UNIVERSITY *of the* WESTERN CAPE

The South African Business Judgement Rule – An analysis of the rationality standard for reviewing the conduct of a director

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Prepared under the Supervisor

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DECLARATION

I, **Dylan Melenephy**, hereby declare that this dissertation is original and has never been presented at any other institution. I also declare that secondary information used has been duly acknowledged in this dissertation.

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Keywords

- Corporate Governance
- Directors’ Duties
- Duty of care, skill and diligence.
- Duty to act in the best interest of a company
- Rational basis
- Rationality
- Reasonableness
- South African Company law
- Standard of conduct
- Standard of review
- *Visser Sitrus*

List of Abbreviations:

- ALI – The American Law Institute formulation
- *Asics – Asics v Rich*
- BJR – The Business Judgement Rule
- Corporations Act – The Australian Corporations Act 2001
- CSI – Corporate Social Investment
- CSR – Corporate Social Responsibility
- Delaware – The State of Delaware
- DTI – Department of Trade and Industry
- *Fisheries – Fisheries Development Corporations of SA Ltd v Jorgensen & Another*; *Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd & Others*
- *Re City – Re City Equitable Fire Insurance Co Ltd*
- *Shuttleworth – Shuttleworth v. Cox Brothers & Co*
- *Teck Corporation – Teck Corporation Ltd. v Millar*
- The Companies Act – The Companies Act 71, of 2008
- The Old Act – The Companies Act of 1973
- USA – United States of America
- *Visser Sitrus - Visser Sitrus (PTY) LTD v Goede Hoop Sitrus (PTY) LTD and Others.*

CHAPTER ONE – A GENERAL OVERVIEW

1.1. Introduction and Background

The legal nature of a company is that of an artificial person, which exists separately from the management and shareholders of that company.[1] Consequently, it lacks the ability to act on its own and must act through representatives.[2] In this regard, section 66(1) of the Companies Act 71 of 2008 (hereafter, the Companies Act) provides that:

> The business and affairs of a company must be managed by or under the direction of its board, which has the authority to exercise all of the powers and perform any functions of the company, except to the extent that this Act or the company's Memorandum of Incorporation provides otherwise.[3]

In essence, this provision accounts for the statutory duty of a director to act on behalf of the company in a representative capacity. A director also occupies a fiduciary position in relation to the company. [4] This fiduciary position requires the director to exercise a power given, in line with all the fiduciary duties in terms of both common law and statutory law.[5] Under common law, the director is required to, *inter alia,* exercise their powers *bona fide* and in the best interest of a company as well as exercise their powers for the purpose for which the power was conferred.[6] These duties have been codified in terms of s 76 (3) of the Companies Act.[7] This section provides that:

> A director, acting in that capacity, must exercise the powers and perform the functions of director- (a) in good faith and for a proper purpose; (b) in the best interest of the company; and (c) with the degree of care, skill and diligence that may reasonably be expected of a person – (i) carrying out the same functions in relation to the company as those carried out by that

[1] Kennedy-Good S 'The Business Judgment Rule (Part 1)' (2006) *Obiter* 27(1), 63.
[2] Cassim F.H.L *et al, 'Contemporary Company Law'* 2nd edition (2012) 187.
[3] The Companies Act 71 of 2008, section 66(1).
[4] *Visser Sitrus (PTY) LTD v Goede Hoop Sitrus (PTY) LTD and Others,* 2014 (5) SA 179 (WCC) para 58.
[5] *Visser Sitrus (PTY) LTD v Goede Hoop Sitrus (PTY) LTD and Others,* para 58.
[6] *Visser Sitrus (PTY) LTD v Goede Hoop Sitrus (PTY) LTD and Others,* para 58.
[7] The Companies Act 71 of 2008, section 76.

director; and (ii) having the general knowledge, skill and experience of that director.[8]

S76(3)(c) has become one of the most controversial and well researched sections of the Companies Act. This section illustrates a divergence from the standard of the duty at common law. The common law position of this duty was summarised by Margo J in the case of *Fisheries Development Corporations of SA Ltd v Jorgensen & Another; Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd & Others* (hereafter, *Fisheries case*).[9] Margo J makes 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* (emphasis added).[10] The statutory version of the duty on the other hand, as outlined in s76(3)(c) of the Act, imposes a subjective-objective standard. This statutory standard is a two-step enquiry, firstly it requires the director to act reasonably and secondly the test takes into account the director's general knowledge, skill and experience.[11] This new standard, set by statutory law, is regarded by academics as being more demanding than it was at common law.[12] It is for this reason that the Companies Act introduced the 'business judgement rule' (hereafter, BJR) in terms of s 76(4) of the Act, as a means to give relief to the duty of care, skill and diligence.[13]

The BJR was first considered by *King I* in 1994, as an amendment to the 1973 Companies Act (hereafter The Old Act) and in relation to the common law duty of care and skill.[14] It was proposed that, "[a] director should not incur liability for a breach of the duty of care and skill where they have exercised a business judgement in good faith in a matter in which their decision is an informed and rational one and there is no self-interest".[15] The origin of this rule is found to have been developed in the United States of America (hereafter, USA) alongside

[8] The Companies Act 71 of 2008, section 76(c).
[9] *Fisheries Development Corporations of SA Ltd v Jorgensen & Another; Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd & Others* 1980 (4) SA (W).
[10] *Fisheries Development Corporations of SA Ltd v Jorgensen & Another; Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd & Others.* 166.
[11] Cassim F.H.L *et al, 'Contemporary Company Law'* 2nd ed. (2012) 559.
[12] Cassim et al *Contemporary Company law* 2 ed (2012) 558.
[13] Kennedy-Good S 'The Business Judgment Rule (Part 1)' (2006) 63-64; The Companies Act, section 76(4).
[14] King M. E. '*The King report on Corporate Governance'* (1994) 28.
[15] King M. E. '*The King report on Corporate Governance'* (1994) 28.

their duty of care.[16] For this reason, the BJR as developed in the USA has to be considered to aid the interpretation of the South African BJR. Australian law has also introduced a version of the BJR, with the introduction of s180(2) of the Corporations Act 2001.[17] The Australian version of the BJR has also influenced the South African BJR, thus the Australian BJR also needs to be considered. [18]

The South African BJR as laid out in s76(4) of the Companies Act protects a director, where that director allegedly breached the duty in terms of s 76(3)(b) namely, to act in the best interest of the company or s 76(3)(c) where that director failed to act with necessary degree of care, skill and diligence which may be expected.[19] In order to satisfy the BJR under s 76(4), it is required that:

> (a)- (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 personal financial interest in the matter; or (bb) the director complied with the requirements of section 75 with respect to any interest contemplated in 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 interests of the company; and …[20]

If the director complies with these provisions, they will be protected from the liability of a breach of s76(3)(b) and (c)

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[16] Kennedy-Good S. & Coetzee L. *'The Business Judgment Rule (Part 1)'* (2006) 64; Mupangavanhu BM. *'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* 63(1), 128.

[17] The Corporations Act 2001, s180(2).

[18] Mupangavanhu BM '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' (2016) (published) LLD thesis, 15.

[19] The Companies Act 71 of 2008, section 76.

[20] The Companies Act 71 of 2008, section 76(4)(a)

1.2. Problem Statement

Importantly, with regard to s 76(4)(a)(iii), there appears to be a departure from the commonly well-known standard of review in South Africa, namely, reasonableness. The legislature herein uses 'rational basis' (herein also referred to as rationality) as the standard of review for believing that the decision taken was in the best interest of the company.[21] The standard of rationality has been described as a 'reduced standard' when compared to reasonableness. [22] Eisenberg has identified the distinction between the standards, observing that the standard of rationality is less demanding and, to the effect, easier to satisfy than the reasonableness standard.[23] Given that an unnecessary divergence from a standard leads to an unnecessary complication in the administration of relevant standards,[24] this dissertation aims to show the interpretation issues that arise due to the introduction of the rationality standard in this context. Considering that the standard of rationality is otherwise unknown to South African Company law, it remains unclear how a director complies with showing that he had a 'rational basis' for believing that a decision taken was in the best interest of the company. The court in *Visser Sitrus* plays a role in the discussion of the rationality test required by s76(4)(a)(iii). Rodger J herein, uses principles relating to the existence of a rationality test in the exercise of public power.[25] This formulation takes into account whether the means employed are rationally related to the purpose for which the public power was given.[26] Consequently, this dissertation aims to unpack and critique the views of Rodger J in the *Visser Sitrus* case, in order to provide clarity to the standard of rationality in South African Company law.

1.3. Significance of the study.

The main aim of this dissertation is to navigate the complexities in understanding rationality as the standard of review for assessing whether a director has acted in the best interest of a company. This research differs from other studies, given the perspective from which it aims to add to the existing narrative on the issue. This dissertation aims to engage in an examination of the BJR through the lens of the rationality requirement. Therefore, it concerns itself with a

[21] The Companies Act, section 76(4)(a)(iii).
[22] Cassidy J *'Models for reform: The Directors duty of care in a Modern Commercial World'* (2009) *Stellenbosch Law Review* 20(3), *375.*
[23] Eisenberg M, *'The Divergence of Standards of Conduct and Standards of Review in Corporate Law'* (1993) *Fordham Law Review* 62(3), 443.
[24] Cassidy J *'Models for reform: The Directors duty of care in a Modern Commercial World'* (2009), *374.*
[25] *Visser Sitrus (PTY) LTD v Goede Hoop Sitrus (PTY) LTD and Others*, para 76.
[26] *Visser Sitrus (PTY) LTD v Goede Hoop Sitrus (PTY) LTD and Others*, para 77.

detailed analysis of the standard of review which is found in s76(4)(a)(iii) of the act. The overall aim of this dissertation is to provide clarity in relation to the standard of review applied to a director, in order for that director to rely on the BJR. Fulfillment of the requirements of the BJR would result in that director being absolved from personal liability for the breach of a statutory duties found in s76(3)(b) and (c) of the Act. Therefore, the findings herein aim to assist South African courts, legal representatives and directors in the application of this standard of review.

1.4. Research Question(s)

The main aim of this dissertation is to analyse the rationality standard of review within the context of the South African Business Judgement Rule. Therefore, this dissertation aims to answer three sub-questions. Firstly, what is meant by the rationality test? Secondly, how does the rationality test differ from the well-known reasonableness test? Lastly, is the standard of rationality appropriate in the current world of corporate governance?

To achieve this, the study will be guided by the following objectives:

- To provide an understanding of a director's duties, including the duty of care, skill and diligence as well as the duty to act in the best interest of a company.
- To provide an understanding of the BJR through its formulations in USA, Australia and South Africa
- To provide the link between a director's duties and the BJR.
- To review the rationality test as the standard of judicial review.
- To assess how the USA and Australia have interpreted rationality as a standard for reviewing the conduct of a director.
- To illustrate the appropriateness of the standard of rationality as a standard of judicial review.

1.5. Methodology

This dissertation involves an analytical desktop research method. This will include the analysis of legislation such as the Companies Act 71 of 2008 as well as previous versions of the Act. These legislative measures will be used in conjunction with important case law and various secondary sources, such as journal articles and textbooks, in order to effectively discuss rationality in relation to the BJR in South Africa. To further strengthen this study, foreign legislation, case law and other secondary sources will be used to provide an analysis of the BJR and its standard of review in the jurisdictions of the USA and Australia. This analysis will ultimately be used to aid the interpretation of the rationality standard of review found in the South African BJR formulation.

1.6. <u>Chapter Outline</u>

This dissertation consists of five chapters.

Chapter one: A general overview

This chapter serves as an introduction to the study. It consists of the background to the study, problem statement, purpose of the study, significance of the study, research methodology and chapter outline. This will provide readers with a clear overview of the research this dissertation will consist of.

Chapter two: Directors' duties as standards of conduct

The director(s) of a company, by relying on the BJR, may only escape liability for failing to act in the best interest of a company and/or acting with the necessary degree of skill care and diligence – as codified by s76(3)(b) and s76(3)(c) of the Companies Act. Therefore, this chapter aims to provide an overview of the director(s) duties – to which the BJR may apply. This chapter will not only look at the codified versions of these duties as per the Companies Act, but also their common law counterparts. This chapter will also address some concerns, such as, the link between acting in good faith and the duty to act in the best interest of a company; the meaning of diligence as included in the duty of care and skill as well as the objective-subjective approach of the duty of care, skill and diligence adopted by the *Fisheries* case.

Chapter three: Formulations of the BJR

This chapter discusses the various formulations of the BJR found in the USA, Australia and South Africa. This chapter provides for an analysis of the requirements of the BJR in terms of s36(4) of the Companies Act and will address some of the concerns regarding the formulation, including the absence of good faith in the South African BJR as read in s76(4) of the Companies Act.

Chapter 4: Rationality as a standard of judicial review

This chapter discusses rationality as a standard of review. In doing so it looks at the differences between standards of review and standards of conduct. This chapter examines the development of the review of the duty to act in the best interest of a company – which is directly linked to rationality as the current standard of review, in this regard. It also discusses the standard as found in the USA and Australian formulations of the BJR. This chapter also provides for a discussion of the standard through the court in *Visser Sitrus*. This chapter also addresses some concerns regarding the standard of the review, including its appropriateness when compared to the commonly used standard of reasonableness.

Chapter 5: Conclusion and Recommendations

This chapter concludes this dissertation by drawing together the key concepts discussed throughout the dissertation. The recommendations provided, will focus and readdress on four important concerns. Firstly, Does the Companies Act need to be amended to include good faith as a requirement under s76(4); Secondly, is there a need for more research on the judicial review of the duty to act in the best interest of a company; Thirdly, what can be learnt from the *Visser Sitrus* judgment; Lastly, are the advancements made by Einsenberg enough to conclude on the appropriateness of rationality as a standard of review.

CHAPTER TWO – DIRECTORS' DUTIES AS STANDARDS OF CONDUCT

2.1. Introduction

Section 66(1) of the Companies Act provides for the statutory duty of a director to act on behalf of the company in a representative capacity. Therefore, the proper exercise of the director(s)' duties is essential to ensuring the success and effective operation of a company. Historically, South African common law has always followed the English Law approach regarding Company law.[27] Likewise, the Old Companies Act followed this approach by leaving the duties of directors to the courts for development. This adopted approach inevitably became concerning in that, directors' duties were being dealt with inconsistently across different courts.[28] Therefore, directors' duties are easily characterised as being widespread and riddling.[29] Due to the importance of these duties, there was an inherent desire to clearly define these duties and attempt to have consistency in its application across courts. In this regard, the 2008 Companies Act introduced the partial codification of directors' duties with the aim of creating certainty in relation to the conduct required by a director as well as the creation of unity amongst courts in the application of these duties.[30] Whether the partial codification of these duties achieved the main objective aimed at is uncertain. This is due to courts being required to interpret the act together with common law - which inevitably leads to differences across courts. Thus, the partial codification merely provides a unified foundation from which the courts develop and interpret directors' duties.

Whilst the shift from relying wholly on the common law to define directors' duties to a partial codification thereof does create some clarity and uniformity, it is not without its disadvantages. Due to its rigid nature, any codification of rules or principles creates the risk of stifling

[27] Mupangavanhu BM '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' (2016) (published) LLD thesis page 110.

[28] Mupangavanhu BM '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' (2016) (published) LLD thesis 110.

[29] This author characterises directors duties as being widespread as the common-law fiduciary duties of directors were developed by the courts over the past 200 years. (see Cassim et al *Contemporary Company law* 2 ed (2012) 19). This author characterises the directors duties as being riddling as partial codification provided the opportunity for the legislature to rectify and resolve the conflicting judicial decisions and dicta on these fiduciary duties. See Cassim et al *Contemporary Company law* 2 ed (2012) 508.

[30] Lee A 'Business judgement rule: should South African law follow the King Reports recommendation?' (2005) *the University of Botswana Law Journal* 1(6) 77.

innovation.[31] In effect, this approach limits the scope of courts to develop directors' duties. The benefit of having a partial codification system of rules is the ability of the common law position to be preserved. The applicability of common law rules ensures that the directors' duties remain flexible and capable of development.[32] Importantly, the effectiveness of this hybrid system relies on the relationship between common law and statutory law to be clearly defined.

The nature of the relationship between the duties of directors' at common law and their codified statutory counterparts is that the statutory law is the primary source of directors' duties and the common law versions merely supplement where necessary. Thus, where a conflict arises between statutory and common law, the statutory law will prevail and override the common law version.[33] Where the statutory law does not provide for a certain duty, but the duty exists at common law, the common law duty is accepted and applied. Where no duty exists, courts can also develop a common law duty.[34]

The effect of this hybrid system is that any breach of the duties codified in s76(3) of the Companies Act or those existing in terms of common law may result in personal liability being incurred upon the duty-breaching director(s). The BJR in s76(4) of the Companies Act protects a director where that director breached the codified duty in terms of s76(3)(b) namely, the duty to act in the best interest of the company and s76(3)(c) the duty to act with the necessary degree of care, skill and diligence which may be expected.[35] Thus, the BJR is only applicable to those codified duties. In effect, a director cannot rely on the BJR to escape their common law duties. This dissertation is primarily focused on the effect of the BJR, particularly the requirement of rational basis as found in s76(4)(bb)(iii). Therefore, a discussion of directors' duties is narrowed to those duties against which the application of the BJR relates. In this regard, the fiduciary duty to act in the best interest of a company and its link to the duty to act in good

[31] Cassim et al *Contemporary Company law* 2 ed (2012) 508.
[32] Leach J 'The Correct Understanding of the Business Judgment Rule in Section 76(4) of the Companies Act 71 of 2008: Avoiding the American Mistake' (published) LLM thesis page 7.
[33] Stein C & Westbrook D 'Directors and Officers Liability Insurance' available at *http://services.bowman.co.za/Brochures/DutiesAndLiabilities/DutiesAndLiabilitiesBrochure-lr.pdf* (accessed on 30/05/2021) ; see also Smit I 'The application of the Business Judgment Rule in fundamental transactions and insolvent trading in South Africa: foreign precedents and local choices' (published) LLM Thesis page79.
[34] Coetzee L 'Directors' fiduciary duties and the common law: the courts fitting the pieces together' (2016) *Obiter* 32(1) 401.
[35] The Companies Act, section 76.

faith will be examined, alongside the delictual-natured statutory duty to act with a degree of care, skill and diligence – in order to provide a foundation upon which to discuss the BJR.[36]

2.2. <u>S76(3)(b) - Duty to act in the best interest of a company</u>

The duty to act in the best interest of a company has been codified by s76 (3) (b) of the Companies Act. This section entails that a director, when acting in the capacity of a director, must exercise their duties' and perform their functions in the best interest of the company.[37]

In terms of this duty, it would be clearly breached when the director(s) exercise their powers in a manner which defeats or harms the interests of the company.[38] In addition, if the director acts with their own personal financial interests in mind, the director is deemed to not have acted in the best interest of the company – unless a disclosure of their personal financial interests is made in terms of s75 of the Act.[39]

The duty to act in the best interest of a company is a well-established rule of common law.[40] This rule at common law is inextricably linked to good faith.[41] In other words, at common law the duty exists as the 'duty to act in good faith and in the best interest of a company'.[42] It is clear from the outset that the duty to act in the best interest of a company is context specific and differs from company to company. In other words, the nature of the duty allows for a director to define which action is in the best interest of a company by considering the surrounding circumstances. Therefore, the duty may be classified as one which is highly subjective and lax in effect. In *Re Smith & Fawcett Ltd*[43] the court laid out the long standing subjective view that the directors are bound to exercise the powers conferred upon them *bona fide* in what they consider is in the best interests of the company.[44] This subjective view of the

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[36] Leach J 'The Correct Understanding of the Business Judgment Rule in Section 76(4) of the Companies Act 71 of 2008: Avoiding the American Mistake '(published) LLM thesis page 7; see also *Ex parte Lebowa Development Corporation Ltd* 1989 (3) SA 71 (T); *Du Plessis NO v Phelps* 1995 (4) SA 165 (C).
[37] The Companies Act, section 76(3)(b).
[38] Joubert W 'Companies: Part 2, Duties of Directors and Officers, Fiduciary Duties, Duties to exercise powers for proper purpose' available at http://www-mylexisnexis-co-za.ezproxyuct.ac.za/index.aspx# (accessed on 07/06/2021)
[39] The Companies Act, section 75.
[40] Cassim et al *Contemporary Company law* 2 ed (2012) 524.
[41] Cassim et al *Contemporary Company law* 2 ed (2012) 524.
[42] Cassim et al *Contemporary Company law* 2 ed (2012) 524.
[43] *Re Smith & Fawcett Ltd* [1942] Ch 304 at 306.
[44] *Re Smith & Fawcett Ltd* [1942] Ch 304 at 306.

duty is also supported by the court in *Visser Sitrus* where it was made clear that the duty to act in the best interest of the company is *not* one which is objective in nature (emphasis added).[45] In other words, it is the directors who have to subjectively believe that they are acting in the best interest of a company and not what the court objectively believes is in the best interest of the company. This subjective approach is not without its limits, when reviewed by the court this duty has always had an objective element attached thereto. The development of the judicial review of the duty to act in the best interest of a company is further discussed in Chapter 4.3 of this dissertation

2.2.1. Contextualisation of '*the best interest*' of the company

In order to understand what is in the best interest of a company, one must understand what the primary interests of a company are. In this regard there are two main schools of corporate governance on the topic, namely profit maximisation as well as wealth and value creation.

