Codification of the Business Judgment Rule in Section 76 (4) Companies Act 2008: Comparing the South African with the German Approach

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DECLARATION

I,

<u>Stefan Eisele</u>

Hereby declare that I have read and understood the regulations governing the submission of Masters in Commercial Law dissertations, including those relating to length and plagiarism, as contained in the rules of the University of Capetown, and that this minor dissertation conforms to those regulations.

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§ 1. Introduction

A. Statement of the Problem

The duties and liabilities of directors and officers are a perennial issue within the international legal discussion. Particularly after the massive corruption scandals of ENRON and Worldcom and in the light of the experiences of the global financial crisis, there is a rising public interest in good corporate governance and diligent and reasonable management. The financial crisis of 2008 showed clearly, that manager took enormous risks in order to gain financial advantages. It is evident, that the system of risk overview and other precautionary measures failed to prevent the occurred damages. Although there were numerous red flags, directors were not alarmed and carried on with their risky business[1].

In the light of these experiences, the Business Judgment Rule forms of one the most important centre of attention within this discussion. Amongst other possibilities such as exculpation statutes in the Memorandum of Incorporation, the Business Judgment Rules shields directors from the risk of personal liability[2].

The Business Judgement Rule stems from the US common law and relates to the director's duty of care and skill. It is a judicial device used to limit the scope of personal liability for directors and officers. The rule consists of a rebuttable presumption that a director or officer, when making a business decision, has acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company. It should thus form a safe harbour for rational and informed managerial actions.

The Business Judgment Rule has been in operation in the US for over a hundred years, and has been developed in countless court decisions. Nevertheless, academic writers in the USA have struggled to find a common definition of the Business Judgment Rule. Finding a common definition is quite challenging regarding the fact that every federal state has its own jurisdiction and therefore its own company. There have been several attempts to codify the Business Judgment Rule; these include section 4.01 of Corporate Governance: Analysis and Recommendations, published by the American Law Institute and section 8.31 of the Revised Model Business Corporation Act ("**RMBCA**"). However, none of these definitions are binding. The following commentary on section 8.31 RMBCA reflects the current position of the Committee on Corporate Laws in the US with regards to the Business Judgment Rule:

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[1] *In re* Citigroup, Inc. Shareholders Derivative Litigation, No. 07 Civ. 9841, 2009 WL 2610746, at 5–6 (S.D.N.Y. Aug. 25, 2009).

[2] Reza Dibadj, *Delayering Corporate Law*, 34 Hofstra Law Review (2005), 469 at 485–86.

"Section 8.31 does not codify the business judgment rule as a whole. The section recognizes the common law doctrine and provides guidance as to its application in dealing with director liability claims. Because the elements of the business judgment rule and the circumstances for its application are continuing to be developed by the courts, it would not be desirable to freeze the concept in a statute."[3]

Despite these well-known problems, several countries adopted the Business Judgment Rule in their respective Companies Act as well.

The South African Companies Act, 71 of 2008[4], has incorporated the Business Judgment Rule into South African Law. However, this recently implemented tool has not yet been applied by the South African courts. It is therefore highly important to fully understand the Business Judgment Rule, to examine its prerequisites and to identify the potential problems courts possibly may have to deal with. The aim of the codification is to create a safe harbour for directors and to provide a shield against liability imputations[5]. As long as there is uncertainty in the application of the Business Judgment Rule, the intended behavioural impact on managers may be hindered.

Germany adopted the Business Judgment Rule in the German Stock Corporation Act in 2004 as well. Since then, academic writers as well as the jurisdiction try to define the scope of its application as well as the meaning of its prerequisites. There seem to be several similarities between the South African and the German approach. Firstly, both approaches are based on the US-American Business Judgment Rule, leading to a similar structure of the respective codifications. Secondly, the Business Judgment Rule as a tool to limit the liability of the management has a long history in both countries. Courts applied the Business Judgment Rule in numerous courts decisions and established certain standards of a proper decision making process before the legislation implemented a codification in the binding law.

However, the rule and its application is rather intricate and a deep insight in its complex application is required to avoid a misunderstanding and a misapplication of the rule[6]. The

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[3] Section 8.31 of Model Business Corporation Act Official Text with Official Comment and Statutory Cross-References Revised through December 2007.

[4] The Companies Act 71 of 2008 is hereinafter referred to as "**CA 2008**".

[5] *Muswaka 'Directors' Duties and the Business Judgment Rule in South African Company Law: An Analysis'* (2013) International Journal of Humanities and Social Science, Volume 3 Number 7 at 89.

[6] *Cassim at al* Contemporary Company Law at 564-5; *Leach* at 19.

taking the necessary risks which are necessary for a company's success. Based on German experience it is problematic to ensure legal clarity and to determine the scope of judicial review, in particular regarding highly complicated prerequisites such as adequate information and reasonable belief. Analysing German cases as well as German judicial science would make it possible to identify potential fields of problems and adopt them to the special characteristics of the South African company law. This might be helpful because South African courts have not yet been applying the codified rule that often.

C. Methodology and Overview of Chapters

In order to achieve the above-mentioned aims of research this paper will provide a legal comparison between Germany and South Africa with regard to the codified Business Judgment Rule. However, before comparing the two different approaches it is necessary to understand the directors' duties and liabilities in South African legal framework. Without a basic understanding of the obligations of directors and their relationship with the company it is not possible to properly determine the scope of application of the rule. Due to the word limitations of this paper the German system of duties and liabilities will unfortunately not be described in detail. For the understanding of the German codification the paper will only provide briefly explanations of the German legal system if necessary.

Subsequent to this overview the rule's two different approaches will be described. Again, due to the limitations of this paper it will only be possible to provide information with regard to the prerequisites of the respective rule. Additional problematic areas such as the burden of proof and other obstacles[10] are not part of this examination. The interpretation of both codifications requires the analysis of court decisions and legal literature with regard to the subject matter. However, it is important to mention that the legal comparison will only include the micro-level of the rule itself. Other than macro comparisons[11] this paper will not provide a comparison between the entire legal company system of Germany and South Africa. However, the author is aware of the fact that the entire legal system of these two countries highly differ. Germany is not influenced by common law and thus written codifications are way more common than in common-law influenced countries as South Africa. In addition, the structure of stock corporations in both countries is different, too. Whereas Germany follows the *two-tier board concept,* South African stock corporations are structured according to the

[10] The effectiveness of the Business Judgment Rule in general is discussed fiercely. Apart from specific legal arguments some authors in the US have identified additional general aspects which can influence the effectiveness of the rule. This includes financial as well as procedural and psychological aspects.
[11] See for the difference between micro and macro law comparison *Ralf Michaels* 'Comparative law' (2012) in Max Planck encyclopedia of European private law.

opinions about the rule, its application and its concrete effect diverge and the idea of a codified rule in modern corporation acts has been massively criticized[7].

B. Aims of Research

One of the purposes of the South African Companies Act is to balance the rights and obligations of shareholders and directors[8]. Directors of a company act as trustees for the owner of the property, the shareholders. To protect the shareholders from ineffective or false management the law imposes personal liability on the directors for mistakes in managing the company. As an offset for this personal liability the Business Judgment Rule should protect them from excessive and unjustified risk of personal liability with regard to business decision. In order to provide this main purpose the rule must be well understood and applied uniformly. Consequently, judicial science and jurisdiction must obtain a solid understanding of the underlying reasons of the rule as well as a deep insight in its scope of application and the meaning of its prerequisites. This thesis intends to offer additional knowledge about the rule and its concrete applications.

Therefore, the first aim of this paper is to provide an overview about the different codifications of the Business Judgment Rule in South Africa and Germany. By identifying the similarities and the differences of the codification the reader will be able to get a deeper insight in both codifications particularly regarding respective requirements and underlying justifications. [9].

Furthermore, this paper aims to identify potential problems with regard to the application of the codified Business Judgment Rule in South Africa. Instead of dealing with a flexible common law rule implemented in the general system of directors' duties and liabilities the courts must now adhere to a more inflexible binding law regulation. Hence, the understanding of the rule changes, because the rule now forms part of the expressively regulated system of the directors' duties and liabilities. The requirements for expressively formulated regulations are much higher in terms of predictability and legal certainty. The addressed directors and officers must be able to predict the expectations of the law precisely. The jurisdiction must secure that same cases are equally decided. A lack of clarity of the definitions of the rule or uncertainty with the scope of judicial review of business decisions may hinder the directors in

[7] *Du Plessis* at 263; *Jones* 'Directors' Duties: Negligence and the Business Judgment Rule' (2007) South African Mercantile Law Journal Volume 19 at 326; *Bouwman* 'An Appraisal of the Modification of the Director's Duty of Care and Skill' (2009) South African Mercantile Law Journal Volume 21 at 509.
[8] Section 7 (f) CA 2008.
[9] However, it is beyond the borders of this thesis to examine all prerequisites in detail.

one-tier board concept[12]. These differences might affect the concrete interpretation of the prerequisites and may also influence the scope of judicial review by the courts. Therefore, it will be necessary to highlight specific issues in this regard as well when interpreting the prerequisites and examining the scope of application of the rule.

Subsequently to the description and interpretation of the two codifications the relevant similarities between the two approaches hasto be identified. Similarities are existing obviously with regard to the prerequisites and the underlying reasons of the rule. However, despite the similar formulations of the codifications, the differences between the two legal systems might require a closer examination to obtain precise and informative results.

Based on these results and in the light of the interpretation of the prerequisites and the analysis of related court decisions this paper will finally provide an identification of potential problematic areas arising out of the application of the codified rule in South Africa. It is important to mention that this identification cannot be proved, because South African courts have not dealt with the codified rule a lot yet. Prediction of future developments are always difficult and insecure, in particular because the German experience with the rule and its application by the jurisdiction is not the prototype of dealing with the difficulties of the rule. Nevertheless, even the knowledge of potential problems may be an advantage in future cases.

In addition, the whole paper will also content the analysis of other foreign courts decisions, mostly from the United States of America. This is because the Business Judgment Rule stems particularly from the US American company law[13]. An insight of important cases and other attempts to codify the rule will help to get an even deeper understanding of the rule, the underlying reasons, the prerequisites and the scope of application. This additional comparative approach is also in line with the South African legal framework. According to Section 5 (2) CA 2008, courts should consider foreign company law when interpreting or applying the Companies Act. This applies particularly to such provisions of the Act, which regulate foreign legal constructions such as the Business Judgment Rule. Since the Business Judgment Rule stems originally from the US company law, notably from the federal state of Delaware, the American jurisdiction has lots of experience with regard to the application of the rule. In order to define and interpret the South African Business Judgment Rule, it is

[12] The main difference between these two concepts is the separation of responsibilities. Whereas the board of directors in the one-tier system manages and controls, these two responsibilities are allocated to different boards in the two-tier system The managing board has sole responsibility for managing the company and ensures that the business is conducted in accordance with the applicable law. In contrast, the supervisory board monitors and advises the managing board and audits the efficiency of its work regularly.
[13] *Wiese* at 17 and 137.

therefore useful to consider particularly US American case law regarding the Business Judgment Rule. Such additional analysis might also help to promote Section 5 (1) CA 2008, which states that the Act "*must be interpreted and applied in a manner that gives effect to the purpose of Section 7*". Section 7 (e) regulates, that the Act must be interpreted in "*a manner that enhances the economic welfare of South Africa as a partner within the global economy*." Since companies often act transnational and failing of management affects shareholders in all different countries, the personal liability of management is a topic of international relevance. It is in the best interest of every country to provide reliable and clear regulations with regard to these issues to attract potential investors and competent management. Being in line with international developments and trends can help with competing on the international markets.

Finally, a conclusion will summarize the findings.

§ 2. Directors Duties and Liablities

In order to understand the Business Judgment Rule, it is necessary to understand the general director's tasks and duties. According to Section 66 (1) CA 2008, the directors are responsible for the management of a company on their own discretion. They have the authority to exercise all of the powers and perform any of the the functions of the company, except to the extent that the Companies Act or the Memorandum of Incorporation provides otherwise[14]. In fulfilling this general task, there are several duties to exercise.

The Companies Act 2008 regulates these duties only partial. According to Sec 76 (3) CA 2008, a director must act in good faith and for a proper purpose, in the best interests of the company and with the necessary degree of care, skill and diligence. In addition, several other duties are also expressively imposed, such as the duty to avoid a conflict of interest[15] or the duty to disclose personal financial interests[16]. These codified duties seem to be the most important common law duties for directors. This does not mean that the common law duties are out of function, as long as they are not amended by Section 76 CA 2008 or would directly conflict with the expressively codified duties[17] The Companies Act does not provide a regulation, that the statutory duties fully replace the common-law duties of directors, such as the UK Companies Act 2006 is doing[18]. The courts can therefore relate to the common law duties as well[19]. The paper will concentrate mostly on the codified duties of directors, because they are the most relevant factors in order to understand the codified Business Judgment Rule.

It is not intended to give an exhaustive overview about the system of directors' duties and liabilities, because the system is too complex and several aspects are discussed controversy[20]. It is more intended to only provide an overview about the most fundamental principles of these duties to get a better understanding of the basic function of the business judgment rule.

A. Duty of Care, Skill and Diligence

The most important duty in relation to the Business Judgment Rule is the Duty of Care, Skill and Diligence. The Business Judgment Rule and the Duty of Care cannot be considered

[14] Section 66 (1) CA 2008.
[15] Section 76 (2) CA 2008.
[16] Section 75 CA 2008.
[17] Henochsberg Companies Act s76 at 290 (4).
[18] Section 170 (3) of the UK Companies Act 2006.
[19] Henochsberg Companies Act s76 at 290 (4).
[20] Henochsberg Companies Act s76 at 290 (4).

separately, because managing the company and taking business decisions always relate to this duty[21]. In order to understand the Business Judgment Rule, it is thus necessary to understand the duty of care.

The Duty of Care stems initially from the Common Law[22]. It has been strongly influenced by English company law[23]. Historically, the South African Duty of Care has been interpreted very conservative. The benchmark for the South African duty of care has been set in the leading case "*Fisheries Development Corporation of SA Ltd v Jorgensen*"[24]. In fact, the court decided that the duty of care requires no greater skill from the directors than what could be expected from a person with the respective knowledge[25]. Thus, the duty of care largely depends on the respective circumstances, i.e. the nature of the respective business, the concrete tasks of the respective director and his or her obligations within the company. A full-time executive director must meet higher standards than a non-executive director[26]. Furthermore, a director is not required to have a special expertise or a special knowledge about the respective business of the company[27]. In contrast to the general standard of negligence, which defines the requirements on the basis of the reasonable person standard, the duty of care is defined subjectively. A director, for instance, had to exercise a lower standard while managing the company, than he or she would while driving a car. This does not mean, that a director can manage the business without having specific skills and a basic understanding of his activities. Exercising the duty of care requires a director to consider decisions diligently and to exercise his or her specific judgment on the diligent analysis of the circumstances and present information[28]. The problem with such an approach is, that the definition of the concrete extent of the duty of care is difficult, if not impossible. However, it

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[21] *Du Plessis* 'A comparative analysis of directors' duty of care, skill and diligence in South Africa and in Australia' *(2010)* Acta Juridica at 263-64*; Michele Havenga '*The Business Judgment Rule – Should we follow the Australian Example' (2000) South African Mercantile Law Journal at 1; *Kennedy-Good/Coetzee* 'The Business Judgment Rule (Part 1)' (2006) Obiter Volume 27 Number 1, 62 at 64.

