DIRECTORS' FIDUCIARY DUTY TO ACT IN THE BEST INTEREST OF THE COMPANY-

IS THE BUSINESS JUDGEMENT RULE BEING ABUSED BY DIRECTORS TO PREVENT LIABILITY?

by

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OPSOMMING

Direkteure se vertrouensplig om in die beste belang van die maatskappy op te tree.- Word die sake-oordeelsreël misbruik deur direkteure om aanspreeklikheid te voorkom?

Direkteure se vertouensplig in Suid-Afrika se maatskappyereg is afgelei van die Romeins-Holandse reg terwyl die plig van sorg van Engelse reg afkomstig is. Hierdie pligte is deurlopend ontwikkel deur die interpretasie van regspraak asook addisionele beginsels wat deur die verskeie King verslae aanvaar is, welke beginsels geag word as internationale beste praktyke. Die Suid-Afrikaanse Maatskappyreg het 'n meer inklusiewe model aanvaar wat gely het tot die uitvaardiging van die Maatskappyewet 71 van 2008. Direkteure se vertrouensplig en plig van sorg is gedeeltelik gekodifiseer deur Artikel 76 van die Maatskappywet. Die insluiting van die sake-oordeelsreël ten einde addisionele beskerming aan direkteure te verskaf is gekritiseer deur verskeie akademici. Daar is onder meer benadruk dat die insluiting daarvan verwarring tussen die verskeie pligte meebring en onnodig is weens die gemenereg wat reeds voldoende daarvoor voorsiening maak. Huidige skandale en misbruik van direkteursmagte het die vraag laat ontstaan oor die onvermoë om direkteure aanspreeklik te hou vir die verbreking van hierdie direkteursverpligtinge. Verskeie lande en in besonder Duitsland en Australië se benadering en implimentering van die sake-oordeelsreël, is ondersoek. Weens die skade aan die maatskappy maar ook die gemeenskap as geheel is dit van uiterste belang dat die pligte van direkteure meer breedvoerig omskryf word en die toepassing van die sake-oordeelsreël ingeperk word.

CHAPTER 1

INTRODUCTION

1.1 Background

It is well known that a company is a juristic person which acts through its board of directors.[1] The board of directors, unless provided for otherwise through its memorandum of incorporation has complete powers to perform any function of the company they represent.[2] Fiduciary duties' in South African company law are derived from Roman-Dutch law and not from English law[3] whereas the directors' duty of care is largely derived from English law.[4] These duties were derived from 18th and 19th century English company law which was judicially created and improved through continuous interpretation and application in case law.[5] South African Company law is modelled after English company law, although it is merely persuasive and not binding.[6] Developments in other countries have become more significant in company law, especially where it has not been in accordance with derivatives of the European Union.[7] Fiduciary duties of directors are based on loyalty, good faith and the avoidance of conflict of interest.[8] A director must therefore rationally believe that his actions are in the best interest of the company,[9] which should be exercised with a degree of care, skill and diligence. Having the general knowledge and experience required of such directors.[10] These requirements have been entrenched by partial codification of directors' duties in the Act.[11]

The 1973 Companies Act[12] commenced on 1 January 1974 and was refined and modernised on an ongoing basis through the African standing advisory committee on company law which

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[1] *Salomon v Salomon* [1897] AC 22.
[2] S 66(1) Companies Act 71 of 2008. Oosthuizen Chapter 11 "The nature and purpose of a company" in Botha and Barnard (eds) 2019 *De Serie Legenda Vol III* 218.
[3] Mupangavanhu (2017) 1 *Stellenbosch Law Review* 157.
[4] *Fisheries Development Corporation of SA v Jorgensen; Fisheries Development Corporation of SA Ltd v AWJ Investment (Pty) Ltd* 1980 4 SA 156 (W) 165; Cassim FHI (eds) (2012) 509.
[5] Cassim FHI (eds) (2012) 509.
[6] Pretorius (1999) 2; *Jonker v Akerman* 1979 3 SA 575 (O) 588.
[7] Havenga (2000) 12 *SA Mercantile LJ* 25.
[8] Cassim FHI (eds) (2012) 285.
[9] Pretorius (6th ed) (1999) 279; *Da Silva v CH Chemicals* 2008 SA 620 (SCA); *Mouritzen v Greystone Enterprises (Pty) Ltd* 2012 (5) SA 74 (KZD).
[10] S 76(3)(b) Companies Act 71 of 2009, *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty)* 2014 5 179 (WCC).
[11] *Ibid.*
[12] Companies Act 61 of 1973.

was established in terms of the provisions of the 1973 Act.[13] This act did not provide clear rules regarding the fiduciary duties and liabilities of directors nor any guidance on corporate governance.[14] Directors' fiduciary duties were as a result thereof derived from common law, directors' contracts with their company and the memorandum and articles of association of the company. The corporate law reform program initiative started in 2003 with the intention to reform the South African entrepreneurial law and to overhaul the 1973-Companies Act.[15] The 1994 King I report adopted several new approaches to corporate governance including some of the corporate governance principles proposed by the 1992 UK Cadbury report.[16]Additional principles were also adopted by the King II -IV reports as these principles have been seen as international best practices.[17]

The South African company law shareholder model shifted to a more inclusive model when the department of Trade and Industry released a policy document in May 2004 entitled "*South African Company Law for the 21st Century Guidelines for Corporate Law Reform"*.[18] The document acknowledged that South Africa had no extensive statutory provisions covering the duties of directors and their possible accountability in the event of contravening fiduciary duties.[19] This resulted in the proclamation of the Companies Act 71 of 2008[20] which partially

[13] Cilliers (2000) 24-25; du Plessis Chapter 3 "Some myths and fallacies regarding corporate law and corporate governance principles and rules: have they been debunked in South Africa" in Botha and Barnard (eds) 2019 *De Serie Legenda Vol III* 41.
[14] Davies and Le Roux (2012) 309; Botha Chapter 2 "First do no harm! On oaths, social contracts and other promises: How corporations navigate the corporate social responsibility labyrinth" in Botha and Barnard (eds) 2019 *De Serie Legenda Vol III* 18-19.
[15] Du Plessis Chapter 3 "Some myths and fallacies regarding corporate law and corporate governance principles and rules: have they been debunked in South Africa" in Botha and Barnard (eds) 2019 *De Serie Legenda Vol III* 41.
[16] King 1 Report on corporate governance; Committee on the financial aspects of Corporate Governance, Report of the committee on the financial aspects of Corporate Governance (Sir Adrian Cadbury, Chair) (1992) para 2.5.
[17] Cassim FHI (2012) 475.
[18] *Government Gazette* 26493, GN 1183 of 2004 (2004-06-23) Department of Trade and Industry *paper South African Company law For The 21 Century: Guidelines For Corporate Law reform*; van Tonder (2015) *Obiter* 702-724: Oosthuizen (2019) *De Serie Legenda Vol III* 224.
[19] Davis (2009) 2ed 111; DTI South African Company Law for the 21st Century Guidelines for Corporate Law Reform 2004 17.
[20] *GG* 34239 R32 (2011-05-01).

codified[21] the duties of directors and introduced the business judgment rule,[22] regulating to the standards of directors' conduct.[23] The business judgement rule has been applied in the United States of America for over 160 years and has also been adopted in Australia.[24] Under the Act, the business judgement rule purports to have an alleviating effect on the less subjective and more rigorous duty of directors to exercise reasonable care, skill and diligence in the performance of their duties.[25] Criticism against the introduction of the business judgement rule was that these statutory duties were not a complete codification of common law duties.[26] The exact contours and limits of the fiduciary duties still remained uncertain as fiduciary duties were never static and were still evolving.[27] The partial codification of directors' fiduciary duties does however not exclude the common law. It is for this reason that the common-law duties were not expressly amended by Section 76(2) of the 2008-Companies Act.[28] Common-law duties not in conflict with these provisions still applies.[29]

1.2 Directors' fiduciary duty to act in the best interest of the company

Directors' fiduciary duty to "act in the best interest of the company" has always been a core duty of directors under South African company law.[30] The meaning of the word "company" to whom the fiduciary duty is owed has been contentious as different views exist. The Act provides that unless the MOI provides otherwise, the board of the company has ultimate power in the company.[31] Shareholders have indirect control as they are empowered

