

**DIRECTORS' STANDARDS OF CARE, SKILL, DILIGENCE, AND THE
BUSINESS JUDGMENT RULE IN VIEW OF SOUTH AFRICA'S
COMPANIES ACT 71 OF 2008:
FUTURE IMPLICATIONS FOR CORPORATE GOVERNANCE**

BY

BRIGHTON MURISA MUPANGAVANHU

LL.B (UFH), LL.M (Natal), PG CERTIFICATE - LEGAL PRACTICE (UCT)

This thesis is presented in fulfilment of the requirements for the award of the degree of

DOCTOR OF PHILOSOPHY: COMMERCIAL LAW

In the Faculty of Law

UNIVERSITY OF CAPE TOWN

Supervisors:

Professor CAROLINE NCUBE, Professor of law, University of Cape Town

&

Professor ROCHELLE LE ROUX, Professor of law, University of Cape Town

Date of submission: February 2016

The copyright of this thesis vests in the author. No quotation from it or information derived from it is to be published without full acknowledgement of the source. The thesis is to be used for private study or non-commercial research purposes only.

Published by the University of Cape Town (UCT) in terms of the non-exclusive license granted to UCT by the author.

AUTHOR'S DECLARATION

I Brighton Murisa Mupangavanhu hereby declare that the work on which this thesis is based is my original work (except where acknowledgement indicate otherwise) and that neither the whole work nor any part of it has been, is being or is to be submitted for another degree in this or any other university. I authorise the University of Cape Town to reproduce for the purpose of research only, either the whole or any portion of the contents in any manner whatsoever.

Signed at CAPE TOWN on this 15th day of February 2016

_____BM_____

Brighton Murisa Mupangavanhu

SPECIAL POSTHUMOUS DEDICATION TO A BELOVED BROTHER

In loving thoughts and memory of my dearest brother Cliff Mupangavanhu, the late ZARNET (Pty) Ltd CEO, whose untimely death in a car accident on 6 June 2015 robbed me of one of my biggest cheerleaders, among many other things that he was and will always remain to me and our family. Cliff's role as an Executive Director in a highly promising IT company directly influenced my choice to conduct research in the area of corporate governance. His influence and love will forever be remembered and cherished in my heart, his family members' hearts, his friends' hearts and former colleague's hearts. Cliff ran his race with some remarkable achievements. We will be inspired by his legacy to run our own races with distinction, till we meet again in another life.

DEDICATION

I dedicate this work to my first line of support, the front row of my cheerleaders – my family: Yeukai my beloved wife, my beloved princess Kupakwashe, a brilliant girl with a heart of gold (daddy loves the young woman that you are developing into), and my champion in the making, my prince-charming Carl Anesu – a typical daddy’s boy. At home we call him Mr. Carl. Through you boy and your sister, I have a challenge to be the best man I can be in everything. You, my family, are the main influences behind my sitting up late at night to do what I do in the interest of professional growth.

ACKNOWLEDGEMENTS

To God who is the beginning and inspiration of all that I do, thank you for guidance, insight, strength and provision throughout my studies. With you on my side Oh Lord, I shall know no limitation.

I wish to acknowledge my two supervisors for their sterling efforts in supervising me throughout the writing of this thesis. To Professor Caroline Ncube: From the first day that I visited the Wilfred Kramer Building (UCT Law Faculty) proposing to undertake PhD studies, you were very supportive. I remember you taking me to Professor Tom Bennet for assistance. Your professionalism made you a natural choice for a supervisor. Eventually you became my Supervisor. Thanks for your guidance, advice and mentorship throughout this journey. There is no doubt that your dedication to duty is recognised everywhere. It is little wonder why you are HOD: Commercial Law department at such a top law faculty on the continent and co-editor of a journal. I salute you Caroline, and thanks!

To Professor Rochelle le Roux: I couldn't have asked for a better co-supervisor. Your eye for detail, your insight, your critical analysis, your amazing turn-around time after receiving a chapter from me, really served as great motivation to me. Your quality includes your forthrightness and your insistence on quality – I like that! You are a Labour Law specialist, but your ability to analyse corporate governance issues and especially the Business Judgment Rule left me amazed. I cannot stop talking about my supervisors to my colleagues in the Mercantile and Labour Law department at the University of the Western Cape (UWC). Rochelle, you and Caroline have had such an impact not only on my scholarship but even on my role as an LL.M supervisor. I learnt a lot from you two!

To Prof Louis van Huyssteen, the quality of your mentorship is difficult to describe with words. All I can say is that your eye for detail and your mentorship greatly enriched my writing. Thank you!

To UCT, especially the Law Faculty, I am proud to have been a student of this great faculty. Thank you for financial support. I was a proud recipient of the Wilfred Kramer Scholarship. Thank you for the opportunity to work with a group of first year students (the PASS class) as a Mentor in 2013. I picked up a lot of techniques on lecturing and tutorial administration from Professors Hugh Corder, Lesley Greenbaum and Tjakkie Naude. Professor Pierrre de Vos, thanks for the two hour chat that we had in 2013 on how to produce a concise and qualitative piece of work. Many thanks to the former Dean of the Faculty Prof PJ Schwikkard for support and encouragement during my studies.

To the UWC Law Faculty, many thanks for allowing me to present my work during the Doctoral Colloquia between 2014 and 2015. Many thanks to the Dean Prof Bernard Martin, HODs from other departments, the deputy deans and my HOD Prof Kitty Malherbe, my faculty and departmental colleagues for words of encouragement. Prof Malherbe and Prof Martin you really motivated me to complete this Study. Prof Riekie Wandrag, thank you for being a willing sounding board and for your patience each time I came to you bubbling with excitement after discovering some research nuggets! I acknowledge with gratitude the one term teaching relief I received from my employer, UWC, to enable me to finalise my thesis draft. I also acknowledge my UWC colleague Liyaquat Mohamed for the technical support offered.

I appreciate the support of my family and friends for always checking up on my PhD progress. To my team, Yeukai, Kupa and Carl, thank you for allowing me to pursue my studies and for braving many evenings without me while I worked on my thesis. I appreciate your love, sacrifice and support! I also wish to appreciate my mother Mrs. Angeline Mupangavanhu for her unchanging love and support. To the rest of my family, my brothers, my in-laws, sisters and cousins, thank you for the support.

ABSTRACT

Decision-making is the most critical role that company directors have to play in the life of a company that they are appointed to manage. South African law (in s66 of the Companies Act 71 of 2008, the Act) has now followed the global trend of recognising that directors have original authority or mandate to manage or direct company affairs or business. A director is accorded (by law) powers to exercise to enable him or her to fulfil the functions of that office. Decision-making, which is not an easy task, is critical to enterprise efficiency and advancement of the national economy. Directors have to make business decisions, at times under imperfect circumstances and while confronting tensions inherent in the corporate form. Not least of these tensions is the pressure to balance the profit maximisation drive from shareholders and accountability for how the directors exercise the powers at their disposal. Despite pressures involved in decision-making, the law requires that directors should exercise their powers in the best interests of the corporation. Thus the Act has attempted to put mechanisms in place to ensure that directors' freedom to manage corporations has to be necessarily constrained and balanced by the need for them to be accountable.

The thesis focuses on the duty of care, skill and diligence on one hand (standard of conduct), and the business judgment rule (BJR- standard of review) on the other. These are two mechanisms put in place by the Act to ensure a balance between directors' freedom to manage and accountability. The thesis seeks to answer the key question whether the Act has made standards of care, skill and diligence clearer, more accessible and enforceable than before in light of the Act's adoption of BJR. The thesis analyses the duty of care, skill under s76(3)(c) and BJR under s76(4) in light of the context of law reform (that is the purposes of law reform) and international experiences. In this thesis, an appraisal of the positives brought about by the codification of the duty of care and the adoption of BJR into statute for the first time in SA is given. It is argued that while some purposes of law reform have been achieved, the Act has not achieved the purpose of clarity of standards. For example, the analysis reveals unfortunate omissions and worrying ambiguities in the formulation of standards of care, skill and diligence in s76(3)(c). While giving in-depth analysis of the scope and policy rationale of BJR under the Act, the thesis further notes that the characterisation of BJR in s76(4)(a) as a standard of conduct as opposed to standard of review is problematic. It has also been argued that the BJR is not properly aligned to international standards. Clear amendments to the Act have been suggested to improve clarity of standards and the law in s76(3)(c) and s76(4)(a).

LIST OF ABBREVIATIONS

AC	Appeal Cases (UK case law context)
ACLR	Australian Company Law Reports
ACSR	Australian Corporation and Securities Reports
AD	Appellate Division
ADR	Alternative Dispute Resolution
Akron. L. Rev	Akron Law Review
ALI	American Law Institute
ASIC	Australian Securities and Investment Commission
ASX	Australian Securities Exchange
BCLC	Butterworths Company Law Report (UK)
BJR	Business Judgment Rule
BOR	Bill of Rights (under the Constitution of South Africa)
BRICS	Brazil, Russia, India, China & South Africa (acronym for the group of five emerging economies of the world)
CA	Court of Appeal (UK)
CC	Constitutional Court (of South Africa)
CEO	Chief Executive Officer
ChD	Chancery Division Law Reports
CIPC	Companies and Intellectual Property Commission
CIPRO	Companies and Intellectual Property Registration Office
CJ	Chief Justice
CI	Clause
CLR	Commonwealth Law Reports
CNP	Centro Property Group
CPD	Cape Provincial Division
CSR	Corporate Social Responsibility

Del. J. CORP. L	Delaware Journal of Corporate Law
DP	Deputy President (of a South African higher court)
DTI	Department of Trade and Industry
EWCA	England and Wales Court of Appeal
EWHC	High Court of England and Wales
FCA	Federal Court of Australia
FCAFC	Federal Court of Australia Full Court
FCCA	Federal Circuit Court of Australia
Fordham Int'l L.J	Fordham International Law Journal
FRSC	Financial Reporting Standards Council (SA)
GG	Government Gazette
GN	Government Notice
HCA	High Court of Australia
IoDSA	Institute of Directors in Southern Africa
IT	Information Technology
JA	Judge of Appeal
JHIL	James Hardy Industrial Limited
JPPL	Journal of Private and Property Law
L.Q.R	Law Quarterly Review
MAF	MacAndrew and Forbes Group Incorporated
Merc. LJ	Mercantile Law Journal
MLR	Modern Law Review
MOI	Memorandum of Incorporation
NSWCA	New South Wales Court of Appeal (Australia)
NSWLR	New South Wales Law Reports
NSWSC	Supreme Court of New South Wales

OECD	Organisation for Economic Development and Cooperation
PPWAWU	Paper, Printing, Wood & Allied Workers Union (SA)
Reg	Regulation
SA	South Africa
SAcLJ	Singapore Academy of Law Journal
SALJ	South African Law Journal
SCA	Supreme Court of Appeal (SA)
Stan. L. Rev	Stanford Law Review
THRHR	Tydskrif vit Hedendaage Romeins Hollandse Reg (translated from Afrikaans to English to mean Journal of Contemporary Roman-Dutch Law)
UK	United Kingdom
U. PA. L. Rev	University of Pennsylvania Law Review
USA or US	United States of America
VA. L. Rev	Virginia Law Review
Vand. L. Rev	Vanderbilt Law Review
WASC	Supreme Court of Western Australia
WLD	Witwatersrand Local Division (of the South African High Court)
Wm. & Mary Bus. L. Rev	William and Mary Business Law Review

TABLE OF CONTENTS

Author's declaration.....	i
SPECIAL POSTHUMOUS DEDICATION TO A BELOVED BROTHER.....	ii
DEDICATION.....	iii
ACKNOWLEDGEMENTS.....	iv
ABSTRACT.....	v
CHAPTER 1: INTRODUCTION TO STUDY.....	1
1.1 Background to the Study.....	1
1.2 Problem Statement and Introduction to Research Question.....	2
1.3 Key Research Question and sub-inquiries.....	5
1.4 Brief Literature Review, Justification of Study & gaps in knowledge.....	6
1.5 Purpose of the Study.....	13
1.6 Scope and delimitation of Study.....	13
1.7 Methodology.....	14
CHAPTER 2: DIRECTORS' STANDARDS OF CONDUCT & THE.....	16
BUSINESS JUDGMENT RULE – A CONCEPTUAL FRAMEWORK.....	16
2.1 INTRODUCTION.....	16
2.2 DEFINITIONS AND INTRODUCTION OF KEY CONCEPTS.....	17
2.2.1 Corporate Governance.....	17
2.2.2 Company Director.....	21
2.2.3 THE BJR – Meaning.....	26
2.2.4 Subjective, Objective, Dual objective/subjective standards of care & gross negligence.....	28
2.3 Corporate governance in South Africa- voluntary compliance framework.....	30
2.3.1 <i>King Reports</i> on Corporate Governance.....	31
2.4 NATURE OF THE DIRECTOR – COMPANY RELATIONSHIP.....	36
2.4.1 Theories on the nature of a company.....	36
2.4.1.1 <i>The Agency/Contractarian theory</i>	37
2.4.1.2 <i>The Concession theory</i>	39
2.4.1.3 <i>The Communitaire theory</i>	40

2.4.2 The Legal status of a company in South Africa	44
2.4.3 Legal status of company directors: Are directors agents, trustees, managing partners or is their status sui generis?	48
2.5 Meaning of ‘the best interests of the company’ – Does the Enlightened Shareholder Value approach provide an answer to the meaning of this phrase under the Act?	52
2.6 The relationship between duty of care and BJR	57
2.7 CONCLUSION	59
CHAPTER 3: INTERNATIONAL BENCHMARKS & TRENDS IN EVOLUTION OF STANDARDS OF CARE, SKILL, DILIGENCE & THE BJR.....	61
3.1 INTRODUCTION	61
3.2 The UK duty of care	62
3.2.1 From a traditional approach to modern standards of care in the UK	63
3.2.1.1 Shift from subjective to dual objective/subjective elements	65
3.2.1.2 Dual Objective/Subjective standards and the UK Law Reform	68
3.2.2 Standards of care under s 174 of the Companies Act 2006.	70
3.2.3 The UK decision to exclude BJR in statute.....	75
3.2.4 Comparing UK and SA law reforms	76
3.3 Australian standards of care and THE BJR	78
3.3.1 The Australian Standards of care	79
3.3.1.1 Australian common law duty of care	79
3.3.1.2 Australian statutory duty of care and diligence	83
3.3.1.3 Emerging case law principles in Australia post 2001 – duty of care	87
3.3.1.4 Brief comment on lessons for SA from emerging case law principles in Australia... 93	
3.3.2 Australian BJR - s 180(2)	95
3.4 United States of America.....	98
3.4.1 The duty of care in the USA.....	99
3.4.2 The US BJR experiences	101
3.4.2.1 Approaches to and rationale for the BJR	101
3.4.2.2 Purposes of and policy rationale for the BJR in the USA	102
3.4.2.3 US traditional formulations of the BJR	105
3.5 Conclusion.....	107
CHAPTER 4: MODERN STANDARDS OF CARE, SKILL & DILIGENCE IN SA:	109