[22] *Du Plessis NO v Phelps 1995 (4) SA 165 (C)*: "*Apart from their statutory duties, directors owe fiduciary duties to the company as well as a common law duty to take reasonable care in the management of the company's affairs. Liability in the event of a director failing to take reasonable care in the management of the company's affairs is based on the principles of the Lex Aquilia. The basic requisite for liability under the Lex Aquilia is fault, i.e. dolus or culpa which results in loss to the plaintiff*".

[23] *Havenga* S. Afr. Mercantile L.J at 1.

[24] *Fisheries Development Corporation of SA Ltd v Jorgenson* 1980 (4) SA 156 (W).

[25] *Re City Equitable Fire Insurance Co Ltd* [1925] Ch 407; *Fisheries Development Corporation of SA Ltd v Jorgenson* 1980 (4) SA 156 (W).

[26] *Du Plessis* at 265.

[27] See also *Re Brazilian Rubber Plantations and Estates Ltd (1911) 1 Ch 425 (Ch D).*

[28] *Kanamugire/Chimuka* 'The Directors` Duty to Exercise Care and Skill in Contemporary South African Company Law and the Business Judgment Rule' (2014), Mediterranean Journal of Social Sciences Volume 5 Number 20, 70 at 72.

becomes evident that ordinary negligence is not enough to hold directors accountable for a breach of their duty of care[29].

Despite the fact, that there are some good arguments for this subjective approach[30], it has been criticized as being insufficient and too mild[31]. The Australian case *Daniels v Anderson* then stated, that the duty of care and skill should be determined in a more objective way[32]. This change of attitude influenced the understanding in South African as well. The King II Report of South Africa identified the low standard of the duty of care also as a problem and consequently recommended a more objective standard[33].

Within the new Companies Act, the Duty of Care has therefore partially been codified[34]. Instead of determining the duty of care strictly subjective, this regulation imposes a more objective approach[35]. Section 76 (3) (c) states:

> *Subject to subsections (4) and (5), a director of a company, when acting in that capacity, must exercise the powers and perform the functions of director- with 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.*

Subsection (i) determines the general threshold for all directors in order to avoid liability. It is merely the bottom line of the required skill and diligence and it is determined objective[36]. The modern approach is regulated in Subsection (ii), whereas directors are obliged to exercise their individual level of skill, knowledge and experience as well. The phrase "*having the general knowledge, skill and experience of that director*" differs from the *reasonable third*

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[29] *Re Brazilian Rubber Plantations and Estates Ltd* (1911) 1 Ch 425 (Ch D) at 436-7: "*So long as they act honestly, they cannot be made responsible in damages unless guilty of gross negligence.*".

[30] It seems almost impossible to determine an objective level of required skill, care and diligence for directors. Due to the fact, that almost any person can be appointed as a director of a company, regardless the respective expertise or qualification, there is no average of skill and expertise. In other professional groups such as lawyers or doctors, each professional has to pass several examinations in order to practice. It is therefore much easier to determine the bottom line of required and expected skill and diligence. Cf also *James Leach* at 9.

[31] *Botha/Jooste '*A Critique of the Recommendations in the King Report Regarding a Director's Duty of Care and Skill*'* (1997), 114 South African Law Journal at 76.

[32] *Daniels v Anderson* 16 ACSR 607 CA (NSW) at 664-665.

[33] King Report II chapter 4 at 55 in paragraph 2.3: "*Must, in line with modern trends worldwide, not only exhibit the degree of skill and care as may be reasonably expected from persons of their skill and experience, but must also: Exercise both the care and skill any reasonable person would be expected to show in looking after their own affairs".*

[34] Section 76 (3) CA 2008.

[35] *Cassim et al.* Contemporary Company Law. 2ed (2012) at 558.

[36] Henochsberg Companies Act s76 at 295; *Kanamugire/Chimuka*, 70 at 73.

person approach[37] This means, that a director has to do more in order to avoid his personal liability than under the common law approach. The judicial review of certain actions of directors has changed. The courts must now firstly examine what level of care, skill and diligence is expected from a director in the concrete situation of that respective director (subjective approach)[38]. Afterwards, the courts will have to determine how other directors would have act in the same situation exercising the subjectively determined diligence of the respective director (objective approach)[39]. If a court for example finds, that the respective director has special knowledge or a superior expertise and did not use it while managing the company, this director will certainly be held liable to this higher applicable standard[40]. The more skill and knowledge a director has, the higher is the level of diligence and care he or she must exercise while managing the business of the company[41]. This puts certainly more risks on the directors. Someone who takes office as a director of a company must now ensure, that he or she has the necessary knowledge, expertise and skill to fulfil the respective duties. Otherwise, a court could decide that a higher level of skill could objectively be expected. In addition, the more qualified a director actually is, the higher is the level of skill and care expected from him or her.

In the light of the above, authors tend to assess the purpose of the Business Judgment Rule as an attenuation of the statutory duty of care and skill[42]. Whether this purpose is really fulfilled has to be examined within this paper.

B. Good faith and proper purpose

In addition to the general duty of care, skill and diligence, directors owe several fiduciary duties towards the company. Fiduciary duties have been implemented by the courts, because directors act as trustees for the shareholders[43]. Instead of acting in their own interests, directors are expected to act in the interests of their trustors. To avoid selfish acting for their own advantage, directors can be held liable for a breach of their respective fiduciary duties.

Parallel to the duty of care, skill and diligence the fiduciary duties stem from the common law as well. However, it is difficult to categorize the various forms of the fiduciary duty. For the

[37] *Du Plessis* 265 at 269.
[38] Ibid at 269-70.
[39] Ibid.
[40] *Kanamugire/Chimuka*, 70 at 73.
[41] Ibid at 74.
[42] *FHI Cassim.et al* Contemporary Company Law.2ed. (2012) 563; *Kanamugire/Chimuka*, 70 at 74.
[43] *Finch*, 'Company Directors: Who Cares about Skill and Care?' (1992) The Modern Law Review Volume 55 Number 2 at 200.

purpose of this paper, it should only be noted that the judicative understands the concept of the directors' fiduciary duties towards the company as flexible and still evolving[44]. Therefore, this concept can change from time to time since courts must assess the respective duties on a case to case basis including the consideration of the substance of the relationship between management and company and any other relevant circumstances[45] For the understanding of the Business Judgment Rule it should therefore only be noted, that the common law fiduciary duty in general requires undivided loyalty and the avoidance of conflict of interests[46]. These important duties have now been regulated expressively in the new Companies Act[47].

The duty to act in good faith and for a proper purpose is consistent with the common law principle of *bona fide*[48] and is seen as the most fundamental duty of directors[49]. It is directly linked to the duty to act in the best interest of the company because acting in good faith in the directorial context always requires focussing on the company's best interests[50]. If a director pursues any different interests than those of the company, he or she certainly does not act in good faith, because the term *good faith* is grounded on the concept of honesty[51]. Although the judicial review in those cases was mainly focused on the examination of best interests, the courts also examined good faith and proper purpose of business decision by applying the proper purpose approach.[52].

The fiduciary duty of acting in good faith and for a proper purpose is not directly linked to the codified business judgment rule, because Section 76 (3) (a) is expressively excluded from the rules scope of application[53]. Therefore, courts always have to review a business decision upon its compliance with this fiduciary duty and the rule itself. Given this fact, it seems highly important for the personal liability of directors to define the meaning of the term *proper purpose* because this term causes an extension of judicial review even for business decisions.

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[44] *Ultraframe (UK) Ltd v Fielding* [2005] EWHC 1638 (Ch).
[45] Ghersi v Tiber Development (Pty) Ltd 2007 (4) SA 536 (SCA) at para 9; Robinson v Randfontein Estates Gold Mining Co Ltd 1921 AD 168 at 268; Bellairs v Hodnett and Another 1978 (1) SA 1109 (A) at 1128A.
[46] *Ultraframe (UK) Ltd v Fielding* see supra Fn. 44.
[47] Section 76 (2) and (3) CA 2008.
[48] *Van Tonder 'An Analysis of the directors' duty to act in the best interests of the company through the lens of the Business Judgment Rule' (2015)* Obiter Volume 36 Number 3, 702 at 713.
[49] *Cassim et al* Contemporary Company Law at 524; *Van Tonder* at 713-14.
[50] *Teck Corporation Ltd v Millar* (1973) 33 DLR (3d) 288 at 315-16.
[51] *Cassim et al* Contemporary Company Law at 524; *Van Tonder* at 714.
[52] *Van Tonder* at 714.
[53] *Cassim et al* at 564, *Leach* at 21.

In fact, the term allows courts to effectively intervene in the internal matters of the company[54].

Historically, the term has been used to guarantee effective control of the exercise of discretional power[55]. Under the common law, the duty to act for a proper purpose has been justified upon the idea of the balance of powers[56]. Given the fact that directors act as trustees for the shareholders and have the wide power to act on behalf of the company in all circumstances, an effective control mechanism had to be in place to avoid misuse of this powers. However, under the new Act are various regulations in place to secure judicial review even with regard to the internal matters of the company. In particular the business judgment regulates the judicial review in the most internal matter possible, the original business decisions of the board. It is thus questionable if the duty to act on a proper purpose can be justified even under the regime of the new Companies Act and if so, whether is the duty to act for a proper purpose actually applicable in cases of business decisions.

The prevailing opinion is that the proper purpose duty applies to all forms of directorial acting and thus has also to be adhered to in taking business decisions. This understanding might cause problems with regard to the personal liability of directors and the effectiveness of the codified rule in general. Firstly, the term *proper purpose* is highly unclear[57]. The use of the term bears the risk to undermine one of the main intentions of the new Act, the clarification of the law and the enhancement of its accessibility. But even with regard to the codified business judgment rule the duty is problematic, because it broadens the scope of judicial review as already mentioned. This problem will be examined in more detail[58].

In addition to these problems comes the lack of clarity of the duty itself. The Act itself does not provide a definition of the term proper purpose. And even the historical understanding of the term does not help very much in this regard. If the term shall ensure the propriety of the exercise of the directorial power, the nature and the scope of this powers must be examined by the courts as a necessary first step. Section 66 simply states that directors have the authority to exercise all of the powers and perform any of the functions of the company. The absent of any expressively regulated limitations makes it highly complicated to distinguish what a proper purpose can be. The starting point for this examination is always the conclusion that the

[54] *Saul Friedman* 'An Analysis of the Proper Purpose Rule' (1998) Bond Law Review Volume 10 Issue 2, 164 at 166.
[55] Ibid at 167.
[56] *Balls v Strutt* (1841) 1 Hare 146 at 149; *Vatcher v Paull* [1915] AC 372 at 378 per Lord Parker of Waddington.
[57] *Friedman* at 167.
[58] See below under § 5.B 4.

unlimited power of directors is based upon the trust of the shareholders. Therefore, the universal proper purpose in almost all cases of directorial acting is the promotion of the interest of the shareholders as the trustors. Bases on such an understanding, the term of proper purpose would not differ from the best interests of the company, because the interests of the company are mainly identical with the interests of the shareholder[59]. The jurisdiction in South Africa seems to have the same understanding. In *Visser Sitrus (Pty) LTD v Goede Hoop Sitrus (Pty) Ltd and Others* the court held that the duty to act for a proper purpose is similar to the principles of the exercise of public power[60]. Therefore, based on this interpretation, it is the courts duty to examine whether there was any rational link between the decision and the purpose for which the directorial power has been given[61].

C. Duty to Act in the Best Interests of the Company

Directors have to exercise both the duty of care and skill and the fiduciary duty in the best interests of the company. There is no universal definition of what the best interests of the company are. The term is an indefinite phrase, which requires a case-to-case determination of its content[62]. Therefore, the directors have to define the best interests of the company in the respective given circumstances.

The courts will restrain from defining the best interests of the company when the directors honestly believed that they acted for the sole benefit of the company[63]. Fundamentally, courts will not enquire the financial or commercial basis of a business decision[64]. The task of the courts is solely to examine the basis on which the directors build their decision, i.e. if there were reasonable grounds to believe the decision has been in the best interests and the directors actually believed to act in those interests.

The only objective guide the Act provides is the definition of the company itself. The conservative definition of a company would only include the interests of the shareholder –

59 See below under § 2.C.
60 2014 (5) SA 179 (WCC).
61 *Wiese* at 139.
62 *Van Tonder* at 721.
63 *Explanatory Memorandum Companies Bill* 2008 at 187.
64 *Levin v Felt & Tweeds Ltd* 1951 (2) SA 401 (A) at 414-15; *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] 1 All ER 1126 (PC) at 1131.

both present and future – as the sole owners of the share capital[65]. This common law based understanding is known as the *shareholder dominance theory*[66].

Nevertheless, the new Companies Act seems to open this narrow definition towards the consideration of more interests, in particular the interests of various stakeholders. Public, state-owned and listed companies are obliged to appoint a Social and Ethics Committee[67]. The purpose of this Social and Ethics Committee is to monitor the company's activities with regard to social and ethical matters and to draw these matters to the attention of the board of directors[68]. In addition, Section 7 read together with Section 5 implementing broader stakeholder interests in the Companies Act as well. These regulations might entitle the board to consider social interests in general and particularly the interests of the shareholders[69].

This uncertainty about the proper definition obviously affects the potential liability of directors. The problem is even more relevant with regard to the statutory business judgment rule, because business decision under the protection of the rule must also be taken in the best interests of the company[70]. However, it is one of the intentions of the rule to effectively protect the directors against this uncertainty, because it is clearly stated that the director must only had a rational basis for his or her believe to act in the best interests of the company[71]. Courts are therefore required to defer to the directorial judgment if this rational basis can be found. The link between this fiduciary duty and the business judgment rule must accordingly be examined in more detail[72].

D. Liability towards the Company

Every director of a company owes the respective duties individually towards the company and is personal liable for a breach of those duties[73]. Therefore, the Business Judgment Rule is highly important as a legal tool in order to limit the liability of directors for false business decisions.

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[65] *Alexander v Automatic Telephone Co* [1900] 2 Ch 56 (CA) at 67, 72; *Coronation Syndicate Ltd v Lilienfeld* 1903 TS 489 at 497; *Parke v Daily News Ltd* [1962] Ch 927 at 963; [1962] 2 All ER 929 at 948; *Henochsberg* s76 at 296; Van Tonder at 712.

[66] *Cassim et al* at 515; *Ramnath/Nmehielle* 'Interpreting Directors' Fiduciary Duty to Act in the Company's Best Interests Through the Prism of the Bill of Rights: Taking Other Stakeholders into Consideration' Speculum juris 2013 (2), 98 at 102.

[67] Section 72 (4) CA 2008.

[68] Regulation 43 (5).

[69] *Wiese* at 133.

[70] See also at § 3.B.d).

[71] Section 76 (4) (a) (iii).

[72] See for an examination in detail below at § 3.B.d).

[73] *Wiese* at 130-31.

The Companies Act distinguishes between three different liabilities, i.e. the liability for a breach of fiduciary duties, for a breach of the duty of care and other statutory duties[74].

However, the Companies Act allows a company to indemnify its directors from any liability, although this opportunity is not granted unlimited[75].

E. Liability towards the Shareholders

In addition to the liability towards the company, the shareholders of a company may also have a claim for damages against the directors under certain circumstances[76].

§ 3. Codifications of the Rule in Germany and South Africa

A. The German approach

1. Case Law

Within the German law-system, there exists no common law as in South Africa. Application of law therefore always refers to binding codifications. Due to the principle of separation of powers the judiciary is only entitled to apply the law and not create the law. Nevertheless, whenever legal regulations or principles must be applied to the specific facts of a case, courts in fact create law by solving the current conflict. New rules emerge from such decisions and the judiciary thus formulates *de facto* new principles.