With regard to profit maximization, Milton Friedman, a pioneer in this area and Nobel Laureate in Economics, stated that, 'there is only one social responsibility of business and that is to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud'.[46] The view expressed here is very clear that the only interest of business is to increase profits. Stated differently, the interest of business is profit maximization. Therefore, when a director acts in the best interest of a company, the *best interest* should only be to maximize profit. Friedman's view also states that companies do not have any social responsibility.[47] In addition, if such a responsibility exists then such a responsibility falls in line with the duty of government or regulators. In this regard, the view expresses that it is the duty of the government and regulators to impose taxes in accordance with the preferences and desires of the public.[48] This is the measure through which, according to Friedman, social interests should be regulated.

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[45] *Visser Sitrus (PTY) LTD v Goede Hoop Sitrus (PTY) LTD and Others 2014 (5) SA 179 (WCC)* para 25.

[46] Friedman M '*The social responsibility of Business is to increase its profits*' (1970) *The New York Times Magazine* available at http://umich.edu/~thecore/doc/Friedman.pdf (6 accessed on 29/05/2020).

[47] The World Bank defines corporate social responsibility as the 'commitment of business to managing and improving the economic, environmental and social implications of its activities at the firm, and local levels' see 'Corporate Social Responsibility Course Handbook' available at https://www.fasset.org.za/downloads/CSR_Handbook_Review.pdf (accessed on 02/06/2020).

[48] Friedman M '*The social responsibility of Business is to increase its profits*' (1970) 2.

Friedman also illustrates that where a director acts for the 'socially good', they always do so with someone else's money.[49] Essentially, where the director(s) efforts to be socially responsible result in, *inter alia* ; (a) a decrease of profits- shareholders' money is spent, (b) increase is product cost- customers' money is spent, (c) lower wages – employees' money is spent.[50] He proposes that the stockholders and shareholders, customers or the employees could be socially responsible themselves by spending their money in this regard – if they wished to do so. Friedman's view of profit maximisation clearly aligns itself with a shareholder centric theory of corporate governance. The Shareholder theory of corporate governance asserts that the managers of a firm or company are selected by the shareholders and thus their duty is to serve the shareholders.[51] This theory of corporate governance is often judged for its short-sightedness as well as critiqued for being too centered on short-term profit making to the detriment of long-term sustainability. Friedman's Profit Maximisation approach to business shares this same short-sightedness because it assumes that a director only has the duty to ensure the highest monetary value of company returns. This dissertation supports another view, which is that directors are responsible for company overall wealth and value creation.

2.2.2. **Wealth and Value Creation**

The wealth and value creation approach to business accounts for the Stakeholder theory of corporate governance. This theory of corporate governance emphasizes that managers and directors have the duty to both the corporation's shareholders as well as individuals and constituencies that contribute, either voluntarily or involuntarily, to the wealth-creating capacity and activities of the firm or company, and who are thus its potential beneficiaries and/or risk bearers.[52] Importantly, this not only takes into account those parties that contribute to the functions of a corporation, but also those who are vulnerable to corporate conduct. The modern world of corporate governance has had an increased shift from shareholder centric view of corporate governance to a stakeholder inclusive view of corporate governance. [53] This is ultimately due to the stakeholder approach being more likely to support the long-term growth and sustainability of a company. Essentially, this theory recognizes the impact that

[49] Friedman M '*The social responsibility of Business is to increase its profits'* (1970) 2.
[50] Friedman M '*The social responsibility of Business is to increase its profits'* (1970) 2.
[51] Smith HJ '*The Shareholders vs. Stakeholders debate'* (2003) *MIT Sloan Management review* 85.
[52] Smith HJ '*The Shareholders vs. Stakeholders debate'* (2003) *MIT Sloan Management review* 85.
[53] Smith HJ '*The Shareholders vs. Stakeholders debate'* (2003) *MIT Sloan Management review* 89.

shareholders as well as other key stakeholders have over the wealth and value of a business. In this regard, other key stakeholders include customers, employees, suppliers and the local community. The wealth and value creation approach to business amounts to a duty placed on directors to balance the interests of shareholders and other key stakeholders when taking an action. In essence, it requires directors to balance the need of profit maximisation together with other interests to ensure the long-term growth of the company. [54] In this regard, it is the consideration for the interests of other stakeholders which links itself to modern Corporate Social Responsibility.

2.2.3. <u>Corporate Social Responsibility and Related Concepts</u>

Under Corporate Social Responsibility (hereafter, CSR) companies are expected to take into consideration the interests of society at large and the environment when making business decisions. The World Bank defines CSR as the 'commitment of business to managing and improving the economic, environmental and social implications of its activities at the firm, and local levels'.[55] The World Business Council for Sustainability Development defines CSR as 'the continuing commitment by business to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as of the local community and society at large'. [56] CSR recognises that profit making is important for profit-businesses, but also recognises the importance of promoting social and environmental change. For CSR to be correctly implemented it must be internalised in the primary scope and mission of the business.

The concepts of corporate citizenship and corporate responsibility are akin to CSR and are described in similar ways to CSR. Corporate citizenship creates the legal fiction of a company as a person. [57] In this regard, companies can thus operate as either good or bad corporate citizens. Corporate citizenship takes into account factors and activities which contribute to company reputational building and good public relations.[58] Conversely, corporate

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[54] Smith HJ '*The Shareholders vs. Stakeholders debate*' (2003) *MIT Sloan Management review* 86.
[55] Naidoo R *'Corporate Governance: An Essential Guide for South African Companies'* 3rd ed (2016) 376.
[56] 'Corporate Social Responsibility Course Handbook' available at *https://www.fasset.org.za/downloads/CSR_Handbook_Review.pdf* (accessed on 02/06/2020) 3.
[57] Naidoo R *'Corporate Governance: An Essential Guide for South African Companies'* 3rd ed (2016) 379.
[58] Shiller B *'The Future of Progressive Business in Companies that are good, Not just doing good'*. Available at *https://www.fastcompany.com/3056482/the-future-of-progressivebusiness-is-companies-that-are-good-not-just-doing-good* (accessed on 03/06/2020).

responsibility is often described in terms of a company considering, managing and balancing the economic, social and environmental impacts of its activities.[59] In essence, it considers how companies assess and manage risks, pursue opportunities as well as create corporate value in areas beyond a company's primary business.[60]

These theories, along with CSR, clearly point out that for a company to remain profitable in the long run, it is not only required that the company serve a need in the market but also that they act as good citizens.[61] In this regard, it is expected that companies minimise their social and environmental harm, report on their impacts and act in a socially aware manner.

In addition to these concepts or theories another theory which takes into account social and environmental interests is Corporate Social Investment (hereafter, CSI). CSI appears to occasionally be used interchangeably with CSR. However, this is incorrect, CSI is merely an element of a company's CSR activities.[62] As stated previously, CSR is concerned with broader solutions to the economic, social and environmental impacts, which contribute to a corporation's overall profit. Alternatively, CSI is limited in the dimension of *investments*. CSI only encompasses projects which are external to the normal business activities of that company and is not directly for the purpose of increasing profits.[63]

The view expressed by Friedman that a company simply needs to focus on profit maximisation within the restraints of the law, is no longer appropriate in the modern world of business. Today the responsibility to ensure that a corporate entity is behaving socially and ethically responsible is an obligation that easily transcends the law into the realm of what is or is not acceptable activity or action by that company with reference to its social context.[64] In other words we don't just simply expect a company to follow the law, in addition, we also expect an active participation to contribute to economic, environmental and social change – within the course

[59] Kerr M, *et al* *'Corporate Social Responsibility- A Legal Analysis'* (2009) 23.
[60] Kerr M, *et al* *'Corporate Social Responsibility- A Legal Analysis'* (2009) 23.
[61] Shiller B *'The Future of Progressive Business in Companies that are good, Not just doing good'*. Accessed on *https://www.fastcompany.com/3056482/the-future-of-progressivebusiness-is-companies-that-are-good-not-just-doing-good* (03/06/2020).
[62] Naidoo R *'Corporate Governance: An Essential Guide for South African Companies'* 3rd ed (2016) 377.
[63] *'Corporate Social Investments Solutions'* available at *http://www.csisolutions.co.za/why-csi.php* (accessed on 02/06/2020).
[64] Werksmans *'Corporate Social Responsibility as a legal obligation in South Africa'* available at *https://www.werksmans.com/legal-updates-and-opinions/whats-really-right-corporate-social-responsibility-as-a-legal-obligation-in-south-africa/* (accessed on 16/06/2020).

of its profit making.[65] Essentially, this means that the interests of companies are extended beyond the scope of profit maximization. The modern understanding of the interest of a company leans towards wealth and value creation. This approach is clear, given the multiplicity of theories directed at a firm or company taking into consideration economic, environmental and social impacts – in the ordinary course of business.

2.2.4. <u>Contextualisation of 'the company'</u>

The duty of a director to act in the best interest of a company only extends itself to the scope of what a company is. Therefore, in order to understand the scope of the duty, one has to have an idea of what a company is. S76 (3) (b) of the Companies Act specifically states that 'the director has the duty to serve the best interests of the company'.[66] Whilst the Companies Act does define a company as a juristic person, this definition provides little clarity as to the contextual nature of a company.[67] Historically the common law definition for 'company', referred to the collective body of shareholders.[68] Cassim *et al* echoes that the basic goal of the directors of a company is the success of the company *and* the collective best interests of the shareholders of the company.[69] The interpretation of a company in this manner perpetuates a system of corporate governance which favours the interests of company shareholders over other stakeholders.[70] Shareholder privilege should not exist to the extent of excluding other interests. The common law definition of a company, being the collective body of shareholders, is an archaic ideal compared to the current theory of corporate governance. In essence, it no longer accurately reflects society's standards of corporate governance and accountability.

When developing the Companies Act, the developers therefore looked to *'South African Company Law for the 21st Century: Guidelines for Corporate Law Reform'* (May 2004), a

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65 Shiller B *'The Future of Progressive Business in Companies that are good, Not just doing good'* available at https://www.fastcompany.com/3056482/the-future-of-progressivebusiness-is-companies-that-are-good-not-just-doing-good (accessed on 03/06/2020).
66 The Companies Act, section 76(3)(b).
67 The Companies Act, section 1.
68 Cassim et al *Contemporary Company law* 2 ed (2012) 515.
69 Cassim et al *Contemporary Company law* 2 ed (2012) 514.
70 'Other stakeholders' refers to other parties who can affect or are affected by the achievement of a company's objectives such as creditors, employees, suppliers, customers and the local community *inter alia.* ; Muswaka L *'A Critical Analysis of the Protection of Stakeholders' Interests under the South African Companies Act: (Part 2)'* (2014) *Mediterranean Journal of Social Sciences* 70.

policy document developed by the Department of Trade and Industry (hereafter, the DTI).[71] This document recognised the need to bring South African law in line with international trends and in doing so, introduced protection of the interests of various stakeholders.[72] It is clearly stated in the policy document that 'a company should have as its objective the conduct of business activities with a view to enhancing the economic success of the corporation, taking into account, as appropriate, the legitimate interests of other stakeholder constituencies'.[73] Therefore, in understanding the wording of section s76(3)(b) of the Companies Act, one cannot automatically dismiss the protection of other stakeholder interests.

There are many other obvious signs of a shift from a shareholder centric governance of a company to a stakeholder focused governance. Examples of such efforts include the Companies Act requiring the establishment of a Social and Ethics Committee, thereby taking into account the interests of other stakeholders.[74] The King reports on corporate governance also makes it clear that the stakeholder approach is to be followed. This is evidenced from the recognition of economic, environmental and social concerns addressed in the reports.[75] In addition there are a multiplicity of other legislative measures protecting the interest of stakeholders, such as the Broad Based Black Economic Empowerment Act, the Employment Equity Act?, Mineral and Petroleum Resources Development Act, the Mining Charter as well as many others.[76] The interpretation of s76(3)(b) should therefore include the current view of a company - which includes the balancing of shareholders' and other stakeholders' interests.

2.2.5. <u>**The link between good faith and the duty to act in the best interest of a company**</u>

A director occupies a fiduciary position in relation to the company. [77] This fiduciary position requires the director to exercise a power given, in line with all the fiduciary duties in terms of

[71] Department of Trade and Industry *'The Companies Act, no. 71 of 2008: An explanatory guide'* (2010) 6.
[72] Policy Document Department of Trade and Industry '*The Guidelines for Corporate Law Reform, South African Company Law Reform for a 21st Century'* (2004) 6.
[73] Policy Document Department of Trade and Industry '*The Guidelines for Corporate Law Reform, South African Company Law Reform for a 21st Century'* (2004) 8.
[74] Muswaka L *'A Critical Analysis of the Protection of Stakeholders' Interests under the South African Companies Act: (Part 2)'* (2014) *Mediterranean Journal of Social Sciences* ,69.
[75] Naidoo R *'Corporate Governance: An Essential Guide for South African Companies'* 3 ed (2016) 379.
[76] Further discussion of the impact of these legislative measures on company law is beyond the scope of this paper.
[77] *Visser Sitrus (PTY) LTD v Goede Hoop Sitrus (PTY) LTD and Others,* 2014 (5) SA 179 (WCC) para 58.

both common law and statutory law.[78] Under common law, the director is required to, *inter alia*, exercise their powers *bona fide* and in the best interest of a company as well as exercise their powers for the purpose for which the power was conferred.[79] In this regard, it is a well-established rule of common law that directors have a fiduciary duty to exercise their powers in good faith and in the best interests of the company.[80] This long-standing rule at common law inextricably links good faith to acting in the best interest of the company. Generally, good faith depends largely on honesty – which is subjective.[81] In essence, a breach of this duty consequently requires a subjective awareness of wrongdoing. Interestingly, the Companies Act does not link good faith to acting in the best interest of a company. The Companies Act separates the duty from acting in the best interest of a company and couples it with acting for a proper purpose in s76 (3) (a).[82] In effect, in terms of the companies act, the duty to act in good faith has been separated from its counterpart and now linked to acting with a proper purpose, this removes the impact that the BJR has on the duty to act in good faith at a statutory level. In essence, a director cannot rely on the BJR to escape liability when failing their statutory duty to act in good faith and for a proper purpose – as it falls outside the scope of the application of the BJR. The glaring absence of good faith is further discussed in chapter 3.4.2.iv.

2.3. <u>The Duty of Care, Skill and Diligence</u>

The development of the duty of care and skill of directors under South African common law has been consistent with the development thereof under English law. [83] The duty of care, skill and diligence in South Africa is directly linked to the South African BJR. [84] Conceptually, the formulation of the BJR was intended to give relief to the duty of care, skill and diligence. The BJR was first considered in the 1994 King Report on Corporate Governance as a recommendation to amend the Companies Act, to provide a statutory limitation on a director's

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[78] *Visser Sitrus (PTY) LTD v Goede Hoop Sitrus (PTY) LTD and Others*, para 58.
[79] *Visser Sitrus (PTY) LTD v Goede Hoop Sitrus (PTY) LTD and Others*, para 58.
[80] Contemporary company law page 523-4.
[81] Contemporary company law 524
[82] The companies act s76 (3) (a)
[83] Mupangavanhu BM. '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* 63(1) 110.
[84] Muswaka L 'Directors Duties and the Business Judgement Rule in South African Company Law: An Analysis' (2013) *International journal of humanities and Social Science* 90.

duty of care and skill. This recommendation was criticized for being founded on the false interpretation of the duty of care and skill at common law.[85] In essence, King *I* regarded the duty as onerous and thus requiring a limitation. A burdensome interpretation of the duty is challenging to conceive, especially through the impression created by the *Fisheries case* – which effectively summarised the common law position. Once incorporated into the Companies Act, this duty has remained a topic of controversy. S76(3)(c) provides for the partial codification of this duty. Due to the duty of care, skill and diligence being deeply rooted in English law, this dissertation follows a discussion of its English Law origins. Thereafter, the formulations of the duty in South African common law will be discussed as well as its partial codification through the Companies Act.

2.3.1. <u>English common law</u>

Under English law, the case of *Re City Equitable Fire Insurance Co Ltd* (hereafter *Re City*) is commonly regarded as the landmark case for the standard of the duty of care and skill of a director. The Court herein, articulated three principles to be followed when looking at the duty of care and skill of a director. The first principle is that a director is not required to exhibit in the performance of his duties a greater degree of skill than may reasonably be expected from a person of their knowledge and experience.[86] This principle is highly subjective in nature and consequently has always been criticized as operating as a bias towards an inexperienced director.[87] This is because the director in theory is tested against a person with *his* knowledge and *his* experience. Consequently, an inexperienced director would be subjected to a lower standard and duty, whereas the more experienced director is subjected to a higher standard and has a greater potential and risk of being held liable for the breach of the duty of care and skill. The second principle established by the court in *Re City* is that a director will not be bound to give continuous attention to the affairs of the company. This principle enforces the intermittent nature of a director's duties. In other words, the duties of directors were regarded as intermittent in nature and only exercised periodically at general board meetings.[88] This principle seems only applicable to what is commonly regarded as a non-executive director. In other words, a

[85] Muswaka L 'Directors Duties and the Business Judgement Rule in South African Company Law: An Analysis' (2013) *International journal of humanities and Social Science* 90.
[86] Cassim et al *Contemporary Company law* 2 ed (2012) 557.
[87] Cassim et al *Contemporary Company law* 2 ed (2012) 556.
[88] Cassim et al *Contemporary Company law* 2 ed (2012) 557.

director who has no executive powers in the company and who is only called on periodically to vote on certain decisions. The third principle established is that a director, where his duties may properly be left to another, is allowed to delegate these duties and may be justified in trusting the delegated individual in the absence of suspicion.[89] These English law principles discussed by the court in *Re City* are the basis and the origin of the duty of care and skill in South African common law.

2.3.2. <u>South African common law</u>

The South African common law position regarding the directors' duty of care and skill was discussed and summarised by Margo J in the case of *Fisheries Development Corporation of SA Ltd v Jorgensen & Another; Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd & Others* (hereafter *Fisheries*).[90] The court in the *Fisheries* judgement relied heavily on the three principles already established in the *Re City case*.[91]

i. ***<u>Executive and non-executive directors</u>***

It appears that there has always been a desire to differentiate between an executive and non-executive director for the purposes of liability. The court in *Fisheries* begins by affirming that the extent of a director's duty of care and skill will depend on the nature of the company's business and the obligations assumed or assigned to the director.[92] The Court thereafter continues into a discussion of the distinction '*needed*' to be drawn between a full-time director and a non-executive director. [93] The former is usually responsible for the day-to-day management of the company, whilst the latter exercises their duties intermittently.[94] This creates the impression that a full-time director must exercise a greater duty of care and skill

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[89] Cassim et al *Contemporary Company law* 2 ed (2012) 557.

[90] *Fisheries Development Corporation of SA Ltd v Jorgensen & Another; Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd & Others*.

[91] *Fisheries Development Corporation of SA Ltd v Jorgensen & Another; Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd & Others* 165-166.

[92] *Fisheries Development Corporation of SA Ltd v Jorgensen & Another; Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd & Others* 165.

[93] *Fisheries Development Corporation of SA Ltd v Jorgensen & Another; Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd & Others* 165.

[94] *Fisheries Development Corporation of SA Ltd v Jorgensen & Another; Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd & Others* 165.

than a non-executive director.[95] In *obiter* in *Howard v Herrigel NO and Another,*[96] the court stated that the distinction made by the *Fisheries* court in relation to the duties of executive and non-executive directors is 'misleading'.[97] The Court proposed that the legal rules are the same for all directors, regardless of whether they are executive or non-executive directors. It is generally agreed upon that the extent of a director's duties is dependent on numerous factors, including the nature of the company's business and the obligations assumed or assigned to that director. Therefore, the extent of a director's duties would consequently differ from director to director. In effect, two 'executive' directors would owe the company duties to different extent. Whilst their duties differ, the legal rules of how they conduct those duties remains the same. This makes the task of differentiating between executive and non-executive directors, for purposes of liability, meaningless.

ii. ***Duty of care and skill – Through the Fisheries case***

In setting out the common law standard of the duty of care and skill, Margo J in *Fisheries* makes it clear that the test for the duty of care and skill of a director is a very lenient one. In this regard, it was stated that a director is only expected to exercise the care which can reasonably be expected of a person with *his* knowledge and *his* experience. [98] Due to the inclusion of 'reasonably', the test appears to be a dual subjective-objective test. However, the nature of this test is single legged or limbed and the emphasis of 'his knowledge' and 'his experience' negates any objective element that the test might have. In other words, the standard of reasonability is directly limited to 'his knowledge and 'his experience'. Therefore, the more inexperienced or incompetent a director was, the lower the standard of care expected of them.[99] There appears to be no effective minimum threshold.

