Accountability, transparency and openness have always been demanded of South African company directors. However, prior to 1994, business people had no clear guidelines on how these broad principles were to be applied. This is because they were found in the common law, which is primarily based on court decisions and not readily accessible to businessmen.

The First King Report on Corporate Governance (“First Report”) was published in 1994 by the Institute of Directors in response to the increasing concern over corporate failures and the perceived need for a formal code of corporate governance. The First Report sought to assist companies and their directors by providing a comprehensive set of principles and guidelines to codify, clarify and (in certain circumstances) expand upon the common law principles of corporate governance. It was intended as a code of good practice that emphasised the responsibilities of company directors with regard to corporate governance. The Second King Report (“King II”) was finalised in March 2002 and both reviewed and expanded on the First Report.

The Third King Code and Report on Corporate Governance (“King III”) was released on 1 September 2009, and became effective on 1 March 2010. The review of King II was prompted by a number of developments that had occurred in South Africa since its release, including the publication of the new Companies Act 71 of 2008 (“new Companies Act”) and changes in international governance trends. The Code sets out a number of governance principles that should be read together with the Report, which contains best practice recommendations on each principle. The Institute of Directors has also issued a number of Practice Notes to assist companies in implementing the Code.

King III addresses many of the same areas as were addressed in King II. There is an increased focus on sustainability, risk management, information technology, internal audit, remuneration, alternate dispute resolution, business rescue and fundamental and affected transactions. King III also introduces new requirements regarding independence and remuneration of directors.

In a change of approach, King III moves from a “comply or explain” approach to an “apply or explain” approach. This allows directors to conclude that following a recommended practice in King III is not necessarily in the best interests of the company. Companies may therefore deviate from a suggested practice and still comply with the overarching corporate governance principles of fairness, accountability, responsibility and transparency. Proper compliance will nevertheless require an explanation of how the principles and recommendations were applied, or if not applied, the reasons for not doing so.
Significantly, King III will apply to all legal entities irrespective of their manner or form of incorporation or establishment and whether or not they are listed. All entities are encouraged to apply King III principles to the extent that best suits their size and complexity. The drafters intend that entities will aspire to apply King III on the basis that if its principles are adhered to, then the entity will have practised good governance.

As was the case with King II, the listings requirements of the JSE (i.e. the Johannesburg Stock Exchange) have also been amended to mandate compliance with certain provisions of King III. Changes introduced by King III must be complied with in respect of all financial years commencing on or after 1 March 2010. However, the new requirement that any director that participates in a share incentive/option scheme will not be regarded as “independent”, will only apply to listed companies from 1 April 2011. All other changes to the JSE listings requirements as a result of King III apply to listed companies from 1 April 2010.

King III is not law and failure to comply with it will not result in direct liability for directors, save to the extent that compliance is made mandatory by the JSE listings requirements or other legislation. That being said, it is likely that the principles set out in King III will constitute a base for determining whether directors have performed their duties with reasonable care, skill and diligence as required by the new Companies Act.

Duties and responsibilities of directors

The most significant recent development for directors and officers has, undoubtedly, been the promulgation in 2008 of what is now the new Companies Act. The new Companies Act will come into operation, on a date yet to be fixed by the President, by proclamation in the Government Gazette. This is expected to be in October or November 2010.

The new Companies Act completely rewrites South African company law legislation, and contains the first statutory codification of South Africa’s directors’ duties, which have historically only been embodied in the common law. The new Companies Act also regulates the liability of directors and provides much needed clarity in respect of the ability of companies to indemnify their directors and purchase directors’ and officers’ insurance.

A significant feature of the new Companies Act is the formal extension of the application of “directors’ duties” to persons other than directors. This is achieved through the introduction of the concept of a prescribed officer. The term “director” is defined to include “prescribed officers”, on the basis that prescribed officers are subject to the same duties and liabilities as directors. In the draft regulations which were published on 22 December 2009, persons who are not directors, but who nevertheless have general executive authority over various aspects of the company’s business (e.g. finance, operations), regardless of their title, are regarded as “prescribed officers”.

The new Companies Act sets out certain standards of directors’ conduct, which include elements of the traditional common law fiduciary duties and the duty to act with care and skill.

