Companies Act No. 71 of 2008
Duties and Liabilities of Directors
This booklet provides insight into certain of the responsibilities and duties of the board of directors of South African companies as set out in the new Companies Act No. 71 of 2008 (the Act).

The following topics are covered:
- scope of directors’ duties;
- potential liability and relevant penalties for breach of law and/or directors’ duties;
- limitation and/or indemnification against directors’ liability;
- appointment and removal of directors of a company;
- restrictions imposed on who may become a director; and
- quorum for a meeting of a company’s board of directors.

Background
The Act was signed into law on 8 April 2009 and became operative from 1 May 2011.

Section 66 of the Act provides that the business and affairs of a company must be managed by or under the direction of its board of directors, which has the authority to exercise all of the powers and perform all of the functions of the company, except to the extent that the Act or the company’s Memorandum of Incorporation (MOI) provide otherwise.

Section 66 of the Act further stipulates that:
- the board of a private or personal liability company must comprise of at least one director, in addition to the minimum number of directors that the company must have to satisfy any requirement to appoint an audit committee, or a social and ethics committee;
- the board of a public or non-profit company must comprise of at least three directors, in addition to the minimum number of directors that the company must have to satisfy any requirement to appoint an audit committee, or a social and ethics committee; and
- the company’s MOI may specify a higher minimum number of directors.

In terms of the Act, a company’s MOI may:
- specifically authorise one or more named persons to appoint and remove one or more directors;
- provide for one or more persons to be ex officio directors of the company; and
- provide for the appointment or election of one or more persons as alternate directors of the company.
Importantly, in the case of a profit company (other than a state owned company), the MOI must provide for the election by shareholders of at least 50% of the directors and 50% of any alternate directors.

Except to the extent that the MOI of a company provides otherwise, the company may pay remuneration to its directors for their services, but such remuneration may only be paid in accordance with a special resolution approved by the shareholders within the previous two years.

**Directors' duties**

Prior to the introduction of the Act, the duties of company directors were governed by South African common law. This dictates that directors act in the utmost good faith and in the best interests of their companies and includes the need to exercise care, skill and diligence so as to promote company success through independent judgment.

Failure to properly perform the common law duties may render a director personally liable to pay monetary damages.

The Act now codifies the common law position and makes a few notable additions (which do not alter the common law position significantly). The Act extends the duties of directors and increases the accountability of directors to the shareholders of the company.

Section 76 of the Act addresses the standard of conduct expected from directors and extends it beyond the common law duty of directors by compelling them to act honestly, in good faith and in a manner they reasonably believe to be in the best interests of, and for the benefit of, their companies. Section 76(3) of the Act states that a director of a company, when acting in that capacity, must exercise the powers and perform the functions of a director:

- in good faith and for a proper purpose;
- in the best interests of the company; and
- with the degree of care, skill and diligence that may reasonably be expected of a person carrying out the same functions in relation to the company as carried out by that director, and having the general knowledge, skill and experience of that director.

Section 76(4) of the Act states that in respect of any matter arising in the exercise of the powers or the performance of the functions of a director, a director will have satisfied the obligations in section 76(3) of the Act, if the director:

- has taken reasonably diligent steps to become informed about the matter;
- has made a decision, or supported the decision of a committee or the board with regard to that matter; and
- had a rational basis for believing, and did believe, that the decision was in the best interests of the company.

In further compliance with this section, the director is required to communicate to the board, at the earliest practicable opportunity, any material information that comes to his or her attention, unless he or she:

- reasonably believes that the information is publicly available or known to the other directors; or
- is bound by a legal or ethical obligation of confidentiality.

Section 72 of the Act entitles companies to appoint board committees and delegate to any committee any authority of the board. Such committees may include people who are not directors of the company, but they may not be ineligible or disqualified to be a company director and may not vote on any matter to be decided by the committee.

Board committees have the full authority of the board in respect of matters referred to them and may consult with or receive advice from any person. However, the creation of any committee and the delegation of any power do not by themselves satisfy or constitute compliance by a director with his or her duties as a director.

**Directors' liability**

Section 77 of the Act prescribes certain statutory liabilities, which are placed on the directors of a company. In terms of section 77(2)(a) of the Act, a director of a company may be held liable (in accordance with the principles of the common law relating to the breach of a fiduciary duty) for any loss, damages or costs sustained by the company as a consequence of any breach by the director of the duties contemplated, inter alia, in section 76 of the Act.

Any action taken that directly or indirectly purports to relieve a director of liability is considered void. A director of a company will, in addition, be held liable where that director:

- purports to bind the company or authorise the taking of any action by or on behalf of the company without the requisite authority;
- acts in the name of the company in a way that is false or misleading; or
- knowingly or recklessly signs or consents to the publication of a financial statement which is false or misleading.

