

Selected Challenges Related to the Business Judgement Rule

by

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ABSTRACT

This study analyses the South African business judgement rule and its introduction in the Companies Act 71 of 2008 through section 76(4). It investigates why a provision may be regarded as providing a “safe harbour” for directors against a breach of their fiduciary duty to act in the best interest of the company and their duty of care, skill, and diligence.

This study reflects on the effect the 2008 Companies Act’s partial codification of directors’ duties in section 76(3) had on the South African business judgment rule. This is of particular importance given that the rule applies only to directors codified fiduciary duty to act in the best interest of the company and their duty of care, skill, and diligence.

This study also looks at the development of the business judgement rule internationally and investigates its important role in being a foundational element of corporate governance. It investigates the key theoretical principles behind the rule that have developed internationally.

This study aims to enhance readers' comprehension of the duty of care, skill, and diligence under both common law and statutory law in South Africa. This will provide the reader with insight into the business judgment rule and its relevance in South African law. The main aim of this study is to make recommendations in an attempt to improve/refine the formulation of the current section 76(4) of the Companies Act, 2008. These recommendations are based on the comparisons drawn with the jurisdiction of Australia.

This study will hopefully enhance the judiciary’s understanding of how to approach the rule should it come under the subject of judicial scrutiny by the courts.

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CHAPTER 1: INTRODUCTION

1.1. Background

Recent decades, has seen the corporate world experience major financial collapses resulting, in the main, from board mismanagement. The Enron¹ and WorldCom² group of companies in the United States of America (USA) are notable examples of corporate collapses that had international repercussions. Locally, South Africa faced similar situations with the KPMG and Steinhoff scandals.

KPMG, a prominent auditing business in South Africa, was involved in a scandal associated with the Gupta wedding. KPMG reportedly neglected to contest the purportedly improper handling of expenses associated with the Gupta wedding.³ Media outlets disclosed emails revealing that KPMG was cognizant of the Gupta family enterprises classifying wedding expenses as business expenditures, hence allowing for tax deductions on these charges.⁴ Consequently, KPMG experienced several leadership transitions as the firm sought to enhance its corporate governance frameworks.⁵

The general secretary of the Federation of Unions of South Africa (FEDUSA) labelled the Steinhoff saga as the biggest scandal to hit South Africa Investor fear caused a loss of approximately R282 billion in market value for Steinhoff and seven companies linked to the Steinhoff group.⁶ The loss was propagated by concerns over accounting irregularities pointing to possible fraud by the household goods retailer.⁷ As a result of the losses incurred, Steinhoff International Holdings NV held a general meeting of

¹ Brickey "From Enron to Worldcom and beyond: Life and crime after Sarbanes-Oxley" 2003 *Washington University Law Review* 357.

² *CRS Report for Congress Order Code RS21253* available at [research.policyarchive.org/3622.pdf](https://www.policyarchive.org/3622.pdf) (accessed 11/11/2023). On 25 June 2002, WorldCom, a large long-distance telecommunications company, announced that it had overstated its earnings in 2001 and the first quarter of 2002 by more than \$3.8 billion. WorldCom filed for bankruptcy on 21 July 2002.

³ See <https://citizen.co.za/news/south-africa/1334530/who-are-the-guptas-details-according-to-madon-sela/> (accessed 15/10/2023).

⁴ As Above.

⁵ See <https://www.businesslive.co.za/bd/companies/financial-services/2017-06-30-kpmg-to-be-investigated-for-audit-of-linkway/> (accessed 19/10/2023).

⁶ See <https://www.cnbcafrica.com/2018/steinhoff-rise-fall/> (accessed 19/10 2024)

⁷ See "The Steinhoff Saga: Part two – The board that looked the other way", available at <https://www.fin24.com/Opinion/the-steinhoff-saga-part-two-the-board-that-looked-the-other-way20180628> (accessed 13/11/2023).

shareholders in April 2018 and the board was subsequently restructured to improve corporate governance.⁸ Furthermore, more recently on 27 May 2020, Judge Tolmay issued a ruling in *Organisation Undoing Tax Abuse and Another v Myeni and Other wherein the High Court of South Africa (Gauteng Division, Pretoria)* designated Dudu Myeni, the former non-executive chairperson of South African Airways SOC Limited (SAA), as a “delinquent director” under the Companies Act 71 of 2008.⁹ The court determined that Ms. Myeni engaged in dishonest, reckless, and grossly negligent conduct, violating her fiduciary duties during her directorship, which resulted in substantial injury to both SAA and the nation at large.¹⁰

Corporate failures and scandals have prompted numerous countries to evaluate whether company directors adhere to anticipated standards.¹¹ Numerous nations have amended their corporate legislation to strengthen the responsibilities and liabilities of directors.¹² The countries comprise Ireland, Australia, Italy, Spain, China, the United Kingdom, Japan, Canada, and the United States.¹³

⁸ Van der Linde “The Steinhoff Corporate Scandal and the Protection of Investors Who Purchased Shares on the Secondary Market” 2022 *PELJ* 3The announcement on the evening of 5 December 2017 regarding an independent inquiry into alleged accounting discrepancies at Steinhoff International Holdings NV (SIHNV), together with the departure of its South African chief executive officer Markus Jooste caused significant disruption in financial markets across South Africa and Europe. Despite SIHNV being incorporated in the Netherlands, with a primary listing on the Frankfurt Stock Exchange (FSE), SIHNV had its administrative headquarters in South Africa and a secondary listing on the JSE Limited (JSE); its chief executive officer and other directors were South Africans; 67% of its shareholders were from South Africa, including its three largest shareholders who between them held 35% as at 29 December 2017. Furthermore SIHNV had become the ultimate holding company of this global retail group through a scheme of arrangement in terms of which shareholders of the erstwhile parent company Steinhoff International Holdings Ltd (SIHL), subsequently converted into a private company Steinhoff International Holdings (Pty) Ltd (SIHPL), and exchanged their shares for shares in the newly incorporated SIHNV in 2015.

⁹ *Myeni v Organisation Undoing Tax Abuse and Another; Organisation Undoing Tax Abuse and Another v Myeni and Another* (15996/2017) [2020] ZAGPPHC para 56. The court determined that Ms. Myeni violated her fiduciary responsibilities to act in good faith, for a legitimate purpose, and in the best interests of SAA, thereby causing irreparable damage to SAA and the nation. The court furthermore emphasized two essential principles: first, that a non-executive director is not exempt from fiduciary duties. The legal obligations of all directors, both executive and non-executive, are identical. Secondly, a director cannot evade accountability by relying on the collective board; each director must assume responsibility for their individual acts.

¹⁰ As above.

¹¹ <https://www.pwc.co.za/en/publications/king4.html> (last accessed 2024-10-19).

¹² As above.

¹³ Ferran “Company law reform in the UK: A progress report” 2005 *Journal of Comparative and International Private Law* 623.

Much has been written about the concept of “corporate governance” but uncertainty remains regarding the precise definition of the term.¹⁴ The Cadbury Committee on Financial Aspects of Corporate Governance’s Final Report and Code of Best Practice (Cadbury Report) is considered to include the most authoritative definition of this elusive concept.¹⁵ The Cadbury Report considers corporate governance as the system by which companies are governed and controlled.¹⁶ Effective corporate governance necessitates the recognition that an organization exists within a societal context and thus bears responsibility to both present and future stakeholders.¹⁷

The author agrees with the above notion as the role played by directors in the management of company affairs through decision-making involves in essence of corporate governance as it provides a conceptual framework for directors’ standards of care skill and diligence and the business judgement rule (decision-making aspects).¹⁸

The significance of implementing a proficient corporate governance system has been a focal point throughout the evolution of corporate law. Corporate officers and directors act as the conduits for the conduct of a company and make decisions that steer the company in a particular direction.¹⁹ It is therefore no surprise that directors have been at the core of many business scandals and corporate failures in recent years – nationally and internationally.²⁰

1.2. South Africa

The Companies Act 61 of 1973 regulated company law in South Africa for thirty-seven years and was modified 42 times during this period.²¹ The King Report on Corporate Governance (King II) Code and common law provided guidance on the responsibilities

¹⁴ Cadbury Committee on Financial Aspects of Corporate Governance *Final Report and Code of Best Practice* 1992 para 2.5.

¹⁵

<https://documents1.worldbank.org/curated/fr/194571468330288811/pdf/346690v20Corporate0governance0Rationale.pdf> last accessed 26/01/2025

¹⁶ As above.

¹⁷ See <https://www.pwc.co.za/en/publications/king4.html> last accessed 2024/19/10.

¹⁸ Muswaka “Directors’ duties and the business judgment rule in South African company law: An analysis” 2013 *International Journal of Humanities and Social Science* 93.

¹⁹ <https://idealsboard.com/importance-of-corporate-governance/> last accessed 2023/19/10.

²⁰ As above.

²¹ Cassim et al *Contemporary Company Law* (2022) 117.

and legal obligations of corporate directors during that period.²² Cassim notes that the 1973 Companies Act did not codify the duty to exercise the requisite level of skill, care and diligence, which was consequently assessed in accordance with common law and the company's memorandum and articles of association.²³ The 1973 Companies Act did, however, create statutory provisions that imposed certain limitations and delineated obligations for directors.²⁴ In this regard it is of good import to note that sections 423 to 426 of the 1973 Act established the personal liability of directors for careless and dishonest business activity.²⁵ Additionally, Sections 234 to 241 of the 1973 Companies Act addressed directors' duty to disclose any direct or indirect material interests in contracts previously executed by the company.²⁶ Furthermore, section 248 of the 1973 Companies Act stipulated that directors may be exempt from liability if they undertook diligent efforts to inform themselves about the issue, possessed no financial interest in the matter or and made a business decision rationally, believing it to be in the company's best interests.²⁷ Section 248²⁸ closely mirrored the business judgment rule; however, specific circumstances had to be present for directors to receive the relief contemplated by the section.²⁹ Section 248 stipulates that the court may absolve a director of liability if the director has acted in a manner that is both honest and reasonable.³⁰ It is, however, argued that the court will consider all the circumstances of the specific case before granting a director the relief envisioned by the section, and that special circumstances must exist. A director who has acted honestly may utilize section 248 as an effective mechanism to be exempt

²² Institute of Directors in South Africa, *The King Report on Corporate Governance for South Africa (2002) – King II*.

²³ Cassim et al *Contemporary Company Law (2022)* 117.

²⁴ These provisions included, for example, ss 221-227 (restrictions on the issuing of share capital by directors) and ss 234-246 (interests of directors and officers regarding contracts)

²⁵ See Companies Act 61 of 1973, ss 423-426. These provisions still apply in respect of insolvency in terms of transitional arrangements of Companies Act 71 of 2008. See schedule 5 of the Companies Act 71 of 2008.

²⁶ These provisions are similar to Section 75 of the Companies Act 71 of 2008.

²⁷ Section 248(1) of the Companies Act 61 of 1973.

²⁸ The origin of this provision is to be found in a recommendation of the UK *Company Law Amendment Committee* (“*Reid Committee Report*”) 1906. In para 24 the *Committee* warned that “the provisions of the Companies Act should not be used as engines of oppression for honest and prudent men.” See *AWA Ltd v Daniels* (1992)

²⁹ Section 248 of the 1973 Act was amended by cl 93 (4) and (5) of the Companies Bill, 2007, and later replaced by s 77(9) of the Companies Act 71 of 2008.

³⁰ Good “The business Judgment rule part 2” 2006 *Sabinet African law Journal* 34.

from criminal liability to the company.³¹ In *Ex parte Lebowa Development Corporation Ltd*, it was determined that section 248 was inapplicable when a third party filed a claim against directors for damages incurred due to the directors' negligence.³²

The common law forms an essential part of the South African legal framework. Although common law is not written legislation, it becomes binding law through various court decisions³³ According to South African common law, it is widely acknowledged that a director's paramount duty is to act and make decisions in good faith for the company's benefit.³⁴ A director, in exercising his/her/their powers and fulfilling his responsibilities, is expected to demonstrate the requisite level of care, expertise, and diligence³⁵ The duty of care encompasses a wide scope and pertains to all decisions that directors make or ought to make if they are to operate in the company's best interests.³⁶

Notwithstanding the significance of this prerequisite, the common law has historically encountered and continues to confront the issue of a minimal standard of review on the duty of care.³⁷

English law significantly impacted the evolution of South African common law regarding norms of care, skill, and diligence.³⁸ An evocative example of this is seen in Margo J's application of English law principles in *Fisheries Development Corporation of SA Ltd v Jorgensen & Another*.³⁹ This 1980 ruling continues to be the precedent-setting case on relevant standards of the duty of care, skill and diligence in South

³¹ As above. This section is often used in the event that a third party attempts to hold a director liable on the basis of delict, the general principles of delict will protect the director from liability if they have acted honestly. As a result, it is contended that the business judgment rule was not needed in South African law.

³² *Ex parte Lebowa Development Corporation Ltd* 1989 (3) SA 71 (T) 103G-103I Therefore, the only relief that the section permitted was relief from liability to the company in question and from criminal liability.

³³ As above.

³⁴ *Fisheries Development Corporation of SA Ltd v Jorgensen & Another* para 163.

³⁵ Havenga "The business judgment rule – Should we follow the Australian Example?" 2000 *SA Merc LJ* 33-34.

³⁶ Mupangavanhu *Directors' standards of care, skill, diligence, and the business judgment rule in view of South Africa's companies act 71 of 2008: future implications for corporate governance* (PhD thesis 2016 UCT) 110.

³⁷ As above.

³⁸ Cassim (2022) 120.

³⁹ *Fisheries Development Corporation of SA Ltd v Jorgensen & Another* para 163.

Africa.⁴⁰The test predominantly adopted was a subjective test for the duty of care, skill and diligence.⁴¹ Furthermore the court in *Fisheries Development Corporation of SA Ltd v Jorgensen & Another* ruled that the extent of a director's standard of duty of care and diligence required is circumstance-based.⁴² Factors such as the economic interests involved, the size of the company and the particular obligation assumed would play a part.

There was significant development after the Fisheries case. And as mentioned previously South African Common law appeared to be massively influenced by English law developments during this period. So, when English case law moved to dual objective/subjective standard based on section 214(4) of the Insolvency Act, 1986, it appeared that South African case law followed along the same route.⁴³

Cases such as in *Howard v Herrigel & Another NNO*⁴⁴ appear to have steered toward this direction. It is not entirely clear whether the *Howard v Herrigel & Another NNO* overruled *Fisheries Development Corporation of SA Ltd* regarding the differentiation of standards of care for directors. However, it has been seen that post-1990s cases in South Africa followed the position in *Howard v Herrigel & Another NNO*. This was evident in the case of *Philotex (Pty) Ltd & Others v Snyman & Others*.⁴⁵ It was becoming more and more evident in *Philotex (Pty) Ltd & Others v Snyman & Others*

⁴⁰ *Fisheries Development Corporation of SA Ltd v Jorgensen & Another* para 156. This case set an overly lenient stance toward the common law duty of care. This was predicated on assumptions that no longer hold validity in the contemporary commercial landscape. Some perspectives included the notion that directors should be perceived as well-meaning amateurs devoid of specialized skills or technical expertise. Consequently, it was unreasonable to anticipate and expect from them participation in company matters or the use of skills not mandated for possession. This subjective assessment did not mandate directors to assure attentive fulfillment of their responsibilities. Margo J determined that directors are not obligated to provide constant oversight of a company's operations. Concerning standards of expertise, the preeminent South African case subjectively mandated that directors utilize the information and experience they possessed. This is currently obsolete and unsuitable in a contemporary commercial environment.

⁴¹ As above.

⁴² *Fisheries Development Corporation of SA Ltd v Jorgensen & Another* at 156. Such interests include the economic interests involved, the size of the company and the particular obligation assumed.

⁴³ Mupangavanhu 24.

⁴⁴ The court in *Howard v Herrigel & Another NNO* seems to have adopted a divergent perspective. The court deemed parameters or designation for distinguishing directors as unhelpful or perhaps misleading for determining their obligations to the company. The court determined that the standards of care owed, remained consistent among all directors. In this regard the court seemed to have incorporated into South African common law, the idea articulated in *Dorchester Finance Co v Stebbing* that states that when a director has specialized skills and expertise, then the anticipated standards of care and proficiency expected are higher.

⁴⁵ *Philotex (Pty) Ltd & Others v Snyman & Others* para 14.

case that the courts were moving towards a dual objective/subjective test when it comes to the common law duty of care and skill⁴⁶ The court in this instance maintained that the criterion for recklessness is an objective norm evaluated against that of a hypothetical reasonable person, but also incorporating subjective factors that include the knowledge held by the specific director.⁴⁷ Consequently, the subjective factors necessitated an evaluation of the additional knowledge, experience, and ascertainable skills possessed by a certain director.⁴⁸

From the preceding discussion, it is clear to see that the legislation regulating the duties and obligations of directors was not easily available to the majority of corporate entities and was, furthermore, not necessarily easily ascertainable.⁴⁹ Furthermore, these regulations were antiquated and not in line with modern trends.⁵⁰

South Africa embarked on a corporate governance review process that began with the first *King Report on Corporate Governance* (King I) in 1994⁵¹ and culminated in the fourth *King Report on Corporate Governance* report (King IV) released in 2016,⁵² although the process of reviewing King Reports is arguably on-going. The role of the *King Reports* in fostering the highest standards of corporate governance in South Africa cannot be underemphasised as they played a major role in the development of jurisprudence in the country on key issues such as directors' standards of care, skill and diligence.⁵³

In 2004, the Department of Trade and Industry issued a policy paper titled *South African Company Law for the 21st Century: Guidelines for Corporate Law Reform*.⁵⁴ The reasoning behind the drafting of the policy paper was the need to review and modernise the South African company law in order to align it with international

⁴⁶ As above.

⁴⁷ As above.

⁴⁸ As above.

⁴⁹ Bouwman 2009 SA Merc LJ 518.

⁵⁰ As above.

⁵¹ The Institute of Directors in South Africa *King Report on Corporate Governance for South Africa* 1994, available at <http://www.iodsa.co.za> (accessed: 14/10/2023).

⁵² The Institute of Directors in South Africa *King Report on Corporate Governance for South Africa* 2016, available at <http://www.iodsa.co.za> (accessed: 14/10/2023).

⁵³ As above.

⁵⁴ Department of Trade and Industry Policy Paper *South African Company Law for the 21st Century: Guidelines for Corporate Law Reform* 2004.

trends.⁵⁵ The extensive review process that followed – with the aim of introducing new corporate legislation – involved consultations with industry participants and company-law experts, and focused on incorporating international best practice into the South African framework.⁵⁶ The review culminated in the Companies Act 71 of 2008 (the 2008 Act), which repealed the Companies Act 61 of 1973. There are, however, still certain provisions of the 1973 Companies Act that remain in force.⁵⁷

The 2008 Act, which came into effect on 1 May 2011, effected numerous modifications to the South African company law⁵⁸. Scholars noted the aim of the Act was to enhance the accessibility of the law by the general public. It was therefore written in a clear and simple manner.⁵⁹ During the policy-making process, the Department of Trade and Industry explicitly stated that the purpose of the Act was to update company law to conform to global patterns and cater to the requirements of contemporary corporations operating within South Africa's distinctive commercial and societal environment.⁶⁰ The Act introduced several new regulations and legal concepts to the legislative framework, modified existing common law, and even impacted the policies and philosophy of corporate law as a whole.⁶¹

The legislature deemed it appropriate to partially codify the provisions pertaining to the obligations and liabilities of directors in order to enhance the accessibility of the law.⁶² The 2008 Act truly expanded the range of statutory responsibilities of directors and incorporated the business judgment rule (the rule) into the corporate law framework.⁶³ The business judgment rule is a legal principle founded in USA common law that

⁵⁵ As above.

⁵⁶ Department of Trade and Industry *Companies Bill. Memorandum on the Objects of the Companies Bill* 2008 para 1.1.5.

⁵⁷ Item 9(1) sch 5 of the 2008 Companies Act; See also *HBT Construction and Plant Hire CC v Uniplant Hire CC* 2012 5 SA 197 (FSB) par 3. The provisions of Chapter 14 of the Companies Act 61 of 1973 dealing with the winding-up and liquidation of insolvent companies, will continue to govern those matters. The intention is, at some stage, to introduce a new and modern insolvency statute in South Africa in order comprehensively to govern insolvencies of all types of entity.

⁵⁸ As above.

⁵⁹ Boraine and Van Wyk "The application of "repealed" sections of the Companies Act 61 of 1973 to liquidation proceedings of insolvent companies" 2013 *De Jure* 671; Gwanyanya "The South African Companies Act and the realisation of corporate human rights responsibilities" *PELJ* 34.

⁶⁰ South African Company Law for the 21st Century – Guidelines for Corporate Law Reform (GG 26493 of 23 June 2004) (referred to as *Guidelines for Corporate Law Reform*).

⁶¹ Boraine and Van Wyk 2013 *De Jure* 675.

⁶² Ahern "Directors' duties, dry ink and the accessibility agenda" 2012 *Law Quarterly Review* 114.

⁶³ Yaru "The business of judging directors' business judgments in Singapore courts" 2016 *SACLJ* 25.

restricts the culpability of directors when duties are breached while making business decisions.⁶⁴

The rule was developed in the USA with the purpose of protecting honest directors and officers from the innate risk that decisions – taken with the goal of encouraging more innovation and venturesome business activity – may, in hindsight, turn out to have been poor decisions.⁶⁵ The potential liability of directors whilst undertaking risky business decisions is balanced by the implementation of a mechanism to limit liability known as the business judgment rule.⁶⁶ Consequently, the rule developed in the USA determines that the decisions made by a company's management and board of directors, which are made in good faith, with reasonable care, and in the belief that they are acting in the best interests of the company will be protected.⁶⁷ This rule allows leaders to exercise their business judgment without fear of personal liability for the outcomes, as long as they are not engaged in gross negligence or self-dealing.⁶⁸

In South Africa, section 76(4) of the 2008 Act contains the so-called business judgment rule. It relates to directors' duty to act in the best interests of the company⁶⁹ and with due care, skill and diligence.⁷⁰ To summarize briefly, the rule “provides protection to a director who faces allegations of a breach of these duties if the director has satisfied the requirements set out in section 76(4).”⁷¹ Important to note, is that it operates as a “standard of non-review”,⁷² and establishes a safe harbour for directors with respect

⁶⁴ As above.

⁶⁵ Havenga 2000 *SA Merc LJ* 27.

⁶⁶ Muswaka “Shielding directors against liability imputations: The business judgment rule and good corporate governance” 2013 *Speculum Juris* 28.

