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DUTIES AND RESPONSIBILITIES OF COMPANY DIRECTORS IN SOUTH AFRICA

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Version: May 2014

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INTRODUCTION

South African law does not impose an all-embracing code of conduct on company directors. In practice, a company's constitution, comprising of its Memorandum and Articles of Association, prescribes the extent of the directors' powers. A director who acts outside the ambit of the company's constitution is accordingly answerable to the company for his conduct. The function of the law is to supplement and add detail to the responsibilities of directors as contained in a company's internal constitution and to deal with areas on which a company's constitution is usually silent or not precise enough.

The relevant law, which supplements a company's constitution, may be found in statute – primarily in the Companies Act 71 of 2008, and here especially section 77, and in the case law. Furthermore the duties of a director may be set out in the director's employment contract (if any) with the company.

A. Common law duties

According to common law a director owes two types of duty to the company, a fiduciary duty and a duty of skill and care.

1. Fiduciary Duty

A fiduciary is a person who is in a special position of trust. A director is a fiduciary and therefore must act in good faith in his dealings with or on behalf of the company and he must exercise the powers and fulfill the duties of his office honestly. A director cannot be relieved of his duty in the company's Memorandum of incorporation or in contract. Any act amounting to an evasion of his duty is seen in the same light as a breach of the duty itself.

His fiduciary duty has four aspects:-

1.1 Duty to Act in Good Faith

A director has a duty to act in good faith and do what he honestly believes is in the best interests of the company;

1.2 Duty to exercise his Powers for a Proper Purpose

A director must not use his powers for improper purposes, even if he believes that to do so would be in the best interests of the company. In addition he must exercise his powers as director for the benefit of the company and for the purpose of which they were conferred;

1.3 Conflicts of Interest

A director must not put himself in a position where there is an actual or potential conflict between his duty to the company and his personal interests; and

1.4 Misuse of Company Property

A director is regarded as a trustee of company property. Accordingly, he must not knowingly participate in or ignore the misapplication of company property.

2. Duty to display reasonable Skill and Care

When a director is acting in the company's interests he is to exercise whatever skill he possesses and reasonable care. This duty has two aspects:-

2.1 Degree of Skill

A director is not expected to exercise a level of skill he does not have. The level of skill required of a director is subjective. He is not expected, merely by virtue of his office, to

possess any particular skills. His performance will be judged by the way he applies any skills, which he actually has. However, in the case of an insolvent company a director incurs personal liability for wrongful trading if he does not display both the general knowledge, skill and experience that he actually has and that which might be reasonably expected of someone carrying out his function within the company.

2.2 Degree of Care

The degree of care required is different for executive and non-executive directors. The non-executive director must display the same care a layman might be expected to take in the same circumstances on his own behalf. By contrast, an executive director's service contract will normally stipulate that he must devote his full attention to the business of the company.

B. Statutory Duties

The common law principles governing a director's conduct as set out above are complimented by a range of specific duties imposed by statute. Some of these duties are imposed not on the directors in their own right, but on the company. However, since the directors are responsible for the performance of the statutory duties imposed on the company, it is they who must ensure that the company does everything that is required of it. Consequently a vast range and number of managerial duties are indirectly imposed on directors. The following requirements are worth highlighting:-

1. Restrictions on directors taking financial advantage

Directors must disclose the nature of any interest in a contract or proposed contract with the company at the first board meeting at which such contract is to be discussed. A director who fails to comply commits a criminal offence punishable by a fine.

A director who wishes to acquire assets from or transfer assets to the company which exceed a certain value must have that contract or arrangement approved by the members of the company in general meeting. Otherwise the director can be compelled to make restitution to the company or, if this is no longer possible, pay damages.

2. Share Dealings

The issue of shares by directors to themselves and / or their beneficiaries may only take place under very limited circumstances.

A director must, within five days of his appointment, notify the company in writing of his interests in shares and debentures of the company and other companies in its group. Any subsequent change in these interests must be notified within five days of the change.

3. Public Disclosure Duty

A register of directors and secretaries must be maintained by every company. Any change in the details contained in the register must be filed with the Companies and Intellectual Property Commission (CIPC) within 20 days.

The directors are required to make certain documents available for inspection by the shareholders. These include:-

(i) register of shareholders;

(ii) minutes of general meetings;

(iii) register of directors and secretaries;

(iv) directors' service contracts.

Every company must file with CIPC an annual return either signed by a director or the secretary or filed electronically by the company secretary or corporate law services provider such as Into SA. The return must be completed within a prescribed period and must be in a prescribed form, failing which it will attract penalties, for the company, not the directors, but the company may hold the directors liable for his or her omission to file in time.

4. Loans and financial assistance

A company must not make loans to its directors or persons connected with them. A director who contravenes this section commits a criminal offence, if the company is a public company or belongs to a group, which includes a public company.

5. Accounting responsibilities – Annual Financial Statements

The directors must ensure that the financial statements are laid open for inspection at the annual general meeting. The annual financial statements must consist of the balance sheet and the income statement. The directors must prepare annual accounts for the company's financial year and ensure that they are delivered and filed with to the Registrar of Companies within a prescribed period.

