caused loss to the company. The problem however is that the insurer 'steps into the shoes' of the insured company; thus if a company indemnifies the director in question, the insurer's right of recovery is prejudiced. The insurance policy would invariably provide that such prejudice is a ground for the insurer to repudiate the company's claim under the insurance policy. Any compromise of the right against the director must be with the insurer's consent and must be subject to the relevant policy.

## PROTECTION FOR WHISTLE-BLOWERS (SECTION 159)

- 16.1 Section 159 of the 2008 Act contains a whistleblower protection mechanism which encourages a range of persons to come forward with information about contraventions by a company or any of its directors or officers of the 2008 Act or other laws which apply to the company. Section 159 is concerned with disclosures made in good faith to the Companies and Intellectual Property Commission, the Companies Tribunal, the Takeover Regulation Panel, a regulatory authority, a securities exchange, a legal adviser, a director, prescribed officer, company secretary, auditor, a person performing the function of internal audit, board or committee of the company concerned.
- 16.2 A person, including a director, who makes a disclosure under s159 has qualified privilege in respect of the disclosure, and is immune from any civil, criminal or administrative liability for that disclosure.
- 16.3 The person is entitled to compensation from another person for any damages suffered if he is entitled to make, or has made, a disclosure and, because of that possible or actual disclosure, the second person:
- 16.3.1 engages in conduct with the intent to cause detriment to him, and the conduct causes such detriment; or
  - 16.3.2 directly or indirectly makes an express or implied threat, whether conditional or unconditional, to cause any detriment to the director or to another person.

- 16.4 In order to qualify for the protections afforded by this section, the disclosure must however comply with the requirements that it must have been made in good faith, to the persons authorised to receive the disclosure in terms of the 2008 Act, and the person making the disclosure must, at the time of making the disclosure, reasonably believe that the information showed or tended to show that a company or external company, or a director or prescribed officer acting in that capacity, had contravened the 2008 Act, or had committed, or was committing any of the range of other actions proscribed by the 2008 Act. It may further be required to comply with prescribed internal processes, and this is certainly advisable, given that such compliance is required when reliance is placed on other protective legislation such as the Protected Disclosures Act, No 26 of 2000.

A person, including a director, who makes a disclosure under s159 has qualified privilege in respect of the disclosure, and is immune from any civil, criminal or administrative liability for that disclosure.



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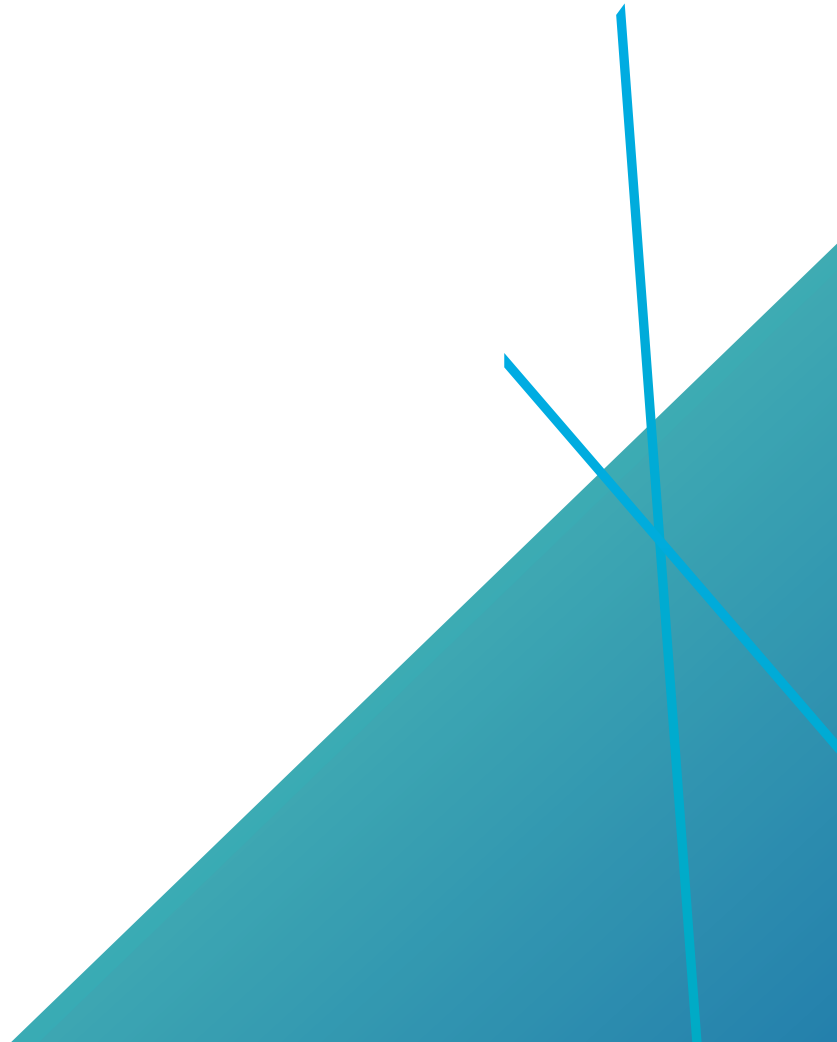
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**BBBEE STATUS:** LEVEL ONE CONTRIBUTOR

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.

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