Consequently, the effect thereof is a common law standard of the duty which allows for a lot of slack in holding directors accountable. This lax approach in holding directors accountable is simply a result of directly adopting the lax principles of English common law. The principles

95 *Fisheries Development Corporation of SA Ltd v Jorgensen & Another; Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd & Others* p165.
96 *Howard v Herrigel NNO* (1991) (2) SA 660 (A).
97 *Howard v Herrigel NNO* (1991) (2) SA 660 (A)58.
98 *Fisheries Development Corporation of SA Ltd v Jorgensen & Another; Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd & Others 166*.
99 Cassim *et al* 'Contemporary Company law 2nd edition' (2012), 555.

expressed by the *Fisheries* court are lax in holding directors accountable due to the adopted English common law principles being founded on the rationale that shareholders should be responsible for the competence or incompetence of managers or directors – appointed by them.[100] Therefore, the principles are originally aimed at holding shareholders accountable for unwise appointments rather than holding directors accountable for unwise decision-making.[101]

Many authors criticize the standard of the duty of care and skill at common law. Authors such as Finch argue that the common law operates in a manner that gives directors a remarkable freedom to run companies incompetently.[102] Gower also states that 'the common law duties of care, skill and diligence are admittedly lax'.[103] Mupangavanhu also expresses that the common law duty of care and skill is 'overly lenient'.[104] It has also been stated that '[t]he common-law standard of care imposed … is manifestly inadequate in modern times to protect shareholders from carelessness and negligence of directors of a company'.[105] To illustrate how lenient the duty of care and skill is at common law, *Niagara v Langerman & Others*[106] is (currently) the only reported case wherein a director was held liable for the breach of the duty of care and skill at common law.[107]

2.3.3. English Statutory law

The UK Companies Act 2006 has codified the duty of care, skill and diligence in line with the recommendations of the Law Commission.[108] The duty to exercise reasonable care, skill and diligence in s174 of the UK Companies Act provides that:

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[100] Bouman N 'An appraisal of the modification of the directors' duty of care and skill' (2009) *South African Mercantile Law Journal* 511-512.

[101] Cassim *et al* 'Contemporary Company law 2nd edition' (2012), 555.; Bouman N 'An appraisal of the modification of the directors' duty of care and skill' (2009) *South African Mercantile Law Journal* 511-512.

[102] Finch V 'Who still cares about skill and care' *Modern Law Review* (1992) 179.

[103] Gower LC *Gowers Modern Company law,* 5 ed (1992) 589.

[104] Mupangavanhu BM '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* 111.

[105] Cassim et al *Contemporary Company law* 2 ed (2012) 558.

[106] *Niagara Ltd (in liquidation) v Langerman & Others* 1913 WLD 188.

[107] Bouman N 'An appraisal of the modification of the directors' duty of care and skill' (2009) *South African Mercantile Law Journal* 526.

[108] See 'The Law Commission and Scottish Law Commission' 5.38. In terms whereof the specific recommendation regarding the duty of care was as follows:
―To summarise, our recommendations under this Part are (1) that a director's duty of care, skill and diligence to
his company should be set out in statute; (2) that the standard should be judged by a two-fold objective/subjective test; (3) that regard should be had to the functions of the particular director and the

> '(1) A director of a company must exercise reasonable care, skill and diligence (2) This means the care, skill and diligence that would be exercised by a reasonably
> diligent person with- (a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company, and (b) the general knowledge, skill and experience that the director has.'[109]

These provisions clearly provide for a dual objective-subjective approach. In other words, the duty has two legs or limbs. Subsection (2)(a) sets a standard which all directors must meet. In essence, the standard under this leg or limb is not reliant on the directors' specific capabilities.[110] In other words, this is a minimum irreducible objective standard which all company directors are expected to meet. Subsection (2)(b) adds a subjective standard that accounts for the specific characteristics of the director(s) whose conduct is under scrutiny.[111] The subjective elements do not operate to lower the minimum objective standard. In other words, subsection (2)(b) only operates to enhance the application of the objective standard.[112] On observation, subsection (2)(b) operates to increase the level of care required of the director.[113] To illustrate, this is achievable through requiring the director to utilise the specific set of skills they might have – in addition to meeting the minimum objective standard required of all directors.[114]

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circumstances of the company; and (4) that there should not be a statutory business judgment rule or statutory provisions dealing with delegation of a director's powers to others or reliance on information provided by others‖. Mupangavanhu BM '*Standard of Conduct or Standard of Review? Examination of an African Business Judgment Rule under South Africa's Companies Act 71 of 2008'* (2019), 71.

109 The English law UK Companies Act of 2006, s174.

110 Davies Gower and Davies' Principles of Modern Company Law, 435; see Mupangavanhu BM '*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'* (2016) (published) LLD thesis,71.

111Dignam Hicks & Goo's *Cases & Materials on Company Law*, 392; see Mupangavanhu BM '*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'* (2016) (published) LLD thesis,71.

112 Dignam Hicks & Goo's *Cases & Materials on Company Law* 392-3; see Mupangavanhu BM '*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'* (2016) (published) LLD thesis,71.

113 Davies Gower & Davies Principles of *Modern Company Law* 435; see Mupangavanhu BM '*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'* (2016) (published) LLD thesis,72.

114 Mupangavanhu BM '*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'* (2016) (published) LLD thesis,72.

2.3.4. South African statutory law

The Companies Act 71 of 2008, provides for the partial codification of the duty of care, skill and diligence contained in s76(3)(c) of the Act.[115]

S76(3) provides that:

> "a director of a company, when acting in that capacity must exercise the powers and perform the functions of director (c) with the degree of care, skill and diligence that may reasonably be expected of a person – (i) carrying out the same functions in relation to the company as those carried out by that director; and (ii) having the general knowledge, skill and experience of that director."[116]

i. ***The inclusion of 'diligence'***

S76(3) provides the test for care, skill and *diligence* (emphasis added). Diligence has never been part of the duty under South African common law. Diligence is argued to have been derived directly from Australian law.[117] In this regard, diligence requires they ensure that they become sufficiently informed about the situation at hand prior to taking action and in doing so they can be in compliance with the duty of care, provided that the manner in which they became informed is the same as the manner in which a reasonable person would have become informed.[118]

It is argued by the authors of *Contemporary Company Law 2nd Edition* that diligence means the proper attendance to one's duties, which naturally *inter alia* requires a director to regularly attend board meetings.[119] It is also argued that failure to regularly attend board meetings and other mandatory events could result in the director's failure to exercise reasonable care and diligence. However, no irrevocable certainty can exist as to the implication or purpose of diligence in s76(3). This is because it is not defined by the legislature and has not been presented to court for determination. It is likely that if it comes before a court, it might be given

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[115] The Companies Act 71 of 2008.

[116] The Companies Act 71 of 2008, section 73(3)(c).

[117] Du Plessis J '*A comparative analysis of directors' duty of care, skill and diligence in South Africa and in Australia'* (2010) *ActaJuridica* 263

[118] Kershaw D *Company Law in Context: Text and Materials* 2ed (2012) 444.

[119] Cassim et al *Contemporary Company law* 2 ed (2012) 560.

a meaning which accords with the English law case of *Re Barings plc,*[120] wherein it was stated that directors may be required to understand the company's business and maintain that knowledge and understanding, failing which that director could be liable for failure to act diligently.[121] Importantly, the term diligence relates quite closely to the term *due diligence* which is used frequently by legal practitioners.[122] In practice, due diligence (in relation to a company) means that the legal practitioner will conduct research on the company by meeting with the employees and management in order to assess the company, its operations and finances.[123] Similarly, if one were to apply this term in the context of directors, it simply means that directors are required to thoroughly investigate the implications of their decisions, prior to making a final decision which could impact the company.[124]

ii. ***The objective-subjective approach of the duty of care, skill and diligence***

The South African Companies Act 2008, like the UK Companies Act also adopted a dual objective-subjective standard to the duty of care, skill and diligence contained in s76(3)(c) of the South African Companies Act. The first leg of the standard requires a director to act reasonably. This is clearly an objective standard of a reasonable person and not that of a reasonable director.[125] This leg, like the UK Companies Act, is an irreducible objective standard which all company directors are required to meet. However, this reasonable person has the general knowledge, skill and experience of the director whom he is tested against. Therefore, the second leg of the test imposes a subjective standard. In essence, S76(3)(c) operates in a manner where the minimum standard is that a director must act reasonably. However, if the director has a special skill, is more experienced or possesses a greater

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120 *Re Barings plc* (NO.5) [1999] 1 BCLC 433.

121 Mupangavanhu BM 'Standard of Conduct or Standard of Review? Examination of an African Business Judgment Rule under South Africa's Companies Act 71 of 2008' (2019) 126.

122 National Paralegal College ‗The Duty of Care' available at http://nationalparalegal.edu/public_documents/courseware_asp_files/businessLaw/Directors&Officers/DutyOfCare.asp (accessed on 06/07/2021).

123 National Paralegal College ‗The Duty of Care' available at http://nationalparalegal.edu/public_documents/courseware_asp_files/businessLaw/Directors&Officers/DutyOfCare.asp (accessed on 06/07/2021); see also Smit I '*The application of the Business Judgment Rule in fundamental transactions and insolvent trading in South Africa: foreign precedents and local choices'*, 86.

124 Smit I '*The application of the Business Judgment Rule in fundamental transactions and insolvent trading in South Africa: foreign precedents and local choices'*, 86.

125 Cassim et al *Contemporary Company law* 2 ed (2012) 559.

knowledge then the director will be subjected to a higher standard – based on this subjective element.

To illustrate, the director is tested against a hypothetical person of the same potential and ability. This person, at a minimum, is still required to have acted reasonably. S76(3)(c) provides for a dual subjective-objective standard, because it still imposes that the director's skill, knowledge and experience be considered as subjective factors. This new standard, set by statutory law, is slightly more demanding than it was at common law. This new standard when compared to its common law counterpart is considered by academics to be a more accurate reflection of modern commercial practice.[126]

The common law version of the duty of care and skill does not appear to have a minimum basis for a director's conduct. Due to the new statutory law standard requiring at a minimum for a director to act reasonably, this creates a new subjective-objective standard. It is often argued that it is this new statutory objective-subjective approach to the duty of care, skill and diligence, has contributed to the adoption of the South African BJR and alludes to the idea that it was introduced to soften the effect of the objective element.[127]

2.4. Conclusion

If a director complies with the requirements of the BJR found in s76(4) of the Companies Act, they may escape liability for failing to act in the best interest of a company and/or acting with the necessary degree of skill care and diligence – as codified by s76(3)(b) and s76(3)(c) of the Companies Act. Therefore, this chapter was aimed at providing a general overview of these duties.

The duty to act in the best interest of a company entails that the director(s), when acting in the capacity of a director, must exercise their duties' and perform their functions in the best interest of the company. The duty requires the director *not* to act in a manner which defeats or harms the interest of a company. The director must also *not* act with their own financial interests in mind – if a director has a personal financial interest, they must disclose this financial interest

[126] Cassim et al *Contemporary Company law* 2 ed (2012) 558.
[127] Kanamugire JC & Chimuka TV 'The Director's duty to exercise care and skill in Contemporary South African Company law and the Business Judgement Rule' (2014) 1(20) *Mediterranean Journal of Social Sciences* 74.

in terms of s75 of the Companies Act. The test for deciding the best interest of the company is generally a subjective test, due to the decision as to what is regarded as the best interest of a company being left in the hands of the director(s). However, the judicial review thereof has always had an objective element thereto. The review of the duty to act in the best interest is directly linked to the BJR in s76(4)(a)(iii) of the Companies Act. This link illustrates the overall link between standards of conduct and standards of review – which is discussed in greater detail in Chapter 4.2 of this dissertation. The judicial review of the duty to act in the best interest of a company is also dealt with in Chapter 4.3 of this dissertation.

To understand what acting in the best interest of a company means, one must consider two factors- namely what is meant by 'best interest' and what is meant by 'the company'.

As previously stated, in relation to the best interest of the company, two main theories of corporate governance exist, namely, profit maximization as well as wealth and value creation. The long-standing theory of profit maximization is a shareholder centric form of corporate governance, whereby directors are only tasked to act in the best interest of the company by increasing its profits. Profit maximization is often judged for its short-sightedness and often critiqued for being centered on short-term profit making to the detriment of long-term sustainability. This theory feels out of touch with the current world of corporate governance. The current world of corporate governance considers shareholders' interests as well as the interests of the economy, society and environment. Therefore, the preferred theory is wealth and value creation. This theory considers all factors which contribute to the wealth-creating ability of the firm or company by balancing the interests of shareholders and all other stakeholders when making a decision. In essence the best interests of a company are value and wealth creation. Therefore, when directors make decisions, they should do so to increase the value and wealth of the company.

In relation to what is meant by 'the company', the current law relating thereto indicates that a company is generally the collective body of shareholders. This is an archaic ideal which needs to be evolved. This chapter has also clearly illustrated the multiplicity of surrounding factors alluding to the idea of a company including all other key stakeholders.

Thus, when a director acts in the best interest of a company, the director must act to increase the value and wealth of the company by balancing the interests of shareholders and all other key stakeholders.

The duty to act in the best interest of a company has undergone some changes. Historically, under common law it was always inextricably linked to good faith. S76(3)(a) of the companies act, separates the duty from acting in the best interest of a company and couples it with the duty of acting for a proper purpose. The effect hereof is that the BJR cannot be relied upon to escape the statutory duty found at s76(3)(a) of the Companies Act- the duty to act in good faith and for a proper purpose. This view is supported by the absence of the duty to act in good faith from the South African formulation of the BJR in terms of s76(4) of the Companies Act – further discussed in Chapter 3.4.2.iv of this dissertation.

Like the duty to act in the best interest of a company, the duty of care, skill and diligence has also undergone some changes. The duty of care and skill of directors, under South African common law has been consistent with the common law development thereof under English law. In this regard, the common law principles relating to the duty of care and skill are directly adopted from the English law case of *Re City*. The common law version of the duty of care and skill is best articulated by the court in *Fisheries*. In setting out the common law standard of the duty of care and skill, Margo J in *Fisheries* makes it clear that the test for the duty of care and skill of a director is a mostly subjective test. In this regard, it was stated that a director is only expected to exercise the care which can reasonably be expected of a person with '*his* knowledge' and '*his* experience'. This has created a very lax approach in holding directors accountable. The Companies Act 71 of 2008, provides for the partial codification of the duty of care, skill and diligence contained in s76(3)(c) of the Act. S76(3) provides that "a director of a company, when acting in that capacity must exercise the powers and perform the functions of director (c) with the degree of care, skill and diligence that may reasonably be expected of a person – (i) carrying out the same functions in relation to the company as those carried out by that director; and (ii) having the general knowledge, skill and experience of that director."[128] The test set out by s76(3)(c) has two clearly defined legs. The first leg of the standard requires a director to act reasonably, which is an objective standard and irreducible in nature. The second leg is a subjective standard and takes into account the general knowledge, skill and experience of the director. It is often argued that it is this new statutory objective-subjective approach to the duty of care, skill and diligence, has contributed to the adoption of the South African BJR and alludes to the idea that it was introduced to soften the effect of the objective element.

[128] The Companies Act 71 of 2008, section 73(3)(c).

This chapter has provided the general overview of the duties upon which the BJR may be relied upon to escape liability for failure to comply. In this regard it forms the foundation for the discussion of the BJR. Chapter 3 engages in a general overview of the BJR in the USA, Australia and South Africa.

CHAPTER THREE – FORMULATIONS OF THE BUSINESS JUDGMENT RULE

3.1. Introduction

As stated previously, the nature of a company is that of an artificial juristic person – as such it has to conduct its affairs through representatives.[129] In this regard, the company representatives are the board of directors, who are entrusted with the management of the company's affairs.[130] It is also generally understood that directors exercise a measure of judgement and risk-taking inherent in their daily decision-making. Therefore, it is important that the board of directors be granted limited freedom in the company to perform their tasks effectively.[131] Despite the board's good intentions or the integrity of the decision-making process, a corporate decision made by the board may have disastrous results. In this scenario, the Business Judgement Rule (hereafter, BJR) could apply to protect honest directors against liability where due care processes were followed.

Chapter 2 provided for a general overview of the statutory duties found in s76(3)(b) and s76(3)(c) of the Companies Act– to which the BJR may apply where the director has failed one or both duties. The main aim of this Chapter is to provide a general overview of the formulations of the BJR in the USA and Australia. Thereafter, this Chapter will provide a general overview of the South African formulation, its requirements as well as the glaring absence of the good faith requirement in the South African formulation.

3.2. The background of the BJR

The understanding of what is meant by 'business judgment rule' has been quite elusive. This is due to the rule continuously evolving and taking on fresh meanings to fit the context.[132] As a result, there is a large amount of uncertainty surrounding the BJR. Historically, academics and the judiciary have spent their efforts in attempting to understand the underlying policy

129 Cassim et al *Contemporary Company Law* 2 ed (2012) 187.
130 Havenga 'Corporate Opportunities: A South African Update (part 1)' (1996) 8 SA *Mercantile Law Journal* 66.
131 Kennedy-Good S and Coetzee L 'The Business Judgment Rule (Part 1)' (2006) 27(1) *Obiter* 63.
132 Duesenburg R 'The Business Judgment Rule and Shareholder Derivative Suits: A View from the inside '(1982) 60 *Washington University Law Review* 311.

justifications, the correct theoretical formulation as well as the correct practical application of the BJR – resulting in a multiplicity of theories.[133] In effect, a rule initially designed to be straightforward, has now become one which academics and judiciaries battle to understand.[134] Despite the uncertainty surrounding the rule, it is continuously adopted in various countries.[135] The BJR originated in the United States of America (hereafter, USA) and was developed alongside their duty of care.[136] Australia was one of the first countries to codify the rule into their commercial law. South Africa also has a codified version of the BJR, in terms of s76(4)(a) of the Companies Act.

An all-encompassing rationale behind the adoption of the BJR is that it provides great potential benefit to an economy and commercial practice. This general perception comes from analysing a plethora of policy rationales for adopting the BJR, which includes that it is known to encourage risk-taking; persuade competent persons to undertake office of director; permits effective market mechanisms to manage director behaviour; prevents judicial second-guessing and avoids shareholder management in the corporation.[137]

In terms of the risk-taking purpose of the BJR, it functions under the impression that business decisions inherently require the undertaking of risk. This also alludes to the conceived idea that – greater risk in business decisions can result in a greater yield of benefit to the firm or company. As such, the BJR exists to grant directors certain discretion and allows the company to determine its appetite for risk.[138] Essentially, without the existence of the rule, the court would be indirectly determining the risk level of various companies.[139] In effect, BJR functions as a tool that encourages optimal risk-taking by directors without the risk of stifling innovation and venture of some business activity.[140]

[133] National Paralegal College 'The Business Judgment Rule' available at http://nationalparalegal.edu/public_documents/courseware_asp_files/businessLaw/Directors&Officers/BusinessJudgmentRule.asp (accessed 06/07/2021).
[134] Durckheim L *Does South Africa Need a Statutory Business Judgment Rule* (published LLM thesis, University of Pretoria, 2012) 13.
[135] Durckheim L *Does South Africa Need a Statutory Business Judgment Rule* (published LLM thesis, University of Pretoria, 2012) 16.
[136] Kennedy-Good S and Coetzee L 'The Business Judgment Rule (Part 1)' (2006) 27(1) *Obiter* 64.
[137] These purposes are discussed by Kennedy-Good S and Coetzee L 'The Business Judgment Rule (Part 1)' (2006) 27(1) *Obiter* 65 -66.
[138] Kennedy-Good S and Coetzee L 'The Business Judgment Rule (Part 1)' (2006) 27(1) *Obiter* 65.
[139] Kennedy-Good S and Coetzee L 'The Business Judgment Rule (Part 1)' (2006) 27(1) *Obiter* 65.
[140] Mupangavanhu BM 'Standard of Conduct or Standard of Review? Examination of an African Business Judgement Rule under South Africa's Companies Act 71 of 2008' (2019)63(1) *Journal of African Law* 132.