Under the new Companies Act, a director of a company must:

(a) not use the position of director, or any information obtained while acting in the capacity of a director
   (i) to gain an advantage for the director, or for another person other than the company or a wholly-owned subsidiary of the company; or
   (ii) to knowingly cause harm to the company or a subsidiary of the company; and
(b) communicate to the board at the earliest practicable opportunity any information that comes to the director’s attention, unless the director
   (i) reasonably believes that the information is (aa) immaterial to the company; or (bb) generally available to the public, or known to the other directors; or
   (ii) is bound not to disclose that information by a legal or ethical obligation of confidentiality.

In addition, a director must exercise the powers and perform the functions of 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 (i) carrying out the same functions in relation to the company as those carried out by that director; and (ii) having the general knowledge, skill and experience of that director.

These duties are not materially different from the common law duties.

The new Companies Act provides some comfort to directors through the introduction of a presumption of compliance if certain factors are met. This provision is akin to the “business judgment rule” that has been adopted in the United States of America. The provision provides that a director will have satisfied the obligations regarding acting in the best interests of the company and with the necessary degree of care, skill and experience if:

► the director has taken reasonably diligent steps to become informed about the matter;
► either (i) the director had no material personal financial interest in the subject matter of the decision, and had no reasonable basis to know that any related person had a personal financial interest in the matter; or (ii) the director complied with the requirements regarding the disclosure of such interests; and
► the director made a decision, or supported the decision of a committee or the board, with regard to that matter, and the director had a rational basis for believing, and did believe, that the decision was in the best interests of the company.

As a further comfort to directors, the new Companies Act specifically provides that the directors are, in certain circumstances, entitled to rely on the advice of employees, professional advisors and other committees of the board.

The new Companies Act sets out in detail the bases upon which a director may be held liable for his conduct. These are:

► liability in accordance with the principles of the common law relating to 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 a duty relating to (i) disclosure of director’s financial interests; (ii) the duty not to use information of the company to gain an advantage; and (iii) the duty to act in good faith and for a proper purpose and in the best interests of the company; and
► in accordance with the principles of the common law relating to delict (i.e. tort) for any loss, damages or costs sustained by the company as a consequence of any breach by the director of (i) the duty to act with care, skill and diligence; (ii) any other provision of the new Companies Act; and (iii) any provisions of the company’s Memorandum of Incorporation.

The new Companies Act also sets out certain specific acts that will give rise to director liability, such as (i) acting in the name of the company despite knowing that the director lacked the authority to do so; and (ii) signing, consenting or authorising, the publication of any financial statements that
were false or misleading in any material respect. Importantly, the test for knowledge is both subjective and objective, and includes, in addition to actual knowledge, knowledge which the director ought to have had.

If directors are liable, their liability is joint and several with others who are liable on the same basis. Proceedings to recover any loss may not be commenced more than three years after the act or omission that gave rise to that liability.

The underlying principle of King III, the common law and the new Companies Act is that directors should act not just in accordance with the letter of the law, but also in accordance with the spirit of their fiduciary duties. There is no doubt that new legislation in South Africa poses certain new risks for directors, although steps have been taken to protect non-conflicted directors who act in good faith. It remains to be seen whether shareholders will use this new legislation to apply a higher level of scrutiny to the conduct of directors. Regardless, it is clear that the introduction of this new legislation and the increased emphasis on executive behaviour means that there should be an increased emphasis by directors on the proper role and functioning of boards.

Enhancement of corporate governance is increasingly seen as a means to build shareholder confidence, add value to the company and attract foreign investment to South Africa. The implementation of King III and compliance with the governance requirements of the common law and the new Companies Act should accordingly not be viewed merely as imposing bureaucratic and formalistic requirements which divert energy and resources away from the actual running of a business. The increased emphasis on corporate governance structures, procedures and principles forms part of a worldwide movement. King III (together with our existing common law and the new Companies Act) provides a world class and comprehensive code of conduct for South African business which should be taken into account by all business people in their management of companies.
Established in the early 1900s, Werksmans Attorneys is a leading South African corporate and commercial law firm serving multinationals, listed companies, financial institutions, entrepreneurs and government. Operating in Gauteng and the Western Cape, and connected to an extensive African network through Lex Africa*, the firm's reputation is built on the combined experience of Werksmans and Jan S. de Villiers, which merged in 2009.

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*In 1993, Werksmans co-founded the Lex Africa legal network, which now comprises 25 leading law firms in Africa's major economies.

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