AN ANALYSIS OF SECTION 76(3) OF THE COMPANIES ACT 71 OF 2008	109
4.1 Introduction	109
4.2 Duty of care, skill and diligence prior to 2008: The need for reform.....	110
4.2.1 The common law duty in SA before 2008	110
4.2.2 <i>King Reports'</i> contribution to law reform	114
4.2.3 Corporate law reform objectives- the DTI Policy Paper 2004.....	115
4.3 The Companies Bill 2007.....	119
4.4 Analysis of s76 (3) (c) of the Act	120
4.4.1 S 76 (3) (c) in context and implications thereof	121
4.4.2 Provisions of s76 (3) (c).....	123
4.4.3 A critical analysis of the standards in s76 (3) (c).....	123
4.5 Reliance and delegation in s76 (4) (b)	135
4.5.1 Common law reliance and delegation	135
4.5.2 Reliance and delegation in ss76 (4) (b) and 76(5)- a commentary	137
4.6 Conclusion	140
CHAPTER 5: BUSINESS JUDGMENT RULE IN SOUTH AFRICA	142
5.1 INTRODUCTION	142
5.1.2 BJR in practice: varying approaches and modern challenges.....	145
5.1.2.1 Modern Challenges associated with BJR.....	146
5.2.1 BJR: A standard of conduct or a standard of review?	154
5.2.2 The BJR: A standard of liability, presumption of good faith in favour of directors or a presumption against judicial review?	156
5.3 SA courts' experience with the BJR, international influence and law reform	159
5.3.1 Business judgment doctrine in SA prior to 2008: the common law	160
5.3.2 The BJR debate and rationale for inclusion in the Act	161
5.4 Analysis of s 76(4)(a) of the Act – BJR provisions	163
5.4.1 Relationship of the BJR to standards of conduct in s76 (3) (b) and 76(3) (c).....	165
5.4.2 The components or requirements of the BJR under s76 (4) (a).....	167
5.4.3 A summary critique of THE BJR provisions in s76 (4) (a)	177
5.4.4 The BJR provisions- Highlighting the positives	180

5.5 South African BJR version in practice—a guide to application and administration	181
5.5.1 Provisions relevant to application of BJR – the legal framework	181
5.5.2 BJR in practice in SA: form, burden of proof & an approach in line with s76 (4) (a)	183
5.6 Conclusion	186
CHAPTER 6: LIABILITY, INTERPRETATION & ENFORCEMENT OF	188
STANDARDS UNDER THE COMPANIES ACT 2008.....	188
6.1 Introduction	188
6.2 Liability of directors and other company officers under the Act	189
6.2.1 Bases of liability for breach of the duty of care, skill and diligence	190
6.2.2 Liability for breach of a fiduciary duty	192
6.3.1 Relevant provisions for interpreting standards	193
6.3.2 Teleological interpretation–Impact of the Constitution’s normative framework.....	197
6.3.2.1 The interpretation clause s39 (2) – ‘the spirit, purport and objects’ of the	198
BOR.....	198
6.4 Enforcement mechanisms for standards & remedies	200
6.4.1 Extended <i>locus standi</i> , derivative action & effect on enforcement	201
6.4.2 Remedies & enforcement of standards under the Act: An overview	204
6.5 Conclusion	206
CHAPTER 7: CONCLUSIONS – SUMMARY AND RECOMMENDATIONS	209
7.1 Introduction	209
7.2 Summary of Chapters: Highlights, Challenges and Opportunities.....	209
7.2.1 The research focus (the legal problem) and Hypothesis.....	209
7.2.2 Conceptual Framework - Directors’ Standards of Conduct and BJR	210
7.2.3 International best practices on standards of care and BJR: Lessons for South Africa?	211
7.2.4 A critical analysis of standards of care, skill and diligence under the Act	219
7.2.5 BJR under the Act – a standard of review.....	220
7.2.6 Legal framework for liability, interpretation and enforcement of standards	222
7.3 Recommendations and proposals for law reform.	222
7.3.1 Proposals for improving standards of care, skill and diligence	222
7.3.2 Proposals for improving standards of review or BJR provisions in s76(4)(a)	223

7.3.3 General Recommendations	223
7.3.4 Recommendations on interpretation of and approach to standards	224
7.4 Concluding remarks: The future of corporate governance in South Africa	226
BIBLIOGRAPHY	228

CHAPTER 1: INTRODUCTION TO STUDY

1. 1 BACKGROUND TO THE STUDY

Decision-making in companies, which implicates the duty to exercise reasonable care, skill and diligence and the business judgment rule (hereafter BJR), has come under an increasing national and global spotlight in recent years. This is attributed to the recent global financial crisis and the evolving international best practices in corporate governance.¹ The credit crunch, which is widely accepted as having been the *sine quo none* of the global financial crisis, was a result of a sustained period of careless and inappropriate lending in the USA banking sector.² The crisis caused major corporate collapses in different parts of the world.³ It has been remarked that the global financial crisis was a corporate governance crisis.⁴ Consequently many countries, including South Africa were spurred to begin to critically consider the effectiveness of directors' standards of conduct especially during decision-making – when business judgments are made. Closer attention was given to investigating whether directors managed companies with the standard of care, skill and diligence that investors legitimately expect of directors in an ever modernising commercial world.⁵

South Africa has now followed the example of nations such as Australia, the United Kingdom (the UK) and the United States of America (the USA) in effecting major corporate law reforms. The earlier *King Report on Corporate Governance for South Africa (Institute of Directors in South Africa, 1994) (King I)* and *King Report on Corporate Governance for*

¹ See A Reisberg 'Corporate Law in the UK after Recent Reforms: The Good, the Bad and the Ugly' (2010) 316 *Current Legal Problems Vol 63* pp315-374; J Cassidy 'Models for Reform: The Directors' Duty of Care in a Modern Commercial World'(2009) 3 *Stell LR* 373-406; M Bekink 'An Historical Overview of the Director's Duty of Care and Skill: From the Nineteenth Century to the Companies Bill 2007" (2008) 20 *SA Merc LJ* 95-116; N Bouwman "Modification of the Director's duty of care and skill" (2009) 21 *SA Merc LJ* 509-534. See also an article by a corporate lawyer in Germany T Zwinge entitled 'Have Directors Duties Of Care And Skill Become More Stringent? What Has Driven This Development? Is this development beneficial- An analysis of the Duty of Care in the UK in Comparison to German Duty of Care, copy which is available at <http://ssrn.com/abstract=1591590> accessed on 10 November 2012.

² McCarthy, C.2009. *The global financial and economic crisis and its impact on Sub-Saharan economies.* tralac Trade Brief 1, available at <http://www.tralac.org/wp-content/blogs.dir/12/files/2011/uploads/TB012009GlobalCrisis20090401Fin.pdf> . Accessed on 22 November 2012.

³ The spate of the world-wide high profile corporate collapses includes Enron, Global Crossing, Xerox and WorldCom in the USA. Australia witnessed collapses of the Bond Corporation group of companies in the 1980s and the HIH group in the 2000s, while Parmalat collapsed in Italy. Masterbond, Saambou Bank and Fidentia were failed businesses in South Africa in the recent past. Bekink (2008) *SA Merc LJ* 95.

⁴ See the *King Report on Corporate Governance for South Africa* (The Institute of Directors in Southern Africa), September 2009 (*King III*). See "Corporate Governance and the Financial Crisis" on p8 of the report.

⁵ Cassidy (2009) *Stell LR* 373.

South Africa, 2002 (*King II*) and international experiences with respect to corporate law reforms gave South Africa the much needed impetus to revise its corporate laws. The publication of a policy paper entitled *South African Company Law for the 21st Century: Guidelines for Corporate Law Reform* (hereafter the DTI Policy Document 2004) ignited the process of the “overall review of company law” in South Africa.⁶ The result of this corporate law review process is a new Companies Act 71 of 2008⁷ (hereafter, the Act) which came to replace the old Companies Act 61 of 1973.

The Act has interesting features and innovations which include the partial codification of directors’ duties (including the duty of care, skill and diligence) and the inclusion of a USA-style BJR.⁸ The Act is in addition to a plethora of other commercial pieces of legislation recently passed by parliament.⁹ It can be said that the Act has opened the door for accelerated modernisation of corporate governance in South Africa.

1.2 Problem Statement and introduction to Research Question

While the provisions of the Act certainly bring something new to South African company law, it is doubtful if the Act has fully met expectations and some of its own stated goals. Of relevance to this thesis is the DTI Policy Document 2004’s stated goal regarding directors’ duties and standards of conduct. This goal is captured as a desire to provide for “a clear, facilitating, predictable and consistently enforced law” which provides a “protective and fertile ground for economic activity”.¹⁰ It appears that the objective here was to present clear, ascertainable, unambiguous and easily enforceable directors’ common law duties under s 76(3)(a)-(c) of the Act (a statutory statement of directors’ duties). The sub-goal of partial as opposed to total codification was to avoid stunting growth of the common law fiduciary duties and the duty of care, skill and diligence. This would allow for continued incremental development of the common law directors’ duties through application by courts of law to different arising situations.¹¹ It has been correctly stated that directors’ common law duties

⁶ GN 1183 in GG 2004-06-23.

⁷ GN 421 2009 in GG 32121, April 2009.

⁸ Cassim FHI “The Challenge of Treasury Shares” in Mongalo TH (ed) *Modern Company Law for a Competitive South African Economy* (Juta Cape Town 2010) 151-164.

⁹ Examples include the Financial Intelligence Centre Act 38 of 2001, the Securities Services Act 36 of 2004, the Auditing Profession Act 26 of 2005, the National Credit Act 34 of 2005, the Consumer Protection Act 68 of 2008 and the Financial Markets Act 19 of 2012.

¹⁰ DTI Policy document 2004.

¹¹ D Ahern ‘Directors’ duties, Dry Ink and the Accessibility Agenda’ (2012) 128 *L.Q.R* 114-139. Also see *Carmichele v Minister of Safety and Security (Centre for Applied Legal Studies Intervening)* 2001 4 SA 938 (CC).

have “endured remarkably, subject to incremental refinement by the courts to meet new factual scenarios and changing societal expectations”.¹²

Whether s 76(3) of the Act can be said to have made the statutory statement of directors’ common law duties “a clear” or “facilitating” law remains debatable due to some ambiguous presentation of the provisions in that part of the Act. It is also seriously doubted if the law is now readily ascertainable and in particular, if the standards of care, skill and diligence have been clarified, going forward.¹³

At a first reading of s76, the reader gets a sense that the section is drafted ambiguously and thus raises a number of questions of clarification. To begin with, it is very doubtful if s76 is correctly titled. The heading of the section reads ‘Standards of directors’ conduct’. While this aptly captures the standards contained in s 76(3) (a) –(c), it is not clear why the legislature categorised s76 (4) (a) as a standard of conduct. S 76(4) (a) is a South African statutory version of the BJR.¹⁴

As aforementioned, another major question which needs to be answered concerns the clarity of directors’ standards of care, skill and diligence. S 76 (3) (c) of the Act does not appear to have been presented in a manner that clarifies and improves the relevant standards of conduct expected of directors in a modern South Africa. The intention of the legislature with regards to the duty of care, skill and diligence is unclear. In fact, it appears to be difficult to reconcile the lofty objectives of law reform plus the purposes of the Act¹⁵ on one side and the now statutory standards of care, skill and diligence on the other side. The exact standards, by which the duty was measured at common law, were not clear.¹⁶ Thus one major law reform objective was to develop a “clear, facilitating, predictable and consistently enforced law”.¹⁷ In this context, the Act appears to have intended to introduce high standards of corporate governance under the Act.¹⁸ By implication, clarifying and improving standards of care, skill and diligence had to be part of this goal because it is the duty of care that needed to have clearer standards.¹⁹

¹² Ahern (2012) *L.Q.R* 114-115.

¹³ See Cassidy (2009) *Stell LR* 404. Also see K H Lindsay “Codification of directors’ duties- Between the devil and the deep blue sea”, available at <http://www.hrfuture.net/governance/codification-of-directors-duties.php?Itemid=153> (visited on 25 November 2012).

¹⁴ See part 5.4.1 of Chapter 5 for proper characterisation of the BJR.

¹⁵ See s7 for purposes of the Act.

¹⁶ Bekink (2008) *SA Merc L.J* 95. Part 4.2.1 of Chapter 4 further canvasses this point.

¹⁷ See the *Explanatory Memorandum to the Companies Bill, 2007*, at p3.

¹⁸ See s7(b) (iii) of the Act.

¹⁹ See HS Cilliers, ML Benade, JJ Henning, JJ du Plessis, PA Delpont, L de Koker & JT Pretorius *Corporate Law* 3 ed (2000) at 147

Related to the question of clarity highlighted above is the question of exactly what test is now applicable to the statutory duty of care, skill and diligence under the Act. From the manner that s76 (3) (c) is drafted, it is not crystal clear whether an objective test is intended to apply. Is the subsection comparable to the dual objective/subjective standards applicable under the current English statutory law?²⁰ Was the Act designed to be declaratory of the common law without any statutory modification of the duty of care? The judiciary is likely to face difficulties in interpreting the purpose of s76 (3)(c) in the absence of any indication under s76 as to whether the Act intended to modify common law or not.

Yet another question which needs to be answered relates to the status of the statutory duty of care vis-à-vis the common law. The inquiry is whether legislative standards of conduct should operate in place of, in addition to, or whether they override the common law. This could potentially lead to confusion in given scenarios if for example, the content of the statutory duty of care is to be found to be more advanced than the common law. The language employed in formulating s76 (3)(c) is not crystal clear in these respects. This presents difficulties in assessing whether the Act improves the standards of care, skill and diligence, and could thus facilitate more effective enforcement.

Closely related to the grey areas pointed to in the paragraph above is the need to establish clarity regarding the exact relationship between s 76(3) (b) – (c) and s 76 (4) (a) of the Act. It is widely accepted and recognised that s 76 (4) (a) of the Act is an incorporation of the USA-style BJR,²¹ despite the Act not referring to or even defining the concept ‘Business Judgment’. The first question that needs to be answered is whether the application of the BJR will have the effect of limiting the effectiveness and enforcement of the duty of care, skill and diligence. This work will investigate whether the BJR may have the opposite effect of enhancing the standards of corporate governance in South Africa.

A double-edged question with regards to adoption of the BJR under the Act relates to an inquiry into the scope, content and rationale for BJR in South Africa. With regards to scope of application of the BJR under s76 (4) (a), it is not clear whether the BJR has general application, whether it applies in certain situations only and does not apply to other situations. In the USA where the rule originated in the state of Delaware as state case law, the rule is

²⁰ That is under s174 of the Companies Act 2006 to be discussed in Chapter 3. See part 3.2.

²¹ Cassim et al *Contemporary Company Law* 2nd ed (2012) 563.

mostly applicable in take-over defences.²² The statutory position in South Africa regarding the application of the BJR remains unexplained and therefore unclear.

In the future interpretation and application of the BJR by the courts, spotlight will likely fall on the content of the rule. This thesis seeks to lead a discussion about and proposes to proffer suggestions on interpretation and application of the rule. This discussion is in form of the question as to why the South African version of the BJR specifically relates to subsections 76(3) (b) and (c) only. *Prima facie*, the rationale for the exclusion of good faith requirements²³ from the content of the rule is inexplicable. Traditionally, the BJR relates to the triads of the fiduciary elements of good faith and loyalty to the company as well as process due care in decision-making.²⁴

Another interesting point to note is that while South Africa has incorporated the BJR under the Act, the rule is not the subject of a statute in the USA²⁵ and remains uncodified to this day.²⁶ Two USA attempts to codify the rule in a statute failed.²⁷ The rule is only the subject of a provision in the American Law Institute Principles of Corporate Governance (the ALI Draft) and the Delaware courts formulation of the rule.²⁸

1.3 Key Research Question and sub-inquiries

The central question in this study is whether the Companies Act 2008 has adopted clearer, improved and more effective standards of directors' conduct in light of s76(3)(c) and the adoption of the BJR under the Act. Put differently, the question is whether the new Act can be said to have made the standards of care, skill and diligence more accessible, clearer, ascertainable and more enforceable in light of the incorporation of the BJR than prior to 2008, in a manner that enhances corporate governance in South Africa.