Against this background the German business rule was developed since the 1970's. Before codifying the Business Judgment Rule courts had to decide cases only on the basis of the general director's duties and liabilities[77]. According to Section 93 (1) (1) German Stock Corporation Act[78], a member of the supervisory board has to exercise the due care and diligence of a prudent manager. This general provision does not distinguish between business decisions and other actions of the managing board, i.e. fulfilling their lawful tasks and adhere to binding law concerning the company. However, this general provision is open for interpretation and must be filled with content by the competent courts[79]. The German legislator leaves it up to the jurisdiction and academic writers to define the concrete level of

[74] Section 77 (2) and (3).
[75] Section 78 (5).
[76] Section 20 (6).
[77] Whenever the term "*director*" is used with regard to German law, it describes the members of the supervisory and managing board.
[78] Hereinafter "**AktG**".
[79] *Mertens/Cahn* in KölnKomm AktG, s93 para 11; *Fleischer* in Spindler/Stilz AktG, s93 para 10; *Dauner-Lieb* in Henssler/Strohn, s93 AktG para 6; *Scholz* Existenzvernichtende Haftung, at 86.

care and diligence[80]. It was thus possible for the courts to distinguish between certain actions of the managing board and consequently set different standards for the required level of care and the extent of judicial review.

German courts therefore began to recognize in the 1970s, that a strict liability for certain business decisions is contradicting with the business reality. The courts began to develop a certain leeway for directors for performing their managerial tasks. In the famous "Kalli und Salz" judgment, the German Federal Supreme Court[81] firstly decided, that business decision taken by the members of the supervisory or managing board are subject only to a limited review by the courts[82]. It was clearly stated, that a judicial review must be excluded, because it cannot be the tasks of judges to replace a balanced and competent decision taken by the responsible persons with their own decisions[83]. From this starting point on, the framework of such a commercial discretion has been more and more clarified in various courts decisions. The BGH even further extended the managerial leeway on decisions under uncertainty[84]. Whenever a decision requires a prognosis about future developments and thus the identification of the best interests of the company, courts must restrain from a full review of that decision.

However, these early judgments never named this commercial discretion as Business Judgment Rule or even referred directly to the common law Business Judgment Rule. This discretion has been solely developed on the basis of Section 93 (1) (1) AktG, which regulates the general director's duty of care. There has been no consistent or universal dogmatic of the Business Judgment Rule. The BGH rather decided on a case by case basis and modified the prerequisites of the limited liability, in particular the limits of the managerial discretion. Whereas some cases reviewed the present business decisions upon the benchmark of *realistic prognosis*[85], other decisions had been reviewed upon their *seriousness*[86]. It becomes clear, that the original purpose of the Business Judgment Rule of securing a safe harbour had not been reached in terms of clarity and predictability. Board members could not be sure about the extent of their leeway and thus their possible liability in cases of wrong business decisions.

[80] *Hölters* AktG s93 para 2.
[81] Hereinafter referred as "**BGH**".
[82] BGH, Decision from 11.03.1978, AZ: II ZR 142/76 = BGHZ 71, 40.
[83] BGH, Decision from 11.03.1978, AZ: II ZR 142/76 = BGHZ 71, 40.
[84] BGH, Decision from 09.07.1979, AZ: II ZR 118/77.
[85] BGH, Decision from 09.07.1979, AZ: II ZR 118/77 (para 42 in juris).
[86] BGH, Decision from 05.10.1992, AZ: II ZR 172/91 = BGHZ 119, 305.

More clarity was provided by the leading case from 1997 called "*ARAG/Garmenbeck*"[87]. This decision firstly referred expressively to the Business Judgment Rule and is commonly accepted amongst German authors as the most important case in relation to the development of the Business Judgment Rule[88]. In addition, the German legislator has expressly relied on this case to formulate the German Business Judgment Rule in Section 93 (1) (2) AktG[89]. The BGH had to decide, if the members of the supervisory board of a stock corporation are obliged to pursue potential claims of the company against members of the managing board in case of wrong business decisions[90]. In the present case, the members of the supervisory board had refused to pass appropriate resolutions. In this judgment, the BGH clearly stated, that the decision of the supervisory board to pursue potential claims is subject to full judicial review. Nevertheless, such potential claims must be well founded to some extent. When assessing the probability of potential claims against members of the managing board, the members of the supervisory board have to respect the wide leeway of the managing board with regard to business decisions. Only if the managing board exceeds the limits of rational and responsible behaviour, personal liability of the members of the managing board can possibly arise. Such liability is most likely in cases, in which the managing board takes unjustified and irresponsible risks. The formulation of the prerequisites of this managerial leeway derives directly from the US Business Judgment Rule. In later cases, this understanding of the leeway has been confirmed[91].

2. Section 93 (2) (1) German Stock Corporation Act

In 2004, the German Stock Corporation Act had been extensively revised and extended through the "*Act for Corporate Integrity and Modernization of the Law of Avoidance*"[92]. One of the main objectives of this revision was to strengthen the rights of shareholders, in particular of minority shareholders. The revised legislation gives shareholders with a certain amount of shares the right to pursue a derivative suit to hold members of the supervisory or managing board personally liable[93]. The Business Judgement Rule was expressly included in

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[87] BGH, Decision from 21.04.1997, AZ: II ZR 175/95 = BGHZ 135, 244.
[88] *Fleischer* ZIP 2004, 685 at 686; *Henze* NJW 1998, 3309 at 3310; *Koch* in Hüffer AktG, s93 para 11; *Dauner-Lieb* in Henssler/Strohn, s93 AktG para 17; *Mertens/Cahn* in KölnKomm AktG, s93 para 12; *Hopt/Roth* in GroßKomm AktG, s93 para 62.
[89] RegE UMAG, BT Drucks. 15/5092 at 11.
[90] Because of the German two-tier board system, the members of the supervisory board have to decide, whether the company should sue the members of the supervisory board for damages because of wrong business decisions.
[91] BGH, Decision from 03.12.2001, AZ: II ZR 308/99 = NZG 2002 at 195.
[92] „Gesetz zur Unternehmensintegrität und Modernisierung des Anfechtungsrechts"; hereinafter referred as „**UMAG**".
[93] Section 148 AktG.

the German Stock Corporations Act to offset the extensive protections afforded to shareholders[94]. The rule shall operate in favour of directors and shall act as a safe harbour for those who have acted rationally in making business decisions. More transparency and legal certainty for members of supervisory board and managing board should thus be secured[95]. Therefore, the basic concept of the provision is to clearly separate the liability for wrong business decisions from the liability for any other actions taken by the managing board. This is the explicit intention of the German legislator[96].

According to Section 93 (1) (2) AktG, a member of the supervisory board is acting with the due care and diligence of a prudent and conscientious director, if this member (i) could reasonably believe that he or she acts (ii) on the basis of adequate information and (iii) in the best interests of the company[97]. The drafters have relied on US case law and definitions as well as on German judicial decisions to formulate the German Business Judgment Rule[98].

To achieve the main purpose of this work, it is necessary to give a brief overview of

3. Prerequisites of Section 93 (2) (1) German Stock Corporation Act

a) Business decision

The intention of choosing the phrase *business decision* was to exactly determine the scope of application of Section 93 (2) (1) AktG[99]. The German legislator and judicial science understand the phrase as a negative distinction. Based on this understanding, on the one hand managerial actions can be distinguished into legally bound actions (actions required by binding law, actions required by the articles of association and the employment agreement and actions arising out of the fiduciary duties[100]) and on the other hand into business decisions. In addition, academic writers in Germany made some effort to define the phrase also positively. If one summarizes the various definitions attempts, it is possible to identify the fundamental elements of a business decision. The simplest element of a business decision is the assessment of a valid decision situation. A business decision can only be assumed, if the respective decision maker actually has a choice between different alternatives[101]. If there is

[94] RegE UMAG, BT Drucks. 15/5092 at 11.
[95] *Fleischer* ZIP 2004, 685 at 687; *Lutter* ZIP 2007 at 841-42; *Bürkle* VersR 2013, 792 at 796.
[96] RegE UMAG, BT Drucks. 15/5092 at 11.
[97] The same applies to members of the supervisory board according to Section 116 AktG.
[98] RegE UMAG, BT Drucks. 15/5092 at 11.
[99] RegE UMAG, BT Drucks. 15/5092, at 11; *Fleischer* Hdb VorstandsR, s7 para 53; *Fleischer.* ZIP 2004 685 at 690.
[100] These different legally bound actions will be summarized hereafter simply as *legally bound actions* for the purpose of simplification.
[101] BGH, Decision from 21.04.1997, AZ: II ZR 175/95 = BGHZ 135, 244 (para 23 in juris).

only one option to choose, there is no decision to be taken and the rule would not be applicable.

The other fundamental elements are more complicated to determine and understand. Firstly, a business decision must be future orientated, which means that the decision maker has to predict future developments[102]. The main problem with such a prognosis is that the information basis for the decision is incomplete. No matter how many information are present in the decision situation, certain future factors cannot be enlightened. The most common examples for such decisions of the managing to board is for example the investment in new technology or the entry into new sales markets. Even if the managing board has properly surveyed the development of the new technology, the previous responses of the markets or the circumstances of new market segments, unknown factors still remain. Taking business decisions therefore always bears the risk of wrong decisions and negative outcomes. This risk element – resulting out of the prognosis element – is the second fundamental element of business decisions. The potential risks differ and cannot be structured. Mostly, the decision-maker has to deal with simple financial risks. Sometimes tough financial risk will cumulate and might threaten the company's existence. In such cases, the decision-making process has to be adapted to these fundamental risks[103]. Some authors even argue that Section 93 (1) (2) AktG must also apply in cases of legal risks[104]. These authors argue, that the main reason for the rule is to shield the directors from excessive personal liability. Personal liability can arise from wrong decision. No matter what kind of risk has been materialised, the perspective of the concrete decision-maker shall be the same[105]. An unequal treatment of these comparable situations shall not be justifiable.

This discussion shows, why the above specified negative distinction of business decisions and legally bound obligations is highly problematic. Insecure decisions containing prognosis and risk elements may also occur with regard to legally bound obligations. Under German law, there exist numerous legally bound obligations of directors, which force them to deal with

[102] RegE UMAG, BT Drucks. 15/5092 at 11; *Mutter* Unternehmerische Entscheidungen *at* 23; *Dauner-Lieb* in FS Röhricht 2005, 83 at 96; *Fleischer* Hdb VorstandsR, s7 para 258; *Schneider* DB 2005, 707 at 708-09.; *Koch/Dinkel* NZG 2004, 441 at 442; *Hoor* DStR 2004, 2014 at 2105; *Altmeppen* in Roth/Altmeppen GmbHG, s43 para 11.
[103] See below under § 3.A.c)
[104] *Buck-Heeb* BB 2013, 2247 at 2252; *Kaulich* Rechtsanwendungsfehler at 187; *Sieg/Zeidler* in Hauschka Corporate Compliance, s3 para 23.
[105] *Buck-Heeb* BB 2013, 2247 at 2252.

insecurity and risks[106]. Before the rule has been codified, the German courts recognised these risks and granted a leeway for the execution of the obligations[107]. They could do so without addressing the critical issue of distinction from other decisions under uncertainty, because they were applying the general Section 93 I 1 AktG. After having codified the rule in Section 93 I 2 AktG, it is no longer possible to apply the same standard of leeway for all decisions under uncertainty. If the courts would do so, there would be no unique scope of application of the rule and its codification would be useless.

Based on these and other findings, authors in Germany also argued that the term *business decision* is useless and does not provide a reasonable distinction between the different forms of decisions under insecurity. And indeed: The wording of the term *business decision* suffers from a lack of clarity. It is therefore highly important to avoid a literally understanding of the term. Instead, the term must be interpreted teleological. Only if one takes into account all underlying reasons of the rule and its implementation in the respective legal system, the term can actually provide the necessary distinction between privileged business decisions and other legally bound obligations. It is beyond the scope of examination of this paper to provide such a complete interpretation of the prerequisite. But the German discussion in this regard highlights the importance of a reasonable understanding of the term in order to be able to determine the scope of application of the codified rule. It has to be examined if such problems also arise with regard to the South African understanding of the term[108].

b) *Best Interests of the Company*

The term *best interests of the company* provides the guideline for the discretionary decision of the directors. It provides the basic guideline for the decision process and secures, that the own interests of the decision-maker do not influence decisions[109]. Although acting in a conflict of interest usually results in the inapplicability of Section 93 I 2 AktG due to a breach of the fiduciary duties the prerequisite gets important in cases of partial conflicts of interests within the collegial body of the managing or supervisory board[110]. In addition, the further meaning of the term is quite unclear. The main problem with the term is, how the courts should be able to

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[106] For example, the decision of the supervisory board about the remuneration of the members of the managing board according to Section 87 AktG or duties with regard to business rescue and insolvency according to Section 15 a German Insolvency Code or Section 92 (2) AktG.

[107] BGH, Decision from 06.06.1994, AZ: II ZR 292/91 = BGHZ 126, 181 (para 32 in Juris); OLG Frankfurt, Decision from 25.10.2000, AZ: 17 U 63/99 = NZG 2001, 173 (para 44 in Juris).

[108] See below under § 3.B.a).

[109] RegE UMAG, BT Drucks. 15/5092 at 11; *Lutter* in FS Canaris (2007) Band II, 245 at 246; *Ulmer* DB 2004, 859 at 860; *Spindler* in MünchKomm AktG, s93 para 47; *Mertens/Cahn* in KölnKomm AktG, s93 para 25.

[110] *Bunz* NZG 2011, 1294 at 1295.

review a decision upon the specific pursued interests. Apart from identifying conflicts of interest, the determination of the best company's interests lies within the discretion of the directors. Every attempt to finally define these best interests would consequently mean to reduce the leeway of the directors. Therefore, there exist no final definition of the term. The German legislator understands the term strictly economical and formulates the main interest of a company as the enhancement of turnover, profits and competiveness[111]. This definition gets extended by the strengthening of the inner constitution of the company[112] and the consideration of stakeholder interests[113]. However, this list of possible interests is not exhaustive. The focus of judicial review therefore has not to concentrate on the assessment of certain interests. Instead, courts must examine if the given interests could be reasonable pursued[114].

