

Corporate Governance and Directors' obligations and potential liabilities¹

INTRODUCTION

Much has been said in recent times of the new standards expected of directors of companies and the potential liabilities for directors.

This guide consolidates a summary of the expectations of the 2009 3rd King Report on Corporate Governance (“King III”), standards required by the new Companies Act 71 of 2008² (“the Act”) and potential liabilities for directors under the Act.

King III is substantially similar to the first and second King reports (King II and King I), but consideration of present day factors required an updated and more comprehensive corporate governance code. Unlike the previous versions, King III does not apply only to listed companies but to all corporate entities irrespective of their nature, size or form of incorporation or establishment.

It is also flexible and is on an “apply and explain” basis where consideration of the particularities of a company is taken into account when applying the principles. The directors of a company have a legal duty to act in its best interests. Accordingly, under certain circumstances, the board could decide to apply a principle differently, but still achieve the same objective of the primary corporate governance principles of *fairness, accountability, responsibility and transparency*.

The stakeholders of the company are the ultimate compliance officers or regulators as the board will need to fully explain the rationale behind any decision it takes.

It should be noted that, whilst King III is an aspirational document and therefore not in and of itself law, compliance is required by most shareholders and parts of King III have become law, especially through the enactment of certain sections of the Act.

Anything in the Act is of course law and failure to adhere to it may result in criminal and civil liabilities for directors.

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² Please note the commencement date is yet to be proclaimed.

KING III

1. PRINCIPLES³ REGARDING BOARDS AND DIRECTORS: ROLE AND FUNCTION OF THE BOARD

- 1.1. The board should act as the focal point for and custodian of corporate governance;
- 1.2. The board should appreciate that strategy, risk, performance and sustainability are inseparable;
- 1.3. The board should provide effective leadership based on an ethical foundation
- 1.4. The board should ensure that the company is and is seen to be a responsible corporate citizen;
- 1.5. The board should ensure that the company's ethics are managed effectively;
- 1.6. The board should ensure that the company has an effective and independent audit committee;
- 1.7. The board should be responsible for the governance of risk;
- 1.8. The board should be responsible for information technology (IT) governance;
- 1.9. The board should ensure that the company complies with applicable laws and considers adherence to non-binding rules, codes and standards;
- 1.10. The board should ensure that there is an effective risk-based internal audit;
- 1.11. The board should appreciate that stakeholders' perceptions affect the company's reputation;
- 1.12. The board should ensure the integrity of the company's integrated report;
- 1.13. The board should report on the effectiveness of the company's system of internal controls;
- 1.14. The board and its directors should act in the best interests of the company;
- 1.15. The board should consider business rescue proceedings or other turnaround mechanisms as soon as the company is financially distressed as defined in the Act;

³ Each principle is of equal importance and together forms an holistic approach to governance. Consequently, 'substantial' application of the King III Code and the Report does not achieve compliance.

- 1.16. The board should elect a chairman of the board who is an independent non-executive director. The CEO of the company should not also fulfill the role of chairman of the board;
- 1.17. The board should appoint the CEO and establish a framework for the delegation of authority;

THE ACT

2. DIRECTOR'S⁴ REQUIRED STANDARDS OF BEHAVIOUR

Directors' standards of behaviour are prescribed by Section 76 of the Act. In summary:

- 2.1. A director of a company must not abuse the position of director by using information gained in that capacity to cause harm to the company or its subsidiaries; or further the advantage of a director or another person other than the company or a wholly-owned subsidiary company.
- 2.2. A director of a company must communicate to the board at the earliest practicable opportunity any information that comes to the director's attention, unless such information is immaterial, general knowledge, known to other directors or if there is a legal or ethical obligation of confidentiality
- 2.3. Subject to subsections 2.4. and 2.5. below, a director of a company, must exercise the powers and perform the functions of director:
 - (a) in good faith and for a proper purpose;
 - (b) in the best interests of the company; and
 - (c) with the degree of care, skill and diligence that may reasonably be expected of a person in such position.

⁴ "director" includes an alternate director, and (a) a prescribed officer; or (b) a person who is a member of a committee of a board of a company, or of the audit committee of a company, irrespective of whether or not the person is also a member of the company's board.

