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Standard of Conduct or Standard of Review? Examination of an African Business Judgment Rule under South Africa's Companies Act 71 of 2008

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Abstract

This article highlights that section 76(4)(a) of South Africa's Companies Act, which reflects the business judgment rule (BJR) concept, is a standard of review, providing a means of determining whether a director has met his or her undertakings under section 76(3). The article suggests that section 76 should be titled "Standards of conduct and review" instead of referring only to standards of conduct. It draws a clear distinction between standards of conduct (including the personal financial interests disclosure requirements) on one hand, and a standard of review on the other. After tracing the traditional international requirements of BJR, the article analyses the decision-making requirements under section 76(4)(a). It concludes that, while section 76(4)(a) compares favourably with US and Australian laws, the omission of a good faith requirement is unfortunate since that is a critical component of decision-making. The article proposes that good faith and proper purpose under section 76(3)(a) should form part of the section 76(4)(a) requirements.

Keywords

Business judgment rule, standard of conduct, standard of review, duty of care, good faith, decision-making

INTRODUCTION

The Business Judgment Rule (BJR) in section 76(4)(a) counts among the most interesting innovations under South Africa's Companies Act 71 of 2008 (the Act).[1] The idea of a BJR has obviously been borrowed from other jurisdictions

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1 BM Mupangavanhu *Directors' Standards of Care, Skill, Diligence and the Business Judgment Rule in View of South Africa's Companies Act 71 of 2008: Future Implications for Corporate Governance* (PhD thesis, University of Cape Town, 2016) at 142.

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that either originated it[2] or adopted it in statute.[3] As such, in order to understand better the purpose and application of the BJR in South Africa, one needs to locate analysis of the rule within its international context and its legislative scheme. This article mainly focuses on the proper characterization of the BJR under the Act. The thesis of the article is that BJR is not correctly and clearly characterized under section 76 of the Act.[4] It argues that section 76 wrongly classifies the BJR as a standard of conduct when its correct characterization should be as a standard of review. It further argues that the element of good faith has been inexplicable omitted in the BJR formulation under the Act. An analysis of the South African version of the BJR in this article is done through the prism of international experiences of the rule and the BJR legislative context.

The article begins by defining the BJR and touching on common approaches to the BJR at an international level. It then sketches the legal framework within which the BJR must be understood, interpreted and applied in South Africa. A critical analysis of section 76(4)(a) follows, with the focus on the proper characterization of that section and the BJR elements contained in it. The final part gives a conclusion and recommendations for improving the law on the BJR in South Africa.

ORIGIN, MEANING AND FORMULATIONS OF, AND APPROACHES TO, BJR

The BJR developed in the USA as a common law standard of review closely linked to a standard of conduct, namely the duty of care.[5] Thus, right from its origins, the BJR has been a standard of review distinguishable from a standard of conduct.

Various definitions of the BJR have been suggested in international literature. It cannot however be stated with confidence that there is a universal consensus on the meaning of the BJR. The concept still divides opinion and remains poorly understood, despite its popularity and growing currency.[6] Establishing the meaning of the BJR is important, because how a jurisdiction understands the BJR drives how the rule is to be interpreted and applied.[7]

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2 US courts developed the BJR as a common law rule alongside the duty of care. See C Weng "Assessing the applicability of the business judgment rule and the 'defensive' business judgment rule in the Chinese judiciary: A perspective on take-over dispute adjudication" (2010) *Fordham International Law Journal* 124 at 128.

3 Australia adopted the BJR in statute through sec 180(2) of the Corporations Act 2001.

4 Sec 76 indiscriminately classifies all provisions under it as "standards of directors' conduct"; the author argues that this is a misnomer.

5 Weng "Assessing the applicability", above at note 2 at 128.

6 S Bainbridge "The business judgment rule as an abstention doctrine" (2004) *Vanderbilt Law Review* 83 at 84. See also HG Manne "Our two corporation systems: Law and economics" (1967) 53/2 *Virginia Law Review* 259 at 270.

7 See L McMillan "The business judgment rule as an immunity doctrine" (2013) *William & Mary Business Law Review* 521 at 524.

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Among the popular world views is McMillan's preferred approach of the BJR providing director immunity to liability claims. In this preferred approach, McMillan defines the BJR to mean a judicially developed doctrine that protects company directors from personal liability for the decisions they make on behalf of corporations.[8]

Three other leading writers agree on the understanding that the BJR provides a standard of review to a standard of conduct expected of directors. Bainbridge's contribution to the meaning of and approach to the BJR is that, in the USA today, the BJR is commonly understood as a standard of liability by which courts review "decisions" by boards of directors.[9] Branson queries why the BJR should be considered a rule at all, given that it provides no substantive "dos" and "don'ts" for company officers or directors.[10] Branson nonetheless agrees with Bainbridge that the BJR should be seen as a standard of judicial review, entailing only slight review of business decisions.[11] Branson also appears to agree with McMillan when he argues that the BJR as a standard of review becomes a defence if the directors have made a business judgment.[12]

The common denominator among all these definitions of the BJR is the reality that the BJR involves a standard of review connected to the decisions made by boards of directors. In this construction, the courts obviously have a role in reviewing decisions made in the boardroom, and this is how USA case law has developed the rule.[13] The development of the BJR was predicated on the understanding that directors have to make decisions on behalf of corporations and those decisions often entail an assumption of risk.[14] As a separate legal person, a company has all the legal powers and capacity similar to a natural person, except to the extent that a juristic person is incapable of exercising such powers.[15] Thus a company can make its own decisions affecting its business, but can only do this through human agency.[16] Directors, and no other stakeholder, are the only legitimate organ in a company authorized to make

8 Id at 521.

9 Bainbridge "The business judgment rule as an abstention doctrine", above at note 6 at 87.

10 D Branson "A business judgment rule for incorporating jurisdictions in Asia?" (2011) *Singapore Academy of Law Journal* 687 at 687.

11 Ibid.

12 Ibid.

13 See Weng "Assessing the applicability", above at note 2 at 128.

14 McMillan "The business judgment rule as an immunity doctrine", above at note 7 at 528.

15 See the Act, sec 19(1)(b)(i). Also see *Investigating Directorate: Serious Economic Offences v Hyundai Motor Distributors (Pty) Ltd; In re Hyundai Motor Distributors (Pty) Ltd v Smit NO* 2001 (1) SA 73 (W) 106.