Such a director is held personally liable to the company and to any other affected person for any consequential loss suffered by the company or such person.

The liability of a director is, in terms of section 77(6) of the Act, joint and several with any other person who is or may be held liable for the same act (which means that a single director can be held liable for the totality of damages suffered by a third party as a result of the breach of fiduciary duties).
Proceedings to recover any loss, damages or costs for which a person is or may be held liable in terms of section 77 of the Act may not be commenced more than three years after the act or omission that gave rise to that liability.

The Act further provides for the liability of directors, where they trade recklessly or conduct the company’s business with the intention of defrauding a creditor. Sub-sections 77(3)(b) and (c) of the Act state that any director of a company is liable for any loss, damages or costs sustained by the company as a direct or indirect consequence of the director:

► having acquiesced in the carrying on of the company’s business despite knowing that it was being conducted in a manner prohibited by section 22(1) of the Act; or
► being party to an act or omission by the company despite knowing that the act or omission was calculated to defraud a creditor, employee or shareholder of the company or had another fraudulent purpose.

Section 22(1) of the Act states that a company must not carry on its business recklessly, with gross negligence, with intent to defraud any person or for any fraudulent purpose. Therefore, if a company continues to incur debts, where, in the opinion of reasonable businessmen standing in the shoes of the directors, there would be no reasonable prospect of the creditors receiving payment when due (i.e. commercial insolvency), it will in general be a proper inference that the company’s business is being carried on recklessly or negligently as contemplated by section 22(1) of the Act.

The test will always be that there will come a point in time when reasonable businessmen would wind up the company and pay creditors in full, unless they have access to further capital which can revitalise the company with some appropriate form of capital reconstruction. The detail of financial information available to a director, together with the veracity of such information, will be taken into account when the personal liability of such director is examined in terms of section 77 of the Act.

It is also important to note that where a company is considered to be financially distressed (in that it appears that within the immediately ensuing six months it is either reasonably unlikely that the company will be able to pay all of its debts as they become due and payable, or that it is reasonably likely that the company will become insolvent - whether as a result of the business of the company being carried on recklessly or otherwise) and as a result, business rescue proceedings have commenced, the Act, in section 142, imposes additional responsibilities on company directors.

Each director must, in terms of section 142(1) and (2) of the Act, deliver to the business rescue practitioner, all books and records relating to the affairs of the company which are in such director’s possession, or must inform the business rescue practitioner of the whereabouts, if known, of such books and records. Moreover, the directors must, in terms of section 142(3) of the Act, provide the business rescue practitioner, within five business days after business rescue proceedings begin, with a statement of affairs of the company, containing, at a minimum, the particulars set out in section 142(3). Section 142 of the Act therefore imposes further duties and liabilities on company directors.

Section 214 of the Act renders a director (or any person) guilty of a criminal offence if such director / person was knowingly a party to an act or omission by a company calculated to defraud a creditor or employee of the company, or a holder of the company’s securities or with another fraudulent purpose.

To the extent that a director has fulfilled his or her fiduciary duties and conducted the affairs of the company in accordance with sound business practices that fall within the parameters of these expectations, the evidence should speak for itself. Compliance with what can be reasonably expected of a director when faced with similar circumstances will therefore constitute a defence to any action launched in terms of section 77 of the Act.

“Reasonable behaviour” will differ from case to case and will be considered having regard to the peculiar circumstances of the issues facing a particular director. As in all cases involving negligence, the test in South African law is essentially an objective one, in that it postulates the standard of conduct of the notionally reasonable director.

It is subjective insofar as the notional director is seen as conducting himself or herself with the same knowledge and access to financial information as the relevant director would have had in the circumstances. In this regard the court will
consider inter alia, the:

- scope of operations of the company;
- role, functions and powers of the directors;
- amount of the corporate debt;
- extent of the company’s financial difficulties; and
- the prospect, if any, of recovery.

In terms of section 162 of the Act, a company, shareholder, director, company secretary, prescribed officer, registered trade union representing employees, or any other representative of the employees of the company, may apply to court for an order declaring a person delinquent or under probation. This is if the person is a director of that company or was a director within the 24 months immediately preceding the application, and grossly abused the position of a director or intentionally, by gross negligence, inflicted harm upon the company or a subsidiary of the company, contrary to the provisions of the Act.

If a director acts in any manner that amounts to gross negligence, wilful misconduct or breach of trust in relation to the performance of his or her director’s duties, a court may declare him or her to be delinquent. The Act also states that any director that takes personal advantage of information or opportunities contrary to the provisions of the Act, will face the possibility of being declared delinquent. Any declaration of delinquency will subsist for the lifetime of the person concerned and may be made subject to any conditions that the court considers appropriate, including conditions limiting the application of the declaration to one or more particular categories of companies.