⁶⁷ Beuerle “The duty of care and the business judgment rule: a case study in legal transplants and local narratives” in Afsharipour and Gelter (eds) *Comparative Corporate Governance* (2021) 11.

⁶⁸ As above.

⁶⁹ Section 76(3)(b) of the Companies Act.

⁷⁰ Section 76(3) (c) of the Companies Act.

⁷¹ Muswaka 2013 *Speculum Juris* 30; Section 76(4) of the Act states that “in respect of any matter arising in the exercise of the powers or the performance of the functions of a director, a director will have satisfied the obligations in section 76(3) of the Act, if the director: has taken reasonably diligent steps to become informed about the matter; has made a decision, or supported the decision of a committee or the board with regard to that matter; and had a rational basis for believing, and did believe, that the decision was in the best interests of the company”

⁷² Muswaka 2013 *Speculum Juris* 23; Branson “The rule that isn't a rule – the business judgment rule” 2002 *Val. U.L.Rev.* 631 In South Africa the BJR functions a principle of non-review. Which entails that courts will not review the challenged conduct unless the plaintiff can rebut that presumption.

to decisions which adversely impact the company.⁷³ The South African variant of the business judgment rule will be delved into in more depth in chapter 3.

1.3. Problem statement

Coetzee and Van Tonder observe that the 2008 Companies Act partially codified the common law duties of directors and inserted a South African version of the statutory business judgment rule into corporate law.⁷⁴ The partial codification of directors' fiduciary duties did not exclude the common law and common law-based directors' duties.⁷⁵ The business judgment rule is presently a statutory defence and takes precedence over principles which might have been developed through a common law interpretation of the rule. The correct application of the rule is complicated and a deep understanding of its operation is required to avoid a misapplication of the rule. The South African courts have not yet been called to analyse the operation of the rule comprehensively and provide detailed guidelines that affect the interpretation and application of the rule.⁷⁶ Consequently a comparative study of how the rule has been applied in selected foreign jurisdictions will be undertaken in this work.⁷⁷ This comparative approach is particularly relevant as section 5(2) of the 2008 Act allows for a court to consider foreign company law when interpreting a provision of the 2008 Act. This section complements section 5(1) of the 2008 Act, which directs that the Act must be interpreted and applied in a manner that gives effect to the purposes set out in section 7. Section 7 mentions the evolution and utilisation of companies to enhance the economic welfare of South Africa – in particular, the rule is core to corporate

⁷³ Van Tonder 2015 *Obiter* 722. A safe harbour entails that the court will assume that the company directors made business decisions based on informed judgment, in good faith, and with a reasonable belief that their actions or omissions were in the company's best interests. Secondly, the board of directors will not bear accountability for its decision unless it can be demonstrated that it acted outside these limitations. The court will not overturn the decision itself provided that it can be linked to a logical commercial rationale.

⁷⁴ Coetzee and Van Tonder "Advantages and disadvantages of partial codification of directors' duties in the *South African Companies Act 71 of 2008*" 2016 *Journal for Juridical Science* 20.

Section 76(3) of the Companies Act 71 of 2008 partially codifies directors' fiduciary duties and the duty of care. Section 76(4) of the Companies Act 71 of 2008 codifies the business judgment rule.

⁷⁵ Esser and Du Plessis "The stakeholder's debate and directors' fiduciary duties" 2007 *SA Merc LJ* 347. Thus common law duties that do not conflict with statutory provisions still apply.

⁷⁶ As above.

⁷⁷ Watkins and Burton *Research Methods in Law* (2017) 100. Comparative law is the study of the differences and similarities between the laws of different countries.

governance and section 7(b)(iii) of the 2008 Companies Act highlights that “high standards of corporate governance” must be pursued.

This dissertation will consider how the business judgment rule can be effectively implemented. Particularly given the rules innate ability to, on the one hand, ensure that directors can act without fear of liability and, on the other hand, to ensure that directors are held liable where they should be held liable. This perfect balancing act will be examined in this works given that the rule should framed to not be so wide as to allow unintended “escapes” of liability but also not be so strict that the relief that it aims to provide is of limited availability. In particular, this study aims to investigate why the South African version of the rule specifically and exclusively relates to subsections 76(3) (b) and (c) of the 2008 Act and the rationale behind the exclusion of good faith requirements from the content of the rule. Given the locality of the business judgment rule, certain duties related to the rule more generally will be investigated.

1.4. Research questions

The business judgment rule applies in a large number of nations worldwide as a legal tool used to restrict the extent of officers' and directors' personal liability.⁷⁸ The rule consists of a rebuttable presumption that an officer or director has acted in good faith, with knowledge, and with the sincere belief that the action was in the best interests of the firm while making a business decision.⁷⁹ The primary research question this study seeks to investigate is: How can the codified version of the business judgment rule be enhanced in order to align it with the purposes of the Act set out in section 7 and foreign trends; and ensure that it functions as intended. In order to assist in answering the main question the study will be guided by a number of subquestions listed below.

1. What is the business judgment rule and how does it relate to corporate governance?
2. How did the rule develop nationally and internationally?
3. What is the legal framework for the rule in South Africa?
4. What is the legal framework for the rule in Australia?

⁷⁸ Mongalo *Corporate law and corporate governance: a global picture of business undertakings in South Africa* 2023 Van Schaik Publishers

⁷⁹ As above.

5. How does the legal framework of South Africa compare with the framework of Australia?

1.5. Delineations and limitations

This study focuses on the business judgement rule and deals with selected key issues that arise when attempting to interpret the rule. As the rule relates to directors' duties, a brief discussion on the development of the common law and statutory duties of directors which have bearing on the rule will be provided as these duties are relevant for purposes of the study. A detailed study of the directors' duties under section 76 of the Act fall outside of the scope of this study.

As the purpose of the study is to evaluate key aspects of the rule, a basic reference will be made to the common law relating to the standards set for directors' conduct but the intention is not to provide a detailed study of the history of common law duties.

As the word count is limited, it is also important to note that only certain aspects of the South African business judgement rule were identified to be particularly relevant and only these will be discussed. Due to the size of the company law legislation of South Africa and that of foreign jurisdictions, the entirety of the legislation, and the length of the processes contained therein, cannot be explained. However, the most important factors and processes will be duly explained and unpacked to explain their impact and relevance to the study.

1.6. Methodology

Desktop research of relevant laws, case law and policies which informed the research question and arguments was undertaken. In the premises, relevant South African legal principles found in the primary and secondary sources of law applicable to the scope of study were analysed. A qualitative approach was used when considering the common law and statutory law duties of directors including the business judgment rule. The substantial parts of this dissertation emphasizes the common law and the 2008 Companies Act.

A comparative study was undertaken with Australia. Australian corporate law is of comparative value when considering South African company law as it is also based

on English common law.⁸⁰ Consequently, it is pertinent to examine the evolution of Australian corporate law concerning directors' duties and to juxtapose it with the status of South African company law. Australia, similar to South Africa, has included a statutory business judgment rule into its company law through section 180(2) of the Corporations Act, 2001.⁸¹ Additionally a brief disquisition is provided on the USA's business judgement rule in chapter 2, which provides comparative value stemming from the fact that it is credited with originating the business judgement rule rule.

1.7. Structure of the dissertation

Chapter 1 provides a background to the link between The business judgement rule and the director's duties. A brief overview of what the business judgement rule is, and its development in common law to its codification in South African law is provided. The chapter also provided the research questions to be investigated, as well as the methodology to be utilized in answering these questions

Chapter 2 deals with the origins of the business judgement rule. The aim of this chapter is to discuss the origins of the business judgement rule and consider the way in which the rule has developed in the international corporate governance sphere. This chapter will briefly discuss the origins of the rule in the USA because the rule stems from this jurisdiction and thus, it forms the basis of the international development of the rule.⁸²

Chapter 3 considers the business judgement rule in South Africa. This chapter will begin with a brief discussion of the assimilation of the rule into the South African Corporate law landscape and the key aspects that make it unique.⁸³ It will focus on the field of application of the rule in South Africa, the range of decisions subject to the rule, and how it functions as a standard within corporate law.

Chapter 4 considers the codified business judgment rule in Australian corporate law by way of an analysis of section 180(2) of the Corporations Act, 2001. The drafting and application of the business judgment rule in Australia will be considered alongside

⁸⁰ Du Plessis "A comparative analysis of directors' duty of care, skill and diligence in South Africa and in Australia" 2010 *Acta Juridica* 265.

⁸¹ Siems *Methods of Comparative Corporate Law* 13.

⁸² Wiese *Corporate Governance in South Africa: with International Comparisons* (2017) 23.

⁸³ Wiese *Corporate Governance in South Africa: with International Comparisons* (2017) 23.

directors' duties to see how it has developed over the years. The aim is to compare the position in South African company law with the position in Australian company law and benchmark South Africa against its international counterpart.

Chapter 5 concludes the study by reflecting on the key concepts discussed throughout the dissertation. The recommendations provided will focus on improving the South African variant of the business judgment rule and will be derived from the Australian variant of the business judgement rule.

CHAPTER 2: THEORETICAL DOCTRINES THAT UNDERPIN THE BUSINESS JUDGEMENT RULE

2.1. Introduction

Taking business decisions that require judgment to be exercised is a dangerous undertaking. Directors must make challenging decisions that include evaluating unknown risks against prospective rewards to the company when carrying out their management responsibilities. As a result, and due to human error, some of these judgments may cause harm to the company.⁸⁴ The disputed question is whether directors should be held accountable for their (bad) judgments. This highlights the dilemma that arises: giving directors the freedom to take management decisions where there is a risk that the outcome may be profitable or hazardous; or holding them accountable for their actions in all instances.⁸⁵ Although directors devoted to corporate decision-making often do so in an environment that is not an entirely a predictable one, the need for accountability cannot be ignored. There is consequently an inherent conflict between the need to safeguard directors' authority and discretion in making decisions and the requirement to hold directors accountable for those decisions.⁸⁶

Economist Kenneth Arrow contended that “the power to hold to account is ultimately the power to decide”.⁸⁷ It stands to reason that directors cannot be held accountable without a part of their authority being reduced.⁸⁸ This could impact their authority in the sense that their decisions will always be made with fear of making a mistake and being held to account. The general approach among judges in foreign jurisdictions has been to avoid second-guessing corporate actions retrospectively.⁸⁹ Courts have generally been unwilling to intervene in directors' business judgments, believing that the boardroom rather than the courtroom is better suited to examine corporate choices.⁹⁰ Some countries have gone even farther, implementing a formal business

⁸⁴ Yara “The Business of judging director’s business judgements in Singapore courts” 2016 *Singapore Academy of Law Journal* 10.

⁸⁵ <https://plato.stanford.edu/entries/arrows-theorem/> last accessed 2024-10-31

⁸⁶ Bainbridge “The business judgment rule as abstention doctrine” 2004 *Vand L Rev* 83 84.

⁸⁷ <https://plato.stanford.edu/entries/arrows-theorem/> last accessed 2024-10-31

⁸⁸ Bainbridge 2004 *Vand L Rev* 104.

⁸⁹ As above.

⁹⁰ Yara 2016 *Singapore Academy of Law Journal* 23.

judgment rule that protects directors from responsibility if they were properly informed, took their decisions in good faith, and had no conflict of interest insofar as the decision was concerned.⁹¹ The business judgment rule is the courts' method to balance efficiency and accountability, and it is an essential extension of the division between ownership and control in companies.⁹²

The business judgment rule has become the courts' way of establishing a proper balance between efficiency and accountability.⁵ Although there are different formulations of the business judgment rule across jurisdictions, the essence is that courts will not second-guess directors' decisions if the directors were well informed, unconflicted, and acting in the company's best interests when taking those decisions.⁹³

There are differing sentiments towards the business judgment rule and not all countries have adopted the rule.⁹⁴ In addition, the methods to incorporate the business judgment rule into the law relating to corporate governance have differed. Yari notes that some countries, such as Australia and Germany, have codified the business judgment rule, whilst others, like the US, Japan, and Canada, opted instead to develop it through case law.⁹⁵

As indicated in chapter 1, South Africa incorporated the business judgment rule into its legal framework through section 76(4) of the Companies Act 71 of 2008. Case law depicting the approach of the courts when it comes to balancing risk-taking against accountability within company management is nevertheless limited. The aim of this chapter is to discuss how the business judgement rule developed nationally and international as well as the key policies and doctrines that underscore the rule.

This chapter is very instrumental for understanding the South African position as it will display the genesis of the rule in the international corporate law landscape and will help us understand the foundational principles underpinning South Africa's formulation

⁹¹ As above.

⁹² Bainbridge 2004 *Vand L Rev* 110.

⁹³ Bainbridge "Director primacy in the courts" 2008 *The New Corporate Governance in Theory and Practice* 111.

⁹⁴ Yari 2016 *Singapore Academy of Law Journal* 432. Countries such as the UK and Singapore have not adopted the rule.

⁹⁵ Yari 2016 *Singapore Academy of Law Journal* 430.

of the rule. To enable us to understand these foundational principles behind the rule adoption it is important for the author to differentiate between the concepts of theories and doctrines as they will be used interchangeably throughout this chapter. A theory is a systematic explanation of phenomena based on principles and evidence, developed through observation, experimentation, and reasoning.⁹⁶ It provides a framework for understanding phenomena, while a doctrine is a set of beliefs or principles promoted by a group or institution, often rooted in tradition or authority. Doctrines typically have a more prescriptive or normative character. While theories are typically subject to testing, modification, or falsification.⁹⁷ Understanding the essential differences between these two concepts are essential in understanding how different scholars have conceptualised the reasons for the existence of the business judgement rule in corporate governance. The main research question that this chapter addresses is how the business judgment rule developed internationally.

2.2. Policy foundations for the business judgement rule

The concept of the "business judgment rule" remains somewhat ambiguous. This is a result of the rule's continuous evolution and its adaptation to new contexts.⁹⁸ Consequently, the business judgment rule business judgement rule is surrounded by a significant quantity of uncertainty. Throughout history, the judiciary and academicians have dedicated their focus to comprehending the fundamental policies that underpin a proper understanding of the rule. Courts and scholars rely on several policies that justify the existence of the business judgment rule. resulting in a multiplicity of theories.⁹⁹ There are four major policy considerations that have emerged from the academic discourse surrounding the rule, which will be briefly explained in the preceding paragraph.

⁹⁶ Russ Shafer-Landau *Ethical theory an anthology* (2013) 216.

⁹⁷ Gauch, *Scientific Method in Practice*. (2003) 233.

⁹⁸ Duesenburg R 'The Business Judgment Rule and Shareholder Derivative Suits: A View from the inside' (1982) 60 *Washington University Law Review* 311.

⁹⁹ National Paralegal College "The Business Judgment Rule" available at http://nationalparalegal.edu/public_documents/courseware_asp_files/businessLaw/Directors&Officers/BusinessJudgmentRule.asp last accessed 03/11/2024.

The first policy consideration is the notion of knowledge asymmetry or the incompetence of courts to review business decisions.¹⁰⁰ It is argued that there are two sides to the information asymmetry imbalance.¹⁰¹ On the one hand, Giraldo contends that the court lacks the necessary expertise to make commercial judgments and should not interfere with directors' decisions.¹⁰² He argues that directors have more experience and awareness of a company's internal affairs than judges because they are involved in its daily operations.¹⁰³ Directors typically have greater knowledge and expertise regarding their firms than the courts and, therefore, it can be assumed that their decisions are better aligned with the needs of the company.¹⁰⁴

On the other hand, Bainbridge contends that directors may lack complete knowledge of the future, limiting their ability to make informed decisions.¹⁰⁵ This is true as directors cannot predict the future. As a result, should the decision negatively affect the company, directors should not be held responsible for something that a reasonable person in their position could not have rationally predicted.¹⁰⁶ The information asymmetry relates to judges who cannot hold directors to account where they do not have the necessary knowledge and information to do so. This may be true but the courts still compel directors to make informed decisions.¹⁰⁷ The author is in agreement with this notion of information asymmetry as after the fact litigation is often a faulty tool to evaluate corporate decisions due to the impulsive nature of business decisions that necessitate a quick decision being made on less than perfect information.¹⁰⁸ A closely related sub-variant of the notion of the incompetence of courts to review business decisions is the notion that it is extremely critical to safeguard directors against the

¹⁰⁰ McMillan "The business judgment rule as an immunity doctrine" 2013 *William and Mary Business Law* 521; Kennedy-Good and Coetzee "The Business Judgment Rule (Part 1)" 2006 *Obiter* 65-66.

¹⁰¹ Yari 2016 *Singapore Academy of Law Journal* 434.

¹⁰² Giraldo 2006 *Vicepresidencia Juridica* 123.

¹⁰³ As above.

¹⁰⁴ As above.

¹⁰⁵ Bainbridge 2004 *Vanderbilt Law Review* 119.

¹⁰⁶ *Aronson v Lewis* 473 A 2d 805 812 (Del 1984); Branson "The rule that isn't a rule – the business judgement rule" 2002 *Valparaiso Law Review* 636.

¹⁰⁷ McLennan "Duties of care and skill of company directors and their liability for negligence" 1996 *SA Merc LJ* 94.

¹⁰⁸ See also *Joy v North* 692 F 2d 880 (1982) for the perspective of USA Court of Appeal for the Second Circuit This judgement highlighted that the entrepreneur's role involves facing risks and addressing ambiguity; a well-considered decision made at the moment may appear as a mere speculation when assessed years later with complete knowledge.

potential of hindsight bias.¹⁰⁹ Hindsight is the enhanced knowledge or comprehension of a situation or event after it has occurred.¹¹⁰ In this context, it refers to judicial officers and stakeholders who believe that the directors' decision in a particular instance was unreasonable, or negligent – in particular due to understanding the circumstances of the decision better after the judgment was made.¹¹¹ It is, therefore contended that the business judgement rule provides a great deal of legal protection for directors who often have to make decisions in difficult, unpredictable corporate environments. The rule supports the notion that directors ought not to be penalized for all decisions that result in unwelcome results.¹¹²

The second policy consideration is the need to avoid constraining ingenuous and venturesome entrepreneurial activity.¹¹³ Competition is said to foster creativity, which entails some level of risk-taking.¹¹⁴ Innovation itself necessitates the introduction of new concepts, procedures, or products to enhance existing ones.¹¹⁵ In this regard, it is important to note that not every innovative idea is guaranteed to be successful, given that it is challenging to predict how consumers or clients will react to a company's product. However, it is imperative that companies remain innovative and constantly introduce new products and services to meet changing consumer tastes.¹¹⁶ McLennan views taking risks as an inevitable part of being a director.¹¹⁷ In contrast to persons like trustees, being a director by nature requires one to assume commercial risks no matter how much is on the line.¹¹⁸ The business judgement rule acknowledges directors' 'honest mistakes' and fosters an environment where flawed individuals can aspire to become directors in companies.¹¹⁹ This is because it serves as a form of

¹⁰⁹ Giraldo 2006 *Vicepresidencia Juridica* 122.

¹¹⁰ Hornby *Oxford Advanced Learner's Dictionary of Current English* (2015) 721.

¹¹¹ Muswaka 2013 *Speculum Juris* 14.

¹¹² As above.

¹¹³ Arkes and Schipani "Medical Malpractice *versus* the Business Judgment Rule: Differences in Hindsight Bias" 1994 *Or L Rev* 631; also see Section 7(b) of the South African Companies Act 71 of 2008 (the Act) provides that one of the purposes of the Act is to "promote innovation and investment in the South African markets".⁴⁵

¹¹⁴ As above

¹¹⁵ Arkes and Schipani 1994 *Or L Rev* 631.

¹¹⁶ As above.

¹¹⁷ McLennan 1996 *SA Merc LJ* 95.

¹¹⁸ As above.

¹¹⁹ <https://www.derebus.org.za/rescuing-the-director-can-the-business-judgment-rule-be-at-your-rescue/> (last accessed 2024/07/08)

protection for directors and allows them to make informed decisions even if they face the threat of liability to the company and shareholders because of the desired outcome not being reached.

The fourth consideration underscoring the rule is the notion that the business judgment rule involves “respecting shareholders’ will”.¹²⁰ In other words, shareholders should not become the managers of their company. Directors are nominated by shareholders, and shareholders have the option to invest or continue investing in the company managed by their chosen directors.¹²¹ Theoretically, this argument strongly supports the shareholder primacy model where directors are viewed as agents of shareholders.¹²² Under this model, directors’ fiduciary duty to act in the best interests of the company is owed to shareholders.¹²³ However, some authors contend that this rationale is flawed in several ways. Firstly, scholars’ question whether this would imply that directors can act as they see fit while the courts stand silent. Secondly, they question how one would deal with the situation where shareholders disagree with directors’ decisions – in particular, those decisions that will have no consequences for the directors where the business judgment rule is inevitably applied.¹²⁴

Lastly, it has been contended that directors require the protection of the business judgment rule under the notion of bounded rationality.¹²⁵ Bounded rationality refers to the restrictions that decision makers encounter when gathering and processing information.¹²⁶ As humans have inherent limitations in memory and mental tools – which speak to our fallibility – a rule such as the business judgment rule can aid in ameliorating the veracity and accuracy behind major decisions that affect a company and lessen the potential prejudice that may ensue afterwards.¹²⁷

¹²⁰ Giraldo 2006 *Vicepresidencia Juridica* 123.

¹²¹ Giraldo 2006 *Vicepresidencia Juridica* 127, referring to *Joy v North* 692 F 2d 880 (1982).

¹²² Ajibo “A critique of Enlightened Shareholder Value: Revisiting the Shareholder Primacy Theory” 2004 *Birkbeck LR* 44–47.

¹²³ Esser and Du Plessis “The stakeholder debate and directors’ fiduciary duties” 2007 *SA Merc LJ* 351.

¹²⁴ As above.

¹²⁵ Giraldo 2006 *Vicepresidencia Juridica* 123.

¹²⁶ Bainbridge 2004 *Vanderbilt LR* 112.

¹²⁷ As above.

2.3. Theoretical doctrines underpinning the rule

The USA, being the country where the rule originated has three main theoretical formulations of the business judgment rule that have developed all within the state of Delaware. These are the standard of liability, the abstention doctrine and the immunity doctrine.¹²⁸ All of these theoretical doctrines will be unpacked in the preceding paragraph.