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[21] Delport (2020) *Henochsberg on the Companies Act 71 of 2008* 295; Cassim (2018) 507; Davis *et al Companies and other business structures in South Africa: Commercial Law* 2ed 110.
[22] S 76(4).
[23] S 76.
[24] Cassim FHI (eds) (2018) 563.
[25] *Ibid.*
[26] Delport *the new companies act manual* (2011) 90.
[27] Cassim FHI (eds)*The law of business structures* (2018) 507.
[28] S 76 Companies Act, 71 of 2008.
[29] Esser and Du Plessis (2007) 19 *SA Merc LJ* 346 347; S 77(2) Companies At 71 of 2008; Williams "*Companies"* in Joubert and Faris (eds) *The law of South Africa Vol 4(1)* 238. *Mthimunye-Bakoro v Petroleum Oil and Gas Corporation of SA* (*SOC) Limited* (12476/2015) [2015] ZAWCHC 113; 2015 6 SA 338 (WCC).
[30] Blackman *Companies* in Joubert (ed) *LAWSA* (2006) 178-179, 124.
[31] S 66 (1) Companies Act 71 of 2008; Esser and Delport (2017) Part 2 *De Jure* 221-241 http://dx.doi.org/10.17159/2225-7160/2017/v50n2a2 225 (accessed 29 September).

to appoint and remove directors.[32] There are three different approaches, namely the "pluralist approach", the "enlightened shareholder approach"[33] and the "corporate governance approach".[34] According to the pluralist approach, non-shareholder stakeholders are an important constituency of a company and shareholders merely one of several constituencies.[35]

For this reason, directors should ignore shareholder interest in favour of stakeholder interest where it is in the best interest of the company.[36] The "enlightened shareholder value" approach requires directors to maximise profits for the benefit of shareholders. Directors are allowed to take stakeholder interest into account ensuring profit -maximisation and shareholder interest.[37] Naudé referred to this traditional approach as outdated.[38] The understanding of the word "company" for the purpose of directors acting in the best interest of the company has been incorrectly understood and applied in South African law.[39] This approach has been endorsed by the 2002 King II report[40] and supported by several South African scholars.[41] The 2016 King IV report has further adopted the view that several different interests are represented in the company as a separate legal entity.[42] The "corporate governance approach" acknowledges that directors owe their duties to the company alone as a separate legal entity.[43] A company represents several interests of shareholders, employees, consumers, the environment, and community.[44] Corporations are regarded as part of a society just as much as each individual and, selfish indulgence has been replaced by a concern for

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[32] *Ibid.*
[33] Cassim FHI (eds) (2012) 518.
[34] Botha Chapter 2 (2019) *De Serie Legenda Vol III* page 18-19.
[35] Cassim FHI (eds) (2012) 518.
[36] *Ibid*
[37] *Dodge v Ford Motor Co*, 204 Mich 495; 170 NW 668 (1919); *Hutton v West Cork Railway Co* (1883) 23 (ChD) 654 (CA).
[38] Naudé *Die regsposisie van die maatskappydirekteur met besondere verwysing na die interne maatskappyverband* (LLD thesis UNISA 1969) 154-155: Du Plessis Chapter 3 (2019) *De Serie Legenda Vol III* 46.
[39] Esser and Du Plessis (2007) *SA Merc LJ* 538.
[40] King Committee on Corporate governance executive summary of the King report 2002 institute of company directors in Southern Africa (2002) 10 para 17.2.
[41] Cilliers (2000) 139-140; Du Plessis (1992) *De Jure* 378-379; Havenga (2000) 12 *SA Merc LJ* 26-27; Esser 208.
[42] King Committee on Corporate Governance 26, n 4.
[43] Esser and Du Plessis 360-361.
[44] *Ibid.*

society.[45]

1.3 Problem statement

Current scandals, abuses and misuses as seen in the Steinhoff collapse,[46] the Tongaat Hulett sugar scandal[47] the collapse of the South African Airways [48] and the case of *OUTA v Myneni*[49] have raised the question about the inability to hold directors accountable for breach of their fiduciary duty. The dissertation will consider whether the business judgement rule, as adopted in South Africa, has contributed to the failure to hold directors accountable for breach of their fiduciary duty, and whether it has reduced the director's duty of care and skill.[50] The paper will further examine whether the statutory standards of conduct provision are aligned with the common law duty. Chapter 2 will consider the business judgement rule[51] in accordance with its technical layout, the duty to act in good faith in the best interest of the company and for proper purpose. Chapter 3 will focus on comparative jurisdictions assessing the alignment of the South African approach to these jurisdictions. Finally, the conclusion and recommendations will be set out in Chapter 4.

1.4 Research questions

The primary research question will focus on whether the business judgement rule as contained in section 76(4) of the Companies Act 71 of 2008, contributes to the failure to hold directors accountable for breach of their fiduciary duty. In answering the primary research question the following secondary research questions flow from it, namely:

- What measures could be included to ensure that directors are held accountable for breach of their fiduciary duty?

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[45] Crowther and Jatana (2005) Vol vi; Botha Chapter 2 (2019) *De Serie Legenda Vol III.*
[46] The University of Stellenbosch Business School The Steinhoff Saga http://www.usb.ac.za/usb_reports/steinhoff-saga/ (accessed 16 July 2020).
[47] Stoddard *Tongaat Hulett scandal raises more red flags about corporate governance in corporate South-Africa* (4 June 2019) https://www.dailymaverik.co.za/article/2019-06-04-tongaat-hullet-scandal-raises-more-red-flags-about-governance-in-south-africa/ (accessed on 16 July 2020).
[48] *Organisation Undoing Tax Abuse v DC Myeni* (15996/2017) (12 December 2019) [2020].
[49] *Organisation Undoing Tax Abuse & Another v DC Myeni* [2019] ZAGPPHC 957 (12 December 2019)
[50] Bouwman (2009) *SA Merc LJ* 509 533.
[51] S 76(3); S 76(4) Companies Act 71 of 2008.

- Should alternative measures be introduced to enhance the enforcement of the degree of care and skill if directors are seldom found to be in breach of their duty of care and skill?

1.5 Research purpose

The aim of this paper is to investigate the impact of the business judgement rule on the statutory and common law fiduciary duties of directors together with the Companies Act 2008 approach on combining the objective and subjective standards in evaluating directors' duty to act in the best interest of the company.

1.6 Scope of research

Research will include a comparison between South African common law and statutory duties of directors. Assessment of the business judgement rule on the director's duty to act in the best interest of a company will be done. The South African statutory provisions will further be compared to comparable jurisdictions focussing on the Australian and German approach.

CHAPTER 2
STATUTORY STANDARD OF DIRECTORS' CONDUCT

2.1 Introduction

The partial codification of directors' duties has created an undue distinction between fiduciary duties and the duty of care.[52] The 1973-Act did not codify directors' duties but merely contained statutory duties in addition to fiduciary duties and duties of care and skill.[53] Section 424(1) of the 1973 Act was enacted with the intention to curb acts of fraud and recklessness by company directors when the company was being wound up or undergoing judicial management.[54] Chapter XIV of the 1973-Act continues to apply in conjunction with Sections 22(1) and 77(3) of the Companies Act 71 of 2008.[55] Directors' duties were largely regulated by the common law and codes of best practice, like the King IV report on Corporate Governance for South Africa 2016. Section 76(3)(b) and (c) combine these duties which are problematic due to the difference in these duties. Fiduciary duties are derived from Roman Dutch law whereas the duty of care is derived from English common law and leads to claims for delictual damages.[56]

2.2 Section 76 of the Companies Act, 71 of 2008

Section 76 of the 2008 Companies Act sets out the conduct standard for directors. It is required when acting in the capacity of a director to exercise and perform duties in good faith, for a proper purpose and in the best interest of the company.[57] Directors are required to act with a degree of care, skill and diligence that may be reasonably expected of a director in the same position.[58] This requirement is in accordance with the common law duty to act *bona fide*, in the best interest of the company and for a proper purpose.[59] Directors will accordingly be regarded

[52] Cassim FHI (2012) 564.
[53] Delport (2020) *Henochsberg on the Companies Act 71 of 2008* 295.
[54] S 424(1) Act 61 of 1973.
[55] Item 9 of Schedule 5 to the Companies Act 72 of 2008.
[56] Bouwman 509.
[57]Delport (2020) *Henochsberg on the Companies Act 71 of 2008* 295.
[58] S 76(3) Companies Act, 71 of 2008.
[59] *Ibid.*

to have satisfied their obligations of acting in the best interest of the company and acting with a degree of care, skill and diligence when complied with Section 76 of the Act. These requirements will be discussed briefly.