16 In *Lennard's Carrying Co Ltd v Asiatic Petroleum Co Ltd* (1915) AC 705, Lord Richard Burdon Haldane made a telling remark in this regard, when he said (at 713): "A corporation is an abstraction. It has no mind of its own any more than it has a body of its own; its active and directing will must consequently be sought in the person of somebody who for some purposes may be called an agent, but who is really the directing mind and will of the corporation, the very ego and center of the personality of the corporation …"

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decisions on behalf of a company.[17] It is recognized that business decision-making is a difficult task, as business does not always involve black and white issues.[18] At times decisions have to be made under pressure and under imperfect circumstances, given factors such as information asymmetry and bounded rationality. It is possible that even well intended decisions may turn out badly, given the vagaries of business.[19]

In this construction, the BJR seeks to protect directors in respect of well-made decisions even though, with the benefit of hindsight, those decisions may prove to have undesirable consequences for the company.[20] For directors' business decisions to qualify for legal protection against hindsight bias, they should meet a certain criterion developed by US case law and other BJR approaches developed around the world. Directors' decisions are protected if they meet their fiduciary obligations in the form of triads.[21] In US case law the criteria / triads were stated to be 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 interests of the company.[22] These criteria were put differently and in detail in *Brehm v Eisner*.[23] Building on the understanding in earlier case law,[24] the court stated that the courts will respect directors' business decisions if they do not violate the triads of a fiduciary duty in any of three ways.[25] First, directors' decisions will be respected unless they were infected by conflict of interest issues that could have disabled the directors' independence in respect of their decision-making.[26] Secondly, courts will not respect decisions if directors fail to act in good faith or act in a manner that cannot be attributed to a rational business purpose.[27] Thirdly, decisions will not be respected if directors reach them by a grossly negligent process that includes failure to take into account all material facts reasonably available.[28]

17 The Act, sec 66(1) confirms this principle.

18 McMillan "The business judgment rule as an immunity doctrine", above at note 7 at 527.

19 See Bainbridge "The business judgment rule as an abstention doctrine", above at note 6 at 113–14.

20 McMillan "The business judgment rule as an immunity doctrine", above at note 7 at 526.

21 Triads comprise three fiduciary obligations. See L Johnson "The modest business judgment rule" (2000) *Business Law* 625 at 627.

22 See *Aronson v Lewis* 473 A.2d 805 (Del 1984) at 812.

23 746 A.2d 244 (Del 2000) at 264.

24 Especially in *Shlensky v Wrigley* 237 NE 2d 776 (III App Ct 1968). The understanding established by the court in this case (at 778) was that, "the directors' [board] room rather than the courtroom is the appropriate forum for thrashing out purely business questions". The court in this case appears to have advocated a strong presumption against the judicial review of boardroom decisions.

25 *Brehm v Eisner*, above at note 23 at 264.

26 Ibid.

27 Ibid.

28 Ibid. A good example of this is to be seen in the decision of the Delaware Supreme Court in *Cede & Co v Technicolor, Inc* 634 A.2d 345 (Del 1993) at 360. The defendant board of directors could not be protected against liability claims because it failed to make a properly

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INTERNATIONAL EXPERIENCES: BJR MODELS FOR SOUTH AFRICA

As mentioned above, any country that decides to adopt a new concept needs models. South Africa needed models from which to learn when developing its BJR law, which is, hopefully, tailor-made to suit the needs of the country. As an originator of the rule, the USA was an obvious model from which to learn, as was Australia given her experience of adopting the US-style BJR in its legislation.[29] Adopting international company law principles such as the BJR is in line with one of South Africa's company law reform objectives, as well as meeting some of the Act's stated purposes. Harmonization of law with the best practice jurisdictions internationally was one of the goals of law reform in South Africa.[30] This objective can be twinned with one of the purposes of the Act, namely the need to promote the use of companies in a manner that enhances the economic welfare of South Africa as a partner in the global economy.[31] Both the Act and the Constitution of the Republic of South Africa (the Constitution) encourage ensuring global competitiveness of company law and companies. In this regard, one of the purposes of the Act is to ensure that interpretation and application of company law promotes the Act's compliance with the Bill of Rights.[32] Part of the Bill of Rights urges courts of law and other adjudicating fora to consider the persuasive value of relevant foreign company law and other international principles when applying and interpreting statutory provisions.[33] This provides South Africa's justification for having used international models when crafting the Act. Now the Act is in force, this provides justification for the comparative value of foreign company law. This article will consider BJR laws in the USA and Australia, given their value to the development of BJR regulation in South Africa. It is predicted that the developed and still evolving jurisprudence in these jurisdictions will inform the interpretation of law by South African courts and the development of relevant jurisprudence.

USA: Policy rationale and BJR formulations

An examination of the use and application of the BJR in the USA reveals two important aspects from which South Africa and other jurisdictions intending to incorporate the BJR into statute can learn. These two closely-linked aspects are the policy rationale for and formulations of the BJR. There are two

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informed decision before taking a decision to merge Technicolor into MacAndrew and Forbes Group, Inc.

29 Australia adopted BJR into statute through sec 180(2) of the Corporations Act 50 of 2001.

30 See *South African Company Law for the 21st Century: Guidelines for Corporate Law Reform* GN 1183 in GG 2004-06-23, para 1.2.

31 See the Act, sec 7(e).

32 See id, sec 7(a).

33 See the Constitution, sec 39(1)(c).

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formulations of the BJR followed in the USA: the American Law Institute's *Principles of Corporate Governance* (the ALI Formulation)[34] and the Delaware formulation.[35] Each US formulation of the BJR provides a policy rationale for the rule, as demonstrated below.

The ALI Formulation is said to be the formulation that enjoys wider currency in the USA, since it has been adopted by many courts in many federal states.[36] The ALI Formulation captures part of the policy rationale for the BJR. The BJR is said to be necessary to protect "directors and officers from the risks inherent in hindsight reviews of their business decisions".[37] The ALI Formulation is premised on an understanding that directors have to take decisions in the interest of promoting the maximization of companies' wealth. In the USA there is an implied obligation on directors to promote the maximization of shareholders' wealth.[38] The BJR thus encourages optimal risk-taking by directors without "the risk of stifling innovation and venturesome business activity".[39] This ensures that decisions made by directors in good faith are protected even though, in retrospect, they may prove to be unsound or results may turn out badly.

According to the ALI Formulation, directors who make a business judgment in good faith are protected against liability for breaching the duty of care, if the director or officer: is not interested in the subject of his business judgment; 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 rationally believes that the business judgment is in the corporation's best interests.[40]

The Delaware formulation of the BJR is a common law rule developed by Delaware courts as a presumption of good faith in favour of directors, as aptly captured in *Aronson v Lewis*.[41] As per 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

34 *Principles of Corporate Governance: Analysis and Recommendations* (1994, The American Law Institute). See D Branson "The rule that isn't a rule: The business judgment rule" (2002) *Valparaiso University Law Review* 631.

35 Branson "A business judgment rule for incorporating jurisdictions", above at note 10 at 691.

36 Ibid. See *Rosenfield v Metals Selling Corp* 643 A 2D 1253 (Conn 1994) at 1261; *Omnibank v United Southern Bank* 607 So 2d 76 (Miss 1992) at 85; *Cuker v Mikalauskas* 92 A 2d 1042 (Pa 1997) at 1045.

37 See ALI Formulation, as adapted from P Lipton and A Herzberg *Understanding Company Law* 6th ed (1995, Law Book Co Information Services) at 393.

38 *Dodge v Ford Motor Co* 170 NW 668 (Mich 1919) at 684 is authority to the effect that a corporation is organized and carried on primarily for the profit of the stockholders.