2.3.1. Standard of Liability

The first conceptualisation that will be discussed is that of the business judgment rule as a substantive standard of liability.¹²⁹ In this regard, Bainbridge a renowned scholar, notes that “The business judgment rule in this particular conceptualisation will not apply, if the courts find that the directors have breached their duties of care.”¹³⁰ The rule, so conceived, entails some objective review of the quality of a board of director’s decision.¹³¹ It is contended that for this conceptualisation, the business judgment rule shields directors from liability so long as they act in good faith.¹³² The standard-of-liability test in Delaware courts allows plaintiffs to shift the burden of proof if conditions like fraud, illegality, self-dealing, or are established.¹³³ The standard of liability conceptualisation of the business judgment rule is the approach highly preferred by Delaware courts. This approach was recognized in the *Omnicare Inc v NCS Healthcare Inc* case as an approach to the business judgment rule that recognizes the statutory authority vested in the board of directors to manage a corporation, raising

¹²⁸ Bainbridge 2004 *Vand LR* 56.

¹²⁹ Bainbridge 2004 *Vand LR* 90; Eisenberg, “The Divergence of Standards of Conduct and Standards of Review in Corporate Law” 1993 *Fordham L. Rev.* 437. Understanding the business judgment rule under this formulation necessitates recognizing the contrast between standards of conduct and standards of review. The former delineates the expected conduct of directors, whereas the later articulates the criteria courts will employ to ascertain if the directors’ conduct could give rise to liability. The duty of care is regarded as a standard of conduct, while the business judgment rule is viewed as a standard of review.

¹³⁰ As above.

¹³¹ As above.

¹³² Gevurtz, “The Business Judgment Rule: Meaningless Verbiage or Misguided Notion?” 1994 *S. Cal. L. Rev* 287.

¹³³ See *Cede & Co v Technicolor Inc* 634 A.2d 361 (Del.1993) The court ruled that a shareholder plaintiff must prove that directors breached their fiduciary duty of good faith, loyalty, or due care in their challenged decision. If the plaintiff fails to meet this burden, the business judgment rule will act as a shield and protect corporate officers and directors’ decisions. Concomitantly courts will not second-guess these judgments. If the rule is rebutted, the burden shifts to defendant directors to prove the entire fairness of the transaction to the shareholder plaintiff.

the standard of liability for a director's decision.¹³⁴ Oost notes that the business judgment rule in this context elevates the standard of liability for a director's decision from ordinary negligence to gross negligence to establish liability.¹³⁵

2.3.2. The abstention doctrine

The abstention doctrine conceptualisation of the business judgment rule is framed as a presumption that courts in adjudicating matters concerning director liability, will not adjudicate on the merits of directors' decisions unless it can be shown that the directors did not abide by "appropriate decision-making procedures."¹³⁶ Thus unlike the previous conceptualisation of the business judgment rule as a substantive standard of liability, the business judgment rule, under this doctrine, does not "state the director's scope of liability".¹³⁷

According to the abstention doctrine, the judiciary should abstain or be prohibited from reviewing the substantive merit behind commercial decisions made by directors.¹³⁸ As mentioned earlier, the business judgment rule embodies the struggle between authority and responsibility.¹³⁹ Bainbridge contends that abstention does not mean that the judiciary abandons its responsibilities.¹⁴⁰ Rather, the court becomes reluctant to interfere without detracting from its prerogative to get involved in specific situations as it sees fit.¹⁴¹ The key challenge lies in recognizing the specific situations where judicial intervention is necessary because it is difficult to ascertain when accountability ought to take precedence over preserving a board of directors' autonomy and authority.¹⁴² Bainbridge's question, as to whether judicial involvement is necessary,

¹³⁴ *Omnicare, Inc v NCS Healthcare Inc* 818 A.2d at 914, 927 (Del. 2003) 927.

¹³⁵ Oost 56.

¹³⁶ *Brehm v Eisner* 746 A.2d 244, 264 n.66 (Del 2000). The abstention doctrine prevents the court from evaluating a director's conduct's merits unless the plaintiff can challenge the business judgment rule's presumption of good faith.

¹³⁷ Bainbridge 2004 *Vand LR* 56.

¹³⁸ *Mongalo Corporate Law and Corporate Governance: A Global Picture of Business Undertakings in South Africa* (2023) 159.

¹³⁹ Bainbridge "Director primacy in corporate takeovers: preliminary reflections" 2002 *Stanford LR* 806.

¹⁴⁰ Bainbridge 2004 *Vanderbilt LR* 113.

¹⁴¹ As above.

¹⁴² Bainbridge 2004 *Vanderbilt LR* 130.

can therefore be addressed by demonstrating fraud, personal interest, or lack of good faith – all which should warrant judicial interference.¹⁴³

The abstention doctrine originated in the USA – independently of the business judgment rule – in the case of *Railroad Commission of Texas v Pullman Co.*¹⁴⁴ The case was concerned with the autonomy of state courts in comparison to the jurisdiction of federal courts.¹⁴⁵ Frankfurter J determined that the lawsuit raised a significant constitutional problem in a delicate area of social policy that federal courts should avoid unless there are no other options for resolution.¹⁴⁶ It was further decided that federal courts should use discretion to limit their authority in order to respect the independence of state governments and ensure the efficient functioning of the federal judiciary.¹⁴⁷

Frankfurter J's *ratio decidendi* implies that the abstention concept was founded on principles of respect and efficiency. When applied to the business judgement rule context, the approach supports the idea that effective corporate governance necessitates centralizing decision-making power.¹⁴⁸ The *Burford v Sun Oil Company*¹⁴⁹ case followed the precedent set in *Railroad Commission of Texas v Pullman*. In this case, the Sun Oil Company challenged the legitimacy of a Texas Railroad Commission order that approved Burford's authority to drill wells in the East Texas oil region.¹⁵⁰ The question of the jurisdiction of state and federal courts re-emerged.¹⁵¹ The court determined that federal courts of equity should use their discretionary jurisdiction while respecting the freedom of state governments in implementing their domestic policies.¹⁵²

¹⁴³ Bainbridge 2004 *Vanderbilt LR* 100.

¹⁴⁴ *Railroad Commission of Texas v Pullman Co* US 1941 para 496; McMillan 2012 *William & Mary Business LR* 537.

¹⁴⁵ *Railroad Commission of Texas v Pullman Co* 312 US para 499.

¹⁴⁶ As above.

¹⁴⁷ Bainbridge "The Bishops and the Corporate Stakeholder Debate" 2002 *Villanova Journal of Law and Stakeholder Development* 5.

¹⁴⁸ As above.

¹⁴⁹ *The Burford v Sun Oil Company* 319 US (1942) para 332.

¹⁵⁰ *The Burford v Sun Oil Company* 319 US (1942) para 496.

¹⁵¹ As above.

¹⁵² As above.

Another case where the abstention doctrine was applied was the *Colorado River Water Conservation District v United States*.¹⁵³ This case also involved the conflict between state and federal courts' jurisdiction. The case focused on two specific situations where the application of the abstention doctrine was deemed suitable.¹⁵⁴ It was said that the doctrine applied where a state court's decision on relevant state law court trigger a federal constitutional issue, especially if the case involved complex state law questions with significant public policy implications that went beyond the current case.¹⁵⁵ It was furthermore stated that federal jurisdiction could be applied to cease state criminal proceedings and a clearly invalid state law.¹⁵⁶

By contextualizing these conditions and using reasoning by analogy, the federal court would be the court practicing abstention, while the state court would be likened to the board of directors.¹⁵⁷ Thus, it is contended that courts are expected to rely on the abstention doctrine in circumstances where directors are more knowledgeable or experienced, in situations where difficult commercial matters arise, or where there is no evidence of bad faith.¹⁵⁸ The case law discussed above demonstrates the ongoing evolution of the abstention doctrine, which has implications for the interpretation of the business judgment rule. In *Railroad Commission of Texas v Pullman*, the doctrine was used to delay judicial intervention. In *Burford v Sun Oil Company*, the court implemented a hands-off policy, while in *Colorado River Water Conservation District v United States* the court emphasized the exceptional circumstances where the doctrine should be applied.¹⁵⁹

The abstention doctrine iteration of the business judgement rule precluded courts from determining whether directors breached the duty of care.¹⁶⁰ This approach comes with advantages and disadvantages.¹⁶¹ Benefits of the abstention theory include

¹⁵³ *Colorado River Water Conservation District v United States* 424 US para 817 (1976); McMillan 2012 *William & Mary Business LR* 539

¹⁵⁴ As above.

¹⁵⁵ As above.

¹⁵⁶ As above.

¹⁵⁷ Hamadziripi and Osodett "The nature and evolution of the business judgment rule and its transplantation to South Africa under the Companies Act of 2008" 2019 *Speculum Juris* 38.

¹⁵⁸ As above.

¹⁵⁹ As above.

¹⁶⁰ Bainbridge 2004 *Vanderbilt LR* 102.

¹⁶¹ Hamadziripi and Osodett 2019 *Speculum Juris* 40.

conserving judicial resources.¹⁶² This is achieved by avoiding unnecessary expenditure of time and resources on matters that will ultimately be redirected to the board of directors due to the court's lack of sufficient information and expertise.¹⁶³ The abstention doctrine also assists in preserving the internal group dynamics of the board of directors.¹⁶⁴

Bouwman explains that market processes support the abstention doctrine due to the fact that, in order for directors to remain in the market and to continue to be sought after as directors, they need to run the company effectively and comply with regulations in order to maintain their position and be considered for future positions.¹⁶⁵ The notion of shareholder profit maximization has influenced the business judgment rule's application by ensuring that directors' choices are only safeguarded if they have directly benefited shareholders.¹⁶⁶ Nevertheless, there are cases where the rule has been enforced despite directors favouring the interests of other stakeholders over shareholders.¹⁶⁷

Courts and scholars concur that the business judgment rule, and its implementation against the background of abstention, operates as a rebuttable presumption.¹⁶⁸ In order for the abstention doctrine to be applicable, some requirements need to be fulfilled.

First, the director or board of directors must have made a deliberate and well-informed decision.¹⁶⁹ This implies a positive deed or an official assignment. Not acting is not protected by the business judgment rule as it is considered an omission, but choosing not to act is included in the ambit of the doctrine.¹⁷⁰ Also, it is one thing to simply take

¹⁶² Branson "The rule that isn't a rule" 2002 *Valparaiso University Law Review* 636.

¹⁶³ Hamadziripi and Osodett 2019 *Speculum Juris* 32.

¹⁶⁴ Bainbridge 2004 *Vanderbilt LR* 127.

¹⁶⁵ Bouwman 2009 *SA Merc LJ* 527.

¹⁶⁶ Bainbridge "In defense of the Shareholder Wealth Maximization Norm: A reply to Professor Green" 1993 *Wash & Lee LR* 1441; Bainbridge 2002 *Stanford LR* 805. See Bainbridge "Much ado about little – directors' fiduciary duties in the vicinity of insolvency" 2007 *J Bus & Tech L* 341 and Bainbridge 2002 *Villanova Journal of Law and Stakeholder Development* 19, where the same scholar argues that the rule grants the management discretion to make some trade-offs between shareholder and non-shareholder interests.

¹⁶⁷ Bainbridge 2002 *Villanova Journal of Law and Stakeholder Development* 19.

¹⁶⁸ *Gimbel v The Signal Companies Inc* 316 A 2d 599 (1974); *Aronson v Lewis* 473 A 2d (Del 1984).

¹⁶⁹ Section 76 of the Act.

¹⁷⁰ Bouwman 2009 *SA Merc LJ* 525.

a decision but it is another thing to make an informed decision.¹⁷¹ The latter presupposes that one commits oneself to fervently seek relevant information before making a decision.¹⁷² It is this type of conduct that is covered by the business judgment rule. Second, the decision-maker has to have acted in good faith and the directors should be disinterested and independent.¹⁷³

Third, the presence of certain factors precludes the utilisation of the business judgment rule in general, but in particular as a rule founded on the abstention doctrine. These include, amongst others, proof of fraud, illegality in the decision, and conflict of interest of the decision-maker.¹⁷⁴

Connecting the requirements to the court's approach reveals that the essence of an abstention conceptualisation of the business judgment rule is judicial deference to directors' decisions.¹⁷⁵ The court will reconsider a decision only when specific preconditions are satisfied. The court in *Kamin v. American Express Co.* exemplifies the practical application of this deferential mindset in action, in interpreting the business judgment rule.¹⁷⁶ In *Kamin*, the American Express board's judgment was evidently erroneous; yet, the court dismissed the lawsuit due to a lack to articulate a valid claim.¹⁷⁷

Some scholars question how the court assesses the reasonableness of a judgment under the abstention theory without directly analysing the decision.¹⁷⁸ Moreover, if the abstention theory is used, there is a possibility that the business judgment rule could simply become a factor in determining which party has the burden of proof.¹⁷⁹ X Importantly, under the abstention theory as mentioned previously the court refrains from reviewing the substantive merits of director's conduct unless the plaintiff can

¹⁷¹ *Smith v Van Gorkom* 488 A.2d supra at 871-872.

¹⁷² Hamadziripi and Osodett 2019 *Speculum Juris* 39.

¹⁷³ Davies *et al Companies in South Africa* (2013) 124; Cassim *et al Contemporary Company Law* (2012) 564.

¹⁷⁴ Bainbridge 2004 *Vanderbilt LR* 98.

¹⁷⁵ Bainbridge 2004 *Vanderbilt LR* 100.

¹⁷⁶ *Kamin v American Express Co.* 383 N.Y.S.2d 807 (Sup. Ct. 1976) *aff'd*, 387 N.Y. S2d 993. In this case the court, upon application of the business judgement rule, dismissed the applicant's case despite a demonstrably wrong decision by the board.

¹⁷⁷ As above.

¹⁷⁸ Bainbridge 2004 *Vanderbilt LR* 98.

¹⁷⁹ Bainbridge 2004 *Vanderbilt LR* 105.

rebut the business judgment rule's presumption of good faith.¹⁸⁰ Consequently, as the court recognizes a presumption favoring directors under the business judgment rule, the opposing party bears the burden of demonstrating that the directors breached their duty in some manner.¹⁸¹ The burden of proof will, however, switch if a plaintiff shows that a large multitude of directors show a personal interest in the transaction as opposed to a benefit which devolves upon the company or all shareholders in a general sense.¹⁸² Consequently, when the burden of proof shifts to the directors, they need that the transaction was fair.¹⁸³

2.3.3. The immunity doctrine/ safe harbour

The business judgement rule has also been framed as an immunity doctrine. The term "immunity" refers, literally, to "a special privilege or exemption from any duty, obligation, or penalty".¹⁸⁴

In the context of the rule, directors will be afforded immunity as long as they conduct their duties in their capacity as directors.¹⁸⁵ In the conceptualisation of the business judgment rule as an immunity doctrine it is seen as a qualified immunity rather than an absolute immunity.¹⁸⁶ It would be contrary to the office of all law concerning director liability, most prominently the duty of care, skill and negligence to imbue directors with absolute immunity.¹⁸⁷ This would furthermore most definitely also open the gates for directors to act without fear of liability for any such duties,

When the business judgement rule operates as an immunity doctrine, the burden of proof¹⁸⁸ rests with the defendant, who must establish his or her eligibility for immunity. This entails that a defendant director needs to demonstrate that the protection afforded

¹⁸⁰ *Guth v Loft Inc* 5 A.2d 503, 510 (1939)

¹⁸¹ As above.

¹⁸² See *Schlensky v Wrigley* 237 NE2d 776 (Ill. App. 1968) for an illustration of the business judgment rule as an abstention doctrine.

¹⁸³ See *Brehm v Eisner* 746 A.2d 244, 264 n.66 (Del. 2000) 264.

¹⁸⁴ Black *Black's Law Dictionary* (1979) 676.

¹⁸⁵ McMillan 2012 *William & Mary Business LR* 569.

¹⁸⁶ As above.

¹⁸⁷ Leach *The Correct Understanding of the Business Judgment Rule in Section 76(4) of the Companies Act 71 of 2008: Avoiding the American Mistakes* (LLM thesis, University of Cape Town, 2014) 47.

¹⁸⁸ Giraldo 2006 *Vicepresidencia Juridica* 135.

by the business judgment rule should apply in a particular instance.¹⁸⁹ The practical impact is that if the rule is applicable, the immunity becomes enforceable, so shielding the director from liability.¹⁹⁰ Essentially, the director is entitled to the protection of the rule only if the court determines that such entitlement is warranted.¹⁹¹ The court determines, depending on the evidence and arguments submitted by the director, whether the director qualifies for the protection of the business judgment rule under this theoretical conception.¹⁹² The onus of evidence rests entirely with the director, who must demonstrate eligibility for the rule's protection.

The author resonates more with this theoretical conception as it is intuitively compelling to mandate that a defendant director demonstrate the applicability of the business judgment rule in any specific case. This requirement the author contends, permits the evaluation of each case based on its own merits and accommodates variability in the application of the rule to all cases. The author furthermore agrees with the notion that the immunity doctrine appears to align more closely with South Africa's corporate governance principles concerning director conduct.¹⁹³ Specifically, the immunity doctrine would enable directors to explain their decisions instead of permitting directors to maintain a default stance where their decisions are protected from judicial review and the responsibility is assigned to the Shareholders to provide justification for the review.¹⁹⁴

Scholars contend that it is accurate to consider the stipulations of section 76(4) as "the components of the objective standard necessary for the invocation of a qualified immunity."¹⁹⁵ Qualified immunities necessitate that the individual seeking immunity demonstrate the reasonableness of their behaviour, after which the court assesses that conduct to determine if immunity is granted.¹⁹⁶ It is important to note that the evaluation does not pertain to the substantive accuracy of the conduct.¹⁹⁷ In numerous

¹⁸⁹ Leach 45.

¹⁹⁰ Leach 46.

¹⁹¹ Leach 48.

¹⁹² As above.

¹⁹³ *Contemporary Company Law* Chapter 11. This section is aimed at providing an elucidation into the corporate governance culture that is relevant to corporate law in South Africa.

¹⁹⁴ As above.

¹⁹⁵ Leach 48.

¹⁹⁶ https://www.law.cornell.edu/wex/qualified_immunity (last accessed 2024 -11-12).

¹⁹⁷ Leach 49.

cases, responsibility may not be imposed even if the conduct is deemed erroneous retrospectively.¹⁹⁸ For liability to be established, the disputed conduct must be deemed unreasonable beforehand. Conduct deemed justified beforehand, will not be deemed wrongful, thereby precluding liability.¹⁹⁹ Cassim contends that the business judgment rule operating as an immunity doctrine provides directors with a "safe harbour" from liability.²⁰⁰ A safe harbour provision is a provision in a statute that minimises a party's liability under law provided that the person acting did so in good faith or in compliance with the defined standard.²⁰¹

2.3.4. A standard of liability

The business judgment rule has also been framed as, what corporate law scholars term, a standard of liability.²⁰² Such a standard of liability dictates how one should conduct oneself or how one is expected to perform in an assigned role.²⁰³ In other words, role players are given a certain amount of freedom or room to make mistakes but, when the boundaries are exceeded, liability would be imputed to the offender.²⁰⁴ In this specific context, those given the necessary – but bounded – freedom are company directors.²⁰⁵ The business judgment rule is thus a test applied by the courts to determine whether a director's conduct gives rise to personal liability.²⁰⁶

The standard of liability test and the abstention doctrine is similar to the extent that it is up to the plaintiff to present proof that there were factors such as fraud, self-dealing, and illegality present and, consequently, the plaintiff fails to meet the appropriate standard of proof – the court may then apply the business judgment rule to protect the directors.²⁰⁷ However, decisions that are blatantly negligent are not covered by the "grace" of the business judgment rule – the boundaries referred to above apply here.²⁰⁸

¹⁹⁸ As above.

¹⁹⁹ McMillan 2012 *William & Mary Business LR* 572.

²⁰⁰ Cassim *et al Contemporary Company Law* (2012) 563.

²⁰¹ Morrison (2013) 361 *University of Michigan Law: Public law and Legal Theory Research*.

²⁰² McMillan 2012 *William & Mary Business LR* 529.

²⁰³ McMillan 2012 *William & Mary Business LR* 528.

²⁰⁴ Hamadziripi and Osodett 2019 *Speculum Juris* 33.

²⁰⁵ Hamadziripi and Osodett 2019 *Speculum Juris* 34.

²⁰⁶ McMillan 2012 *William & Mary Business LR* 530.

²⁰⁷ McMillan 2012 *William & Mary Business LR* 533.

²⁰⁸ As above.

The challenge has been to determine when boundaries were crossed, for example, which conduct constitutes gross negligence and this differs from “simple” negligence. Additional considerations – relevant or not – include how much damage was done to the company or how arbitrary the decision was.²⁰⁹ Branson contends that the level of care that is needed is due care, not slight care or gross negligence.²¹⁰ The Business as a standard of liability is activated when due-process allegations are asserted against directors over their decision-making procedures.²¹¹ This occurs when a plaintiff, typically a dissatisfied shareholder, is displeased with the outcomes of prior choices made by directors.²¹² A legal case would then contest the standard of conduct, with claims of failing to meet the expected standard being presented.²¹³ Due diligence, good faith (lack of conflicts of interest), and a rational foundation for decision-making (such as decisions made in the company's best interests) exemplify the expected standard of conduct.²¹⁴ The court must then implement a standard of liability test to ascertain if a director failed to uphold the requisite standard of conduct, in manner that could give rise to personal liability.²¹⁵ Should the party bearing the onus of proof discharge this obligation and demonstrate the directors' failure to adhere to the expected standard of conduct, the business judgment rule will not safeguard the directors.²¹⁶ Should the party neglect to fulfil the burden of proof, the business judgment rule (business judgement rule) will be invoked.²¹⁷ In summary, the aforementioned delineates the relationship between a standard of conduct and a standard of review.

The business judgment rule was considered in the American case of *Cede & Co v Technicolor Inc.*²¹⁸ It was said that this rule, as a rule of evidence, creates a presumption that, in making a business decision, a director of a company made the

²⁰⁹ Hamadziripi and Osodett 2019 *Speculum Juris* 33.

²¹⁰ Branson 2002 *Val U LR* 638. My emphasis.

²¹¹ McMillan 2012 *William & Mary Business LR* 535.

²¹² As above.

²¹³ As above.

²¹⁴ As above.

²¹⁵ As above.

²¹⁶ As above.

²¹⁷ As above.

²¹⁸ 634 A 2d 345 (1993).

decision on an informed basis – that is, with due care, in good faith, and with the honest belief that the action taken was in the best interest of the company.

The standard of liability as a theoretical basis for the business judgment rule is not without criticism. Bainbridge, for instance, contends that the standard of liability method is analogous to putting the cart before the horse because of the fact that the courts look for proof of wrongdoing first and, if no wrongdoing is found, they follow a hands-off approach.²¹⁹ He contends that, with this approach, the courts would be asked to review directors' decisions more often whereas judicial review of directors' decisions should only occur on rare occasions – not all the time.²²⁰ This kind of behaviour could lead to judges taking over the duties of directors. The fundamentally important question that emerges is thus who the final decision-maker is when it comes to the company.