Beyond this meaning, the prerequisite of the company's best interests ensures the absence of any directorial conflict of interests[115]. If a director pursues any other interests than the best interest of the company, the business judgment rule is not applicable and courts can fully review the decision process and the fairness of the result. Legal problems arise, if only a member of the supervisory or managing board is influenced by a conflict of interest, because the whole managing or supervisory board including the uninfluenced members usually takes a business decision. Consequently, the decision of the whole board is subject to judicial review. It is therefore questionable, if the business judgment rule is completely inapplicable. This would obviously disadvantage the non-influenced members of the board. Academic writers in Germany fiercely discuss this legal problem. Whereas one opinion proposes the inapplicability of the rule in total[116], another opinion favours the applicability of the if the decision was taken by a majority of uninfluenced directors. Other academic writers choose an individual approach to this problem and differ between the influenced and uninfluenced members of the board[117]. With regard to the influenced member the rule remains inapplicable, whereas the other members are protected. It is beyond the scope and the possibilities of this paper to highlight the arguments for the respective opinions in detail. However, it is important

[111] RegE UMAG, BT Drucks. 15/5092 at 11.
[112] *Kock/Dinkel* NZG 2004, 441 at 443.
[113] *Hopt/Roth* in GroßKomm AktG, s93 para 98.
[114] For the important prerequisite of the *reasonable belief* see below under § 3.A.d).
[115] *Lutter* in FS Canaris (2007) Band II, 245 at 248; *Hopt/Roth* in GroßKomm AktG, s93 para 90; *Spindler* in MünchKomm, AktG s93 para 60.
[116] *Paefgen* AG 2004, 245 at 253; *Hopt/Roth* in GroßKomm AktG, s93 para 94.
[117] *Bunz* NZG 2011, 12994, 1295; *Spindler* in MünchKomm AktG, s93 para 64; *Koch* in Hüffer AktG, s93 para 26; *Hölters* AktG, s93 para 38.

to bear this legal problem in mind since it could also affect the practical application of the South African business judgment rule.

c) Adequate Information

A director is only able to take privileged business decisions if he or she could reasonable believe to act on an adequate information basis. This prerequisite sets out the requirements of a reasonable and diligent decision process and has the largest impact on the practical application of the rule[118]. The regulation of procedural minimum requirements for the decision process shall balance the missing review of the decision result. This prerequisite is directly linked with the fundamental reason of the business judgment rule itself: The limited liability of directors with regard to business decisions can only be justified if a diligent preparation and conduct of the decision process is guaranteed. The intention of the adequate information basis is therefore prevention[119].

Although the prerequisite is of great practical importance, its substance is complicated to understand. The problems arise mostly from the determination of the adequacy of the information base and the scope of judicial review in this regard. The definition of the level of adequacy is important in two respects: The acting directors must be able to determine how to structure the decision process in order to avoid personal liability and the courts must be able to define the limits of the adequacy in order to decide the damage cases[120]. Although the German codification of the rule is formulated subjectively, the definition of the adequate information basis requires it to objectify the prerequisite to some extent.

The first fiercely discussed problem in this regard is the extent of the information required. Some authors asked for example, if directors are obligated to review the legal opinion of a professional law firm by having another expert opinion[121]. The discussion was caused by a court decision, in which the BGH found that directors are required to evaluate all available information[122]. Therefore, some authors also stated that the adequate information basis relates to all available information in the present decision situation[123]. However, such an understanding of the prerequisite is not in line with the subjective formulation of the rule in Section 93 I (2) AktG and its underlying reasons and is therefore opposed by the majority of

[118] *Lutter* ZIP 2007, 841 at 844; *Freitag/Korch* ZIP 2012, 2281 at 2282.
[119] *Becker* at 267.
[120] *Grundei/v. Werder* AG 2005 at 825; *Binder* AG 2008, 274 at 279-80.
[121] *Kiefner/Krämer* AG 2012, 498 at 499.
[122] BGH, Decision from 14.07.2008, AZ: II ZR 202/07 = NJW 2008 at 1231.
[123] *Kinzl* DB 2004, 1653-4; *Goette* ZGR 2008, 436 at 448 in Footnote 46.

academic writers in Germany[124]. The German legislator formulated Section 93 I 2 AktG subjectively from the perspective of the acting director. This acting director must reasonable assume that he or she is acting on an adequate information basis. With this change of perspective the German legislator granted a leeway not only for assessing the decision and its results, but also for assessing the adequacy of the procedural information basis. Courts therefore only have to examine if the statutory limits of discretion are exceeded.

The determination of the concrete limits of this *information discretionary* requires the evaluation of the official explanatory memorandum of the UMAG, judicial science and courts decisions and business administration science. The latter particularly supports the judicial science in understanding business decision processes and provides helpful insights in the reasonable structure of such processes[125]. It is not possible to provide all results in detail. In summary it can be stated that a full objectification of the prerequisite cannot be provided. It is therefore highly important that the courts respect the directorial leeway with regard to the information base. This result is in line with the US-American court experience in this regard[126].

For the practical application of the rule it is important to mention that directors should base their concrete decision process upon objective information sources such as market studies, legal opinions or internal reports as well as on their own experiences, senses and intentions[127]. The requirements of the adequacy increase with the importance of the concrete decision[128]. The more a decision endangers the benefit of the company the more objective information has to be evaluated and considered. Such decisions are usually fundamental strategic decisions with a substantial investment of resources, which might have substantial impact on the

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[124] *Fleischer* in MünchKomm GmbHG s43 para 86; *Hopt/Roth* GroßKomm AktG s93 para 105; *Roth* Unternehmerisches Ermessen Vorstand at 81; *Fleischer/Wedemann* AcP 209 (2009), 597 at 601-02.; *Haas/Ziemons* in Michalski GmbHG s43 para 70; *Schäfer* ZIP 2005, 1253 at 1258; *Ulmer* DB 2004, 859 at 860; *Brömmelmeyer* WM 2005, 2065 at 2067; *Redeke* NZG 2009 at 496; *Bayer* NJW 2014, 2546 at 2547.

[125] According to business administration science, business decision processes need to be structured in a very specific way in order to ensure the best results. According to these findings, business decision processes must meet the requirements of rationality, argumentation depth and argumentation width. As a result of the process, the decision maker must be able to substantively explain the decision, its direct and indirect consequences and the predicted results towards an objective and reasonable third part. See for more details in this regard *Grundei/v. Werder* AG 2005 at 825; *v. Werder* BB 1995 at 2177.

[126] In re RJR Nabisco, Inc. Shareholders Litigation 14 Del. J. Corp. L. 1132, 1165:“ It concludes that the amount of information that it is prudent to have before a decision is made is itself a business judgment of the very type that courts are institutionally poorly equipped to make.“.

[127] RegE UMAG, BT Drucks. 15/5092 at 12.

[128] *Spindler* in MünchKomm AktG, s93 para 50; *Hopt/Roth* in GroßKomm AktG, s93 para 107; *Schneider* DB 2005 at 707-08; *Ulmer* DB 2004, 859 at 860-61; *Brömmelmeyer* WM 2005, 2065 at 2067; *Kock/Dinkel* NZG 2004, 441 at 444.

company's economic development[129]. It is quite unclear if the adequacy of the information basis can be reduced in urgent decision situations. Some authors tend to propose such a reduction in cases, in which there is not enough time to evaluate all present information sources[130]. In contrast, the jurisdiction does not seem to grant any exceptions even in urgent situations. According to the BGH, directors must at least try to obtain reasonable objective information in highly complicated situations, i.e. by acquire legal advice[131]. The BGH only grants exceptions with regard to the concrete legal advice, which might for example be only verbally instead of written[132]. Only in fundamental crises in which the existence of the company is highly jeopardized, directors may be allowed to take business decisions without having evaluated all present information sources[133].

d) Reasonable Belief

The prerequisite of the reasonable belief is what actually forms the privileged effect of the rule. It determines the scope of judicial review with regard to the decision process and the decision result. It is therefore highly important for the scope of application of Section 93 I 2 AktG to determine what reasonableness in this context means.

The German legislator and academic writers stated, that this formulation results in a necessary change of perspective[134]. Instead of an objective standard of due care, the due care in cases of business decisions is determined partly subjectively. The courts have to respect this directorial leeway to the extent of the reasonableness. The standard of reasonableness secures that judicial review is actually possible even with regard to the concrete result of the decision[135]. The US-American formulation of the rule in the RMBCA and the ALI Principles inspired the wording[136].

[129] *Mutter* Unternehmerische Entscheidungen at 20-1.
[130] *Spindler* in MünchKomm AktG, s93 para 48; *Fleischer* FS Wiedemann (2002), 827 at 841; *Kock/Dinkel* NZG 2004, 441 at 444.
[131] BGH, Decision from 20.09.2011, AZ: II ZR 234/09 = ZIP 2011, 2097.
[132] Ibid.
[133] KG Berlin, Decision from 22.03.2005, AZ: 14 U 248/05 = AG 2005, 581, in which the board of directors had to decide whether to renew excisting loans without any securities or write-off the excisting repayment claims which amounted up to DM 400 Mio.
[134] RegE UMAG, BT Drucks. 15/5092 at 11; *Fleischer* in MünchKomm GmbHG, s43 para 78; *Seibert/Schütz* ZIP 2004, 253 at 254; *Thümmel* DB 2004, 471 at 472; *Raiser* Kapitalgesellschaften, s14 para 76.
[135] RegE UMAG, BT Drucks. 15/5092 at 11.
[136] Section 8.31 (2) (B) RMBCA: "(…) as to which the director was not informed to an extent the director **reasonably believed** appropriate in the circumstances (…); Section 4.01 ALI Principles: "A director or officer who makes a business judgment in good faith fulfils 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

The first notable thing in this regard is, that the criteria of *reasonableness* requires the courts to carefully examine the decision process and the result from the perspective *ex-ante*, i.e. from a pre decision view. The reason for this is the avoidance of the phenomenon of the *hindsight bias*[137]. Courts cannot asses the decision and its circumstances by having the enhanced knowledge of the actual results, because this would most certainly lead to an excessive personal liability of the decision-maker. There is only a thin line between deciding a case on the knowledge being present in the business decision situation and deciding the case on the basis of the enhanced knowledge obtained by the courts after the concrete damage occurred. The Higher Regional Court of Duesseldorf for example had to decide about the gross breach of duty of the managing board of a stock corporation in connection with the finance crises 2008[138]. The court found that the managing board could not reasonable believe to act on an adequate informed basis, because the respective derivatives businesses has been so complex and unclear that the board has not been able to obtain a sufficient level of competence in this regard[139]. The problematic issue in this case tough is the argumentation of the court with regard to the concrete information sources, which has been evaluated by the managing board. The board based the concrete decision to engage in the derivatives business upon the report of the world's leading rating agencies in 2008. In this regard the court stated in 2015 (!) that such reports have been totally inadequate to inform about the subject matter in the concrete decision situation, because rating agencies acted in a conflict of interest[140]. The board in the concrete decision situation should have recognized this acting under a conflict of interests. However, the court did not take into account that rating agencies had been the ultimate information source in such cases. Not only this concrete managing board was relying on such reports, the entire market sector relied on rating agencies. Only after the total collapse of the financial system, the contribution of rating agencies to the systematic failure has been discovered. The court therefore based its decision on the enhanced *after crises knowledge* instead of examining the situation *ex ante*. Examining the case on the basis of the required *ex ante* view would have required to evaluate the concrete circumstances of the present decision and to ask if the directors are able to rationally explain their decision towards an impartial third party with the knowledge given at that time. This court decision exemplifies the tremendous risks of the hindsight bias for the personal liability of directors. By having the

circumstances; and (3) rationally believes that the business judgment is in the best interests of the corporation.".

[137] See for more details in this regard below at § 3.B 1.

[138] OLG Düsseldorf, Court order from 09.12.2009, AZ: I-6 W 45/09, 6 W 45/09 = AG 2010, 28 (para 43f. in Juris).

[139] Ibid (para 45-6 after Juris).

[140] Ibid (para 49 after juris)

standard of reasonableness expressively codified in the German Stock Corporation Act, there now exists a legal obligation to avoid the hindsight bias in these cases.

Important for the system of directors' duties and liabilities is also the determination of the scope of judicial review. As stated above, the courts examined business decisions in the time before the codification upon different standards such as seriousness or realism[141]. However, the courts now have to adhere to the mandatory standard of reasonableness set out in Section 93 I 2 AktG. Although this seems clear, German courts and academic writers struggle in defining the actual content of this applicable standard. The German judicial science is inconsistent in this regard. One understanding is, that reasonableness means acting rationally. The limit of reasonableness is reached, if a director acts completely irrational[142]. Such understanding is in line with the US-American understanding of the applicable standard of judicial review. US-American courts mostly apply the *Rational Business Purpose Test* when assessing business decisions on the basis of the business judgment rule[143] and actually only ask if the intentions of the board are rationally understandable[144]. In contrast to this standard of judicial review, other authors understand the term reasonableness as *unjustifiable* acting[145]. This standard enlarges the scope of judicial review. Instead of only asking if the concrete decision is plausible, courts will examine the given decision in more detail. The main problem with the latter opinion is, that such an understanding is not in line with the intention of the German legislator and the findings drawn from the US-American jurisdiction. US-American courts in Delaware particularly examine business decisions only on the basis of the rational business purpose test. The formulation in Section 4.01 of the ALI Principles also expressively states rationality as the applicable standard for reviewing business decisions. The US-American understanding expressively inspired the German formulation of the rule. The German legislator also referred expressively to the standard of rationality in the official justification for the law.

I propose an understanding of the term *reasonableness* in a way that complies with the US-American rational purpose test, i.e. reasonableness means rational. This term sets the

[141] See above at § 3.A 1.

[142] OLG Naumburg, Decision from 15.09.1999; AZ: 5 U 92/99 = NZG 2000 at 380; *Koch* in Hüffer AktG, s93 para 23; *Koch* ZGR 2006, 769, 790; *Bachmann* ZHR 177 (2013), 1, 9.

[143] Sinclair Oil Corp. v. Levien 280 A.2d 717 (720), Unocal Corp. v. Mesa Petroleum Co., 493 A. 2d 946 (954); In re Walt Disney Co. Derivative Litigation 906 A.2d 27, 74; *Eisenberg* DK 2004, 386, 391f.

[144] Ruth Panter v. Marshall Field & CO 646 F.2d 271, 293; In re Walt Disney Company Derivative Litigation 907 693, 748.

[145] *Mutter* Unternehmerische Entscheidungen at 193-94; *Spindler* in MünchKomm AktG, s93 para 56; *Scheider* in Hdb Managerhaftung, s2 para 17; *Krieger/Sailer-Coceani* in Schmidt/Lutter AktG, s93 para 18; *Redeke* ZIP 2011, 59 at 61-2.

minimum standard of judicial review. In contrast of acting unjustifiable, courts are restricted to review the decision upon its rational grounds. In contrast, the standard of unjustifiable acting also applies in cases of uncertain decisions, i.e. legal obligations under uncertainty as described above[146]. The difference between these two standards of review is, that the latter allows courts to examine the decisions in more detail. They are capable of doing so, because the respective leeway granted in specific decision situations is more restricted than in typical business decisions. As an example, the legal obligation of the Supervisory board to decide about the concrete remuneration of the members of the managing board is not a business decision in the sense already described above[147]. However, the applicable Section 87 (1) AktG contents some legal concepts which are not precisely defined, such as *adequate* or *situation of the company*. In addition, the remuneration of the managing board must be in reasonable relation to the services rendered by the board both present and in future. The remuneration decision therefore also includes the element of prognosis and thus uncertainty about future developments. Accordingly it is commonly accepted that the supervisory board has a specific leeway when taking this remuneration decision. Consequently, courts must respect this discretion and defer from a full judicial review of the remuneration decision. However, the law itself imposes restrictions on the discretion, which the members of the supervisory board have to adhere to. For example, they are not allowed to take the remuneration decision without taking the situation of the company into account. A court therefore must not only examine, if there is any rational purpose for the specific remuneration decisions. Instead, they have to check if the decision is meeting the specific requirements of the applicable law including the imposed borders of the directorial leeway. The reason for this is, that the legislator decided to restrict the directorial leeway for situations like the remuneration decision. This is possible, because of the lower level of uncertainty. These types of decisions are better predictable due to their lesser complexity. In contrast, there is no typical business decision situation. Possible business situations are sheer endless, which is why there is no definition of a typical business decision. Therefore, the law itself provides a more detailed checklist of how to use the discretionary power in this regard.

