

The Companies Act
Australian 'Centro-case'
confirms duties of all directors



The new Companies Act, 2008 (the Act) emphasises the responsibility and accountability of directors. Recent international and local jurisprudence also underline the demanding standard of conduct that is expected of company directors.

Standard of directors' conduct

The standard of directors' conduct in section 76 of the Act sets the bar very high for directors, with personal liability where the company suffers loss or damage as a result of a director's conduct not meeting the prescribed standard. The intention of the legislature seems to be to confirm the common law duties and to encourage directors to act honestly and to bear responsibility for their actions - directors should be accountable to shareholders and other stakeholders for their decisions and their actions on behalf of the inanimate company.

The unintended consequence may be that directors would not be prepared to take difficult decisions or expose the company to risk. Since calculated risk taking forms an integral part of any business, the Act includes a number of provisions to ensure that directors are allowed to act reasonably without constant fear of personal exposure to liability claims. In this regard, the Act has codified the business judgment rule, and provides for the indemnification of directors under certain circumstances, as well as the possibility to insure the company and its directors against liability claims in certain circumstances.

In terms of the Act a director must exercise his or her powers and perform his or her 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 reasonably be expected of a person carrying out the same functions and having the general knowledge, skill and experience of that particular director.

In essence, the Act combines the common law fiduciary duty and the duty of care and skill. This codified standard applies in addition to, and not in substitution of the common law duties of a director. The body of case law dealing with the director's fiduciary duty and the duty of care and skill remains applicable.

The codified standard of conduct applies equally to all the directors of the company. The Act makes no specific distinction between the responsibilities of executive, non-executive or independent non-executive directors.

Of course, it is trite that not all directors have the same skill and experience, and not all directors have a similar understanding of the functioning of the company. This raises the question as to what is expected of different types of directors when it comes to their duties. In this regard, the court, in *Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd* made it clear that the test is applied differently to different types of directors. The court concluded that the extent of a director's duty of care and skill depends on the nature of the company's business, that our law does not require a director to have special business acumen, and that directors may assume that officials will perform their duties honestly.

The test for the duty of care and skill as contained in the Act provides for a customised application of the test with respect to each individual director – in each instance both the objective part of the test (measured against a person carrying out the same functions as that director), as well as the subjective element of the test (measured against a person having the same knowledge, skill and experience as that director) will be applied. Thus, even though all directors have the same duties, the measurement against the standard of conduct will account for the personal circumstances of each director.

In discharging any board or board committee duty, a director is entitled to rely on one or more employees of the company, legal counsel, accountants or other professional persons, or a committee of the board of which the director is not a member. The director, however, does not transfer the liability of the director imposed by this act onto such employee, nor can a director blindly rely on the advice of employees or advisors.

Centro case

In a recent Australian judgment, *Australian Securities and Investments Commission v Healey*, commonly referred to as the Centro case, the court emphasised the responsibility of every director to pay appropriate attention to the business of the company, and to give any advice due consideration and exercise his or her own judgment in the light thereof. This case is relevant to directors of South African companies, because the new Act indicates that a court, when interpreting or applying the provisions of the Act, may consider foreign company law.

In this case the non-executive Chairman, six other non-executive directors and the Chief Financial Officer of the Centro Property Group ("Centro") faced allegations by the Australian Securities and Investments Commission that they had contravened sections of the Corporations Act 2001 arising from their approval of the consolidated financial statements of Centro. Similarly to our Companies Act, the Australian Corporations Act requires the board to approve the financial statements.

The relevant facts are that the 2007 financial statements of Centro Properties Group failed to disclose, or properly disclose, some AU\$1.5 billion of short-term liabilities by classifying them as non-current liabilities and failed to disclose guarantees of short-term liabilities of an associated company of about US\$1.75 billion that had been given after the balance sheet date, but before approval of the statements.

The central question was whether directors of publicly listed entities are required to apply their own minds to and carry out a careful review of, the proposed financial statements and the proposed directors' report, to determine that the information they contain is consistent with the director's knowledge of the company's affairs, and that they do not omit material matters known to them or material matters that should be known to them. In short, the question was to what extent reliance may be placed on the audit committee and the finance team.