2.2.1 Duty to avoid conflict of interest

Directors are not allowed to utilise information received from their position as directors in their company for their own or any other persons' gain or profit.[60] Section 76 (2)(a)(i) and (ii) imposes a mandatory and positive duty on directors to avoid conflict of interest which also includes the common-law 'no-profit' rule and 'corporate opportunity rule'.[61] The 'no-profit' rule determines that directors may not retain any profits made by them while performing their duties as directors.[62] The 'corporate opportunity' rule further prohibits directors from appropriating any information, contract or any other opportunity that belongs to the company which were acquired while acting as director of the company.[63] Directors may not use information to cause harm to the company or any of its subsidiaries.[64] This section will be applicable on both the avoidance of conflict of interest and a conflict of directors' duties. Directors will contravene section 76(2)(a)(i) even if there was no dishonesty and they truly believed that they acted in the best interest of the company.[65] It is further irrelevant if the company suffered any loss.[66]

2.2.2 Good faith and proper purpose

Directors have a fiduciary duty to exercise their powers in good faith and in the best interest of the company.[67] They owe no fiduciary duty to the members or shareholders of the company individually.[68] Their fundamental duty is to act *bona fide* in the interest of the

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[60] *Regal Hastings Ltd v Gulliver* [1942] 2 All ER 378 (HL*); Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168; Da Silva above n *9; Phillips v Fieldstone Africa (Pty) Ltd* 2004 3 SA 464 (CSA).
[61] Cassim FHI (eds) (2012) 551.
[62] *Ibid* 536
[63] *Ibid* 538
[64] *Ibid* 550.
[65] *Ibid.*
[66] *Regal (Hastings) Ltd v Gulliver* [1942] 2 All ER 378 (HL)
[67] *Da Silva* above n9.
[68] *Percival v Wright* [1902] 2 Ch 421; *Pergamon Press Ltd v Maxwell* [1970] 2 All ER 809 (Ch) 814. *Hlumisa Holdings (RF) Ltd v Kirkinis* (1423/2018) [2020] ZASCA.

company as a whole and its shareholders as a body.[69] To act in good faith is commonly accepted to be the act of acting honestly and without an intention to deceive. The concept of good faith is further closely linked to acting in the best interest of the company. This duty will not replace any other duty owed by directors.[70]

The test to ascertain if a director acted with proper purpose is objective. Once the actual purpose has been ascertained it must be determined if the actual purpose falls within the purpose for which power was conferred.[71] This will largely be a matter of interpretation of the empowering provision in the context of the instrument as a whole.[72] The 'proper purpose' duty therefore indicates that a director must not exceed the limitations of his own authority or exceed the limitations of the company.[73] The court held in *Visser Sitrus (Pty) Ltd v Goede Hoop Citrus (Pty) Ltd* [74] that there will often be a close relationship between the requirement that a power must be exercised for a proper purpose and the requirement that the directors should act in what they consider to be in the best interest of the company.[75] The overarching purpose for which directors must exercise their powers is the purpose of promoting the best interest of the company.[76] Directors will be in breach of their fiduciary duties if they purport to exercise powers which are non-existent because they are beyond the corporate capacity of the company.[77] The duty to act *bona fide* in the best interest of the company is distinguished from the duty to act for the purposes of the business of the company only as authorised by its objective clause even if their actions are *intra vires*.[78]

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[69] *SA Fabrics Ltd v Millman* 1972 4 SA 592 (A).
[70] Delport (2020) *Henochsberg on the Companies Act* 298(3).
[71] *Visser Sitrus* above n 10 para 80.
[72] *Ibid.*
[73] Naudé (1970*)* 111-115.
[74] *Visser Sitrus* above n 10.
[75] *Ibid* para 77.
[76] Delport (2020) *Henochsberg on the Companies Act 71 of 2008* 298.
[77] *Cullerene v The London & Suburban General Permanent Building Society* (1890) 25 QB 485 (CA) 488, 490.
[78] Blackman (1990) 1 *SA Merc LJ*.

2.2.3 Best interest of the company

The duty to act in good faith and the duty to act for the benefit of the company are two separate duties although not consistently applied.[79] Acting in the best interest of the company relates to the question whether the directors honestly believe that their decision is in the best interest of the company.[80] Rogers J in *Visser Sitrus (Pty) Ltd and Goede Hoop Citrus (Pty) Ltd* [81] states that section 76(4) of the Act makes it clear that the duty to act in the best interest of the company is not an objective one. What is required is that the director, after taking diligent steps to become informed, subjectively believed that the decision taken was in the best interest of the company.[82] This belief must have a "rational basis." The rational criteria as set out in section 76 of the Act is an objective criterion but differs from the determination if a decision was objectively in the best interest of the company.[83] In *Pharmaceutical Manufacturers Association of SA: In Ex parte Precedent of the Republic of South Africa*,[84] Chaskalson P said:

> *"... the setting of a standard does not mean the Courts should substitute their own opinion as to what is appropriate for the opinion of those in whom the power has been vested. As long as the purpose sought to be achieved by the exercise of public power is within the authority of the functionary, and as long as the functionary decision, viewed objectively, is rational, a Court cannot interfere with the decision because it disagrees with it or consider that the power was exercised inappropriately. A decision that is objectively irrational is likely to be made only rarely but, if this does occur, the court has the power to intervene and set aside the irrational decision...."*[85]

It is viewed that the joining of subjective duty to act *bona fide* with the objective requirement to act in the best interest of the company, is one of the elements of the business judgement rule'.[86] This requirement is, however, not sufficient as it only serves to prove that

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[79] Naudé (1970) 155; *Da Silva* above n 9 para 18; *Companies and Intellectual Property Commission v Tshelane and Chemicals (Pty) Ltd* (99920/2015) [2017] ZAGPPHC 720 (13 November 2017) para 68.
[80] *In re Smith & Fawcett Ltd* [1942] Ch 304 (CA) 306 [1942] 1 All ER 542 at para 543; *Visser Sitrus* above n 10 para 74.
[81] 2014 5 SA (WCC).
[82] *Ibid* para 74.
[83] *Ibid* para 76.
[84] 1999 4 SA 788 (T): *Ex parte Precedent of the Republic of South Africa* [2002] ZACC 1; 2000 2 SA 674 (CC) para 90.
[85] *Ibid.*
[86] S 76(4)(a)(iii) Companies Act 71 of 2008.

the director acted in accordance with the requirement of section 76(3)(b) and 76(3)(c) and not to act *bona fide* in terms of section 76(4)(a).[87]

The main goal of a fiduciary duty is the prohibition of misconduct harmful to the company.[88] In *Bristol and West Building Society v Mothew (t/a) stapley & Co*[89] the court cited remarks by La Forest J in *LAC Minerals Ltd v International Corona Resources Ltd*[90]

"not every legal claim arising out of a relationship with fiduciary incidents gives rise to a claim for breach of Fiduciary duty."