6. General Meetings

An annual general meeting ("AGM") must be held in each calendar year within 15 months of the last one. The duty to call an AGM lies with the directors and failure to do so leaves the company and every officer responsible liable to a fine.

An extraordinary general meeting ("EGM") is any general meeting other than the AGM. The directors are usually empowered to call an EGM for specific reasons (usually to obtain consent of the shareholders to carry out a specific act) and must do so at the request of the shareholders.

Business cannot be transacted at a general meeting unless a *quorum*, as stipulated in the Articles, is present.

7. Board Meetings

Apart from the requirement to keep minutes there are no statutory rules in relation to the calling and conduct of board meetings. In practice, large companies tend to retain a degree of formality while small private companies often dispense with formal meetings almost entirely.

C. Duties and liabilities of directors, where financial position of the company is uncertain

Where a company's financial position is so uncertain that it is trading in insolvent circumstances or a winding-up is likely, then a director should be very careful about his activities. If, during the period leading up to the winding up of the company, a director acts improperly or recklessly he may incur a personal liability to contribute to the company's assets notwithstanding the fact that the company of which he is a director is a limited liability company. The circumstances in which this may happen are set out in the Insolvency Act, No. 24 of 1936. Briefly, these circumstances are:-

1. Misfeasance by a director

Misfeasance in this context means that a director will be liable, if he fails to perform one of his specific duties properly and as a result causes a loss to the company.

2. Defrauding creditors

A director will be liable, if he is shown to have carried on the company's business with the intention of defrauding creditors. Fraudulent trading is both a civil wrong and a criminal offence punishable under the Companies Act with imprisonment.

3. Wrongful trading

Where a director of a company, which becomes insolvent, who knew or should have known that his company could not avoid becoming insolvent, may find that he is liable to contribute to the assets of the company. Liability can only be avoided if the director can satisfy the court that he took every step to minimize the potential loss to the company's creditors.

It is therefore crucial that a director should recognize the moment when the company can no longer avoid insolvent liquidation and that he should take immediate and positive action to protect the interests of creditors. In taking such action, an objective level of skill will be expected of him. He will be expected to act not merely as a reasonable man, but as a skilled director.

D. Criminal and Delictual Liability

Section 332 of the Criminal Procedure Act, No. 51 of 1977, creates potential liability for directors through offences committed by the company. A number of statutory provisions state that, where an offence has been committed by a company with the consent or connivance of, or attributable to the neglect of, a director, such director may also be guilty of the offence. There are also a number of statutes, which impose direct criminal liability. Furthermore, in certain instances, a cause of action may be construed against a director personally where he causes the company to commit a delict.

E. Those to whom a duty of care is owed

Directors are responsible to the company, not to the shareholders. This responsibility extends to the interests of both present and future shareholders of the company as a whole. Courts tend, therefore, only to interfere with the directors' decision, if there is evidence that they acted in bad faith intending to prejudice the interests of some of the shareholders, or taking all the alternatives into account, no sensible board of directors could reasonably have come to the decision, which the directors reached.

Statutes compliment and supplement the common law to provide additional protection for minority shareholders. The Companies Act enables any member of a company to approach the court for relief on the ground that the company's affairs are being or have been conducted in a manner unfairly prejudicial to the interests of one or more members. If the ground is made out, the court has a general power to grant whatever relief it thinks necessary. The current company law has increased the statutory protection of minority shareholders significantly.

Directors of holding companies should remember that their principal duty is owed to the company of which they are a director, and in the case of a subsidiary it means that it is owed to that subsidiary. If the individual concerned is a director or employee of the holding company as well as of the subsidiary, this means that he owes a similar duty to two principals.

F. Mitigation of directors' liabilities

Insurance (for which the company may normally pay the premiums) is available for the liabilities that may arise from holding the office as a director.

G. Power to bind the company / to manage the company

The Companies Act states that when a director deals with a third party, and the third party acts in good faith, the power of the director to bind the company is unlimited. Therefore, to all intents and purposes, the directors have the power to enter into contracts and agreements with third parties and the company will be bound by those contracts, even though the director in question may be acting outside the scope of his authority, which might have been limited by his employment contract or shareholder resolutions.

However, if a director does act outside the scope of his authority, he will be answerable to the company for those actions and liable in his internal relationship to his company.

H. Limitations of Directors' Powers

Even though directors are not limited in their dealings with the outside world, their powers can be limited by the constitution (the Memorandum of Incorporation, MOI) of the company. As stated above, these limitations will not affect third parties but may make the director liable towards the company for his actions. The objects clause contained in the company's MOI may limit the powers of the directors of the company. However, the shareholders of the company may ratify any action of a director, which exceeds his authority.

Limitations can be placed on the authority of the directors in the MOI of the company. It is a duty of the directors, owed to the company, to remain within these limitations on their powers. In addition, the Companies Act operates to protect third parties dealing with the company and even though the directors act outside their authority their actions will be effective to bind the company as set out above.

I. Duties and Liabilities under the Business Rescue Regime

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 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, section 142 of the Actimposes 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.

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