2.4. The international development of the business judgement rule

The model of the business judgment rule in the USA shall serve as the lens through which to analyse the business judgment rule in various jurisdictions. This is because the USA is the jurisdiction where the rule originated.²²¹

The United States has two formulations of the business judgment rule: the Delaware business judgment rule and the American Law Institute (ALI) formulation found in the ALI's Principles of Corporate Governance.²²² Johnson notes that neither of these formulations has been enshrined into their legislative framework.²²³

²¹⁹ Bainbridge 2004 *Vanderbilt LR* 108.

²²⁰ As above.

²²¹ Yari 2016 *Singapore Academy of Law Journal* 435.

²²² The American Law Institute *Principles of corporate governance: Analysis and recommendations* vol 1 (1994) 173. See also Triem "Judicial schizophrenia in corporate law: Confusing the standard of care with the business judgment rule" 2007 *Alaska L Rev* 23 36 – 37 (noting that "the ALI formulation of the BJR has been adopted by some state courts – but not codified by their respective legislatures

²²³ Johnson "The Modest Business Judgment Rule" 2000 *Washington and Lee University School of Law* 30; The American Law Institute *Principles of corporate governance: Analysis and recommendations* (1994).

The ALI articulation of the business judgment rule in section 4.01(c) of the ALI Principles asserts that a director and the business decision will be shielded from judicial review if the director –

“(a) was not engrossed in the subject of the business judgment; (b) was abreast with regards to the subject of the business judgment to the extent they reasonably believe to be appropriate under the circumstances; and (c) rationally believe that the business judgment [was] in the best interests of the corporation”.²²⁴

Essentially for the Business Judgement rule to be applicable, a director must have executed a 'business judgment' in good faith. The director also needs to remain uninfluenced by conflicts of interest when rendering this judgment or decision. The director responsible for this business judgment or decision must not possess any personal or financial interest in the matter.²²⁵ Furthermore the director must demonstrate a degree of consideration in rendering that judgment or conclusion. The director is expected to thoroughly familiarize themselves with the subject matter prior executing a decision.²²⁶ The highest courts in several USA states have accepted the ALI formulation.

The ALI formulation is, however, subject to criticism. Firstly, the issue of whether the director was reasonably apprised concerning all the material information relevant to the subject matter of the decision at scope that that director thought was pertinent will enjoin the court to look at the amount of information possessed by the director at the time that the decision was made.²²⁷ This argued to be potentially problematic as decision that looked reasonable at the time may turn out to look disastrous after the fact given the power of hindsight lieu of presuming an informed decision, the ALI formulation sets the requirement as a prerequisite which directors have to satisfy before being able to rely on the business judgment rule.²²⁸ In terms of the ALI formulation directors must inform themselves of all information available to them which

²²⁴ American Law Institute, ALI Corporate Governance Project (1994) para 4.01(c).

²²⁵ Hopt K, Kanda H & Roe M et al 'Comparative Corporate Governance: The State of the Art and Emerging Research' 1998 326.

²²⁶ As above.

²²⁷ Carney "Section 4.01 of the American Law Institute's Corporate Governance Project: Restatement or misstatement?" 1988 *Wash U L Q* 27.

²²⁸ Yaru 2016 *Singapore Academy of Law Journal* 443.

themselves of all information which they reasonably believe to be appropriate which has raised the difficulty of for directors to meet the requirement for protection under the business judgement rule as it such an onerous demand and higher standard of review given the different situations Directors might find themselves, with regards to information availability when making a decision.

Secondly, it has been contended that the phrase “rationally believes” encompasses both an objective and subjective dimension.²²⁹ A director must really feel that the business choice serves the company's best interests, and this opinion must be rational.²³⁰ Consequently, the court has reason to scrutinize the director's reasoning to determine if the decision possessed a sound foundation. The literature indicates that the ALI supports the use of a "standard of reasonable belief" as a criterion for assessing a director's actions in relation to its protection.²³¹ Thus it is argued that This could, in turn, lead to the court challenging directors' decisions more often as the court will question the rationality of decisions more often which could lead to more judicial interference of business decisions which as has been mentioned above is something the business judgement rule tries to prevent.²³²

However, to counter these concerns, ALI presents compelling theoretical foundations for its formulation of the rule. First, ALI aims to encourage directors to put themselves in a position to make as informed and careful a decision as circumstances permit²³³ This does not negate the fact that directors might be have an urgent time frame and thus be forced to take the risk of “not having all relevant facts concerning a proposed transaction”.²³⁴ This is already considered as part of ALI because directors' decisions to “accept the risk of incomplete information” will still be protected under the business judgment rule as long they had the reasonable belief that “such informational risk [was] appropriate under the circumstances”.²³⁵

²²⁹ Yaru 2016 *Singapore Academy of Law Journal* 449

²³⁰ As above.

²³¹ As above.

²³² Arsalidou “Objectivity versus flexibility in civil law jurisdictions and the possible introduction of the business judgment rule in English law” 2003 *Comp Law* 232.

²³³ Carney 1988 *Wash U L Q* 273.

²³⁴ As above.

²³⁵ The American Law Institute *Principles of corporate governance: Analysis and recommendations* vol 1 (1994) 178.

Factors to decide if such a belief was “appropriate under the circumstances” include, amongst others, the significance of the business decision that had to be made, and the time taken to retrieve the relevant information.²³⁶ Second, the ALI formulation recognizes that a “rational” basis is already much broader than a “reasonableness” test and furnishes enough protection to directors whose decisions might not be the most reasonable but are still not so far dislodged from the realm of reason.²³⁷ In this regard, Branson submits that a “rational” basis test is already a much more lenient standard than a “reasonable” basis since directors only need to show a plausible basis for making their decisions.²³⁸ There is thus no reason for the ALI formulation to adjust to criticism in this regard as this may protect irrational business decisions which are completely removed from the realm of reason.²³⁹

The Delaware courts also apply a “rational” belief test by reinforcing the notion that “the board’s decision will be upheld unless it cannot be connected with any rational business purpose”.²⁴⁰ In this regard, the Delaware formulation is primarily geared towards analysing the directors’ decision-making process, rather than looking at the specific content of the decision.²⁴¹ This formulation was affirmed in the landmark case of *Aronson v Lewis* and formulated as follows: “In making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.”²⁴² In this regard Kershaw contends that the Delaware formulation dictates that if directors satisfy their duty of care in decision-making and their duty of loyalty—requiring good faith and the absence of direct conflicts of interest—then the decision will undergo only a rationality

²³⁶ As above.

²³⁷ The American Law Institute *Principles of corporate governance: Analysis and recommendations* vol 1 (1994) 181.

²³⁸ Branson and Keong “Balancing the scales: A statutory business judgment rule for Hong Kong?” 2004 *HKLJ* 2 8.

²³⁹ Yari 2016 *Singapore Academy of Law Journal* 438.

²⁴⁰ Veasey “On corporate codification: A historical peek at the model business corporation act and the American Law Institute principles through the Delaware Lens” 2011 *Law & Contempt Probs* 101.

²⁴¹ As above.

²⁴² *Aronson v Lewis* 473 A 2d 805 (Del Sup Ct, 1984).

review.²⁴³ If a rational justification exists for the decision, courts will not investigate further.²⁴⁴ This perspective seems to be widely endorsed by the majority of scholars.²⁴⁵

It is noted that, consequently, in the absence of an abuse of discretion, the courts will uphold the business judgment.²⁴⁶ The onus lies with the party contesting the decision to present evidence that contradicts the presumption.²⁴⁷ Kershaw contends that although the elements of the Delaware and ALI formulations are identical, the Delaware formulation assigns the burden of proof to the plaintiff.²⁴⁸ Whereas the directors must demonstrate that they meet the criteria of the ALI formulation to invoke the protection of the rule.²⁴⁹ Additionally it is of good import to note that the Delaware presumption could be rebutted and directors might have to partake in a full trial to prove that they should not be held liable.²⁵⁰ The directors will essentially have to prove the fairness of their decision in trial and why they deserve the protection of the rule.

The Delaware courts tend to alternate between the substantive standard of liability and the abstention doctrine when applying the business judgement rule. The case of *Cede & Co v Technicolor*²⁵¹ was decided on the basis of a substantive standard of liability.

The court initially explained how the board of directors has the managerial authority to run the company.²⁵² In this case the Delaware Supreme Court outlined multiple procedural deficiencies by Technicolor's directors, constituting a breach of the duty of care.²⁵³ The court determined that the directors of Technicolor did not adequately familiarize themselves with all pertinent information adequately accessible before sanctioning the merger agreement with MAF.²⁵⁴ This failure encompassed inability to conduct a judicious search for alternatives and failing to get pertinent information in a

²⁴³ Kershaw *The Foundations of Anglo-American Corporate Fiduciary Law* (2018) 3.

²⁴⁴ As above.

²⁴⁵ As above.

²⁴⁶ Kershaw *The Foundations of Anglo-American Corporate Fiduciary Law* (2018) 24.

²⁴⁷ As above.

²⁴⁸ As above.

²⁴⁹ As above

²⁵⁰ As above,

²⁵¹ *Cede & Co v Technicolor, Inc* 634 A 2d 345 (Del Sup Ct, 1993).

²⁵² As above.

²⁵³ As above.

²⁵⁴ As above.

reasonable manner on a decision that impacted the company. The plaintiff in this matter successfully rebutted the presumption, the court did not only review the process by which the decision was made, but ultimately also the substance of the directors' decision ultimately, penalising the directors responsible for various breaches of duties and concluding that the plaintiff had successfully rebutted the applicability of the business judgment rule.²⁵⁵

Thus, in assessing directors' performance in decision-making, the Delaware Supreme Court focused on the duty of care obligations of directors, which fall under the legal jurisdiction of the courts.²⁵⁶ From an analytical perspective The court in *Technicolor* identified five deficiencies in the decision-making process amounting to a breach of the duty of care.²⁵⁷ The court's finding of gross negligence was based on the conclusion that the plaintiff successfully proved that the defendant, Technicolor, Directors failed to sufficiently familiarize themselves of all relevant information available prior to the approval of the merger agreement.²⁵⁸ The court employed the Van Gorkom test, a procedural due care assessment necessary for applying the Business Judgment Rule. According to this test Directors who do not act in an informed and deliberate manner may be unable to invoke the business judgement rule as a defence, to duty of care claims.²⁵⁹

Subsequently, in *Brehm v Eisner*, the Delaware Supreme Court made a judgement on the basis of a substantive standard of liability. The Court rejected the plaintiff's argument that a failure by the directors to exercise substantive due care in their decision making warranted them forfeiting the protection afforded under the business judgment rule.²⁶⁰ In *Brehm v Eisner*, the court asserted that directors' decisions will be

²⁵⁵ *Cede & Co. v Technicolor, Inc* in this case Cinerama Inc., a minority stakeholder possessing 4.4 percent of Technicolor Inc.'s outstanding stock, was the plaintiff in this case. Technicolor served as the defendant. The Technicolor board sanctioned a merger to become a subsidiary of MacAndrews and Forbes Group, Inc. (MAF). In the finalized deal, Technicolor stockholders earned \$23 in cash per share. Cinerama opposed the transaction, initiated an appraisal proceeding, and filed a separate lawsuit for damages. The case for equitable relief stemmed from their assertion that the Technicolor board of directors breached their duty of care requirements during the approval of the merger.

²⁵⁶ As above.

²⁵⁷ As above.

²⁵⁸ *Cede & Co. v Technicolor, Inc.* at 371.

²⁵⁹ Johnson "Unsettledness in Delaware Corporate Law: Business Judgment Rule, Corporate Purpose" 2013 *Del. J. 2013 Corp. L* 40.

²⁶⁰ *Brehm v Eisner* 746 A 2d 244 (Del Sup Ct, 2000).

upheld unless tainted by conflicts of interest that compromise their decision-making independence.²⁶¹ Situations that could create a conflict of interest include if directors do not act in good faith or if they arrive at their decision by a flagrant careless procedure that disregards all pertinent facts reasonably accessible. Thus, suggesting that the standard for the application of the business judgment rule has shifted from simple errors to gross negligence.

2.5. Conclusion

This chapter discussed the origins of the business judgement rule and the theoretical doctrines that define the rule.

This chapter highlighted the fact that a considerable amount of scholarly and judicial effort has been devoted to elucidating the business judgement rule's foundational policy arguments, determining its accurate theoretical formulation, and establishing its appropriate practical application. It was furthermore established that, notwithstanding the different perspectives on the theoretical doctrines that underpin the business judgement rule, there is widespread agreement among academics that there is no comprehensive theory that elucidates the practical implementation of the rule and its context. This chapter also looked at how the rule developed in the international corporate governance framework where a specific focus was placed on the USA since it is the country where the rule originated from. Case law from the USA and the state of Delaware specifically was examined to help the reader better understand how the business judgement rule developed.

This chapter also established that the South African business judgment rule, is a safe harbour. This means that the rule in South Africa assumes that directors acted in good faith while making a business decision that aligns with the concept of a safe harbour. Moreover, the defined standards include that the court will assume directors acted on an informed basis and with a rational belief that their actions or omissions were in the company's best interests.²⁶²

²⁶¹ As above.

²⁶² See s 76(4) of the Companies Act 71 of 2008.

The South African business judgment rule not only mitigates directors' culpability but absolves it entirely, provided the stipulations of the rule are satisfied. Directors are exempt from liability if they fulfil the criteria outlined in section 76(4).²⁶³

This section provides:

“In respect of any particular matter arising in the exercise of the powers or the performance of the functions of a director, a particular director of a company will have satisfied the obligations of exercising his or her powers and functions as a director in the best interests of the company and with a degree of care, skill and diligence reasonably expected of a person (as specified in Section 76(3)(b) and (c)) if....”

It is contended that the words “will have satisfied” and “if” clearly hint at the notion that if the directors meet the requirements of section 76(4) they will have satisfied their obligations and will thus escape liability.²⁶⁴ This is in line with a safe-harbour provision. The South African business judgement rule will be examined in great detail in the next chapter.

²⁶³ See s 76(4) of the Companies Act 71 of 2008.

²⁶⁴ As above.

CHAPTER 3: THE BUSINESS JUDGEMENT RULE IN SOUTH AFRICA

3.1. Introduction

This chapter will provide a general overview of the South African formulation of the business judgment rule, its requirements as well as the glaring absence of the good faith requirement in the South African formulation. It will look at the historical development of the rule from common law to its incorporation in the Companies Act of 2008. Further, the chapter touches briefly on the fiduciary duties of directors and directors' duty of care. This is of significant importance in this chapter as the South African statutory business judgment rule applies not only to directors' duty of care but also to their fiduciary duties. It will be demonstrated throughout the course of this chapter that a director may only invoke the statutory business judgment protection rule after fulfilling their duties in the best interests of the company; consequently, it focuses exclusively on this specific fiduciary duty, omitting discussion of the other fiduciary duties. The value of this chapter with respect to the broader scheme of the study will be invaluable to us in understanding why South Africa felt the need to implant this foreign rule into the Companies Act. This chapter will attempt to provide elucidation to research the question on how the business judgment rule developed in South Africa.

3.2. Background to the rule's introduction into South African law

Similar to the development of the business judgment rule in the USA (specifically the ALI formulation), the South African business judgment rule business judgment rule was incorporated as part of the duty to act with care, skill and diligence.²⁶⁵ The enduring influence of English law is prevalent in the fact that South African courts have demonstrated their preparedness to refrain from interfering with the business decisions of a company.²⁶⁶ This view is highlighted by the many cases that have come before the South African courts. For example, in *Levin v Feld and Tweeds*, the court

²⁶⁵ Mupangavanhu "Standard of conduct or standard of review? Examination of an African business judgment rule under South Africa's Companies Act 71 of 2008" 2019 *Journal of African Law* 138–9.

²⁶⁶ *Levin v Feld and Tweeds* 1951 (2) SA 401 (A) at 414.

clearly expressed the view that it is not part of its scope to determine the wisdom of a course adopted by a company in the management of its own affairs.²⁶⁷

Other cases, such as *Ben-Tovim v Ben-Tovim and Others*, also expressed similar sentiments. In this case, the court made it clear that it is not part of judicial policy to second-guess the business decisions of company directors.²⁶⁸ This view contributed to some academics considering the existence of a potential common law version of the Business judgement rule in South Africa.

I agree with Mupangavanhu who argued for the existence of a potential Business judgement doctrine at common law and not a business judgement rule necessarily.²⁶⁹ He furthermore contends that where the business judgment rule is applied, that jurisdiction ought to develop a clear approach. It needs to be easy to establish (from the empowering legislation).²⁷⁰ Additionally, the specification of the business judgement rule as either a standard of review or a standard of conduct needs to be clear.²⁷¹ Thus I agree with certain authors that, obiter statements made by judges, indicating that courts do not second-guess management decisions, may merely be indicative of an existence of a business judgment doctrine rather than a recognized statutory rule.²⁷²

Nonetheless, the South African common law's strong inclination towards judicial restraint and deference to directors' business judgment is crucial understanding to grasp before delving into an intricate interpretation of section 76(4)(a).²⁷³ This is because it shows that there was already an attitude that emerged to allow flexibility for directors to make decisions without being second-guessed by the courts, provided those decisions met the basic criteria of good faith, rationality, and absence of

²⁶⁷ As above.

²⁶⁸ *Ben-Tovim v Ben-Tovim and others* 2001 (3) SA 1074 (CPD); Mupangavanhu 2019 *Journal of African Law* 139. See *Lordon v Dusky Dawn Investments (in liquidation) (Pearnain Intervening)* 1988 (4) SA 519 (SECLD) at 521 B-D.

²⁶⁹ Mupangavahu 2019 *Journal of African Law* 140.

²⁷⁰ As above.

²⁷¹ Mupangavanhu 2019 *Journal of African Law* 142.

²⁷² As above.

²⁷³ As above.

personal conflicts of interests.²⁷⁴ The Companies Act, as will be discussed later in this chapter has established a more formal and organized framework for the application of the business judgment rule, with particular legislative prerequisites for the protection of directors.²⁷⁵ The statutory codified business judgement rule offers directors more explicit defences against allegations of negligence or suboptimal decision-making, provided they adhere to the stipulations set forth in the Act.²⁷⁶

The King Report on Corporate Governance for South Africa, published in 1994 (King I), was the first official document to consider the South African version of the Business judgement rule.²⁷⁷ This report recommended that the Companies Act be amended to allow for a statutory limitation on a director's duty of care and skill.²⁷⁸ The report emphasised the fact that when a director makes a business decision in good faith that is based on information that is both reasonable and in the interest of the company self-interested, the director should not be held accountable for violating the duty of care and skill.²⁷⁹ Furthermore, it was identified that there was a need to entice entrepreneurship and to push persons of skill to accept appointments in enterprises.²⁸⁰

It was contended that the test for breach of the duty of care and skill at the time was onerous and necessitated limitation.²⁸¹ I agree with several authors who, at the time, believed this contention to be founded on a false interpretation of the duty of care and skill – in particular, viewing the duty as lax based on the dictum of Margo J in the *Fisheries Development Corporations of SA Ltd v Jorgensen & Another; Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd & Others*.²⁸²

In setting out the common law standard of the duty of care and skill, Margo J in *Fisheries* made it clear that the test for the duty of care and skill of a director is a very

²⁷⁴Du Plessis "Open sea or safe harbour? American, Australian and South African business judgment rules compared (part 1)" 2011 *Company Lawyer* 23.

²⁷⁵ As above.

²⁷⁶ Section 76 (4) of the Companies Act

²⁷⁷ Kennedy-Good and Coetzee "The Business Judgment Rule (Part 2)" 2006 *Obiter* 287.

²⁷⁸ The Institute of Directors South Africa *The King report on Corporate Governance* (1994).

²⁷⁹ As above.

²⁸⁰ Kennedy-Good and Coetzee 2006 *Obiter* 287.

²⁸¹ Melenephy *The South African Business Judgement Rule – An analysis of the rationality standard for reviewing the conduct of a director* (LLM thesis 2023 UWC) 40.

²⁸² 1980 (4) SA (W) para 166.

lenient one.²⁸³ In this regard, it was stated that a director is only expected to exercise the knowledge and experience such as they possessed.²⁸⁴ Margo J made it clear that the duty imposed is a subjective duty, due to the director only being expected to exercise the care and skill which can reasonably be expected of a person with his knowledge and experience.²⁸⁵ Therefore, the directors could not be anticipated to engage in corporate matters or demonstrate any competencies they were not obligated to possess.²⁸⁶ Furthermore, this subjective assessment did not mandate directors to guarantee diligent fulfilment of their duties.²⁸⁷ Scholars such as Cassidy criticised the common law duty of care for being unsuitable for the contemporary commercial landscape.²⁸⁸ Cassidy accurately asserts that there is no justification for a director at common law to be exempt from the standards expected of other professionals, such as accountants, lawyers, and doctors, who are all required to uphold the standard of a reasonable person in their respective fields.²⁸⁹

3.3. The standards and rationale of the rule

The business judgement rule was introduced to offset the Companies Act's stringent objective-subjective criteria for the duty of care, skill, and diligence.²⁹⁰ The Act applies a dual objective-subjective standard to the duty of care, skill and diligence contained in section 76(3)(c).²⁹¹ The first part of the standard necessitates that a director act

²⁸³ As above.

²⁸⁴ *Fisheries Development Corporation of SA Ltd v Jorgensen & Another* (supra) para 156.

²⁸⁵ *Fisheries Development Corporation of SA Ltd v Jorgensen & Another* (supra) para 156.

The Court in this case also laid out three important principles

1) A director need not exhibit a greater degree of skill than may reasonably be expected from a person of his or her knowledge and experience. This would therefore imply that one is expected to exercise the care that can reasonably be expected of a person with his or her knowledge or expertise. 2) A director is not obligated to devote contentious attention to the management of the company's operations. The responsibilities of a director are sporadic and executed during regular board meetings. This indicates a distinction between a full-time executive director, who is involved in the daily management of the company, and a non-executive director, who has not assumed any specific responsibilities.

3) Concerning all responsibilities that, considering commercial necessities and the articles of organization, may appropriately be delegated to an official. A director, in the absence of any grounds for suspicion, is warranted in trusting an official to execute such duties with integrity.

²⁸⁶ As above.

²⁸⁷ As above.

²⁸⁸ Cassidy 'Models for reform: The directors' duty of care in a modern commercial world' 2009 *Stell LR* 403 .

