

**The Implications of software non-compliance for  
companies and directors under the Companies Act 2008**

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**Where a company is found to be using pirated software and/or fails a software compliance audit initiated by software vendors, there are likely to be certain important implications for the company and its directors under the Companies Act 2008.**

***Required standards of directors' conduct under the Companies Act***

Chapter 2, Part F of the Companies Act, 71 of 2008 (the “**Act**”), addresses the governance of companies. Certain sections within this chapter set out the standards and other requirements for directors' conduct<sup>1</sup>. It is important to bear in mind that the definition of a “director” is quite broad and includes:--

- an alternate director;
- a prescribed officer; and/or
- any person who is a member of a committee of the board,

in each case, irrespective of whether such person is also a member of the board of directors. For the purposes of clarity, any references in this article to a “director” will include each of the people described above, as well as the board as a whole.

The Act indicates that a director must *not* use his position or any information obtained while acting as a director to knowingly cause harm to the company or any of its subsidiaries<sup>2</sup>. In this context, the word “knowingly” is defined as including circumstances where the person concerned:--

- had actual knowledge of the matter; or
- ought reasonably to have:--
  - had actual knowledge;
  - investigated the matter sufficiently so as to obtain actual knowledge; or
  - taken other steps which, if taken, would have been expected to provide the person with actual knowledge.

As can be seen from the above, the standards set and steps expected of a director to ensure that he becomes informed have been set at quite a high level.

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<sup>1</sup> s. 76 of the Act.

<sup>2</sup> s. 76(2) of the Act.

The Act also requires all directors to exercise their powers:--

- in good faith;
- for a proper purpose;
- in the best interests of the company;
- with the degree of care, skill and diligence reasonably expected of a person:--
  - carrying out the same functions for the company as those carried out by that director; and
  - having the general knowledge, skill and experience of that director.<sup>3</sup>

#### Standards considered met

The director will be deemed to have met the standards required if:--

- such director took reasonably diligent steps to become informed about the software to be procured, licensed to or used by the company;
- he had a rational basis for believing that any decision taken in relation to the software was in the best interests of the company;
- the director relied on any person to whom the board had delegated any authority or duty (please see below for more information on those parties to whom the board may delegate authority); or
- the director relied on any information, opinions, recommendations, reports or statements prepared by any of the persons described below<sup>4</sup>.

#### The board may rely upon

As indicated above, a director will be permitted to rely on:--

- any employees of the company who the director reasonably believed were reliable and competent in the functions performed or information or opinions provided;
- any legal counsel, accountants or other professionals retained by the company, the board or a committee, provided that:--
  - the director reasonably believed that such matters were within the particular person's professional or expert competence; or
  - as to which the particular person merited confidence; or
- any committee of the board of which the director was not a member, unless the director had reason to believe that such committee or its actions did not merit confidence<sup>5</sup>.

In my opinion, it will accordingly no longer be possible for a director to simply argue that he "was not aware" that the company was using pirated software or had an

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<sup>3</sup> s.76(3) of the Act.

<sup>4</sup> s.76(4)(a) and (b) of the Act.

<sup>5</sup> s.76(5) of the Act.

insufficient number of user licences without having first having taken diligent steps to become informed and/or for having a reasonable basis to be satisfied with the current status of software procurement, licensing and use by the company. Of course, it would be acceptable for the director tasked with IT oversight to rely on the confirmations, advice and input provided by the company's IT manager *provided that* the director had confidence in such employee's competence in this area. Given the fact that the use of pirated software may result in fines and other sanctions for the company and taking into account that software vendors often apply certain penalties for a failure to have the correct number of user licences, any such failure on the part of the director concerned to perform his oversight function correctly can be said to have directly resulted in harm to the company.

#### Other avenues available to software vendors acting against deviant companies

In addition to the above, the Act also specifies that a company should *not* carry on its business:--

- recklessly;
- with gross negligence;
- with the intention of defrauding any person; and/or
- for any other fraudulent purposes<sup>6</sup>.

Given the broad categories set out above, it seems highly likely that where a deviant company fails a software compliance audit or where software vendors have received tip-offs on the use by a company of pirated software, such software vendors may approach the Companies and Intellectual Property Commission ("**CIPC**") for the appropriate relief.