The application of the BJR has the likelihood of persuading a competent person to undertake the office of director – without the fear of being liable for ordinary business decisions that yield unfavourable results.[141] The BJR may also serve the purpose of permitting effective market mechanisms to manage the director(s) actions.[142] This is premised on the basis that if it were not for the BJR, ordinary negligence standards would be implemented – resulting in an increase of directors being held liable for decisions taken which yielded unfavourable results.[143]

In addition, the BJR prevents judicial second-guessing. This rationale is premised on the understanding that whilst judges have legal qualifications and experience in the field of legal practice – they generally lack business skill and expertise.[144] This rationale was echoed in *Ben-Tovim v Ben-Tovim and others,* where the South African court made it clear that it is not part of judicial policy to second-guess the business decisions of company directors.[145] In addition, when judges preside over a case they do so through the lens of hindsight bias. Hindsight bias is best understood through the decision in *re Citigroup Inc. Shareholder Derivative Litigation*[146] where the court remarked as follows:

> 'There is a substantial risk that suing shareholders and reviewing judges will be unable to distinguish between competent and negligent management because bad outcomes often will be regarded ex-post, as having been foreseeable and, therefore, preventable ex ante. If liability results from bad outcomes, without regard to the ex-ante quality of the decision or the decision-making process, managers will be discouraged from taking risks.'[147]

It was also stated in *Brehm v Eisner*[148] that if judges failed to respect the decisions of the directors that were made in good faith it would have the effect of the courts becoming super-directors.[149] Generally it is understood that the BJR has the effect of ensuring that decisions

[141] Block, Barton and Radin 'The Buisness Judgement Rule: Fiduciary Duties of Corporate Directors' and Officers*'* (1987) 42 *The Business lawyer* 995.
[142] Kennedy-Good S and Coetzee L 'The Business Judgment Rule (Part 1)' (2006) 27(1) *Obiter* 65.
[143] Kennedy-Good S and Coetzee L 'The Business Judgment Rule (Part 1)' (2006) 27(1) *Obiter* 65.
[144] Kennedy-Good S and Coetzee L 'The Business Judgment Rule (Part 1)' (2006) 27(1) *Obiter* 65.
[145] *Ben-Tovim v Ben-Tovim and others* 2001 (3) SA 1074 (CPD); Mupangavanhu BM 'Standard of Conduct or Standard of Review? Examination of an African Business Judgement Rule under South Africa's Companies Act 71 of 2008' (2019)63(1) *Journal of African Law* 139.
[146] *re Citigroup Inc. Shareholder Derivative Litigation,* 964 A.2d 106, 126 (Del. Ch. 2009)
[147] *re Citigroup Inc. Shareholder Derivative Litigation*, 964 A.2d 106, 126 (Del. Ch. 2009)
[148] *Brehm v Eisner* 746 A.2d 244 (del. Supr. 2000)226.
[149] *Brehm v Eisner* 746 A.2d 244 (del. Supr. 2000)226 ; Kennedy-Good S and Coetzee L 'The Business Judgment Rule (Part 1)' (2006) 27(1) *Obiter* 65.

made by directors, in good faith, are protected even though *in retrospect* they may prove to be unsound or yield unfavourable results.[150]

The BJR can also serve the purpose of preventing shareholders from managing the company. In this regard, the rule functions on the contention that if it were not for the BJR, shareholders would litigate more frequently with the effect of controlling decisions of directors. With the rule in place, shareholders will take caution (in light of costs of a suit) before implementing claims against a director.[151] This purpose ties in with the idea that the affairs of a corporation should be managed by or under the direction of its board of directors and thus the BJR exists to protect and promote the full and free exercise of the managerial power granted to directors.

Whilst there are many other policy rationales for the adoption of the BJR, the general impression (as stated previously) is that the BJR is being adopted by countries due to its potential benefit to the economy and overall commercial practice.

This chapter will discuss the existence of the BJR in the USA, Australia and South Africa. In this regard it will follow an overview of the two formulations found in the USA as well as the Australian formulation. The BJR as it exists in South Africa will also be examined with an overview of its requirements, followed by a critique of the absence of good faith as a requirement under the South African BJR.

3.3. An overview of the USA BJR

The BJR was founded in the USA in the 19th century, with the initial objective of limiting litigation and judicial scrutiny in respect of decisions that are taken within the private business sector.[152] In this regard, it functions as a rule of restraint that prevents a court from interfering in honest and reasonable business decisions of the directors of the company.[153] Generally directors would be protected if they meet their fiduciary obligations in the form of 'triads' or

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150 Mupangavanhu BM 'Standard of Conduct or Standard of Review? Examination of an African Business Judgement Rule under South Africa's Companies Act 71 of 2008' (2019)63(1) *Journal of African Law* 132.
151 Kennedy-Good S and Coetzee L 'The Business Judgment Rule (Part 1)' (2006) 27(1) *Obiter* 65.
152 Kennedy-Good S and Coetzee L 'The Business Judgment Rule (Part 1)' (2006) 27(1) *Obiter* 64; Leach J 'The Correct Understanding of the Business Judgment Rule in Section 76(4) of the Companies Act 71 of 2008: Avoiding the American Mistake '(published) LLM thesis 13.
153 Cassim et al *Contemporary Company law* 2 ed (2012) 563.

criteria.[154] These 'triads' are, namely, that the directors must have acted on an informed basis, in good faith and in the honest belief that the decision was in the best interest of the company.[155]

The earliest articulation of the BJR, was found in the case of *Percy v Millaudon*.[156] The court herein stated that;

> 'The only correct mode of ascertaining whether there was fault in an agent is by enquiring whether he neglected the exercise of that diligence and care, which was necessary to a successful discharge of the duty imposed on him. There are many things which, in their management, require the utmost diligence, and most scrupulous attention. There are others, whether the duties imposed are presumed to call for nothing more than ordinary care and attention, and where the exercise of that degree suffices.'[157]

It is this early articulation, which developed into what is commonly understood as the BJR. The USA has two distinctive formulations of the BJR.[158] These formulations are, namely, the Delaware formulation, which is a common law version of the BJR as developed by the courts in the state of Delaware. The American Law Institute formulation (hereafter, ALI formulation), was an attempt to codify the BJR into USA law.[159]

3.3.1. The Delaware formulation

The State of Delaware (hereafter, Delaware) has been referred to as the corporate capital of the world and its courts have become the most distinguished venues in the United States for resolving corporate disputes.[49] The corporate law rules adopted in Delaware, such as the BJR, are thus adopted and followed in the rest of the United States.[160] Therefore, (when comparing

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[154] Mupangavanhu BM 'Standard of Conduct or Standard of Review? Examination of an African Business Judgement Rule under South Africa's Companies Act 71 of 2008' (2019)63(1) *Journal of African Law* 130.
[155] Mupangavanhu BM 'Standard of Conduct or Standard of Review? Examination of an African Business Judgement Rule under South Africa's Companies Act 71 of 2008' (2019)63(1) *Journal of African Law* 130.
[156] *Percy v Millaudon* (1829) 8 Mart. (n.s.) 68 (La. 1829).
[157] *Percy v Millaudon* (1829) 8 Mart. (n.s.) 68 (La. 1829) 68.
[158] Cassim et al *Contemporary Company law* 2 ed (2012) 565-6.
[159] Cassim et al *Contemporary Company law* 2 ed (2012) 565-6; see also Smit I *The application of the Business Judgment Rule in fundamental transactions and insolvent trading in South Africa: foreign precedents and local choices* (published LLM Thesis, 2016) 21.
[160] Ridgley H & Reed J 'Delaware Corporate Law and Litigation: What Happened in 2015 and What it Means For You in 2016' available at

the USA formulations) the Delaware formulation has a more prominent role, as it has been largely adopted across the USA.

The Delaware formulation functions as a presumption of good faith in favour of directors and was captured in *Aronson v Lewis.*[161] In terms of this case, the BJR is;

> '[A] presumption that 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 interest of the company. In an absence of abuse of discretion, that judgment will be respected by the Courts. The burden is on the party challenging the decision to establish facts rebutting the presumption'.[162]

The court in *Technicolor* [163] explained how the presumption in favour of the director works:

> 'Thus, a shareholder plaintiff challenging a board decision has the burden at the outset to rebut the rule's presumption. To rebut the rule, a shareholder plaintiff assumes the burden of providing evidence that directors, in reaching their challenged decision, breached any one of the triads of their fiduciary duty – good faith, loyalty or due care. If a shareholder plaintiff fails to meet this evidentiary burden, the business judgment rule attaches to protect corporate officers and directors and the decisions they make, and our courts will not second-guess these business judgments. If the rule is rebutted, the burden shifts to the defendant directors, the proponents of the challenged transaction, to prove to the trier of fact the entire fairness[164] of the transaction to the shareholder plaintiff.'[165]

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https://www.dlapiper.com/~/media/Files/Insights/Publications/2016/02/DelawareCorporateLawandLitigationReport20152016.pd f(accessed on 18/02/2022).

[161] *Aronson v Lewis 473* A 2d 805 (Del 1984) at 812.

[162] *Aronson v Lewis 473* A.2d 805, (Del. 1984) at 812.

[163] *Cede & Co and Cinerama Inc v Technicolor Inc* 1990 Del.

[164] Entire fairness refers to the Entire Fairness Doctrine applied by the courts. This doctrine plays a pivotal role in Delaware case law; see Chalian S & Bandura K 'The Business Judgment Rule and the Entire Fairness Doctrine' available at http://www.rc.com/documents/Primer%20on%20Business%20Judgment%20Rule.pdf (accessed on 29 June 2021); see also Smit I *The application of the Business Judgment Rule in fundamental transactions and insolvent trading in South Africa: foreign precedents and local choices* (published LLM Thesis, 2016) 21.

[165] *Cede & Co. v Technicolor Inc*. 634 A.2d 345 (Del. 1993) at 361.

Kershaw D, emphasises that the Delaware formulation provides that if the directors comply with both their duty of care in the process of making a decision and their duty of loyalty – which requires that they act in good faith and that there be no direct conflict of interests – then the decision will only be subject to 'rationality review'. [166] That is, if there is a rational reason to support the decision, courts will not inquire further.[167] This view appears to be generally supported by most academics.[168] In this regard, the court will assess the board's conduct by placing an emphasis on the process the board took in coming to a decision and not the actual wisdom thereof. In other words, if a rational reason can be attributed to a decision taken by a director, that decision will be upheld by the courts.[169]

3.3.2. <u>The ALI formulation</u>

Paragraph 4.01(c) of the American Law Institute Corporate Governance project, provides for the USA codified version of the BJR as a standard of review.[170] The rule provides that;

> '[A] director or officer who makes a business judgment in good faith fulfills the duty under this Section if the director or officer: (1) is not interested in the subject of the business judgment; (2) is informed with respect to the subject of the business judgment to the extent the director or officer reasonably believes to be appropriate under the circumstances; and (3) rationally believes that the business judgment is in the best interests of the corporation.'[171]

Under this formulation, for the BJR to apply, a director must have made a 'business judgement' in good faith. In making this judgement or decision, the director should not be influenced by conflicts of interests. In this regard, the director who makes this business judgement or decision should not have a personal or financial interest in the business decision.[172] Secondly, the

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[166] Kershaw D 'The Foundations of Anglo-American Corporate Fiduciary Law' (2018) 3.
[167] Kershaw D 'The Foundations of Anglo-American Corporate Fiduciary Law' (2018) 3.
[168] Smit I *The application of the Business Judgment Rule in fundamental transactions and insolvent trading in South Africa: foreign precedents and local choices* (published LLM Thesis, 2016) 23 ; see also Mupangavanhu BM *'Standard of Conduct or Standard of Review? Examination of an African Business Judgement Rule under South Africa's Companies Act 71 of 2008'* (2019), 133
[169] In Re Walt Disney Co. Derivative Litig. 906 A.2d at 74 - quoting Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971).
[170] American Law Institute, ALI Corporate Governance Project (1994).
[171] American Law Institute, ALI Corporate Governance Project (1994) para 4.01(c).
[172] Hopt K, Kanda H & Roe M et al 'Comparative Corporate Governance: The State of the Art and Emerging Research' (1998) 326.

director must express a level of care in making that judgement or decision. In this regard, the director is expected to sufficiently inform themselves of the subject matter of the decision before coming to a decision. [173] Lastly, the director should have had a rational basis for believing that they were acting in the best interest of that corporation when making that business judgement or decision.

3.3.3. <u>The relationship between the two USA formulations of the BJR</u>

Both the ALI formulation and the Delaware formulation share common key features. In this regard, the principle of good faith is a cornerstone of both formulations.[174] The ALI Formulation makes it clear that a director is protected against liability for breaching his duty of care obligations if the business judgement was made in good faith, in addition to meeting the triad rule. Similarly, the Delaware Formulation provides for a presumption of good faith in favour of the director(s). In addition, informed decision-making and scrutinizing available alternatives – is a requirement for both formulations.[175] It is also a requirement under both formulations that there should be a rational basis for believing that the decision is in the best interest of the company.[176]

Importantly, the two formulations differ in their approaches to the BJR – they have different rationales behind their adaptation of the BJR. In this regard, one of the key differences between the two formulations considers *'where the burden or onus of proof of fact lies'*. In terms of the ALI formulation, the burden of proof rests on the defendant directors.[177] The rationale behind this onus considers that the matterial or information pertaining to the disputed decision are more within the access or reach of the directors, than the party challenging the decision. If this onus placed upon the director gets discharged, they escape personal liability for the decision taken. Conversely, the onus in terms of the Delaware Formulation operates as a presumption

[173] Hopt K, Kanda H & Roe M et al 'Comparative Corporate Governance: The State of the Art and Emerging Research' (1998) 326.
[174] Mupangavanhu BM 'Standard of Conduct or Standard of Review? Examination of an African Business Judgement Rule under South Africa's Companies Act 71 of 2008' (2019)63(1) *Journal of African Law* 133.
[175] This is known as the due care process; see *Smith v Van Gorkom* and *Cede v Technicolor*; see also Mupangavanhu BM 'Standard of Conduct or Standard of Review? Examination of an African Business Judgement Rule under South Africa's Companies Act 71 of 2008' (2019)63(1) *Journal of African Law* 133.
[176] Mupangavanhu BM 'Standard of Conduct or Standard of Review? Examination of an African Business Judgement Rule under South Africa's Companies Act 71 of 2008' (2019)63(1) *Journal of African Law* 133.
[177] Mupangavanhu BM 'Standard of Conduct or Standard of Review? Examination of an African Business Judgement Rule under South Africa's Companies Act 71 of 2008' (2019)63(1) *Journal of African Law* 134.

in favour of the directors. Therefore, the plaintiff has a heavy burden to prove that the board, in making the disputed decision, breached one or more of its fiduciary duties of loyalty and good faith or failed to take due care.[178] Only upon a successful rebuttal of the presumption does the reverse onus apply.[179]

Both USA formulations of the BJR require rationality as the standard for reviewing whether a decision taken is in the best interest of the company. The interpretation of rationality is central to this dissertation. The rationality standards found in the USA formulations are further discussed in Chapter 4.4.1 of this dissertation.

3.4. An overview of the Australian BJR

The Australian version of the BJR is adopted in s180 (2) of the Corporations Act 2001 (hereafter, Corporations Act) as a standard of judicial review. Similar to other formulations of the BJR, the Australian BJR is intricately linked to the duty of care.[180] S180(2) of the Corporations Act provides that a director or officer who makes a business judgment is considered to have met the requirements of s180(1) of the Corporations Act, and their equivalent duties at common law and equity, if he:

> '(a) makes a business judgment in good faith for a proper purpose; (b) does not have a material personal interest in the subject matter of the judgment; (c) informs himself/herself about the subject matter of the judgment to the extent they reasonably believe to be appropriate and (d) rationally believes that the judgment is in the best interests of the corporation.' [181]

The Australian BJR mirrors the USA versions of the BJR. S180(2) of the Corporations Act is strikingly similar to the ALI Formulation in that the Australian BJR is inextricably connected to the standard of conduct found in s180(1) of the Corporations Act. The Australian BJR is also regarded as a modified legislative version of the USA common law BJR – due to its

[178] Mupangavanhu BM 'Standard of Conduct or Standard of Review? Examination of an African Business Judgement Rule under South Africa's Companies Act 71 of 2008' (2019)63(1) *Journal of African Law* 134.
[179] *Cede & Co and Cinerama Inc v Technicolor Inc at 361*
[180] Mupangavanhu BM 'Standard of Conduct or Standard of Review? Examination of an African Business Judgement Rule under South Africa's Companies Act 71 of 2008' (2019)63(1) *Journal of African Law* 134.
[181] s 180 (2) (a) - (d) of the Corporations Act 2001; see also Havenga 'Corporate Opportunities: A South African Update (part 1)' (1996) 8 SA *Mercantile Law Journal* 33.

presumption in favour of the director(s). [182] The Australian Formulation of the BJR applies to directors, officers and other managers – as s180(2) clearly refers to 'a director or other officer who makes a business judgment'. Conditions (a) to (d), which are based on the ALI Formulation have to be fulfilled, otherwise a director's action will not survive judicial scrutiny in the face of liability claims for breach of the statutory duty in s180(1) and its equivalent duties at common law and equity.[183] The Australian BJR also generally applies to the statutory duty of care and diligence as well as the equivalent duties at common law and in equity.

In terms of the requirements of the Australian version of the BJR, a business judgement must have been made. In accordance with these requirements, s180(3) of the Corporations Act defines a business judgement to mean 'any decision to take or not to take action in respect of a matter relevant to the business operations of the corporation'.[184] It is also generally accepted that s180(3) should be distinguished from an omission to act where a positive duty to act is in existence. Where this positive duty to act exists, and there is failure to act, it could potentially qualify as negligence – which is a ground that excludes the application of the Australian BJR. [185] By defining 'business judgment', the Australian BJR directly limits the scope and application of the BJR. The decision of the legislature to define a business judgment in S180(3) of the Corporations Act, distinguishes the Australian BJR formulation from other formulations of the rule.

Like the two USA formulations of the BJR, the Australian BJR formulation includes good faith as a requirement. In addition, a director must rationally believe that the judgment is in the best interests of the corporation.

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[182] Mupangavanhu BM 'Standard of Conduct or Standard of Review? Examination of an African Business Judgement Rule under South Africa's Companies Act 71 of 2008' (2019) 63(1) *Journal of African Law* 135.
[183] Farrar J 'Directors' duties of care: Issues of classification, solvency and the business judgment and the dangers of legal transplants' (2011) *Singapore Academy of Law Journal* 758.
[184] The Corporations Act 2001, section 180(3).
[185] Mupangavanhu BM *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* (published LLD thesis, 2016) 96.

3.5. An overview of the South African BJR and the requirements

Akin to the development of the BJR in the USA (specifically the ALI formulation) and the Australian formulation, the South African BJR was incorporated as part of the duty to act with care, skill and diligence.

As a legacy of the enduring influence of English law, South African courts have demonstrated their preparedness not to interfere unjustly with the business decisions of a company.[186] This view is expressed by many cases that have come before the South African Courts. For example, in *Levin v Feld and Tweeds*[187] the court clearly expressed that 'It is not part of the business of a court of justice to determine the wisdom of a course adopted by a company in the management of its own affairs'.[188] Similar sentiments were also echoed in other cases, such as *Ben-Tovim v Ben-Tovim and others,*[189] where the court made it clear that it is not part of judicial policy to second-guess the business decisions of company directors.[190] This has contributed to some academics considering the existence of a potential common law version of the BJR in South Africa. Author Mupangavanhu also argues the existence of the rule at common law, referring to it as a 'watered down version of the BJR'.[191] Other authors are of the view that whilst this is true, the obiter statements made by courts to this effect has not developed to 'a state of sophistication sufficient to make [the BJR] a common law rule of any significant utility to practitioners, judges or directors.'[192]

Regardless of the arguments in support or against the existence of a common law BJR, there is a general acceptance that the South African formulation of the BJR was first formally considered in the 1994 King Report on Corporate Governance for South Africa.[193] This report

[186]Mupangavanhu BM 'Standard of Conduct or Standard of Review? Examination of an African Business Judgement Rule under South Africa's Companies Act 71 of 2008' (2019)63(1) *Journal of African Law* 138 - 9.
[187] *Levin v Felt and Tweeds* 1951 (2) SA 401 (A) at 414.
[188] *Levin v Felt and Tweeds* 1951 (2) SA 401 (A) at 414.
[189] *Levin v Felt and Tweeds* 1951 (2) SA 401 (A) at 414.
[190] *Ben-Tovim v Ben-Tovim and others* 2001 (3) SA 1074 (CPD); Mupangavanhu BM (2019), 139.
[191] Mupangavanhu BM 'Standard of Conduct or Standard of Review? Examination of an African Business Judgement Rule under South Africa's Companies Act 71 of 2008' (2019)63(1) *Journal of African Law* 140.
[192] Du Plessis JJ *'Open sea or safe harbour? American, Australian and South African business judgment rules compared (part 1)'* 32 (2011) *The Company Lawyer* 345 at 346; see also Farrar prefers to refer to the obiter remarks by judges that reflect a judicial policy of deference to business judgments of directors as 'business judgment doctrine' Farrar JH '*Business judgment and defensive tactics in hostile takeover bids'* in DB King (ed) *Essays on Comparative Commercial and Consumer Law* (1992, Fred B Rothman & Co) 173.
[193] Kennedy-Good S and Coetzee L 'The Business Judgment Rule (Part 2)' (2006) 27(2) *Obiter* 287.

recommended that the Companies Act be amended to provide for a statutory limitation on a director's duty of care and skill.[194] The report provided that:

> 'A director should not incur liability for a breach of the duty of care and skill where they have exercised a business judgement in good faith in a matter in which their decision is an informed and rational one and there is no self-interest.'[195]

It was identified that there was a need to encourage entrepreneurship and entice persons of skill to accept appointments in enterprises.[196] Furthermore, it was contended that the present tests of the breach of the duty of care and skill were onerous and thus requiring limitation.[197] However, this contention was founded on a false interpretation of the duty of care and skill. In other words, as expressed through the interpretation by Margo J in *Fisheries*, the duty of care and skill is exceptionally lax and does not require any limitations.[198] This view is also supported by other authors such as Kennedy-Good and Coetzee who have also criticised this false impression of the duty of care and skill being onerous.

Nevertheless, the BJR was introduced with the introduction of the 2008 Companies Act. This time to counterbalance the new stricter objective-subjective standard of the duty of care skill and diligence introduced by the 2008 Companies Act. This rationale for the introduction of the Statutory BJR is also shared by Kanamugre and Chimuka who remark on the possibility of the BJR being introduced to soften the duty of care, skill and diligence codified in the 2008 Companies Act.[199] Cassim *et al*, is of the same view stating that the introduction of the BJR 'alleviates the less subjective and more rigorous duty of directors'.[200] Potentially, another reason as to why the South African BJR was introduced is due to the Companies Act formally introducing the statutory obligation on a director to manage the business and affairs of the company in s66 of the Act.

