

COVID-19 – Duties of Directors

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Capital markets have been rattled by the multiple effects of COVID-19: A reported R2.3 trillion has been wiped off the Johannesburg Stock Exchange (JSE) All Share Index; manufacturing activity is decreasing; large conferences/events are being cancelled; and tourism is waning. What is most disconcerting is the anticipated drop off in retail spending. Banks and investors are adjusting their risk assessment profiles of their customers in order to take account of the deteriorating economic environment, including a further revision of South Africa's estimated GDP growth to even lower estimates than the already revised estimate of 0.5% GDP growth, which could lead to a lack of access to affordable credit.

It is therefore imperative for directors of South African companies to understand their responsibilities, duties and liabilities, as set out in the Companies Act 71 of 2008 (the Act), when facing the financial impact that the COVID-19 pandemic can or will have on their businesses.

Directors' duties and responsibilities

Directors would be expected to become informed about the steps that should be taken to alleviate and mitigate against the possible fall-out that the spread of COVID-19 will have on the company's operations and the impact it will have on the way the company does its business.

In this regard, a director must, in terms of section 76(3) of the Act, perform his/her powers and 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 be reasonably expected of a person carrying out the same functions in relation to the company as those carried out by that director; and having the general knowledge, skill and experience of that director.

Section 76(4) of the Act states that, in respect of any particular matter arising in the exercise of the powers of the performance of the functions of a director, a particular director will have satisfied his/her obligations if that director has taken reasonably diligent steps to become informed about the matter, and has a rational basis to believe that the all decisions taken were in the best interest of the company at the time.

Reliance on others' advice

In taking reasonably diligent steps to become informed about the company's business and affairs, directors are entitled to rely on information prepared by the employees of the company, or any other professional person retained by the company. This would include health experts and those professionals who would be able to properly advise the company on the methods and protocols to be taken to ensure that COVID-19 has the least possible impact on the company and all of its stakeholders.

The directors must reasonably believe that such a professional person or expert merits confidence and that, that person's professional competence has enabled that person to properly advise management and all the employees of the company. Also, an unquestioning reliance on others by a director is not acceptable. Pertinent questions need to be asked and answered

and in order to ensure that directors elicit the best possible information and which is for the benefit of the company and its financial future.

Steps to take when faced with financial difficulties

In the weeks and months ahead, directors behaviour in response to the virus will be tested. A company's board should therefore carefully assess whether or not the company is facing financial difficulties which it may well be able to overcome (albeit with some difficulty), or is in fact financially distressed or insolvent within the meaning of the Act.

A company is financially distressed within the meaning of the Act if it is reasonably unlikely that it will be able to pay all its debts as they fall due and payable within the immediately ensuing six months, or it is reasonably unlikely that the company's assets will continue to exceed its liabilities within the immediately ensuing six months.

When a company is facing financial difficulties it will be necessary for the board of directors to take the necessary steps to overcome those difficulties (e.g. restructure the company's business operations and/or its financial affairs) and to continually assess the company's financial status.

Should a company nevertheless become financially distressed, then the Board should either pass a resolution to place the company in business rescue, or deliver a statutory written notice to each affected person confirming that the company is financially distressed and is not being placed into business rescue and providing reasons for such decision.

If a company is trading in insolvent circumstances and there is no longer any prospect for [business rescue](#) to succeed, the Board should immediately resolve to propose to the company's shareholders that a special resolution for the company's voluntary liquidation be adopted. Alternatively, a director can apply to court for the liquidation of the company.

Tough decisions ahead for directors

Directors may become tempted in times of uncertainty to blindly forge ahead and take on credit (whether receiving goods and/or services on credit, or loans from lenders) in an attempt to keep the company afloat, whilst knowing full well that the company cannot, in its present circumstances, repay that credit. Some directors may even be tempted to misrepresent the company's financial position in order to obtain such credit.

Where the company's only salvation will be the economy returning to a semblance of normality once the COVID-19 pandemic is under control, directors should note that section 77(3)(b) of the Act, as read with section 22 of the Act, penalises and holds directors personally liable to the company for any loss incurred through knowingly carrying in the business of the company recklessly, with gross negligence, with intent to defraud any person or for any fraudulent purpose. In addition, a director can also be held personally liable, based on section 218(2), for any loss or damage to a third party, which resulted from any contravention of the Act.