Based upon these findings, I examined that directors have to take decisions under uncertainty inside and outside the scope of application of the business judgment rule. The latter are less uncertain, because they are specified either by law, contracts or the memorandum of association. The standard of unjustified acting therefore provides a flexible standard, which

[146] See above at § 3.A.a).
[147] Ibid.

adjusts to the level of uncertainty of the respective decision. Inside the scope of application of Section 93 I 2 AktG, the only applicable standard is the standard of reasonableness as the minimum standard of judicial review. This concept of different review standards is also in line with the US-American understanding in this regard. In particular, the jurisdiction in Delaware reviews different decisions under uncertainty in different ways. Usually the rational purpose applies, whereas for example in hostile takeover situations the *rule of proportionality* is applicable[148] In such cases, the courts extend their review from any rational purpose to the standard of proportionality[149]. Directors have to prove that their actions have been based upon the reasonable assumption of a serious threat for the company and were proportionally and effective to avoid the danger[150].

The proposed approach helps in understanding the effect of the German codification and provides a solution in dealing with the critics of various academic writers in Germany[151]. In relation to the topic of this paper, it has to be examined if such an approach could also possibly influence the understanding of the South African codification.

e) Good Faith

The prerequisite of good faith requires it, that directors must be convinced to act right in taking the respective business decision[152]. If a director is personally not fully convinced, the protection of the business judgment rule is not justifiable[153].

The scope of application of the prerequisite is quite unclear. Whereas some authors do not see a specific scope of application because of the requirement of acting in the best interests of the company[154], other authors understand it as a last resort of judicial review for extraordinary cases[155]. It seems clear, that the latter understanding is based upon a mistrust of the effectiveness of the rule. The concerns of these authors seem to be, that the other prerequisites of the rule do not ensure an effective avoidance of intentional wrongful actions of the directors. In fact, the examination of case law both in Germany and South Africa clearly indicates, that there is no need for this prerequisite. Whenever American courts judged a case upon the application of a breach of good faith the same results could have been achieved by

[148] *Gilson/Kraakman* 44 Bus. Law. 247; *Jones* at 19.
[149] Unocal Corp. v. Mesa Petroleum Corp. 493 A.2d 946; confirmed in Moran v. Household International, Inc. 500 A.2d 1346.
[150] *Block/Barton/Radin* Volume II at 2234.
[151] See below at § 3.B 4 for more details in this regard.
[152] *Dauner-Lieb* in Henssler/Strohn, s93 AktG para 25; *Fleischer* in Spindler/Stilz AktG, s93 para 76.
[153] *Block/Barton/Radin* Volume I at 80-2.; *Fleischer* in Hdb VorstandsR, s7 para 60.
[154] *Mertens/Cahn* in KölnKomm AktG, s93 para 31; *Spindler* in MünchKomm AktG s93 para 66.
[155] *Fleischer* in Spindler/Stilz AktG, § 93 Rn. 76; *Hopt/Roth* in GroßKomm AktG, § 93 Rn. 115.

applying the general standards of the duty of care and the corresponding application of the business judgment rule[156]. The only reason for the application of good faith in the US is the contractual releases and limitations of directors' personal liability in the MOI of the companies. Such regulations are possible especial in Delaware[157]. However, these liability limitation statutes are not applicable in case of breaches of good faith[158]. The jurisdiction therefore adheres this standard to avoid unjustified and unintentional limitations of liability.

Under German company law the implementation of any forms of liability restrictions except of D&O-insurances is not allowed. The risk of the linked liability gap is not as high in Germany as in America. Therefore, there are currently no German courts decisions based upon the prerequisite of good faith. I therefore support the opinion the prerequisite of good faith is unnecessary. In order to effectively handle the risks of highly abusive conduct, the reasonable interpretation of the other prerequisites of the rule is sufficient. Understanding the requirement as a last resort of judicial review for extraordinary cases would simply mean to extend the scope of judicial review over the applicable standard of reasonableness. Such understanding cannot be justified, because this would contradict the underlying intentions of the rule. The German legislator clearly intended to strengthen the position of directors and to clarify the system of their duties and liabilities. By implementing the unclear and barely defined requirement of good faith, the uncertainty would grow. The difficult task of defining the scope of judicial review would be way more complicated, because courts would be able to extend the objective – not the subjective – assessment of a decision and its outcome.

[156] For example: In re: Abbott Laboratories Derivative Shareholders Litigation 325 F.3d 795 at 807-09 and In re Walt Disney Company Derivative Litigation 825 A.2d 275 at 286. In *Abbott Laboratories*, the board of directors did not sufficiently evaluate obvious information sources such as internal security regulations. In *Walt Disney* the board gave approval for a new employment contract for the new president of the company without having the necessary knowledge of its content.

[157] s102 (b) (7) Delaware General Corporation Law; see for more details in this regard *Veasey* 'State-Federal Tension in Corporate Governance and the Professional Responsibilities of Advisors' (2003) in 28 Journal of Corporation Law 441 at 447.

[158] Section 102 (b) (7) Delaware General Corporation Law.

B. The South African approach

1. Common Law

The common law forms an essential part of the South African legal framework. Although common law is not written legislation, it becomes binding law through various court decisions[159].

The same way, the jurisdiction in the US understands the Business Judgment Rule, it has been understood in the common law. The leading case regarding the Business Judgment Rule clarified the leeway; directors have in managing the company[160]. This understanding has been confirmed for South Africa in *Levin v Felt and Tweeds Ltd*[161]. The court explicitly decided, that it is not on the jurisdiction to clarify the best interests of the company. In *Mafikeng Mail (Pty) Ltd v Centner* it was held that not even recklessness or a gross error result in a personal liability of the directors, provided there is a rational basis for their assumptions being made in the concrete decision-situation[162]. Since then, courts in South Africa were generally reluctant to second-guess business decision[163]. The explanations for this commonly accepted approach are multiple.

The most important reason for this reluctance is the phenomena of the *hindsight bias***.** Hindsight bias describes the human tendency to conclude from the occurred damage to a breach of duty during the decision procedure or with regard to the concrete decision result[164]. The possibility of averting the occurred damage is overestimated, because possibilities of averting the occurred damage seem more likely from a retrospective view[165]. Thus, the occurred damage would be seen as a direct consequence of the decision and the breach of duty of duty then would lie within the non-preventing of the damage. Managing a company though means to take risks and act under uncertainty. Even if all due care has been exercised damages cannot be avoided sometimes [166]. Courts would just second-guess another possible decision in the situation ex-ante, but with the knowledge of the situation ex-post. This judicial second-guessing must be avoided[167]. This applies even more, if one takes into take account

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159 *Wiese* at 15.

160 *In re Smith and Fawcett Ltd* [1942] CH 304 (Ca) at 306): "*They must exercise their discretion bona fide in what they consider – not what a court may consider – is in the best interests of the company*"**.**

161 *Levin v Felt & Tweeds Ltd* 1951 (2) SA 401 (A).

162 *Mafikeng Mail (Pty) Ltd v Centner (No 2)*1996 (4) SA 607 (WLD)

163 *Howard v Herrigel* NNO 1991 (2) SA 660 (A); *Ozinsky NO v Lloyd* 1992 (3) SA 396 (C); *Triptomania Twee (Pty) Ltd v Connolly* 2003 (3) SA 558 (C).

164 *Arkes/Schipani* 73 Or. L. Rev. 587; *Riley* 62 Modern L. Rev. 697 at 710.

165 *Bainbridge* 57 Vand. L. Rev. 83 at 114; *Jolls/Sunstein/Thaler* 50 Stan. L. Rev. at 1471.

166 *Bainbridge* 57 Vand. L. Rev. 83 at 114.

167 In re Citigroup Inc. Shareholder Derivative Litigation 964 A.2d 106, 126.

the limited competence of judges in this regard. Judges are well qualified within the field of law, but they are certainly not competent in managing a company[168]. Courts therefore cannot be seen as a supervisory board for the board of directors[169]. If the directors finally take a decision, and such decision can be seen as rational one, taken in accordance with the proper performance of the director's duties, the court are not able to take a better decision afterwards.

Secondly, it is common sense that directors cannot – or at least should not – be strictly liable while they are managing the business. Otherwise competent and diligent people would probably restrain from becoming director of a company[170]. This conclusion was already drawn by the judicative in the United States of America in the early 18th century[171]. Directors should thus only be liable for false business decision, if they acted with fraudulent intention or were completely incompetent[172]. Such an approach has been changed in later court decisions. Instead of examining the concrete fault of the directors, courts implied a presumption of proper conduct, if the director demonstrated good faith and reasonable diligence[173]. Even if the concrete result of the decision suggests or clearly shows a false decision, directors were not held liable for any damages, unless the decision process was reasonable and diligent[174]. There is no evidence for the fact tough, that suitable candidates would really restrain from taking the office. Research indicates, that directors are often not clear about their concrete duties and their respective liability[175]

Thirdly, managing a company in an economically successful way requires, that the directors identify risks and take these risks, if its reasonable and possible rewarding. It would be counterproductive in this matter, if directors would always act in the most safely way possible[176]. Avoiding risks would result in economic disadvantages. Such a strategy is not in the best interests of the shareholders, because they expect some return of their respective

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[168] *Joy v North* 692 F.2d 880.
[169] *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821 at 832.
[170] *Washington Bancorporation v. Said* 812 F.Supp. 1256 at 1268: „*To impose liability on directors for these good-faith business decisions, however, would effectively destroy the corporate system in this country, for no individuals would serve as officers and directors.*"; see also Joy v. North, 692 F.2d 880, 885 (2d Cir. 1982).
[171] *Godbold v. Branch Bank*, 11 Ala. 191, 199: „The inevitable tendency of such a rule, would be hostile to the end proposed by it, as no man of ordinary prudence would aceept (accept) trust surrounded by such perils"; cf. also Washington Bancorporation v. Said 812 F.Supp. 1256, 1268.
[172] *Godbold v. Branch Bank*, 11 Ala. 191.
[173] *Pollitz v. Wabash R.R. Co.* 207 N.Y. 113, 124.
[174] *Pollitz v. Wabash R.R. Co.* 207 N.Y. 113, 124.
[175] *South African Company Law for the 21st Century: Guidelines for Corporate Law Reform* GN 1183 GG 26493 at 38.
[176] *Allen/Jacobs/Strine* 'Realigning the Standard of Review of Director Due Care with Delaware Public Policy: A Critique of Van Gorkom and Its Progeny as a Standard of Review Problem', 96 NQ. U. L. REV. 449 at 454–55.

invests in the company[177]. Limiting the possible liability for directors in case of business decisions therefore encourages the directors to bold actions to the extent, that these actions can be seen as rational. In addition, the shareholders are vested with the control of the appointment of directors. They put the primal responsibility for managing their company on the directors. This has to be respected by the courts. Some courts even argue that the shareholders should initially be blamed for potential damages of the company, because they are responsible for appointing the directors and thus should be jointly responsible for possible damages[178].

Thirdly, the courts only have limited resources[179]. A full review of a business decision would mean to fully evaluate all information being present in the concrete decision situation. This systematic processing of a reasonable decision process would thus be time and cost intense[180]. By limiting the judicial review, courts can deal with such cases more efficiently.

2. Section 76 (4) of the Companies Act 2008

With the new Companies Act, a statutory version of the common law Business Judgment Rule has been implemented[181]. Section 76 (4) CA 2008 states as follows:

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

[177] *Gagliardi v. TriFoods Int´l Inc.*, 683 A.2d 1049, 1052: *„Shareholders don´t want (or shouldn´t rationally want) directors to be risk averse. Shareholders´ investment interests, across the full range of their diversifiable equity investments, will be maximized if corporate directors and managers honestly assess risk and reward and accept for the corporation the highest risk adjusted returns available that are above the firm´s cost of capital.*“.
[178] *Daniels v Anderson* (1995) 37 NSWLR 438.
[179] *Leach* at 19.
[180] *Arkes/Schipani* 73 Ore. L. Rev. 587 at 601.
[181] Section 76 (4) CA 2008.

(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; (…)

This statutory Business Judgment Rule directly refers to subsection 3 (b) and (c) of the Act. Therefore, it only applies to the statutory duty of care and duty to act in the best interests of the company[182]. A director will thus fulfil his or her duties under the Act, if the three prerequisites of the Business Judgment Rule are fulfilled.

These three prerequisites stem from the American Business Judgment Rule[183]. To fully understand the South African Business Judgment Rule, it is necessary to define each of the three prerequisites. In order to secure a safe harbour for managers, there has to be legal certainty about the application of Section 76 (4) CA 2008. In order to achieve the goal of

a) Business decision

The first notable issue with regard to the South African codification of the rule is the absence of a restrictive requirement such as business decision[184]. Unlike the German or the US-American understanding of the rule, Section 76 (4) seems to apply to "*any particular matter arising in the exercise of powers or the performance of the functions of a director*"[185].

The only restriction that arises out of this terminology is the requirement of a decision situation. As described above, a decision situation only exists if the decision maker has the choice between different alternatives. As well as in Germany, supine acting is not protected under Section 76 (4)[186].

Besides that, there are no further restrictions for the scope of application of the rule. Section 66 CA 2008 defines the responsibilities of directors. Their fundamental task is to manage the business and the affairs of the company. This power is an original one and is not delegated by the shareholders[187]. Based upon this directorial power, the directors become the company in terms of decision-making[188]. The directors are therefore responsible to adhere the applicable law. If the law requires the company to take certain actions, it is on the board to fulfil these obligations instead. The affairs of the company therefore include all legal obligations of the

[182] *Stein/Everingham,* 245-6.
[183] *Wiese at* 17 and 137.
[184] *Cassim et alt* at 564
[185] Section 76 (4) CA 2008.
[186] Australian Securities and Investment Commission v Rich [2009] NSWSC 122; *Henochsberg* s76 at 299.
[187] Henochsberg s66 at 250(3).
[188] *Henochsberg* s66 at 250(4).

company. These legally binding obligations are also within the scope of Section 76 (4) CA 2008. In contrast to the German or even the US-American rule, the law grants a directorial leeway even with regard to statutory duties. It has thus to be examined if this extension of the scope of application can cause problems in the practical application of the rule[189].

b) Reasonable Informed decision

The second prerequisite of the South African rule is the requirement of a reasonable informed decision. An uninformed decision is not protected from the rule and will thus cause personal liability. The findings from the German and the US-American law show, that this prerequisite is the most important element in practice. Its relevance for the jurisdiction is immense, which is why a proper definition is so important.

It seems that South African academic writers are also struggling with the determination of the required level of information before taking business decisions. It is only highlighted that the decision must be an informed one and the level of information is obviously determined by the term *reasonably*[190].

The level of reasonableness should be determined by the requirements of Section 76 (3) (c) CA 2008, which means that the directors must obtain the level of information with the degree of care, skill and diligence that may reasonably expected from them[191]. Such understanding is in line with Section 76 (4) (a) after which directors must take reasonable diligent steps to become informed about the subject matter. As mentioned above, the examination of the reasonableness requires an objective and a subjective test. The referral to a reasonable third party carrying out the same functions as the respective director objectifies the duty to take only informed decision.

Two difficulties arise out of such an understanding: Firstly, such an understanding would mean that the business judgment rule applies towards its own prerequisites. If a decision suffices the requirements of Section 76 (4) CA 2008 including the prerequisite of an informed decision, there is an assumption that the decision also suffices Section 76 (3) (b) and (c). This sounds like a contradiction in terms. In order to examine compliance with Section 76 (3) courts must examine the exactly same reasonableness. The dilemma is even bigger if one takes into account that the judicial review mainly focuses on the review of the decision process, i.e. if the decision was taken on an adequate information base. This questions the

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[189] See below at § 5.A.