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194 The Institute of Directors in South Africa 1994 Nov.

195 The Institute of Directors in South Africa 1994 Nov 9 par 3.5.

196 Kennedy-Good S and Coetzee L 'The Business Judgment Rule (Part 2)' (2006) 27(2) *Obiter* 287.

197 Kennedy-Good S and Coetzee L 'The Business Judgment Rule (Part 2)' (2006) 27(2) *Obiter* 287.

198 *Fisheries Development Corporations of SA Ltd v Jorgensen & Another; Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd & Others 1980 (4) SA (W)* para 166.

199 Kanamugire JC & Chimuka TV *'The Director's duty to exercise care and skill in Contemporary South African Company Law and the Business Judgement Rule'* (2014) 74.

200 Cassim et al *Contemporary Company Law* 2 ed (2012), 563.

3.4.1. The codification of the BJR in South Africa

S76(4)(a) of the Companies Act provides for the South African BJR. 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[201]

Importantly, upon first inspection s76(4)(a) offers a wide protection, in that it protects much more than business decisions.[202] This is due to s76(4)(a) making use of the terms 'any particular matter arising in the exercise of the powers or performance of the functions of director'. This clearly extends the scope of the BJR beyond the formulations found in the USA and Australia. Indications of this extended scope is evident in the drafters of the Act's efforts to avoid the use of words such as '*business decision* or *judgment*' – which is commonly used in other formulations of the rule. The drafters in this instance chose to make use of '*decision*' instead of 'business decision or judgement'. The Companies Act also does not define business decision or judgment – as it is not required in terms of s76(4). Conclusively, the South African BJR extends itself to decisions falling outside the scope of the USA and Australian formulations of the rule.

S76(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 s76 (3) (b) and the duty of care, skill and diligence in s76 (3) (c). In terms of the section, the director is regarded to have

[201] The Companies Act 71 of 2008, section 76(4)(a).

[202] Du Plessis JJ *'Open sea or safe harbour? American, Australian and South African business judgment rules compared (part 1)'* 32 (2011) *The Company Lawyer* 38.

complied with their duties in terms of s76(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 s76(4)(a) of the Companies Act – the BJR. This emphasises an explicit link between standards of conduct and review.[203]In effect, where it is alleged that a board's decision did not satisfy the obligations of s76(3) (b) and (c), a court of law will test the director(s) conduct against the standard of review under s76(4)(a).[204] If a director successfully meets the standard of review under s76(4)(a) it becomes their defense against the liability claims for breaching their statutory obligations under section s76(3)(b) and (c).[205] Conclusively, this is the essence of the South African Formulation of the BJR.

3.4.2. <u>The requirements of the BJR</u>

For a director to escape liability for the breach of their duty to act in the best interest of a company and/or their duty to act with the necessary degree of skill, care and diligence – as codified by s76(3)(b) and (c) of the Companies Act – that director must comply with the requirements of the BJR under s76(4)(a) of the Companies Act. S76(4)(a) of the Companies Act requires that the director (in summary) made an informed decision, was free of conflicts of interest and in taking that decision acted on a rational belief that the decision would be in the best interest of the company.[206] Therefore, this section of the dissertation provides an overview of these requirements. In addition, this section provides a critique as to the absence of the good faith requirement.

3.4.2.i. ***<u>The director made an informed decision</u>***

S76(4)(a) of the Companies Act firstly requires that before making a decision, a director must ensure that he has taken reasonably diligent steps to become informed about the matter.[207] This requirement is clearly more objective than compared to the way it has been framed in both the

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[203] The standards of directors conduct in S76(3)(b) and (c) are directly linked to s76(4)(a) which contains the BJR. The BJR by nature is the standard at which the court reviews a decision taken by the director(s).
[204] Mupangavanhu BM 'Standard of Conduct or Standard of Review? Examination of an African Business Judgement Rule under South Africa's Companies Act 71 of 2008' (2019)63(1) *Journal of African Law* 143.
[205] Mupangavanhu BM 'Standard of Conduct or Standard of Review? Examination of an African Business Judgement Rule under South Africa's Companies Act 71 of 2008' (2019)63(1) *Journal of African Law* 143.
[206] The Companies Act 71 of 2008, section 76(4)(a).
[207] The Companies Act 71 of 2008, section 76(4)(a)(i).

Australian formulation and The USA ALI formulation. To put into perspective, the Australian Corporations Act s180(2)(c), which is drafted similarly to S4.01 of the ALI formulation requires that a director 'informs themselves about the subject matter of the judgement to the extent *they* reasonably believe to be appropriate' (emphasis added).[208] This clearly is reminiscent of a more subjective approach, when compared to the way s76(4)(a)(i) has drafted this requirement. The standard under s76(4)(a) is *not* based on the director's reasonable belief that he informed himself about the matter.[209] Instead, it is an objective standard – which applies an objective test when reviewed. This objective standard also differs from the Delaware Formulation in which gross negligence is considered the appropriate standard of review.[210] Conclusively, the standard required by the South African BJR in terms of assessing whether a director made an informed decision places a hypothetical reasonable person in the position of that director in question. In other words, it asks whether a reasonable person in the shoes of the director would have regarded the steps taken by the director (to become informed about the subject matter) as diligent.

3.4.2.ii. ***The decision taken by the director was made free of conflicts of interest***

It is required under s76(4)(a) that a director must have had no material personal financial interest in the decision.[211]Alternatively, if the director has a material personal financial interest in the matter, the director must have complied with the disclosure requirements set out in s75 of the Companies Act.

The terms 'material' and 'personal financial interest' are set out and defined in section 1 of the Act. In understanding the term 'material' the act defines it as 'significant in the circumstances of a particular matter (a) of consequence in determining the matter; or (b) might reasonably affect a person's judgement or decision-making in the matter'. 'Personal financial interest' is defined as '(a) a direct material interest of that person, of a financial, monetary or economic nature, or to which a monetary value may be attributed; but (b) does not include any interest

[208] Mupangavanhu BM 'Standard of Conduct or Standard of Review? Examination of an African Business Judgement Rule under South Africa's Companies Act 71 of 2008' (2019)63(1) *Journal of African Law* 144.
[209] Mupangavanhu BM 'Standard of Conduct or Standard of Review? Examination of an African Business Judgement Rule under South Africa's Companies Act 71 of 2008' (2019)63(1) *Journal of African Law* 144.
[210] Mupangavanhu BM 'Standard of Conduct or Standard of Review? Examination of an African Business Judgement Rule under South Africa's Companies Act 71 of 2008' (2019)63(1) *Journal of African Law* 144.
[211] The Companies Act 71 of 2008, section 76(4)(a)(iii).

held by a person in a unit trust or collective investment scheme unless that person has direct control over the investment decisions of that fund or investment'.

This definition (combination of both defining terms[212]) limits itself to certain categories of persons. Thereby, directly excluding the category of persons that falls outside the scope of the definition. The Companies Act requires the interest to not only be 'material' but also 'direct' – in terms of its personal financial interest requirement. This automatically excludes indirect interests that a director may have. However, S76(4)(a)(ii)(aa) also requires that a director must not have a reasonable basis to know that any related person had a personal financial interest in the matter.[213]

In terms of this section, s76(4)(ii)(bb), if a director has a material (direct, by implication) personal financial interest in the matter or there exists a reasonable basis to know that any related person had a direct personal financial interest in the matter, that director has to make a disclosure in terms of s75 of the Act.[214] S75, requires that the 'interested' director makes advance disclosures in writing (ahead of a board meeting). These disclosures need to be done with sufficient detail to enable the board to apply its mind and understand the nature of the personal financial interest of the director or of a related person.[215] If the 'interested' director is to remain in the meeting after making such a disclosure, it should only be for the purposes of allowing the 'disinterested' directors the opportunity to ask for such particulars to enable them to gain pertinent insight related to the disclosure(s).[216] S75 makes provision for what is described as the new 'disclose and recuse' approach to disclosures under the Companies Act.[217] This is because, after making the full disclosure the 'interested' director should recuse himself from the meeting and allow the decision-making to continue without their participation.[218] In terms of the Companies Act, the director is not allowed to ordinarily execute any document relating to the subject matter of the decision-making which they have an interest in (as defined

[212] The definition of 'material' and 'personal financial interests' are to be combined for the effect of the BJR.
[213] The Companies Act, s76(4)(a)(ii)(aa).
[214] The Companies Act, s76(4)(a)(ii)(aa).
[215] The Companies Act, section 75 (4).
[216] The Companies Act, section 75 (5)(e).
[217] Mupangavanhu BM 'Standard of Conduct or Standard of Review? Examination of an African Business Judgement Rule under South Africa's Companies Act 71 of 2008' (2019)63(1) *Journal of African Law* 148.
[218] Mupangavanhu BM 'Standard of Conduct or Standard of Review? Examination of an African Business Judgement Rule under South Africa's Companies Act 71 of 2008' (2019)63(1) *Journal of African Law* 148.

above). The only exception which exists is where such a director is specifically instructed by the board to execute a document, despite their interest in the matter.[219]

3.4.2.iii. ***The director had a rational basis for believing that the decision was taken in the best interest of the company***

This section can be separated into two main elements. Firstly 'rational basis' and secondly 'decisions taken in the best interest of the company'. The latter of which relates to the duty found under s76(3)(b), 'the duty to act in the best interest of the company'. At first glance, its insertion appears to be circular in nature – due to the requirement repeating itself in both the standard of conduct and the review of a directors' conduct. In other words, you are deemed to have fulfilled the requirement under s76(3)(b) to 'act in the best interest of a company', if you can show that in terms of s76(4)(a)(ii) that you acted in the best interest of a company. However, the element needs to be viewed through the lens of the rational basis standard – as required. In other words, the requirement to 'act in the best interest of a company' at judicial review is limited or narrowed to 'rational basis' for believing that the decision was in the best interest of the company. Therefore, although they appear to be the same, they are not. In effect, the standard imposed at judicial review has a limited scope in comparison to the standard of conduct. In this regard, the understanding of what is in the best interest of a company remains the same at s76(3)(b) and s76(4)(a)(ii) – it is only the standard thereof that changes. Thus, it is generally complied with in the same manner, which was demonstrated by the court in *Visser Sitrus.*[220]

The Court emphasised the highly subjective nature of this element in s76(4)(a)(ii). It was stated that what is in the best interests of the company is a matter to be decided by company directors in the boardroom and falls outside the scope of judges in the courtroom.[221] In this regard, what is simply required is that the directors subjectively believe (on a rational basis) that the decision was in the best interest of the company.[222]

The importance of s76(4)(a)(ii) rests on whether the director had a *rational basis* for believing that the decision taken was in the best interest of a company. This standard of review remains

[219] The Companies Act 71 of 2008, section 75(5)(g).
[220] *Visser Sitrus (PTY) LTD v Goede Hoop Sitrus (PTY) LTD and Others* 2014 (5) SA 179 (WCC) para 90.
[221] *Visser Sitrus (PTY) LTD v Goede Hoop Sitrus (PTY) LTD and Others* 2014 (5) SA 179 (WCC) para74.
[222] *Visser Sitrus (PTY) LTD v Goede Hoop Sitrus (PTY) LTD and Others* 2014 (5) SA 179 (WCC) para 74.

mystified, due to it being otherwise unknown to South African Company law. The standard of rationality is central to this dissertation and is discussed throughout, Chapter 4.4 and Chapter 4.5 provides the most detailed analysis of the standard herein.

3.4.2.iv. ***The absence of Good Faith in the BJR***

It is difficult to conceive how the BJR can exclude good faith.[223] Good faith is seen as the overarching duty from which all other duties emerge,[224] due to the inextricable link to acting in the best interest of a company – at common law.[225] When the BJR was first formally considered in the 1994 King Report, good faith was a requirement under the formulation.[226] The report provided that:

> 'A director should not incur liability for a breach of the duty of care and skill where they have exercised a business judgement in *good faith* in a matter in which their decision is an informed and rational one and there is no self-interest.'[227]

Good faith as a requirement for the BJR is missing from the statutory version of the BJR found in s76(4).[228] This brings into question whether there was an error by the legislature for neglecting the requirement. This author is of a view that offers potential in explaining why good faith might have been erased from the South African BJR, hereby supporting the current formulation of the BJR as found in s76(4) of the Act.

As previously stated, at common law good faith is directly connected to the duty of acting in the best interest of a company. This differs to the way the directors' codified duties have been structured in s76(3) of the Companies Act. The statutory duty to act in good faith is directly connected to acting for a proper purpose which is found at s76(3)(a).[229] Throughout this

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[223] Mupangavanhu BM *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* (published LLD thesis, 2016)166.

[224] Naicker M *A critical exploration of the fiduciary duties of a director to act in good faith and for proper purpose in respect of a company and an evaluation of the developments from common law to statute* (published LLM thesis, 2015, University of KwaZulu-Natal)30 (hereafter referred to as Naicker M (2015)).

[225] Cassim et al *Contemporary Company Law* 2 ed (2012), 523-4.

[226] Kennedy-Good S and Coetzee L 'The Business Judgment Rule (Part 2)' (2006) 27(2) *Obiter* 287.

[227] The Institute of Directors in South Africa 1994 Nov 9 par 3.5.

[228] The Companies Act 71 of 2008, section 76 (4).

[229] The Companies Act 71 of 2008, section s76 (3) (a).

dissertation it has been stated that the BJR may only be used as a defense against the failure to comply with the duties to act in the best interest of a company and/or the duty of care, skill and diligence – found at s76(3)(b) and (c) of the Companies Act.[230] Thus, the duty to act in good faith and for a proper purpose falls outside the application of the BJR.

In effect, a director cannot utilise the BJR to escape liability for failure to act in good faith and for a proper purpose. Thereby emphasising the importance of these duties. This author is of the view that the absence of good faith from the South African BJR is *no* error on the part of the legislature. The inclusion of the requirement to act in good faith in the South African BJR is completely unnecessary and futile. If the director acts in bad faith, the director fails to comply with s76(3)(a) – for which the BJR 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.

3.5. Conclusion

This chapter discussed the various formulations of the BJR found in the USA, Australia and South Africa. Although the understanding of what is meant by 'business judgment rule' has been quite elusive, it is continuously being adopted in various countries. The BJR originated in the USA and was developed alongside the duty of care. Australia was one of the first countries to codify the rule into their commercial law. South Africa also has a codified version of the BJR, in terms of s76(4)(a) of the Companies Act. An all-encompassing rationale behind the adoption of the BJR is that it provides great potential benefit to an economy and commercial practice. This general perception comes from analysing a plethora of policy rationales for adopting the BJR, which include the encouragement of risk-taking; persuading competent persons to undertake the office of the directors; permitting effective market mechanisms to manage director behaviour; the prevention of judicial second-guessing and avoiding shareholder management in the corporation.

The USA has two distinctive formulations of the BJR. These formulations are, namely, Delaware formulation, which is a common law version of the BJR as developed by the courts in the state of Delaware. The second USA formulation is the codified ALI formulation. Of the

[230] The Companies Act 71 of 2008, section 76(4).

two USA formulations, the Delaware formulation is the most prominent as it has been largely adopted across the USA. Both the ALI formulation and the Delaware formulations share common key features. However, the two formulations differ in their approaches to the BJR as well as rationales behind their adaptation of the BJR. In this regard, one of the key differences between the two formulations is where the burden or onus of proof rests upon. In terms of the ALI formulation, the burden of proof rests on the defendant directors. Conversely, the onus in terms of the Delaware Formulation operates as a presumption in favour of the directors. Therefore, the plaintiff is left with a heavy burden to prove that the board, in making a disputed decision, breached one or more of its fiduciary duties of loyalty and good faith or failed to follow the requirement to take due care.

The Australian version of the BJR was adopted in s180(2) of the Corporations Act. Similar to other formulations of the BJR, the Australian BJR is directly linked to the duty of care. The Australian BJR mirrors the USA versions of the BJR. In this regard, Section 180(2) is strikingly similar to the ALI Formulation in that the standard of review is inextricably connected to the standard of conduct in s180(1).

The South African BJR is incorporated as part of the duty to act with care, skill and diligence. As a legacy of the enduring influence of English law, South African courts have demonstrated their preparedness not to interfere unjustly with the business decision making of a company. This has contributed to some academics considering the existence of a potential common law version of the BJR in South Africa. Nevertheless, the BJR was introduced in the 2008 Companies Act. Perhaps, this time to counterbalance the new stricter objective-subjective standard of the duty of care, skill and diligence introduced by the 2008 Companies Act. Importantly, upon first inspection, s76(4) (a) offers a wider protection and protects much more than business decisions. This is due to s76(4) (a) making use of the terms 'any particular matter arising in the exercise of the powers or performance of the functions of director'. This clearly extends the scope of the traditional scope of the BJR beyond the formulations found in the USA and Australia.

For a director to escape liability a breach of their duty to act in the best interest of a company and their duty to act with the necessary degree of skill, care and diligence, as codified by s76(3)(b) and (c) of the Companies Act, that director must comply with the requirements of the BJR under s76(4)(a) of the Act. S76(4)(a) of the Companies Act requires that the director (in summary) made an informed decision, was free of conflicts of interest and in taking that decision acted on a rational basis that the decision would be in the best interest of the company.

This chapter has provided an overview of the BJR as found in the USA, Australia and South Africa. In this regard, together with Chapter 2, this chapter provides for the foundation of this dissertation. Chapter 4 will provide a discussion of rationality as the standard of review for testing whether a director has acted in the best interest of the company - as found in the USA, Australia and s76(4)(a)(iii) of the South African Companies Act. Chapter 5 will provide for recommendations as to whether the Companies Act needs to be amended to include good faith as a requirement under s76(4) of the Act - hereby drawing from the discussion in this chapter at 3.4.2.iv , as well as discussions in Chapter 2.2.5 of this dissertation

CHAPTER FOUR – RATIONALITY AS A STANDARD OF JUDICIAL REVIEW

4.1. Introduction

Chapter 2 of this dissertation provided for a general overview of the codified duties found in s76(3)(b) and (c) of the Companies Act – to which a director may rely on the BJR to escape liability. The essence of Chapter 2 was to provide a foundation upon which the BJR applies. Chapter 3 provided a general overview of the formulations of the BJR in USA and Australia, thereafter Chapter 3 discussed the requirements of the South African BJR as codified in s76(4) of the Companies Act. The essence of Chapter 3 was to provide a general understanding of the BJR and its various formulations. This Chapter is concerned with utilising the discussion in Chapters 2 and 3 as a basis for engaging in specific discussions surrounding rationality as a standard of judicial review.

Firstly, this chapter will discuss the divergences in standards of conduct and review. Thereafter this chapter will discuss the development of the judicial review of the duty to act in the best interest of a company. This chapter will thereafter look at rationality as found in the USA and Australia. Importantly, this chapter will critically discuss rationality through the court in *Visser Sitrus.* Lastly, this chapter will consider the appropriateness of this rationality as standard of review in the current world of corporate governance.

Importantly, this chapter will *not* discuss rationality in isolation. In this regard, when discussing rationality, a comparison between rationality and reasonableness will also be drawn. The overall aim of this chapter is *not* only to provide an overview of the rationality standard of review but also to understand it in relation to reasonableness. These two standards of review in isolation can easily seem to be the same. Therefore, the aim of discussing rationality in relation to reasonableness allows one to easily distinguish between the two standards.

4.2. Divergence between standards of conduct and review

Generally, a standard of conduct (such as the *duty* to act in the best interest of a company) specifies how directors should conduct themselves.[231] Conversely, the BJR is a standard of

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[231] Eisenberg "The divergence of standards of conduct and standards of review in corporate law"1993Fordham Law Review437 at 444–45

review which sets forth the test courts will use in determining whether or not the directors' conduct gives rise to liability.[232]

With regard to the South African Companies Act, s76(3)(b) and (c) provide standards of conduct, while s76(4)(a) provides the standards of review.[233] In other words, whenever it is alleged that a board's decision did not satisfy the standard of conduct required in terms of s76(3)(b) and (c), a court of law will apply a standard of review under s76(4)(a).[234] The purpose of the standard found at s76(4)(a) – and thus the essence of the BJR – is to determine whether a director indeed failed to meet the required standard of conduct in a manner that gives rise to personal liability.[235] If the directors meet the standard of review under section 76(4)(a), then that becomes their defense against liability claims for breaching their statutory obligations under section 76(3)(b) and (c).[236]

Standards of conduct and review are usually conflated or converged – this is usually done to simplify the review process. [237] In practice, conduct rules normally have decisional side effects and decisional rules normally have conduct side effects.[238] Therefore, having converged standards help simplify the entire process. The essence of why standards of conduct and review are converged or conflated is a matter of prudence and not necessity or logic.[239] In the South African Companies Act, the standard of conduct for the duty of care, skill and diligence as codified by s76(3)(c) remains the same when reviewed by the court in s76(4)(a)(i). In this regard, both the standard of conduct and judicial review require the standard of reasonableness.