²⁸⁹ As above.

²⁹⁰ As above.

²⁹¹ Cassim *et al Contemporary Company law* (2012) 559.

reasonably. It is axiomatic that this is the objective standard of a reasonable director.²⁹² This is an intricate objective standard which all company directors are required to meet. Henochsberg contends regarding the duty of care, skill and diligence, an objective test is employed to ascertain what a reasonable director would have done in a similar circumstance, alongside a subjective test that considers the particular director's general knowledge, skill, and experience.²⁹³ This duty comprises two components: subjective and objective.²⁹⁴ The objective standard, as defined by common law, serves as the minimum threshold, while the subjective standard may elevate the level above the objective standard, but cannot fall below it.²⁹⁵

Essentially, section 76(3)(c) functions in a manner wherein the minimum standard is that a director must act reasonably.²⁹⁶ However, if the director possesses a special skill, or is more knowledgeable, then the director will be subjected to a higher standard – based on this subjective element.²⁹⁷ The director is evaluated against a hypothetical individual of equivalent capability. This individual is, at the very least, obligated to have acted with reasonableness.²⁹⁸

Section 76(3)(c) therefore provides for a dual subjective-objective standard, due to the fact that it still imposes that the director's skill, knowledge and experience be seen as

²⁹² Delport et al Henochsberg on the Companies Act 71 of 2008 pg. 298.

²⁹³ As above.

²⁹⁴ As above.

²⁹⁵ Section 76(3)(c)(i) of the Companies Act 71 of 2008. Bouwman 2009 SA *Merc LJ* 514; Kanamugire and Chimuka 2014 *Mediterranean Journal of Social Sciences* 73. Section 76(3)(c) encompasses the objective aspect within the initial component of the test, establishing a minimum level that all directors are required to fulfil. The subjective component, present in the second part of the test, establishes a benchmark for directors who possess greater competence or experience than anticipated according to the objective norm. The review standard aligns with the common-law duty of care but extends beyond it, both in the nature of the tasks and the degree of compliance required in that the greater the talent, knowledge, and experience of directors, the higher the level of skill they must employ.

²⁹⁶ As above.

²⁹⁷ Melenephy 23; *Organisation Undoing Tax Abuse and Another v Myeni and Others* [2020] 3 All SA 578 This case examined the legal responsibilities and liabilities of directors under the Companies Act, emphasizing the duty of care and skill required from directors, as well as the repercussions of their failure to meet these obligations. This case emphasized the necessity for directors to comply with the responsibility of care, skill, and diligence as stipulated in Section 76(3) of the Companies Act. Directors are required to act judiciously and properly in their capacities, undertaking the requisite measures to safeguard the company's interests. In Para 23 it was argued that the objective standards will only apply to the skill and diligence, as "general knowledge, skill and experience"

²⁹⁸ As above.

subjective elements.²⁹⁹ Bouwman contends that this new threshold, established by statutory law, is marginally more stringent than it was under common law.³⁰⁰ Also this new standard, in comparison to its common law counterpart, is regarded by experts to be a notably more realistic reflection of contemporary commercial practices.³⁰¹

Kanamugre and Chimuka believe in the potential for the statutory business judgement rule in the Companies Act to lighten the duty of care, skill, and diligence.³⁰² This rationale for the introduction of the statutory business judgement rule is also shared by Cassim who contends that the introduction of the business judgement rule assists in the alleviation of the less subjective and more rigorous duty of directors.³⁰³ To elaborate further, the rule permits directors to make business decisions without the apprehension of personal liability for adverse results, provided they act in good faith and believe their judgments serve the company's best interests. This provides protection when judgments, made based on sound judgment and available information, yield unfavourable results.³⁰⁴ This is essential in mitigating the subjective burden on directors to a degree, as it offers a definitive defence against culpability for misjudgements.³⁰⁵ In the absence of the business judgement rule directors may encounter subjective evaluation of their decision-making. The business judgement rule offers a more impartial framework for evaluating the reasonableness of a director's actions.³⁰⁶ It examines whether the decision was taken with appropriate attention and for a reasonable purpose, rather than assessing its correctness in retrospect. This mitigates the subjectivity that can occasionally encumber directors in fulfilling their overarching duty of care, skill, and diligence.³⁰⁷ The author feels that it is desirable to ease up on the objective approach.

²⁹⁹ Cassim et al *Contemporary Company law* (2012) 558.

³⁰⁰ Bouwman (2009) 21 *SA Merc LJ* 529

³⁰¹ As above.

³⁰² Kanamugire and Chimuka "The director's duty to exercise care and skill in contemporary South African company law and the business judgement rule" 2014 *Mediterranean Journal of Social Sciences* 74.

³⁰³ Cassim et al *Contemporary Company Law* (2012) 563.

³⁰⁴ Schoor *Directors' fiduciary duty to act in the best interest of the company- is the business judgement rule being abused by directors to prevent liability* (LLM thesis 2020 UP) 35

³⁰⁵ As above.

³⁰⁶ As above.

³⁰⁷ AS above.

3.4. The codification of the rule in South Africa and its scope of application

Section 76(4)(a) of the Companies Act provides for the South African business judgement rule . This section provides that:

- (4) In respect of any particular matter arising in the exercise of the powers or the performance of the functions of the director, a particular director of a company – (a) will have satisfied the obligations of subsection (3)(b) and (c) if –
- (i) the director has taken reasonably diligent steps to become informed about the matter;
 - (ii) either –
 - (aa) the director had no material personal financial interest in the subject matter of the decision, and had no reasonable basis to know that any related person had a financial interest in the matter; or
 - (bb) the director complied with the requirements of section 75 with respect to any interest contemplated in the subparagraph (aa); and
 - (iii) the director made a decision or supported the decision of a committee or the board, with regard to that matter, and the director had a rational basis for believing, and did believe, that the decision was in the best interest of the company.³⁰⁸

Fundamentally, it appears that section 76(4)(a) provides broad protection, covering far more ground than just business decisions.³⁰⁹ This is evident through the use of the words “any particular matter arising in the exercise of the powers or performance of the functions of director” seen in section 76(4)(a). This distinctly broadens the Rule’s application beyond the formulations discussed in respect of the USA in the previous chapter. Signs of this extended scope are evident in the Act’s drafters’ attempts to

³⁰⁸ Section 76(4)(a) of the Companies Act.

³⁰⁹ Melenephy 41.

eschew the use of terms like “business decision or judgment”, which are frequently used in other formulations of the rule.³¹⁰ In the South African case, the drafters opted to utilize the word “decision” rather than “business decision or judgement”. It is noted that the Act also does not define business decision or judgment – as it is not required in terms of section 76(4).³¹¹ It is self-evident that the South African business judgement rule extends itself to decisions falling outside the scope of the USA’s formulation of the rule.

Furthermore, it is noted that section 76(4)(a) also only relates to two of the three codified directors’ common law duties under the Act. These are the duty to act in the best interests of the company in section 76(3)(b) and the duty of care, skill and diligence in section 76(3)(c).³¹² In terms of the section, the director is regarded to have complied with their duties in terms of section 76(3)(b) and (c), namely, the duty to act in the best interests of the company and the duty of care, skill and diligence if the directors conduct meets the requirement of section 76(4)(a) of the Companies Act – the business judgement rule.³¹³ This highlights an explicit link between standards of conduct and review.³¹⁴ To elucidate further, if the director's conduct satisfies the requirements of section 76(4)(a) of the Companies Act – the business judgement rule – then the section considers the director to have complied with the duties in terms of section 76(3)(b) and (c), namely, the duty to act in the best interests of the company and the duty of care, skill, and diligence.³¹⁵ A court of law will evaluate a director's actions in light of the standard of review established by section 76(4)(a) in cases where it is claimed that the board's decision did not meet the requirements of section 76(3)(b) and (c).³¹⁶ A director's defence against liability claims for violating section 76(3)(b) and (c) of the Act is established if the director is able to satisfy the standard of review under

³¹⁰ As above.

³¹¹ As above.

³¹² Section 76(4)(a) Companies Act. This Section makes it clear that the BJR has been clearly defined to apply only to section 76(3)(b) – the fiduciary duty to act in the best interests of the company rather than all the fiduciary duties.⁴

³¹³ Mupangavanhu (2019) *Journal of African Law* 143.

³¹⁴ As above

³¹⁵ As above.

³¹⁶ As above.

section 76(4)(a).³¹⁷ Fundamentally this is the core of the South African formulation of the business judgement rule .

3.5. The requirements of the business judgement rule

As discussed in the previous section, a director must abide by the business judgement rule 's requirements under section 76(4)(a) of the Companies Act in order to avoid liability for violating the duties to act in the best interest of the company and/or to act with the required level of skill, care, and diligence, as codified by sections 76(3)(b) and (c) of the Companies Act.³¹⁸ According to section 76(4)(a), the director must, in essence, have acted with a rational belief that the choice would be in the best interests of the company, have taken an informed decision, and be free from conflicts of interest.³¹⁹ The following sections will delve deeper into these requirements.

3.5.1. Due care requirement as per section 76(4)(a): Director must be reasonably informed

Section 76(4)(a)(i) is unambiguous in that, before making a decision, a director must ensure that he “has taken reasonably diligent steps to become informed about the matter”.³²⁰ The court in the USA case of *Smith v Van Gorkom* found that directors had engaged in gross negligence when they failed to fully educate themselves before making crucial business decisions.³²¹ They were unable to use the business judgment rule as a defence as it was determined that they had violated their duty of care by failing to make an informed business choice.³²² Oost contends that directors should follow the due care process in terms of which they must consider matters carefully, and closely scrutinise any alternatives.³²³

³¹⁷ As above.

³¹⁸ Section 76(4)(a) of the Companies Act.

³¹⁹ Section 76(4)(a)(i) of the Companies Act.

³²⁰ Muswaka “Shielding directors against liability imputations: The business judgment rule and good corporate governance” 2013 *Speculum Juris* 29.

³²¹ *Smith v Van Gorkom* 488 A.2d (Del 1985) 877.

³²² As above.

³²³ Oost *A safe harbour for directors in South Africa A comparative study of the business judgment rule* (LLM thesis 2020 UNISA) 274.

According to section 76(4)(a)(i), the business judgment rule will be in effect if the directors have taken “reasonably diligent steps” to educate themselves about the decision’s subject matter.³²⁴ Mupangavanhu notes that the standard under section 76(4)(a) does not turn on the director’s reasonable belief as to whether the steps taken to become sufficiently informed to meet the required level of knowledge and understanding, but it is rather an objective standard, which applies an objective test when reviewing the standard of conduct expected.³²⁵

The reasonable person standard, sometimes known as the objective standard of review, is adhered to in this section.³²⁶ It is noted the court will not base its decision on whether directors reasonably believed their decisions to be appropriate – a subjective standard of review – but on whether directors had taken reasonable steps to become informed.³²⁷

In this regard a comparison should be made between section 76(4)(a)(i) and section 76(4)(a)(iii), which stipulates that directors must have rational reason for the belief that their choice was in the best interests of the company.³²⁸ The test for rationality is also objective. There is consequently no subjective element in section 76(4)(a). This contradicts section 76(3), which embodies a dual objective/subjective standard of review.³²⁹

It is contended that, whether or not directors have taken reasonably diligent steps to become informed of the matter on which they are required to decide, the general principles of the South African law of delict should be considered by applying the wrongfulness test.³³⁰ The test for wrongfulness is founded on the *boni mores* or legal convictions of the community.³³¹ The legal convictions of the community are analysed

³²⁴ Section 76(4)(c)(i)

³²⁵ Mupangavanhu 2019 *Journal of African Law* 145.

³²⁶ As above.

³²⁷ As above.

³²⁸ Cassidy “Models of reform: The director’s duty of care in a modern commercial world” 400 available at <http://www.companylaw.uct.ac.za/clh/research/journal/cassidy> (accessed: 17/07/2024) Nethavhani *Business Judgment Rule: Undue Erosion* (LLM thesis 2015 UP) 32.

³²⁹ Section 76(3) of the Companies Act 71 of 2008.

³³⁰ Muswaka 2013 *Speculum Juris* 29.

³³¹ Muswaka 2013 *Speculum Juris* 30

through an objective test rooted in reasonableness.³³² The essential question is whether, in terms of the legal convictions of the community and in the light of all the circumstances of a particular case, the defendant infringed the interests of the plaintiff in a reasonable or unreasonable manner.³³³

Several variables need to be considered when determining whether directors acted in a wrongful manner.³³⁴ These include the directors' full-time employment status, their access to pertinent information, the kind of experience and expertise they brought to the company, and the makeup of the business.³³⁵ According to Muswaka, this demonstrates a subjective interpretation of what "taking reasonably diligent steps to become informed" means. The test is still considered to objective, primarily in that it considers the community's beliefs and what would be expected of a person in that circumstance.³³⁶ In order to make an informed decision, directors with little understanding can seek expert help and consultation. Directors may rely on any individual mentioned in section 76(5), according to section 76(4)(b).

3.5.2. Requirement that a director must have had a rational basis for believing that decision was made in the best interests of the company

Muswaka notes that Section 76(4)(a)(iii) stipulates that directors are required to make decisions, or endorse the decisions of a committee concerning an issue, while possessing a belief, grounded in rational justification, that the decision serves the best interests of the company.³³⁷ Thus briefly reflecting on the previous chapter it is clear to see that The South African iteration of the business judgement rule parallels the ALI version, in stipulating that for a director to receive protection, a court must ascertain that the director reasonably believed the business judgment served the company's best

³³² *Loureiro and Others v Imvula Quality Protection (Pty) Ltd* 2014 (3) SA 394 (CC) para 55; *Country Cloud Trading CC v MEC, Department of Infrastructure Development* 2015 (1) SA 1 (CC).

³³³ Neethling *Law of delict* (2021) 30.

³³⁴ Muswaka 2013 *Speculum Juris* 30.

³³⁵ As above.

³³⁶ See the American Law Institute Principles of Corporate Governance and Structure § 401 (c) (3).

³³⁷ Muswaka 2013 *Speculum Juris* 30..

interests.³³⁸ In other words, the business decision or simply decision “must have been actuated for a rational business purpose”.³³⁹

Mupangavanhu notes that the rationality requirement under section 76(4)(a)(iii) can have implications for the applicable standard of review.³⁴⁰ The subsection requires that a director should have a rational basis for believing and did believe that the decision was in the best interests of the company.³⁴¹ This is distinctly discernible from them being required to have a “reasonable basis” For believing that the decision taken serves the best interests of the company. The author notes that in section 76(4)(a)(i) and (ii), the legislature carefully employed the “reasonableness requirement” before intentionally moving to the rationality requirement in section 76(4)(a).

Rational basis conveys the notion of simply being logical, with the result that one may even make an unreasonable judgment, objectively speaking, but one which is not wholly illogical.³⁴² Thus it is contended that rationality is said to be more accommodating of decisionmakers idiosyncrasies than the concept of reasonableness.³⁴³

It was determined in *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty)* with regards to this requirement ,that section 76(4) clarifies that the obligation established by section 76(3)(b) to act in the company's best interests is not an objective standard.³⁴⁴ This implies that a court, when a board decision is contested, cannot ascertain what is, from an objective standpoint, in the company's best interests.³⁴⁵

What is needed is that the directors, having taken reasonably diligent steps to become informed, “ought to subjectively have believed that their decision was in the best

³³⁸ As above.

³³⁹ Mupangavanhu 2019 *Journal of African Law* 145.

³⁴⁰ Mupangavanhu *Directors' standards of care, skill, diligence, and the business judgment rule in view of South Africa's Companies Act 71 of 2008: future implications for corporate governance* (LLD thesis 2016 UCT) 174.

³⁴¹ As above.

³⁴² Cassidy “Models for reform: the directors' duty of care in a modern commercial world” 2009 *Stell LR* 404.

³⁴³ Bainbridge *The difference between reasonableness and rationality in corporate law* available at <http://www.professorbainbridge.com/professorbainbridgecom/2010/09/the-difference-betweenreasonableness-and-rationality.htm> (last accessed 2024/11/20)

³⁴⁴ 2014 (5) SA 179 (WCC).

³⁴⁵ *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd and Others* 2014 (5) SA 179 (WCC) para 76.

interests of the company and this belief must have had a rational basis.”³⁴⁶ Consequently, a decision compromised by a conflict of interest will, logically, fail to satisfy the requirement that the director must utilize his authority to further the company’s best interests.³⁴⁷ The determination of what serves the company’s best interests is a prerogative of the board of directors, rather than a decision for judges in a courtroom.³⁴⁸

3.5.3. Absence of conflict of Interests

The South African business judgment rule necessitates that directors have no substantial personal financial interests, or disclose them in a way that complies with section 75.³⁴⁹ Section 75(4) allows directors to disclose a financial interest in advance, and this standing notice will suffice for the purposes of section 75.³⁵⁰

According to section 76(4)(a)(ii), directors should not have a “material personal financial interest” in the matter of the decision. This section makes it clear that it only covers a director's own personal financial interests. Oost contends that this is an error due to the fact that it makes no provision for other instances “where directors may compromise their independence for reasons other than personal financial” interests.”³⁵¹ Consequently, if directors lack a “financial interest” yet possess “other interests” in the subject matter, they will have fulfilled this criterion. Thus, for example the author notes, if a director may have a conflict of interest while deciding to hire a family member for a senior job over a more qualified candidate. If a family member inflicts damage on the company, the director would still satisfy this aspect of the business judgment criterion, as he or she had no “financial” interest in the decision made, a point the author argues is not ideal.

Section 76(4)(a)(ii) enumerates, as a component of the business judgement rule under the Act, the stipulation that a director must not possess a major personal financial

³⁴⁶ *Visser Sitrus (Pty) Ltd* para 74.

³⁴⁷ Mupangavanhu 2019 *Journal of African Law* 145.

³⁴⁸ *Visser Sitrus (Pty) Ltd* para 75.

³⁴⁹ See section 76(4)(a)(i) and (ii). See also section 75.

³⁵⁰ As above.

³⁵¹ See *Visser Sitrus (Pty) Ltd* para 74 as an illustration of the way the court applies section 76(4) of the Companies Act; Oost 130.

interest in the subject matter of the decision.³⁵² The term “materiality of a personal financial interest” refers to a substantial interest that may influence or compromise the integrity of judgment during decision-making.³⁵³ The interest must be direct, excluding any secondary considerations.³⁵⁴ The interest must be material as defined in section 1 of the Act.³⁵⁵ Mupangavanhu notes that, in order to ascertain what is material, a court must conduct an objective evaluation with the result contingent upon the specific facts and circumstances of the case at hand.³⁵⁶ Additionally, a director ought to provide accurate disclosures.³⁵⁷ Section 75 specifically mandates that, if a director possesses a personal financial interest in the item under consideration or is aware that an associated individual has such an interest, they must disclose these interests prior to the board meeting.³⁵⁸

It is clear that the conflicted director is legally prohibited from engaging in decision-making about the topic in respect of which he is conflicted and must refrain from executing any documents on behalf of the firm related to that matter.³⁵⁹ If the company permits a director to execute such a document, it should have thoroughly evaluated the ramifications of such indulgence.³⁶⁰ The objective of section 76(4)(a)(ii) is to avert conflicts of interest that may impair the independency of a director and enable the entire board to make decisions that serve the best interests of the firm.³⁶¹

Common law frequently determines that officers and directors are prohibited from exploiting their positions of trust and confidence to advance their own or associated

³⁵² Parts of the term are defined in section 1 of the Companies Act 2008. Material in this context means “significant in the circumstances of a particular matter, to a degree that might reasonably affect a person’s judgment or decision-making.” Personal financial interest is defined in section 1 to mean a “direct material interest” of that person, of a financial, monetary or economic nature, or to which a monetary value may be attributed.

³⁵³ Cassidy 2009 *Stell LR* 35.

³⁵⁴ As above.

³⁵⁵ Section 1 of the Companies Act.

³⁵⁶ Mupangavanhu 169.

³⁵⁷ See section 75 of the Companies Act. The term “related person” is defined in section 2(1) of the Act and includes natural persons romantically related, such as married couples or even co-habitants. It further includes people separated by no more than two degrees of natural or adopted consanguinity or affinity, and natural persons in such a position in relation to a juristic person, as to enable those persons to exercise direct or indirect control of the juristic person concerned.

³⁵⁸ Section 75(5) (a)-(g).

³⁵⁹ Section 75(5)(e).

³⁶⁰ Mupangavanhu 170.

³⁶¹ Mupangavanhu 180.

individuals' interests.³⁶² The principle mandating unwavering and altruistic commitment to the business stipulates that personal interests must not undermine or corrupt the fulfilment of responsibilities.³⁶³ Directors are anticipated to be guided solely by the best interests of the corporation while making business decisions.³⁶⁴ They ought to possess the autonomy to make decisions that serve the best interests of their organization rather than that of any individual or collective group.³⁶⁵

According to common law, a director's need to prevent conflicts of interest is fundamental to their fiduciary duties.³⁶⁶ A director obligated to act in the company's interest must avoid situations where personal interests conflict with this duty.³⁶⁷ Conflicts that may impair independent decision-making encompass the director's direct financial interests and familial interests, to name a few.³⁶⁸

A subtype of conflict of interest situations pertinent to the business judgement rule in South Africa is instances where directors exhibit a lack of independence in their commercial decision-making.³⁶⁹ In the United States, these cases are termed "dominant director" cases.³⁷⁰ A complainant may assert that one or more directors are influenced by a dominant shareholder or are subservient to an overbearing CEO. In the case of *Shlensky v. Wrigley*, the plaintiff Shlensky sought to contest Philip Wrigley's decision not to add lights to Wrigley Field baseball stadium in Chicago.³⁷¹ He decided not to litigate against the entire board of the Chicago National League Ball Club, Inc. Shlensky's impetus to confront only Wrigley, the principal shareholder and president of the company, stemmed from the fact that the other directors were so subjugated by Wrigley that they inappropriately consented to his economic judgments.³⁷² This influence on decision-makers impairs autonomous decision-making. This constitutes a conflict of interest as directors may make choices that favour a related individual rather

³⁶² See *Fisheries Development Corporation of SA Ltd* at 163.

³⁶³ As above.

³⁶⁴ As above.

³⁶⁵ As above.

³⁶⁶ *Imageview Management Ltd v Jack* [2009] BCLC 725 (CA) at 739.

³⁶⁷ *Howard v Herrigel* (1991) ZASCA 137.

³⁶⁸ As above.

³⁶⁹ As above.

³⁷⁰ As above.

³⁷¹ As above.