Answers to the following sub-enquiries will provide building blocks towards finding answers to the central research question:

1. What *lacuna* (gap in law) did the Act seek to close through the reforms in standards of care, skill and diligence and by adopting the BJR?

²² J Farrar "Directors' duties of care: Issues of Classification, Insolvency and Business Judgment and the Dangers of Legal Transplants" (2011) 23 *SACLJ* 745-761.

²³ See s76 (3) (a) of the Act.

²⁴ See part 5.2.1 of Chapter 5 below.

²⁵ Farrar (2011) *SACLJ* 761.

²⁶ D Branson "The Rule that isn't a Rule- The Business Judgment Rule" (2002) 36 *Val.U.L. Rev* 631-654.

²⁷ See D Botha & R Jooste "A critique of the Recommendations in the King Report regarding a Director's Duty of Care and Skill" (1997) *SALJ* 65-76; and Farrar (2011) *SACLJ* 761.

²⁸ See Branson (2002) *Val.U.L. Rev* at 634.

2. Are there international best practices relating to reforms of the duty of care, skill and diligence and the BJR? Are there any lessons for South Africa?
3. Does s 76 (3) (c) introduce a purely objective test, a dual objective/subjective test or an even lower test for the duty of care and skill? How appropriate is this test for improving clarity and enforcement of the standards in light of adoption of the BJR?
4. What is the content, rationale and scope of application of the BJR under the Act?
5. Does s 76(4) (a) have the effect of limiting the application of s 76(3) (c) and weakening the standards or could it have the opposite effect? Could the BJR have the effect of blurring the fiduciary duty and the duty of care?
6. Has the Act put in place mechanisms to ensure more effective interpretation, application and enforcement of the standards of care, skill and diligence than before?

1.4 Brief literature review, justification of Study & gaps in knowledge

The purpose of this section is to give a brief literature review on the opinions of major writers on the main questions relating to the directors' duty of care, skill, diligence and the BJR in South Africa in light of the new Act. The methodology in this part is to briefly state the views expressed by the leading writers, showing points of convergence and divergence. Any gaps in the existing body of knowledge and questions which still need further inquiry or alternative view- points will be identified. These will serve as justification for this Study.

The duty of care is vital to the development of corporate law in South Africa. It has been correctly submitted that 'the duty of care and skill is of paramount importance as it applies to all decisions directors make or should make were they to exercise their powers to the benefit of the company and its shareholders'.²⁹ It is of great significance to the development of jurisprudence that at a time when there is a new law on directors' duties in South Africa, a PhD Study is devoted to a critical analysis of the standards of care, skill, diligence and the BJR under the Act. Other writers have certainly expressed views on the state of the law prior to the Act, while a few have attempted a review of the law after the enactment of the Act. It is argued in this part that there are still gaps in the law – making it necessary to further inquire into the state of directors' standards of care, skill, diligence and the BJR post the Act.

The conceptual framework (Chapter 2) attempts to deal with the themes on foundational principles underpinning decision-making by directors (that is duty of care and

²⁹ Bekink (2008) *SA Merc LJ* 95.

the BJR). This includes definitions of key terms and concepts to be covered in this Study. Views have been expressed on these issues by South African and international writers. For example on corporate governance, Marie-Esser & Delpont,³⁰ Bekink³¹ and Bouwman³² agree that directors' duties fall under corporate governance. It is further agreed that contemporary principles of corporate governance have played a key role in informing the need for and shaping the content of modern day standards expected of company directors. The aforementioned South African authors are also in agreement as to the role of the *King Reports* in fostering the highest standards of corporate governance in South Africa.³³ Bouwman in particular demonstrates the importance of the *King Reports* in contributing to development of jurisprudence in the country on key issues such as directors' standards of care, skill and diligence.³⁴ The author further points out how the *King II* report in particular dealt with the contentious question on whether at law the role of the non-executive and executive directors should be distinguished. Bouwman remarks that though a distinction is drawn between the executive and non-executive directors of the company, both are bound by the duty of care and skill. The author does not clarify as to whether there is a differentiation of the standards expected of these two types of directors.³⁵ These are two issues which are not yet trite law in South Africa even post the new Act.

It is accepted by leading authors that the paramount duty of company directors in South African law is loyalty to the company by observing utmost good faith towards the company and to act in the best interests of the company. While discharging this responsibility, a company director is expected to, without fail, act with the necessary care, skill and with due diligence.³⁶ That makes the duty of care critical and even central to the proper and lawful discharge of directorial responsibilities.

With respect to whether South African law insists that there should not be a blurring of the distinction between the fiduciary duty and the duty of care, there appears to be both points of convergence and divergence among authors. For the reason that the BJR by its nature and origin potentially muddles the distinction between the two duties, its adoption under s 76(4) (a) has revived this debate. It was clearly trite before the new Act that in South Africa, a common law duty of care, skill and diligence is separate and distinct from a

³⁰ I Esser & P Delpont "The Duty of Care, Skill and Diligence: The King Report and the 2008 Companies Act" (2011) 74 *THRHR* 449-455.

³¹ Bekink (2008) *SA Merc LJ* 95-116.

³² Bouwman (2009) 21 *SA Merc LJ* 509-534.

³³ See Esser & Delpont (2011) *THRHR* 449.

³⁴ Bouwman (2009) 21 *SA Merc LJ* 518.

³⁵ *Ibid.*

³⁶ See Bekink (2008) *SA Merc LJ* 100.

fiduciary duty. Those who wish to maintain the distinction between the composite duty of care and the fiduciary duties have already criticised the Act for having blurred the celebrated distinction between fiduciary duties and the duties of care, diligence and skill.³⁷ This gives rise to the debate as to whether it is still necessary and possible to maintain the distinction between these two common law duties in light of the inclusion of the BJR under the Act.

In South Africa, strong views have been expressed as to why the fiduciary duty and the duty of care are different and should remain distinct.³⁸ Equally strong counter arguments as to why the distinction between the two duties could be considered superfluous given possible overlaps between the two duties have been proffered. Bouwman strongly believes that the fiduciary duties and the duty of care should never be confused in South African law in the same manner they were “forced together under the heading ‘fiduciary duties’ ” in the USA.³⁹ Bouwman further argues, without giving clear reasons, that if the duties are not kept distinct, confusion will be created in their application, and this may lead to directors’ being able to escape liability for the breach of their duties.⁴⁰ Jones agrees with Bouwman that adoption of the BJR by the new Act threatens to distort the celebrated distinction of these two common law duties and is undesirable.⁴¹ McLennan has a different opinion to that of Bouwman or Jones. He observes that there is no “sharply delineated borderline between the fiduciary duty and the duty of care and skill”, and even adds that “situations may arise where the two [duties] overlap”.⁴² The BJR, in this construction is viewed as providing such a perfect situation for potentially blurring the distinction between the duties.⁴³ Therefore the question as to whether there is scope for conflation of the fiduciary duty and the duty of care under the Act needs to be investigated and debated in the light of the statutory adoption of the

³⁷ See Cassim *Contemporary Company Law* 564. Also see Jones (2007) *SA Merc LJ* 327.

³⁸ Some of the differences between the fiduciary duties and the composite duty of care and the fiduciary duties includes the different origins and basis of liability. With regards to origin there seems to be little difference between the two duties. Fiduciary duties have been connected to the Roman-Dutch law by Innes CJ in his judgment in *Robinson v Randfontein Estate Gold Mining Co* 1921 AD 178 & 289, but content of the duty has been developed with reference to English Law –see *Osry v Hirsch, Loubser & Co* 1922 (CPD) 548. The duty of care in SA is derived from Roman-Dutch law and content has been given to it by English law. Liability for breaching duty of care is founded on delict and the Lex Aquilia – see *Ex Parte Lebowa Development Corporation Ltd* 1989 (3)SA 71 (T) . The cause of action for breach of a fiduciary duty, however, is not founded upon delict or contract, but is said to be *sui generis* (unique) – see the view expressed by Kotze JA in this regard in *Sackville West v Nourse* 1925 AD 516 533-536.

³⁹ Bouwman (2009) *SA Merc LJ* 531

⁴⁰ *Ibid.*

⁴¹ See E Jones “Directors’ Duties: Negligence and the Business Judgment Rule” (2007) *SA Merc LJ* 327.

⁴² JS McLennan “Duties of Care and Skill of Company Directors and Their Liability for negligence” (1996) 8 *SA Merc L.J* 94-102 at 95.

⁴³ *Ibid.* Cassim has added the growing voices in this regard and also observes that “section 76(4) blurs the distinction between the fiduciary duties and the duty of directors to exercise reasonable care and skill”, see Cassim *Contemporary Company Law* 564. Note to Examiner 3: The author indeed makes this comment on p564. Please check the book and the page again.

BJR in South Africa. It is however, my preliminary view that unlike the situation in the state of Delaware in the USA, s76 of the Act cannot be read to have opened the door for conflation of duties in the context s76 (4) and review of director's decision-making.

On standards of care, skill and diligence, most authors writing prior to the passing of the Act, agreed that the common law provided low and inadequate standards of care and skill, which was the result of an inheritance from English case law. Bouwman correctly states that English courts initially followed a lenient approach in holding directors accountable for breach of their duty of care and skill.⁴⁴ It is agreed by most writers that through passage of time, the test for breach of the duty developed beyond the entirely subjective test, to an objective/subjective test. This was especially the case with the passing of s 214(4) of the UK Insolvency Act 1986.⁴⁵ Esser & Delpont⁴⁶ note that the main limitation of the dual objective/subjective test applied at common law by English courts was that with respect to care, the minimum standard was always the lower of the two. McLennan submits that the UK position compared well with the position under South African common law and that the s 214(4) test correctly reflects our common law position.⁴⁷ It is important to point out that there is also general agreement that the test for skill under common law has always been low and subjective. This is the legacy of *Re City Equitable Fire Insurance Co Ltd*⁴⁸ and *In Re Brazillian Rubber Plantations and Estates Ltd*⁴⁹ which cases have been said to have allowed for lax standards of skill among company directors. This led Finch to argue that the common law operates to give directors a remarkable freedom to run companies incompetently.⁵⁰ Finch focused on effective enforcement of the duty of care and skill, and was concerned that only gross negligence as opposed to mere negligence was punishable.

Views have been expressed regarding the adequacy, clarity and effectiveness of the standards of care, skill and diligence under the Act. Even prior to the Act, authors agreed that the standards by which the required degree of care and skill are measured were not clear.⁵¹ This is the anomaly which the DTI Policy document 2004 sought to correct. Post-mortem reviews have attempted to establish the exact standards introduced into South African

⁴⁴ Bouwman (2009) *SA Merc LJ* 511.

⁴⁵ See McLennan (1996) *SA Merc LJ* 97; Bouwman (2009) *SA Merc LJ* 512. Also see *Re D'Jan of London Ltd* [1993] BCC 646 and *Norman & another v Theodore Goddard (a firm) & others (Quirk, third party)* [1991] BCLC 1028 (CLD).

⁴⁶ Esser & Delpont (2011) *THRHR* 453

⁴⁷ McLennan (1996) *SA Merc LJ* 101.

⁴⁸ [1925] Ch 407.

⁴⁹ [1911] 1 Ch 425.

⁵⁰ V Finch "Company Directors: Who Care About Skill and Care?" (1992) 55 *The Modern Law Review* 179-214 at 179.

⁵¹ Bouwman (2009) *SA Merc LJ* 510. Also see Cilliers and Benade *Corporate Law* 3 ed 141.

company law by the new Act. To what extent the policy goal of presenting clear and easily enforceable standards has been achieved by the new Act remains highly debatable. There are points of convergence and divergence in this regard. Du Plessis⁵² who served as a member of the International Reference Group in the drafting of the Act indirectly admits that the framing of s 76(3)(c) could be problematic. Du Plessis seems to tacitly admit that the phrase “having the general knowledge, skill and experience of that director” in s 76(3)(c)(ii) could have the effect of lowering the standards of “skill” expected of South African company directors.⁵³ The author however defends the appropriateness of this subsection. He argues that this is necessary to avoid a situation where, if standards are pegged too high, it may act as a barrier to competent people accepting directorships of companies. Some authors counter argue that despite such fears as expressed by du Plessis, in South Africa and elsewhere, there has not been a shortage of people who have gone ahead to take up directorships in companies. Botha and Jooste⁵⁴ argue that fears such as expressed by du Plessis are based on misunderstanding of the law, which led others to advocate for a lightening of the duty of care and skill, and the introduction of the BJR as a safe harbour for directors.

Cassidy opines that there are problems of clarity in section 76(3)(c), due to serious omissions which creates ambiguity in the provisions and that there are challenges of divergence of standards of care and skill at common law and now in the statutory law.⁵⁵ I share these views. Cassim *et al*,⁵⁶ while noting that the new Act has introduced innovation, that the goal of making duties accessible might have been achieved and that it has modified the common law, is not convinced that the Act has made the law clearer and ascertainable. Cassim *et al* bemoan the “uneasy and uncertain combination of statutory law and still evolving judicial precedent”.⁵⁷ Bouwman appears satisfied with the choice of partial codification as opposed to total codification. She argues that it allows courts to “reach for answers in the treasure chests of the common law where the statute cannot provide us with guidance or an answer in a set of complicated factual circumstances”.⁵⁸ The only question that remains to be answered according to Bouwman with regards the duty of care, skill and

⁵² JJ Du Plessis “ A comparative analysis of directors’ duty of care, skill and South Africa and Australia” (2010) 1 *Acta Juridica* 263-289.

⁵³ *Ibid* at 287.

⁵⁴ Botha & Jooste (1997) *SALJ* 65-76.

⁵⁵ Cassidy (2009) *STELL LR* at 376-386.

⁵⁶ Cassim *et al* *Contemporary Company Law*

⁵⁷ *Ibid* at 508.

⁵⁸ Bouwman (2009) *SA MercLJ* 533.

diligence is whether the statutorily codified duties and the common law will co-exist and function successfully.⁵⁹ This is one of the questions that this study also seeks answers to.

There are certainly gaps in law which necessitate further inquiry into the exact statutory standards of care, skill and diligence introduced into South Africa by the Act. For example, it is unclear whether s 76(3)(c)(ii) has the effect of undermining the objectivity of standards of care under s 76(3)(c)(i) in any way or whether the subjectivity in s 76(3)(c)(ii) only affects the test for the “skill” component of the duty. The author is unaware of any recent work which has adequately dealt with such questions. The question regarding the exact relationship between the statutory duty of care, skill and diligence in s 76(3)(c) and the BJR under s 76(4)(a) also still needs to be answered.

Yet another gap in the existing body of knowledge requiring attention of research is the question of ensuring the effectiveness of the standards of care, skill and diligence through enforcement. It is not enough to say that standards of care and skill must be improved. Once such high standards of corporate governance have been established, they will need to be enforced. This implicates matters of liability for breach of the statutory and common law duties of care, skill and diligence, and an exploration of enforcement mechanisms established by the Act. This is partly the focus of Chapter 6 of this Study.

It remains unclear as to whether South African law accepts that there should be a differentiation at some point in the standards of care and skill expected of executive full-time and non-executive directors. This question has to be asked given the confusion brought into our common law by the seeming conflicting views by courts in two very important cases. In *Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd*⁶⁰ the court expressed a view that because a director’s duty *inter alia* depends on the nature of the particular obligations assumed or assigned to the director, there is a difference between the so-called executive director and a non-executive director. In *Howard v Herringel NNO*⁶¹ the Appellate Division regarded it as being unhelpful or even misleading to classify company directors as executive or non-executive for purposes of ascertaining their duties to the company. The Court in the latter case remarked that the rules are the same for all directors. Interestingly even this Court acknowledged that all relevant factors need to be taken into account, including whether the director is engaged full-time or part-time in the affairs of the company..