39 M Havenga "The business judgment rule: Should we follow the Australian example" (2000) 12 *South African Mercantile Law Journal* 25 at 28.

40 ALI Formulation, above at note 34, sec 4.01(c).

41 473 A 2d 805 (Del 1984) at 812.

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was in the best interests of the company".[42] The policy rationale for this formulation of the rule is best illustrated in the case of *Smith* v *Van Gorkom* as follows: "[u]nder Delaware law, the business judgment rule is the offspring of the fundamental principle, codified in [Delaware General Corporation Law] § 141 (a), that the business and affairs of a Delaware corporation are managed by or under its board of directors … The business judgment rule exists to protect and promote the full and free exercise of the managerial power granted to Delaware directors".[43]

It is interesting to note that section 66(1) of the South African Companies Act appears to have borrowed much from the Delaware policy rationale for BJR. It similarly acknowledges that the board of directors has an original mandate and freedom to manage the company in line with the law.[44]

The main features of the BJR in the ALI Formulation and the Delaware formulation are similar. First, it is clear that good faith is a cornerstone of both formulations. Under the ALI Formulation, a director is protected against liability for breaching his duty of care obligations if the business judgment was made in good faith, in addition to meeting the triad of the rule.[45] The Delaware formulation provides a presumption of good faith in favour of the directors. Secondly, informed decision-making, including scrutinizing available alternatives, is a requirement for both formulations.[46] Thirdly it is 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.

The important differences between the formulations pertain to their approaches to the BJR. For example, there is a difference in terms of where the burden or onus of proof of facts lies. In South Africa and many other common law jurisdictions, the general rule appears to be that the person who alleges a fact must prove it.[47] Exceptions to this general rule may be provided by statute, which may provide for a reverse onus.[48] According to the ALI

42 Ibid. Also see *Cede v Technicolor*, above at note 28 at 361 for a similar manner in which the Delaware formulation was presented.

43 488 A 2d 858 (Del 1985) at 872.

44 Sec 66(1) of the Act similarly 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 of the functions of the company, except to the extent that this Act or the company's Memorandum of Incorporation provides otherwise".

45 The triad includes the absence of disabling conflicts of interest, informed business decision-making and a rational basis for believing that the business judgment was in the corporation's best interests.

46 As per *Smith v Van Gorkom* and *Cede v Technicolor* this entails due care of process.

47 See *Cecilia Goliath v Member of the Executive Council for Health, Eastern Cape* (085/2014) [2014] ZASCA 182 (25 November 2014).

48 For example, with respect to dismissal matters under labour law, the Labour Appeal Court has held that, as per sec 192(2) of the Labour Relations Act 66 of 1995, once an employee has established the existence of a dismissal in terms of sec 192(1), the onus shifts to the employer to prove the fairness of the dismissal. See *SACWU v AFROX* 1999 20 *ILJ* 1718 (LAC).

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Formulation, the burden of establishing the presence of the BJR elements does not necessarily lie with the plaintiffs,[49] but with the defendant directors.[50] This seems logical, for the reason that the matters pertaining to the disputed decision are more within the reach of the directors than the party challenging the decision. If the directors discharge this onus, they sail into a safe harbour where they become unassailable and are immune from liability.[51] In contrast, the presumption according to the Delaware rule formulation, as demonstrated above, operates to give a plaintiff 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 follow the requirement to take due care.[52] Where the plaintiff fails to meet this burden, the BJR applies to protect the directors. In the event of a successful rebuttal of the presumption, the reverse onus applies, as explained in *Cede v Technicolor*.[53]

Australia: section 180(2) of the Corporations Act

Australia adopted the BJR in section 180(2) of the Corporations Act 2001 (Corporations Act). Like the ALI Formulation, the Australian BJR is intricately linked to the duty of care.[54] Section 180(2) provides that a director or officer who makes a business judgment is considered to have met the requirements of section 180(1) of the Corporations Act, and their equivalent duties at common law and equity, if he: makes a business judgment in good faith for a proper purpose; does not have a material personal interest in the subject matter of the judgment; informs himself about the subject matter of the judgment to the extent he reasonably believes to be appropriate and rationally believes that the judgment is in the best interests of the corporation. The

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49 As is also the case in the dismissal cases under the Labour Relations Act.

50 Branson "A business judgment rule for incorporating jurisdictions", above at note 10 at 692.

51 Ibid.

52 ibid.

53 Above at note 28. The court in *Cede v Technicolor* explained how the presumption in favour of the director works, by stating (at 361): "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' of the transaction to the shareholder plaintiff …"

54 See Corporations Act 50 of 2001, sec 180(1), entitled "Care and diligence: Directors and other officers", which provides: "A director or other officer of a corporation must exercise their powers and discharge their duties with the degree of care and diligence that a reasonable person would exercise if they: (a) were a director or officer of a corporation in the corporation's circumstances; and (b) occupied the office held by, and had the same responsibilities within the corporation as, the director or officer."

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Corporations Act defines a "business judgment" to mean "any decision to take or not to take action".[55] This should be distinguished from an omission to act where there is a positive duty to act. An omission to act could qualify as negligence, a ground that should exclude application of the BJR to protect directors.

Section 180(2), as can be noted from its wording, is reminiscent of the ALI Formulation in that it is a standard of review that has a relationship with the standard of conduct provided for in section 180(1). Another similarity with the ALI Formulation pertains to the level of information the director must have before making a decision. The requirement is similarly that a director should have informed him or herself to the extent that he / she reasonably believes to be appropriate.[56] While parallels can be drawn with the ALI Formulation, the Australian statutory BJR in section 180(2) is regarded as a legislative modification of the American common law BJR.[57] The subsection applies to officers and other managers, not only directors. It applies to the duty of care and diligence. 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 section 180(1) and its equivalent duties at common law and equity.[58]

Another interesting feature in section 180(2) is the reference to "proper purpose".[59] This differentiates the Australian BJR version from the ALI Formulation and the South African version of the rule.[60] The South African BJR formulation surprisingly excludes "good faith and proper purpose"[61] in its reference to the conditions in section 76(3) that must be satisfied for directors to enjoy protection of the rule. It is also important to note the reference in section 180(2) to the "reasonableness" of the informed decision and the requirement of "rationality" in paragraph (d), just as in section 76(4)(a).[62]

Some criticisms levelled at the Australian statutory BJR may serve as lessons for the future interpretation and application of section 76(4)(a) under the South African Act. For example, the Australian act has been criticized for

55 See id, sec 180(3).

56 Under the South African equivalent in sec 76(4)(a) of the Act, the director should have "taken reasonably diligent steps to become informed about the subject matter of the decision". That is different from a more relaxed requirement in sec 180(2) of the Corporations Act that a director "informs himself / herself about the subject matter of the judgment to the extent they reasonably believe to be appropriate".

57 See J Cassidy "Models for reform: The directors' duty of care in a modern commercial world" (2009) *Stellenbosch Law Review* 373 at 403.

58 See J Farrar "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.

59 See sec 180(2)(d).

60 See the Act, sec 76(4)(a).

61 The duty to act in good faith and for a proper purpose is one of the three common law duties codified under sec 76(3). See the Act, sec 76(3)(a).

