

The Companies Act Implications for directors and prescribed officers



Introduction

The Companies Act (the Act) contains a number of provisions that will directly impact all directors and the prescribed officers. The provisions relate to:

- The codified standard of conduct.
- Personal liability where a third party suffers loss or damage where a director or prescribed officer did not adhere to the standard of conduct.
- Declaration of conflicts of interest and the consequences of non-compliance.
- Disclosure of all remuneration received by directors and prescribed officers in the annual financial statements.

It is important to take note of these provisions, and to ensure that all directors and prescribed officers meet the requirements of the Companies Act, and are aware of the implication and potential consequences of non-compliance with the new Act.

Identifying directors and prescribed officers

Directors

The term “director” has been defined in law. The Companies Act, 2008 (the Act) defines a director as:

“A member of the board of a company, or an alternate director of a company and includes any person occupying the position of director or alternate director, by whatever name designated”.

In terms of section 66 of the Companies 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.

In general terms, the directors of a company are those individuals empowered by the Memorandum of Incorporation of that company to determine its strategic direction. As a consequence of the nature of a company, being a lifeless corporate entity, human intervention is required to direct its actions and therefore determine its identity.

The directors are entrusted by the shareholders of the company with the ultimate responsibility for the functioning of the company. While some of the day-to-day running of the company is generally delegated to some level of management, the responsibility for the acts committed in the name of the company rests with the directors.

Prescribed officers

The Companies Act determines that prescribed officers are required to perform their functions and exercise their duties to the standard of conduct as it applies to directors. Prescribed officers will be subject to the same liability provisions as it applies to directors.

Prescribed officers include every person, by whatever title the office is designated, that:

- Exercises general executive control over and management of the whole, or a significant portion, of the business and activities 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.

<p>It is important for companies to identify the prescribed officers. They need to ensure that these persons meet the requirements of the Companies Act, and ensure that they understand the implications and potential consequences of accepting appointment to the particular office.</p>

Qualifications to serve as a director or prescribed officer

With a few specific exceptions, anyone can be appointed as a director or prescribed officer of a company.

The Companies Act is the primary determinant of who may or may not be appointed to be a director or prescribed officer. A company's Memorandum of Incorporation may provide additional grounds for ineligibility or disqualification, or additional minimum qualifications that should be met by directors.

Section 69 of the Companies Act provides that any person is *ineligible* for appointment as director or prescribed officer, if that person is a juristic person, an unemancipated minor (or is under a similar legal disability), or does not satisfy the qualifications as per the company's Memorandum of Incorporation.

Also, a person is *disqualified* from being a director or prescribed officer, if the person:

- Has been prohibited to be a director by the court.

- Has been declared by the court to be delinquent in terms of this Companies Act or the Close Corporations Act.
- Is an unrehabilitated insolvent.
- Is prohibited in terms of any public regulation to be a director of the company.
- Has been removed from an office of trust, on the grounds of misconduct involving dishonesty.
- Has been convicted and imprisoned without the option of a fine, or fined more than R1 000 for theft, fraud, forgery, perjury or an offence under the Companies Act, the Insolvency Act, the Close Corporations Act, the Competition Act, the Financial Intelligence Centre Act, the Securities Services Act, or the Prevention and Combating of Corruption Activities Act.

The Companies Act provides the courts with wide discretion to either extend any disqualification for no longer than a period of five years at a time, or to exempt any person from the disqualifications as set out above.

The Companies Act determines that the appointment of an ineligible or disqualified person as director or prescribed officer is null and void.

Deemed resignation

In terms of the Transitional Arrangements set out in Schedule 5 of the Companies Act, a person holding the office of director or prescribed officer immediately before the implementation of the new Companies Act (that is ineligible or disqualified from appointment in terms of the provisions of the Companies Act) is regarded to have resigned that office as from the effective date of the Act.

This implies that all companies have to determine which officers will be classified as prescribed officers once the new Companies Act becomes effective. If any of these persons are ineligible or disqualified from appointment, they have to be removed from those positions and replaced by persons that meet the requirements set out in the Companies Act.

Failure to do so may result in potential liability for the company, as the decisions and actions of disqualified prescribed officers will be regarded as void.

The standard of directors' conduct

By accepting their appointment to the position, directors and prescribed officers agree that they will perform their duties to a certain standard, and it is a reasonable assumption of the shareholders that every individual director and prescribed officer will apply their particular skills, experience and intelligence to the advantage of the company.

The Companies Act codifies the standard of directors' conduct in section 76. The standard sets the bar

for directors very high. The intention of the legislature seems to be to encourage directors to act honestly and to bear responsibility for their actions - directors should be accountable to shareholders and other stakeholders for their decisions and their actions. However, with the standard set so high, the unintended consequence may be that directors would not be prepared to take difficult decisions or expose the company to risk. Since calculated risk taking and risk exposure form an integral part of any business, the Companies Act includes a number of provisions to ensure that directors are allowed to act without constant fear of personal exposure to liability claims. In this regard, the Companies Act has codified the business judgement rule, and provides for the indemnification of directors under certain circumstances, as well as the possibility to insure the company and its directors against liability claims in certain circumstances.