⁵⁹ Ibid.

⁶⁰ *Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd* (supra)

⁶¹ (1991) (2) SA 660 (A).

The reading of the two cases referred to above can lead to a *prima facie* conclusion that there should be a minimum irreducible standard of conduct which is not the same as a uniform standard. Such a standard takes into account the peculiarities of the directorship held. The significance of the research in this regard is that it will propose how the law can bring clarity to these important questions which have occupied academic debates and remain unresolved at this stage. This work intends to build upon the foundation of knowledge already available and to make a significant contribution to the body of existing knowledge as proposed herein.

Drawing upon the experiences of countries such as Australia⁶² and the UK, the South African academic articles were fiercely critical of the introduction of a USA-style BJR.⁶³ Prior to the adoption of the Act, most academic commentators concurred that the USA-originated the BJR was unnecessary and unsuited to the peculiarities of the Roman-Dutch legal system in South Africa, which system also boasts a heavy English law influence in its company laws.⁶⁴ As a consequence of the distinction between a fiduciary duty and the duty of care, the basis for founding liability for breach of each of the duties is different. There were perhaps genuinely mistaken fears that the BJR, viewed as a “legal transplant” from America,⁶⁵ posed risks of incompatibility with South African law. Unlike South African law’s mixed legal system, USA law has a pure common law foundation.⁶⁶ Now and contrary to views and suggestions from prominent South African academic writers, a statutory version of the rule has become part of the Act.⁶⁷

Writers like McLennan, Jones and co-authors Botha and Jooste argued prior to the adoption of the BJR under the Act that the rule was unsuited to South Africa. Yet little has been done to investigate how this rule evolved in the USA, how and why it’s original purpose and application may be unsuited to South Africa. Farrar has criticised countries such as Australia and South Africa who have to date statutorily adopted the BJR. Farrar criticises these countries’ failure to do enough research on the operation of the rule in the US in order to gauge if the application of the rule into local conditions should not be tampered with to suit the peculiar conditions in the importing jurisdiction.⁶⁸ Little has also been written about the alternative incremental development of the rule, something akin to how the common law

⁶² Australia was probably the first country to adopt the US-style BJR in a statute in s180(2)(a)-(d) of the Corporations Act 2001. See Farrar (2011) *SAC LJ* 756-760.

⁶³ See Havenga (2000) *SA Merc LJ* 25- 37 & Bouwman (2009) *SA Merc LJ* 531.

⁶⁴ See Botha & Jooste (1997) 62 *SALJ* 65-76.

⁶⁵ *Ibid* at 70-74.

⁶⁶ See Bouwman (2009) *SA Merc LJ* 530-531; McLennan (1996) *SA Merc LJ* 100.

⁶⁷ Jones (2007) *SA Merc LJ* 326.

⁶⁸ See Farrar (2011) *SAC LJ* 761.

duties developed in South Africa before partial codification under the Act. There is need to investigate how the rule could be better utilised in South Africa to enhance the standards of corporate governance without unnecessarily “stifling innovation and venturesome business activity” in companies.⁶⁹ Potential to strike such a balance exists if courts adopt a purposive approach to the interpretation of s 76(3) and s 76(4)(a) when applying these provisions to a given situation, taking into account the spirit, purposes and objects of the Act.⁷⁰

1.5 Purpose of the Study

The following are the goals which the study sets out and hopes to achieve:

- (i) To identify the gaps which the new Act was expected to fill with respect to the duty of care, skill and diligence in South Africa, and to further identify the lacuna which it was proposed that BJR comes to close.
- (ii) To establish if the partial codification of directors’ common law duties under the Act has achieved the legislature’s stated goals of providing clarity with regards to standards of care, skill and diligence now contained in section 76(3)(c) of the Act.
- (iii) To critically analyse the provisions of sections 76(3) (c) of the Act in the light of international best practices with regards to the standards of care, skill and diligence. To further propose ways in which standards can be further clarified, and to investigate ways of improving enforcement of the standards.
- (iv) To provide a critical analysis of the adoption of the BJR under section 76(4) (a) of the Act in light of experiences from legal systems such as Australia, the UK and the USA.
- (v) To inquire into and establish the nature of the relationship between sections 76(3)(b) and (c) and section 76(4)(a). In other words, the aim is to find out if the incorporation of the BJR under the Act has the effect of limiting the application of the duty of care or whether it rather enhances corporate governance by promoting high standards of conduct.

1.6 Scope and delimitation of Study

This study focuses on directors’ standards of care, skill, diligence and the BJR under section 76 of the Act. Any other common law and statutory duties of directors which have no

⁶⁹ American Law Institute *Principles of Corporate Governance and Structure: Restatement and Recommendations* (1982), as adapted from P Lipton & A Herzberg *Understanding Company Law* 6th ed (1995) at 393, quoted in Havenga (2000) *SA Merc LJ* 28.

⁷⁰ S 5 provides for a purposive interpretation of the Act. Also see s7 which lists the purposes of the Act. Further see s158(b).

bearing on these selected standards of directors' conduct fall outside the scope of this study. Such duties are only referred to where relevant for purposes of this study. The purpose of the thesis is to evaluate the position of the standards of care, skill and diligence post the Companies Act 2008, as well as the implications of the inclusion of the BJR. This may involve a cursory reference to the common law relating to the selected standards, but the intention is not to provide a detailed study of the history of common law directors' duties. Cursory reference will be made to the partially codified directors' duties implicated in this study. It is nonetheless not the aim of this study to give a detailed discussion of the merits and demerits of codification of directors' duties under the Act.

It was initially considered to look at directors' duty of care in specific contexts such as during take-overs and the standards of care expected of company directors when the company is in the zone of insolvency and a possible duty to care for the environment. However, it has since been considered prudent to exclude these matters from the thesis as there is little room to adequately deal with them. This thesis will suggest these matters as fertile ground for future or further research by would-be researchers.

1.7 Methodology

This study adopts a methodology of analysing relevant South African legal principles contained in the primary and secondary sources of law applicable to the scope of study. Comparative studies with international best practice nations will also be done, and nations will be selected for their comparative values. The Constitution of South Africa 1996 provides legitimacy to the use of comparative materials in this Study. Section 39 (1) (b) –(c) encourages the use of public international law and foreign law which deal with comparable provisions to the Act to serve as tools of interpretation.⁷¹ This approach promotes harmonisation of public international law with South African domestic law as will be further clarified in Chapter 6, especially part 6.3.

England (UK) has been selected for the reasons that South African company law has inherited English principles relating to directors' duties. The UK recently revised its corporate laws and enacted the Companies Act 2006. Interestingly, the UK resisted the temptation to adopt a USA-style BJR whereas South Africa elected to. Australia has been selected for two main reasons. Firstly, Australia has revised its corporate laws resulting in the Corporations Act 2001, and is believed to have influenced South Africa's codification of

⁷¹ Further see s233 of the Constitution. Also see *S v Makwanyane* 1995 (3) SA 391 (CC) paras 36-37.

directors' duties as well as the adoption of the BJR. Secondly, Australia has already had its standards of care, skill and diligence tested in recent cases.⁷² South Africa can derive lessons from this experience. The USA's comparative value stems from the fact that the US is credited with originating the BJR.

⁷² See *Australian Securities and Investments Commission v Healey and Others* [2011] FCA 717, *Australian Securities and Investments Commission v Healey and Others* (No.2) [2011] FCA 1003 (Federal Court of Australia, Middleton J, 27 June 2011, 31 August 2011).

CHAPTER 2: DIRECTORS' STANDARDS OF CONDUCT & THE

BUSINESS JUDGMENT RULE – A CONCEPTUAL FRAMEWORK

2.1 INTRODUCTION

The purpose of this Chapter is to lay down the foundational principles relating to company directors' composite duty of care⁷³ and the BJR. The Act places a premium on promotion of high standards of corporate governance 'given the significant role of enterprises within the social and economic life of the nation'⁷⁴ of South Africa. Directors inevitably have to make key or strategic decisions when directing the business or affairs of the company.⁷⁵ Such decisions affect both the company and the many stakeholders associated with the enterprise. Thus, decision-making is undoubtedly central to the role fulfilled by the board in the governance of corporations. In order to make real the Act's vision of high corporate governance standards, decision-making has to be punctuated by appropriate care, meticulousness or attention to detail and competence. A corporate decision made by the board may have disastrous results despite the board's good intentions or the integrity of the decision-making process. In such a case, the BJR now applies under the Act to protect honest directors against liability where due care process was followed. Central to this study is an inquiry into the effectiveness of standards of care, skill and diligence of directors established by the Act in light of the inclusion of the BJR provisions.⁷⁶

The chapter begins by defining key concepts relevant to the study such as corporate governance, the BJR and company director inter alia.. Thereafter, the chapter will consider the regulation of corporate governance in South Africa. The interaction between standards of care, skill, diligence and the BJR under the Act is a governance issue and the discussion of the central question in the study has to be located within proper context. It is also considered vital in this chapter to clarify the nature of the relationship between the company and a director in light of relevant theories on the nature of the company as espoused in literature. As part of the nature of the director-company relationship, Chapter 2 will also briefly

⁷³ The term 'duty of care' is normally used as a composite term for the full spectrum of the duty, that is, the duty of care, skill and diligence. The Act uses the full spectrum of the duty. See s76(3)(c).

⁷⁴ See s7(b) (iii) the Act.

⁷⁵ See s66(1) of the Act.

⁷⁶ See s76(4) (a) of the Act.

examine the legal status of a company in South Africa. The chapter will also briefly look at the relationship between the duty of care and the BJR, before the conclusion to the chapter.

2.2 Definitions and introduction of key concepts

2.2.1 Corporate Governance

The importance of corporate governance to this Study is to be seen in the fact that the central focus implicates the standards of corporate governance in South Africa in light of relevant provisions of the Act. The recent global financial crisis has been credited for being one of the catalysts in the incremental development of the concept.⁷⁷ Throughout the world, there is an acknowledgement of the critical role of corporations in the global market economy.⁷⁸ As has been correctly acknowledged, corporations are responsible for the control and management of a sizeable quantity of the world's wealth and other resources.⁷⁹ It is little wonder there is heightened attention on development of the concept of corporate governance following recent global corporate failures.⁸⁰ In South Africa, the importance of corporate governance has been underscored by the judiciary. The court in *Minister of Water Affairs and Forestry v Stilfontein Gold Mining* made an important observation. It remarked that the practice of sound corporate governance is essential for the well-being of companies.⁸¹ Integrity of the leadership role of directors in companies in the decision-making process has been held to be a critical principle underpinning corporate governance in South Africa.⁸² Thus corporate governance provides a conceptual framework for directors' standards of care, skill and diligence and the BJR (decision-making aspects).

2.2.1.1 Meanings of corporate governance

There is a multiplicity of opinions regarding what constitutes corporate governance. This could be attributed to the fact that corporate governance is complex. Some commentators even claim that it is undefinable,⁸³ and that there are no hard and fast rules that constitute corporate governance.⁸⁴ The concept involves an intersection of often competing multi-stakeholder interests, and thus by its very nature, is laden with tensions. Not least of

⁷⁷ See part 1.1 of Chapter 1.

⁷⁸ See Cassidy (2009) *Stell L.R* 373.

⁷⁹ Du Plessis, Hargovan & Bagaric (eds) *Principles of Contemporary Corporate Governance* 2ed (2011) 3.

⁸⁰ See part 1.1 in Chapter 1.

⁸¹ 2006 (5) SA 333 (W), see para 16.7

⁸² See *South African Broadcast Corporation Ltd v Mpofu* [2009] 4 All SA 446 at 447.

⁸³ See Du Plessis et al *Contemporary Corporate Governance* 3.

⁸⁴ *Ibid* at 5.

such difficult-to-resolve tensions is the directors' task to balance the profit-making objective of corporations, need for accountability and the interests of the wider community.⁸⁵ Different people attach different meanings to corporate governance. This has led to the concept becoming so malleable and elastic to the extent of falling prey to the idiosyncrasies of the person defining it. While there may not be a universally agreed upon definition of corporate governance, there are shared fundamentals regarding how directors are expected to carry out their responsibilities in a company. This will be illustrated through the few definitions to be considered below and a contribution to the meaning of corporate governance to be proffered by this study.

A definition of corporate governance by Bob Tricker⁸⁶ demonstrates the different viewpoints within the concept. Tricker defines the concept as falling under the following perspectives; an operational perspective,⁸⁷ a relationship perspective,⁸⁸ a stakeholder perspective,⁸⁹ a financial economics perspective⁹⁰ and a societal perspective.⁹¹ Each perspective focusses on the matter of major concern to the person defining corporate governance as a concept and shows an understandable level of bias. The examples of attempts at defining the concept show both strengths and limitations of each perspective, and reveal a possible incremental development of the concept from the 1990s till the present day.

The most popular definition of corporate governance during the 1990s is the perspective adopted by the UK's Cadbury Report⁹² as well as the *King II Report*. This perspective views corporate governance as "the system by which companies are directed and controlled".⁹³ The definition focusses on governance structures, processes and practice.

⁸⁵ Ibid at xxv.

⁸⁶ Tricker B *Corporate Governance: Principles, Policies and Practices* 2ed (2012) 4.

⁸⁷ The operational perspective focusses on governance structures, processes and practices of corporate governance. The idea of best practices in the interaction of the board, the shareholders and management, as well as the emergence of the corporate governance codes such as the King Codes of Corporate Governance in South Africa, are by-products of the influence of the operational perspective. Ibid.

⁸⁸ A relationship perspective looks at the relationship amongst various participants in corporate governance. There is probably no closed list among the participants, but to date, the following participants have featured prominently in definitions based on this perspective; shareholders, company management, the board of directors, employees, the community, creditors to a certain extent and the environment. Ibid at 30.

⁸⁹ A stakeholder approach is not conceptually different from the relationship perspective, save for the fact that it takes a wider view of those involved and affected by corporate governance. Ibid.

⁹⁰ The main concern of this perspective is the ownership of capital in corporate governance systems and the legal protection afforded to investors. Ibid at 30.

⁹¹ The Societal perspective has been described by Tricker as one such perspective which sets corporate governance "at a high level of abstraction" as it attempts to include a broad spectrum of stakeholders in and outside the corporation who could be affected by or have a vested interest in corporate behaviour. Ibid.

⁹² *Report of the Committee on The Financial Aspects of Corporate Governance* (the Cadbury Report), (published on 1 December 1992, Gee and Co. Ltd).

⁹³ See Du Plessis *et al Principles* op cit 10 at 3, quoting an earlier definition of corporate governance preferred by the *King I Report*, as well as the Cadbury Report 1992, *ibid*.

Similarly, the Organisation for Economic Co-operation and Development (hereafter OECD) defines corporate governance as being “...about the procedures and processes according to which an organisation is directed and controlled”.⁹⁴ The OECD definition demonstrates a consciousness of the broader context in which corporate governance is practised.⁹⁵ These two definitions may be classified under an operational perspective. An operational perspective views the company board as being primarily responsible for the governance of companies. The role of shareholders in this regard being to appoint the board, the auditors and ensuring checks and balances in the running of corporations.⁹⁶

A relationship perspective looks at corporate governance as “the relationship among the shareholders, directors and management of a company, as defined by the corporate charter, by-laws, formal policy and the rule of law”.⁹⁷ As stated above, the list of participants in the corporate governance practice under this perspective can also include role players like employees, the community and/or the environment. The relationship perspective could be seen as supplementing what could be lacking in the operational perspective. For example the OECD definition supplements the operational perspective by combining the relationship and stakeholders’ perspectives beautifully. It describes the concept of corporate governance as a structure that “specifies the distribution of rights and responsibilities among the different participants in the organisation- such as the board, managers, shareholders and other stakeholders-and lays down the rules and procedures for decision-making”.⁹⁸

The different versions of corporate governance definitions suggested by various writers above cannot as yet be said to be universally accepted, but they certainly appeal to people with a particular focus or bias. In addition, all the different definitions are not necessarily mutually exclusive.