Provided that the CIPC on reasonable grounds believes that such company is engaging in the prohibited conduct detailed above, it may issue a notice requiring such company to show why it should be permitted to carry on its business. If the company then fails within 20 business days to satisfy the CIPC that it is not engaging in prohibited conduct, the CIPC may issue a compliance notice requiring it to cease carrying on its business or trade<sup>7</sup>. Given the severity of the above, it seems highly likely that software vendors and their advisors will look to make increasing use of this provision of the Act when taking action against deviant companies.

#### Potential liability for the board or director(s) concerned

In the event that the director tasked with IT oversight fails to meet the required standards set out in the Act, such director may be held liable:--

- under the common law for a breach of fiduciary duty for loss, damages or costs sustained by the company as a result of such director's breach for:--

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<sup>6</sup> s.22(1) of the Act.

<sup>7</sup> s.22(2) and (3) of the Act.

- knowingly causing harm to the company or any of its subsidiaries;
- failing to act in good faith and for a proper purpose;
- failing to act in the best interests of the company<sup>8</sup>; and/or
- under the common law for delict in respect of any loss, damages or costs sustained by the company as a result of such director's breach for:--
  - failing to exercise the degree of care, skill and diligence reasonably expected of a person:--
    - carrying out the same functions as those performed by him; and
    - having the general knowledge, skill and experience of that director;
  - for breaching any provisions of the Act; and/or
  - for breaching any provision of the company's Memorandum of Incorporation<sup>9</sup>.

A director of a company may be held personally liable for any loss, damages and/or costs incurred by a company, whether arising directly or indirectly, where the director is party to an act or omission by the company despite knowing that such act or omission was calculated to defraud a creditor of the company or had another fraudulent purpose<sup>10</sup>.

The liability of any person who breaches the standards set by the Act for directors' conduct is joint and several with any other person who is found liable for the same act<sup>11</sup>. The risks for any director who fails to meet the required performance standards, as well as the severity of the potential liability which directors may face, should be sufficient to dissuade directors from becoming involved in restricted conduct and/or failing to adequately oversee the company's procurement, licensing and use of software utilised by the business.

It is also worth noting that the costs for which a director may be held personally liable would include the costs of all parties to any court proceedings and the cost of restoring to the company any amount(s) improperly paid by the company as a result of the improper act<sup>12</sup>.

The Act furthermore specifies that any person who is found to have contravened any provision of the Act, may be held liable to any other person for any loss or damage suffered by that third person as a result of such contravention<sup>13</sup>. Once again, it seems likely that software vendors and their advisors will make increasing use of these provisions of the Act when taking action against deviant companies.

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<sup>8</sup> s.77(2)(a) of the Act.

<sup>9</sup> s.77(2)(b) of the Act.

<sup>10</sup> s.77(3)(c) of the Act.

<sup>11</sup> s.77(6) of the Act.

<sup>12</sup> s.77(8) of the Act.

<sup>13</sup> s.218(2) of the Act.

### Liability may be limited in exceptional circumstances

Notwithstanding the above, a court or a director on application to a court, may relieve any director either wholly or in part from any liability as described above, if it appears to the court that:--

- the director is or may be liable, but has acted honestly and reasonably; or
- having regard to the circumstances, it would be fair to excuse the director from full or partial liability<sup>14</sup>.

### Conclusions

In light of the high standards for directors' conduct set out above, it is imperative that any director who is responsible for or tasked with oversight of the company's IT systems and, in particular, its software procurement, licensing and use, takes this role very seriously. This responsibility and oversight should include at a minimum:--

- recruiting a competent IT manager;
- having regular update meetings with the IT manager;
- ensuring that regular (6- or 12-monthly) software compliance audits are conducted internally within the company, the results of which are then discussed in detail with the IT manager and, where appropriate, the board; and
- establishing a software asset management policy for the company and ensuring that all employees are made aware of and comply with its requirements.

In the event that a director fails to meet the performance standards required, each responsible director could be held personally liable for any losses, damages and/or costs associated with the use by the company of pirated or unlicensed software. It is likely that these losses, damages and/or costs may well include any fines or penalties levied by the software vendors, the costs associated with court action brought against the company concerned and/or the costs of restoring to the company any amounts improperly paid by the company.

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<sup>14</sup> s.77(9) of the Act.