The Act states that if any person was a director of more than one company (irrespective of whether concurrently, sequentially or at unrelated times) and where two or more of those companies each failed to pay all of their creditors or meet all of their obligations (except in terms of a business rescue plan resulting from a board resolution or a compromise with creditors in terms of the Act), that person could be subject to a declaration of delinquency. A court may order (as conditions applicable or ancillary to a declaration of delinquency or probation) that the person concerned:

- undertakes a designated program of remedial education relevant to the nature of the person’s misconduct as director;
- carries out a designated programme of community service; or
- pay compensation to any person adversely affected by the person’s conduct as a director to the extent that such a victim does not otherwise have a legal basis to claim compensation.

If a person has been placed under probation, he or she is to be:

- supervised by a mentor in any future participation as a director while the order remains in force; or
- limited to serving as a director of a private company or of a company of which that person is the sole shareholder.

Any person who has been declared delinquent may apply to court to either suspend the order of delinquency, with or without conditions, at any time more than three years after the order of delinquency was made, or to set it aside at any time more than two years after it was suspended. In the same way, any person who is subject to an order of probation may apply to court to substitute the order, with or without conditions, or to set it aside at any time after such order was made.

**Limitation of liability, indemnification and directors’ insurance**

Section 78(2) of the Act provides that any provision of an agreement, the MOI or rules of a company, or a resolution adopted by a company, which directly or indirectly purports to relieve a director of any duty or liability, or negate, limit or restrict any legal consequences arising from an act or omission that constitutes wilful misconduct or wilful breach of trust on the part of the director, is void.

However (and except to the extent that the MOI of a company provides otherwise), a company may, in terms of section 78(5) of the Act, indemnify a director in respect of any liability arising. This is except for liability arising:

- from wilful misconduct or wilful breach of trust on the part of the director; or
- where a fine has been imposed as a consequence of a director having been convicted of an offence; or
- where a director acted recklessly, or despite knowing he or she lacked authority, or with the intent to defraud creditors, or with any other fraudulent purpose.

Furthermore, the company may, in terms of section 78(4) of the Act and subject to its MOI:

- advance expenses to a director to defend litigation in any proceedings arising out of the director’s service to the company; and
- directly or indirectly indemnify a director for the expenses incurred, or to be incurred, for such litigation if such litigation is abandoned, or which exculpates the director, or which arises in respect of any liability for which the company may indemnify the director, as described above.

Section 78(7) of the Act provides further, that a company may (subject to its MOI) purchase insurance to protect:

- a director against liability or expenses for which it is permitted to indemnify a director; and
- the company against any liability for which the company is permitted to indemnify a director, or any contingency including any expenses it is permitted to advance in respect of the defending of litigation by a director, or to indemnify a director for such expenses.
Disqualification and ineligibility of directors

Section 69 of the Act addresses and stipulates the restrictions relating to the persons which qualify to be appointed as a director of a company. A person is ineligible and may not therefore act as a director if such person is either a juristic person, an unemancipated minor or under a similar legal disability, or does not satisfy any qualification prescribed in the company’s MOI.

The Act further makes provision in section 69(8) for a director to be disqualified and provides that this will occur if:

- a court has prohibited that person from being a director; or declared the person delinquent in terms of section 162 of the Act, or in terms of section 47 of the Close Corporations Act No. 69 of 1984 (the Close Corporations Act); or
- the person:
  - is an unrehabilitated insolvent; or
  - is prohibited in terms of any public regulation to be a director of the company; or
  - has been removed from an office of trust on the grounds of misconduct involving dishonesty; or
  - has been convicted, in South Africa or elsewhere, and imprisoned without the option of a fine, or fined more than the prescribed amount for theft, fraud, forgery, perjury, or an offence involving fraud, misrepresentation or dishonesty, or in connection with the promotion, formation or management of a company, or an offence under the Act, the Insolvency Act No. 24 of 1936, the Close Corporations Act, the Competition Act No. 89 of 1998, the Financial Intelligence Centre Act No. 38 of 2001, the Securities Services Act No. 36 of 2004 or chapter 2 of the Prevention and Combating of Corruption Activities Act No. 12 of 2004.

A person who is ineligible or disqualified may not act as a director of a company, be appointed or elected as a director of a company, nor may such person consent to being so appointed or elected. Where a person has been removed from office on the grounds of misconduct, or been convicted of the offences referred to above, the disqualification applies for a period of five years after the removal from office, or the completion of the sentence imposed for the relevant defence, but these periods may be extended.