Recent definitions of corporate governance appear to attempt to combine elements of the different perspectives and importantly identify the underlying tensions in corporate law

⁹⁴ See the *OECD Principles of Corporate Governance* 2004 document, available at www.oecd.org/corporate/ca/corporategovernanceprinciples/31557724.pdf, accessed on 16 February 2013.

⁹⁵ In this regard, the OECD acknowledges two very critical facts. Firstly, it acknowledges that the framework of corporate governance depends on the legal, regulatory and institutional environment. Secondly, the OECD recognises that factors such as business ethics and corporate awareness of the environmental and societal interests of the communities in which a company operates can also have an impact on a company’s reputation and its long term success. Ibid.

⁹⁶ See *King Report on Corporate Governance for South Africa, 2009 (King III Report)* p6.

⁹⁷ See “The Corporate Library”, an influential corporate law website, cited in B Tricker *Corporate Governance: Principles, Policies and Practices* 30. The Corporate Library is available at www.thecorporatelibrary.com , accessed on 17 February 2013.

⁹⁸ *OECD Principles of Corporate Governance* 2004 document, available at www.oecd.org/corporate/ca/corporategovernanceprinciples/31557724.pdf, accessed on 16 February 2013.

between ownership of the corporation on one hand, and its control on the other hand.⁹⁹ While this tension is not new to corporate law, it could have been revived by the recent corporate failures witnessed by several developed countries. The first example comes from the post-mortem analysis of the collapse of HIH Insurance Ltd in Australia. The Report of the HIH Royal Commission made a bold attempt at defining corporate governance. It views corporate governance as referring ‘generally to the legal and organisational framework within which, and the principles and processes by which, corporations are governed’.¹⁰⁰ This definition goes on to identify the board of directors and management as chief participants in corporate governance. The definition indirectly recognises the implication that corporate governance has on the ‘ownership and control’ debate by acknowledging corporate governance’s ‘impact on the relationship between shareholders and the company’.¹⁰¹ While this tension is important to corporate law, it is important to note that corporate governance is shifting away from its traditional preoccupation with agency conflicts. It now seeks to address fundamental issues of business ethics, accountability, transparency and disclosure.¹⁰²

Corporate governance is therefore evolving into a multi-stakeholder concept. This is due to the increasing realisation that corporate behaviour ultimately affects the lives of many people. It is for this reason that a narrow approach to the definition of corporate governance is not progressive enough to keep up with the pace of growth and development of the concept in the 21st century. There are basic relationships and participants in corporate governance. These are shareholders, the board of directors and operational management. It is also apparent from the diversity of opinions on the meaning of the concept that it is hardly possible to come up with a closed list of stakeholders or additional participants, given the evolutionary nature of corporate governance. Other stakeholders are gaining in importance in the 21st century given their increasing contribution to or impact on the sustainability of the business interests of companies. It is true to say that “properly governed companies with a reputation for practising good corporate governance are more likely to attract better calibre employees”.¹⁰³ Apart from employees, the environment is fast growing into a major stakeholder as a result of the challenges of climate change.. Such important social

⁹⁹ See how Justice Owen noted this tension in *The Bell Group Ltd v Westpac Banking Corporation* (No.9) [2008] WASC 239 (28 October 2008) [4362].

¹⁰⁰ See Background Paper 11 (HIH Royal Commission) *Directors’ Duties and Other Obligations under the Corporations Act* (November 2001) 27 para 76 (the Owen Report), cited in Du Plessis et al *Contemporary Corporate Governance* 4.

¹⁰¹ *Ibid.*

¹⁰² Amiram Gill ‘Corporate Governance as Social Responsibility: A Research Agenda’ (2008) 26:2 *Berk. J. Int. Law* 452.

¹⁰³ Cassim et al *Contemporary Company Law* 2ed (2012) 473.

considerations are the main focus of the Corporate Social Responsibility (CSR) movement which has sought to use corporate governance principles as a vehicle for incorporating social and environmental concerns into the decision-making processes of companies. This is seen as benefiting not only financial investors, but also employees, consumers and communities.¹⁰⁴

A new definition is added as promised earlier on in this chapter. In addition to other definitions, corporate governance has to do with a quest to achieve a balance within the key leadership relationships in the life and business of the corporation. In this regard, the shareholders provide capital for business, appoint or remove the company board of directors where necessary, make decisions affecting the company, and make the board accountable for its oversight on the management of company business. This provides checks and balances to the directors' duties of managing company resources as good stewards. The board provides oversight and supervision to the management of a company by appointing executive management. Senior Management/Executives do the actual management of the company including setting policies for proper functioning of the company, for the approval of the board.

2.2.2 Company Director

The Act defines a 'director' to mean:

a member of the board of a company, as contemplated in section 66, or an alternate director of a company and includes any person occupying the position of a director or alternate director, by whatever name designated.¹⁰⁵

As is evident from this definition provided in s1 of the Act, a 'director' is defined in such broad and to some extent unclear terms. It appears that this definition was carefully designed to ensure that it is expansive and more inclusive than it was intended to be exhaustive. It sounds more like a description of a director rather than a definition of the term. The Act also merely defines 'board' to mean 'the board of directors of a company'.¹⁰⁶ It could as well be that the legislature assumed that the term director has become so commonplace that everyone should know what it means. Directors could be defined as persons appointed or elected according to law, and are authorised to manage and direct the affairs of a corporation or

¹⁰⁴ Sneirson, Judd F 'Doing Well By Doing Good: Leveraging Due Care for Better, More Socially Responsible Corporate Decision-making' (2007) 3 *Corp. Governance. L. Rev.* 438, available at <http://ssrn.com/abstract=970359> or <http://dx.doi.org/10.2139/ssrn.970359> accessed on 19 February 2013.

¹⁰⁵ S1 of the Act.

¹⁰⁶ See s1 of the Act.

company.¹⁰⁷ By defining directors in singular terms the crafters of the Act probably sought to ensure that individuals tasked with the responsibility of managing the affairs of a company are held accountable in terms of their conduct when fulfilling directorial functions. In making the definition of directors expansive, it appears that the legislature intended to cover many situations which could be classified as directorial roles or functions.

The wide definition of ‘director’ in s1 includes some senior company officials other than the individuals who are traditionally referred to by that title. A part of the definition identifies an official ‘by whatever name designated’ as a director, even if such an official could be called by some other title such as ‘manager’ for example.¹⁰⁸ The message from the Act’s definition of a ‘director’ appears clear. What a person is called in terms of title is now not as relevant in determining whether a person is a director. Of greater importance than the title is the substance of that person’s activities, or in other words, the power exercised or function performed.¹⁰⁹

Also included in the broadened definition of a director in s1 are such individuals who are considered to be ‘occupying the position of a director’ at any relevant times. The phrase ‘occupying the position of a director’ is understood in South African law to denote a person who acts in the position of a director, with or without lawful authority.¹¹⁰ The phrase ‘occupying the position of a director’ could denote a type of a director recognised under South African law as a *temporary director*. Such a director is appointed to serve on a temporary basis until the vacancy is filled at a properly constituted meeting of shareholders.¹¹¹

In addition to the types of directors clearly identified in section 1 of the Act, there are also other types of directors recognised under South African law. In terms of the Act,¹¹² the MOI may provide for appointment of a person as an *ex officio* director by virtue of that person holding a position elsewhere which qualifies him/her for appointment as an *ex officio* director.¹¹³ Another type of a director recognised by the Act and who can be appointed in line with a provision in the company’s MOI is an *alternate director*. An alternate director is

¹⁰⁷ This definition is available at <http://legal-dictionary.thefreedictionary.com/directors> , accessed on 19 July 2013. This is a law dictionary by John Bouvier of the United States of America, published in 1856.

¹⁰⁸ See s1 of Act.

¹⁰⁹ See *Re Mea Corporation Ltd* [2007] BCC 288 para 82, referred to in Cassim et al *Contemporary Company Law* 404.

¹¹⁰ See *Corporate Affairs Commission v Drysdale* (1978) 141 CLR 236 at 242, where the court gave the phrase ‘occupying the position of a director’ the same meaning as of a person who acts in the position of a director.

¹¹¹ Appointment is done in terms of ss68 (2) & (3) of the Act.

¹¹² See s66 (4) (a) (ii).

¹¹³ See s66, for definition of an *ex officio* director. Also see s66 (5) (a) & (b) for the role of this type of director and the nature of his/her liabilities.

defined in s 1 of the Act to mean ‘a person elected or appointed to serve, as the occasion requires, as a member of the board of a company in substitution for a particular elected or appointed director of that company’.¹¹⁴

There is a host of other types of directors who might not have been specifically defined by the Act, but who are recognised under South African law, as already stated.¹¹⁵ Impliedly and for purposes of the Act, any person who is not formally appointed as a director of a company may nonetheless be deemed to be a director if he or she exercises the authority of a director, regardless of whether he/she is properly appointed at law.¹¹⁶

In South African law, as elsewhere in developed legal jurisdictions, company directors are known to fall into two descriptive categories, namely ‘Executive’ directors and ‘Non-Executive’ directors. Executive directors are the full-time salaried executive/senior officers in the employ of the company, who serve the company under a contract of service for a specified period. The Executive directors undertake additional or special functions and participate in the day-to-day management of the company’s affairs.¹¹⁷ Non-executive directors on the other hand, are part-time directors of a company, who are not full-time employees and have not undertaken any special functions¹¹⁸ in the company by means of employment contract. A non-executive director is one who has no other relationship with the company outside of his or her directorship to the company.¹¹⁹ Thus no relationship or circumstances should affect, influence or impair the director’s independent judgment¹²⁰ - and the emphasis appears to be on the ‘independence’ of the director. The *King III Report* understands ‘independence’ in this context to mean the absence of undue influence and bias that could be affected by the intensity of the relationship between the director and the company, rather than any particular fact such as length of service or age.¹²¹ *King III Report* appears to suggest that an objective assessment should be done to determine whether a director is independent or not. Thus a director should not only be independent in fact, but

¹¹⁴ See s66 (4) (a) (iii).

¹¹⁵ For an expansive list of other types of directors recognised under South African law see Cassim et al *Contemporary Company Law* 407- 409.

¹¹⁶ See Cassim et al *Contemporary Company Law* 404.

¹¹⁷ Per Margo J in *Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd* (supra) 165-166. Also see the remarks of Goldstone JA in *Howard v Herrigel* 1991 (2) SA 660 (A) 678. Further see *Philotex (Pty) Ltd v Snyman* 1998 (2) SA 138 (SCA) 144.

¹¹⁸ *Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd* (supra) 165-166. .

¹¹⁹ Cassim et al *Contemporary Company Law* 478.

¹²⁰ See *King III Report* at 38 para 66.

¹²¹ *Ibid.* The *King III Report* at 38 para 67 gives a lengthy definition of an independent non-executive director which places a director outside the province of any possibility of influence by any sort of attachment to any interest that could potentially impair independent judgment to properly make a decision in the best interest of the company, and the company alone.

should, in the perception of a reasonably informed outsider, appear to be independent.¹²² The common law and now statutory law imposes an obligation on all directors to fulfil their fiduciary duties as well as the duty to exercise care, skill and diligence when performing company functions. Common law duties, including the standards of care to be analysed in Chapter 4, apply equally to directors whether they fit the description ‘executive’ or ‘non-executive’. The distinction between executive and non-executive directors is not relevant to the standards of conduct required of a director. Nonetheless, the courts will take into account all relevant factors such as the nature of the company’s business, any particular functions assigned by the board to the director whose conduct is being judged and whether the director also holds a position under the company.¹²³

While the King Reports¹²⁴ have taken time to draw a distinction between executive and non-executive directors, and also while in practice the distinction remains, the Act is curiously silent on the issue.¹²⁵ Non-executive directors are expected to bring an independent external perspective and to add objective judgment in decision-making within the board. Case law buttresses the view that such directors should remain independent in the execution of their functions to the extent of disregarding the views and decisions of those who appointed or nominated them for appointment.¹²⁶ In fact, in the collective functioning of the board, all directors are expected to act in the best interests of the company, in keeping with its separate legal personality as will be explained in part 2.4 below.¹²⁷ Therefore the independence of the board is a concept which is strongly supported by our courts as noted in the *PPWAWU National Provident Fund* case.¹²⁸ The *King III Report* advocates for a balance of power in the company board, and recommends that the majority of the board members should be non-executive directors, adding that the majority of the non-executive directors should be independent.¹²⁹

It cannot be gainsaid that every company director should give the company the benefit of his independent judgment when deliberating issues of policy or matters affecting the company in a board meeting. The Act makes it mandatory for all directors (not only certain non-executive directors) to perform their functions ‘in the best interests of the

¹²² *King III Report* at 38 para 65.

¹²³ Blackman, Jooste & Everingham *Commentary on Companies Act* 193

¹²⁴ See *King II Report* at 54. Also see Bouwman (2009) *SA Merc LJ* 518.

¹²⁵ Cassim et al *Contemporary Company Law* 411.

¹²⁶ *PPWAWU National Provident Fund v Chemical, Energy, Paper, Printing, Wood and Allied Workers’ Union* 2008 (2) SA 351 (W), (hereafter *PPWAWU National Provident Fund* case).

¹²⁷ See specifically part 2.4.2 .

¹²⁸ *PPWAWU National Provident Fund* (supra).

¹²⁹ *King III Report* Principle 2.18.

company’.¹³⁰ The exact meaning of the phrase ‘in the best interests of the company’ may be subject to different interpretations. Nonetheless, it can never be interpreted to exclude acting in a manner that benefits the company ahead of any other competing interest. As will be established in 2.4.3 below, a company is a separate legal entity that needs to be distinguished from its shareholders and/or incorporators. The duty in s76(3) (b) needs to be read in conjunction with the duty to exercise the degree of care, skill and diligence expected of a director in ‘relation to the company’.¹³¹ When this is done, it should remove doubt as to whether a director is obliged to advance the interests of any other parties to the exclusion of or ahead of those of the company.

Any of the directors on a company board may have their own interests or some form of loyalty to some shareholders. Notwithstanding this, in exercising their legal powers and executing their functions, such directors should exercise a level of independence that allows them to ‘act in the best interests of the company’. This should hold true regardless whether this clashes with their own personal interests or not. That should be the hallmark of the concept of ‘independence’ as far as the role of directors in a company is concerned. It is for that reason that in *Howard v Herrigel* the Court held that ‘...once a person accepts an appointment as a director, that person becomes a fiduciary in relation to the company and is obliged to display the utmost good faith towards the company and in his dealings on its behalf.’¹³² The courts generally appear not to be in favour of separating or distinguishing directors in terms of their expected independent functioning in a company board. To this end it was argued in *Re Elgindata Ltd* that ‘it is unhelpful and even misleading to classify company directors as ‘executive’ or ‘non-executive’ for purposes of ascertaining their duties to the company...’¹³³

A question could be asked regarding why the Act chose not to pronounce on the executive-non-executive director distinction. The reason for the Act’s silence could be in keeping with the understanding that all directors are equally bound by their common law and now statutory duties. This is what can be discerned from section 76(3) of the Act. The codified common law duties apply to all directors without exceptions.¹³⁴ A case could be made for the Act to have at least emphasised the issue of independence by clarifying that all directors are expected to be independent. The omission to emphasise the requirement that all

¹³⁰ See s76(3) (b).