[190] *Kassim et alt.* at 564-65; Henochsberg Companies Act s76 at 298 (6).

[191] *Henochsberg* ibid.

purpose of the codified rule as a whole. Can there really be a safe haven for directors, if their managerial acting is measured by the exactly same standard of care? From a directors' perspective the risk of being held liable for wrong business decisions does not chance whether the rule is applicable or not, because the standard of judicial review does not change. Does that mean that one of the main underlying reasons of the rule – the avoidance of the hindsight bias – is being jeopardized, because it seems that courts might tend to assume that the analysis of additional information in the respective decision situation would have led to other results of the concrete decision? Such risks are substantial as the analysis of US-American jurisdiction shows. The most important court decision in this regard is the famous decision of *Smith v. Van Gorkom*[192]. The Delaware Supreme Court had to decide about a derivative suit against the members of the board of directors. These members had decided to sell the company by issuing the share for a price of 55 $ each. The shareholders taking the court alleged that this purchase price has been too low and the board missed to obtain a higher price. The Supreme Court examined the information basis for the purchase decision in detail. In order to prepare the purchase decision, the board got an expert opinion whereupon the market price for one share differs between 24 $ and 39 $ and a realistic purchase price would be around $ 50. Based on these findings, the CEO negotiated with the subsequent buyer on his own without informing the other board members or the shareholders of the company. After having agreed on the above named purchase price the CEO discussed it with the other board members. The board meeting took two hours, in which the CEO presented the proposed transaction orally without furnishing any documents. The Supreme Court found that this concrete decision-making process is not sufficient to prepare a fundamental decision like the given sale of the company. Therefore, the court consequently found that the board failed to fulfil its obligation to be proper informed about the real company value[193]. According to the Supreme Court it is not assumable that the board has been able to reasonable weigh all circumstances of the proposed transactions and particularly its disadvantages. In addition, the duty to be informed also requires it to be critical. Therefore, the members were also acting contrary to duty by neglecting asking critical questions, for example clarifying the role of the CEO in the whole negotiation process. In summary, the court found that the board was merely relying on the twenty minutes' presentation of the CEO and thus did not form their own opinion notably with regard to the reasonableness of the purchase price[194]. This directorial acting was assessed

[192] Smith v. Van Gorkom 488 A.2d 858.
[193] Smith v. Van Gorkom 488 A.2d 858, 874.
[194] Ibid.

as gross negligence[195]. Academic writers have heavily criticized this court decision[196]. This criticism is based on the dissenting opinion of judge *McNeilly*, who was voting against the final decision of the Supreme Court[197]. *McNeilly* had the opinion, that the members of the board had sufficient competency to reasonable decide even on the given information base[198]. He pointed out that all members of the board were highly experienced. Whereas the five inside directors were members of the company's board for an accumulated time of 116 years, the outside directors were members for 53 years in total[199]. The Supreme Court when examining the adequate level of information has not considered this outstanding experience. In doing so, the court would have to admit that even an oral statement of the CEO might be sufficient to reasonable overthink the decision because all members of the board might have already had a deep insight in the company's business and could therefore estimate its value even on the basis of the two-hours meeting. The Supreme Court therefore has chosen an objective approach whereas *McNeilly* based his opinion on a more subjective approach. The argumentation of the Supreme Court therefore highlights the risk of an underlying hindsight bias. Instead of examining the concrete decision situation, courts tend to allege directors of omitting the examination of additional information sources. However, finding such additional information sources is easier when assessing from a post decision point of view, because there is the assumption of an uninformed decision due to the bad outcome.

The second problem arising out of this understanding is similar to the German experience already mentioned above[200]. If the judicial standard of review refers to an objective third party, courts must be able to set up objective criteria in this regard. Neither German nor US-American courts have been able to set up objective standards with regard to the information base. However, the German experience shows that the prerequisite of the adequate information can be partly objectified[201]. The findings of the judicial science and the business administration science allow it to set up objective guidelines for the structure of decision-making processes in business contexts. As already mentioned, such guidelines can never be complete and there must be a remaining leeway for directors. However, based upon these fundamental guidelines the jurisdiction is able to review the process of decision making in

[195] Smith v. Van Gorkom 488 A.2d 858, 873.
[196] *Herzel/Katz* 41 Bus. Law. at 1187; *Fischel* 40 Bus. Law. 1437 at 1440-41; *Quillen* 10 Del. J. Corp. L. 465 at 468-69.
[197] *Quillen* Del. J. Corp. L. 465 at 468.
[198] Smith v. Van Gorkom 488 A.2d 872 at 894-95.
[199] Ibid.
[200] See above at § 3.A.b).
[201] Ibid.

more detail. Such understanding is in line with the fundamental intention of the rule: Judicial review has to be limited with regard to the concrete result or the consequences of a business decision. The focus on the decision process balances the minimalistic review of the decision result. Therefore, the differentiation between rationality in Subsection 76 (4) (a) (iii) and reasonableness in (i) seems to make sense because it clarifies this differentiation. In contrast, the German codification does not differ in this regard. According to the wording of Section 93 I 2 AktG, both the result and the process have to be determined upon the standard of reasonableness[202]. The codifications in the US are also inconsistent in this regard. Whereas the formulation in the RMBCA contents only one standard of review for the decision process and the result, Section 4.01 ALI Principles distinguishes in the same way as Section 76 (4) CA 2008.

The two above named problems might cause problems in the practical application of the rule by the courts. The possible problems therefor have to be examined in more detail.

c) No Conflict of Interest

Section 76 (4) (a) (ii) CA 2008 regulates explicitly the duty to avoid any conflict of interests. Whereas the German codification and the formulation in the ALI Principles does not content a similar provision, Section 8.31 RMBCA also regulates the duty not to act under the influence of a conflict of interest.

The intention of this prerequisite is to effectively protect the interest of the company. Directors must exercise independent discretion and must only intend to pursue the best interests of the company. Whenever a director acts under the control of a third person or pursues his or her own interests over the interests of the company the respective decisions are not protected by the business judgment rule, unless the respective director discloses any relevant information in this regard according to Section 75 (5) CA 2008. This principle also applied before the effective date of the new Act[203]. Therefore, the duty to avoid any interests of conflict and to disclose relevant information in this regard immediately and before taking the decision

The German approach to the avoidance of directorial conflict of interests slightly differs. As mentioned above, the requirement to act in the best interests of the company also includes the

[202] *"Vernuenfigerweise annehmen durften".*

[203] *S v Shaban* 1965 (4) SA 646 (W) at 651-52; *Fisheries Development Corporation of SA Ltd v Jorgensen* 1980 (4) SA 156 (W) at 163.

duty to act uninfluenced and independently[204]. Consequently, there exists no explicit formulation of this duty amongst the requirements of the business judgment rule. Such understanding seems in line with the understanding in the time prior the New Companies Act in South Africa since this duty is also understood as a part of the duty to act *bona fide* in the best interests of the company[205]. However, the result of this requirement is that Section 76 (4) does not apply if a director is acting under the influence of a conflict of interest[206].

d) Rational belief to act in the best interests of the company

The last prerequisite of the rule is that directors must rational belief to act in the best interests of the company[207]. This element forms an integral part of the rule and its application, because it sets the subjective standard for the directors' decision-making process and the objective standard of judicial review[208]. An irrational decision cannot be protected by the business judgment rule and is subject to full judicial review[209]. There is a presumption that irrational acting is based on bad faith and improper conduct[210]. Since the standard is an objective one, courts can review the result of a decision to the extent of rational grounds. However, the scope of the judicial review seems to be quite unclear. Although Section 76 (4) a) (iii) clearly expresses rationality as the applicable standard, academic writers tend to understand it as the standard of reasonableness[211]. Since the requirement of rationality is seen as a "*pivotal ingredient*" of the rule, its correct understanding seems highly important.

Since the South African legislator chose a different wording in Subsection 76 (4) a) and aa)[212] there is an assumption that rational and reasonable must have different meanings. In my understanding, the difference is as follows: As already mentioned above, the standard of reasonableness applies for the review of the decision process, i.e. the adequate information base, whereas the standard of rationality refers to the result of the business decision. Since the most important underlying reason for the rule is the restriction of judicial review with regard to the decision result the standard of rationality represents the minimum standard of judicial review. As explained with regard to the German codification there exist also other standards of judicial review which are more extended than the standard of rationality.

[204] See above at § 3.A.b)
[205] *Henochsberg* s76 at 298(7).
[206] *Cassim et alt* at 565.
[207] Section 76 (4) a) (iii) CA 2008.
[208] *Cassim et al* at 564; *Henochsberg* s76 at 298.
[209] Ibid.
[210] *Shuttleworth v Cos Brothers & Co (Maidenhead) Ltd* 1927 2 KB 9 (CA) at 23.
[211] For example *Cassim et alt* at 564: "*The decision must be reasonable one.*".
[212] "*reasonably diligent steps" and "rational basis".*

If one acknowledges the requirement of a differentiation, the main problem remains how to determine the different standards. I will examine this problem in more detail below[213]

3. Standard of Judicial Review or Standard of Liability

After having described the underlying intentions of the South African rule and its prerequisites, the nature of the rule has to be examined as well.

In Germany, the rule is understood as the general standard's specification of due care with regard to uncertain business decisions[214]. If the prerequisites of Section 93 I 2 AktG are fulfilled, the respective member of the supervisory or managing board acted with due care and cannot be held liable. This means that business decisions are reviewed upon the same standard of liability as all other managerial acts. This understanding is in line with the intentions of the German legislator. The initial formulation of Section 93 I 2 AktG included the standard of gross negligence as a separation from simple negligence[215]. This first formulation was later amended and the prerequisite of the reasonable belief has been implemented. One can therefore argue that even the German legislator did not intent to change the applicable standard of liability.

This approach excludes an understanding after which the codification in Section 93 I 2 AktG can be seen as a lesser standard of liability. The formulation of Section 93 I 2 AktG clearly refers to the general duty of care and diligence in Section 93 I 1 AktG. If Section 93 I 2 AktG would regulate a lower standard of liability, a breach of this conduct would inevitable constitute a breach of the higher standard in Section 93 I 1 AktG. If this would apply, the whole codification of the rule would be pointless, because the same results could be achieved on the basis of the general standard of the duty of care.

Therefore, the real difference between Section 93 I 1 and 2 AktG lies within the scope of judicial review. As stated above, courts tended to review decisions in a business context upon different standards[216]. Due to this inconsistent application it was unclear which conduct directors must adhere to in order to avoid personal liability. Since the general duty of care in Section 93 I 1 contains simple, moderate and gross negligence, courts were free in setting the applicable conduct on a case-to-case basis. It was thus possible that the jurisdiction examines fundamental decisions on the basis of simple negligence, whereas routine decisions were

[213] See below at § 5.B 2.
[214] *Hopt/Roth* in GroßKomm AktG, s93 para 67; *Spindler* in MünchKomm AktG, s93 para 39; *Spindler* NZG 2005, 865 at 871; *Brömmelmeyer* WM 2005, 2065 at 2068; *Weiss/Buchner* WM 2005, 162 at 163 and 165.
[215] Draft bill of the UMAG from the German federal government dated January 2004 at 18.
[216] See above under § 3.A.d).

examined on the basis of gross negligence. Both reviews were consistent with the general duty of care. Under the codified rule, courts are no longer able to apply a flexible standard of review but are now obliged to adhere the minimum standard of the reasonableness. The restricted judicial review actually results in the fact, that directors are only liable for gross negligent conduct with regard to the business decision process, but this does not constitute a lower standard of liability, since this standard of liability also applied to certain decision in the business context before. The general duty of care thus remains applicable. The rule with regard to the decision-making process only concretes it.

It is thus questionable how one should understand and interpret the South African codification. It is either possible to understand it as a standard of judicial review or as an own standard of directors' liability[217]. Whereas a standard of liability states how directors have to conduct, a standard of review forms the test the jurisdiction applies when it reviews this conduct[218].

Some US-American courts tend to understand the Business Judgment Rule as less of a standard of the general duty of care[219]. Based on this understanding, directors are required to exercise a certain amount of diligence in order to fulfil the requirements of the rule[220]. The codification of the rule in the American Revised Model Business Corporation Act is based on this understanding as well. Whereas section 8.30 is setting up the applicable standard of the duty of care, section 8.31 provides the above-mentioned formulation of the business judgment rule[221]. Due to this system, a director can be held liable under the duty of care and simultaneously being not liable under the lesser standard of liability provided by the business judgment rule[222].

In contrast, others understand the rule as a standard of review[223]. Based upon this understanding the key intention of the rule is to create a different and less demanding standard

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[217] *Leach* at 30.
[218] *Eisenberg* 'The Divergence of Standards of Conduct and Standards of Review in Corporate Law' (1993) Fordham Law Review at 437; *McMillan* 'The Business Judgment Rule as an Immunity Doctrine' (2013) Williams & Mary Business Law Review Volume 4 Issue 2, 521 at 529.
[219] Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914 at 927; *Norlin Corp v Rooney Pace Inc* 744 F.2d 255 (2d cir. 1984).
[220] *Hinsey* 'Business Judgment and the American Law Institute's Corporate Governance Project: The Rule, the Doctrine, the Reality' (1984) 52 George Washington Law Review 609 at 615.
[221] See supra in footnote 136.
[222] *Leach* at 23.
[223] *Eisenberg* 'The Divergence of Standards of Conduct and Standards of Review in Corporate Law' (1993) Fordham Law Review Volume 62, 437 at 444-45.

of judicial review than the standard of conduct under the general duty of care[224]. The main problem with this understanding is the uncertainty about the applicable standard with regard to business decisions. Possible standards of review range from the fundamental standard of good faith over gross negligence and even recklessness[225]. This problem seems similar to the German experience in the time before the codification of the rule.

In addition, some US-American authors tend to understand the rule merely as an abstention doctrine[226] or as a doctrine of immunity[227]. The common basis of these understandings is the underlying intention of the rule to ensure positive behavioural effects on directors' decision-makings. Whereas *Bainbridge* states that the optimal and most efficient directorial decision is one, where there is no risk of judicial review[228], *McMillan* argues that the risk of excessive judicial review will force directors to take the safest and not the best business decision[229]. Therefore, the practical application of this understanding is limited to the restriction of judicial review. These approaches do not eliminate any form of judicial review, but rather restrict it to a minimum[230].

Despite all these different approaches, Section 76 (4) CA 2008 should be understood in the same way as the German codification because of its systematic and its underlying intentions.

With regard to the systematology, the formulation of the rule definitely supports such an understanding, because the phrase "(…) *will have satisfied the obligations of Subsection (3)(b) and (c) if (…)"* indicates that the subsequent requirements will concretise the duties set out in (3) (b) and (c). In contrast, Section 76 (3) formulates "(…) *must exercise the power and perform the functions of director* (…)" in a certain way. Whereas the latter sets a certain standard of conduct, the first only clarifies this respective conduct for the specific situation of uncertain business decisions. This formulation clearly indicates that the South African rule cannot be understood as a standard of liability[231].