62 See id, sec 76(4)(a)(iii) in particular.

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the divergence between the standards of conduct and review. Section 180(1) clearly sets an objective standard of conduct, while section 180(2) does not appear to provide for an equally objective standard of review. For example, section 180(2) appears to leave it to the director to decide the appropriateness and reasonableness of his diligence in ensuring that the business judgment is an informed one.[63] It is also left to the director to decide whether the decision is in the corporation's best interests. This is understandable given that it is the role of directors to decide what is in the best interest of the company, by making a judgment call on the basis of information at their disposal. However, the test as to whether all material considerations were taken into account in decision-making[64] needs to be tempered with some objective considerations. The assessment cannot be a purely subjective one. It is therefore understandable that there is prima facie a divergent standard of review in section 180(2).[65] The court may, however, decide to view this seemingly lower standard through the lens of the objective standard of conduct in section 180(1).

STANDARD OF CONDUCT VERSUS STANDARD OF REVIEW

According to Velasco, standards of conduct are rules addressed to actors, specifying expectations regarding their behaviour.[66] On the other hand, standards of review are rules addressed to courts, specifying how actions are to be judged.[67] Eisenberg provides a similar definition that distinguishes between the two standards and specifically distinguishes a standard of conduct from a standard of review.[68] A standard of conduct such as the duty of care specifies how directors should conduct themselves.[69] The BJR, as a standard of review, then sets forth the test courts will use in determining whether or not the directors' conduct gives rise to liability.[70]

Having considered international experiences of BJR, and before analysing the relevant parts of the South African Act in which BJR has been adopted,[71]

63 The requirement in sec 180(2)(c) of the Corporations Act is that the director "informs himself / herself about the subject matter of the judgment to the extent they reasonably believe to be appropriate".

64 Including the need to scrutinize alternatives available, as was remarked by the Delaware Supreme Court in *Cede & Co v Technicolor*, above at note 28 at 361.

65 See a similar view expressed by Prof Cassidy in Cassidy "Models for reform", above at note 57 at 404.

66 J Velasco "A defense of the corporate law duty of care" 2015 *Journal of Corporation Law* 648 at 651.

67 Ibid.

68 M Eisenberg "The divergence of standards of conduct and standards of review in corporate law" 1993 *Fordham Law Review* 437 at 444–45.

69 Ibid.

70 See Bainbridge "The business judgment rule as an abstention doctrine", above at note 6 at 89.

71 See sec 76(4)(a).

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it is vital to sketch the contours of a standard of conduct compared with a standard of review. This is important for various reasons, of which two are especially important in the context of this article. First, even at international level, the relationship between the two standards[72] is not as clear as it should be. For instance, in most areas of law, the standards of conduct and review tend to be conflated[73] or tend to converge for the purposes of review.[74] However, in corporate law,[75] especially in decision-making, the standard of conduct (under duty of care), which is ordinary negligence, diverges from the standard of review (in the BJR context), which is gross negligence.[76] It is important at this point to note that, under South African common law, the standard used to determine liability for breach of the duty of care is one of negligence, not gross negligence.[77]

The divergence of standards of conduct and review in corporate law is given as one of the rationales for the BJR under US law.[78] Justifications are put forward as to why corporate law must be treated differently from other areas of law. The reasons range from the "institutional nature of the corporation",[79] to information asymmetry and bounded rationality.[80] All these factors tend to affect the quality of business decision-making by directors. Now that South Africa has legislated for a BJR, it will be interesting to see whether the standard of conduct (ordinary negligence) will diverge from the standard of review (under the BJR in section 76(4)(a)), as is the case under US law.[81]

The second reason why it is vital to clarify the contours of and the nature of interaction between standards of conduct and review is that the Act

72 That is between the standard of conduct and the standard of review, in particular between the duty of care and the BJR.

73 See Eisenberg "The divergence of standards of conduct", above at note 68.

74 See 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.

75 Rhee, ibid.

76 US case law decided that gross negligence is the appropriate standard of review in duty of care claims; see the Delaware Supreme Court's decision in *Smith v Van Gorkom*, above at note 43 at 873.

77 See M Blackman, R Jooste, GK Everingham et al *Commentary on the Companies Act* (2010, Juta & Co) at 190. This standard was confirmed in the South African cases of *Ex parte Lebowa Development Corporation Ltd* 1989 (3) SA 71 (T) 106 and *Du Plessis v Phelps* 1995 (4) SA 154 (C) 170.

78 Rhee "The tort foundation", above at note 74.

79 Ibid.

80 See TS Ulen "Cognitive imperfections and economic analysis of law" (1989) *Hamline Law Review* 385 at 385–87, cited in Eisenberg "The divergence of standards of conduct", above at note 68 at 466.

81 Importantly, the implications of such a potential divergence of standards for South African law will have to be explored.

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indiscriminately refers to both directors' duties and the BJR as "standards of conduct".[82] Is this an error[83] that can simply be ignored and hopefully be cured through interpretation? The Act must have avoided an overly simplistic approach to the characterization of standards[84] for the reason that there are numerous conceptions of the BJR that view it differently and sometimes in a confusing manner. One such view even conflates the BJR with the duty of care and confusingly views the BJR as a standard of care.[85] Alternatively, the duty of care can be viewed as a component of the BJR.[86] Such a conception has attracted criticism from writers such as Gervurtz who labelled the BJR a "misguided notion" for the potential confusion it creates and the reason that it requires greater fault than negligence.[87]

SOUTH AFRICA: THE BUSINESS JUDGMENT RULE

This part briefly considers South Africa's preparedness not to second-guess management decisions made in good faith before the Companies Act 2008. It then briefly sketches the legal framework for the application of the BJR under the Act, before critically analysing section 76(4)(a).

Common law experience relevant to BJR

As a legacy of the enduring influence of English law,[88] South African courts have demonstrated their preparedness not to interfere unjustifiably with

82 That is the heading chosen by drafters of the Act for all provisions falling under sec 76.

83 Put differently, is this a legislative design by the drafters of the Act? If so, what purpose could they have sought to achieve by describing a standard of review as a standard of conduct? Such questions are not easily answered from the reading of the legislative text. For this reason, it is suggested below that the title of this section needs to be changed to avoid unnecessary confusion.

84 There should have been clarity regarding classification of the different standards in sec 76(3) and the standard in sec 76(4)(a). Housing all standards under one umbrella title of "Standards of conduct" in sec 76 is a cause for confusion and can wrongly create the impression that the Act intended to conflate standards.

85 This is a result of the fact that the duty of care is said to be a late arrival on the corporate law scene in Delaware after the BJR had been in use for many years, leading to an overemphasis on the BJR and the diminishing importance of the duty of care. See such a view expressed in LPQ Johnson "Unsettledness in Delaware corporate law: Business judgment rule, corporate purpose" (2013) 38 *Delaware Journal of Corporate Law* 406 at 424.