¹³¹ See s76(3)(c) of the Act.

¹³² 1991 (2) SA 660 (A) at 678.

¹³³ 1991 BCLC 959 at 985.

¹³⁴ According to *Howard v Herrigel* (supra) ‘no such distinction (between executive and non-executive director) is to be found in any statute’. The Act also makes no such distinction.

directors ought to be independent should not be seen to be fatal. Courts can interpret s76(3) to imply that all directors are enjoined by law to be independent and to act in the best interests of the company.

2.2.3 The BJR – Meaning

There is no generally accepted definition of the BJR. Different people and institutions define the term differently, depending on their preferred approach to the BJR. The BJR originated in the USA and has been evolving to assume new meanings and possibly new scope. Establishing a proper understanding of the BJR¹³⁵ is vital for two closely connected reasons. The first one is that this study discusses the BJR and its interaction with standards of care, skill and diligence under the Act. Secondly, a good understanding of the BJR is important because how one views the BJR drives how the rule is interpreted.¹³⁶ More importantly, for South Africa, it is vital to establish what must be considered by courts in determining the rule's application.¹³⁷ During the 1960s, BJR was considered one of the least understood concepts in corporate law then.¹³⁸ Post the 2000s, the BJR as a concept or term remains poorly understood despite its usage and growing popularity.¹³⁹ The search for proper meaning of the rule is on-going. Some theories are emerging to attempt to find an acceptable explanation as to why the BJR exists, what its proper relationship with the duty of care is, and what its scope of application should be.

In addition to the approaches to the BJR which will be discussed in Chapter 3, some writers have attempted the difficult task of providing its definition or meaning. McMillan in his approach to the BJR as immunity defines the term to mean a judicially developed doctrine that protects company directors from personal liability for the decisions they make on behalf of corporations.¹⁴⁰ Bainbridge, an advocate for the BJR to be viewed as a judicial 'abstention doctrine', acknowledges that the BJR has been evolving over the years. He further comments that the BJR is commonly understood today as a standard of liability by which courts review directors' 'decisions'.¹⁴¹ Branson¹⁴² argues that the BJR, which is often misunderstood, is not a rule at all, as it provides no substantive 'do's' and 'don'ts' for officers or directors of

¹³⁵ Including what it is not, its scope and content.

¹³⁶ See L McMillan 'The Business Judgment Rule as an Immunity Doctrine' (2013) 4 *Wm. & Mary Bus. L. Rev.* 521 at 524.

¹³⁷ *Ibid.*

¹³⁸ See H G. Manne 'Our Two Corporation Systems: Law and Economics' (1967) 53 *VA. L. Rev.* 259 at 270.

¹³⁹ S Bainbridge 'The Business Judgment Rule as an abstention Doctrine' (2004) 57 *Vand. L. Rev.* 83 at 84.

¹⁴⁰ McMillan (2013) *Wm. & Mary Bus. L. Rev.* 521.

¹⁴¹ Bainbridge (2004) *Vand. L. Rev.* 87.

¹⁴² D Branson 'A Business Judgment Rule for Incorporating Jurisdictions in Asia?' (2011) 23 *SAC LJ* 687.

companies. Instead of viewing the BJR as a rule, Branson suggests that it should rather be seen as a standard of judicial review entailing only slight review of business decisions. This standard of review which becomes a defence if the directors have made a business judgment is what is called BJR. To the extent that BJR precludes the judiciary from reviewing the substantive merits of the board's decisions where directors were not somnambulant on duty, the BJR may even be seen as a standard of non-review.¹⁴³

The understanding of the BJR as a standard of review is shared by Eisenberg,¹⁴⁴ who distinguishes the duty of care as a standard of conduct from the BJR as a standard of review. In this understanding, the duty of care specifies how directors should conduct themselves. The BJR then sets forth the test courts will use in determining whether the directors' conduct gives rise to liability or not.¹⁴⁵

There is a common thread running through the definitions by various authors considered above and the approaches to the BJR which follow below. The first commonality is that the BJR involves a standard of review connected to the decisions made by boards of directors. The second commonality is the role of the courts in reviewing decisions made in the board room. In any case, the BJR was developed by American courts hence it is referred to as a common law standard of review.¹⁴⁶ The BJR was developed with the understanding that directors have to make decisions on behalf of corporations, which decisions often entail an assumption of risk.¹⁴⁷ The BJR thus seeks to ensure that decisions made by directors, provided they meet a set criterion,¹⁴⁸ are protected even though, with the benefit of hindsight, the directors' decisions may prove to be erroneous.

The problem of separation of ownership and control is well known in corporate law.¹⁴⁹ Directors are employed or engaged to manage the assets of absentee owners. While it is debatable whether shareholders are these absentee owners, there is a general agreement that shareholders are residual claimants of the assets of the corporation.¹⁵⁰ The interest of shareholders includes that corporate decision-making powers in directors' hands must be

¹⁴³ Ibid.

¹⁴⁴ M Eisenberg 'The Divergence of Standards of Conduct and Standards of Review in Corporate Law' (1993) 62 *Fordham L. Rev.* 437 at 444-445.

¹⁴⁵ See Bainbridge (2004) *Vand. L. Rev.* 89.

¹⁴⁶ C Weng 'Assessing the applicability of the Business Judgment Rule and the 'Defensive' Business Judgment Rule in the Chinese judiciary: A perspective on take-over dispute adjudication' (2010) 34 *Fordham Int'l L.J.* 124 at 128.

¹⁴⁷ McMillan (2013) *Wm. & Mary Bus. L. Rev.* 528.

¹⁴⁸ In the US case of *Aronson v Lewis*, 473 A.2d 805, 812 (Del. 1984) the criterion was given as that the directors must have acted on an informed basis, in good faith and in the honest belief that the action was in the best interests of the company.

¹⁴⁹ See J Velasco 'The Fundamental Rights of the Shareholder' (2006) 40:407 *UC. Davis L. Rev.* 412 at 445-448.

¹⁵⁰ Bainbridge (2004) *Vand. L. Rev.* 110.

exercised to maximise shareholder wealth.¹⁵¹ There is a general correlation between the desired return (maximisation of shareholders' wealth) and risk. In order for directors to fulfil their role and expectations, there is a need to exercise fiat- a level of freedom to manage companies. Fiat, as has been argued by others, entails a risk that directors may be tempted to divert company profits from shareholders to themselves.¹⁵² This creates tension in corporate law, between the exercise of power by the board and the need for accountability to stakeholders. The BJR is increasingly being seen as a fulcrum used to balance these competing concerns.¹⁵³ How courts play a role in striking the much needed balance, is subject to different approaches espoused in the common law and in literature. Chapter 3 draws on the approaches to and formulations of the BJR under American law as well as US case law relating to the BJR in order to aid development of South African jurisprudence. Chapter 5 substantively discusses the BJR, and provides a critical analysis of the South African version of the BJR¹⁵⁴ in light of international jurisprudence¹⁵⁵ and purposes of the Act.¹⁵⁶

2.2.4 Subjective, objective, dual objective/subjective standards of care & gross negligence

The terms listed above will be encountered mainly in Chapter 3 and Chapter 4, and these terms may also be used throughout the Study. It is thus considered vital to provide simply a basic meaning of each term in order to provide a good foundation for comprehension. The best way to understand the hybrid terms on standards of conduct is to begin by giving meanings of the terms 'subjective' and 'objective' standards of conduct.

A subjective standard is used to evaluate an applicable standard of conduct that is dependent upon the individual characteristics, personal abilities, attributes or competences of a particular director. For example in the early nineteenth century cases in England, directors were expected to show such care and skill which an ordinary man might be expected to take, in the circumstances, on his own behalf. The common law required directors to offer what they could offer, given their level of skill and experience.¹⁵⁷ A subjective standard would be

¹⁵¹ Ibid at 86.

¹⁵² Ibid at 103.

¹⁵³ E Norman & CT Di Guglielmo 'What happened in Delaware Corporate Law and Governance from 1992-2004? A Retrospective on Some Key Developments' (2005) 153 *U. PA. L. Rev* 1399 at 1424-1425. Also see McMillan (2013) *Wm. & Mary Bus. L. Rev* 528

¹⁵⁴ As provided in s76 (4) (a) of the Act.

¹⁵⁵ Sketched in Chapter 3

¹⁵⁶ See part of 4.2.3 under Chapter 4 for a reference to the relevant purposes of the Act in the context of a discussion of corporate law reform objectives.

¹⁵⁷ See *Overend, Gurney & Co v Gibb* (1872) LR HL 480. Also see *Re Cardiff Savings Bank: Marquis of Bute's Case* [1892] 2 Ch 100.

low if the director had little knowledge and experience although for directors with special expertise it may be higher than ordinary objective standard.

In contrast to subjective considerations, an objective standard is a uniformly applicable standard to all persons. The standard relating to directors' duty of care is given meaning by the law of negligence.¹⁵⁸ A negligent director is liable to the victim in terms of the common law remedies deriving from the *actio legis Aquilae* for patrimonial loss resulting from negligence.¹⁵⁹ The objective standard in this context is not reduced to the level of the director's actual ability to take care of something, and neither is it 'limited by a director's knowledge and experience or ignorance or inaction'.¹⁶⁰ Thus, a reasonable person test is applied, and such a person is an ideal person – and this is a creation of legal fiction. Conduct is ordinarily measured by reference to what the reasonable man of ordinary prudence would do in the circumstances of the director who faces allegations of breach of duty of care.¹⁶¹ This appears to clearly apply to the standard of care, which can be assessed objectively. It is considered¹⁶² difficult or even impossible to have a single objective standard of skill, given that there is no requirement that a director should 'bring any special qualifications to his office'.¹⁶³ In addition it was also held in South African case law that there is no requirement that a director should possess 'special business acumen or expertise, or singular ability or intelligence, or even experience in the business of the company'.¹⁶⁴

Dual objective/subjective standard is where a director owes a duty to his company to exercise the care, diligence and skill that would be exercised by a reasonable person in the same circumstances having both:

- (a) the knowledge and experience that may reasonably be expected of a person in the same position as the director, and
- (b) the director's knowledge and experience.¹⁶⁵

A dual objective/subjective standard thus requires the conduct of directors to be judged or assessed objectively (as far as care is concerned) and subjectively (by reference to directors'

¹⁵⁸ See Blackman, Jooste & Everingham *Commentary on Companies Act* 190.

¹⁵⁹ See *Ex parte Lebowa Development Corporation Ltd* 1989 (3) SA 71 (T) 106. Also see *Niagra Ltd v Langerman* 1913 WLD

¹⁶⁰ See *Daniels v Anderson* (1995) 16 ACSR 607 666 CA (NSW).

¹⁶¹ Blackman, Jooste & Everingham *Commentary on Companies Act* 191.

¹⁶² *Ibid.*

¹⁶³ As per Neville J in *Re Brazilian Rubber Plantations and Estates Ltd* [1911] 1 Ch 425 437 (CA).

¹⁶⁴ As per Margo J in *Fisheries Development Corp of SA Ltd v Jorgensen* (supra) at 166. See Blackman, Jooste & Everingham *Commentary on Companies Act* 191.

¹⁶⁵ This description forms part of the proposal for law reform by the Law Commission in the UK prior to the finalisation of the Companies Act 2006. See Law Commission and Scottish Law Commission, *Company Directors: Regulating Conflict of Interest and Formulating a Statement of Duties* (Law Com. No. 261) (London: Stationary Office, 1999).

own characteristics).¹⁶⁶ The applicable test considers the notional knowledge and experience that may reasonably be expected of a person in the same position as the director.¹⁶⁷

Gross negligence can be defined to mean a conscious and voluntary disregard of the need to use reasonable care, which conduct is likely to cause foreseeable grave injury or harm to persons, property, or both.¹⁶⁸ It is conduct that is extreme when compared with ordinary negligence, which is a mere failure to exercise reasonable care.¹⁶⁹ In *S v Dhlamini*¹⁷⁰ gross negligence was described as including an attitude or state of mind characterised by ‘an entire failure to give consideration to the consequences of one's actions. In other words, it is an attitude of reckless disregard of such consequences.’¹⁷¹ Respected South African author Blackman, on the basis of applicable case law, argues that the standard applicable under common law is negligence, and not gross negligence.¹⁷² South Africa appears to have inherited this position from English law.¹⁷³ English company law principles have had an enduring influence on South African common law in this regard.

2.3 Corporate governance in South Africa- voluntary compliance framework

In South Africa the concept of corporate governance has been given its recognisable regulatory form through the publication of the *King Reports* on corporate governance between 1994 and 2009. As has been justifiably argued, the *King Reports* have indeed institutionalised corporate governance¹⁷⁴ by setting minimum standards for directors’ conduct when running and controlling companies. The *King Reports* have attempted to give South Africa an accurate statement of the international benchmarks on the new trends, principles and best practices in corporate governance.¹⁷⁵ The reports are the fruit of the hard work of the

¹⁶⁶ See Dignam *Hicks & Goo's Cases & Materials on Company Law* 393-394.

¹⁶⁷ *Ibid* at 394.

¹⁶⁸ Alternatively it can be viewed as indifference to, and a blatant violation of, a legal duty with respect to the rights of others. See definition given by the Legal Dictionary available at <http://legal-dictionary.thefreedictionary.com/gross+negligence> accessed on 14 September 2016.

¹⁶⁹ See definition by the Legal Dictionary available at <http://legal-dictionary.thefreedictionary.com/gross+negligence>, accessed on 14 September 2016.

¹⁷⁰ 1988 (2) SA 302 (A) at 308 D – E.

¹⁷¹ This definition was cited approvingly by Howie JA in *Philotex (Pty) Ltd & Others v Snyman & Others* (1998) (2) SA 8.

¹⁷² See Blackman, Jooste & Everingham *Commentary on Companies Act* 191. Also see *Ex parte Lebowa Development Corporation Ltd* (supra) at 106.

¹⁷³ As confirmed by Margo J in *Fisheries Development Corp of SA Ltd v Jorgensen* (supra) at 166. Also see *Du Plessis NO v Oosthuizen* 1999 (2) SA 191 (O).

¹⁷⁴ See Bekink (2008) SA Merc LJ 97.

¹⁷⁵ See Bouwman (2009) SA Merc LJ 520.

King Committee.¹⁷⁶ The King Committee followed the same format as the one followed by the Cadbury Report and subsequent reports in the UK.¹⁷⁷ It shares the distinction with the UK reports of being pioneers in the world in making comprehensive investigations into the state of global corporate governance.¹⁷⁸ The *King Reports* like the UK reports, became an important means of corporate regulation for local companies in South Africa. This was done through the Codes of Corporate Practice and Conduct (here after ‘Codes’ or ‘Code’ where applicable) which accompanied each of the three reports which have been produced by the King Committee to date.¹⁷⁹

This part considers the impact of the *King I Report*, the *King II Report* and *King III Report* on the development of the standards of care, skill, diligence and the statutory adoption of the BJR under the Act. The *King reports* represent a voluntary basis for governance compliance by South African corporates, as juxtaposed with a legislated basis for governance compliance where there are legal consequences (sanctions) for non-compliance.¹⁸⁰ It will be argued and demonstrated in this part that the pioneering work of the King Committee sowed seeds for future legislative development of the standards of care, skill, diligence and the incorporation of the BJR under the Act.