The court tried to clarify the duty of a fiduciary and stated that:

"a fiduciary must act in good faith; he must not make a profit out of his trust; he must not place himself in a position where his duty and interest may conflict; he may not act for his own benefit or the benefit of a third person without the informed consent of his principal."[91]

The cause of action for breach of a fiduciary duty is not regarded as delictual neither contractual and has been held to be simply *sui generis.*[92] A director of a company may be held liable for breach of the fiduciary duty in accordance with the principles of common law.[93] Delictual liability however can only be incurred in the event of breach of fiduciary duty of care, skill and diligence .[94] In terms of the law of delict, this will be regarded as any voluntary human act or omission.[95] An omission or failure to take certain measures might not be a form of conduct but may well indicate that the action was negligent.[96] Deciding whether the duty

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[87] *CDH Investment NV v Petrobank South Africa (Pty) Ltd* [2018] 1 All SA 450 (GJ), 2018 (3 SA 157 (GJ) para 66 ; *CDH Investment NV v Petrobank South Africa (Pty) Ltd* [2019] JOL 41627 (SCA), 2019 4 SA 436 (SCA).
[88] Velasco *(*2015) 40 *J Corp L* 648-664.
[89] [1996] 4 All ER 698 (CA).
[90] 91989 61 D.L.R. (4th) para 14, 28.
[91] *Bristol and West Building Society v Mothew (t/a) Stapley & Co* [1996] 4 All ER 698 (CA).
[92] *Robinson v Randfontein* above n 59 as per Innes CJ and Solomon JA: Cilliers (1992) 141.
[93] S 77(2)(a)
[94] S 77(2)(b)(i) Companies Act 71 of 2008.
[95] Neetling (2010) 30.
[96] *Ibid.*

was observed, the court will consider whether a reasonable man could have believed that the action was in the best interest of the company in the same circumstances.[97]

In most cases the requirement of acting in the best interest of the company will overlap with the requirement of good faith.[98] Breach of fiduciary duty is a serious infraction by a person placed in a position with fiduciary duties and usually involves dishonesty or a lack of probity.[99] The duty of care, skill and diligence regulates the performance of these fiduciary duties[100] whereas the business judgment rule[101] provides the circumstances in which the duty to act in the best interests of the company and with the duty of care, skill and diligence will be satisfied by a director.[102]

Directors will incur liability to the company for breach of their fiduciary duty or as restricted by the company's MOI if they exceed their powers, unless their act has been ratified by a special resolution of the company's shareholders.[103] The liability for a breach of fiduciary duty arises irrespective of the *bona fides* of the director in question.[104]

2.2.4 Degree of care, skill, and diligence

The standard for duty of care and skill in South-African common law was laid down in *Fisheries Development Corporation of South Africa Ltd V Jorgensen.*[105] The requirements for the duty of care and skill depends largely on the nature of the company's business and on the particular obligations assigned to the director.[106] The Act imposes a higher standard of a director's duty of care and skill and also covers diligence.[107] A director is not required to have special business expertise but is only expected to exercise the level of care that reasonably can

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[97] *CDH Invest NV v Petrotank South Africa* above n 87.
[98] *Mouritzen v Greystone* above *n 9*.
[99] *Master of the High Court v van Zyl* [2018] A276 (WC).
[100] Cilliers 147.
[101] S 76(4)(a) Companies Act 71 of 2008; Delport *et al Henochsberg on the Companies Act 71 of 2008* 297.
[102] S 76(4)(a) Companies Act 71 of 2008; *Visser Sitrus* above n 10 para 80.
[103] *Cullerne v London and Suburban General Permanent Building Society* (1890) 25 QBD 485; Cassim *et al* (2018)
[104] *Lands Allotment Co Ltd* (1894) 1 Ch 616 (CA).
[105] 1980 4 SA 156 (W).
[106] *City Equitable Fire Insurance Co Ltd* at 427[1925] Ch 407 (CA).
[107] S 76(3)(c) Companies Act 71 of 2008.

be expected of a person with his knowledge and experience.[108] A director cannot be held liable for his errors of judgement.[109] A director will be entitled to accept and rely on the judgement and advice of management but will have to ensure that due consideration, was given to the subject matter as a reasonable director exercising reasonable care, would not have accepted information and advice blindly.[110] The common law subjective standard remains part of the test of care and skill and is therefore subjective and objective.[111] The subjective standard can increase the level beyond that of the objective standard but not below the objective standard.[112] In *Dorchester Finance Co. v. Stebbing*,[113] the court held that a director is required to exhibit in the performance of his duties such a degree of skill as may be reasonably expected from a person with his knowledge and experience. Professional or experienced persons are therefore held to a higher standard.[114] In *Elgindata Ltd*, [115] the court held that members of a company had no right to expect a reasonable standard of general management from the company's managing director and that it was considered a normal risk of investing in a company that the company's management may not be of the highest quality.[116] Unfortunately, in the event of an inexperienced director a lesser level of care and skill will be expected from a director subject to the objective minimum standard of care, skill and diligence applicable to all directors[117]. Section 76(3)(c) accordingly varies expected standards in accordance with the director's responsibilities.

[108] *City Equitable Fire Insurance Co Ltd* above n 106.
[109] *Ex parte Precedent of the Republic of South Africa* above n 84.
[110] Bouwman (2009) *SA Merc LJ* 4 509.
[111] *Ibid.*
[112] Cassim FHI (2012) 559.
[113] [1989] BCLC 498 (Ch).
[114] Cassim FHI (2012) 560
[115] (1991) BCLC 959 (Ch).
[116] *Ibid.*
[117]Cassim FHI (2012) 559.

2.3 Section 76(4) of the Companies Act 71 of 2008

2.3.1 Introduction: The Business Judgement Rule

It is required that directors sometimes take risks without the fear that their decisions may be subjected to judicial review.[118] According to the American Law Institute, the business judgement rule was developed due to the desire to protect honest directors and officers from the risk inherent in hindsight reviews of their unsuccessful decisions.[119] The business judgement rule[120] as introduced in section 76(4) of the 2008-Companies Act relates to a directors' duty to act in the best interest of company.[121] It is a separate analysis of whether or not a director has complied with his fiduciary duties and duty of care.[122] The business judgement rule may find application in personal liability cases and cases with reference to transactional justification matters, which would include matters relating to an alteration of articles,[123]consideration of shares, reflective loss, refusal to register transfers, reduction of capital,[124] scheme of arrangements and takeovers.[125] There are numerous arguments in favour of the business judgement rule, namely: to encourage directors to take part in activities that would be risky to their company, to persuade competent persons to take office as directors, to avoid judicial second guessing and to prevent shareholder management of the company.[126] The business judgement rule in essence protects directors from liability if the requirements of section 76(4)(a)(i) to (iii) are met. [127] The courts will not, with the benefit of hindsight, second-guess business decisions taken by a director of a company.[128]

In its current form the business judgment rule goes beyond applying to the business decisions and could apply to any matter relating to the performance of a director's fiduciary duty.[129]

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[118] Havenga (2000) 12 *SA Merc LJ* 29.
[119] Lipton & Hertzberg *Understanding company law* (1995) 393.
[120] The King Report on Corporate Governance for South Africa 2009 7.
[121] S 76 (3)(b) and S 76 (3)(c) Companies Act 71 of 2008.
[122] Muswaka (2013) (1) *Speculum Juris*.
[123] *Shuttleworth v Cox Brothers & Co* [1927] 2 KB 9.
[124] *Visser Sitrus* above n 10*; Smith and Fawcett above n 80*; *Hlumisa Investment Holdings (RF) Ltd v Kirkinis* above n 68.
[125] *Howard Smith Ltd v Ampol Ltd* [1974] UKPC 3.
[126] Bouwman (2009) (21) *SA Merc LJ* 509-534.
[127] S 76(4)(a)(i) to (iii) Companies Act 71 of 2008.
[128] Cassim FHI (2012) 565.
[129] S 76 (4)(a) Companies Act 71 of 2008.

Davies states that the 2008-Act read as a whole promotes the objective that there should not be an over-regulation of the Act.[130] This protection will therefore only be applicable where a director:-

(a) has taken reasonable steps to become informed about the matter,[131]

(b) had no conflict of interest in the matter or complied with the requirements of Section 75 of the Act,

(c) had a rational basis for believing and did indeed believe that the decision was in the best interest of the company.[132]

2.3.2 Reasonable steps to become informed

The first requirement of the business judgement rule is that the director should have taken reasonable steps to become informed about the matter.[133] The Act does not specify the meaning of "reasonable diligent steps". When deciding whether or not a director has taken reasonable steps to become informed about a matter it is necessary that the matter should be in line with the general principles of South African law of delict,[134] which could be answered by applying the wrongfulness test.[135] The wrongful test will be determined by the legal convictions of the community and the *boni mores*[136] of that community. This legal conviction of the community is an objective test that will be applied based upon reasonableness.[137]

2.3.3 No material personal financial interest

Directors must not have any material personal financial interest in a matter that requires a decision and no reasonable basis to know that any related person might have a financial interest in the matter.[138] This interest does not need to be financial but could also be material in