The codified standard applies to all directors, prescribed officers or any other person who is a member of a board committee irrespective of whether or not that the person is also a member of the company's board. The Act makes no distinction between executive, non-executive or independent non-executive directors. The standard, and consequent liability where the standard is not met, applies equally to all directors.

In terms of this standard, a director (or other person to whom section 76 applies), must exercise his or her powers and perform his or her functions:

- In good faith and for a proper purpose
- In the best interest 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 and having the general knowledge, skill and experience of that director.

The Companies Act prohibits a director from using the position of director, or any information obtained while acting in the capacity of a director, to gain an advantage for himself or herself, or for any other person (other than the company or a wholly-owned subsidiary of the company), or to knowingly cause harm to the company or a subsidiary of the company.

Directors have a fiduciary duty to act in the best interest of the company as a whole. Directors owe this duty to the company as a legal entity, and not to any individual, or group of shareholders – not even if the majority shareholder appointed the director. Directors are obliged to act in good faith in the best interest of the company. They should act within the bounds of their powers, and always use these powers for the benefit of the company. Where a director transgresses his or her powers, the company might be bound by his or her action, but he or she can be held personally liable for any loss suffered as a result of the transgression.

The duties imposed under section 76 are in addition to, and not in substitution for, any duties of the director of a company under the common law. The traditional concept of fiduciary duties is not replaced by the codified standard of conduct.

The Companies Act also codifies the business judgment rule. In terms of this rule a director will have met the required standard if he or she has taken reasonable diligent steps to become informed about

the subject matter, does not have a personal financial interest (or declared such a conflicting interest) and the director had a *rational basis* to believe that the decision was in the best interest of the company.

In discharging any board or committee duty, a director is entitled to rely on one or more employees of the company, legal counsel, accountants or other professional persons, or a committee of the board of which the director is not a member. However, the director does not transfer the liability of the director imposed by this Act onto such employee.

Directors of a company may be held jointly and severally liable for any loss, damage or costs sustained by the company as a result of a breach of the directors' fiduciary duty or the duty to act with care, skill and diligence. The Companies Act sets out a range of actions for which directors may be held liable for any loss, damage or costs sustained by the company. These actions include:

- Acting in the name of the company without the necessary authority
- Being part of an act or omission while knowing that the intention was to defraud shareholders, employees or creditors
- Signing financial statements that were false or misleading in a material respect, or
- Issuing a prospectus that contained an untrue statement.

In certain instances, except if a company's Memorandum of Incorporation provides otherwise, a company is allowed to indemnify a director in respect of any liability, or a company may purchase insurance to protect a director against liability (but only for those instances for which a company may indemnify the director), or to protect a company against expenses or liabilities for which the company may indemnify a director. A company may indemnify a director in respect of any liability, except for:

- Any liability arising from situations where the director :
 - Acted in the name of the company, signed anything on behalf of the company, or purported to bind the company or authorise the taking of any action by or on behalf of the company, despite knowing that the director lacked the authority to do so.
 - Acquiesced in the carrying on of the company's business despite knowing that it was being conducted in a reckless manner.
 - Been a party to an act or omission by the company despite knowing that the intention was calculated to defraud a creditor, employee or shareholder of the company, or had another fraudulent purpose.
- Any liability arising from wilful misconduct or wilful breach of trust, or
- Incurred a fine as a result of a conviction on an offence in terms of national legislation.

Conflicts of interest

One of the fundamental duties of a director is to avoid any possible conflict of interests with the company. It is an accepted principle in South African law that, as a result of the trust placed in the

director, he or she is bound to put the interests of the company before their own personal interests.

Section 75 of the Companies Act makes clear provision for dealing with a director's use of company information and conflict of interest. It extends the application of the conflict of interest provisions to prescribed officers and members of board committees (even if those persons are not directors).

Where a director, prescribed officer or member of board committees has a conflicting personal financial interest (where his or her own interests are at odds with the interests of the company), he or she is prohibited from making, participating in the making, influencing, or attempting to influence any decision in relation to that particular matter. This provision seems to impose a strict duty not to allow personal financial interest to impact, in any way, on the dealings with the company. In addition, where a director, prescribed officer or member of board committees has a conflicting personal interest in respect of a matter on the board agenda, he or she has to declare that personal interest and immediately leave the meeting. Such person is also prohibited from any action that may influence or attempt to influence the discussion or vote by the board, and is prohibited from executing any document on behalf of the company in relation to the matter, unless specifically requested to do so by the board.

It is important that all directors and prescribed officers comply with the conflict of interest declaration provisions, as non-compliance may render certain transactions and agreements void.