2.3.1 *King Reports* on Corporate Governance

The *King I Report*, released in 1994 at the dawn of constitutional democracy in South Africa, was the first comprehensive report of its kind in the country. It dealt with principles of corporate governance relating to directors’ duties towards the company. The report recommended that all companies listed on the Johannesburg Securities Exchange (hereafter JSE) should comply with and give due consideration to the application of its accompanying Code. The application of the *King I Report* and the Code was generally not prescribed by law. The *King I Code*, as is the case with the subsequent codes, was a matter of voluntary or self-regulation by South African companies.¹⁸¹ Nonetheless, the enforcement of the Code was as

¹⁷⁶ Since 1994 the King Committee has worked under the auspices of the Institute of Directors in Southern Africa (IoDSA), who influenced and supported the formation of the committee led by Professor Mervyn King. The IoDSA has provided all the necessary support to the work of the King Committee ever since 1994.

¹⁷⁷ The following are the subsequent reports published in the UK following the Cadbury Report; the Greenbury (*Directors’ Remuneration Report: Report of Study Group Chaired by Sir Richard Greenbury* (1995)), the Hampel Report (*Report of the Committee on Corporate Governance Final Report* (1998)), among other reports.

¹⁷⁸ See Bekink (2008) *SA Merc LJ* 107.

¹⁷⁹ See Cassim et al *Contemporary Company Law* 473.

¹⁸⁰ See ‘Introduction and Background’ to *King III Report*.

¹⁸¹ Bouwman (2009) 21 *SA Merc LJ* 518. Also see Bekink (2008) *SA Merc LJ* 108.

effective as legislative enforcement can be, or even better. This is because enforcement was driven by the JSE who made compliance with the Code one of its listing requirements.¹⁸² Under the relevant Listing Requirements, a company was and is still expected to explain in its annual report how it complied with the Code or how it intended to comply with the Code.¹⁸³

King I sought to promote the highest standards of corporate governance by firmly recommending standards of conduct for company directors of listed companies, banks, and certain state-owned enterprises in South Africa. The report emphasised responsible ethical directorial conduct, integrity and quality of decision-making by the board in a manner that promotes the broader interests of the company. It has further been stated that the challenge which confronted drafters of *King I* was to seek principles striking an appropriate balance between directors' freedom to manage, accountability, and the interests of stakeholders.¹⁸⁴ The report came at a time when there was a shift from a traditional view which held that the function of directors is none other than that of profit maximisation for shareholders.¹⁸⁵ By 1994, a new thinking in corporate governance was emerging. It focussed not only on the interests of shareholders, but the interests of the broader spectrum of stakeholders, if this will promote the interests of the company. As such *King I* sought to promote an integrated approach to good governance.¹⁸⁶ This approach takes into account stakeholders' interests and encourages the practice of financial, social, and environmental accountability. Consequently the report advocated for directors to act with the necessary care and skill in fulfilling their responsibilities towards the company and the stakeholders involved. As part of its contribution towards development of the duty of care, the *King I Report* advocated that directors should not be held accountable for breaching a duty of care and skill in the event that they exercised the BJR.¹⁸⁷ Whether there was a need to include the BJR in modern South African company legislation was hotly debated following this recommendation by the report. The two views within this debate are partly covered in Chapter 4. It suffices to only point out here that with regard to the BJR and the proposed limitation of the duty of care, critics questioned the appropriateness of 'transplanting' a foreign legal concept into the South African law.

¹⁸² See Bekink (2008) *SA Merc LJ* 108.

¹⁸³ Ibid. Also see ss.8.63 (a)(i) and ss.8.63(a)(ii) of the JSE Listings Requirements available at http://www.jse.co.za/listing_requirements.jsp, accessed on 20 February 2013.

¹⁸⁴ Bekink (2008) *SA Merc LJ* 108.

¹⁸⁵ See Gill (2008) *Berk. J. Int. Law* 452 for a consideration of the shareholder primacy v stakeholder interests debate.

¹⁸⁶ Bekink (2008) *SA Merc LJ* 108.

¹⁸⁷ See *King I Report* paras 3.4 and 3.5.

King II Report came about as an update of the *King I* in March 2002. While the first report provided for general corporate governance principles and practices, the *King II Report* extensively covered on specific standards of directorial conduct. Of great relevance to this study are the guidelines of the *King II Report* for directors in performing their duties of care, skill and diligence and recommendations regarding the need for the BJR in law. Regarding the duty of care, the report encouraged the acquisition of knowledge by directors and an understanding of the affairs of the company for which one is a director. Like *King I* this report also made reference to the BJR, which relates to one aspect of the duty of care, that is, decision-making. Conceptually, *King II* saw the board of directors as the focal point of the corporate governance system.¹⁸⁸ Thus the board is ultimately responsible and accountable for the performance and affairs of the company.¹⁸⁹ An interesting feature of this conceptualisation is the aspect of delegation of responsibility to perform company tasks as well as reliance on others for performance. The report provided that the board cannot delegate its ultimate responsibility to monitor performance of operational management and its legal duty to provide strategic direction to the company. Where authority was delegated to operational management in the course of company business, the board remained ultimately answerable for the final results.¹⁹⁰

King III Report has now effectively replaced *King II* and contains updated corporate governance principles in line with trends consistent with international best practice jurisdictions. This was one of the goals of the DTI policy document for the review of corporate law in South Africa, and it is a goal which the King Committee also envisaged for *King III*.¹⁹¹ The *King III Report* and the accompanying Code were released in September 2009. Publication of the Report became necessary because of the Act which had been in the pipeline since about 2004, and also due to the changes in corporate governance at international level.¹⁹² The *King III Report* is evidently an upgrade from *King II* in three critical ways. Firstly, it develops corporate governance principles covered in the past reports. Secondly, the *Report* provides with clarity, the governance framework upon which *King III* is based and establishes an important connection between *King III* and the Act.¹⁹³ Thirdly, the

¹⁸⁸ I Esser & P Delpont 'The duty of care, skill and diligence: The *King Report* and the 2008 Companies Act' (2011) 74 *THRHR* 449 at 452. See s66 (1) of the Act for directors' original authority to manage the affairs and business of a company.

¹⁸⁹ *King II Report* p22 para 2.1.1.

¹⁹⁰ *Ibid.*

¹⁹¹ See the 'Introduction and Background' to the *King III Report*.

¹⁹² *King III Report* p 2 para 1.

¹⁹³ See the preface to Professor Mervyn King's article, 'The synergies and interaction between *King III* and

Report imports into South Africa new trends in governance and places an emphasis on ethical leadership, sustainability of corporations and consideration of the company's role as a socially responsible corporate citizen. While *King III* and similar reports before it provides for a recommended practice, the Act prescribes standards which are binding on directors.¹⁹⁴

King III has maintained the view expressed under *King II* and states that the '*King III* report was written from the perspective of the board as the focal point of corporate governance'.¹⁹⁵ By implication, it is the board's responsibility to ensure that the company applies the *King III Report*, the accompanying Code and complies with the law. *King III* is in form of a Code of principles and practices, which is a recommendation for a course of conduct. A board must ensure that the company meets the requirements of the JSE by accounting for the adherence or non-adherence to the principles and recommendations in the Code.¹⁹⁶ It may be important at this stage to point out that *King III* operates on an 'apply or explain' basis, which is a refinement from the *King II*'s 'comply or explain' basis.¹⁹⁷ South Africa has now realised that a 'comply or explain' basis is now outdated as it denotes a mindless adherence to the letter of the Code without flexibility and understanding of implications for the company and society at large.¹⁹⁸ In this regard, the *King III Report* accepts that a board of directors may decide that applying the Code may not be 'in the best interests of the company', and could therefore decide to apply the Code differently or apply a different practice which still meets the requirements of the Code.¹⁹⁹

Of particular relevance to this study is the special role that the *King III Report* sees for the common law duty of care in the context of the board's decision-making processes. The *King III Report* provides that consistent application of corporate governance practices, guidelines and codes by boards will not only raise perceptions of what are regarded as the appropriate standards of directors' conduct.²⁰⁰ The more established the governance practices become, the more courts of law will likely regard them as meeting the standard of care.²⁰¹

the Companies Act 71 of 2008' in *Modern company law for a competitive South African economy* (2010), at 446. This book was first published as *Acta Juridica* 2010.

¹⁹⁴ The *King III Report* clearly gives its philosophy as revolving around three key aspects, namely leadership, sustainability and corporate citizenship. See the 'Introduction and Background' to *King III*.

¹⁹⁵ See *King III Report* p 7 para 7. Also see a similar provision of the *King II Report* 22, para 2.1.1.

¹⁹⁶ Bouwman (2009) *SA Merc LJ* 520. Also *King III Report* p7.

¹⁹⁷ See Esser & Delpont (2011) *THRHR* 450.

¹⁹⁸ *King III Report* p 4 para 3.

¹⁹⁹ *Ibid*.

²⁰⁰ *King III Report* p7. Also see Bouwman (2009) *SA Merc LJ* 520.

²⁰¹ Bouwman (2009) *SA Merc LJ* 520. Also see *King III Report* p5 para 4. In the *Stilfontein* case (supra para 16.9) the court tested the conduct of directors of Stilfontein Gold Mining Co Ltd against the requirements of *King II Report* and disapproved the negligence and reckless conduct of the board, namely, resigning *enmasse* at a time the company needed them most to avert an environmental disaster. Despite the directors' sudden

Hence the King Committee could boldly argue and warn company directors that failure to meet recognised standards of governance that are not legislated could result in legal liability of boards and directors.²⁰² *King III* qualifies this point by stating that the report (*King III*) points to ‘those matters that were recommendations in *King II*, but are now matters of law because they are contained in the Act’.²⁰³ Lack of due diligence to read and understand the recommended course of conduct for directors freely provided for in the Code could also be construed as lacking the required standard of care by a company director.

The *King III* Report also links the duty of care to some new trends in or principles of corporate governance such as Information Technology (hereafter IT) governance²⁰⁴ and use of Alternative Dispute Resolution (hereafter ADR).²⁰⁵ With regard to the required standard of skill for directors in relation to IT use, the Report provides that ‘in exercising their duty of care (and skill) directors should ensure that prudent and reasonable steps have been taken in regard to IT governance’.²⁰⁶ As far as the exercise of the requisite standards of care and skill in enhancing productive relationships beneficial to the interests of the company is concerned, the Report sternly recommends that directors should attempt to resolve disputes expeditiously, efficiently and effectively.²⁰⁷ On applying the required standards of diligence, the Report explained that directors are required to adequately acquaint themselves with the content of applicable laws, rules, codes and standards generally in order to discharge not only their duty of care, skill and diligence, but also their fiduciary duties.²⁰⁸

The *King III Report*, like the *King II*, makes reference to the BJR, which relates to the decision-making aspect of the duty of care. *King III* describes the BJR as a ‘statutory defence...introduced (by the Act) for the benefit of directors who have allegedly breached their duty of care’.²⁰⁹

The *King III Report* revolves around three philosophical underpinnings or what the report describes as ‘key aspects’ which have assumed great importance at international level. The first of these key aspects of the report is leadership or good governance of companies

resignation from the company, Hussain J ruled that they had to be held responsible for the environmental crisis.

²⁰² *King III Report* p5 para 4.

²⁰³ *Ibid.*

²⁰⁴ *Ibid* p12 para 11 and Chap 5 where the issue of IT governance is dealt with in detail.

²⁰⁵ *Ibid* p11 para 10.

²⁰⁶ *Ibid* p13 para 11.

²⁰⁷ *Ibid* p88 principle 8.6.

²⁰⁸ See Bouwman (2009) *SA Merc LJ* 521.

²⁰⁹ *King III Report* p6 para 4. Words in brackets are for emphasis only.

steeped into the constitutional values given best expression through the concept of Ubuntu.²¹⁰ The second aspect is sustainability.²¹¹ The third aspect is corporate citizenship.²¹²

2.4 Nature of the director–company relationship

In this part, it is considered vital to sketch an understanding of the ever evolving legal nature of a company. Closely connected to this is the need to establish an understanding of the role and legal responsibilities of a company director in advancing the main business of the company. This is in light of a considerably transformed and still evolving company law framework globally and more particularly in South Africa.²¹³

2.4.1 Theories on the nature of a company

The theories on the nature of a company serve the purpose of giving insight into the origin and proper purpose of the corporate form. It has been suggested that the theories help to shape the corporate governance model which a company adopts, a model which indicates in whose best interest directors should manage a company.²¹⁴ In discussing the theories, this study intends to show the nexus between the evolving nature of a company and the expected standards of directorial conduct during decision-making. Three theories, namely the contractual or agency theory, the concession theory and the *communautaire* theory, are of relevance to this study.

The theories on the nature of a company are considered in search of answers to questions such as: What is a company? An understanding of the legal nature of a modern day company is important in order to deal with challenges arising from issues of separation of ownership and control of companies. No clear cut answers have been found over decades. An attempt at answering this question is vital as the bedrock to understanding the nature of the role and standards of conduct expected of directors. A related question which this section may also seek answers to is: In whose interests must company directors govern? Should directors manage companies in the interests of a collective body of shareholders, the supposed owners

²¹⁰ Ibid at 8 para 8.

²¹¹ With regards to sustainability, *King III* underscores the need for a modern company to take cognisance of the fact that nature, business and society are interconnected in complex yet mutually beneficial ways. As such, the sustainability of the company in this environment should be the primary moral and economic imperative guiding company decision-makers. See *King III Report* p8 para 8.

²¹² On corporate citizenship, the report states that the company as a person (albeit as juristic person) should operate in a sustainable manner. As a good citizen, a company should be conscious of its constitutional obligations of respecting and aiding the promotion of fundamental human rights as provided for in the Bill of Rights under the Constitution of the Republic of South Africa (hereafter Constitution of SA). Ibid. Also see ss2, 3(2)(a) & 8(2) of the Constitution.

²¹³ In South Africa, the Act provides for the legal nature of a company in s19.

²¹⁴ Irene-Marie Esser *Recognition of Various Stakeholder Interests in Company Management* (unpublished PhD thesis, UNISA, 2008) at p19.

of corporations? Or should this be done in the best interests of the company as a separate legal entity, different from its incorporators? Yet another related double edged inquiry is: To whom is the duty of care, skill and diligence owed by company directors? Tensions in corporate law and corporate governance have come about as a result of differences of opinion in answering the above questions. Different theories discussed below are an attempt to provide insight into the nature of the problem as described above and possible answers to such challenges.

2.4.1.1 The Agency/Contractarian theory

The Contractarian theory has been described as the antithesis of the concession theory.²¹⁵ The two theories stand in contradiction to each other regarding their views on the nature of a company. The interesting paradox is that the contrasts between the two theories vitally help to illustrate the private nature and the public nature of a corporation. Where the contractarian theory²¹⁶ views the company as a result of a purely private initiative,²¹⁷ the concession theory views a company as a creation of the state.²¹⁸

The Contractarian theory sees the company as a consequence of private individuals exercising their freedom to contract with each other out of their free will.²¹⁹ A clear evidence of the impact of the *Contractarian theory* on the Act is the reference to incorporation of a company as a right, as juxtaposed with a privilege bestowed by the state.²²⁰ S 13 of the Act reflects a core essential principle of corporate law reform in South Africa. This principle provides that the ‘formation of a company is an action by persons in the exercise of their constitutional right to freedom of association,²²¹ combined with their common law right to freedom of contract’.²²² The purpose of corporate law according to the *Contractarian theory* is therefore seen as that of providing an enabling set of rules empowering stakeholders to establish contractual relationships.²²³ Thus the ‘nexus of contracts’²²⁴ results in a product

²¹⁵J.E. Parkinson *Corporate Power and Corporate Responsibility- Issues in the Theory of Company Law* (1993) 25.