[130] Davies (2011) 16.
[131] S 76(4)(a)(i) Companies Act 71 of 2008.
[132] S 76(4)(a)(iii) Companies Act 71 of 2008.
[133] S 76(4)(i) Companies Act 71 of 2008; Muswaka (2013) (1) S*peculum Juris* 29.
[134] Muswaka (2013) (1) S*peculum Juris* 29.
[135] *Ibid* 30; Neetling 50.
[136] *Ibid*.
[137] Neetling 31, 51.
[138] S 76(4)(ii)(aa) Companies Act 71 of 2008.

nature. As indicated previously in paragraph 2.2.1, above section 76(2)(a)(i) and (ii) imposes a mandatory and positive duty on directors to avoid conflict of interest which includes the common-law 'no-profit' rule and "corporate and opportunity rule".[139]

2.3.4 Rational basis for believing the decision was in the best interest of the company

The rational criterion provides an objective assessment as to what "a reasonable" person in the position as director would hold reasonable.[140] If the decision making is concluded in good faith, with no personal self-interest and with due care, a rational business purpose would be established. If the requirements of the business judgement rule have been established, rational belief provides considerable protection to directors.[141] A director may be in breach of the duty to act in the best interest of the company if he does not comply with any law whether the companies act or any other law.[142]

2.4 Statutory Accountability

The court may develop common law where a director's conduct must be decided.[143] The court must ensure that it promotes the spirit, purpose and objects of the Act when developing the common law and where more than one meaning, the court must prefer the meaning that best improves the realisation and enjoyment of these rights.[144] The 2008-Act is remedy orientated and not about substantive rights which provide remedies for specific rights.[145] The Act currently provides for directors to be held liable for breach of their fiduciary duties which I will briefly discuss.

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[139] Cassim 551; above n 58.
[140] Du Plessis (2011) 23(1) *SA Merc LJ* 145-146.
[141] *Ibid.*
[142] *Bester v Wright; Bester No v Mouton; Beste v Van Greunen* [2011] 2 All SA 75 (WCC); Delport (2020) *Henochsberg on the Companies Act* 296; van Tonder (2015) *Obiter 2015* 720.
[143] S 158(a) Companies Act 71 of 2008.
[144] S 158(b)(ii) Companies Act 71 of 2008.
[145] Oosthuizen (2019) 219.

2.4.1 Section 77 Companies Act 71 of 2008

Section 77(2)(a) and (b) stipulates that a director of a company may be held accountable for any loss, damage or cost sustained by the company as a consequence of any breach.[146] Dishonest directors and directors that act irrationally can be held liable for breach of their duty to act in the best interest of the company,[147] to act with care, skill and diligence.[148] Section 77(3) provides that a director can be held liable for any loss, damage, or cost sustained by the company as a direct consequence of the director having acquiesced in the carrying on of business of the company despite knowing that it was conducted in a reckless manner, with gross negligence or with the intent to defraud.[149] In *Hlumisa Investment Holdings (RF) Ltd v Kirkinis*[150] the court held that:

"*...duties owed by directors in terms of section 76(3) are owed to the company, not to individual shareholders. The company, in the event of a wrong done to it in terms of any of the provisions of that subsection can sue to recover damages. The company would be the proper plaintiff...* "[151]

Where a court finds a director contravened section 77(3)(a), (b) or (c) the court must make an order declaring that the director is delinquent in terms of section 62(5)(c)(iv). This will have the effect that the director will be personally liable for the company's debts and will not be allowed to act as a director of any company again for a period of seven years.[152]

2.4.2 Section 22 Companies Act 71 of 2008

Section 22(1) of the Act prohibits reckless trading and states that a company must not carry on business recklessly, with gross negligence, with the intent to defraud any person or for any fraudulent purpose. In *Hlumisa Investment Holdings (RF) Ltd v Kirkinis*,[153] the court held that the applicants were misconceived on their reliance on section 22 of the Companies Act and

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[146] Van Tonder (2015) *Obiter* 212.
[147] S 76(3)(b) Companies Act 71 of 2008; Ramnath (2013) (1) *Speculum Juris*.
[148] S 76(3)(c) Companies Act 71 of 2008.
[149] S 77(3) of the 2008-Companies Act; S 22 (1) of the 2008-Companies Act.
[150] (1423/2018) [2020] ZASCA 83 (3 July 2020) para a 47.
[151] *Hlumisa Investment Holdings v Kirkinis* above n 68 para 47.
[152] S 162(5)(c)(iv) of the 2008-Companies Act.
[153] *Hlumisa Investment Holdings v Kirkinis* above n 68 para 12-15.

the intention to hold directors liable in term of Section 77(3)(b). The court dealt explicitly with losses suffered by a company as a consequence of a director having acquiesced in the carrying on of the company's business, despite knowing that it was being conducted in a manner prohibited by Section 22.[154] Directors owe no fiduciary duty to its shareholders individually[155] and claims instituted in terms of Section 77(2) for breach of Section 77(3) are brought in terms of the principles of common law.[156] Section 77(3)(b) applies only to losses suffered by the company and therefore a claim for breach of fiduciary duty cannot be brought in terms of Section 22 by other applicants.[157]

2.4.3 Section 218(2), Companies Act 71 of 2008

Section 218(2) provides that any person that contravenes the act will be liable to any person for the damages suffered due to the contravention. The court of appeal held in Gihwala and Others v Grancy Property Ltd [158] that Section 218(2) of the Act imposes a separate duty on directors to shareholders due to the existence of a "bond of trust". In *Hlumisa Investment Holdings (RF) Ltd v Kirkinis,*[159] Molopa-Sethosa J dealt with the qualification that statutes must be interpreted in the context of constitutional values and that the common law must be developed to promote the spirit, purpose and objectives of the bill of rights.[160] It is important to remember that one of the principles that underpins the reflective loss doctrine is the fact that in law a company is a legal personality distinct from its shareholders. Accordingly, a loss to the company that causes a fall in its share price and therefore a loss to the company is not a loss to the shareholder.[161]

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[154] *Ibid.*
[155] *Percival v Wright* [1902] 2 Ch 421 (ChD); *Minister of Water Affairs and Forestry v Stilfontein Gold Mining Co Ltd* 2006 5 SA 333 (W).
[156] *Hlumisa Investment Holdings v Kirkinis* above n 68 40-42.
[157] *Ibid* 42.
[158] *Gihwala v Grancy Property Ltd* [2016] 2 All SA 643 (SCA) 144.
[159] *Hlumisa Investment Holdings v Kirkinis* above n 40-42.
[160] *Ibid* 39.
[161] *Itzikowitz v ABSA* 2016 4 SA 432 (SCA) 8-17.

2.4.4 Section 162(5) of the Companies Act, 71 0f 2008

Section 162(5) of the Act provides for the circumstances a court will be obliged to declare a person a delinquent director. When the constitutionality of Section 162 was attacked in Gihwala and Others v Grancy Properties Ltd [162] the Supreme Court of Appeal held that it is an appropriate and proportionate response by the legislature due to the harm caused to the public who trusts them.[163]

The court identified four grounds for delinquency under Section 162(5)(c). Firstly, where a person grossly abuses the position of director by taking personal advantage of information or opportunities available due to the person's position as a director.[164] Secondly, where the director has intentionally or by gross negligence inflicted harm upon the company or its subsidiary.[165] Gross negligence as referred to in Section 162(5)(c)(ii) and(iv) is the equivalent of "recklessness".[166] Recklessness and gross negligence have been described as the complete obtuseness of mind, or where there is no conscious risk-taking, a total failure of care.[167] Thirdly, an entire failure to give consideration to the consequences of one's actions which includes both foreseen and unforeseen consequences.[168] And fourthly, the carrying on of the business of the company by conduct which evinces a lack of any genuine concern for its prosperity.[169]

2.5 Conclusion

The interaction between the business judgement rule and the duty of care, skill and diligence have caused much controversy and has been criticised in South Africa before the enactment of the 2008 Companies Act.[170] South African common law sufficiently provides for mechanisms protecting against directors' liability. Our courts may not second guess the merits

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[162] 2017 2 SA 337 (SCA) 144; *Organisation Undoing Tax Abuse & Another v DC Myeni* above n 48 para 11.
[163] *Ibid* para 145.
[164] *Ibid* para 143.
[165] *Organisation Undoing Tax Abuse v DC Myeni* above n 48 para 14; *Gihwala v Grancy Property Ltd* above n 158 para 143.
[166] *Gihwala v Grancy Property Ltd* above n 158 para 144.
[167] *Transnet Ltd t/a Postnet v Owners of MV Stella Tingas* 2003 2 SA (SCA) para 7.
[168] *Phoenix (Pty) Ltd v Snyman* above n 231 para 7; *S v Dhlamini* 1988 2 SA 302 (A) at 308 D-E.
[169] *Tsung v Industrial Development Corporation of South Africa Ltd* 2013 3 SA 468 (SCA) para 31.
[170] Bouwman (2009) *SA Merc LJ* 529.

of corporate decisions and therefore provide results equivalent to results achieved by the American business rule.[171] Introduction of the business judgement rule has caused additional protection as the fiduciary duty and duty of care have become blurred as initially warned by Jones.[172] In the next chapter the South African business judgement rule will be compared with comparable jurisdictions especially Australia and Germany.