86 See Bruner's critique of how the Delaware Supreme Court relegated the status of the duty of care together with the duty of loyalty in *Cede & Co v Technicolor*, above at note 28 at 366, to mere elements of the BJR: CM Bruner "Is the corporate director's duty of care a 'fiduciary' duty? Does it matter?" (2013) *Wake Forest Law Rev* 1040.

87 FA Gervurtz "The business judgment rule: Meaningless verbiage or misguided notion?" (1994) 67 *Southern California Law Review* 287 at 295.

88 A similar view is expressed by renowned South African author Blackman, who confirms that "the essential principles of this branch of our company law are the same as those in English law": Blackman et al *Commentary on the Companies Act*, above at note 77 at 191.

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the business decision-making of a company.[89] In other words, courts demonstrated before the Act that they were prepared to defer to directors' business judgments made in good faith, unless there was evidence of bad-faith in the decision-making.[90] This is the case whether a business decision was made by directors or creditors during a time when a company engages in insolvent trading, as was emphasized in some cases. In *Levin v Felt and Tweeds*, for example, the court expressed the view 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".[91] In *Ben-Tovim v Ben-Tovim and Others*,[92] and in another similar case,[93] the courts confirmed the South African courts' judicial policy of not second-guessing directors' decisions.

South African courts, like courts in other common law jurisdictions, have recognized the need not to second-guess directors' decisions.[94] While this is true, the obiter statements made by the courts to this effect may not as yet have developed to "a state of sophistication sufficient to make [the BJR] a common law rule of any significant utility to practitioners, judges or directors themselves".[95] Hence the paucity of a purely BJR case in South Africa before the Act in the mould of the US cases discussed above. 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".[96]

Therefore, other than saying that, before 2008 South African courts followed a business judgment doctrine, it is difficult to state with conviction that courts followed the BJR as it is now applied in Australia or the US. Where the BJR is applied, it is the author's conviction that a jurisdiction must develop a clear approach. It must be easy to establish (from the empowering legislation) a relationship between the BJR as a standard of review and a standard of conduct. Obiter statements made by judges, to the effect that courts do not

89 For example, in *Howard v Herrigel* 1991 (2) SA 660 (A) at 676, Goldstone JA accepted that "the knowledge of hindsight can be misleading and give rise to unfair criticism" of business directors, especially if their risky decisions result in bad outcomes. Also see Blackman et al, id at 192.

90 See *Shuttleworth v Cox Brothers and Company (Maidenhead) Limited* [1927] 2 KB 9 at 23–24.

91 1951 (2) SA 401 (A) at 414.

92 2001 (3) SA 1074 (CPD).

93 See *Lordon v Dusky Dawn Investments (in liquidation) (Pearmain Intervening)* 1988 (4) SA 519 (SECLD) at 521 B–D. Also see L Mswaka "Directors' duties and the business judgment rule in South African company law: An analysis" 2013 *International Journal of Humanities & Social Science* 89.

94 *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd and Others* 2014 (5) SA 179 (WCC), para 90.

95 See JJ du Plessis "Open sea or safe harbour? American, Australian and South African business judgment rules compared (part 1)" (2011) 32 *The Company Lawyer* 345 at 346. Du Plessis continues however to refer to a South African common law rule, despite having expressed such a view.

96 See JH Farrar "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.

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second-guess management decisions, may only qualify as business judgment doctrine. It may therefore be safe to say that, before 2008, South Africa followed a business judgment doctrine, a watered down version of the BJR. The BJR in South Africa was only introduced by the Act after 2008.[97]

Legal framework and policy rationale for BJR under the Act

This section considers provisions of the Act that are relevant to the interpretation of section 76(4)(a).

In a style reminiscent of the Delaware formulation of the BJR, the South African BJR appears to flow from the new fundamental principle that directors have original legitimate powers as the organ recognized by the Act to control and run company affairs under section 66(1) of the Act.[98] It is also important to note that the "General interpretation of Act", that is, section 5 as read with section 158 of the Act, is an important part of the legal framework. Section 5 importantly makes provision for the consideration of foreign company law when applying and interpreting provisions of the Act such as section 76(4)(a).[99] Both sections 5[100] and 158 agree that section 76(4)(a) must be interpreted in a manner that gives effect to the spirit, objects and purposes of the Act.[101]

The purposes of the Act are set out in section 7. Provisions of relevance to the application and interpretation of the BJR under the Act include confirmation of the applicability of the statutory interpretation clause in section 39(2) of the Constitution.[102] Section 7 achieves this by providing that part of the purposes of the Act is to "promote compliance with the Bill of Rights as provided for in the Constitution, in the application of company law".[103] Another part of section 7 relevant to the BJR is the aim to "promote the development of the South African economy by - encouraging entrepreneurship and enterprise efficiency".[104] This is possible through the promotion of optimal risk-taking and encouraging entrepreneurial flair among directors to ensure

97 It can be argued that it is sec 76(4)(a) of the Act that introduced the real form of the BJR into South African law, as seen in US law and in Australia in sec 180(2) of the Corporations Act.

98 Above at note 44.

99 In this regard, sec 5(2) provides that "to the extent appropriate, a court interpreting or applying this Act may consider foreign company law."

100 See sec 5(1), which provides: "This Act must be interpreted and applied in a manner that gives effect to the purposes set out in section 7."

101 The relevant part of sec 158(b) states: "the Commission, the [Takeover Regulation Panel established by sec 196 of the Act], the Companies Tribunal or a court – (i) must promote the spirit, purpose and objects of this Act".

102 Also see the Constitution, sec 233.

103 See the Act, sec 7(a). Thus, when applying company law, consideration of sec 39(2) of the Constitution constitutes compliance with the Bill of Rights.

104 See the Act, sec 7(b).

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profit-maximization where possible.[105] This purpose is counter-balanced by another purpose. While the BJR provides protection for directors who take business risks in good faith, the Act intentionally seeks to "encourage the efficient and responsible management of companies".[106]

Analysis of section 76(4)(a) of the Act: A BJR only or more than a BJR?

Section 76(4)(a) subsumes a South African version of BJR and provides:

> "In respect of any particular matter arising in the exercise of the powers or the performance of the functions of 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 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."

It is predicted that section 76(4)(a) will play a key role in the analysis of director performance by courts in circumstances where a director's decision-making is challenged. For this reason, it is vital to understand the scope or extent of application of the section. At first glance, the sight of elements in the subsection that are typically associated with the traditional US-style BJR, can tempt one to reach a cursory conclusion that the subsection is all about a BJR. Section 76(4)(a) is however phrased differently from the most common formulations of the BJR as seen through the window provided by the two comparators of choice, namely the US and Australia.[107] The opening statement shows that section 76(4)(a) relates to "any particular matter arising in the exercise of the powers or the performance of the functions of director". The legislature

105 It can be argued that this can in a way result in the attainment of yet another goal of the Act in sec 7(i), which seeks to "balance the rights and obligations of shareholders and directors within companies".

106 See id, sec 7(j).

107 The Corporations Act, for example in sec 180(2), clearly shows that that section applies to a director or officer "who makes a business judgment". Arguably, this can be distinguished from reference in sec 76(4)(a) to "any particular matter arising in the exercise of the powers or the performance of the functions of director".