As much as standards converge, oftentimes we find in law that there is a divergence between standards of conduct and review. What then accounts for a divergence between standards of

[232] Bainbridge S '*The difference between reasonableness and rationality in corporate law*' available at http://www.professorbainbridge.com/professorbainbridgecom/2010/09/the-difference-between-reasonablenessand-rationality.htm1 (accessed on 15/06/2020).

[233] Mupangavanhu BM. '*Standard of conduct or Standard of Review*?' (2019) *Journal of African Law* 63(1)page 17

[234] Mupangavanhu BM. '*Standard of conduct or Standard of Review*?' (2019) *Journal of African Law* 63(1)page 17

[235] McMillan L, 'The Business Judgment Rule as an Immunity Doctrine' (2013) 4 *William & Mary Business Law Review* at 529.

[236] Mupangavanhu BM. '*Standard of conduct or Standard of Review*?' (2019) *Journal of African Law* 63(1) page 17.

[237] Eisenberg M 'The Divergence of Standards of Conduct and Standards of Review in Corporate Law' (1998) 62(3) Fordham Law Review 463.

[238] Eisenberg M 'The Divergence of Standards of Conduct and Standards of Review in Corporate Law' (1998) 62(3) *Fordham Law Review* 463.

[239] Eisenberg M 'The Divergence of Standards of Conduct and Standards of Review in Corporate Law' (1998) 62(3) *Fordham Law Review* 463.

review and conduct? Sometimes standards diverge out of necessity. From an international company law perspective,[240] in decision making, the standard of conduct (under duty of care) is ordinary negligence, which diverges from the standard of review (in the BJR context) of gross negligence.[241] This specific divergence is evident in the USA BJR formulations when observing the standard of conduct of directors' duties and the judicial review thereof. This overall divergence in the standard of negligence does not occur in South African company law. Instead, under South African company law, the standard used to determine liability for breach of the duty of care is one of negligence and not gross negligence.[242] Even though, the standard of negligence remains the same in South African company law for both rules of conduct and the judicial review thereof – there are still divergences between standards of conduct and judicial review in other aspects.

From a South African company law perspective, the requirements related to acting in the best interest of a company, is vastly different at s76(3)(b) compared to s76(4)(a)(ii). S76(3)(b) of the companies act simply requires that the director(s) conduct their duties in the best interest of a company – hereby indicating no threshold. Whereas, in terms of s76(4)(a)(ii) of the Companies Act, the standard of conduct for acting in the best interest of a company at judicial review rests on whether the director(s) had a rational belief – that they were acting in the companies' best interest.

A more general explanation for the divergence between standards of conduct and its judicial review in corporate law (which could apply to all areas of law) concerns differential knowledge of legal rules.[243] The standards of conduct (in corporate law) are usually constructed in a manner which is direct and easier to understand.[244] Whereas the standards of review, directed at legal professionals are drafted in a more complex way.[245] This is due to the legal professional having a more complex understanding of law. In essence, standards of conduct should be

[240] RJ Rhee '*The tort foundation of the duty of care and the business judgment rule*' (2013) *Notre Dame Law Review* 1153. Rhee gives an example of tort law where the standards of conduct and review conflate to a single standard for the purposes of judicial review. Also see Eisenberg, ibid, for further examples of areas of law where standards of conduct and review are conflated without difficulty.

[241] RJ Rhee '*The tort foundation of the duty of care and the business judgment rule*' (2013) *Notre Dame Law Review* 1153.

[242] Mupangavanhu BM. '*Standard of conduct or Standard of Review*?' (2019) *Journal of African Law* 63(1) 11.

[243] Eisenberg M 'The Divergence of Standards of Conduct and Standards of Review in Corporate Law' (1998) 62(3) *Fordham Law Review* 466

[244] Eisenberg M 'The Divergence of Standards of Conduct and Standards of Review in Corporate Law' (1998) 62(3) *Fordham Law Review* 466

[245] Eisenberg M 'The Divergence of Standards of Conduct and Standards of Review in Corporate Law' (1998) 62(3) *Fordham Law Review* 466

simple, so that they can be effectively communicated, and to the extent possible should reflect social norms of upright business behaviour that directors and officers can be expected to know even if they do not know the law. In contrast, the standards of review in corporate law are directed primarily to judges, and secondarily to reviewing corporate organs. Stated differently, judges either know the law or will be instructed in the law prior to making their decisions. Other authors such as Velasco have also expressed similar views.[246] Accordingly the views expressed are that standards of conduct are rules addressed to actors, specifying expectations regarding their behaviour.[247]On the other hand, standards of review are rules addressed to courts, specifying how actions are to be judged.[248]

4.3. <u>The development of the judicial review of the duty to act in the best interest of a company</u>

The duty or standard of the director(s) conduct to act in the best interest of a company has always had an objective standard attached thereto when reviewed by the courts. This objective standard at judicial review has subtly changed form over the years – sailing by almost unnoticed. However, when comparing its current form to its inception, the evolution is quite drastic.

The English Court of Appeal in *Shuttleworth v. Cox Brothers & Co*.[249] (hereafter, *Shuttleworth*) laid down the test for deciding whether a director was acting in the best interest of the company. Accordingly, the court remarked that the question to be asked was whether reasonable shareholders could have considered the action to be of benefit to the company.[250] Indicating that the test applied by the court to test the director(s) conduct (in relation to acting in the best interest of a company) is the *reasonable men* test. In this regard, the test applied by the court was stated as;

> 'when persons, honestly endeavoring to decide what will be for the benefit of the company and to act accordingly, decide upon a particular course, then, provided there are grounds on which *reasonable men* could come to the same decision, it does

[246] J Velasco '*A defense of the corporate law duty of care'* (2015) *Journal of Corporation Law* 648 at 651.
[247] J Velasco '*A defense of the corporate law duty of care'* (2015) *Journal of Corporation Law* 648 at 651.
[248] J Velasco '*A defense of the corporate law duty of care'* (2015) *Journal of Corporation Law* 648 at 651.
[249] *Shuttleworth v CoxBrothers&Co (Maidenhead) Ltd* 1927 2 KB 9.
[250] R Williams. *Bona fide in the interest of certainty* (2007) *The Cambridge Law Journal, 66*(3), 500-503, 501.

not matter whether the court would or would not come to the same decision or a different decision'.[251]

The court makes it noticeably clear that the standard applied is *reasonableness*. The court also inextricably linked this requirement to the requirement of good faith by remarking that 'the absence of a reasonable ground for believing that the director is acting in the interests of the company may be the basis for finding lack of good faith'.[252]

Conversely, Lord Hoffmann in *Shuttleworth*,[253] did remark that in the matter before him the proposed amendment was so unreasonable that *no reasonable* shareholder could consider it beneficial to the company. The standard of '*no reasonable'* is argued to be synonymous with the standard of *rationality*. However, in this instance I do not believe that the court intended to apply a standard of *rationality*. This view stems from the court expressing in noticeably clear terms that the test to be applied is the *reasonable men* test.[254] The standard of reasonableness expresses itself in a manner that the only conclusion is the court applied an objective standard of review.

Importantly, the standard of conduct for a director's duty is still subjective, regardless of the objective standard of review attached thereto. This was made clear in *Re Smitt Fawcett* [255] where the court expressed that directors are required to act 'bona fide in what they consider is in the interest of the company' and not for any collateral purpose.[256] In this regard, the standard of review does not extend itself to what the court considers being the best interest of a company – but rather that (in this case) the director must reasonably believe that he was acting in the best interest of the company.

In *Charterbridge Corporation Ltd v Lloyds Bank Ltd*[257] the objective standard of review formulated by the court was 'whether an intelligent and honest person, in the position of a director of the company concerned, in the whole of the existing circumstances, could have

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[251] *Shuttleworth v CoxBrothers&Co (Maidenhead) Ltd* 1927 2 KB 9
[252] Cassim *et al* 'Contemporary Company law 2nd edition' (2012) 524. van Tonder J '*An Analysis of the Directors' Duty to Act in the Best Interests of the Company, through the Lens of the Business Judgment Rule*' (2015) 3 *Obiter* 715.
[253] J Velasco '*A defense of the corporate law duty of care'* (2015) *Journal of Corporation Law* 648 at 651.
[254] R Williams. *Bona fide in the interest of certainty* (2007) *The Cambridge Law Journal, 66*(3), 500-503, 501
[255] *re Smith and Fawcett Ltd* (1942) Ch 304 (CA).
[256] *re Smith and Fawcett Ltd* (1942) Ch 304 (CA) 306.
[257]Van Tonder J '*An Analysis of the Directors' Duty to Act in the Best Interests of the Company, through the Lens of the Business Judgment Rule*' (2015) 3 *Obiter* 715.

reasonably believed that the transaction was for the benefit of the company.'[258] The standard expressed herein, still has a strong objective standard of review - being *reasonableness.*

Hereafter, a slight change to the wording of the test can be found. In emphasis, the two previous tests had an element of reasonableness – as a subject related to the shareholders or directors. In other words what was required was '*reasonable men'* and the '*directors should have reasonably believed'*.

A slight change to wording can be found in *Teck Corporation Ltd. v Millar* [259] (hereafter, *Teck Corporation*). Herein, the court stated that directors are required to act honestly and must have believed that they were acting substantially for the benefit of the company.[260] Importantly, this belief must be founded on *'reasonable grounds.*[261] Key emphasis must be placed on the subjects of each test. In the previous tests of *Shuttleworth* and *Charterbridge Corporation Ltd v Lloyds Bank Ltd* there is a clear emphasis on the actor or decision maker. *Teck Corporation* shifts the subject from *reasonable men* and *'director to have reasonably believed'* to '*reasonable grounds'*. Thereby, taking the emphasis away from the question of 'did the actor act reasonably?' to a new emphasis of 'was there reasonable grounds for the actor's decision.

The test applied for examining whether there are reasonable grounds for an actor's decision can be similarly expressed as:

> If there are *no reasonable grounds* for an actor's decision, then that actor would fail the review test and would be held liable by the court.

Academics have expressed that a rationality test is expressed as an 'absence of any reasonable ground'.[262] In effect, if there is an absence of any reasonable ground the action

[258] *Charterbridge Corporation Ltd v Lloyd"s Bank* 1970 Ch2; and see also in *Teck Corp Ltd v Millar* 1972 33 DLR (3d) 288 (BCSC)315–316 the court held that "[t]he directors must act in good faith. Then there must be reasonable grounds for their belief. If they say that they believe there will be substantial damage to the company's interests, then there must be reasonable grounds for that belief. If there are not, that will justify a finding that the directors were actuated by an improper purpose'; Van Tonder J '*An analysis of the directors' duty to act in the best interest of a company, through the lens of the business judgement rule'* 715.
[259] *Teck Corp Ltd v Millar* 1972 33 DLR (3d) 288.
[260] *Teck Corp Ltd v Millar*1972 33 DLR (3d) 288.
[261] *Teck Corp Ltd v Millar 1972* 33 DLR (3d) 288.
[262] Cassim *et al* 'Contemporary Company law 2nd edition' (2012) 524. van Tonder J '*An Analysis of the Directors'Duty to Act in the Best Interests of the Company, through the Lens of the Business Judgment Rule*' (2015) 3 *Obiter* 715.

taken was irrational. A '*no reasonable grounds'* test is thus appearing to be synonymous with a rationality test – but it is not.

This author is of the view that the difference between the two standards is a simple exercise of plural against singular. The standard of review (*no reasonable grounds*) for acting in the best interest of the company is plural. Therefore, in order to show that a director acted reasonably the standard only requires the *existence* of multiple *grounds* supporting the directors decision. A rationality test, or absence of any reasonable ground hinges on the singularity – the test asks for a singular factor or ground. The absence of a single ground supporting the director(s) decision, results in the action taken by a director being regarded as irrational.

The same '*reasonable grounds'* test can be found in *Howard Smith v. Ampol Petroleum Ltd*,[263] where the court stated that 'directors are entitled to consider the reputation, experience and policies of anyone seeking to take over the company: If they decide, on *reasonable grounds*, a takeover will cause substantial damage to the company's interests, they are entitled to use their powers to protect the company.'[264] Whilst this standard of judicial review does not directly respond to the duty to act in the best interests of a company, it still relates to generally taking into account the company's interests.

The Companies Act, in effect changed the standard of review for testing whether a director has acted in the best interest of a company. S76(4)(a)(iii) provides that the director must have had a '*rational basis* for believing, and did believe, that the decision was in the best interest of the company'.[265] This change took full effect in *Visser Sitrus* where the court applied the standard of review directly as expressed in s76(4)(a)(iii), which will be discussed in Chapter 4.4.3 of this dissertation.[266]

[263] Howard Smith v Ampel Petroleum Ltd [1974]1 All ER 1126 (PC).

[264] L Ritson, "*The Proper Purposes Duty of Directors and Defensive Measures against Company Takeovers - Pine Vale Investments Ltd. v. McDonnell and East Ltd.,"* 1985 *Sydney Law Review* 10, no. 3 627-638, 631.

[265] The Companies Act 71of 2008, s76(4)(a)(iii)

[266] See Re Smith & Fawcett Ltd supra; and Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd supra par74. Van Tonder J 'An analysis of the director's duty to act in the best interest of a company, through the lens of the business judgement rule' 716.

4.4. <u>The standard of rationality in the USA, Australia and South Africa</u>

The standard of rationality for the review of the duty to act in the best interest of a company is not unique to South African law, the standard appears in the USA and Australian formulations of the BJR.

4.4.1. <u>Rationality USA</u>

In terms of the Delaware formulation, there are some conflicting views, while most academics agree that the rationality standard is present, some academics consider the rationality standard only applicable to the ALI formulation. [267] In terms of the more popular views, the Delaware formulation provides that if the directors comply with both their duty of care in the process of making a decision and their duty of loyalty – which requires that they act in good faith and that there be no direct conflict – then the decision will only be subject to 'rationality review'. [268] This 'rationality review' standard is founded on an amalgamation of various formulations used in various US jurisdictions, such as 'egregious', 'reckless', and 'irrational', and generally means 'a decision which no person of ordinary sound business judgment would make'.[269] In this regard Delaware case law establishes that 'gross negligence is the standard to be applied in deciding whether the directors may be held liable for reaching the '*wrong decision*' and that the rational belief standard is the absence of gross negligence.[270] In this view, if there is a rational reason to support the decision, courts will not inquire further.[271] This is the view which appears to be generally supported by most academics.[272] As commonly seen in judicial review, the court will assess the board's conduct by placing an emphasis on the process the board took in coming to a decision and not the actual wisdom thereof. [273] In other words, if a rational

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[267] Brandson D 'The rule that isn't a rule – The Business Judgment rule' (2002) 36(3) *Valparaiso University Law Review* 643. See Lyman Johnson, The Modest Business Judgment Rule, 55 Bus. LAW. 625,632-33 (2000)

[268] Kershaw D 'The Foundations of Anglo-American Corporate Fiduciary Law' (2018) 3.

[269]Charles Hansen, '*The Duty of Care, The Business Judgment Rule and the American Law Institute Corporate Governance Project'* (1993) 48 *Business Lawyer* 1355, 1375

[270] M Legg & Jordan '*The Australian Business Judgment Rule after ASIC v. Rich: Balancing Director Authority and Accountability'* (2014) *Adelaide Law Review* Vol 34 at 412.

[271] Kershaw D 'The Foundations of Anglo-American Corporate Fiduciary Law' (2018) 3.

[272] Smit I *The application of the Business Judgment Rule in fundamental transactions and insolvent trading in South Africa: foreign precedents and local choices* (published LLM Thesis, 2016) 23; see also Mupangavanhu BM*'Standard of Conduct or Standard of Review? Examination of an African Business Judgement Rule under South Africa's Companies Act 71 of 2008'* (2019), 133

[273] In Re Walt Disney Co. Derivative Litig. 906 A.2d at 74 (quoting Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971))

reason can be attributed to a decision taken by a director, then that decision will be upheld by the courts.

In relation to the ALI formulation, 4.01(c) of the ALI Corporate Governance Project provides that:

> A director or officer who makes a business judgment in good faith fulfills the duty under this Section if the director or officer: (1) is not interested in the subject of the business judgment; (2) is informed with respect to the subject of the business judgment to the extent the director or officer reasonably believes to be appropriate under the circumstances; and (3) rationally believes that the business judgment is in the best interests of the corporation'[274]

From the ALI construction of the BJR it is clear that, in review, different standards are applied. In terms of the duty to be informed, the standard is that the director must have believed that they were reasonably informed. [275] Whereas, in terms of acting in the best interest of a company, the director must have rationally believed that they were acting in the best interest of the company. [276]

Academics have made it a point to argue that the ALI was cognisant of the distinction between 'reasonable' and 'rational' when drafting the ALI formulation of the BJR.[277] The reasonable standard requires a court to look at whether a third-party would have acted in the same manner as the director.[278] In other words, it is aspirational in nature.[279] It is expressed that the phrase 'rationally believes' is intended to permit a significantly wider range of discretion to the director(s) than the term 'reasonable' – this gives a director or officer a safe harbour from liability for business judgments that might arguably fall outside the term 'reasonable' but not

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[274] American Law Institute, ALI Corporate Governance Project (1994) para 4.01(c).

[275] American Law Institute, ALI Corporate Governance Project (1994).

[276] Veasey N 'On Corporate Codification: A Historical Peek at the Model Business Corporation Act and the American Law Institute Principles Through the Delaware Lens' available at https://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=1611&context=lcp (accessed on 21/03/2022).

[277] M Legg & Jordan '*The Australian Business Judgment Rule after ASIC v. Rich: Balancing Director Authority and Accountability'* (2014) *Adelaide Law Review* Vol 34 at 424.

[278] Veasey N 'On Corporate Codification: A Historical Peek at the Model Business Corporation Act and the American Law Institute Principles Through the Delaware Lens' available at https://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=1611&context=lcp (accessed on 21/03/2022).

[279] Veasey N 'On Corporate Codification: A Historical Peek at the Model Business Corporation Act and the American Law Institute Principles Through the Delaware Lens' available at https://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=1611&context=lcp (accessed on 21/03/2022).

to extent that liability should be incurred.[280] In other words, a decision taken by a director could be classified as unreasonable – but will not easily be classified as irrational. Therefore, the standard of rationality is much less stringent than a standard of reasonable – although both standards involve an objective review.[281]

Importantly, the inquiry is not an examination of substance, but only of whether the decision actually made was a rational outcome of the decision-making process actually undertaken. [282] Essentially, the court asks whether there is a rational connection between the sound process actually undertaken and the decision actually reached. Therefore, a rational basis standard would lead judges away from examining the soundness of the decision-making process, to an examination of the decision itself.[283]

4.4.2. Rationality Australia

The fourth requirement of the business judgment rule in terms of s180(2) of the Australian Corporations Act, requires the director(s) to 'rationally believe that the judgment is in the best interests of the corporation'.[284] This requirement is qualified by the statement that 'the director's or officer's believe, 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'.[285]

Prior to the case of *Asics v Rich* (hereafter *Asics*)[286] it had been an open question as to the scope of the rational requirement found in s180(2), specifically whether this was similar to or lesser than the standard of objective reasonableness in s180(1). The court confirmed herein that the rational requirement is not the same as a reasonableness requirement.[287] In doing so, the court

[280] American Law Institute, ALI Corporate Governance Project (1994); See *ASIC v Rich* (2009) 236 FLR 1, 153 [7286].

[281] M Legg & Jordan '*The Australian Business Judgment Rule after ASIC v. Rich: Balancing Director Authority and Accountability'* (2014) *Adelaide Law Review* Vol 34 at 424.

[282] Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971); see also A.L.I. Principles of Corporate Governance: Analysis and Recommendations paragraph 4.01 at 173 (1994).

[283] Bainbridge S '*The difference between reasonableness and rationality in corporate law'* available at http://www.professorbainbridge.com/professorbainbridgecom/2010/09/the-difference-between-reasonablenessand-rationality.html (accessed on 15/06/2020).

[284] Corporations Act 2001 (Cth) s180(2)(d).

[285] M Legg & Jordan '*The Australian Business Judgment Rule after ASIC v. Rich: Balancing Director Authority and Accountability'* (2014) *Adelaide Law Review* Vol 34 at 422.

[286] ASIC v Rich (2009) 236 FLR 1, 153.

[287] ASIC v Rich (2009) 236 FLR 1, 153.

in *Asics* referred to the ALI's formulation of the business judgment rule and the Shorter Oxford English Dictionary to determine that the standard of the word 'rational' is less than that of 'reasonable'.[288] Consequently, the Australian provision is very similar to the ALI formulation of the BJR. This is due to the court preferring an interpretation of s180(2)(d) that is similar to the interpretation of rationality under the ALI BJR formulation.[289] It was explained that the scope of s180(2)(d) as follows 'subparagraph (d) is satisfied if the evidence shows that the defendant believed that his or her judgment was in the best interests of the corporation, and that belief was supported by a reasoning process sufficient to warrant describing it as a rational belief, as defined, whether or not the reasoning process is objectively a convincing one'.[290] The court thought it plausible to say that the drafters of the sub-section intended to capture the meaning that 'the director's or officer's belief would be a rational one if it was based on reason or reasoning, but would not be a rational belief if there was *no arguable reasoning process to support it* (emphasis added).[291] This was articulated by using the words '*no reasonable* person in their position would hold.[292] Conclusively, a director's belief that a certain decision is in the best interests of the corporation will be rational if there is some arguable reasoning process to support it.[293] The test may be expressed differently as a question of whether or not *there is an arguable reason supporting* that the director(s) believed that the decision taken is in the best interest of the company.