A company must not knowingly permit an ineligible or disqualified person to serve or act as a director. In addition, the Act provides that the company may, in its MOI, impose further minimum qualifications to those prescribed in the Act to be met by a director of that company, and add additional grounds of ineligibility or disqualification of directors.

Appointment and removal of directors

The appointment of directors of a company is prescribed in section 68 of the Act. This section stipulates that each director of a company must be elected by the persons entitled to exercise voting rights in such an election. Furthermore, each director should be elected to serve for an indefinite term or for a term as set out in the MOI of the company. In addition, and unless the MOI provides otherwise, the election of directors is to be conducted as a series of votes, each of which is on the candidacy of a single individual to fill a single vacancy, with the series of votes continuing until all vacancies on the board have been filled. Each voting right entitled to be exercised may only be exercised once and the vacancy may only be filled if a majority of the voting rights exercised, support the candidate.

Section 68(3) allows the board, unless the MOI of the company provides otherwise, to appoint a person satisfying the requirements for election as a director to fill any vacancy and to serve as a director of the company on a temporary basis until the vacancy has been filled by election.

Section 71 of the Act prescribes the removal of directors. Section 71(1) provides that a director shall be removed by an ordinary resolution (more than 50% of the voting rights exercised on the resolution or such higher percentage as determined in the relevant MOI) adopted at a shareholders meeting by the persons entitled to exercise voting rights in an election of that director.

However, prior to such resolution being passed, the director concerned must be given notice (at least equivalent to the time which a shareholder is entitled to receive such notice) of the meeting and the resolution, and the director must be afforded reasonable opportunity to make a presentation, in person or through a representative, to the meeting, before such resolution is put to a vote.

Section 71(3) of the Act provides further that where a company has more than two directors and it is alleged that a director has:

- become ineligible or disqualified or incapacitated to the extent that he or she is unable to perform the functions of a director, and is unlikely to regain that capacity within a reasonable time; or
- neglected, or been derelict in the performance of or the functions of director,

then the board, other than the director concerned, must determine the matter by resolution and may remove a director deemed to be so ineligible or disqualified, incapacitated, negligent or derelict, as the case may be.
Before such resolution may be considered by the board, however, the director concerned must be given:

- notice of the meeting, including a copy of the proposed resolution and a statement setting out reasons for the resolution, and
- a reasonable opportunity to make a presentation, in person or through a representative, to the meeting before the resolution is put to a vote.

If the board determines that the director concerned is ineligible or disqualified, incapacitated, negligent or derelict, as the case may be, he or she, or a person who appointed such director, may apply within 20 business days to a court to review the determination of the board.

If it is determined by the board that the director concerned is not ineligible or disqualified, incapacitated, negligent or derelict, as the case may be, any director who voted otherwise on the resolution, or any holder of voting rights entitled to be exercised in the election of that director, may apply to a court to review the determination. The court may either confirm the determination of the board, or remove the director from office.

Section 71(3) of the Act will not apply to a company with fewer than three directors. Any director or shareholder of such a company may apply to the Companies Tribunal to make a determination contemplated in section 71(3) of the Act.

**Quorum for (and voting at) a directors’ meeting**

Section 73(1) of the Act provides that a director who is authorised by the board may call a meeting at any time and that such person must call a meeting if required to do so by at least 25% of the directors (in the case of a board that has at least 12 members) or two directors in any other case. The Act provides further in section 73(5)(b) that a majority of the directors must be present at a meeting before a vote may be called at the meeting.

However the company’s MOI may set out a different quorum for meetings of the directors of the company.

In a similar manner, Section 73(5) of the Act provides that, unless the company’s MOI provides otherwise, each director has one vote at any meeting of the board and board resolutions are passed by simple majority decisions.

**Summary**

Directors need to be aware of the increased obligations and potential exposure to liability as set out in the Act. Directors should also consider the level of insurance required to provide cover for potential claims.

The provisions of the Act require South African directors to make important decisions on company issues at board level.

Directors who allow companies to trade in breach of their newly constituted duties of good faith, or in situations of financial distress, or in insolvent circumstances, must recognise that such trading may be the subject of examination either by a business rescue practitioner or, if the company is placed into liquidation, at insolvency inquiries in the post liquidation period.

Directors should therefore undertake a frank and realistic review of the manner in which their companies trade. This will be essential to avoid personal liability.

Worldwide, directors’ duties to their companies are being elevated to ensure that correct decisions are made for the financial benefit of companies at all times. Failure to maintain a particular level of knowledge of these issues can result in directors being severely criticised or being held liable for company debts as a result of reckless and negligent behaviour.
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