[171] *Ibid* 531.
[172] Jones (2007) 19 SA *Merc LJ* 326 531.

CHAPTER 3
COMPARATIVE LAW

3.1 Introduction

The business judgement rule was developed in the United States of America due to the desire to protect honest directors and officers from the risks inherent to hindsight reviews of incorrect decisions and to refrain from stifling innovation and venturesome business activity.[173] Over the 20th century most major corporations in the USA were incorporated under the Delaware General Corporation Law. This offered lower corporate taxes, fewer shareholder rights against directors and developed a specialized court and legal profession.[174] Courts will not interfere with the business judgement rule as there is no scope for interference as set out in Smith v Gorkom.[175] The business judgement rule is the offspring of the fundamental principle as codified in Delaware Corporation Law. Section 141(a) states that the business affairs of a Delaware corporation are managed by its board of directors.[176] Delaware and numerous states in the USA have inserted provisions in their certificate of incorporation to eliminate or limit personal liability of a director for monetary damages as a result of breach of fiduciary duties.[177] Several countries have incorporated the business judgement rule and codified directors' duties within their respective legislation and through case law.[178]

In 1742 an English court suggested that directors should not be liable for decisions made in good faith on behalf of the company even if the outcome was undesirable.[179] England attempted to codify the duty of care in England in both the 1973 and 1978 Companies Bills but this was

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[173] Kennedy-Good & Coetzee *(2007-2008) LII UST Law Review 149 155.* See *Percy v Millaudon 8 Mart (ns)* 68 (La 1829*).*
[174] Nietsch (2018) Vol 18 No 1, 151-184.
[175] 488 A.2d 858 [872].
[176] S 141(a) Delaware Corporation Act.
[177] S 102(b)(7) of the DGCA.
[178] Bouwman (2009) (21) *SA. Merc LJ* 509.
[179] Holland (2009) 11 *U Penn J Bus L* 675, 679, available at>[https://scolarship.law.upenn.edu/jbl/vol11/iss3/4/>[https://perma.cc/8AZY-66JU]. (accessed 26 July 2020).

never enacted.[180] The English and Scottish Law Commission suggested the codification of directors' duty of care, skill and diligence during 1998 through the insertion of Section 309A of the Companies Act of 1985. In the United Kingdom a director's business judgement is subject to good faith and the promotion of the company's interest of its shareholders. Care and loyalty are not required as a precondition to a separate business review standard.[181] The United Kingdom has an anti-director position with no regard to corporate expectancies and rejects line-of-business restrictions and excludes evidence of financial capacity.[182]

In Germany the "*Government Commission of the German Corporate Governance Code"* was formed to support the continuous development and adaptation of existing frameworks in February 2002.[183] Corporate control was influenced in decisions by the German Supreme court *(Bundesgerichtshof)* at the time. The code confirmed the Germanies two-tier structure, with the management board that was made up of executives *(Vorstand*) and the supervisory board *(Aufsichtstrat).*[184] Both are separate from each other with the supervisory board being elected by the shareholders and the managing board in turn appointed by the executive directors.[185]

Due to space constraints, I will briefly draw a comparison between the German and Australian law approach with reference to the South African approach and implementation of the business judgement rule.

[180] Havenga (2000) 12 *SA Merc LJ* 30.
[181] Kershaw *LSE Law, Society and Economy Working Papers* 15/2018.
[182] *Ibid*.
[183] Baums Bericht der Regierungskommision Corporate Governance, 2001 S1; Nietsch *Blackwell Publishing Corporate governance* Volume 13 Number 3 May 2005 368.
[184] Hommelhoff and Mattheus (1998) 251.
[185] *Ibid*.

3.2 Australian Law

3.2.1 Introduction

The duty of care, skill and diligence in Australia was influenced by English precedents of the late 1800s and early 1900s as also seen in South Africa. Australia has taken the same approach that has been followed in South Africa where statutory directors' duties apply together with the common-law and equity principles.[186] Australia, being the first country in the British Commonwealth, enacted a statutory duty in 1958 providing that a director should act honestly and use reasonable diligence in the discharge of the duties of office.[187] Section 229(2) of the Companies Act of 1981 provided that an officer of a corporation shall at all times exercise a reasonable degree of care and diligence in the exercise of his powers and discharge of his duties. In Daniels v Anderson[188] the court held that it was no longer appropriate to judge directors conduct by the subjective test and that ignorance could not be regarded as a defence.[189]

Section 229(2) of the Federal Companies Code 110 of 1990 were accordingly amended by the Corporate Law Reform Act 210 of 1992 to provide for an objective standard of skill and care. Section 232(4) of the Federal Corporations Law of 1991 in addition provided that an officer of a corporation must exercise a degree of care and diligence that a reasonable person in the same position of a corporation would exercise.[190]

Proposals for reform associated with the "*Corporate Law Economic Reform Program*" (CLERP)[191]lead to the enactment of the statutory business judgement rule.[192] Australia adopted the narrow and technical interpretation to business judgement applying only to business *operations* of the corporation.[193] In 2014 the AIDC published A proposal for reform: The

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[186]Nietsch *Journal of Corporate Law Studies*, 2018 Vol 18 No 1, 151-184.
[187] S 107 Victorian Companies Act 1958.
[188] (1995) 16 ACSR 607 (NSW CA); 13 ACLC 614.
[189] *Ibid*.
[190] Explanatory memorandum to the Corporate Reform bill of 2001; *Francis v United Jersey Bank* 432 A 2nd 814 (1981) at 821-823.
[191] CLERP, Directors duties and corporate Governance: Facilitating Innovation and Protecting Investors Proposals for Reform: Paper No 3, 1997) 22-3 para 5.2.1.
[192] *Ibid*, S 180 Corporations Act 2001.
[193] Corporations Act 2001 (Cth) s 180(3); Explanatory Memorandum, Corporate Law Economic Reform Program Bill 1989, (1998 para 6.8.

Honest and Reasonable Director Defence[194] in the need that "Business judgement" should include a broader view including any business action.[195]

3.2.2 Section 180 Australian Corporations Act 2001

Section 180 of the Act partially codified the duty of care and skill of directors. It established a purely objective standard in determining skill and care.[196] The South African counterpart Section 76(3)(c) establishes an objective-subjective standard where subjective elements like general knowledge, skill and the experience of a director are also taken into consideration.[197] Section 108(1) takes the circumstances of a corporation into consideration whereas Section 76(3)(c) does not. In ASIC v Maxwell[198] the court held that numerous factors should be taken into account which includes the size and nature of the company's business, the provision of its constitution, the composition of the board, directors' position and responsibilities within the company as well as other factors including circumstances of each particular case.[199]

The courts have developed the approach to balance the foreseeable risk of harm against the potential benefits to the company when determining whether a director breached the duty to act with care and diligence.[200] The safe harbour provided by the business judgement rule is contained in Section 180(2) and 180(3) of the Corporations Act 2001 which I will briefly discuss and compare to its South African counterpart.

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[194] Australian Institute of Company Directors, A Proposal for Land Reform: The Honest and Reasonable Directors Defense (AIDC, August 2014) <http://www.companydirectors.com.au/Director Resource-Centre/Policy-on-director-issue/Policy-Papers/2014/The Honest and Reasonable Directors Defense>.

[195] *Ibid*.

[196] S 180(1) Australian Corporations Act 2001.

[197] Nethavhani "The business judgement rule: Undue erosion of directors duty of care, skill and diligence" (LLM Mini dissertation 2015 UP).

[198] *ASIC v Maxwell & Ors* [2006] NSWSC 1052.