In addition, the underlying intentions of the rule prohibit the assumption of an own standard of liability. The rule is designed to protect directors against personal liability, not to impose further liability. Formulation of another standard of liability besides the general standard of

[224] *Bainbridge* 'The Business Judgment Rule as Abstention Doctrine' (2004) Vanderbilt Law Review Volume 57 Number 1, 84 at Footnote 37.
[225] Ibid.
[226] Ibid.
[227] *McMillan* at 542.
[228] *Bainbridge* at 86-6.
[229] *McMillan* at 564-67 and 570.
[230] Ibid at 570-71.
[231] *Leach* at 40.

care, skill and diligence would mean to formulate the specific manner in which directors must conduct the affairs of the company. As stated above, setting up objective and fully reviewable criteria is only possible to a certain extent, but will never be fully feasible. The reason for that lies within the uncertain nature of business decisions. For example, even examining all available information will never secure an absolute certain business decision. Consequently, nobody can answer the fundamental question if the bad outcome of a decision – the damage for the company – is a result of an improper conduct or just bad luck. Therefore, nobody can set up a theoretical standard to avoid improper conduct[232]. The solution for this problem cannot be to set up another standard of liability, because such approach would mean that directors are no longer obliged to adhere the general duty of care while they are carrying out the business of the company. The opposite is true: The uncertainty of business decisions and their possible effects on the company require directors to conduct even more carefully. However, the effect of Section 76 (4) CA 2008 is that it clarifies the adherence of this general standard of care with legally binding effect, if the above-mentioned requirements are fully met. Based on this understanding, the rule operates similar as in Germany: It concretes the general duty of care and sets the applicable standard of judicial review. Since business decisions affect shareholders, stakeholders and even whole societies as the experiences from the global financial crisis has shown, directors should not be encouraged to act negligent. Reducing the applicable standard of care for business decisions to gross negligence or even recklessness would contradict the preventative effect of the duty of care. The opposite should be caused by the codification of the rule. Directors must only be encouraged to proper entrepreneurship and the reasonable management of risk, not to act gross negligent or recklessness. Modern company law should never incentive gross negligence or recklessness in the business context, since this would be the wrong signal towards managers. The business judgment rule is not a *carte blanche* which reliefs managers from their directorial duties. It must be clear that directors always owe their best possible effort towards their company. Decreasing the applicable standard of care would create disincentives to perform the best effort during the daily business, because it would imply the assumption that managing the company in a reasonable way is not fully possible.

Such understanding of the rule would also contradict the interests of the shareholders. By putting the responsibility for the business of the company on the directors they act as trustors

[232] In law of torts for example, this task is easier in most cases. For example: In order to avoid car accidents, a driver must adapt the speed to an appropriate level and must adhere to all relevant traffic rules. If an accident occurs nevertheless, the outcome is treated as inevitable and the driver will most certainly not be liable for damages.

and except their trustees to fulfil their duties in the best possible way. Shareholders would not accept a minimal standard since it would affect their financial interests negatively. It would cause the presumption that it is not possible to manage a company in a reasonable way, which may cause shareholders to refrain from investing capital.

Therefore, it seems highly important to clarify the applicable standard of judicial review with regard to Section 76 (4) CA 2008. As already described above, German as well as US-American courts interpreted the applicable of standard of judicial review inconsistently. In terms of legal clarification, the first important effect of any codified business judgment rule is the regulation of a universal and legally binding standard, which all courts must adhere to. In terms of the South African codification, courts must now strictly apply to the standard of reasonableness with regard to the decision process and rationality with regard to the decision result[233].

It is questionable tough how one can differentiate these two standards of review. I will revert to this problem in more detail, because this differentiation might cause problems in the practical application of the rule by the courts and will therefore be examined at the respective section of this paper[234].

4. Criticism of the Codification

As already mentioned above, the idea of a codified business judgment rule has been massively criticized, in Germany as well as in South Africa. It is not possible to raise all arguments against the codification of the rule in much detail, but it is necessary to give a brief overview about the issues identified by the judicial science.

The first and most important argument against the codification of the rule in South Africa is the blurred distinction between fiduciary duties and the duty of care[235]. And indeed, Section 76 (4) clearly refers to Section 76 (3) (b) and (c). Mixing the fiduciary duty and the duty of care can obviously cause problems because these two duties are fundamentally different. Whereas fiduciary duties stem from the Roman-Dutch law and results in a claim for restitution, the duty of care stems from English common law and leads to claims for delictual damages[236]. By including these completely different duties into the rule's scope of

[233] Section 76 (4) CA 2008.
[234] See below § 5.B.2.
[235] *Bouwman* at 509; *Jones* at 327; *Cassim et al* at 564;
[236] *Bouwman* and *Jones* ibid.

application, some of the main intentions of the new Act, the clarification, the simplification and the enhanced accessibility[237], may be heavily contradicted.

Secondly, *Bouwman* particularly argues that a codified business judgment rule is simply not necessary to effectively shield directors from personal liability. In her argumentation, she critically examines the reasoning of the first *King Report on Corporate Governance for South Africa*[238], which firstly recommended a codification of the rule in 1994. King 1 proposed such codification because of the quite onerous standard of the duty of care and the enhancement of economic competitiveness in South Africa. *Bouwman* states, that this reasoning is incorrect[239]. In her opinion, the standard of duty of care is not onerous or sets high requirements for proper directorial acting. It is rather a lax standard, which gives directors a huge freedom to run the business of the company independently and free from the risks of personal liability[240]. She further points out, that there has been only reported case in South Africa at that time, in which a director has been held liable for a breach of the duty of care[241]. With regard to the intention of enhancing the economic competitiveness of South Africa, *Bouwman* points out that the risk of personal liability, as factor does not influence the decision of competent candidates to take the office as a director[242]. Therefore, the codification will not have any positive effects upon the South African corporate governance system and its economic welfare; instead it will increase the risk of misconduct and wrongful decisions[243].

In addition to these arguments from South African academic writers, several German authors were raising concerns with regard to the implementation of a *legal implant*[244] from a complete different legal system like the US-American company law. They doubt that it is practically feasible to reasonable consider all specific characteristics when drafting the intended regulations[245]. Such a legal transplant will inevitably cause problems in the practical application of the rule, because system immanent conflicts will only occur after the effective date of a regulation. This fundamental problem applies even more with regard to a complicated legal concept like the business judgment rule. Due to the fact, that the rule is

[237] Explanatory memorandum Companies Bill, 2007 at 3; Irene-Marie Esser & Johan Coetzee 'Codification of Directors' Duties: An Option for South Africa'(2004) 12 *Juta's Business Law* 26 at 29.
[238] Hereinafter referred to as "**King 1**".
[239] *Bouwman* at 526.
[240] *Bouwman* ibid; *Finch* 'Company Directors: Who Cares about Skill and Care?' (1992) 55 Modern Law Review *at* 179.
[241] *Niagara* (in liquidation) v Langerman &Others 1913 WLD 188.
[242] *Bouwman* at 526-27.
[243] Ibid.
[244] See for fundamental details with regard to this term *Watson* at 21-3.
[245] *Fleischer* NZG 2004, 1129 at 1130-31; *Druey* in FS Goette (2011), 57 at 60.

solely grounded on case law, these authors basically argue that it cannot be fitted in a rigid and inflexible formulation[246]. In doing so, the legislator raises the rule to a level, which clearly contradicts their original concept[247].

There are various other arguments with regard to the effect of the codified business judgment rule in general. With regard to the German codification, several authors question the necessity of the rule in total, because of the absence of an origin scope of application for the rule[248]. The risk of personal liability for directors does not depend upon the nature of their decision. The liability does not differ no matter directors take business decisions any other directorial decisions, in particular legally regulated obligations[249]. This argumentation is based upon the above-mentioned findings, whereupon the jurisdiction respected the directorial discretion even without a codified business judgment rule. The key argument is that there has never been a risk for directors to be liable for mere errors of judgment, because it has always been a key principle of judicial review to restrain from judicial second-guessing[250]. Such argumentation has also been given in the South African context. *Jones* mentions with regard to the necessity of the South African codification that "*directors have never been held accountable for mere errors of judgment*" under common law[251].

The other arguments raised against the codification of the rule cannot be described in detail. They are not as relevant as the above-mentioned arguments. Moreover, some of them such as a lack of necessary objectification of the prerequisites have already been addressed in the respective sections of this paper.

§ 4. Similarities and differences between the two approaches

The above named findings show that Germany and South Africa chose different approaches to formulate their respective codification of the business judgment rule. However, there are several similarities as well as differences. Based upon the identification of these elements, it will be subsequently possible to identify the potential areas of problems arising out of the South African formulation of the rule.

[246] *Fleischer* ZIP 2004, 685 at 687-88; *Druey* in FS Goette (2011), 57 at 71.
[247] *Druey* ibid.
[248] *Druey* in FS Goette (2011) at 57; *v. Falkenhausen* NZG 2012 at 644; *Haarmann/Weiß* BB 2014, 2114 at 2120-21; *Scholz* Existenzvernichtende Haftung at 73-5 and 105-6.
[249] Ibid.
[250] Ibid.
[251] *Jones* at 333.

1. Similarities

a) Specification of the general duty of care

The first similarity between both approaches seems to be the dogmatic nature and the systematic.

As already described above, both approaches are meant to specify the general duty of scare, skill and diligence with regard to uncertain business decision and to set the mandatory standard of judicial review in this regard. Therefore, none of both codifications sets a lesser standard of due care. Although this understanding is favoured by some US-American courts, it is clearly not in line with the underlying intentions of the rule to decrease the applicable standard of due care with regard to business decisions. The basic intention of the rule is to shield directors from unjustified personal liability. This privilege is granted to directors of companies only due to the fact, that the outcome of their decisions is always vague. There are not enough objective criteria to justify a fully judicial review upon the view *ex post*, i.e. after the director has taken the respective decision. Courts are not competent enough to second-guess what could have been the right conduct and the right decision, because they have already obtained knowledge about the bad outcome of such decision.

b) Focussing on the adequate information basis

Since both codifications operate as specifications of the general duty of care, their main focus lies consequently upon the regulation of a proper decision process. Both codifications impose the requirement of an informed decision upon the directors. Although there are differences in the concrete form of the requirement, the fundamental principle is clear: Instead of examining the concrete result of the decision, the main focus of judicial review lies upon the decision process.

c) Avoidance of conflict of interests

The third fundamental similarity is the avoidance of conflict of interests. Despite the concrete wording it seems clear that in both legislations the rule does not protect influenced and dependent acting at all. Whereas the German codification regulates this principle within the requirement of the best interests of the company, the South African codification expressively regulates the duty to avoid self-dealing and conflict of interests.

2. Differences

a) Differentiation between standard of reasonableness and rationality

The first notable difference between both codifications is their structure with regard to the applicable standard of review. The German codification only contains one standard of judicial review expressed in the wording *vernuenfigerweise annehmen durfte.* I already described my proposal for the right understanding of this term above[252].

In contrast, the South African codification contains two different standards of judicial review. Directors have to act reasonable with regard to the decision process and rationally with regard to the decision result.

b) No explicit prerequisite of 'business decision'

The second important difference is the absence of any limiting requirement such as business decision or business judgment in the South African codification. This seems to expand the scope of application of Section 76 (4) CA 2008 in comparison with the German codification, because Section 76 (4) CA 2008 includes all possible directorial actions in the scope of the rule. In contrast to the German codification, there seems to be no distinction between uncertain business decisions and other decisions under uncertainty, in particular legally binding obligations.

c) No direct link to the duty to act for a proper purpose

The last important difference between both approaches is the exclusion of the duty to act for a proper purpose in the South African codification. Although the German codification does not contain such requirement expressively the German legislator intended to impose the obligation to act *bona fide* or in good faith as requirement for the application of the rule.

§ 5. Identifying the potential problems for South Africa

Based on the findings described above, it should now be possible to identify possible problems that might arise in the practical application of the rule by the jurisdiction.

A. Scope of Application

The first and in my opinion most important problem of the South African codification exists with regard to its unclear scope of application.

[252] See at § 3.A.d).

As described above, German academic writers also struggled with identifying the scope of application of Section 93 I 2 AktG. This determination is necessary because of the restricting requirement of the business judgment. The German legislator intended to restrict the application of the rule strictly to business decisions and did not want to include other decisions under uncertainty in the scope of application. The German challenge lies within the correct understanding of the term *business decision*. As already described, I propose a teleological interpretation of term business judgment rather than a literal interpretation[253]. By interpreting the term in the light of the underlying intentions of the business judgment rule, it is certainly possible to distinguish between several forms of uncertain decision situation.

One could now argue that such effort is not required with regard to the South African rule since there is no respective prerequisite. However, in my opinion it is clearly necessary to limit the scope of application of Section 76 (4) CA 2008 in a way, that legally binding obligations are excluded from the application. Otherwise, the limitation of directors' liability can hardly be justified, in particular in comparison to other professions such as lawyers or doctors. It has already been described above that uncertain decision situations appear in various contexts, so that directors could claim directorial discretion with regard to all of their possible decisions.

The first difficulty arising out of such an understanding is the dealing with breaches of law in the best interests of the company. Since the directors are responsible for the adherence of binding law with regard to the company, there decision power covers the decision whether or not to comply with this law. A board of directors might; for example, consider the breach of mandatory environmental or competition law in order to maximise the profit of their company. Such a decision seems to be similar to a classical investment decision: The board has to weight the possible opportunities and risks of such a breach of law, i.e. the detection's probability against the potential cost savings and turnover increases. If the directors conclude that the possible increase of the annual turnover is worth the risk of being fined with penalties, they could certainly argue to act in the best interests of the company[254]. If there results any damage for the company out of this decision, it is questionable if the directors could be held

[253] See above under § 3.A.a).

[254] For example: Violation of the rules of the Competition Act No. 89 of 1998 will be fined by a penalty up to ten percent of the company's annual turnover in South Africa and its exports from South Africa according to Section 59 (2) Competition Act, 1998. If the potential increase of turnover exceeds this amount and if there is a only a small probability of being detected, a board may be willing to infringe the Competition Act.

personally liable for this loss[255]. According to Section 77 (2) (b) CA 2008, a director is liable for any breach of his duties contemplated in Section 76 (3) (c). If Section 76 (4) CA 2008 would apply in this case, the directors could defend themselves by demanding a directorial leeway even with regard to legally binding obligations. This would result in a restricted judicial review, mainly focussed only on the decision process rather than its result. Such an understanding is not in line with the fundamental intentions of the rule. One of its main purposes is to promote reasonable entrepreneurship and the avoidance of risk-averse management. In contrast, the adherence of binding law regulations should never be subject to risk considerations. Binding legal regulations always claim absolute validity over all other considerations. The purpose of promoting legal interests and protecting legal rights of third parties and the whole society cannot be subject to a directorial leeway. Applying the standard of rationality to such decisions would mean to reduce the judicial review in this regard. It seems clear, that such an approach is not intended and would not be chose by the jurisdiction. However, such approach is possible due to the wording of Section 76 (4) CA 2008 which is problematic.