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2.4. In respect of any matter arising from 2.3. above, a director:

(a) will have satisfied the obligations of subsections 2.3. (b) and (c) if:

- (i) the director has taken reasonably diligent steps to become informed about the matter;
- (ii) either, (aa) the director or any related person known by him had no material personal financial interest in the subject matter of the decision; or (bb) the director complied with the requirements in the Act relating to his/her personal interest as contemplated in subparagraph (aa); and
- (iii) the director, on a rational basis, made or supported a decision of a committee or the board and believed that the decision was in the best interests of the company; and

(b) is entitled to rely on:

- (i) the performance by any of the person, (aa) referred to in subsection 2.5; or (bb) to whom the board may reasonably have delegated authority or performance, formally or informally by course of conduct; and
- (ii) any information, opinions, recommendations, reports or statements, including financial statements and other financial data, prepared or presented by any of the persons specified in subsection 2.5.

2.5. To the extent contemplated in subsection 2.4. (b), a director is entitled to rely on:

- (a) one or more employees of the company whom the director reasonably believes to be reliable and competent in the functions performed or the information, opinions, reports or statements provided;
- (b) legal counsel, accountants, or other professional persons retained by the company, the board or a committee as to matters involving skills or expertise that the director reasonably believes are matters:
 - (i) within the particular person's professional or expert competence; or
 - (ii) as to which the particular person merits confidence; or

- (c) a committee of the board of which the director is not a member, unless the director has reason to believe that the actions of the committee do not merit confidence.

3. DIRECTORS' LIABILITIES

Directors' liabilities are prescribed by Section 77 of the Act. In summary:

- 3.1. A director of a company may be held liable for any loss, damages or costs sustained by the company as a consequence of any breach by the director of a duty prescribed in the Act or any provision of the company's Memorandum of Incorporation.⁵
- 3.2. A director of a company is liable for any loss, damages or costs sustained by the company if the director:
 - (a) acted, signed or authorized the taking of any action on behalf of the company, or purported to bind the company, despite knowing that she/he lacked the authority to do so;
 - (b) consented to the carrying on of the company's business despite knowing that it was being conducted in a manner that may be construed as reckless trading;
 - (c) was a party to an act or omission by the company despite knowing that the act or omission had a fraudulent purpose;
 - (d) signed, consented to, or authorised, the publication of any financial statement, prospectus, or written offers to the public that were false or misleading.
 - (e) was present at a meeting, or participated in the making of a decision and failed to vote against the unlawful issuing, granting, acquisition or a resolution to approve a distribution of any unauthorized shares or securities, or the unlawful provision of financial assistance for such shares or securities, or unlawful allotment of the company, with knowledge that such action was inconsistent with the Act.
- 3.3. The liability of a director in terms where she/he failed to vote against the unlawful resolution to approve a distribution, will only arise where, after making that decision, the

⁵⁵ Please note that pending the type of breach the common law principles of either relating to breach of a fiduciary duty or delict may apply.

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company did not and could not reasonably at the time, satisfy the solvency and liquidity test. Further note that the liability here will also be limited pending the amount exceeded by the unlawful distribution in relation to the lawful distribution and the amount recovered from the person to who distribution was made.

- 3.4. If the board of a company has made a decision in a manner that contravened this Act, as contemplated in paragraph 3.2. (e) above:
- (a) the company, or any director who has been or may be held liable may apply to a court for an order setting aside the decision of the board; and
 - (b) the court may make:
 - (i) an order setting aside the decision in whole or in part, absolutely or conditionally; and
 - (ii) any further order that is just and equitable in the circumstances.
- 3.5. The liability of director is joint and several with any other person who is or may be held liable for the same act.
- 3.6. Proceedings to recover any loss, damages or costs for which a director is or may be held liable may not be commenced more than three years after the act or omission that gave rise to that liability.
- 3.7. In addition to the liability set out elsewhere, any person who would be so liable is jointly and severally liable with all other such persons:
- (a) to pay the costs of all parties in the court in a proceeding contemplated in this section unless the proceedings are abandoned, or exculpate that person; and
 - (b) to restore to the company any amount improperly paid by the company as a consequence of the impugned act, and not recoverable in terms of this Act.
- 3.8. In any proceedings against a director, other than for wilful misconduct or wilful breach of trust, the court may relieve the director, either wholly or partly, from any liability set out in this section, on any terms the court considers just if it appears to the court that:
- (a) the director is or may be liable, but has acted honestly and reasonably; or

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(b) 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.

3.9. 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 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 3.9.

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