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must have intended not to employ the term "business judgment" in the subsection. This can be deduced from the fact that no definition of "business judgment" is to be found in the Act.[108] To conclude, therefore, that section 76(4)(a) applies to any decision-making made by directors in line with their section 66(1) scope of powers and authority, is in line with the manner that the subsection is framed. Thus the author agrees with the view of du Plessis that section 76(4)(a) provides wider protection for directors' decisions, extending beyond the business judgments associated with the duty of care.[109] Business judgments are indeed the main concern of the protection provided by the traditional BJR. Section 76(4)(a) therefore provides a wider application than simply the protection of directors' business judgments, and thus is more than a BJR provision.

Having acknowledged that section 76(4)(a) is more than a BJR, two important observations need to be made. The first is that the fact that wider protection to directors' decisions is offered by the subsection does not mean that business judgments are excluded from its scope. Section 76(4)(a) can be read to include a BJR within its ambit, precisely because a BJR is the exercise of a business judgment in making a decision, even if it may not be styled "business judgment". Secondly, it is commendable that the drafters of the Act did not expose section 76(4)(a) to the confusion associated with typical definitions of what a business judgment or business decision is or is not. The Australian Corporations Act attempted to provide such a definition. It defines a business judgment to mean "any decision to take or not take action in respect of a matter relevant to the business operations of the corporation".[110] This definition raises more questions than the answers it attempts to provide, and one may argue that it would have been better to leave the matter undefined or for section 180(2) not to have referred to a business judgment at all. For starters, it is not clear what the distinction is between what qualifies to be a company business and what falls outside the scope of company business. By the same token, even the rationale to make the BJR apply to "business operations" and not to any other business of the company is unclear. It should therefore be reiterated that the approach adopted in section 76(4)(a) is possibly better or preferable to the approach under the Corporations Act.

Relationship of the BJR to standards of conduct in section 76(3)(b) and 76(3)(c)

It is clear from section 76(4)(a) that the BJR relates to only two of the three codified directors' common law duties under the Act. These are the duty to act in the best interests of the company in section 76(3)(b) and the duty of care, skill and diligence in section 76(3)(c). It is to be noted that section 76(4)(a), read on

108 The term is not defined under either sec 1 or sec 76 of the Act.

109 JJ du Plessis "Open sea or safe harbour? American, Australian and South African business judgment rules compared (part 2)" (2011) 32 *The Company Lawyer* 377 at 381.

110 See Corporations Act, sec 180(3).

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its own, appears to provide requirements that a director should meet when exercising powers given or performing his or her function as a director in order to satisfy the obligations imposed by the two duties.[111] In other words, as a fiduciary, the director "will have satisfied obligations of subsections (3) (b) and (c)" if his conduct does not fall foul of the requirements of section 76(4)(a), which are also in line with BJR elements.

By expressing the link between directorial obligations imposed by section 76 (3)(b) and (c) and the requirements of decision-making in section 76(4)(a), the Act is revealing a relationship between a standard of conduct and a standard of review. In this context, section 76(3)(b) and (c) provide standards of conduct, while section 76(4)(a) provides the standards of review. Whenever it is alleged that a board's decision did not satisfy the obligations of section 76(3)(b) and (c), a court of law will apply a standard of review under section 76(4)(a). This is a standard of liability or standard of review test, the purpose of which is to determine whether a director indeed failed to meet the required standard of conduct in a manner that gives rise to personal liability.[112] If the directors meet the standard of review under section 76(4)(a), then that becomes their defence against liability claims for breaching their statutory obligations under section 76(3)(b) and (c). This is the essence of the South African version of the BJR. This article now examines the requirements that decision-making ought to satisfy according to section 76(4)(a).

Requirements for decision-making under section 76(4)(a)

(i) Due care requirement as per section76(4)(a)(i): Director must be reasonably informed

With regard to obligations imposed by section 76(3)(c), when making a decision, the standard of conduct expected of a South African director under the Act is reasonable process due care, not slight care or anything less.[113] Section 76(4)(a)(i) makes it clear that, before making a decision, a director must ensure that he "has taken reasonably diligent steps to become informed about the matter".[114] To put things into perspective, section 76(4)(a) is phrased differently from its Australian equivalent in section 180(2)(c) of the Corporations Act and from the ALI Formulation.[115] The Australian section 180(2)(c), which was drafted along the lines of section 4.01 of the ALI Formulation, at first glance gives the impression that it applies a subjective

111 The Act, sec 76(3)(b) and (c).

112 See McMillan "The business judgment rule as an immunity doctrine", above at note 7 at 529.

113 See Branson "A business judgment rule for incorporating jurisdictions", above at note 10 at 689. Branson expressed this view with reference to the US Model Business Corporation Act.

114 This obviously refers to the subject matter of the decision to be taken by the board of directors, including a decision that can be taken by a single director.

115 See the ALI Formulation, sec 4.01(c).

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standard of review test.[116] It requires the directors to "inform themselves about the subject matter of the judgement to the extent they reasonably believe to be appropriate".[117] As will be evident, this appears to be a lower standard when compared to the requirement under section 76(4)(a)(i) that a director has to take reasonably diligent steps to become informed. So, can it be said that the Australian standard of review is not based on what a reasonable person in the shoes of the director should have considered to be a reasonable level of being informed? This appears to be the impression created by section 180(2)(c). If this impression is correct, then it would appear that this standard is permissive of a director's idiosyncrasies. Recent case law in both Australia and the US appears however to suggest that even these seemingly subjective standards in sections 180(2)(c) and 4.01(c) may be interpreted by courts to result in a more objective than subjective standard of review.[118]

The South African standard of review is framed differently from the Australian standard and the American standard based on the ALI Formulation. The standard under section 76(4)(a) is not based on the director's reasonable belief that he or she informed himself properly up to the required level. It is a generally objective standard, which applies an objective test when reviewing the standard of conduct expected.

It is understandable that there may be concerns in South Africa[119] that using the US traditional BJR as a standard of review or liability in the USA moves the liability bar from ordinary negligence to a lower standard, namely gross negligence.[120] Case law in the USA has confirmed that, in the state of Delaware in particular, given the policy rationale for the BJR, gross negligence is considered the appropriate standard of review.[121] Even when assessing whether a director was properly informed for the purposes of decision-making, the standard is lowered to gross negligence.[122] Will the application of section 76(4)(a) follow the US path and result in gross negligence being the standard of liability applicable under South African law? A closer examination of section 76(4)(a) however does not seem to suggest that a lower

116 See *Australian Securities and Investments Commission v Rich* [2009] NSWSC 1229 (*ASIC v Rich*). At 7291, the court appears to confirm that the level of information required for decision-making is more subjective than it is objective. The position however is not very clear.

117 Corporations Act, sec 180(2)(c).

118 In *ASIC v Rich*, above at note 116 at 7283, Austin J seemed to have come to the conclusion that the assessment of the reasonableness of the director's belief that he was reasonably informed may result in the application of a somewhat objective standard of an honest and reasonable person in the position of the manager. For the US position, see *Brehm v Eisner*, above at note 23 at 259.