The same problem would arise with regard to decisions under legal uncertainty. As already mentioned, directors are required to conduct the business of the company in accordance with the applicable law. However, legal obligations are not always clear and certain and must often be reasonable interpreted. In addition, the legal situation with regard to certain provisions might also be unclear in certain instances. Such instances can arise because a legal problem is subject to controversial discussion and has not been decided by the jurisdiction. It may also be the case, that different courts had decided differently with regard to the same problem or with regard to a definition of a specific regulation. In all these cases the directors have to take a decision how to deal with the current and uncertain legal problem. Again, such a decision is comparable to a classical business decision. For instance, if a legal term can be interpreted in different ways or different legal consequences are possible, the board is required to take the alternative, which is in the best interest of the company. The uncertainty in such situations arises out of the potential risk, that the court of last instance might decide differently than the directors did. This would result in possible damages for the company due to the breach of the

[255] Notwithstanding their personal liability in terms of Section 74 Competition Act No. 89 of 1998. The author is also aware of the legal rule of *ex turpi causa non aritur action* and the leading case of *Safeway Limited & Others v. Twigger & Others* [2010] EWCA Civ 1472, [2010] All ER (D) 245 (Dec) whereupon a cartelist cannot recover fine payments from their employees and directors because of this rule. However, there might be cases in which courts will not apply this legal rule and where directors might be forced to defend themselves with the application of the business judgment rule.

respective law. The question is, if the business judgment rule is also applicable in such cases. From the wording of Section 76 (4) CA 2008 it would certainly apply. This would result in a reduced judicial review of the decision. Directors would not be required to take a reasonable but rather a rational decision. In my opinion, the application of the business judgment rule cannot be justified in cases of uncertain legal situations. One of the main reasons of the business judgment rule is the avoidance of the hindsight bias. Since judges are not competent businessmen, they should not second guess the right business decision after a decision has been taken by the responsible directors. There is an underlying assumption that directors can take better business decisions than judges. Therefore, they shall not bear the risk of being held liable after they took a reasonable decision. With regard to legal uncertainty such assumption does not exist. It is the primary task of the jurisdiction to resolve legal problems by defining legal terms and interpreting law regulations. It is the sole profession of judges to find binding solutions to such problems. The risk of a hindsight bias therefore does not exist to same extent as in the case of business decisions. Therefore, it cannot be justified to reduce the judicial review in these cases to the minimum standard of rationality. Directors are sufficiently protected in these cases by Section 76 (4) (b) read together with Section 5 (b) CA 2008. If the directors reasonably rely on the opinion of their legal counsels, they cannot be held liable due to a breach of their duty of care.

Due to the above-mentioned difficulties, Section 76 (4) CA 2008 should be interpreted in the way the German and the US-American rule is understood. Its scope of application should be strictly reduced to business decisions. An expansion of the rule would in my opinion conflict with its underlying reasons and its fundamental intentions. Another understanding would also conflict with the systematic between Section 76 (3) and (4) CA 2008. If the business judgment rule would apply to all possible directorial decisions, the standard of reasonableness in Section 76 (3) CA 2008 would be fully negated by the standard of rationality in Section 76 (4) (a) iii) CA 2008[256]. In light of the explicit wording of this Section, courts would be forced to adhere to the standard of rationality instead of reasonableness. Reducing the scope of application strictly to business decisions would avoid this inconsistency.

B. Scope of Judicial Review

The second potential area of problems is the determination of the applicable standard of judicial review. As already mentioned above, there are different issues in this regard.

[256] *Wiese* at 139.

1. Blurred lines between rationality and reasonableness

The first important problem is the unclear distinction between the standards of reasonableness and rationality.

It is necessary to highlight that Section 76 (4) (a) CA 2008 distinguishes between two different standards of judicial review. Whereas the decision process is subject to the standard of reasonableness, the standard of rationality applies to the decision result. In my opinion, this differentiation is of utmost relevance because it constitutes the privileged effect of the business judgment rule. Courts must strictly respect the directorial leeway with regard to the decision process. Instead, they have to examine the decision process in more detail by application of the standard of reasonableness.

However, South African academic writers tend to have a different understanding of the rule. As already mentioned above, the distinction between rationality and reasonableness is not strictly respected[257] or gets criticised[258]. *Wiese particularly* refers to the Canadian understanding of the rule in *Shuttleworth v Cox Brothers & CO (Maidenhead) Ltd*[259], where the court examined a business decision on its reasonable grounds. It is exactly this understanding, which will cause problems with the practical application of the rule by the South African jurisdiction. Although Section 76 (4) (a) iii) literally states that the applicable standard of objective review is rationality only, courts might not differ between the standards and thus extend their judicial review of directorial acting. This applies all the more because of the prevailing opinion that the standard of rationality negates the standard of reasonableness of the duty of care[260]. In my opinion, these irritations result from the unrestricted scope of application of Section 76 (4) CA 2008. If the rule would be applicable to all various forms of directorial acting, the rationality would usually supress the reasonableness, if all other requirements of the rule are fulfilled. It is therefore highly important to distinguish between business decisions and other directorial acting as already proposed above.

2. Determination of the standards

The second potential problem with regard to the scope of judicial review is the concrete determination of the judicial review. This determination must always be subject to the fundamental intention of the business judgment rule, the avoidance of unjustified hindsight biases. A standard of judicial review must therefore adopt to the concrete level of uncertainty.

[257] *Cassim et alt* at 564: "*The decision must be reasonable one.*".
[258] *Wiese* at 139.
[259] 1927 2 KB 9 (CA).
[260] Section 76 (3) (c) CA 2008.

If a decision is highly uncertain the risk of a judicial hindsight bias increases. Consequently courts must restrain from review if (i) they are not more competent than the original decision maker or (ii) must use additional information obtained after the decision situation to adequately assess the subject matter. The result of a classical business decision is subject to the highest uncertainty possible, whereas the decision process can be partly objectified[261]. The standard of rationality must therefore be understood as the minimum standard of judicial review, whereas the reasonableness serves as a flexible standard not only for the decision process but also for all other directorial acting. Such an understanding is in line with the wording of Section 76 CA 2008 and matches with my proposed understanding of the German business judgment rule.

In accordance with the US-American *rational purpose test* the courts have to examine the result of the decision only upon its accordance with any rational purpose. If the decision promotes any plausible business purpose, there is an assumption that the decision is based on rationality. Irrational are only such decisions without reference to any such purpose. Therefore, the practical relevance of the standard of rationality is low. Only if directors are not able to explain their decision at all, courts will assume that they acted irrational[262]. This matches with the above-mentioned link between rationality and proper purpose in Section 76 CA 2008. If there is any rational connection between the business decision and the purpose for which the power has been given, the directors assumption of the decision result will be treated as rational[263]. Since the purpose of the power is usually the strengthening of the economic growth of the company, any plausible economic intention will suffice in terms of rationality.

In contrast, the standard of reasonableness allows a review of the decision process in more detail. Due to the partly objectification of the decision process, i.e. its structure and the proper dealing with obtained information, the level of uncertainty is lower that it is with regard to the decision result. Courts therefore have basic guidelines to review the decision process. The requirements for directors under this standard are therefore much higher. They have to be familiar with the basic requirements of acting on an adequate information basis, since these basic requirements are subject to full judicial review. Only with regard to the concrete

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[261] See above at § 3.A.c).

[262] Selheimer v. Manganese Corp. of America 224 A.2d 634, 646: '(…) in fact, the defendants have failed to give any satisfactory explanation or advance any justification for such expenditures.".

[263] *Wiese* at 139.

assessment of the obtained information and the drawn conclusions exists a directorial leeway, which must be respected by the courts.

3. Avoidance of the hindsight bias

The third problem with which courts will most likely be confronted is the risk of being influenced by the hindsight bias. Therefore, avoiding the hindsight bias is of utmost importance since it usually results in unjustified personal liability of directors. The risk of hindsight bias highly depends on the respective level of uncertainty. Based upon the above-mentioned difference between decision process and decision result, the risk of a hindsight bias is more likely with regard to the decision result than the decision

Judicial review of business decisions must therefore always be flexible and must be adapted to the level of uncertainty.

The German experience shows that hindsight biases can occur with regard to the decision process and the decision result[264]. The first necessary condition to effectively avoid the hindsight bias would therefore be the acceptance of the above named different standards of judicial review. Whenever courts will apply the flexible standard of reasonableness towards the decision result, a hindsight bias will emerge. Results of business decisions are always unpredictable and nobody is able to predict their outcome. If courts review a decision beyond the requirement of a proper business purpose, they cross the border of unbiased judicial review because they will most likely replace conclusions drawn in the situation *ex ante* by their own conclusion based upon information obtained *ex post*. In addition, the application of the flexible standard of reasonableness will cause legal uncertainty. The German experience clearly shows that courts applied different standards of judicial review to different business decision, if there is no mandatory restriction provided by law[265]. The intended behavioural effect of the rule, the encouragement of entrepreneurship and taking risks would be contradicted, because directors could not be sure about the extent of the judicial review. Therefore, the regulation of a mandatory standard of judicial review is the most important effect of every legally binding codification of the business judgment rule.

In order to promote this strict system of two different standards of judicial review, legal science and academic writers must constantly working on the definition of the limits of the respective standard. In particular The flexible standard of the reasonableness in particular will most certainly cause problems with regard to the business judgment rule. The problems will

[264] See above at § 3.A.b).
[265] See above at § 3.A.1.

arise mostly out of the indefinite term of *reasonable information*. The most important task for the jurisdiction and academic writers in South Africa should therefore be the concretisation of the term in order to develop objective guidelines for the decision process. The more objectified the decision process is, the less uncertainty occurs, which would consequently lower the risk of hindsight biases. The findings of German judicial and business administration science can be very helpful in this regard[266], however it is not in this paper to provide an overview about these findings due to the word limit. In my opinion, the following issues are key factors for the partly objectification of the decision process:

- Courts must conclude that there is no obligation to obtain and analyse all possible information sources. Instead, directors must be able to reasonable choose between all possible information sources at their own discretion.

- The structure of the business decision process should be subject to certain objective guidelines[267]. Directors must be familiar with the basic principles of taking uncertain business decisions and how to structure their decision making. These objective guidelines are subject to fully objective judicial review. Directors are therefore obliged to inform themselves how to reasonable structure the decision process.

- Objective guidelines should also apply with regard to the concrete analysis and assessment of the obtained information. This should particularly apply to the dealing with external opinions from professionals, because this information source is of utmost importance in practice. Respective objective guidelines should content regulations with regard to (i) the choice of sufficient competent professionals, (ii) the obligation of transmitting the complete, accurate and detailed facts of the subject matter, (iii) the method of the external consultation, i.e. written opinions or oral consultation and (iv) the obligations of the directors after the respective opinion has been given, i.e. the duty to control the opinion on obvious errors like inconsistencies and other logic errors.

- Courts and academic writers should conclude, that a reasonable information does not only consist out of objective information sources. Being a competent business man also requires it to base judgments, conclusions and decisions upon own subjective experiences. The judgment in *Smith v. van Gorkom* clearly shows that a fully objective approach can lead to excessive personal liability and increases the risk of hindsight biases.

The more objective guidelines can be developed, the more the objective judicial review can be extended. However, it is not feasible to fully structure the decision process. Courts must

[266] See above at § 3.A.c).
[267] Ibid.

therefore respect the directorial leeway with regard to the decision process. No matter how proper the process is structured, directors will always be required to draw the right conclusions out of the information. This implies the concretisation of the company interests. This concretisation can never be subject to fully objective judicial review. The courts should have to respect these limits.

In my opinion, the concrete wording of the South African rule is sufficient to promote such understanding. In contrast, the wording of the German codification does not illustrate this distinction. Regardless, currently there is a broad consensus amongst German academic writers that the decision result cannot be subject to the same standard of judicial review as the decision process. Some academic writers therefore even propose to change the wording of the German codification[268]. Such changes are not necessary with regard to Section 76 (4) CA 2008.

4. Extended judicial review because of the term *proper purpose*

The last potential problem that is important to highlight is the connection between the duty to act for a proper purpose according to Section 76 (3) (a) and the application of Section 76 (4) CA. As already described above, Section 76 (4) CA 2008 makes only reference to Section (3) (b) and (c) and not to (a)[269]. This means that even if directors adhere to all prerequisites of the rule, the judicial review of their decision is extended because of the duty to act for a proper purpose. Since this requirement is subject to full and objective judicial review, the purpose of the rule to generate a safe haven for directors is contradicted. It appears that this requirement causes the same problems as the requirement of *good faith* does with regard to the German codification[270]. The term *proper purpose* seems to be quite indefinite. If it is understood as the duty to exercise directorial powers for the purpose, these powers have originally been granted for, the only purpose with regard to business decisions would be the pursuance of the shareholders' economic interests. Shareholders only grant this power to the directors because they expect economic advantages and a return of invest. These interests particularly form the interests of the company with regard to business decisions. According to Section 76 (4) a) iii) CA 2008, the review of the interests of the company is subject to the restricted standard of rationality, i.e. courts have to respect the directorial leeway in this regard. The application of the *proper purpose* would contradict this legal assessment. Courts would be able to extend the

[268] *Goette* ZGR 2008, 436 at 448 in footnote 46.
[269] See above at § 2.B
[270] See for more details above at § 3.A.e).

scope of judicial review and would thus be able to assess the directorial assumptions retrospectively. This would increase the risk of the hindsight bias greatly.

In my opinion, such an additional assessment is not necessary. If a court concludes that the decision making process has been reasonable and the decision was taken upon a rational basis in the best interests of the company, there is no need for an additional review upon proper purposes. Based upon the above named understanding of the requirement of *good faith* in Germany, courts should not have an additional possibility of reviewing the outcome of business decisions[271]. There is no need for such an additional judicial review, because the proper understanding of the prerequisites of the rule itself provides sufficient protection from wrongful directorial acting. However, this applies only if one aggress on the distinction between business decisions and other directorial decisions under uncertainty, in particular legally binding obligations.

[271] Ibid.

§ 6. Conclusion

The comparison between the German and the South African business judgment rule clearly shows, that every codification of the rule can cause various complicated problems.

Although the German and the South African law system highly differs, the history of the rule in both countries is surprisingly equal. Before its codification, the rule has been developed in various court decisions. And despite the problems in the US-American legal system, the legislators in both countries decided to transform the rule into a binding codification.

Although the concrete wording of the two codifications varies, the underlying intentions are the same. The rule promotes entrepreneurship and establishes a shield from personal liability for directors of companies. Directors shall be able to manage a company on their own discretion without the risk of courts replacing their business decisions with their own judgments. It is common sense in both countries that these intentions are reasonable and should be promoted. However, both codifications have been fiercely criticized. And indeed, the problems linked with the application of the rule are various and complex. They mostly result because the business judgment rule was developed as flexible rule of judicial review with regard to uncertain directorial decisions. By codifying it, the difficulties of defining highly indeterminate terms become obvious. The problem gets even more complex, because written legislation has to be predictable and has to provide legal certainty. In addition, the implementation of the rule as written legislation highly affects the balance between shareholder rights and directors' accountability. Shareholders are interested in risk-averse directors, because taking reasonable risks enables economic success. It is therefore unjustifiable to impose excessive risks of liabilities on the directors. Both codifications therefore were implemented simultaneously with a strengthening of shareholders' rights, i.e. the possibility of derivative actions. It therefore seems, that the codification of the rule is also been used as a political tool.

Since this paper examined German, US-American and South African law, the identified potential areas of problems can be named as universal problems of the business judgment rule. The concrete scope of application, the determination of the applicable standards of judicial review and the restriction of the judicial review can most likely be identified in all jurisdictions worldwide. It has been highlighted that a proper understanding of the rule can only be accomplished if the rule, its prerequisites and its practical application is determined strictly in the light of the underlying intentions and reasons of the rule.

The most important intention of the rule is the avoidance of the hindsight bias. It is the hindsight bias which forms the risk of excessive directors' liability, which then effects all the other intentions of the rule. Consequently, all identified problems with regard to the practical application by the South African courts are linked to the phenomenon of hindsight bias. The restriction of the application to business decisions only, the fundamental distinction between the two different standards of judicial review, their respective definition and the definition of the unclear term of *reasonable information* are all subject to the overall aim of the avoidance of the hindsight bias.

Codifying the rule does not solve all these problems, but the written legislation imposes the mandatory standards of judicial review. However, it is a fine line between necessary review and causing a hindsight bias. The courts therefore have a challenging task. Academic writers therefore must support the jurisdiction by addressing the problems and by finding solutions. This includes especially the difficult task to interpret the prerequisites.

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