4.4.3. **Rationality through the court in *Visser Sitrus***

The court in *Visser Sitrus* makes it clear that in relation to s76(4) that the duty imposed by s76(3)(b) to act in the best interests of the company is not an objective one, in the sense of entitling a court, if a board decision is challenged, to determine what is objectively speaking in the best interests of the company.[294] Thereby, confirming that the duty to act in the best interest of a company is a subjective duty, as discussed in Chapter 2.2 of this dissertation. The court

[288] ASIC v Rich (2009) 236 FLR 1, 153.
[289] M Legg & Jordan '*The Australian Business Judgment Rule after ASIC v. Rich: Balancing Director Authority and Accountability'* (2014) *Adelaide Law Review* Vol 34 at 423.
[290] M Legg & Jordan '*The Australian Business Judgment Rule after ASIC v. Rich: Balancing Director Authority and Accountability'* (2014) *Adelaide Law Review* Vol 34 at 423.
[291] ASIC v Rich (2009) 236 FLR 1, 154 [7289].
[292] ASIC v Rich (2009) 236 FLR 1, 154 [7289].
[293] M Legg & Jordan '*The Australian Business Judgment Rule after ASIC v. Rich: Balancing Director Authority and Accountability'* (2014) *Adelaide Law Review* Vol 34 at 423.
[294] *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd and* others at 74.

also remarks that the 'rationality requirement has been articulated less frequently in the conventional statement of directors' duties but is not necessarily an innovation'.[295] The court affirms that the rationality criterion as laid down in s76 is an objective one but its threshold is quite different from, and more easily met than, a determination as to whether the decision was objectively in the best interests of the company.[296]

Importantly, the court expresses that the BJR requires the director(s) to act in the best interest of a company, by undertaking a *bona fide* assessment which must have a rational underpinning.[297] In this regard, the court links the standard of rationality to a '*no reasonable director´* test by referring to authors of Palmer's Company Law which point out '*no reasonable* director' test is merely an aid in answering the ultimate factual question, which is whether the directors were acting in what they bona fide believed to be the best interests of the company.[298]

The link between good faith and rationality also is supported by other academics. Mupangavanhu illustrates that the standard of rationality cannot conceivably exclude good faith.[299] Thus, it is generally supported that an indication of bad faith on the part of a director would be indicative of a decision taken irrationally. Eisenberg, also draws this link between rationality and good faith noting that for a decision to be taken in good faith it is required that it be rational.[300]

This author also supports the view that an indication of bad faith on the part of the director(s) would be indicative of a decision taken irrationally. However, the decision of the court to read in good faith as a requirement under the BJR seems ill-fitting, due to good faith being linked to acting for a proper purpose in terms of s76(3)(a) of the Companies Act – and thereby falling outside the scope of the BJR in s76(4) of the Act. In this regard, if a decision taken by the director(s) is indicative of bad faith, the director(s) would have failed the statutory duty in s76(3)(a) – for which the BJR cannot be utilised to escape liability.

[295] *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd and* others at 75.
[296] *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd and* others at 76.
[297] The Companies Act s76(4)(a)(iii); and *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd and* others (case no: 15854/2014). Van Tonder J '*An analysis of the director's duty to act in the best interest of a company, through the lens of the business judgement rule'* 716.
[298] *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd and* others at 74-75; Van Tonder J '*An analysis of the director's duty to act in the best interest of a company, through the lens of the business judgement rule'* 716.
[299] Mupangavanhu BM '*Standard of Conduct or Standard of Review? Examination of an African Business Judgment Rule under South Africa's Companies Act 71 of 2008'* (2019), 146.
[300] Eisenberg M *'The Divergence of standards of conduct and standards of review in Corporate law'* (1993)442.

Hereafter, the court draws parallels to public law – specifically in the context of the legality principle applicable to the exercise of public power. In this regard, in an attempt to interpret the rationality test the court in *Visser Sitrus* reffered to Chaskalson P in Pharmaceutical Manufacturers Association of SA & Another[301]:

'The setting of this standard [rationality] does not mean that the Courts can or should substitute their own opinions as to what is appropriate for the opinions of those in whom the power has been vested. As long as the purpose sought to be achieved by the exercise of public power is within the authority of the functionary, and as long as the functionary's decision, viewed objectively, is rational, a Court cannot interfere with the decision simply because it disagrees with it or considers that the power was exercised inappropriately. A decision that is objectively irrational is likely to be made only rarely but, if this does occur, a Court has the power to intervene and set aside the irrational decision'.[302]

The court thereafter elaborated on how the standard is applied in relation to the exercise of a public power.

> 'Again, in the context of the exercise of public power, the requirement of rationality has been held to concern the relationship between the decision and purpose for which the power was given. Was the decision or the means employed rationally related to the purpose for which the power was given?'[303]

Firstly, by doing this the court reaffirms that in relation to s76(4) that the duty to act in the best interests of the company is not an objective one, in the sense of entitling a court, if a board decision is challenged, to determine what is objectively speaking in the best interests of the company.[304] As discussed throughout Chapter 4 of this dissertation, in the judicial review of a directors duty, the court will assess the board's conduct by placing an emphasis on the process the board took in coming to a decision and not the actual wisdom thereof. Therefore, this author finds no need to link the review of the director(s) duty to the review of a *public power* (which exists outside the realm of company law) for

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[301] Chaskalson P in Pharmaceutical Manufacturers Association of SA & Another Ex parte President of the Republic of South Africa & Others 2000 (2) SA 674 (CC) paragraph 90.
[302] *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd and* others at 76
[303] *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd and* others at 77
[304] *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd and* others at 74

the apparent purpose of expressing the process of the judicial review of the director(s) duty – as this process already exists company law and is greatly accepted.

The court also states that relation to a *public power* 'As long as the purpose sought to be achieved by the exercise of *public power* is within the authority of the functionary, and as long as the functionary's decision, viewed objectively, is rational'. The court hereby links rationality to acting for a proper purpose - which falls outside the scope of the BJR and is a codified duty in terms of s76(3)(a) of the Companies Act.

As stated previously, the BJR *only* protects a director where that director breached the codified duty in terms of s76(3)(b) namely, the duty to act in the best interest of the company and s76(3)(c) the duty to act with the necessary degree of care, skill and diligence. S76(3)(a) of the Companies Act, couples the duty to act in good faith with the duty of acting for a proper purpose. The effect hereof is that the BJR cannot be relied upon to escape the statutory duty found at s76(3)(a). Therefore, the duty to act in good faith and for a proper purpose fall outside the application of the BJR. Essentially In this regard, if a decision taken by the director(s) is indicative of bad faith or exercised for an improper purpose, the director(s) *cannot* in any event rely on the BJR to escape liability – as they will be held liable as per s76(3)(a) of the Companies Act.

4.5. <u>The appropriateness of rationality vs reasonability as a standard of judicial review</u>

> *'The rationality test is far less stringent in comparison to the reasonable test as it is easy to characterise a directors conduct as imprudent or unreasonable, but it is very uncommon to characterise a directors'conduct as irrational'.*[305]

Eisenberg hereby observes that the standard of rationality is less demanding and, in effect, easier to satisfy than the reasonableness standard. Cassidy also points out that requiring rationality is a reduction from the commonly used standard of reasonableness.[306] Rationality as a standard of review implies that the director(s) may act unreasonable, but as long as their decision is not wholly irrational - compliance with the rationality standard will have been

[305] Eisenberg M '*The Divergence of Standards of Conduct and Standards of Review in Corporate Law*' (1993) 62 Fordham Law Review 443.
[306] Cassidy J *'Models for reform: The Directors duty of care in a Modern Commercial World.'* (2009) 400.

met.[307] According to Eisenberg, the rationality test only requires minimal bases of reason.[308] In this regard, conduct which may be imprudent or unreasonable is not necessarily irrational. Thus, the difference between the two standards, namely rationality and reasonableness, is quite significant. An example of where a director will fail the rationality test is when a decision is taken that is unable to be explained.[309] Therefore, if a director fails to give a satisfactory explanation or advance any justification for a decision taken, the rationality standard cannot be met.[310]

Although the standard of rationality is easier met, its interpretation is a lot harder to conceive than the standard of reasonableness. To illustrate, rationality requires logical thinking to take place and as a result thereof, when directors are expected to exercise rationality – the manner in which this is done can take different forms.[311] Therefore, there is no uniform criteria used by courts to determine rationality.[312] Unlike rationality, reasonableness has a uniform criteria used by the courts – that being 'the reasonable man' test.

Eisenberg argues the logic behind backing a rationality standard over the standard of reasonableness in the court's review of the duty to act in the best interest of a company. [313] Eisenberg is of the view that the application of reasonableness as a standard of review has a greater risk of leading the discussion into the quality of disinterested decisions[314] by directors and officers – which could result in the unfair imposition of liability.[315] Eisenberg's argument follows three main points; Firstly the nature of business itself is such that rationality is a better

[307] Cassidy J *'Models for reform: The Directors duty of care in a Modern Commercial World.'* (2009) 400.
[308] Eisenberg M *'The Divergence of standards of conduct and standards of review in Corporate law'* (1993) 442.
[309] Eisenberg M *'The Divergence of standards of conduct and standards of review in Corporate law'* (1993) 443.
[310] Eisenberg M *'The Divergence of standards of conduct and standards of review in Corporate law'* (1993) 443.
[311] Bainbridge S '*The difference between reasonableness and rationality in corporate law*' available at http://www.professorbainbridge.com/professorbainbridgecom/2010/09/the-difference-between-reasonablenessand-rationality.html (accessed on 15/06/2020).
[312] Bainbridge S '*The difference between reasonableness and rationality in corporate law*' available at http://www.professorbainbridge.com/professorbainbridgecom/2010/09/the-difference-between-reasonablenessand-rationality.html (accessed on 15/06/2020).
[313] Eisenberg M '*The Divergence of Standards of Conduct and Standards of Review in Corporate Law'* (1998) 62(3) *Fordham Law Review* 443.
[314] Disinterested decisions, appear to refer to those decisions which are not of personal or financial interest to the director.
[315] Eisenberg M '*The Divergence of Standards of Conduct and Standards of Review in Corporate Law'* (1998) 62(3) *Fordham Law Review* 443.

standard for the courts review, secondly interests of shareholders need to be considered, lastly the disproportionality between directors' and officers' incentives and liability.[316]

In terms of the nature of business, Eisenberg first illustrates the nature of ordinary (non-business) negligent cases – like automobile accidents. These cases often involve simple (non-complex) decision-making therefore there is often little difference between decisions that turn out badly and bad decisions.[317] In other words, a negative consequence in ordinary negligence cases is mostly the result of bad decision making. In these types of cases there is typically only one reasonable decision which could have been made to avoid the harm caused.[318] Conversely, the nature of business and business decisions makes it difficult to distinguish between bad-decisions and proper decisions that turn out badly.[319] To illustrate this;

> '[b]usiness judgements are necessarily made on the basis of incomplete information and in the face of obvious risks, so that typically *a range of decisions is reasonable*. A decision maker faced with uncertainty must make a judgment concerning the relevant probability distribution and must act on that judgement. If the decision maker makes a reasonable assessment of the probability distribution, and the outcome falls on the unlucky tail, the decision maker has not made a bad decision, because in any normal probability distribution some outcomes will inevitably fall on the unlucky tail.'[320]

This emphasises that business decisions at its core involve a level of uncertainty and risk taking. As such, a range of decisions can yield unfavourable results. This is due to the outcomes of business decisions being probable and not certain. In addition, the court and judicial officers are experts in legal services but are not trained in business. As such, under the reasonableness standard of review courts might too often erroneously treat decisions that yield unfavourable results as bad decisions – thereby unfairly holding directors liable for such decisions.[321] The

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316 Eisenberg M '*The Divergence of Standards of Conduct and Standards of Review in Corporate Law'* (1998) 62(3) *Fordham Law Review* 437.
317 Eisenberg M '*The Divergence of Standards of Conduct and Standards of Review in Corporate Law'* (1998) 62(3) *Fordham Law Review* 443.
318 Eisenberg M '*The Divergence of Standards of Conduct and Standards of Review in Corporate Law'* (1998) 62(3) *Fordham Law Review* 443.
319 Eisenberg M '*The Divergence of Standards of Conduct and Standards of Review in Corporate Law'* (1998) 62(3) *Fordham Law Review* 443.
320 Eisenberg M '*The Divergence of Standards of Conduct and Standards of Review in Corporate Law'* (1998) 62(3) *Fordham Law Review* 444.
321 Eisenberg M '*The Divergence of Standards of Conduct and Standards of Review in Corporate Law'* (1998) 62(3) *Fordham Law Review* 444.

overall aim of the BJR is to protect directors and other officers from such unfair liability by providing directors and officers with a large zone of protection when their decisions are attacked.[322] Therefore, this overall aim seems to be better served with the standard of rationality used in the review of a directors duty to act in the best interest of a company.

Secondly, in relation to the shareholders' interests being served, Eisenberg expresses that the shareholders' own best interests may be served by conducting only a very limited review of the quality of the directors' and officers' decisions.[323] Although Eisenberg narrows this argument down to *Shareholders interests*, given the modern understanding that directors serve the whole company's interests (that being interests of shareholders and other key stakeholders) the same point of discussion by Eisenberg could apply directly to the company's interests as a whole. A discussion as to what '*the best interests of a company'* entails, is provided in Chapter 2.2.4 of this dissertation.

Eisenberg also expressed that '[i]t is often in the interests of shareholders [and other key stakeholders] that directors or officers choose the riskier of the two alternative decisions, if the expected value of a riskier decision may be greater than the expected value of the less risky decision.'[324] This view correlates with the view that companies are to decide their own risk appetite. In other words, the BJR exists to grant directors certain discretion that allows the company to determine its appetite for risk.[325] Essentially, without the existence of the rule, the court would be indirectly determining the risk level of companies.[326] A standard of review that imposed liability on a director or officer for unreasonable as opposed to irrational decisions might have the effect of discouraging bold but desirable decisions.[327] This is because the court ultimately gets to decide what is reasonable in accordance with the risk profile of the court and not the company. Reasonableness as a standard of review runs a greater risk of the substitution of the company's risk appetite with that of the courts.

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[322] Eisenberg M '*The Divergence of Standards of Conduct and Standards of Review in Corporate Law'* (1998) 62(3) *Fordham Law Review* 444.

[323] Eisenberg M '*The Divergence of Standards of Conduct and Standards of Review in Corporate Law'* (1998) 62(3) *Fordham Law Review* 444.

[324]Eisenberg M '*The Divergence of Standards of Conduct and Standards of Review in Corporate Law'* (1998) 62(3) *Fordham Law Review* 444.

[325] Kennedy-Good S and Coetzee L '*The Business Judgment Rule (Part 1)*' (2006) 27(1) *Obiter* 65.

[326] Kennedy-Good S and Coetzee L *'The Business Judgment Rule (Part 1)*' (2006) 27(1) *Obiter* 65.

[327] E Eisenberg M '*The Divergence of Standards of Conduct and Standards of Review in Corporate Law'* (1998) 62(3) *Fordham Law Review* 445.

Lastly – especially in the case of non-management directors – liability for the losses caused by an imprudent business decision is often far out of proportion to the incentives for accepting a directorship.[328] Therefore, in absence of limitation on such liability, it might become more difficult to attract qualified candidates as management and non-management directors, which also would be contrary to the shareholders' [and other key stakeholders] own best interests.[329] This is in line with the view that the BJR exists for the purpose of persuading competent persons to undertake the office of director. This view illustrates the desire and need in the market to encourage competent persons to serve as directors.[330]

4.6. Conclusion

Standards of conduct specifies how directors should conduct themselves. Conversely, the BJR is a standard of review which sets forth the test courts will use in determining whether the directors' conduct gives rise to liability. Standards of conduct and review are usually conflated or converged – this is usually done to simplify the review process. As much as standards converge, oftentimes we find in law that there is a divergence between standards of conduct and review. From a South African company law perspective, the requirements related to acting in the best interest of a company, is quite different at s76(3)(b) compared to s76(4)(a)(ii). S76(3)(b) of the Companies Act simply requires that the director(s) conduct their duties in the best interest of a company – hereby indicating no threshold. Whereas, in terms of s76(4)(a)(ii) of the Companies Act, the standard of conduct for acting in the best interest of a company at judicial review rests on whether the director(s) had a rational belief – that they were acting in the company's best interest. This illustrates a divergence in the standard of conduct and the standard of review.

The duty or standard of the director(s) conduct to act in the best interest of a company has always had an objective standard attached thereto when reviewed by the courts. This objective standard at judicial review drastically changed over the years.

[328] E Eisenberg M '*The Divergence of Standards of Conduct and Standards of Review in Corporate Law'* (1998) 62(3) *Fordham Law Review* 445.
[329] E Eisenberg M '*The Divergence of Standards of Conduct and Standards of Review in Corporate Law'* (1998) 62(3) *Fordham Law Review* 445.
[330] Block, Barton and Radin '*The Business Judgement Rule: Fiduciary Duties of Corporate Directors' and Officers'* (1987) 42 *The Business lawyer* 995.

Historically, the English Court of Appeal in *Shuttleworth* laid down the test for deciding whether a director was acting in the best interest of the company. Accordingly, the court remarked that the question to be asked was whether reasonable shareholders could have considered the action to be of benefit to the company.[331] This is clearly a standard of reasonableness.

The Companies Act provides for the current standard of review for testing whether a director has acted in the best interest of a company. S76 (4) (a) (iii) provides that the director must have had a 'rational basis for believing, and did believe, that the decision was in the best interest of the company'. The standard articulated by the Companies act is clearly a rationality standard.

Importantly, the rationality test is far less stringent in comparison to the reasonable test as it is easy to characterise a director's conduct as imprudent or unreasonable, but it is very uncommon to characterise a directors conduct as irrational'.

The USA formulations of the BJR also provided for the rationality standard to test whether an action taken was in the best interest of a company. The Delaware formulation provided that 'rationality review' standard is founded on an amalgamation of various formulations used in various US jurisdictions, such as 'egregious', 'reckless', and 'irrational', and generally means 'a decision which no person of ordinary sound business judgment would make'.[332] The ALI expressed that the phrase 'rationally believes' is intended to permit a significantly wider range of discretion to the director(s) than the term 'reasonable' – this gives a director or officer a safe harbour from liability for business judgments that might arguably fall outside the term 'reasonable' but not to extent that liability should be incurred. In other words, a decision taken by a director could be classified as unreasonable – but will not easily be classified as irrational. Therefore, the standard of rationality is much less stringent than a standard of reasonable – although both standards involve an objective review.

The Australian BJR, also contained this rationality standard. In terms of which, the presumption is that 'the director's or officer's belief that the judgment is in the best interests

[331] R Williams '*Bona fide in the interest of certainty'* (2007) *The Cambridge Law Journal, 66*(3), 500-503, 501
[332] Hansen C, '*The Duty of Care, The Business Judgment Rule and the American Law Institute Corporate Governance Project'* (1993) 48 *Business Lawyer* 1355, 1375.

of the corporation is a rational one unless the belief is one that *no reasonable* person in their position would hold'.[333]

The court in *Visser Sitrus* makes it clear that in relation to s76(4) that the duty imposed by s76(3)(b) to act in the best interests of the company is not an objective one, in the sense of entitling a court to determine what is objectively speaking in the best interests of the company.[334] The court also remarks that the 'rationality requirement has been articulated less frequently in the conventional statement of directors' duties but is not necessarily an innovation'.[335] The court affirms that the rationality criterion as laid down in s76 is an objective one but its threshold is quite different from, and more easily met than, a determination as to whether the decision was objectively in the best interests of the company.[336]

Importantly, the court expresses that the BJR requires the director(s) to act in the best interest of a company, by undertaking a *bona fide* assessment which must have a rational underpinning.[337] In this regard, the court links the standard of rationality to a '*no reasonable director´* test by referring to authors of Palmer's Company Law which point out '*no reasonable* director' test is merely an aid in answering the ultimate factual question, which is whether the directors were acting in what they bona fide believed to be the best interests of the company.[338]

The link between good faith and rationality also is supported by other academics. Mupangavanhu illustrates that the standard of rationality cannot conceivably exclude good faith.[339] Thus, it is generally supported that an indication of bad faith on the part of a director would be indicative of a decision taken irrationally. Eisenberg, also draws this link between rationality and good faith noting that for a decision to be taken in good faith it is required that it be rational.[340]

[333] M Legg & Jordan '*The Australian Business Judgment Rule after ASIC v. Rich: Balancing Director Authority and Accountability'* (2014) *Adelaide Law Review* Vol 34 at 422.
[334] *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd and* others at 74.
[335] *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd and* others at 75.
[336] *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd and* others at 76.
[337] The Companies Act s76(4)(a)(iii); and *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd and* others (case no: 15854/2014). Van Tonder J '*An analysis of the director's duty to act in the best interest of a company, through the lens of the business judgement rule'* 716.
[338] *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd and* others at 74-75; Van Tonder J '*An analysis of the director's duty to act in the best interest of a company, through the lens of the business judgement rule'* 716.
[339] Mupangavanhu BM '*Standard of Conduct or Standard of Review? Examination of an African Business Judgment Rule under South Africa's Companies Act 71 of 2008'* (2019), 146.
[340] E Eisenberg M '*The Divergence of Standards of Conduct and Standards of Review in Corporate Law'* (1998) 62(3) *Fordham Law Review* 442.