119 Or any other jurisdiction that incorporates BJR into statute.

120 See McMillan "The business judgment rule as an immunity doctrine", above at note 7 at 534.

121 See this confirmation in *Smith v Van Gorkom*, above at note 43 at 873.

122 In *Brehm v Eisner*, above at note 23 at 259, the court described the approach as follows: "we think the concept of gross negligence is also the proper standard for determining whether a business judgment reached by a board of directors was an informed one".

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standard of review is envisaged. If this were to be the case, that would be contrary to South Africa's common law.[123] As already highlighted, section 76(4)(a) demands that a director should take "reasonably diligent steps to become informed about the subject matter of the business decision.[124] Thus section 76(4)(a)(i) can never be read to be moving the liability bar from negligence to a lower level, being the gross negligence standard of liability. This distinguishes the South African standard of review from the US standard of review."

(ii) Requirement that a director must have had a "rational basis for believing" that the "decision was in the best interests of the company"

The requirement in section 76(4)(a) can be broken down into two closely connected elements: "the rationality requirement" and a director's belief that "a decision is in the best interests of the company". Thus, when making a decision, section 76(4)(a)(iii) requires that a director must have rationally believed that the decision made promotes the best interests or success of the company. This is considered to meet the obligations of section 76(3)(b): a duty to act in the best interests of a company. Thus, a decision tainted or infected by conflict of interests, rationally speaking, will not meet the requirement that the director must employ the powers he has to promote the company's best interests.[125] What is in the best interests of the company, however, is a matter to be decided by company directors in the boardroom, not necessarily by judges in the courtroom.[126]

Recently, in probably one of the first cases to consider the application of section 76(4)(a), a South African court stated that the subsection makes it clear that the duty imposed by section 76(3)(b)[127] is not an objective one.[128] According to Rogers J of the Western Cape High Court, the test to be applied is a subjective test, since directors should have subjectively believed that their decision to be in the best interest of the company.[129] A court of law cannot objectively decide what is in the best interest of the company. In his judgment in *Visser Sitrus (Pty) Ltd*, Rogers J nonetheless demonstrates that the so-called "subjective" test only works to ensure that it is the directors as businessmen who have to decide what is in the best interests of the company, since they

123 South African case law has established that the standard of liability for breach of the duty of care obligations is negligence, not gross negligence. See *Ex parte Lebowa Development Corporation Ltd* 1989 (3) SA 71 (T) 106 and *Du Plessis NO v Phelps*, above at note 77.

124 See in particular the Act, sec 76(4)(a)(i).

125 See id, sec 76(4)(a)(ii).

126 See *Re Smith and Fawcett Ltd* [1942] Ch 304 (CA) at 306.

127 This is the statutory duty to act in the best interests of a company. Section 76(3)(b) codifies the relevant common law duty.

128 It is not an objective one in the sense of entitling a court, if a board decision is challenged, to determine what is objectively in the company's best interests. See *Visser Sitrus v Goede Hoop Sitrus*, above at note 94, para 74.

129 Ibid.

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are best placed to do so.[130] It is not the function of the court to "substitute its own business judgment for that of the directors".[131] Thus the test can be said to be upward looking, in the sense that the other related requirements of decision-making work to give the requirement to act in the best interests of a company an objective flavour. For example, while belief can be said to be subjective, the director's belief[132] has to be a belief inspired by a prudent search for information, with the final product being informed decision-making.[133]

Thus the BJR requires the director to show that he believed rationally that his decision was likely to promote the company's best interests. It is difficult to conceive of how the requirement for rationality can exclude good faith.[134] The absence of a rational basis can be considered under English law, and is accepted in South African law, to be indicative of the directors' lack of good faith when making a decision.[135] For the reason that a failure to meet the obligations to act in the best interests of a company may indicate bad faith, it is unfortunate that section 76(3)(a)[136] does not form part of the BJR scheme in section 76(4)(a). It is very interesting to note that, in probably the first ever case to consider the application of BJR or section 76(4)(a) in the context of decision-making, the court applied the BJR as if section 76(3)(a) were a natural part of section 76(4)(a).[137] Although the absence of the duty to act "in good faith and for a proper purpose" under the section 76(4)(a) formulation is not a specific focus of this article, it is worth mentioning.[138]

(iii) The requirement that a director had "no material personal financial interest" related to the decision or alternatively made a disclosure in terms of section 75

One of the requirements for a decision by a director to qualify for protection under section 76(4)(a) is that he must have had no "material personal financial interest" in the decision to be made.[139] Alternatively, a director must have complied with the disclosure requirements set out in section 75 of the

130 Id, para 90.

131 Ibid.

132 The belief that the decision taken was in the company's best interest.

133 *Visser Sitrus v Goede Hoop Sitrus*, above at note 94, para 74.

134 In the English case of *Item Software (UK) Ltd v Fassihi* [2004] EWCA Civ 1244, a director of Item Software encouraged a distributor company dealing with Item Software to make its terms more stringent and to consider dealing with him direct. In the event, the negotiations between Item Software and the distributor collapsed as a result of the director's interference. In this example it is clear that the director was not acting in the company's best interests.

135 See the views expressed by Scrutton LJ in *Shuttleworth v Cox*, above at note 90 at 23–24. Also see *Dorchester Finance v Stebbing* [1898] BCLC 498.

136 That is the requirement that a director acts in good faith and for a proper purpose.

137 See *Visser Sitrus v Goede Hoop Sitrus*, above at note 94, para 80.

138 A focus on the absence of good faith requirements will be the subject of a future article by the author.

139 See the Act, sec 76(4)(a)(ii)(aa).

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Act.[140] The meaning of each part of this requirement needs to be given, and this is attempted below.

The meaning of the phrase "material personal financial interest" used in section 76(4)(a)(ii)(aa) is derived from key phrases "material" and "personal financial interest", which are respectively defined under section 1 of the Act. Materiality of the interest is to be determined objectively. "Material" in this context[141] means significant, in the circumstances of a particular matter, to a degree that might reasonably affect or colour a person's judgment or decision-making. "Personal financial interest" is defined in section 1 to mean "a direct material interest of that person, of a financial, monetary or economic nature, or to which a monetary value may be attributed".[142] Thus the Act requires the interest not only to be "material", but also to be "direct". By implication, indirect interests may be excluded from the ambit of "material personal financial interest". The Act, unlike the Australian Corporations Act, provides the meaning of "material personal financial interest", albeit not as a composite term, but through the meaning of key words. In the US, the language employed is to the effect that directors must be "disinterested" in the decision to be made. To be "disinterested" in the US context means that the directors, as managers of the company's business, should not appear on both sides of a transaction. In other words, a director should not derive a personal financial benefit from a transaction, which benefit is not the same as one that devolves upon the corporation or on all company shareholders generally.[143]

Section 76(4)(a)(ii)(aa) also requires that a director must not have a basis to know that any "related person" had a financial interest in the subject matter of the decision to be made by a company board.[144] It should be noted that the Act appears to require that the director must not have been aware of the interest of such a "related person". By implication, if the director was not aware that any related person had a personal financial interest, then his or her conduct does not fall foul of the requirements of section 76(4)(a)(ii). In such a situation there is no likelihood that the director would have abused his position for his benefit or the benefit of a related person as opposed to promoting only the best interests of the company.[145] Another implication of the

140 See id, sec 76(4)(a)(ii)(bb).

141 In terms of id, sec 1 and in the context of id, sec 76(4)(a), which is the decision-making context.

142 See id, sec 1.

143 See *Aronson v Lewis*, above at note 22 at 814.

144 Sec 2(1) of the Act defines the term "related person" to include natural persons romantically related, such as married couples or even co-habitants; people "separated by no more than two degrees of natural or adopted consanguinity or affinity", and natural persons in such a position in relation to a juristic person as to enable those persons to exercise direct or indirect control of the juristic person concerned.