[199] *Ibid*.

[200] *Vrisakis v Australian Securities Commission* 1993 9 WAR 395; *Vines v Australian Securities and Investments Commission* 2007 233 FLR 1; *Taxa Australia Pty Ltd v Wang* 2018 130 ACSR 531; Lombard Chapter 9 "Directors' duties and corporate responsibility to protect human rights: An Australian perspective" in Botha and Barnard (eds) 2019 *De Serie Legenda Vol III.*

3.2.3 Section 180(2) Business judgement rule

In *ASIC v Rich*[201] it was generally accepted that Section 180(2) sets out the requirements for when a director will be protected under the business judgement rule and casted the onus on the director to defend his decision-making.[202] To ensure protection under the rule, the first requirement will be that the judgement was made in good faith and for proper purpose. Even if a director has acted honestly, he could still be in breach of the duty to exercise power for proper purpose.[203] This requirement is in accordance with Section 76(3)(a).

Secondly, Section 180(2) requires that the director or officer had no material personal interest in the judgement matter. This requirement is stricter than Section 76(4) which only precludes personal financial interest and the personal financial interest of any known related person. Section 76(4) makes provision where a director has a personal financial interest, in which event, a director should comply with Section 75 to prevent breach of his duties. Section 180(2) has no similar provision where a director would be regarded as taking reasonable diligent steps where there is personal financial interest.

It is further required that the director or officer inform themselves about the judgment matter, which is in accordance with Section 76(4) This requires a director to take steps to inform himself of the subject matter. The outcome of the decision is irrelevant provided the director took steps to become informed.

Finally, the director or other officer must rationally believe that the judgement was made in the best interest of the corporation. Section 180(2) excludes oversight duties of a director like monitoring the company's affairs and policies. Section 180(3) defines the meaning of the word "*business judgement*" as a business judgement which includes any decision, to take or not to take action, in respect of a matter relevant to the business operations of the corporation.[204] Section 76(4) does not include the "not take action" as Section 76(4) refers to matters arising in the exercise of power or the performance of directors' duties.

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[201] [2009] NSWSC 122 (2009) 236 FLR 1.
[202] Nettle *Melbourne University Law Review* 1402 13 2018 41 (3) 7.
[203] Cassim FHC (ed) *The law of business structures (3ed)* 293
[204] S 180(3) Australian Corporations Act 2001.

In ASIC v Rich,[205] the court regarded a broad scope relating to any matter that is relevant to the business operations even if the matter itself is not part of the business operations. The South African business judgement rule does not define business judgement and is therefore not limited to business decisions and extends to any matter arising from directors' duties and could easily be a safe harbour for directors.

3.3 German Law

3.3.1 Introduction

The German Stock Corporation Act was extensively revised and extended in 2004 through the *"Act for corporate Integrity and Modernization of the Law of Avoidance"*[206] and again amended by Article 5 of the Amendment Act dated 10 May 2016.[207] The reason the business judgement rule was included in the German Stock Corporations Act was to counter the extensive protection to shareholders.[208]

The German law-system has no common law system as in South Africa and law refers to binding codifications. Germany has a two-tier board system for the German Corporation Act (*Aktiengesetz*) (hereafter referred to as AG) where a company has a management board and a supervisory board.[209] This supervisory board has become more common in other company forms like companies with limited liability *(Gesellschaft mit beschränkter Haftung*) (hereinafter referred to as GmbH).[210] The AG in terms of Section 93 and the GmbH have both imposed a duty of care and skill on directors.[211] The duty of care and skill is not regarded as contractual or delictual, but liability is based on the fact that directors are regarded as an organ

[205] *Australian Securities and Investment Commission v Rich* (2009) 75 ACSR 1.
[206] *Gesetz zur Unternehmensintegrität und Modernisierung des Anfechtungsrechts*.
[207] www.nortonrosefulbright.com/en/knowledge/publications/bc19a262/german-stock-corporation-act-aktiengeset.(accessed 26 July 2020).
[208] Ibid: Reg E, BT Drucks.15/5092 at para 11.
[209] Wellhöfer, Peltzer and Müller 542.
[210] *Ibid*.
[211] S 93 of the AG; S 43 of the *Gesetz betreffend die Gellschaften mit beschränker Haftung* (GmbHG).

of the company.[212] The test for liability in the GmbH legislation is objective.[213] Directors can further not be held jointly and severally liable as only those directors that are found guilty of breach of their duty will be held accountable.[214] If a decision is therefore illegal or the company constitution breached, there might be liability.[215]

According to Section 102 AG the supervisory board is an independent body which is elected by the shareholders for a maximum period of four years. The supervisory board appoints and supervises the board of directors.[216] The management board's lawful and commercial activities are then supervised by the supervisory board and they are required to report to the supervisory board at least four times per year.[217]

An adapted version of the business judgement rule has been incorporated in the German AG in Section 93. [218] If it can rationally be assumed that the director acted in accordance with reasonable information, he was acting in the best interest of the company.[219] It is presumed that a director has breached his fiduciary duty and duty of care, and would have to prove that the action or omission was not a breach of his duty nor was he negligent.[220] The test determining whether the business judgement rule has been satisfied is "*ex ante*" and not "*ex facto"*.[221] The claim against the director is not classified as delictual although the elements of a delict have to be satisfied.[222] It is therefore crucial that there should be some action regarding a business decision for breach to be present.[223]

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[212] Stevens *PER / PELJ* 2017(20) - DOI http://dx.doi.org/10.17159/1727- 3781/2017/v20n0a1202 (accessed 16 September 2020).
[213] Alexander "GmbHG" 922.
[214] Ihrig and Schäfer *Rechte und Pflichten des Vorstands* 495.
[215] Ibid, 495.
[216] Stevens *PER / PELJ* 2017(20) - DOI http://dx.doi.org/10.17159/1727- 3781/2017/v20n0a1202 (accessed 20 September 2020).
[217] Assman, Lange and Sethe *Law of Business Associations* 154.
[218] Stevens *PER / PELJ* 2017 (20) - DOI http://dx.doi.org/10.17159/1727- 3781/2017/v20n0a1202 (accessed 20 September 2020).
[219] Ihrig and Schäfer *Rechte und Pflichten des Vorstands* 497.
[220] Spindler *S 93 Sorgfaltsplicht und Verantwortlichkeit der Vorstandmitglierder* 601.
[221] Stevens *PER / PELJ* 2017 (20) - DOI http://dx.doi.org/10.17159/1727- 3781/2017/v20n0a1202. (accessed 20 September 2020).
[222] Ihrig and *Schäfer Rechte und Pflichten des Vorstands* 508-509.
[223] *Ibid*.
Stevens *PER / PELJ* 2017 (20) - DOI http://dx.doi.org/10.17159/1727- 3781/2017/v20n0a1202; Havenga (2000) 12 SA. *Merc LJ* 25.

The business judgement rule has not been followed consistently but the BGH (German civil code) decides on a case by case basis and modifies the prerequisites of limited liability.[224] The Act provides for three different liabilities namely the breach of fiduciary duties, the duty of care and other statutory duties.[225] A company may indemnify its directors from any liability although unlimited liability is not allowed.[226]

Section 93 of the Corporations Act stipulates that in conducting business the members of the management board shall employ the care of a diligent and conscientious manager.