³⁷² See Bainbridge 2004 *Vand. L. Rev* 96.

than advance the corporation's interests. This pertains to the business judgement rule stipulations outlined in section 76(4)(a)(ii). Section 76(4)(a)(ii) of the Act addresses conflicts of interest and mandates that a director must not be swayed by significant personal or familial financial interests.³⁷³ Alternatively, a director must adhere to the disclosure of financial interests as mandated by section 75. A director's failure to adhere to the stipulations of section 76(4)(a)(ii) (aa) or section 75 will result in the forfeiture of the protection afforded by the business judgement rule .

3.6. The notable absence as a requirement for applicability of the South African business judgement rule

As a brief side track to the key elements the South African business judgment rule it is important to briefly analyse why the business judgement rule does not necessitate that decisions that need to comply with good faith and the legitimate- purpose requirement.³⁷⁴ In this regard it is important to remember that the scope of the business judgment rule under section 76(4)(a) is explicitly limited by section 76(3)(b), which arguably pertains to the fiduciary obligation to act in the company's best interests, rather than including all fiduciary duties.³⁷⁵ This call into question whether this omission was made on purpose or whether it was an oversight. This author posits that their perspective may elucidate the reasons behind the omission of good faith from the South African Business Judgment Rule, thereby endorsing the existing formulation of the Rule as articulated in section 76(4) of the Act. At common law, good faith is intrinsically linked to the duty to act in the best interest of a company³⁷⁶ This contrasts with the framework of the directors' defined duties as outlined in s76(3) of the Companies Act. The statutory duty to act in good faith is intrinsically linked to acting for a proper purpose as stipulated in s76(3)(a).³⁷⁷ This study till this point as shown that the business judgement rule can serve as a defence against breaches of the obligations to act in the best interest of a company and/or the duty of care, skill, and diligence as outlined in s76(3)(b) and (c) of the Companies Act.³⁷⁸ Consequently, the

³⁷³ Mupangavanhu 172

³⁷⁴ Section 76(4).

³⁷⁵ As above.

³⁷⁶ Cassim et al *Contemporary Company Law* (2012), 524.

³⁷⁷ The Companies Act 71 of 2008, section s76 (3) (a).

³⁷⁸ The Companies Act 71 of 2008, section 76(4).

obligation to act in good faith and for a legitimate purpose is not subject to the Business Judgment Rule.

In other words, a director cannot invoke the business judgement rule to evade accountability for not acting in good faith and for an improper motive. This underscores the significance of these responsibilities. The author agrees with Melenephy who contends that the lack of good faith in the South African business judgment rule is not a legislative oversight.³⁷⁹ The incorporation of the obligation to behave in good faith inside the South African business judgment rule is entirely superfluous. This is because if the director acts in bad faith, they violate section 76(3)(a), so rendering the business judgement rule unable to shield the director from liability. Consequently, a director will not be protected for failing to act in good faith or proper purpose and will remain liable.

One of the arguments against a statutory business judgment rule was the blurring between the duty of care and the fiduciary duties which are two distinct concepts.³⁸⁰ Thus it is contended that omitting good faith and proper purpose from section 76(4) is a step in the right direction to resolve the issue of keeping “directors’ duty of care and the fiduciary duties distinct concepts in law.”³⁸¹ Oost notes that the omission will not exonerate directors of compliance with these duties, but they will not enjoy protection under the business judgment rule in relation to the decision-making process.³⁸²

From the previous paragraphs it is clear to see that the business judgment rule has a limited scope. In this regard it is clear to see that the limitation of the scope of application of the business judgement rule affects the two main duties of directors. Firstly, with regards to the duty of care the business judgement rule limited scope of application means that directors may still incur liability if their decisions are considered reckless or severely negligent.³⁸³ Additionally related to this particular duty, the business judgment rule offers limited protection to directors who do not sufficiently

³⁷⁹ Melenephy 46.

³⁸⁰ Mupangavanhu 183.

³⁸¹ Oost 134.

³⁸² As above.

³⁸³ Beja “The Extent of Protection Provided by the Statutory Business Judgment Rule to Directors Against Personal Liability for Breaches of Some of Their Duties” 2021 *Journal of Corporate and Commercial law practice* 23.

inform themselves prior to decision-making.³⁸⁴ By limiting the scope of the business judgement rule, the South African legal framework ensures that directors cannot evade liability for poor or negligent decisions by simply claiming they made a "business judgment." Furthermore, the limited scope of application requires directors to be more diligent in their decision-making.³⁸⁵ The rule cannot be relied as a blanket defence for decisions made without adequate knowledge or consideration. This forces directors to prioritize their duties more seriously.³⁸⁶

3.7. Safe harbour

As discussed in chapter 2, a safe-harbour provision is a clause in legislation that mitigates or absolves a party's culpability, provided the party behaved in good faith or adhered to certain criteria.³⁸⁷ Legislatures may incorporate safe-harbour laws to safeguard unintentional or justifiable transgressions, or to encourage the implementation of the preferred practice.³⁸⁸

The South African business judgment rule serves as a safe harbour rather than a presumption of compliance.³⁸⁹ In this regard, Oost contends that The South African Business Judgement rule becomes a legislative defence available to directors facing action for alleged breaches of their section 76 (3) (b) and (c) fiduciary duties.³⁹⁰ The South African version of the business Judgement rule should rather be regarded as a defence accessible to a director facing claims of negligence and a breach of duty to act in the company's best interests.³⁹¹ If the business judgement rule is regarded as a defence available to the director, then it follows logically that the director should bear the onus to prove the existence of one or all of delineations of the business Judgement rule under the Act.³⁹² Once the director has satisfied the existence of the Business judgement rule requirements, the rule will then attach to protect the director against

³⁸⁴ As above.

³⁸⁵ Beja 2021 *Journal of Corporate and Commercial law practice* 30.

³⁸⁶ As above.

³⁸⁷ Talbot *Great Debates in Company Law* (2024) 530.

³⁸⁸ Morrison "Case Law, Systematic Law, and a Very Modest Suggestion" 2013 *University of Michigan Law: Public law and Legal Theory Research* 15.

³⁸⁹ Oost 307

³⁹⁰ As above.

³⁹¹ Mupangavanhu 185

³⁹² See s76(4)(a)(i)-(iii) of the Companies Act.

allegations of violating section 76 (3) (b) and (c). Then and only then once all the business judgement rule requirements have been satisfied, will the director then escape into an impregnable safe harbour.³⁹³ This will entail the director is then protected against a full-blown trial pertaining to claims of breaching the said director's duties.³⁹⁴ The burden of proof has beneficial consequences for corporate governance. The author agrees with Mupangavhu, who contends that this onus of proof being on directors will foster a culture in which managers or directors must maintain precise records to substantiate the suitability of the methods employed to achieve specific business outcomes.³⁹⁵ The author contends that this should ultimately improve the integrity of corporate decision-making processes.

Under the safe harbour approach, once the accused director meets the burden of proof, the matter is closed and it will not proceed to full trial. The court will not overturn the decision if it can be linked to a legitimate business purpose.³⁹⁶ It is not a presumption favouring directors; rather, it establishes a safe harbour for them.³⁹⁷ The essential component of the rule mandates that the court must defer to the business judgment of directors, as long as this finding is not entirely illogical. The grounds of the decision are immune to judicial review, and the decision is unchallengeable.³⁹⁸ The criterion for assessing rationality is objective, and the threshold is distinct from, and more readily met than, the evaluation of whether the choice was objectively in the company's best interests. In other words the rule provides protection where it seems that, after a decision was taken, a duty was breached (such as that the decision turned out to not be in the best interests of the company). The rule then states that there will be compliance if other requirements pertaining to the manner in which the decision was taken (and not the decision itself) were met.

³⁹³ Branson (2011) *SACLJ* 692. The nature of safe harbour provisions or statutory defences to liability claims is that they impose on directors the onus of establishing the presence of the rule's elements.

³⁹⁴ As above.

³⁹⁵ Mupangavhu 186.

³⁹⁶ As above.

³⁹⁷ As above.

³⁹⁸ As above.

3.8. Conclusion

This chapter has examined the South African version of the Business Judgement rule in depth and has examined its key elements.

To start of this chapter addressed the partial codification of directors' duties by the Companies Act 71 of 2008.³⁹⁹ The fiduciary duty to act in the company's best interest was addressed, as it, together with the duty of care, falls under the purview of section 76(4) in its present form.⁴⁰⁰ Directors' duties in South Africa are currently based on common law and are partially codified in section 76(3) of the Companies Act, 2008. Furthermore, it was demonstrated that directors are subjected to further obligations under sections 75 (disclosure of personal financial interest) and 76(2) (prohibition against utilizing information acquired for personal benefit or to the detriment of the firm).

Furthermore, the duty of care under common law was briefly analysed. It was discovered that South Africa had a very lax duty of care policy before 1990.⁴⁰¹ Directors were accountable for a breach of their duty of care solely in cases of gross negligence. It was noted that The South African courts initially adhered to the subjective criteria in assessing whether directors violated their duty of care.⁴⁰² Subsequently however, there was a transition from a subjective approach to a dual objective/subjective criterion for evaluation.⁴⁰³ This transition was exemplified with regard to case law.

The chapter thereafter addressed the application of the South African business judgment rule. The South African business judgment rule does not necessitate that the choice be taken in good faith and for a legitimate purpose. Section 76(4) is explicitly limited to section 76(3)(b) - the fiduciary obligation to act in the company's best interest – and does not encompass other fiduciary duties. The South African business judgment rule, as a safe harbour, assumes that directors acted in good faith while

³⁹⁹ Section 76(3)(c) of the Companies Act.

⁴⁰⁰ Section 76(4) of the Companies Act

⁴⁰¹ Bouwman 2009 21 SA Merc LJ 515.

⁴⁰² As above.

⁴⁰³ See *Howard v Herrigel & Another* NNO 1991 (2) SA 660 (A); *Philotex (Pty) Ltd & Others v Snyman & Others* 1998

making a business decision that aligns with the concept of a safe harbour.⁴⁰⁴ Moreover, the established rules stipulate that the court will assume directors acted on an informed basis and with a rational belief that their actions or omissions were in the company's best interests.⁴⁰⁵ The South African business judgment rule not only mitigates directors' culpability but absolves it entirely, provided the criteria of the business judgment standards are satisfied.⁴⁰⁶ The regulation stipulates that directors are exempt from accountability provided they fulfil the criteria outlined in section 76(4).

The next chapter will examine the Australian variant of the business judgement rule to examine what lessons can be learnt.

⁴⁰⁴ Van Tonder (2015) 36 *Obiter* 729

⁴⁰⁵ Van Tonder (2015) 36 *Obiter* 730

⁴⁰⁶ As above.

CHAPTER 4: THE BUSINESS JUDGEMENT RULE IN AUSTRALIA

4.1. Introduction

This chapter will examine the codified business judgement rule in Australia. It will look at the process Australia took to integrate the rule into their corporate governance framework, as well as analyse some cases that have applied the business judgement rule.

The statutory duty of care preceding the significant ruling in *AWA Ltd v Daniels t/a Deloitte Haskins and Sells* is further examined.⁴⁰⁷ The moderate approach of common law was adopted in the initial statutory provisions. The criterion for assessing directors' duty of care was predominantly subjective.⁴⁰⁸ The 1980s witnessed several business failures in Australia, prompting a reassessment of directors' responsibilities and a shift towards a more rigorous, objective standard in both common law and statute.⁴⁰⁹ The pivotal ruling in *AWA Ltd v Daniels t/a Deloitte Haskins and Sells*, subsequently appealed in *Daniels v Anderson*, exemplifies this transition and is examined.

The CLERP Act was superseded by the Corporations Act of 2001. The Corporations Act 2001 functions as a national statute throughout all states and territory of Australia.⁴¹⁰ The statutory of care under section 180(1) of the Corporations Act 2001, applicable to both directors and corporate executives, is explored⁴¹¹ The implementation of the statutory duty of care for directors is exemplified through an examination of prominent case law. Simultaneously with the implementation of the Corporations Act, 2001, the Australian legislature approved the Australian Securities and Investment Commission Act, 2001 ("ASIC Act"). The ASIC Act establishes the Australian Securities and Investments Commission ("ASIC"). ASIC is the regulator for

⁴⁰⁷ *AWA Ltd v Daniels t/a Deloitte Haskins and Sells* (1992) ACSR para 759.

⁴⁰⁸ *AWA Ltd v Daniels t/a Deloitte Haskins and Sells* (1992) para 755.

⁴⁰⁹ Tomasic, Bottomley and McQueen (eds) *Corporations Law in Australia* 2001 316

⁴¹⁰ Gibson and Brown "The ASIC'S Expectation of Directors" 2012 *University of New South Wales Law Journal* 35.

⁴¹¹ As above.

corporate, market services in Australia and is also governed by the Corporations Act, 2001.⁴¹²

The final section analyses the statutory business judgment rule as delineated in section 180(2) of the Corporations Act 2001. The objective is to demonstrate the interpretation and application of the rule by courts since its establishment.⁴¹³

4.2. Background to the rule's introduction into Australian law

English precedents of the late 1800s and early 1900s greatly influenced the duty of care, skill and diligence in Australia. This is similar to the position in South Africa. Australia follow the same methodology as South Africa where statutory directors' duties apply along with common-law and equity principles.⁴¹⁴ Before the codification of specific aspects of Australian directors' duties, particularly regarding the duty of care and skill, Australian common law (similar to South African Company law prior to 2011) adopted a lenient approach towards directors by employing a predominantly subjective standard to assess their liability for breaches of their duty of care and skill.⁴¹⁵ Moreover, directors were not mandated to possess any certain skills or qualifications, and a director's adherence or violation of their duty of care was contingent upon the nature of the corporation's business and any particular responsibilities undertaken by (or assigned to) that director.⁴¹⁶ The statutory and jurisprudential development of Australian law regarding the duty of care, particularly the criteria for assessing liability for its infringement slowly began to progress slowly. Australia recognized the necessity for an objective criterion to assess directors' activities.⁴¹⁷ This incremental transformation, prompted by apprehensions arising from the 1995 Daniels verdict,

⁴¹² As above.

⁴¹³ *ASIC v Vines* (2006) NSWSC para 760; *ASIC v Rich* (2009) 1229 NSWSC.

⁴¹⁴ Nietsch "Corporate illegal conduct and directors' liability" 2018 *Journal of Corporate Law Studies* 157.

⁴¹⁵ Havenga "The Business Judgment Rule – Should We Follow the Australian Example?" 2000 SA Merc LJ 27.

⁴¹⁶ Havenga 2000 SA Merc LJ 32.

⁴¹⁷ Du Plessis "Open sea or safe harbour? American, Australian and South African business judgment rules compared (Part 1)" 2011 *The Company Lawyer* 34.

resulted in the codification of the duty of care and skill.⁴¹⁸ Currently, this obligation is encapsulated in section 180(1) of the Corporations Act, mandating that a director must exercise their powers and fulfil their duties with the level of care and diligence that a reasonable individual would demonstrate if they were a director of a corporation under similar circumstances, occupying the same office and bearing equivalent responsibilities within the corporation as the director in question.⁴¹⁹ It is important to note that this codification was implemented without concurrently codifying the business judgement, resulting in the Australian Business Judgement rule remaining in its historical common law form as detailed below.⁴²⁰ The extensive and transformative impact of the Daniels ruling catalysed the establishment of a legislative Business ruling Rule in Australia.

In 1958, Australia became the first country in the British Commonwealth to enact a statutory duty providing that a director should act honestly and use reasonable diligence in the discharge of the duties of office.⁴²¹ 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 performance of his duties. In *Daniels v Anderson* the court held that it was no longer appropriate for directors' conduct to be judged by means of a subjective test.⁴²² This case removed the notion of ignorance as a defence.⁴²³

In light of this, the Corporate Law Reform Act 210 of 1992 amended Section 229(2) of the Federal Companies Code 110 of 1990 to establish an objective requirement of skill and care.⁴²⁴

⁴¹⁸ *Daniels v Anderson* (1995) 16 ACSR 607 (NSW CA); 13 ACLC 614.

⁴¹⁹ Section 180 (1) of the Corporations Act 50 of 2001 (Cth).

⁴²⁰ Du Plessis 2011 *The Company lawyer* 23.

⁴²¹ Section 107 of the Victorian Companies Act 1958.

⁴²² *Daniels v Anderson*(1995) 16 ACSR 607 (NSW CA); 13 ACLC 614

⁴²³ As above.

⁴²⁴ Explanatory memorandum to the Corporate Reform Bill of 2001; *Francis v United Jersey Bank* 432 A 2nd 814 (1981) para 823

Section 232(4) of the Federal Corporations Law of 1991 concomitantly added that an officer of a corporation needs to exercise a degree of care and diligence that a reasonable person in the same position would exercise.⁴²⁵

Proposals for reform linked with the Corporate Law Economic Reform Program (CLERP) lead to the enactment of the statutory business judgement rule.⁴²⁶ CLERP was instituted by the Treasurer in 1997. Its main goal was to reform key areas of corporate regulation.⁴²⁷ Comprehensive policy proposals on key areas were released during 1997 and advanced in close discussion with the business community.⁴²⁸ CLERP specified certain reforms to provide directors and officers with greater clarity on key aspects of their duties to companies.⁴²⁹

The concern expressed by directors in *Daniels*, where the court posited that directors' conduct cannot adequately be gauged by subjective standards alone, underscored the development of the CLERP Bill of 1998 which codified the Business Judgement Rule.⁴³⁰ The court averred that the law had developed since *Re City Equitable Fire Insurance Co Ltd*, and directors are now subjugated to an objective test and are prohibited from using the lack of knowledge as a defence to exercising the requisite amount of care.⁴³¹ After *Daniels*, CLERP determined that section 232(4) of the Corporations Act of 1989 should be altered to make it clear that the standard of care required must be analysed by reference to the particular circumstances of the director or officer concerned.⁴³² Under the revised provision it would be necessitated of a director of a corporation to exercise his or her powers and exercise duties with the same degree of care and diligence that a reasonable person would have exercised.⁴³³

⁴²⁵ Explanatory memorandum to the Corporate Reform Bill of 2001; *Francis v United Jersey Bank* 432 A 2nd 814 (1981) para 823.

⁴²⁶ *Havenga* 2000 SA Merc LJ 33.

⁴²⁷ As above.

⁴²⁸ Tomasic, Bottomley & McQueen (eds) *Corporations Law in Australia* 2001 23. To highlight: the key areas included "making access to capital easier for small business as well as greater commercial and international focus to accounting standards."

⁴²⁹ As above.

⁴³⁰ *Daniels v Anderson* (1995) 13 ACLC 607 was the appeal to *AWA Ltd v Daniels t/a Deloitte Haskins and Sells* (1992) ACSR 759.

⁴³¹ Byrne "Do directors need better statutory protection when acting on the advice of others?" 2008 *Australian Journal of Corporate Law* 238 at 243.

⁴³² As above.

⁴³³ As above

Section 180(1) of the CLERP Act superseded section 232(4), establishing objective standards for evaluating a director's duty to act with care skill and diligence.⁴³⁴

4.3. The codification of the rule in South Africa and its scope of application

4.1.1. Overview

The business judgment rule, as envisioned by CLERP, was included in the Corporations Act of 2001. Section 180(2) reads as follows:

“A director or other officer of a corporation who makes a business judgment is taken to meet the requirements of subsection (1), and their equivalent duties at common law and in equity, in respect of the judgment if they:

- (a) make the judgment in good faith for a proper purpose; and
- (b) do not have a material personal interest in the subject matter of the judgment; and
- (c) inform themselves about the subject matter of the judgment to the extent they reasonably believe to be appropriate; and
- (d) rationally believe that the judgment is in the best interests of the corporation.

The director's or officer's belief that the judgment is in the best interests of the corporation is a rational one unless the belief is one that no reasonable person in their position would hold.”

4.1.2. The decision

A business judgement must have been rendered according to the Australian business judgment rule. Section 180(2) covers no further decisions and applies to strictly business judgments.⁴³⁵ Section 180(3) of the Corporations Act defines a "business decision". Under section 180(3), a business judgment is defined as “any decision to

⁴³⁴ As above.

⁴³⁵ Nettle “The Changing Positions and Duties of Company Directors” 2018 *Melbourne University Law Review* 1417.

take or not to take action in respect of a matter relevant to the business operations of the corporation.”⁴³⁶

In an attempt to further elucidate on what constitutes a business judgment, Justice Austin in *Australian Securities and Investments Commission v Rich (ASIC v Rich)* stated that the important factor is the requirement for a conscious decision which shows whether or not the director applied his mind to the matter.⁴³⁷ Justice Austin found that the phrase “relevant to the business operations of the corporation” in section 180(3) necessitated a broad interpretation.⁴³⁸ He clarified that, in order to meet the criteria as a business judgment, a matter did not have to be a business operation-related matter in itself but may include, for example, the sale of a company to a third party.⁴³⁹

Certain authors contend that, in order to give directors greater protection against liability, the Australian statutory business judgment rule ought to be improved. They contend that the current wording of section 180(2) should be changed to remove the reference to “business judgement” in substitution for the word “act” to widen its scope of application.⁴⁴⁰ The author agrees that the removal of “business judgement” will allow the expansion of the application of the rule if substituted by the word “act”. This would give directors more protection and would strengthen their defence should it be established that other directors would have acted similarly under the same or comparable circumstances.⁴⁴¹

4.1.3. Informed decision-making

Section 180(2)(c) mandates that directors educate themselves as much as “they reasonably believe” to be necessary on the subject matter of the judgment. Once more, the question is whether the directors themselves had a reasonable belief that

⁴³⁶ Section 180(3) of the Corporations Act of 2001.

⁴³⁷ *ASIC v Rich* (2009) 75 ACSR 236 FLR 1 para 7276.

⁴³⁸ *ASIC v Rich* (2009) 75 ACSR 236 FLR 1 para 7272.

⁴³⁹ As above.

⁴⁴⁰ Du Plessis and Mathiopoulos “Defences and relief from liability for company directors: Widening protection to stimulate innovation” 2016 *Australian Journal of Corporate Law* 19.

