

Covid-19 and downgrades: Director's duties unpacked

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At the same time as grappling with a nationwide lockdown to curb the spread of Covid-19, South Africa's credit rating was also downgraded to below investment grade by Moody's. This is likely to only further depress an already weakening economy, with high unemployment levels and poor socio-economic conditions.



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These deteriorating conditions will bring the governance of companies and businesses into sharp focus and will test the decision-making process and resilience of companies on the edge.

In terms of the Companies Act 71 of 2008, the board of directors is ultimately responsible for guiding and managing the company, and as such would be the body vested with the responsibility of ensuring that the company emerges from a crisis of the nature currently facing South Africa.

In formulating their response to crises such as Covid-19 and South Africa's credit rating downgrade, directors will be required to adhere to their common law and codified duties set out in the Companies Act. These duties require that directors act:

- in good faith and for a proper purpose; and
- in the best interests 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 in relation to the company as carried out by that director, and having the general knowledge, skill and experience of that director.

A director will have satisfied these obligations if the director:

- has taken reasonably diligent steps to become informed about the matter; and
- has no material personal financial interest in the subject matter of the decision; and
- has a rational basis for believing and believed that the decision was in the best interests of the company.

The use of the reasonableness standard requires an objective assessment of directors', which should also take account of the current climate and circumstances in which directors are operating.

Directors must also perform their duties within the ambit of the statutory obligations set out in the lockdown regulations issued in terms of the Disaster Management Act, 2002 and all other applicable areas of law such as employment, health and safety and data protection.

In the face of these crises, directors are advised to:

- Remain informed of government regulations and directions concerning the lockdown and the Covid-19 pandemic. If they are not clear about the way decisions from government might impact their business continuity, they should seek advice;
- Prepare and manage a plan and/or strategy to enable operations of the company (to the extent possible) during the lockdown, including remote working capabilities. Consider the impact on employees who are not able to work remotely as well as data privacy and cyber security issues resulting from remote working;
- Convene regular meetings or check-ins with executive team members and all the directors of the board by tele/video conference to remain informed about business impact and continuity;
- Monitor compliance with financial covenants contained in any arrangements with lenders;
- Consider the impact of the crisis on their companies' contractual obligations (particularly those that cannot be met for reasons beyond the companies' control);
- Ensure frequent communication with stakeholders, including regulators, shareholders, employees, lenders and suppliers and advise them of steps being taken to ensure business continuity;
- Ensure that appropriate leadership succession plans are in place in case key leaders of the business are taken out of their normal working routines due to illness.
- Consider the impact of decisions taken by the board on the interests of employees, suppliers and creditors; and
- Keep proper minutes of meetings held and decisions taken.

Directors should also continuously monitor the solvency and liquidity of their companies, by, amongst other things, considering trading and cash flow projections to take account of the impact of the lockdown and the downgrade and the potential changing trading position of their companies. Where possible and appropriate, the directors should not approve the incurrence of any new liabilities, unless it is clear how any such liabilities are going to be met. In terms of the Companies Act any director may be held liable for loss, damages or costs sustained by the company as a direct or indirect consequence of the director:

- having acquiesced in the carrying on of the company's business despite knowing that it was being conducted recklessly, with gross negligence, with intent to defraud any person or for any fraudulent purpose; and
- being party to an act or omission by the company despite knowing that the act or omission was calculated to defraud a creditor, employee or shareholder of the company or had another fraudulent purpose.

In light of the lockdown regulations, the Companies and Intellectual Property Commission (CIPC) issued Practice 1 of 2020, which provides that the CIPC will not invoke its powers under the Act, to issue a notice to a company that is temporarily insolvent and still carrying on business or trading, provided that the insolvency is due to business conditions caused by the Covid-19 pandemic. This leniency lapses within 60 days after the declaration of a national disaster is lifted.

This practice note does not (and is not able to) suspend, amend or override the provisions of the Companies Act, that a company must not carry on its business recklessly, with gross negligence, with intent to defraud any person or for any fraudulent purpose. The fact that CIPC will not exercise its powers under section 22 of the Companies Act does not absolve companies and boards from the requirements of the Companies Act.

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