Directors' responsibilities and risk taking

By Stephen Kennedy-Good and Akhona Boloko

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Businesses across the country are facing serious headwinds. South African law requires that directors must exercise their powers in the best interests of the company, and with the degree of care, skill and diligence that may be reasonably expected of a person carrying out those functions. Directors can be held personally liable, and are now having to take tough decisions in the context of the pandemic.

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Directors must adhere to the standards of directors' conduct, and do their best in the current economic climate.

Communication with staff, suppliers and creditors is key. Any decisions taken by the board should be properly minuted, with a detailed explanation, to ensure that any subsequent criticism of decisions can be dealt with.

Directors should ensure that the business decisions that they take in the course of dealing with the pandemic comply with the Companies Act 2008 (the Act). The 'business judgment rule' protects directors from liability arising out of their honest and reasonable business decisions. The rule is included in section 77(9) of the Act and provides that courts should exercise restraint in holding directors accountable for business decisions which produce poor results. If a director makes a decision in good faith, with care and on an informed basis, which the director reasonably believed was in the interest of the company, the director should not incur liability in respect of that decision.

To claim protection under the business judgment rule, three requirements need to be met:

1. The director must have made an informed decision;
2. The director must have had no material personal financial interest in the decision or, if they did, they must have made the necessary disclosure; and
3. There must be a rational basis for believing that the director was acting in the best interests of the company.

If the requirements are not met, the business decision falls within the scope of judicial review. The application of the business judgment rule is wide in the sense that it applies to any exercise of power or the performance of any director function.

To help directors make business decisions that are in the best interests of the company, the Act entitles directors to rely on advice from competent employees, legal counsel, accountants or other professional persons with the requisite skills and expertise. The business judgment rule encourages risk taking by protecting certain business decisions and other acts by the directors.

In addition to the business judgment rule, directors must consider the King IV Report on Corporate Governance for South Africa and ensure that their actions are in line with good corporate governance principles. Even though King IV is not law, it provides useful guidelines for directors.

The Companies and Intellectual Property Commission (CIPC), which regulates the Companies Act, has committed not to exercise its powers relating to temporarily insolvent companies (for example the power to order a company to stop trading), if that insolvency was caused by the Covid-19 pandemic.

The Organisation for Economic Cooperation and Development has warned that Covid-19 poses the biggest danger to the world economy since the 2008 financial crisis. Directors will be forced to make difficult and risky business decisions to get through the pandemic. Greater responsibility must be taken by directors regarding the decisions they take when managing the affairs of the company during the pandemic. The business judgment rule and leniency by the CIPC provide some reprieve for directors to take risky business decisions in the interests of the company.

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