145 The mischief that the disclosure rules seek to avoid is rather the prevention of director disloyalty through self-interest. The fiduciary duty is therefore preventative of this

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second part of section 76(4)(a)(ii)(aa) is that, should the director be aware of the personal financial interest of a related person, then he or she is required by law to disclose the interest to the board. The disclosure rules, either under the Act or the common law, flow from the fiduciary nature of the director / company relationship. Such a relationship places a fiduciary duty on directors to avoid placing themselves in a position in which their personal interests conflict with their duties to the company.[146]

The alternative to section 76(4)(a)(ii)(aa) is section 76(4)(a)(ii)(bb), which contains the disclosure requirement in respect of section 75 of the Act. It is not clear whether the emphasis in section 76(4)(a)(ii)(aa) that the personal financial interest must be "material" makes any difference when compared to the provision under section 75 where the word "material" is not included. What is clear however is that the reference to section 75 in section 76(4)(a)(ii)(bb) means that the Act requires that the declaration or disclosure of the "personal financial interest" by the director be made before the matter is considered by the board of directors.[147] In fact, section 75 requires that the "interested" director makes advance disclosures in writing (ahead of a board meeting). This should be done with sufficient detail to enable the board to apply its mind and understand the nature of the personal interest of the director or of a related person.[148] 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 insights related to the disclosure(s).[149] Section 75 makes provision for what has been described as the new "disclose and recuse" approach[150] to disclosures under the Act. In this regard, after making full disclosure, the "interested" director should "recuse" himself from the meeting and allow the decision-making to continue without his or her participation.[151] The Act does not even allow the "interested" director to execute any document relating to the subject matter of the decision-making in which he is interested. The only exception is where such a director is specifically instructed by the board to execute a document, despite his interest in the matter.[152] The board should obviously carefully consider the implications of

contd
mischief by encouraging a director to employ all means to attain the best interests of his principal, the company.

146 FHI Cassim et al *The Law of Business Structures* (2012, Juta Claremont) at 297 and 312.

147 See the Act, sec 75(5).

148 See id, sec 75(4).

149 See id, sec 75(5)(e).

150 Cassim et al *The Law of Business Structures*, above at note 146 at 313.

151 See the Act, sec 75(5)(d)–(e). For the purposes of satisfying quorum requirements, the director who would have "recused" himself is considered to be present at the meeting: see id, sec 75(5)(f)(i). However, for the purposes of determining whether a resolution has sufficient support to be adopted, the "interested" director is regarded as being absent: see id, sec 75(5)(f)(ii).

152 See id, sec 75(5)(g).

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compelling the "interested" director to execute any document regarding subject matter in which he has declared himself to be an interested party.

CONCLUSION

This article has established that, even though there are many conceptions of the BJR, the rule historically developed from a standard of liability or review to a standard of conduct. Thus, the BJR as a standard of review becomes a defence if the directors have made a business decision or have met the necessary requirements for protection against liability for informed decisions, made in good faith and without disabling conflicts of interest.

A preliminary point already noted is that section 76(4)(a), while it can be said to have subsumed elements of the BJR as found in the US and Australian jurisdictions, provides wider protection for directors' decisions. Such protection extends beyond business judgments traditionally associated with the duty of care as already demonstrated.[153] Thus, it can be inferred that section 76(4)(a) is more than a BJR, as it applies to "any particular matter arising in the exercise of the powers or performance of the functions" of a director.

When directors exercise the powers given under the Act and fulfil their functions in line with section 66(1), they are expected to meet requirements of their affirmative undertakings called standards of conduct, as prescribed in section 76(3).[154] Section 76(4)(a) provides that a director will have fulfilled the obligations in section 76(3)(b) and (c) if he satisfies the decision-making elements given under section 76(4)(a)(i)–(iii). Patently, the subsection sets a standard of review, providing the means of determining whether a director has met his or her affirmative undertakings or obligations under section 76(3). It should be added that section 76(4)(a) also provides a standard of review to the material personal financial disclosure obligations in section 75. For this reason, it is an anomaly that section 76 is only titled "Standard of conduct" when it clearly provides for both a standard of conduct and a standard of review. It is therefore proposed that the section 76 title be revised to "Standard of conduct and review" to capture more accurately the standards under the section. The BJR in the context of section 76(4)(a) is not a standard of conduct and should not be characterized as such.

For the reason that section 76(4)(a) provides standards of review to standards of conduct, it is very unfortunate that section 76(3)(a) does not form part of the obligations referred to under section 76(4)(a). The requirement that a director's independent judgment must not be infected by conflicts of interest and that directors should rationally believe that their decision promotes the company's best interests imply an element of good faith. The author also

153 See du Plessis "Open sea or safe harbour? (part 2)", above at note 109 at 381.

154 The section broadly relates to the duties to act: in good faith and for a proper purpose (sec 76(3)(a)); in the best interests of the company (sec 76(3)(b)); and with a degree of care, skill and diligence (sec 76(3)(c)).

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agrees with Rogers J's observation that there is a natural nexus between the requirement that directors should exercise their powers for a proper purpose and the other requirement that directors should act in what they consider to be the best interests of the company.[155] It is therefore proposed that section 76 (4)(a) be amended to read in part that "a particular director of a company will have satisfied the obligations of *subsection 76(3)*" This removes the reference to section 76(3)(b) and (c) only, to the exclusion of section 76(3)(a): the duty to act in good faith and for a proper purpose.

It is also important to note that, unlike the US BJR formulations, section 76 (4)(a) should be read to provide for a fairly objective standard of review. With regard to section 76(4)(a)(i), it is clear that, unlike with the Delaware formulation, the standard of review should not be interpreted to have the effect of moving the liability bar from ordinary negligence to a lower standard, namely gross negligence.[156] As already demonstrated in this article, the standard of review under section 76(4)(a) compares favourably with some of the best in the world.

155 See *Visser Sitrus v Goede Hoop Sitrus*, above at note 94, para 80.

156 In *Smith v Van Gorkom*, above at note 43 at 873, it was stated that gross negligence is that appropriate standard of review for the duty of care.

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