⁴⁴¹ As above.

they knew enough about the topic of the decision.⁴⁴² It is obvious that this review standard is subjective.⁴⁴³ It is key to note that “Directors in Australia will have to inform themselves of all information they reasonably believe to be appropriate and not only material information.”⁴⁴⁴

It is contended that Australia “applies the rationality criterion of review, which is objective, but goes further by adopting a reasonableness standard as evidenced in section 180(2)(d).”⁴⁴⁵ Oost notes that the manner in which the section goes on to define a “rational” belief with reference to the “reasonable person” has caused some disillusionment as to how it ought to be interpreted.⁴⁴⁶ This is due to the fact that the requirement for directors to inform themselves to the extent that they reasonably believe to be appropriate implies a subjective test with an objective element to determine if this requirement has been satisfied.⁴⁴⁷

In *ASIC v Rich*, Justice Austin agreed with the list of factors developed by ASIC to be considered when evaluating this requirement. Examples include “the significance of the decision made, the time constraints to obtain the information, the costs involved in the obtaining of the information, and a wide variety of other factors.”⁴⁴⁸ However, he rejected the notion that respect should be made to what the director should have known, rather than just what the director knew.⁴⁴⁹ He concluded that the rational belief required as an element of the business judgment rule in section 180(2) need not be reasonable. Put differently, directors can invoke the rule if they can show that they arrived at the decision after a reasoning process irrespective of whether or not the

⁴⁴² Section 180(2)(c) & (d) of the Corporations Act of 2001.

⁴⁴³ As above.

⁴⁴⁴ Du Plessis and Mathiopoulos 2016 *Australian Journal of Corporate Law* 22.

⁴⁴⁵ Oost 184; Section 180(2)(d) of the Corporations Act of 2001 provides that directors should rationally believe that the judgment is in the best interests of the corporation. The director’s or officer’s belief that the judgment is in the best interests of the corporation is a rational one unless the belief is one that no reasonable person in their position would hold.

⁴⁴⁶ Oost 183.

⁴⁴⁷ Oost 185.

⁴⁴⁸ *ASIC v Rich* para 7284.

⁴⁴⁹ As above.

reasoning process was convincing to a judge and therefore reasonable in an objective sense of the word.⁴⁵⁰

4.1.4. No material personal financial interest

Section 180(2)(b) stipulates that directors must not possess a "material personal interest" in the subject matter under consideration.⁴⁵¹ The term "material" signifies that the interest must exceed a trivial or negligible interest.⁴⁵² Oost asserts that directors in Australia with a material personal interest will not be safeguarded by section 180(2).⁴⁵³ If the personal interest is not substantial, it will be safeguarded. The Australian business judgment rule does not offer protection to directors under the rule if they reveal their personal interest to the board.⁴⁵⁴ Thus It is contended that even if Australian directors reveal their material personal interest to the board, they will remain unprotected by section 180(2).⁴⁵⁵

4.1.5. The decision is made in good faith for a proper purpose

Section 180(2)(a) of the Corporations Act of 2001 prescribes that directors' decisions must have been made in good faith and for a proper purpose.⁴⁵⁶ Australia included the proper-purpose criterion in addition to the provision that the decision needed to be one taken in good faith.⁴⁵⁷ The notion of proper purpose mandates that corporation powers must be utilized solely for their intended purpose.⁴⁵⁸ Australia's present situation is that the actions of a director are regarded as appropriate if the power is used for the advantage of the company as a whole.⁴⁵⁹ Consequently, the decision should be taken in good faith and help the entire business so that a director satisfies this criterion.⁴⁶⁰ The inclusion of good faith represents a distinct material difference from South Africa's

⁴⁵⁰ *ASIC v Rich* para 7289; See also Legg and Jordan "The Australian business judgment rule after *ASIC v Rich*: balancing director authority and accountability" 2013 *Adelaide Law Review* 415.

⁴⁵¹ See section 180(2)(b) of the Corporations Act of 2001.

⁴⁵² Legg and Jordan 2013 *Adelaide Law Review* 417.

⁴⁵³ Oost 340.

⁴⁵⁴ Legg and Jordan 2013 *Adelaide Law Review* 419.

⁴⁵⁵ Oost 186.

⁴⁵⁶ Section 180(2)(a) of the Corporations Act of 2001.

⁴⁵⁷ As above.

⁴⁵⁸ Greenhow "The statutory business judgment rule: Putting the wind into directors' sails" 1999 *Bond Law Review* 46.

⁴⁵⁹ Greenhow 1999 *Bond Law Review* 46.

⁴⁶⁰ As above.

variant of the business judgement rule, which, as previously discussed in chapter 3, references s 76(3)(b) and (c) exclusively while notably excluding s 76(3)(a).⁴⁶¹ This as previously contended is an omission which essentially removes from the scope of section 76(4)(a) actions taken in violation of a director's fiduciary obligation to act "in good faith and for a proper purpose," as outlined in section 76(3)(a).⁴⁶² As mentioned in chapter three, the author contends that this is in fact, advantageous (compared to the Australian stance) as section 76(4)(a) is explicitly designed to shield directors from liability solely for violations of the duties to act in the company's best interests and with care, skill, and diligence, rather than any other fiduciary obligations (which encompass the duty to act in good faith and for a legitimate purpose).⁴⁶³ It is interesting to note that in Australia, the statutory intent is clearly contrary. It has been contended by scholars that the good faith and proper purpose prerequisite in section 180(2) constitutes a form of "double jeopardy" as it necessitates defendants to demonstrate the absence of a more severe contravention of law.⁴⁶⁴

4.4. The standards of directors' conduct

Section 180(2) highlights that the business judgment rule will only apply to directors' duty of care found section 180(1) of the Corporations Act of 2001, and will not apply to any fiduciary duties of whatever nature.⁴⁶⁵ I submit that this is a laudable formulation of the business judgment rule. Importantly, by including only directors' duty of care, the application of the rule is limited and will exclude any possible blurring of the meanings of directors' fiduciary duties and the duty of care.⁴⁶⁶ Section 180(2) furthermore explicitly states that the business judgment rule applies to the statutory duty of care of directors as outlined in section 180(1), as well as to the corresponding duties under common law and equity.

⁴⁶¹ See paragraph 3.5.

⁴⁶² See paragraph 3.4.

⁴⁶³ As above.

⁴⁶⁴ Ricci and Miyairi "The Abstract Void in Practice: Has the Statutory Business Judgment Rule Changed the 'Acoustic Separation' Between Conduct and Decision Rules for Directors' Duty of Care?" 2017 *Australian Journal of Corporate Law* 30.

Contravention of section 181 of the Corporations Act, 2001.

⁴⁶⁵ See sections 180(1) & 180(2) of the Corporations Act, 2001

⁴⁶⁶ Oost 186.

4.5. Safe-harbour

Ricci and Miyairi note that The Australian statutory business judgment rule functions as a safe harbour as opposed to a presumption and is applied as an immunity doctrine.⁴⁶⁷ Thus to explain further, If directors satisfy the criteria of section 180(2), they will be exempt from liability, and there will be no further scrutiny of the business decision or its merits.⁴⁶⁸ The directors bear the burden of proof to demonstrate compliance with the stipulations of section 180(2).⁴⁶⁹ It is evident from the phrases "take to meet" and "if they" that directors will have satisfied the requirements of section 180(1) (statutory duty of care and its corresponding duties in common law and equity) if they satisfy the requirements in section 180(2)(a)-(d).⁴⁷⁰ Additionally, directors will be exempt from liability, and no inquiry will be conducted.⁴⁷¹ Nevertheless, it is imperative to underscore that the Australian business judgment rule is exclusively applicable to the duty of care owed by directors.⁴⁷²

The next section will examine case law to show how the courts have ruled on the business judgement rule in Australia.

4.6. Case law

ASIC v Adler

In *ASIC v Adler*, the court determined that three directors had violated section 180(1) of their statutory duty of care and that they were ineligible to rely on the business judgment rule as a defence.⁴⁷³ According to Judge Santow, the director had to make a business decision before the safe-harbour "statutory business judgment rule" could be applied.⁴⁷⁴ Additionally, the business decision needed to have been made with the right intention and in good faith, and the director was required to have educated himself or herself to the extent that he or she thought was reasonable regarding the subject

⁴⁶⁷ Oost 188.

⁴⁶⁸ As above.

⁴⁶⁹ As above.

⁴⁷⁰ Ricci and Miyairi 2017 *Australian Journal of Corporate Law* 32.

⁴⁷¹ Ricci and Miyairi 2017 *Australian Journal of Corporate Law* 34

⁴⁷² As above.

⁴⁷³ *ASIC v Adler & 4 Ors* (2002) NSWSC 171 para 406.

⁴⁷⁴ *ASIC v Adler* para 15.

matter of the judgment.⁴⁷⁵ Furthermore, the director had to have reasoned rationally that the judgment was in the best interests of the company and not have had a material personal interest in the subject matter of the ruling.⁴⁷⁶

ASIC v Rich

Judge Austin's ruling in *ASIC v Rich* was rendered on 18 November 2009. This case originated from the early 2001 collapse of One.Tel Ltd (“One.Tel”), an Australian telecommunications firm, with Publishing and Broadcasting Limited (“PBL”) and News Corporation (“News Corp”) as the two principal owners. In late 2001, the Australian Securities and Investments Commission (ASIC) initiated civil-penalty proceedings against four former directors of One.Tel.⁴⁷⁷ ASIC’s primary contention was that these directors had violated their statutory duty of care as stipulated in section 180(1) of the Corporations Act by neglecting to sufficiently inform the board of directors regarding the company's actual financial situation.⁴⁷⁸

Furthermore, ASIC contended that, in the months preceding the appointment of administrators to One.Tel, the defendants violated their obligations by inadequately evaluating One.Tel’s financial status and failing to apprise the board of One.Tel’s actual financial condition. They further neglected to establish systems to ensure the transmission of financial information to the board.⁴⁷⁹

In order to ascertain whether the directors might invoke protection under the business judgment rule, Judge Austin needed to adjudicate on a number of matters. These included:

- Who held the burden of demonstrating the components of the business judgment rule?
- What constituted a business judgment?

⁴⁷⁵ Section 180(2)(c) of the Corporations Act of 2001; *ASIC v Adler* para 15.

⁴⁷⁶ *ASIC v Adler* para 406.

⁴⁷⁷ See *ASIC v Rich* (2009) 75 ACSR 236 FLR 1 para 1.

⁴⁷⁸ *ASIC v Rich* para 1.

⁴⁷⁹ As above.

- Was the decision rendered “in good faith for a legitimate purpose and devoid of a material personal interest?”⁴⁸⁰
- Did the directors adequately familiarize themselves with the subject matter of the judgment to a degree they deemed reasonable?⁴⁸¹
- Did the directors reasonably ascertain that the judgment served the corporation's best interests?

Concerning the initial inquiry, Judge Austin observed that the statutory provisions did not explicitly designate which party was responsible for demonstrating the applicability of the business judgment rule, and he could not derive any indication from merely interpreting the text.⁴⁸² To address the question, Judge Austin examined the United States’ interpretation of the business judgment rule, which significantly influenced the creation of section 180(2).⁴⁸³ Nonetheless, the existing distinctions between the Australian statutory business judgment rule and its American counterpart complicated the matter. Delaware exhibited a robust non-interventionist stance, in respect of which the courts refrained from “second-guessing” a director's decision made in good faith and for a legitimate cause.⁴⁸⁴ The business judgment rule in Delaware presumed that corporate directors, in making business decisions, acted with informed judgment, good faith, and a sincere belief that their actions were in the company's best interests.⁴⁸⁵

In Australia, the business judgment rule served as a safe harbour rather than a presumption, a distinction highlighted by Judge Austin.⁴⁸⁶ In Delaware, the burden of proof rested with the plaintiff and Judge Austin opined that, had the Australian Parliament intended to mirror that stance, it would have articulated it more explicitly.⁴⁸⁷

Judge Austin was also required to determine what a business judgment was according to section 180(2) of the Corporations Act, 2001. He examined the concept of “business judgment” in section 180(3), and determined that the term “relevant to the business

⁴⁸⁰ As above.

⁴⁸¹ As above.

⁴⁸² *ASIC v Rich* para 7264.

⁴⁸³ *ASIC v Rich* para 7265.

⁴⁸⁴ In *Aronson v Lewis* 473 A.2d (Del. 1984) para 812.

⁴⁸⁵ As above.

⁴⁸⁶ *ASIC v Rich* para 7266.

⁴⁸⁷ As above.

operations of the business” in section 180(3) should be construed expansively.⁴⁸⁸ He averred that, to qualify as a business judgment, a matter need not pertain solely to business operations; it may also encompass actions such as the sale of a business to a third party.⁴⁸⁹ Judge Austin emphasized that the crucial factor was that of a “conscious decision”: one taken specifically if the directors or officers actively considered the issue at hand.⁴⁹⁰ On this second inquiry the judge determined that, in general, the material presented to the court did not demonstrate that the defendant directors neglected to consider the decisions that ASIC claimed they ought to have made.⁴⁹¹ Instead, it was mostly a situation in which the defendants had contemplated the issues raised by ASIC and came to different conclusions than ASIC did.⁴⁹² Under those conditions, the decisions made by the defendant directors regarding planning, budgeting, and forecasting were entitled to protection under the Australian statutory business judgment rule.⁴⁹³

Judge Austin's third inquiry was with regards to whether the judgment was rendered "in good faith for a proper purpose" and if the directors may have had any "material personal interest" in the subject matter of the business judgment.⁴⁹⁴ ASIC asserted that two of the directors, Rich and Silbermann, were unable to demonstrate the good faith prerequisite due to their inadequate supervision of the budget and board paper drafting process.⁴⁹⁵ He maintained that, based on the facts, Rich and Silbermann had exercised business judgments as delineated in section 180(3).⁴⁹⁶ He further determined that they had employed their business judgment in good faith for a legitimate objective, specifically to achieve a cash-positive status for the business as projected in the business plan sanctioned by the board.⁴⁹⁷ ASIC further acknowledged

⁴⁸⁸ As above.

⁴⁸⁹ As above.

⁴⁹⁰ *ASIC v Rich* para 7272.

⁴⁹¹ *ASIC v Rich* para 7277.

⁴⁹² As above.

⁴⁹³ As above.

⁴⁹⁴ Section 180(2)(b) of the Corporations Act of 2001.

⁴⁹⁵ *ASIC v Rich* para 7281.

⁴⁹⁶ As above.

⁴⁹⁷ As above.

that the directors had no significant personal interest in the matter concerning the business judgment.⁴⁹⁸

The fourth consideration pertained to whether the directors had adequately informed themselves regarding the subject matter of the judgment to a degree they reasonably deemed suitable.⁴⁹⁹ ASIC contended that consideration should have been given to what the directors were aware of but also to what they ought to have been aware of.⁵⁰⁰ Judge Austin did not agree with this contention.⁵⁰¹ He state that the qualifying phrase, “to the extent they reasonably believe to be appropriate”, implied that protection may be given even if the director was oblivious to pertinent information relevant to the judgment.⁵⁰² Thus, the Judge held that if the directors reasonably felt that reasonable steps were taken to inform themselves about the subject matter during the decision-making process, they would be safeguarded by the business judgment rule.⁵⁰³

Hooper asserts that the addition of the definition of rational belief in the concluding paragraph of section 180(2) was superfluous and has led to the interpretative challenges currently faced by judges and corporate lawyers.⁵⁰⁴ He contends that a rigorous interpretation of the section does not impede the protection offer to directors.⁵⁰⁵ He suggests that the reference to reasonableness may be a calculated effort to compromise or diminish the rule's efficacy.⁵⁰⁶ I submit that this view is correct because, if the statutory business judgment rule aims to offer a true safe harbour for directors, the term "should" ought to be eliminated, as per Hooper's assertion, as would enhance clarity of the section.⁵⁰⁷

The last matter considered in *ASIC v Rich* was whether the directors had a rational belief that the judgment served the corporation's best interests.⁵⁰⁸ In Australia, a

⁴⁹⁸ *ASIC v Rich* para 7282.

⁴⁹⁹ Section 180(2)(c) of the Corporations Act of 2001.

⁵⁰⁰ *ASIC v Rich* para 7281.

⁵⁰¹ As above.

⁵⁰² As above.

⁵⁰³ As above.

⁵⁰⁴ Hooper “The Business Judgment Rule: *ASIC v Rich* and the Reasonable-Rational Divide” 2011 *Bond University Electronic Publications* 11.

⁵⁰⁵ As above

⁵⁰⁶ As above.

⁵⁰⁷ Hooper 2011 *Bond University Electronic Publications* 20.

⁵⁰⁸ Section 180(2)(d) of the Corporations Act, 2001.

director's or officer's conviction that the judgment serves the corporation's best interests is deemed logical, unless it is a belief that no reasonable individual in that position could maintain.⁵⁰⁹ ASIC asserted that the validity of a director's view is contingent upon its reasonableness.⁵¹⁰ Judge Austin disagreed with this submission.⁵¹¹ He determined that the rational belief necessary for the business judgment requirement under section 180(2) need not be reasonable.⁵¹² A director may invoke the business judgment rule by demonstrating that the decision was reached through a thinking process, regardless of whether that reasoning was persuasive to the judge or objectively deemed reasonable.⁵¹³

In this matter, Judge Austin clarified the operation of the business judgment rule by stating that it applies only when directors make decisions after adequately educating themselves on the relevant subject matter as they deem appropriate.⁵¹⁴ The following can be derived from this ruling:

- The burden of proof on the applicability of the business judgment rule to shield directors from liability lies with the defendant.
- Judge Austin determined that the courts should interpret the definition of "business judgment" broadly, emphasizing that a crucial aspect of a business decision is whether the directors have made a deliberate choice – specifically, whether the directors or officers have actively considered the issue at hand.
- If evidence indicates the defendant believed that the choice served the corporation's best interests, and this belief was underpinned by a reasoning process adequately to be deemed rational, it will satisfy the requirement, regardless of the objective persuasiveness of the reasoning process.⁵¹⁵

ASIC v Healey (Centro Case)

⁵⁰⁹ See *ASIC v Fortescue Metals Group Ltd and Andrew Forrest* (2011) 190 FCR 364 at 400; *ASIC v Mariner Corporation Limited* (2015) FCA 589 at 483.

⁵¹⁰ *ASIC v Rich* para 7287.

⁵¹¹ As above.

⁵¹² As above.

⁵¹³ As above.

⁵¹⁴ *ASIC v Rich* para 7294.

⁵¹⁵ As above

In this case ASIC initiated proceedings against the seven directors and the CFO of the Centro Properties Group for violations of directors' and officers' duties over their endorsement of the Group's 2007 financial statements.⁵¹⁶ The directors sanctioned the Group's financial statements, included in the 2007 Annual Report, which classified \$2 billion of liabilities as noncurrent and omitted the disclosure of \$1.75 billion in guarantees for short-term liabilities of an associated company, provided after the balance date but prior to the approval of the financial statements.⁵¹⁷ ASIC argued that the directors violated their fiduciary obligations by endorsing financial statements that significantly underreported the Group's short-term liabilities, misclassifying them as non-current liabilities, and by neglecting to disclose the large post-balance sheet guarantees.⁵¹⁸

In Centro, the court determined that directors neglected to exercise reasonable care and attention by failing to recognize significant monetary problems in the corporation's financial accounts, which they did not examine rigorously.⁵¹⁹

4.7. Conclusion

This chapter has presented a historical overview of Australian company law pertaining to the business judgement rule . It was established that historically, Australia, akin to other Commonwealth nations, adhered to the English doctrine whereby directors were not held accountable for breaches of their duty of care if their actions were merely negligent but that for directors to bear liability for a violation of their duty of care, their actions must have been grossly negligent.⁵²⁰ It was established that following several business failures in Australia, there was a shift towards a more rigorous objective criterion in both common law and statute.⁵²¹ This chapter examined the significant ruling of *AWA Ltd v Daniels t/a Deloitte Haskins and Sells*, which would ultimately result in the appeal decision in *Daniels v Anderson*. This appeal decision saw the CLERP conclude that section 232(4) of the Corporations Act, 1989, necessitates

⁵¹⁶ ASIC v Healey & Ors [2011] FCA 717 (Centro Case).

⁵¹⁷ As above.

⁵¹⁸ As above.

⁵¹⁹ As above.

⁵²⁰ See Para 4.1 above; *Re Denham & Co* (1883) 25 Ch D 752 para 50.

⁵²¹ *Metal Manufacturers Ltd v Lewis* (1988) 13 ACLR 35 para 45.

amendment to clarify that the requisite standard of care must be evaluated in light of the specific circumstances of the director or officer involved.⁵²² Furthermore it was emphasised that a director or officer of a corporation must exercise their powers and fulfil their obligations with the same level of care and attention as a reasonable individual would exhibit.⁵²³ Section 180(1) of the CLERP Act superseded section 232(4) and established a framework of objective criteria for assessing a director's duty to exercise care and diligence.⁵²⁴ The CLERP additionally declared that the corporate legislation should be revised to incorporate a statutory business judgment rule.

This chapter has also examined the scope of the business judgment rule in Australia in order to determine the key characteristics of the rule. It has also examined case law wherein the Rule in was adjudicated upon on by the courts. Case law was examined to demonstrate the Australian courts' interpretation of section 180(1).⁵²⁵ Directors in Australia are not expected to possess boundless knowledge or capability.⁵²⁶ It is expected that a director will exhibit a diligent and astute interest in the facts accessible to them, comprehend that information, and apply an inquisitive mindset to the obligations assigned to them.⁵²⁷ The standard required is an objective duty of skill, competence, and diligence. The mere lack of evil faith will not absolve directors in Australia from accountability for a violation of their duty of care. Information should be evaluated critically

The statutory business judgment rule, as proposed by the CLERP, was included into the Corporations Act 2001 through section 180(2).⁵²⁸ The Australian business judgment rule safeguards directors and corporate officials against violations of their duty of care as outlined in section 180(1) and its common law and equity counterparts. The statutory business judgment rule in Australia serves as a safe harbour, requiring the fulfilment of specific criteria before a director or officer can invoke its protection against violations of duty of care. These are: firstly, a business judgment is required;

⁵²² *AWA Ltd v Daniels t/a Deloitte Haskins and Sells* (1992) para 755.

⁵²³ *Daniels v Anderson* (1995) 13 ACLC 607 was the appeal to *AWA Ltd v Daniels t/a Deloitte Haskins and Sells* (1992) ACSR 759.

⁵²⁴ As above.

⁵²⁵ See Para 4.3.7 above.

⁵²⁶ Legg and Jordan 2013 *Adelaide Law Review* 39.

⁵²⁷ As above.

⁵²⁸ See Para 4.3.7 above.

secondly the business decision must be executed in good faith and for a legitimate purpose; and thirdly the directors or officers must not possess a major personal interest in the business judgment.