Hereafter, the court draws parallels in terms of public law. The court stated that in the context of the legality principle applicable to the exercise of public power;

Chaskalson P said the following in Pharmaceutical Manufacturers Association of SA & Another: In re Ex parte President of the Republic of South Africa & Others 2000 (2) SA 674 (CC) (para 90):'The setting of this standard [rationality] does not mean that the Courts can or should substitute their own opinions as to what is appropriate for the opinions of those in whom the power has been vested. As long as the purpose sought to be achieved by the exercise of public power is within the authority of the functionary, and as long as the functionary's decision, viewed objectively, is rational, a Court cannot interfere with the decision simply because it disagrees with it or considers that the power was exercised inappropriately. A decision that is objectively irrational is likely to be made only rarely but, if this does occur, a Court has the power to intervene and set aside the irrational decision'.[341]

The court thereafter elaborated on how the standard is applied in relation to the exercise of a public power.

> 'Again, in the context of the exercise of public power, the requirement of rationality has been held to concern the relationship between the decision and purpose for which the power was given. Was the decision or the means employed rationally related to the purpose for which the power was given?'[342]

The court also states that relation to a public power 'As long as the purpose sought to be achieved by the exercise of public power is within the authority of the functionary, and as long as the functionary's decision, viewed objectively, is rational'. The court hereby links rationality to acting for a proper purpose - which falls outside the scope of the BJR and is a codified duty in terms of s76(3)(a) of the Companies Act.

In conclusion, the court provides little assistance in explaining the rationality requirement. It simply links it to acting in good faith and for a proper purpose, which is the duty codified by s76(3)(a) of the Companies Act.

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[341] *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd and* others at 76

[342] *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd and* others at 77

The *Visser Sitrus* case clearly shows how South African courts are battling to understand the requirement of rationality in s76(4)(a)(iii)(aa) of the Companies Act. This questions the appropriateness of rationality as a standard of review. Eisenberg convincingly discusses the appropriateness of the rationality standard against the commonly used standard of reasonableness.

Eisenberg illustrates many reasons as to why the standard of rationality is more appropriate than the standard of reasonableness. In summary, the application of reasonableness as a standard of review has a greater risk of leading the discussion into the quality of disinterested decisions by directors and officers – which could result in the unfair imposition of liability.[343] The author's argument follows three main points; Firstly, the nature of business itself is such that rationality is a better standard for the courts review, secondly interests of shareholders need to be considered, lastly the disproportionality between directors' and officers' incentives and liability.[344]

This chapter has provided for a clear understanding of the rationality standard of review - by engaging in discussions central thereto. This chapter together with chapters 2 and 3, concludes the research on the rationality standard for reviewing a director's conduct.

Chapter 5 will provide recommendations as to whether there is a need for the Companies Act to include good faith as a requirement under s76(4) of the act - hereby drawing from discussions in Chapter 2.2.5 and Chapter 3.4.2.iv of this dissertation. Recommendations will also be made in Chapter 5 as to whether there is a need for further research on the development of the judicial review of the duty to act in the best interest of a company; what can be learnt from the *Visser Sitrus* judgment as well as whether the advancements made by Einsenberg are enough to conclude on the appropriateness of rationality as a standard of review - hereby drawing from discussions in this chapter.

343 Eisenberg M '*The Divergence of Standards of Conduct and Standards of Review in Corporate Law'* (1998) 62(3) *Fordham Law Review* 443.
344 Eisenberg M '*The Divergence of Standards of Conduct and Standards of Review in Corporate Law'* (1998) 62(3) *Fordham Law Review* 437.

CHAPTER FIVE: CONCLUSIONS AND RECOMMENDATIONS

5.1. Introduction

The aim of this dissertation was to engage in the examination of the BJR through the lens of rationality as a standard of judicial review – as found in s76(4)(a)(iii) of the Companies Act. A general analysis was conducted of the statutory duties of a director as codified in terms of s76(3)(b) and (c) of the Companies Act – which are directly linked to the South African BJR. Thereafter, a general analysis of the formulations of the BJR found in the USA, Australia and South Africa was conducted. Thereafter this dissertation discussed rationality as a standard of judicial review – which was found to exist in all of the BJR formulations discussed in this dissertation, namely, the USA formulations, the Australian formulation as well as the South African formulation. The last investigation in this dissertation considered the appropriateness of the rationality standard of judicial review when compared to the well-known reasonableness standard of judicial review.

This chapter will consist of two main sections, namely, conclusions and recommendations. The conclusions will be based on the overall findings of the dissertation. The recommendations on the other hand will focus and readdress on four important concerns. Firstly, Does the Companies Act need to be amended to include good faith as a requirement under s76(4); Secondly, is there a need for more research on the judicial review of the duty to act in the best interest of a company; Thirdly, what can be learnt from the *Visser Sitrus* judgment and lastly, are the advancements made by Einsenberg enough to conclude on the appropriateness of rationality as a standard of review.

5.2 Conclusions

In in relation to a director's duties, if a director complies with the requirements of the BJR found in s76(4) of the Companies Act, they may escape liability for failing to act in the best interest of a company and/or acting with the necessary degree of skill care and diligence – as codified by s76(3)(b) and s76(3)(c) of the Companies Act. An overview of these duties is discussed in Chapter 2 of this dissertation.

Chapter 3 of this dissertation provided for an overview of the BJR. As per the Chapter 3 discussion, the BJR originated in the USA and was developed alongside the duty of care. The USA has two distinctive formulations of the BJR. These formulations are, namely, Delaware formulation, which is a common law version of the BJR as developed by the courts in the state of Delaware. The second USA formulation is the codified ALI formulation. Of the two USA formulations, the Delaware formulation is the most prominent as it has been largely adopted across the USA. Both the ALI formulation and the Delaware formulations share common key features. However, the two formulations differ in their approaches to the BJR as well as rationales behind their adaptation of the BJR. In this regard, one of the key differences between the two formulations is where the burden or onus of proof rests upon. In terms of the ALI formulation, the burden of proof rests on the defendant directors. Conversely, the onus in terms of the Delaware Formulation operates as a presumption in favour of the directors.

Australia was one of the first countries to codify the rule into their commercial law. The Australian version of the BJR was adopted in s180(2) of the Corporations Act. Similar to other formulations of the BJR, the Australian BJR is directly linked to the duty of care. The Australian BJR mirrors the USA versions of the BJR. In this regard, Section 180(2) is strikingly similar to the ALI Formulation in that the standard of review is inextricably connected to the standard of conduct in s180(1). The South African BJR is also incorporated as part of the duty to act with care, skill and diligence.

The requirements of the BJR under s76(4)(a) of the Act requires that the director (in summary) made an informed decision, was free of conflicts of interest and in taking that decision acted on a rational basis that the decision would be in the best interest of the company.

The requirement found at s76 (4) (a) (iii) is central to this dissertation and provides that the director must have had a ‘rational basis for believing, and did believe, that the decision was in the best interest of the company’. The interaction between this requirement and the statutory duty found in s76(3)(b), namely, ‘the duty to act in the best interest of the company and for a proper purpose’ indicates the link between standards of conduct and standards of review. In other words the s76(3)(b) duty is a standard of conduct as it specifies how directors should conduct themselves. Conversely, the BJR is a standard of review as it sets forth the test courts will use in determining whether the directors’ conduct gives rise to liability. A general discussion of the differences between standards of conduct and standards of review is provided in Chapter 4.2 of this dissertation, the discussion therein also considers why these standards are conflated and why they diverge.

The current standard of review for testing whether a director has acted in the best interest of a company is that the director must have had a 'rational basis for believing, and did believe, that the decision was in the best interest of the company'. This standard is herein referred to as the rationality standard of review.

As provided in Chapters 4.4.1 and 4.4.2 of this dissertation, the Australian formulation of the BJR and both of the USA formulations provide for the rationality standard to test whether an action taken was in the best interest of a company. The standard of rationality in these countries are clearly defined and well understood in terms of how it should be interpreted and applied – hereby providing some insight as to how the standard should be interpreted and applied in terms of s76(4)(a)(iii) of the Companies Act.

Conversely in Chapter 4.4.3 it is shown that currently in South African law, the court in *Visser Sitrus* is the only court that addresses the standard of rationality in terms of company law – and provides little clarity as to how the requirement should be interpreted and applied. Therefore, the rationality standard in South African law currently remains mysterious.

This logically leads one to question the appropriateness of rationality as a standard of review, and whether the commonly used standard of reasonableness is more appropriate. In this regard, as discussed in Chapter 4.5 of this dissertation, Eisenberg advances a multiplicity of reasons in favour of rationality as the appropriate standard of review.

5.3 Recommendations

5.3.1. Does the Companies Act need to be amended to include good faith as a requirement under s76(4)

Under common law directors have a fiduciary duty to exercise their powers in good faith and in the best interests of the company. This means that good faith is inextricably linked to acting in the best interest of a company. Good faith is also regarded as the overarching duty from which all other duties emerge. The BJR in the USA and Australia also requires that the director acts in good faith as a requirement under the BJR. Under South African law, when the BJR was first formally considered in the 1994 King Report, good faith was a requirement under the formulation. However, with the introduction of the South African Companies Act changes were made in regard to the good faith requirement. As stated previously there appears to be an inextricable link between good faith and rationality – which is generally supported by academics. Mupangavanhu illustrates that the standard of rationality cannot conceivably exclude good faith.[345] Thus, it is generally supported that an indication of bad faith on the part of a director would be indicative of a decision taken irrationally. Eisenberg, also draws this link between rationality and good faith noting that for a decision to be taken in good faith, it is required that it be rational.[346]

In terms of the codification of the director(s) duty to act in good faith under the Companies Act it is separated from the duty to act in the best interest of a company and coupled it with acting for a proper purpose – as can be seen in s76(3)(a) of the Companies Act. In relation to the BJR as found in s76(4) of the Companies Act the duty to act in good faith is completely absent. At first glance this seems absurd and triggering to many academics, as it brings into question *why a director should be protected by the BJR without having acted in good faith?* Many academics have called for South African courts to read in the requirement of good faith into the BJR or alternatively amend the Companies Act to include compliance with the duty of good faith under s76(4) of the Companies Act.[347] The call for a court to read in good faith as a requirement under the BJR is exactly what the court did throughout its judgment in *Visser Sitrus*. However, this author *disagrees* with the view that good faith has to be read into the BJR by the court or that the Companies Act needs to be amended to include this requirement under s76(4).

It has been made clear throughout this dissertation that s76(4) of the Companies Act can only be used by the director(s) for failing its statutory duties in terms of s76(3)(b) and (c). These duties for which the BJR may apply are; the duty to act in the best interest of a company and

[345] Mupangavanhu BM '*Standard of Conduct or Standard of Review? Examination of an African Business Judgment Rule under South Africa's Companies Act 71 of 2008'* (2019), 146.

[346] Eisenberg M *'The Divergence of standards of conduct and standards of review in Corporate law'* (1993)442.

[347] Mqeke R '*Legal Theory 2: Legal Interpretation*' available at *https://www.ru.ac.za/media/rhodesuniversity/content/law/documents/10-students/2013courseoutlines/Legal%20Interpretation.pdf* (accessed on 20/09/2021).

the duty to exercise the necessary degree of care, skill and diligence. The BJR in terms of s76(4) cannot apply to any other duty of the director(s) under the Companies Act nor common law.

As stated previously, the duty to act in good faith is coupled with the duty to act and for a proper purpose – which is found in s76(3)(a) of the act. Therefore, it falls completely out of the scope for the application of the BJR in terms of s76(4) of the Companies Act.

Whilst this author supports the view that at common law there is an inextricable link between acting in good faith and acting in the best interest – and that an indication of bad faith on the part of the director(s) would be indicative of a decision taken irrationally. This author is of the view that decision of the court to read in good faith as a requirement under the BJR seems ill-fitting, due to the codified version of good faith being linked to acting for a proper purpose in terms of s76(3)(a) of the Companies Act – and thereby falling outside the scope of the BJR in s76(4) of the Act.

In this regard, if a decision taken by the director(s) is indicative of bad faith, the director(s) would have failed the statutory duty in s76(3)(a) – for which the BJR cannot be utilised to escape liability.

In conclusion, there is no need for a court to read in good faith as a requirement under the BJR nor is there a need for s76(4) to be amended to include good faith as a requirement.

5.3.2. <u>Is there a need for more research as to the development of the judicial review of the duty to act in the best interest of a company</u>

As stated previously the rationality test is far less stringent in comparison to the reasonable test as it is easy to characterise a director's conduct as imprudent or unreasonable but it is very uncommon to characterise a director's conduct as irrational.[348] In relation to the duty of the director(s) to act in the best interest of a company, it has always had an objective standard attached thereto when reviewed by the courts. This objective standard at judicial review has drastically changed form from its inception to its current formulation.

This is demonstrated in the *Shuttleworth* case where the court pointed out that the best interest of a company is not to be assessed by the court, but rather that the test in this regard is whether

[348] Eisenberg M '*The Divergence of Standards of Conduct and Standards of Review in Corporate Law*'(1993) 62 Fordham Law Review 443.

a *reasonable man* would have considered the act by the directors to be in the best interest of the company. The *reasonable man* test is a stringent objective test as it requires that the court consider whether a reasonable man, placed in the same position as the director(s) would have reached the same decision.

This author is of the view that the stringent objective standard became diluted by courts over the years. The dilution of the stringent test required by *Shuttleworth* is articulated by courts as discussed in Chapter 4.3 of this dissertation. In the *Teck Corp* case,[349] the court required for there to be *reasonable grounds* for the directors' belief that they were acting in the best interests of the company. This took the standard from a reasonable person test, to finding '*reasonable grounds*'. In effect this change takes the emphasis away from the question of 'did the actor act reasonably?' to a new emphasis of 'was there reasonable grounds for the actor's decision'. The court in *Howard Smith*[350]also supports this *'reasonable grounds'* test.

A modern interpretation of the duty to act in the best interest of a company reflects another change in its review. This was articulated by the court in *Visser Sitrus*. The court herein stated that 'what is required is that the directors, having taken reasonably diligent steps to become informed, should subjectively have believed that their decision was in the best interest of the company and that belief must have had a *rational basis*.

As stated previously, in relation to 'no reasonable grounds', the reasonability of a decision depends on the existence of multiple or grounds supporting the decision of the director(s). Whereas the rational basis test rests on the presence of a single ground supporting the director's decision.

Therefore, the court in *Visser Sitrus* further dilutes the objective element from '*reasonable grounds'* to *'rational basis'*- as a result of the BJR.

To illustrate the drastic evolution of the standard of review of the duty to act in the best interest of a company, in *Shuttleworth* it is clear that the standard requires whether a *reasonable man* in the position of the director(s) would have regarded the decision taken as being in the best interest of the company, currently in the test is whether there is a single *rational basis* for the directors belief that the action taken was in the best interest of a company.

349 *Teck Corp Ltd v Millar 1972* 33 DLR (3d) 288.
350 *Howard Smith v Ampel Petroleum Ltd* [1974]1 All ER 1126 (PC).

This author is of the view that this is a remarkably interesting point of discussion that should be investigated to a greater extent than expressed herein. The reasons as to why this development has occurred has not been investigated or is very muddled and thus requires further research to clarify. This area of research is central to the BJR and perhaps further supports the existence of a common law version of BJR. In conclusion, further research would assist in the interpretation of the BJR as found in s76(4) of the Companies Act.

5.3.3. <u>What can be learnt from the *Visser Sitrus* judgment</u>

Although ill-fitting as discussed in Chapter 4.4.3 of this dissertation, the court links rationality with acting in good faith and for a proper purpose, which is the duty codified by s76(3)(a) of the Companies Act. In this regard, the court further stresses the importance of acting in good faith which is the overarching duty from which all other duties emerge.[351]

Importantly, the court expresses that the BJR requires the director(s) to act in the best interest of a company, by undertaking a *bona fide* assessment which must have a rational underpinning.[352] In this regard, the court links the standard of rationality to a '*no reasonable director´* test by referring to authors of Palmer's Company Law which point out '*no reasonable* director' test is merely an aid in answering the ultimate factual question, which is whether the directors were acting in what they bona fide believed to be the best interests of the company. While this author is of the view that to read good faith into the BJR is absurd in this instance, the court importantly linked the *'no reasonable director'* test to the standard of rationality.

The *'no reasonable test'* is discussed in Chapter 4.4.2 of this dissertation, is the applicable test of the standard of rationality in the Australian BJR formulation. In terms of the test under the Australian formulation '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'. Articulated differently the test requires whether *there is an arguable*

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[351] Naicker M *A critical exploration of the fiduciary duties of a director to act in good faith and for proper purpose in respect of a company and an evaluation of the developments from common law to statute* (published LLM thesis, 2015, University of KwaZulu-Natal) 30.

[352] The Companies Act s76(4)(a)(iii); and *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd and* others (case no: 15854/2014). Van Tonder J '*An analysis of the director's duty to act in the best interest of a company, through the lens of the business judgement rule'* 716.

reason supporting that the director(s) believed that the decision taken is in the best interest of the company.

In this regard, the test as found in Australia provides for a strong foundation to interpret the South African standard of rationality under the BJR. The reliance on the Australian interpretation of the standard of rationality would be fitting to South African law. This is due to the duty of care, skill and diligence (especially in relation to the inclusion of diligence) is derived from Australian formulation of the duty.[353] This author is in favour of this interpretation.

However, this author's view is aligned more closely to a different articulation of the same interpretation – which is also supported by other academics. In this regard academics have expressed that a rationality test is expressed as an 'absence of any reasonable ground'.[354] In effect, if there is an absence of any reasonable ground the action taken was irrational. Stated differently, the absence of a single reasonable ground supporting the director(s) decision, results in the action taken by a director being regarded as irrational.

Importantly, *Visser Sitrus* is the first case to make reference to the South African BJR. The court in this regard, has clearly failed at interpreting the BJR and its requirements. Therefore, there is a need for courts or policy documents to extensively interpret the BJR – this author's hope is that in doing so there will be a greater reliance on meanings provided by various academics and foreign case law.

5.3.4. Are the advancements made by Einsenberg enough to conclude on the appropriateness of rationality as a standard of review

Eisenberg convincingly argues the appropriateness of rationality as a standard of review over the well-known standard of reasonableness. Eisenberg's main points of arguments are that the nature of business itself is such that rationality is a better standard for the courts' review, secondly the interests of shareholders need to be considered and lastly the disproportionality

[353] Du Plessis J '*A comparative analysis of directors' duty of care, skill and diligence in South Africa and in Australia'* (2010) *ActaJuridica* 263.

[354] Cassim *et al* 'Contemporary Company law 2nd edition' (2012) 524. van Tonder J '*An Analysis of the Directors' Duty to Act in the Best Interests of the Company, through the Lens of the Business Judgment Rule*' (2015) 3 *Obiter* 715;

between directors' and officers' incentives and liability.[355] These points of argument are discussed in greater detail in Chapter 4.5 of this dissertation.

It is this author's view that the advancements made by Eisenberg directly correlates with the plethora of policy rationales backing the adoption of the BJR, as discussed in Chapter 3.2. In this regard, an overview of the rationales for adopting the BJR includes that the rule is known to: encourage risk-taking; persuade competent persons to undertake office of director; permits effective market mechanisms to manage director behaviour; prevents judicial second-guessing and avoids shareholder management in the corporation.[356]

Despite the correlation between the advancements made by Einsenberg and the policy rationales for the adoption of the BJR, the appropriateness of rationality as a standard of review may still be put into question.

It is understood that rationality is less demanding and, in effect, easier to satisfy than the reasonableness standard. However, the interpretation of the standard of rationality is a lot harder to conceive than the standard of reasonableness. As stated previously, rationality generally requires logical thinking to take place and as a result thereof, when directors are expected to exercise rationality – the manner in which this is done can take different forms. Therefore, there is no uniform criteria used by courts to determine rationality. Unlike rationality, reasonableness has a uniform criteria used by the courts – that being 'the reasonable man' test. The difficulty in interpreting rationality is clearly illustrated by the failure of the court to do so in *Visser Sitrus* as discussed in Chapter 4.4.3 of this dissertation.

In conclusion, while the standard of rationality as a standard of review, on face value appears to be appropriate – based on the correlation discussed above, it is this author's view that the appropriateness of the standard depends on whether it can be successfully utilized. Articulated differently, the appropriateness of this standard of review under South African law will depend on whether it can be correctly interpreted. Therefore, there is a need for courts or policy documents to extensively interpret the standard of review.

word count : 33 750 words

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[355] Eisenberg M '*The Divergence of Standards of Conduct and Standards of Review in Corporate Law'* (1998) 62(3) *Fordham Law Review* 437.

[356] These purposes are discussed by Kennedy-Good S and Coetzee L '*The Business Judgment Rule (Part 1)*' (2006) 27(1) *Obiter* 65 -66.

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