In analysing the director's duty of care and skill, the court commented that:

"all directors must carefully read and understand financial statements before they form the opinions which are to be expressed ... Such a reading and understanding would require the director to consider whether the financial statements were consistent with his or her own knowledge of the company's financial position. This accumulated knowledge arises from a number of responsibilities a director has in carrying out the role and function of a director. "

These include the following:

- a director should acquire at least a rudimentary understanding of the business of the corporation and become familiar with the fundamentals of the business in which the corporation is engaged;
- a director should keep informed about the activities of the corporation;
- whilst not required to have a detailed awareness of day-to-day activities, a director should monitor the corporate affairs and policies;
- a director should maintain familiarity with the financial status of the corporation by a regular review and understanding of financial statements;
- a director, whilst not an auditor, should still have a questioning mind."

Several statements were made in which it became apparent that every director is expected to apply his or her own mind to the issues at hand. Even though directors may rely on the guidance and advice of other board committees, employees and advisors, they nevertheless need to pay attention and apply an enquiring mind to the responsibilities placed upon him or her.

“... a director is not relieved of the duty to pay attention to the company’s affairs which might reasonably be expected to attract inquiry, even outside the area of the director’s expertise.”

“... Whether, for instance, a director went through the financial statements ‘line by line’, he is not thereby taking all reasonable steps, if the director in doing so is not focussed for himself upon the task and considering for himself the statutory requirements and applying the knowledge he has of the affairs of the company”.

A key statement made by the judge is as follows:

“Nothing I decide in this case should indicate that directors are required to have infinite knowledge or ability. Directors are entitled to delegate to others the preparation of books and accounts and the carrying on of the day-to-day affairs of the company. What each director is expected to do is to take a diligent and intelligent interest in the information available to him or her, to understand that information, and apply an enquiring mind to the responsibilities placed upon him or her.”

The court concluded that in the Centro case each director failed to exercise the degree of care and diligence required by law in the course of their review of the financial statements and as such can be held liable for the losses suffered by that company as a result of their failure to comply with their duties.

South African case law echoes the findings of the Centro judgment. In Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd the court stated that:

“Nowhere are [the director’s] duties and qualifications listed as being equal to those of an auditor or accountant. Nor is he required to have special business acumen or expertise, or singular ability or intelligence, or even experience in the business of the company... He is nevertheless expected to exercise the care which can reasonably be expected of a person with his knowledge and experience... a director is not liable for mere errors of judgment. In respect of all duties that may properly be left to some other official, a director is, in the absence of grounds for suspicion, justified in trusting that official to perform such duties honestly. He is entitled to accept and rely on the judgment, information and advice of the management, unless there are proper reasons for querying such. Similarly, he is not expected to examine entries in the company’s books... Obviously, a director exercising reasonable care would not accept information and advice blindly. He would accept it, and he would be entitled to rely on it, but he would give it due consideration and exercise his own judgment in the light thereof”.

How do these judgments affect the position of directors (especially non-executive directors) where the audit committee considered financial and actuarial reports? Are non-executive directors nevertheless expected to review such reports and vote on applicable resolutions? The answer seems to be ‘yes’. The obligation to approve the financial statements of the company rests equally on each director. As such, every director has to study the relevant reports, and ensure for himself or herself that the content of the report confirms and coincides with his or her view of the business. No director is entitled to blindly rely on the conclusions of the audit committee, the finance team or other experts.

Conclusion

The decision to accept appointment to the board of a company should not be taken lightly. Directors need to be confident that they are able to pay adequate personal attention to the business of the company. Even though directors are entitled to rely on the guidance and advice from employees, advisors and other board committees, each director is obliged to apply his or her own mind (i.e. bring their own skill and experience to bear) to the facts at hand. They are not entitled to blindly rely on advice. What each director is expected to do is to ensure that he or she makes a concerted effort to understand the business of the company and the information placed in front of him or her, and to apply an enquiring mind to such information.

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