Notable observations were made regarding the application of the business judgment rule in case law. Initially, it was determined that courts see the business judgment rule as a safeguard for directors, shielding them from accountability for breaches of their obligations.⁵²⁹ Secondly, it was demonstrated that section 180(2) assigns the burden of proof to the defendants.⁵³⁰ Thirdly, the courts should read the word “business judgment” expansively and ascertain that the directors or officers engaged in thoughtful deliberation on their decision.⁵³¹ Lastly, if evidence demonstrates that the directors or officers believed their judgment served the company's best interests, and this belief was underpinned by a reasoning process adequate to be characterized as a "rational belief," it will satisfy the criteria for the rule's application, regardless of whether the reasoning process was objectively persuasive.⁵³² Nonetheless, it was noted that not all observers concur with this interpretation of the statutory business judgment rule by Australian courts.

The next chapter will be the final chapter of the dissertation and will provide a brief comparison between the South African and Australian variant of the business judgement rule and will provide some conclusions.

⁵²⁹ As above.

⁵³⁰ As above.

⁵³¹ As above.

⁵³² As above.

CHAPTER 5: CONCLUSION AND RECOMMENDATIONS

5.1. Introduction

This study set out to understand the business judgement rule as a fundamental rule of corporate governance and company law to understand how the judiciary should interpret the rule should it become the subject of judicial scrutiny. A general analysis was conducted of the statutory duties of a director as codified in terms of section 76(3)(b) and (c) of the Companies Act, which are directly linked to the South African business judgment rule. Thereafter, a general analysis of the formulations of the business judgment rule found in the USA, Australia and South Africa was conducted. This chapter consists of two main sections, namely findings and recommendations. The conclusions will be based on the overall findings of the dissertation. The recommendations are based on the lessons learned from the comparative study with Australia. This chapter will provide the final conclusions of the study and provide recommendations that are divided into three different sections. This chapter will also address the final research question and provide clarity on how business judgment rule in South Africa compares to the business judgment rule in Australia.

5.2. Summary of the findings on chapters of the study

Chapter 1 presented the principal research topic and elaborated on the purpose and rationale for the study. This study is notable as it comes at a time when corporate governance comes under the microscope given the Steinhoff Saga as well as other notable corporate collapses.

The decision-making process is a fundamental principle supporting corporate governance regulation in South Africa. Directors must make business choices, occasionally under suboptimal conditions and while facing inherent difficulties within the company structure. Among these difficulties it is of utmost importance to reconcile the profit maximization objectives of shareholders with the accountability of directors in managing the interests of larger stakeholders. This introductory chapter highlighted the fact that the rule is increasingly regarded as a mechanism for reconciling these

conflicting interests inside the corporate structure.⁵³³ Consequently, the rule establishes a framework for the interplay between a standard of conduct (the duty of care) and a standard of review on the director's responsibilities in managing the business and affairs of a company.⁵³⁴

Chapter 2 highlighted the fact that a considerable amount of scholarly and judicial effort has been devoted to elucidating the rule's foundational policies, determining its accurate theoretical foundations. The key theoretical foundations that have developed internationally were discussed and emphasised. Additionally, much time was spent on the United States being the country where the rule originated from. The business judgment rule emerged in the United States almost two centuries ago and evolved concurrently with the duty of care as a common law standard of review. Chapter 2 delineated the two formulations of the business judgment rule in the United States: the Delaware formulation and the ALI formulation. Both formulations explicitly necessitate the execution of a business decision for the rule to be applicable.⁵³⁵ In *Aronson v. Lewis* The Delaware business judgment rule was established as a presumption that corporate directors, in making a business decision, act on an informed basis, in good faith, and with the sincere belief that the particular action serves the best interests of the corporation.⁵³⁶ The American Law Institute's articulation of the business judgment rule is located in section 4.01(c) of the ALI Principles. Section 4.01(c) stipulates that corporate directors, when making decisions in good faith and in the best interest of the company, are not liable for those decisions, even if they turn out to be unsuccessful.⁵³⁷ In the United States, directors will not have protection under the business judgment rule unless a definitive or intentional business decision has been executed.

Chapter 3 focused on the South African rule found in section 76(4) (a). This chapter highlighted the fact that section 76 presents the business judgement rule as part of standards of directors 'conduct ,which relate to two directors 'statutory duties, namely the fiduciary duty to act in the best interests of the company, and the duty of care, skill

⁵³³ See 1.22 of Chapter 1.

⁵³⁴ See 1.3 of Chapter 1.

⁵³⁵ *Aronson v Lewis* 473 A2d 805, 813 (Del 1984) 813.

⁵³⁶ As above.

⁵³⁷ Section 4.01(c) of the American Law Institute *Principles of Corporate Governance: Analysis and Recommendations*, 1992.

and diligence.⁵³⁸ This chapter highlighted the fact that the business judgment rule, while categorized under "standards of conduct" in section 76, is, in fact, a standard of review. This chapter also discussed importance of the fact that a director owes two distinctive types of duties to a company: the fiduciary-type duties and the negligence-type duties of care, skill and diligence. It highlighted the fact that both forms of directors' duties function concurrently to restrict the powers of directors. This chapter also briefly discussed the relevance and importance of the duty of care in South Africa with regard to the introduction of the business judgment rule.

It analysed the how the duty of care as developed from its common law formulation to the position in the Companies Act.

Chapter 4 provided an in-depth investigation into the business judgement rule in Australia. Australia was the first nation to codify the business judgement rule under their company law legislation. The Australian variant of the business judgment rule was incorporated in section 180(2) of the Corporations Act. The Australian business judgement rule (business judgement rule), akin to other business judgement rule formulations, is intrinsically connected to the duty of care. The Australian business judgement rule parallels the American versions of the business judgement rule . Section 180(2) closely resembles the ALI Formulation, as the criterion of review is fundamentally linked to the standard of conduct in Section 180(1).

Chapter 5 provided a comparative study with Australia which, provided invaluable insights to enrich South African jurisprudence on standards of conduct and review, including interpretation thereof. South African law shares a common law inheritance with Australia and as such, law reforms in a country like Australia will continue to provide lessons for the possible enrichment of standards of conduct in South Africa.

5.3. Lessons learned and recommendations for reform

Directors in both South Africa and Australia must fulfil specific legal prerequisites to benefit from the business judgment rule's protection. This section briefly encapsulates

⁵³⁸ 76(3)(c) of the Companies Act.

the similarities and differences delineated in the discussions of both countries included in this study.

5.3.1. The requirement of the business judgement rule

According to the stipulations of the Australian version of the business judgement rule, a business judgment must have been rendered.⁵³⁹ According to the requirements of, section 180(3) of the Corporations Act a business judgment is defined as 'any decision to undertake or refrain from undertaking action concerning an issue pertinent to the business activities of the corporation.'⁵⁴⁰ In *ASIC v Rich*, the court determined that the expression "relevant to the business operations of the corporation" in section 180(3) should be interpreted widely, and that for a "matter" to qualify as a business judgment, it is not necessary for it to be confined to a business-specific issue.⁵⁴¹ It is important to highlight that the Australian business judgement rule delineates "business judgment", so constraining its scope and applicability. As already discussed Section 76(4) of the Companies Act does not reference a "business decision," but rather refers to "any particular matter arising."⁵⁴² It should be noted Section 76(4) has multiple references to "decision." Section 76(4)(a)(ii) (aa) pertains to the "subject matter of the decision"; section 76(4)(a)(iii) addresses a director who "made a decision" or "supported a decision" of a committee or the board concerning that matter; furthermore, it stipulates that the director possessed a rational basis for believing, and indeed believed, that "the decision" was in the best interests of the company.⁵⁴³

Thus, it is clear to see that in South Africa the rule extends beyond mere business judgments. The author agrees with Oost's contention that it would be better for the rule in South Africa to only find application once business decisions have been made.⁵⁴⁴ This corresponds with the purpose of the rule, which is to protect directors from incurring liability for a breach of their duties when making business decisions in good faith, without a conflict of interest.⁵⁴⁵ Thus the first recommendation is to revise

⁵³⁹ See Para 4.1 of Chapter 4.

⁵⁴⁰ Section 180(3) of the Corporations Act, 2001.

⁵⁴¹ *ASIC v Rich* (2009) 75 ACSR 236 FLR 1 para 7276.

⁵⁴² Section 74 of the Companies Act.

⁵⁴³ See para 4.2 of Chapter 4.

⁵⁴⁴ Oost 322.

⁵⁴⁵ As above.

the provision by removing the phrase “particular matter arising in the exercise of the powers or the performance of the functions of a director” and replacing it with the term “business judgment.” This will restrict the applicability of the business judgment rule and line it with the legislature's intent and the rule's original purpose.⁵⁴⁶

5.3.2. The requirement of an informed business judgment

Section 180(2)(c) of the Corporations Act stipulates that directors must familiarize themselves with the subject matter of the judgment to the extent that they "reasonably believe" is appropriate.⁵⁴⁷ The Australian business judgment rule does not require directors to acquire knowledge of "material" facts.⁵⁴⁸ The criterion is whether the directors genuinely believe they are adequately informed. Directors in Australia must familiarize themselves with all information they reasonably consider relevant, not alone "material" information.

Section 76(4)(a)(i) of the Companies Act section provides that directors should take “reasonable diligent steps” to become informed about the subject matter.⁵⁴⁹ Thus, it can be gleaned that in contrast to the Australian interpretations business judgment rule, an objective standard of review is employed rather than a subjective assessment.⁵⁵⁰ Consequently, South African directors are more inclined to fulfil this obligation than directors in Australia This situation is suboptimal, given that South African directors lack exposure to a litigious environment, and the author contends that it seems unnecessary to diminish the standard of review to enhance their access to protection under the business judgment rule.

It is import to note that section 76(4)(a)(i) does not restrict the information mandated to solely "material" information.⁵⁵¹ South African directors must undertake reasonably diligent measures to educate themselves on the pertinent subject matter related to the decision whether the information is material or immaterial.⁵⁵² Thus it is clear to see

⁵⁴⁶ See Chapter 2 para 2.3 for a discussion of the rationales behind the business judgment rule.

⁵⁴⁷ Section 180(2)(c) of the Corporations Act, 2001

⁵⁴⁸ See Chapter 4 para 4.3

⁵⁴⁹ See Chapter 3. Para 3.2.

⁵⁵⁰ Section 76(4)(a)(i) of the Companies Act 71 of 2008.

⁵⁵¹ See Chapter 3 para 3.3

⁵⁵² As above.

that while a lower level of review is employed to determine if directors have fulfilled this obligation, the requirement is broadened slightly by not restricting it only to material information.

While this formulation is robust, the author agrees with Oost that there remains potential for enhancement concerning the objective standard of review outlined in section 76(4) for assessing whether directors made an informed decision.⁵⁵³

The second recommendation is to alter this segment of section 76(4) to incorporate a subjective level of evaluation rather than the existing solely objective criterion. This will align with the elevated standards anticipated of directors under section 76(3)(c). Thus, it is contended that section 76(4)(a)(i) be revised as follows: The expression “the director has taken reasonably diligent steps to become informed about the matter” should be removed and substituted with “the director must inform him- or herself on the subject matter of the judgment to the extent he or she reasonably believes to be appropriate.” This aligns with Australian versions, which I believe represents a solid formulation. It implies that directors must thoroughly educate themselves on the subject matter – a subjective investigation – rather than simply undertake reasonable diligent steps to acquire knowledge on the subject matter. Modifying section 76(4)(a)(i) to incorporate a subjective standard of review will introduce a subjective component to section 76(4), which presently stipulates just an objective standard of review.⁵⁵⁴ In this regard, the author agrees with Oost that such an amendment will alleviate the worry over the relative ease with which South African directors could fulfil the criteria of the business judgment rule as stipulated in section 76(4).⁵⁵⁵

5.3.3. The deliberate exclusion of good faith as one of the requirements for the application of the South African business judgement rule

Section 180(2)(a) of the Australian Corporations Act 2001 stipulates that the decision must be made in good faith and for a legitimate purpose.⁵⁵⁶ Australia has incorporated

⁵⁵³ Oost 326.

⁵⁵⁴As above.

⁵⁵⁵ Oost 327.

⁵⁵⁶ Section 180(2)(a) of the Corporations Act, 2001.

the proper purpose criterion alongside with the requirement, that the decision must be rendered in good faith. Australian directors need to satisfy both.

As discussed in Chapter 3 South Africa, section 76(4) does not require that directors' decisions be made either in good faith or for a valid purpose.⁵⁵⁷ Neither of these prerequisites need to be completed in order for the business judgment rule to be used by South African directors. In this aspect, the Australian approach is stricter than that in South Africa.⁵⁵⁸ This does not, however, mean that South African directors should not act in good faith and with a suitable purpose when fulfilling their duties South African directors are still required to comply with their fiduciary duties as codified in section 76(3)(a) which include acting in good faith and for a proper purpose, but importantly, these are not stated as preconditions for accessing protection under the business judgment rule in section 76(4)(a).⁵⁵⁹ Directors have a fiduciary duty to their company and are duty-bound to behave in good faith towards the firm.⁵⁶⁰

The author contends that the lack of good faith in the South African business judgement rule is not a legislative oversight. The author in this regard agrees with Melenephy who contends that the incorporation of the obligation to act in good faith inside the South African business judgement rule is entirely superfluous and ineffectual.⁵⁶¹ It is of good import to note that If the director engages in bad faith, the director contravenes section 76(3)(a) – for which the business judgement rule may not apply to protect the director from liability. Therefore, a director will not be protected for failing to act in good faith or proper purpose and will remain liable. Furthermore, South Africa omitting good faith means that the country may not be confronted with the same difficulties facing the USA where the distinction between fiduciary duties and the duty of care have been blurred by the business judgment rule.⁵⁶²

⁵⁵⁷ See para 3.6 above.

⁵⁵⁸ Oost 337.

⁵⁵⁹ Mongalo (2023) 45.

⁵⁶⁰ As above

⁵⁶¹ Melenephy 35.

Smith v Van Gorkom 488 A.2d 858, 872 (Del. 1984). In the USA the fiduciary duties of directors and the duty of care are not distinct concepts as in Australia and South Africa. The business judgment rule in both Delaware and the ALI will consequently apply to both directors' fiduciary duties and their duty of care.

5.4. Conclusion

The essence of the business judgment rule is whether courts ought to evaluate the reasonableness of directors' judgments.⁵⁶³ The judicial deference to directorial discretion and judgments does not equate to the outright relinquishment of the judicial role. In this regard Leach notes that the judiciary maintains the option to intervene in suitable instances, such as in situations of fraud or self-interest that taint a decision.⁵⁶⁴ However In what circumstances does directorial accountability take precedence over directorial authority? What is the suitable degree of judicial deference to directors' judgments that should be implemented within the corporate law framework in South Africa? These are the main questions this piece of work sought to investigate.

The author agrees with Mupangavahu's contention that the implementation of section 76(4)(a) in South Africa is a notable advancement of the Companies Act.⁵⁶⁵ It aims to harmonize our legislation with "best practice jurisdictions internationally", so achieving several core objectives of the Department of Trade and Industry in changing our corporate law.⁵⁶⁶ These encompasses goals such as the establishment and utilization of companies to improve South Africa's economic welfare as a participant in the global economy; to promote elevated standards of corporate governance; to equilibrate the rights and responsibilities of shareholders and directors; to foster efficient and responsible corporate management; and to ensure a predictable and effective framework for the regulation of South African companies.⁵⁶⁷

Section 76(4)(a) effectively establishes a crucial equilibrium, albeit precarious at times, between bestowing directors with considerable authority and powers under section 66(1) and ensuring their accountability and potential liability for any questionable exercise of such authority and powers, particularly under section 77, among others.⁵⁶⁸ 76(4)(a) establishes a suitable and adequate equilibrium between shareholders' frequently conflicting interests in profit maximization and the essential necessity to

⁵⁶³ Leach 68.

⁵⁶⁴ Leach 69.

⁵⁶⁵ Mupangavanhu 2019 *Journal of African law* 13.

⁵⁶⁶ Mupangavanhu 2019 *Journal of African law* 13.

⁵⁶⁷ Para 1.2 of South African Company Law for the 21st Century: Guidelines for Corporate Law Reform GN 1183 in GG 2004-06-23; Section 7(e) of the Companies Act

⁵⁶⁸ Beja 2021 *Journal of Corporate and Commercial Law & Practice* 30.

grant directors the autonomy to operate the firm as outlined in section 66(1).⁵⁶⁹ Most importantly though this work has established that Section 76(4)(a) does not constitute a universally applicable defence for all directors or for all types of conduct. It establishes rigorous criteria that a defendant director, who bears the burden of evidence under section 76(4)(a), must satisfy to effectively assert such a defence.⁵⁷⁰ Thus, section 76(4)(a) does not promote or endorse excessive and imprudent risk-taking or neglect by directors.⁵⁷¹

The business judgment rule functions as a judicial tool to balance responsibility and authority. This may subsequently enhance company leadership and decision-making, thus influencing the effective operation and expansion of the South African economy.⁵⁷² The author contends that South Africa must avoid a situation in which the business judgment rule may result in a culture of ostensible indifference or intentional neglect by those responsible for the welfare of companies. In this regard the rule must not serve as an "insurmountable barrier" to accountability.⁵⁷³ It is axiomatic that companies are essential participants in society, and therefore, directors possess the capacity to significantly impact the economic development of South Africa. Insufficient business guidance and the ensuing failures and scandals that have recently afflicted the country ultimately detrimentally affect investors, employees, and creditors.⁵⁷⁴ Public confidence in financial markets may be negatively impacted, resulting in broader economic consequences. In summary, a direct association exists between particular company decisions and the broader interests of the general population in South Africa. The adverse effects of decisions shaped by the breach of statutory duty of care may surpass simple shareholder dissatisfaction.⁵⁷⁵ It is thus essential to have a work like this to delineate the appropriate stance on the business judgment rule in relation to South Africa, and its potential interpretation by courts.

⁵⁶⁹ As above.

⁵⁷⁰ Leach 59.

⁵⁷¹ Mupangavanhu 210.

⁵⁷² Leach 62.

⁵⁷³ As above.

⁵⁷⁴ See para 1.1 of Chapter 1.

⁵⁷⁵ As above.

However having said all of the above the author agrees with Oost's suggestion that Section 76(4) ought to be revised to elucidate its context and scope more and to restrict the use of the business judgment rule to cases where directorial discretion has been exercised and a business decision has been actually been made.⁵⁷⁶ Until the moment that a The legislative adjustment can be achieved the author agrees with Leach that a restrictive interpretation of section 76(4) ought to be taken wherein the defendant director bears the responsibility of demonstrating the applicability of section 76(4).⁵⁷⁷ Thus if the court finds that the business judgment rule is applicable, meaning the defendant director can demonstrate compliance with section 76(4), the substantive accuracy, or wisdom of the decision will be excluded from judicial review.⁵⁷⁸ This may be warranted to prevent judicial hindsight bias, when judges might erroneously interpret unfavourable outcomes as definitive proof of misconduct.⁵⁷⁹ Directors must be permitted to exercise their discretion freely, and to make hazardous yet potentially profitable decisions, as long as they comply with the corporate governance standards established by King IV.⁵⁸⁰

Each case must be evaluated based on its own merits. The author contends that the greater the discretion involved in a choice, the more deference the judiciary ought to exhibit towards that conclusion. Judicial deference is not an absolute concept and should be subject to varying application. It was mentioned in chapter that many judges are radically incompetent to adjudicate choices that are fundamentally complicated and made within a broad context of ambiguity where flawless outcomes are unattainable.⁵⁸¹ Furthermore the author contends that light of the fact that there is no big body of case law applying the business judgement rule as yet in South Africa directly the rule should be interpreted with purpose and applied flexibly to foster informed decision-making and genuine risk-taking, without impeding innovation and

⁵⁷⁶ Oost 354.

⁵⁷⁷ Leach 60

⁵⁷⁸ As above.

⁵⁷⁹ As above.

⁵⁸⁰ King Committee on Corporate Governance *The King Report on Corporate Governance for South Africa 2016* ("King IV") The Institute of Directors in South Africa. See para 5.4.2.2.2.

⁵⁸¹ See para 2.2 of Chapter 2

efficiency, while also promoting and ensuring good corporate governance and director accountability, implying a purposive approach.⁵⁸²

In this regard a contextual interpretation will give the courts a role to harmonise the Business Judgement rule's provisions with relevant international experiences or evolving international standards. In this light, the author contends that given that the Australian business judgement rule has been extensively examined and applied by Australian courts and commentators, and considering that our courts are authorized to reference foreign law in interpreting the Act, that it is important our courts learn the lessons from Australian Case law. Certain Australian court ratios and interpretations of sections of s 180(2) are likely to possess convincing interpretative value for our courts. For instance, regarding the absence of material personal interest (Adler case)⁵⁸³; acquiring knowledge about the subject matter of a judgment (Centro case)⁵⁸⁴; and rational belief (Rich case, especially about a director's subjective mindset).⁵⁸⁵

⁵⁸² Section 5(1) of the Companies Act in this regard states that the Act must be interpreted and applied in a manner that gives effect to the purposes set out in section 7. This is a text-in-context approach or a purposive approach. The Company's Act's contextual interpretation guarantees that the approach considers context in its adaptable form. The context encompasses the complete legislative framework and the background, which includes the common law deficiencies that prompted the need for legal reform. The suitable interpretative approach mandates that courts must evolve common law when deemed relevant to enhance the enforcement of rights under the Act. It also involves the evaluation of the normative, value-laden constitutional framework articulated through the aims outlined in section 39(2) of the Constitution is essential.

⁵⁸³ Refer to ASIC v Adler (2002) 41 ACSR 72, in which the court determined that the defendant director failed to act in good faith and for a legitimate purpose as mandated by s 180(2)(b), and possessed a material personal interest in the matter concerning the contested decision.

⁵⁸⁴ Refer to ASIC v Healey & Ors [2011] FCA 71. (Centro). The court in this case determined that the directors neglected to exercise due care and attention by failing to identify significant monetary problems in the corporation's financial accounts, which they did not scrutinize thoroughly. It is probable that South African courts will adopt the judicial reasoning and rigorous behavioural standards established in the Centro judgment when interpreting and applying the provisions of section 76(4)(a)(i), which mandate that a director must take steps to become informed about a decision.

⁵⁸⁵ Australian Securities and Investments Commission v Rich [2009] NSWSC 1229. It is probable that our courts will determine, similar to the Australian court's ruling in ASIC v Rich regarding section 180(2), that the elements specified in sections 76(4)(a)(i)(iii) are predominantly within the defendant director's knowledge, rather than a non-director plaintiff. Consequently, after a defendant director has fulfilled the burden of demonstrating compliance with the s 76(4)(a)(i) - (iii) criteria, a court will absolve that director from any liability for violating the responsibilities outlined in ss 76(3)(b) and/or (c) and they will sail into a safe harbour.

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