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## **HOLDING DIRECTORS PERSONALLY LIABLE: WHERE TO DRAW THE LINE?**

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There is no doubt that directors in South Africa are being scrutinised for their role within organisations – and far more than in previous times. Board and executive decision-making is being challenged in parliament and in court and, at the very least, some directors have suffered significant reputational damage for not being seen to have properly and diligently fulfilled their fiduciary duties.

Where the old South African Companies Act of 1973 did not specifically spell out directors' functions and duties in detail, the new Companies Act of 2008 articulately records their statutory and common law duties. To this extent, the board is held ultimately accountable for managing the affairs of the organisation, both jointly and severally. Quite different to the previous Companies Act, under the new Act directors are personally accountable for a great deal more when things go wrong, and when this happens the consequences can be devastating for the organisation and its directors.

*"Corporate economic crime undermines confidence in business, distorts markets and erodes trust. Companies must be held to account for the criminal activity that takes place within them. I want to restore public faith in business and make sure we have the right tools available to crack down on corporate criminality." - Sir Oliver Heald, MP (UK Parliament)*

**Source: Companies face criminal charges over staff fraud  
(13 January 2017)**

Under the old Companies Act, directors were guided mostly by the limited provisions found in the Act, together with the details found in the organisation's Articles of Association and the common law. Moreover, and which is still the case today in the new Companies Act, a director is required to act in good faith, act independently and with a degree of care, skill and diligence that may be reasonably expected of a person of similar standing. Attempting to reproduce a complete list of duties expected of directors under the new Act in this article would be pointless. However, in addition to a director's common law duties, regulators have a long list of duties for which directors can be held accountable should they not fulfil their duties owed to the organisation. Besides a number of critical pieces of legislation which directors *must* understand and apply, such as the Criminal Procedures Act of 1977, the Protected Disclosures Act of 2000 and the Financial Intelligence Centre Act of 2001; directors *must* also be fully compliant to the provisions contained in the organisation's Memorandum of Incorporation ('MOI'). Indeed, if the director holds a non-executive position on a few boards in South Africa, each organisation will have a unique MOI that may also, *inter alia*, address the manner in which directors are sanctioned for poor, reckless and or errant behaviour. Moreover, personal liability including criminal sanction are common cause for concern, yet many directors are blissfully unaware of the immense personal risks they face when they do not fulfil their duties as a director. Even worse is when directors naïvely believe they need only rely on their old practices of simply applying common law in order to 'play it safe'.

In the increasingly litigious environment we live in today, the courts will use the business judgement rule to establish whether the directors have fulfilled their duties. If not, in certain circumstances they can be held

personally liable. Moreover, with new legislation being passed, these circumstances of personal liability are increasing and therefore it is critical that directors have an acute understanding of the organisation's affairs, as well as the consequences the law will have upon a director should they default in their legal duties owed to the organisation. Having regard to the matters of director's and their increased liabilities; one really does need to think twice about entering (or maintaining) a directorship position, particularly if the person is averse to the potential risks and reputational damage. It's one thing if a director can mitigate their risks, but when matters are taken completely out of the director's hands and they are still held liable, that is something altogether different and this begs the question of why a person would want to be a director at all.

Similar to the US, the UK is considering legislation that seeks to prosecute directors if employees in their organisation are found guilty of committing fraud, money laundering and false accounting. Whilst it may be commendable that organisations and their boards are first in the firing line in an attempt to curb and prosecute white collar crime; the question is can such legislation be considered fair and reasonable? This would amount to 'strict liability' where directors are held personally liable for the organisation's breach of legislation even though they may have acted reasonably. Given that a board of directors would have implemented proper and robust procedures to protect their organisation from criminal activity, reality proves time and again that the criminals and their sophisticated cartels are most often many steps ahead of the policing authorities, let alone their own board and management. This being said, it is common knowledge that running a business is not without its risks and if legislation such as that which is being proposed in the UK is passed, directors operating under UK law may have no incentive to remain in these positions. Indeed, if the board of directors had complete assurance that their systems could not be marginalised by thieves, that would present an entirely different situation to retain, or even attract new directors. Clearly, passing such a law makes little sense and offers no incentive for directors who apply their minds and act reasonably whilst being blindsided by much smarter employees with criminal tendencies.

Expectedly, it is quite different when directors act recklessly or blatantly for their own interests, or when their actions do not meet the test of the business judgement rule. In this case, we would agree that directors should be held to account by imposing harsh penalties. When one considers the fact that directors are appointed in a fiduciary position, it is criminal when they abuse their position for selfish motivation and personal gain.

There will be a lot of debate in the months to come pertaining to these increased liabilities placed on directors in the UK, and no doubt the fairness and rights of directors will also be high on the agenda. As much of South African law follows the trends of the criminal legislation produced overseas, it would be a grave mistake for any South African director -- or aspiring director -- to ignore these activities. The reason is simply this; once legislation has been passed in another jurisdiction, particularly in the US and the UK, it has an uncanny ability to quickly permeate the legislative frameworks across the world. And even if this is not the case, and the intended legislation was ring-fenced to the US and the UK alone, South Africa is part of their global business village.

It is just a question of time to see how this draconian UK legislation may affect local and internationally based directors, not least also their business risks and decision-making. There is no doubt that the passing

of this proposed UK legislation will also impact the relationships directors hold with their employees, and the element of trust between these parties could even find itself being substantially challenged. Being a director has its own unique challenges, and being able to mitigate the associated business and personal liability risks is all part of the challenge when one accepts a position of directorship. However, if the risks of the unknown cannot be calculated and a corporate crime occurs under your watch as a director – notwithstanding your best endeavours to prevent it – it's simply speaking 'game over'.

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