The conflict of interest provisions apply equally to persons related to the director, prescribed officer or member of a board committee. Thus, where a director, prescribed officer or member of board committees knows that a related person has a personal financial interest in a matter to be considered at a meeting of the board, or knows that a related person has acquired a personal financial interest in a matter, after the board has approved that agreement or matter, he or she should disclose that fact to the board.

Liability of directors and prescribed officers

The Companies Act makes it clear that a person is not, solely by reason of being an incorporator, shareholder or director of a company, liable for any liabilities or obligations of the company, unless where the Companies Act or the company's Memorandum of Incorporation provides otherwise. The directors and prescribed officers of a company may only incur liability in specific instances.

In terms of the Companies Act a director or prescribed officer of a company may be held liable for any loss, damages or costs sustained by the company as a consequence of any breach by him or her of a duty contemplated in the standard of directors conduct, failure to disclose a personal financial interest in a particular matter, or any breach by the director or prescribed officer of a provision of the Companies Act or the company's Memorandum of Incorporation.

In addition, the Companies Act determines that a 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—

- Acted in the name of the company, signed anything on behalf of the company, or purported to bind

the company or authorise the taking of any action by or on behalf of the company, despite knowing that the he or she had no authority to do so.

- Persisted and went along with any action or decision despite knowing that it amounts to reckless trading.
- Been a party to any action or failure to act despite knowing that the act or omission was calculated to defraud a creditor, employee or shareholder of the company.
- Signed, consented to, or authorised the publication of any financial statements that were false or misleading, or a prospectus that contained false or misleading information, or
- Been present at a meeting, or participated in the making of a decision, and failed to vote against a decision to issue any unauthorised shares or securities, to issue options for unauthorised shares or securities, to provide financial assistance to a director or any person without complying with the requirements of the Companies Act and the Memorandum of Incorporation, to approve a distribution that was contrary to the requirements of the Companies Act, or for the company to acquire any of its own shares, or the shares of its holding company, or make an allotment despite knowing that the acquisition or allotment was contrary to the requirements of the Companies Act.

The Companies Act makes it clear that a director or prescribed officer is jointly and severally liable with any other person who is or may be held liable for the same act. Also, any claim for loss, damages or costs for which a person is or may be held liable in terms of the Companies Act prescribes after three years after the act or omission that gave rise to that liability.

Remuneration

The definition of “remuneration” as per the new Companies Act includes:

- Fees paid to directors for services rendered by them to or on behalf of the company, including any amount paid to a person in respect of the persons accepting the office of director
- Salary, bonuses and performance-related payments
- Expense allowances, to the extent that the director is not required to account for the allowance
- Contributions paid under any pension scheme
- The value of any option or right given directly or indirectly to a director, past director or future director, or person related to any of them
- Financial assistance to a director, past director or future director, or person related to any of them, for the subscription of shares
- Any loan or other financial assistance by the company to a director, past director or future director, or a person related to any of them, or any loan made by a third party to a director, past director or future director, or a person related to any of them.

Approval by special resolution

Remuneration to directors for services rendered to the company as directors may only be paid in accordance with a special resolution approved by the shareholders within the previous two years. In this regard it is important to distinguish between remuneration paid to directors in terms of an

employment contract (in the case of executive directors), and remuneration paid for services as directors. In terms of the Act, shareholder approval is only required for the latter.

With respect to the special resolution approving the remuneration to directors for their services as directors, the resolution may be phrased widely to provide parameters within which the remuneration committee may calculate the exact amounts – thus, it is not necessary to obtain shareholder approval for each payment to a particular director. This approach is in line with the principle as set out in King III, according to which the shareholders must approve the remuneration policy and the board has to determine the exact director remuneration within the parameters of the approved policy.

Disclosure of remuneration

Section 30 of the new Companies Act determines that information pertaining to remuneration paid to directors and prescribed officers should be disclosed in the annual financial statements of all companies that are subject to a mandatory audit.

The requirements in the new Companies Act differ from the provisions of the current Companies Act in mainly three regards. Firstly, the new Companies Act requires disclosure on an individual basis (not in aggregate), secondly, disclosure of payments to past directors is required in most instances, and thirdly, the remuneration of all prescribed officers must be disclosed.

In addition to the requirement that the remuneration of prescribed officers be disclosed in the financial statements, the Companies Act also requires the disclosure of any other payments received by prescribed officers. Further, the Companies Act requires approval by special resolution when the company intends to issue shares to prescribed officers, or where the company renders financial assistance to prescribed officers.

<p>The new Companies Act requires disclosure of remuneration paid to directors and all prescribed officers on an individual basis in the annual financial statements. Prescribed officers have to be informed of the fact that their remuneration will be disclosed in the annual financial statements in future.</p>

Conclusion

The provisions discussed above do not seem unfamiliar – especially with reference to directors. However, these provisions have not applied to prescribed officers before. It is therefore important to ensure that every company identifies all prescribed officers and ensure that they meet the statutory requirements for appointment. These individuals have to be informed of the implications and potential consequences of the new Companies Act.

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