3.3.2 Section 93(1) German Stock Corporation Act

Section 93(1) sets out the grounds where directors will be deemed not to have violated their duty at the time of taking the entrepreneurial decision. Firstly, a director should have faithfully and in the best interest of the company assumed that he was acting based on adequate information. A business decision should have been made on the presumption that adequate information was obtained. According to academic writers in Germany a business decision can only be assumed, if the respective decision maker has a choice between various alternatives.[227] The German courts recognised these risks and granted more leeway for the execution of obligations before the code.[228] The practical application is that directors should base their decisions on objective informative sources such as market studies, legal opinions or internal reports as well as their own experiences, sense and intentions.[229] The prerequisite of good faith further requires that directors are convinced their actions are correct in respect of the business decision.[230]

The South-African counterpart Section 76 does not limit the decisions of the director to only business decisions and only refers to acting in capacity as director of the company,

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[224] Mertens *Cahn in KölnKomm* AktG s93 para 11.
[225] S 77(2) and S 77(3) Companies Act 71 OF 2008.
[226] S 20(6).
[227] BGH, Decision from 21.04.1997, AZ: II ZR 175/95=BGHZ 135,244 (para 23 in juris).
[228] BGH, Decision from 06.06.1994, AZ: II ZR 292/91=BGHZ 126,181 (para 32 in Juris); OLG Frankfurt, Decision from 25.10.2000, AZ: 17 U 63/99=NZG 2001, 173 (para 44 in Juris).
[229] RegE UMAG, BT Drucks 15/5092 12.
[230] Dauner-Lieb in Henssler/Strohn, s 93 AG par 25; Fleischer in Spindler/Stilz AG, s 93 para 76.

therefore, any action by the director could be protected by the business judgement rule.[231] The proper purpose requirement as set out in Section 76(3)(a) is not required by the AG. The requirement of acting in good faith and in the best interest are, however, in accordance with Section 93(1).[232] Finally Section 93(1) stipulates that directors shall not disclose confidential information and secrets of the company, in particular trade and business secrets, which have become known to the members of the management board as a result of their service on the management board.

Decisions of directors are based on the term "best interest of the company" which are guidelines for ensuring that personal interest does not influence the decisions of the director.[233] There is no definition of the term and it is regarded strictly economical by the German legislator formulating the interest of the company as the enhancement of turnover, profits and competitiveness.[234] This view will be strengthened by the inner constitution[235] of the company and the consideration of stakeholder interest.[236]

Section 76(4) makes provision for a director who has a personal financial interest to comply with Section 75 and prevent breach of fiduciary duties. Section 93(1) has no similar provision where a director would have been regarded as taking reasonable diligent steps where there is personal financial interest.

3.4 Conclusion

In its current form the business judgement rule as adopted in South Africa could have contributed to the failure to hold directors accountable for breach of their fiduciary duty. Jones was correct in his view that the business judgement rule blurred directors' fiduciary duty and the duty of care.[237] To ensure that directors act in the best interest of the company it is essential to hold directors accountable for their actions. In the final chapter, I will propose stricter

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[231] S 76(3) Companies Act 71 of 2008.
[232] S 76 (3)(a) and (b) Companies Act 71 of 2008.
[233] Reg E UMAG, BT Drucks. 15/5092 at 11; Lutter in *FS Canaris* (2007) Band II, 245 245.
[234] RegE UMAG, BT Drucks. 15/5092 11.
[235] Kock/Dinkel NZG 2004, 441 443.
[236] Hopt/Roth *in GroßKomm AG*, S93 para 98.
[237] Jones (2007) 19 *SA Merc LJ* 326. 531.

measures regarding the duty of care and skill, restricting directors' decisions to only business decisions. I will also reconsider the objective-subjective standard whereby directors only have to take reasonable steps to become informed and subjectively believe their actions are in the best interest of the company whereas a stricter objective standard could be more appropriate.

CHAPTER 4

CONCLUSION AND RECOMMENDATIONS

4.1 Conclusion

It is common knowledge that directors can be held accountable for breach of their fiduciary duties. There has been limited success in holding directors accountable where a company performed badly due to the dishonesty, gross negligence, or recklessness of a director in the performance and breach of their fiduciary duties. In *OUTA v Myneni* [238]gross negligence and recklessness was described as a complete obtuseness of mind or where there was no conscious risk-taking, a total failure to take care.[239] An entire failure to give consideration to the consequences of one's actions, both foreseen and unforeseen[240] and carrying on business of a company by conduct which evinces lack of any genuine concern for its prosperity.[241]

The business judgement rule as contained, in Section 76(4)(a) of the 2008-Companies Act, in my opinion does contribute to the failure to hold directors accountable for breach of their fiduciary duty. This safeguard from personal liability afforded to directors in its current form, is too extensive. It covers any matter arising from the powers or the performance of the functions of director and will be satisfied if the director has only taken reasonable diligent steps to become informed about the matter. There was no material personal financial interest in the matter and the decision was made while rationally believing that it was in the best interest of the company. In the matter of OUTA v Myeni[242] the court found that not only was Mrs. Myneni deliberate but her gross negligence inflicted substantial harm on SAA and in her attempts to justify her conduct showed that she acted dishonestly, in bad faith and not in the best interests of SAA. Mrs Myeni, through her actions, breached her fiduciary duty to act in good faith, for a proper purpose, and in the best interest of SAA in terms of Section 76(3) of the Companies Act. She was subsequently found guilty and declared a delinquent director.

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[238] *Organisation Undoing Tax Abuse & Another v DC Myeni* above n 48.

[239] *Gihwala v Grancy Property Ltd*, above n 158 par 143: *Organisation Undoing Tax Abuse v Myeni* above n 48.

[240] *Phoenix (Pty) Ltd v Snyman*; *Braaitex (Pty) Ltd v Snyman* 1998 2 SA 138 (SCA) at 143C-144A.

[241] *Tsung v Industrial Development Corporation of SA* above n 169 para 31.

[242] *Organisation Undoing Tax Abuse and Another v Myeni* above n 48.

4.2 Recommendations

With reference to the comparative law in the previous chapter, I believe that the following modifications could be considered to ensure that directors are held accountable for breach of their fiduciary duty. My proposals are as follows:

- Firstly, a two-tier system could be considered in accordance with the German Stock Corporation Act. An independent supervisory board should be appointed by shareholders who then appoint and supervise the board of directors. This will ensure better supervision of directors and oversight powers ensuring lawful and commercial activities are supervised and the risk of fraudulent transactions minimised.
- Secondly, section 76(4) of the business judgement rule could be amended to limit the decisions of directors to only business decisions either by defining business decisions in the Act alternatively amending section 76(4) by replacing the term "any particular matter" with the term "business decision" An amended section 76(4) should read "In respect of any business decision arising in the exercise of the powers or performance of the functions of a director." Both the German Stock Corporation Act and Australian Corporations Act limit directors' decisions to only business decisions. This will ensure that a director will not be able to hide behind the business judgement rule as protection against the failure to carry on business of a company for conduct which evinces lack of any genuine concern for its prosperity.
- Thirdly, the prohibition of "material personal financial interest and the personal financial interest of any known related person" as required in terms of section 76(4)(ii)(aa) could be amended to read “the director had no material personal financial interest in the subject matter of the decision and had no basis to know that any related person had a personal material financial interest in the matter". This would be a stricter requirement and would also ensure that less tender fraud is committed by directors providing opportunities to related or known persons without following proper procedures, adhering to regulations and allocating contracts to people not qualified to provide such service.
- Finally, section 76(4) could further be amended to include a directors' failure to take action” as section 76(4) refers to matters arising in the exercise of power or

performance of directors. Section 76(4) should therefore read " In respect of any particular matter, including the failure to take action in any particular matter, arising in the exercise of the powers or the performance of the functions of director." This will ensure that a director is not covered by the protection of the business judgement rule where he or she fails to ensure that action is taken to prevent damage to the company.

The purpose of the business judgement rule has always been to ensure business growth while safeguarding directors from liability and preventing judicial review when taking risks.[243] Companies are regarded as part of society just as much as each individual and can no longer tolerate or accept selfish indulgence.[244] The company represents several interests of shareholders, employees, consumers, the environment and community.[245] It is for this reason that it is important to ensure a balance between the inherent risk a director undertakes in decision-making and the protection afforded to such a director. Both too stringent and too lenient measures could result in harming the economy and the community as a whole.

[243] Havenga (2000) 12 *SA Merc LJ* 29.
[244] Crowther and Jatana *International dimensions of corporate social responsibility* (2005); Botha Chapter 2 "First do no harm!" in Botha and Barnard (eds) 2019 *De Serie Legenda Vol III.*
[245] *Ibid*.

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List of Abbreviations

AG	Aktiengesetz
FRC	Financial Reporting Council
BGB	German Civil Code
CLERP	Corporate Law Economic Reform Program
GmbH	Companies with limited liability Gesetz betreffend die Gellschaften mit beschränkter Haftung
IoD	Institute of Directors (UK)
IoDSA	Institute of Directors in Southern Africa
MelbUlawRw	Melbourne University Law Review.
MOI	Memorandum of incorporation

Nw UL Rev	Northwestern University Law Review
SAA	South African Airways
SA Merc LJ	South African Mercantile Law Journal
Stell LR	Stellenbosch Law Review