²¹⁶ Also described as ‘the law and economics theory of the corporation’. See Julian Velasco ‘The Fundamental Rights of the Shareholder’ (2006) 40:407 *UC. Davis L. Rev* 412, available at http://lawreview.law.ucdavis.edu/issues/40/2/articles/DavisVol40No2_Velasco.pdf

²¹⁷ Parkinson *Corporate Power* 26.

²¹⁸ *Ibid.*

²¹⁹ Velasco (2006) *UC. Davis L. Rev* 443.

²²⁰ See s13 of the Act which is aptly entitled ‘Right to incorporate company or transfer registration of foreign company’. Another evidence of the influence of the *Contractarian theory* under the Act is the recognition of shareholder agreements in s15 (7) and the obligations created by such agreements in line with the usual principles of contract law.

²²¹ This constitutional right is embodied in s18 of the Constitution of the Republic of South Africa, 1996.

²²² See the *Explanatory Memorandum to the Companies Bill, 2007* p10 of 376.

²²³ Esser *Recognition of Stakeholder Interests* 27

called a corporation, which is viewed under this theory as a ‘web of contractual relationships’²²⁵ constantly renegotiated by parties, with each party seeking to maximise its own advantages.²²⁶ The parties to this network of contractual ties in a corporation are regarded as stakeholders- members on par with each other, separated only by the nature of ‘their inputs in exchange for certain rights with respect to output’.²²⁷ Under this theoretical construction, shareholders are not considered to be owners of the corporation, but ‘merely one type of investor among many’.²²⁸ While this may give the impression that the agency theory downgrades the status of the shareholders, ironically it upholds and affirms the norm of shareholder primacy, nonetheless even if this could be achieved somewhat by default.²²⁹ It has been argued that in the final scheme of things, shareholders, given their unique position among all stakeholders, become the obvious proxy for societal wealth.²³⁰ Arguably, this is for the reason that shareholders are residual claimants to the assets of the corporation – the type of claimants who bear the entire weight of risk in the corporation.²³¹

In addition to the above, the contract theory is anti-regulatory in nature and even goes as far as suggesting that participants in the corporate form should have the option to opt out of rules should they so wish.²³² The contractarians’ stance in this regard stems from the conviction that companies are voluntary associations of individuals tied to each other by means of freewill-driven contracts. As such they should be allowed to structure their relationships freely, without interference from the state.²³³ The state, it is argued, ‘has no greater standing to intervene in the corporate affairs than it has in the individual lives of the citizens who make up the company’.²³⁴ The contractarian theory does not deny the state’s power to make rules. However, the theory understands corporate law’s role as being to enable and empower stakeholders to enter into contractual relationships,²³⁵ while regulating performance of parties in this ‘nexus of contracts’ context. In this connection of the freedom

²²⁴ Velasco (2006) *UC. Davis L. Rev* 443.

²²⁵ *Ibid.*

²²⁶ *Ibid.* Also see Esser *Recognition of Stakeholder Interests* 27.

²²⁷ Velasco (2006) *UC. Davis L. Rev* 442.

²²⁸ *Ibid* 442. Also see Esser *Recognition of Stakeholder Interests* 27.

²²⁹ Velasco (2006) *UC. Davis L. Rev* 442.

²³⁰ *Ibid.*

²³¹ It has been argued persuasively by Velasco that the promotion of shareholder primacy by contractarians (proponents of the contract theory) was arrived at not necessarily by design, but rather by default (as a default rule), almost something akin to choosing the better devil. Velasco reasons that the fact that the status of shareholders is reduced to mere stakeholders by the contract theory appears to have opened the door for consideration of interests of other constituencies. Velasco (2006) *UC. Davis L. Rev* 445-448.

²³² Esser *Recognition of Stakeholder Interests* 27-28.

²³³ Parkinson *Corporate Power* 27.

²³⁴ *Ibid.*

²³⁵ Esser *Recognition of Stakeholder Interests* 27.

of stakeholders in this ‘web of contractual relationships’, the theory regards the shareholders as principals, while directors or managers are seen as agents.²³⁶ As aforementioned, though shareholders are accorded what appears like a higher status to other stakeholders, they are not regarded as owners. With the understanding that the traditional interests of shareholders is profit maximisation, and the unique position which directors occupy in a modern company, there are bound to be tensions. If shareholders are not owners of the corporation,²³⁷ and if it is to be accepted that the company has a separate legal personality from its incorporators, will the directors act in the best interests of the shareholders, their own interests or will they act in the best interests of the company? Where does that leave the shareholders and all those who rely on shareholders primacy for benefit? This is the challenge identified by the contract theory. In this theory’s perspective, the director, as an agent, may not necessarily act in the best interests of the principal (shareholder). The assumption and apprehension in this theory is that if the director chooses to act, he may only do so partially,²³⁸ say by pursuing interests which advance his own ends at shareholders’ expense.

2.4.1.2 The Concession theory

In contrast to the contract theory’s view on the private nature of a corporation as given rise to by private individuals’ initiative, the *concession theory* emphasises the public nature of a company. In this connection, the concession theory views a corporation as a creature of statute, owing its existence to an exercise of state power,²³⁹ and thus owing the state something in return for its very existence.²⁴⁰

The quid pro quo or commensurate return from the corporation as understood by the concession theorists would include what has now come to be known as good corporate citizenship – typically socially responsible behaviour.²⁴¹ Whereas the contractarian theorists believed in freedom of contract, non-interference by the state and adopted a stance against over regulation by the state, the concession theory viewed it differently. The concession theorist believed that the state even had a right to demand socially responsible behaviour

²³⁶ Ibid at 28.

²³⁷ Despite the compelling modern view that a company is incapable of ownership and that shareholders cannot be seen as owners of the corporation and its assets, the traditional view that shareholders are owners appears to be refusing to go away easily, and it appears that it still has strong supporters even among modern contemporary writers. See the view of Julian Velasco ‘Shareholders Ownership and Primacy’ (2010) 3 *U. Ill L. Rev* 898-956.

²³⁸ Esser *Recognition of Stakeholder Interests* 28.

²³⁹ Parkinson *Corporate Power* 25-26.

²⁴⁰ See Michael E. DeBow & Dwight R. Lee, ‘Shareholders, Non-shareholders and Corporate Law: Communitarianism and Resource Allocation’, (1993) 18 *DEL. J. CORP. L.* 397.

²⁴¹ Velasco (2006) *UC. Davis L. Rev* 460.

from the corporation for the many benefits bestowed upon a company.²⁴² Consequently, the concession theorists advocated for double taxation as a means of the state getting some return from the privileges enjoyed by companies. In exchange for the ‘privilege’ involved in obtaining a corporate status, there had to be a concession upon which the validity of the concession theory rested, that is from the state to the corporation.²⁴³ For example, the state was expected to ensure protection of property rights through enacting relevant legislation and also by moulding the company’s constitution so as to protect the interests of shareholders against potential abuse of position by management.²⁴⁴

Much of the basis for the concession theory appears to have fallen by the wayside, and has been criticised for being now ‘antiquated and inaccurate’.²⁴⁵ In modern thinking, incorporation can no longer be considered a privilege. It is rather seen as a right which a company as both a legal person and corporate citizen of a country is capable of enjoying.²⁴⁶ Under the Act, a South African citizen enjoys a right to incorporate a company.²⁴⁷ It is submitted that apart from progressive concepts such as modern day Corporate Social Responsibility (CSR), most of the theoretical bases of the concession theory are now out of sync with modern constitutional and statutory developments.

2.4.1.3 The Communitaire theory

This is the third theory on the nature of the corporation with strong relevance to this study and it will be considered briefly here. This theory has interesting similarities and differences with the contractual and concession theories. Its distinguishing features are a combination of its attempts at balancing interests within the corporation and avoidance of the excesses of either of the contractarian or concession theories. The Communitaire theory does this by holding that companies have political and social dimensions in addition to their obvious economic dimension.²⁴⁸

²⁴² The concession theorists view the granting of a royal charter for purpose of incorporation of a company and benefits of limited liability as a ‘privilege’. See Parkinson *Corporate Power* 27.

²⁴³ The thinking appears to have been that the state could only make demands commensurate with the concession. Without conceding much to the incorporators, the state could not be expected to demand that the corporations advance its social goals. See Velasco (2006) *UC. Davis L. Rev* 461.

²⁴⁴ Parkinson *Corporate Power* 26.

²⁴⁵ Velasco (2006) *UC. Davis L. Rev* 461.

²⁴⁶ David Millon, ‘Theories of the Corporation’, (1990) *DUKE L.J* at 205-32.

²⁴⁷ See s13 (1) of the Act.

²⁴⁸ See Thomas Lee Hazen ‘The Corporate Persona, Contract (and Market) Failure, and Moral Values’ (1991) *69 N.C.L.Rev* at 278.

The basis of the *communitaire* theory appears to be the protection and advancement of the interests of society or community.²⁴⁹ To the communitarian, the objectives of the company should be reflective of the interests of society.²⁵⁰ Consequently, the company has a special place in the community which it serves, and finds justification for its activities only if it fulfils societal needs. It is not clear what the exact meaning or implication of this is, and if this view does not conflict with the economic dimension of a corporation, which the communitarian believes in. It appears that to the *communitaire* theorist, ‘stakeholders’ serve as proxy for the so called interests of the society.²⁵¹ The *communitaire* theorist’s meaning attached to the term ‘stakeholder’ is by no means clear. The weakness or serious omission of the theory in this regard is that ‘stakeholders’ are not clearly defined, making it difficult to know with certainty which interests are excluded and which ones are included. The theory views stakeholders as requiring protection from potential abuse.²⁵² Stakeholder co-operation and maintenance of ethical conduct by all stakeholders become necessary to ensure justice and fairness to all interests represented in the corporation.²⁵³

There are many differences and only a few similarities between the *communitaire* and the contractarian theories. It is important to point out that on some occasions where the two theories appear to agree, differences of approach exist. Good examples of this are to be seen in either theory’s take on the role of contracts in establishing relationships within the company and either theory’s view of the directors’ relationship with the company.

In the discussion of the contractarian theory above, it was established that a corporation is a product of a ‘web of contractual relationships’.²⁵⁴ Thus, to the contractarians, contracts clearly have a role to play in the establishment of a company. The communitarians may be prepared to accept the agency theory’s take that the firm is established by a web of interrelated contracts. They however, do not accept the structure of shareholder primacy that the contract theorists construct as a result of their theory of the ‘nexus of contracts’. While the *communitaire* theorists share the contractarians’ belief in the role of contracts in establishing relationships in a corporation, they tend to argue that the ‘web of contracts’ extends beyond explicit or written contracts to include unwritten contracts. This reasoning

²⁴⁹ Esser *Recognition of Stakeholder Interests* 28

²⁵⁰ s. Ibid

²⁵¹ Ibid.

²⁵² Ibid at 31.

²⁵³ Ibid.

²⁵⁴ Velasco (2006) *UC. Davis L. Rev* 443.

can be criticised for the reason that implicit contracts are problematic to deal with since they are not intended to be enforceable.²⁵⁵

Another point of convergence between the contractarian and the communitaire theories relates to their view of the legal nature of the director's relationship with the company. Either of the theories tends to regard directors as agents of the company. Generally the communitarians in their proposals for reform focus on re-characterising directors as agents of the entire corporation.²⁵⁶ The proposals for reform are geared towards ensuring that directors are lobbied to expand their consideration beyond shareholder wealth maximisation²⁵⁷ to include what is in the best interests of the wider spectrum of stakeholders. The major point of variation on this is that the contractarian theory views shareholders as the proxy for the wider stakeholders. It believes that the primary role of directors as agents of shareholders is profit maximisation for the principals.

The following are clear differences between the *communitaire* and the contract theories. Where the concession theory views a company as a creature of the state, the communitarians regard the company as an instrument available to the state, not necessarily as its mere concession.²⁵⁸ While communitarians do not reject all the elements of the contractual theory, they tend to differ on emphasis and methods of achieving certain goals. For example, on the role of corporate law, the communitarians '...believe that corporate law must confront the harmful effects on non-shareholder constituencies of managerial pursuit of shareholder wealth maximisation'.²⁵⁹ In contrast, the contractarians believe that the law should protect shareholders against potential abuse by directors in line with shareholder primacy and in order to ensure profit maximisation for shareholders.²⁶⁰ Another difference is that where contractarians emphasise principles of freedom and competition, the *communitaire* theorists advocate for norms of justice, cooperation and responsibility towards societal needs.²⁶¹

The strengths and flaws of the theories of the nature of the corporation pointed out above help put into perspective the development of corporate governance and corporate law both at international level and its evolution in South Africa. For example, concession and

²⁵⁵ See Esser *Recognition of Stakeholder Interests* 31 .

²⁵⁶ By corporation is meant '...all of its stakeholders- rather than of the shareholders alone'. See Margaret M. Blair & Lynn A. Stout 'A Team Production Theory of Corporate Law (1999) 85 *VA. L. Rev* 288-289.

²⁵⁷ Velasco (2006) *UC. Davis L. Rev* 456.

²⁵⁸ Esser *Recognition of Stakeholder Interests* 30.

²⁵⁹ David Millon 'Communitarians, Contractarians, and the Crisis in Corporate Law (1993) 50 *WASH. & LEE L.REV* 1378-1379.

²⁶⁰ See Velasco (2006) *UC. Davis L. Rev* 445-448.

²⁶¹ Michael Bradley et al 'The Purposes and Accountability of the Corporation in Contemporary Society: Corporate Governance at a Crossroads (1999) 62 *Law & Contemp. Probs* at 37, cited by Velasco (2006) *UC. Davis L. Rev* 455.

contract theories help to highlight the public nature as well as the private nature of company law respectively, minus the theories' excesses of course. The law in South Africa and indeed the world over, serves to regulate the conducting of business and various relationships created within the life of the corporation as proposed by either the concession or the contractant theories. Some of the thrusts of the theories have somehow been subsumed by law-makers and regulators. The communitaire theory, and also the other two theories' views on the role of stakeholders and the debate around which interests of the stakeholders should receive primacy, are debates which are still present in South African law.

The conflicting views represented by the various theories regarding shareholder primacy versus a stakeholder inclusive approach are present in the current South African corporate law and corporate governance regime.²⁶² South Africa is said to have adopted the enlightened shareholder value approach under the Act.²⁶³ However and regardless, there appears to be an interesting thrust towards giving consideration to the wider interests of other stakeholders in the life of the corporation, other than the interests of shareholders. According to the *King III Report*, while directors are expected to maximise value for shareholders in the long term, they need to maintain healthy and productive relationships with stakeholders.²⁶⁴ It is important to point out that whereas the concession and communitaire theories describe the state as either playing a concessionary role or the corporation as being an instrument of the state, the Act differs from the two theories in its approach as already pointed out above.²⁶⁵

Another double importance of the theories to this study, especially the debate between the contractual and communitaire theories, is the theories' different approaches towards the nature of directors' relationship with the corporation. In this regard, the question debated by the two theories can be represented by one inquiry: Are company directors agents of shareholders, managing partners in the corporation, or is their legal status *sui generis*? Part 2.4.3 will attempt to provide answers to this question by referring to the legal position under the new and still evolving corporate governance regime in South Africa.

The theories on nature of companies can be summed up to lead to two common models of corporate governance, namely the contractual model and the concession model. The first model, the contractual model, as discussed above, is based on the contractarian or

²⁶² As represented by the *King III Report* and the Act.

²⁶³ Davis et al *Companies and other Business Structures in South Africa* 3ed (2013) 12.

²⁶⁴ *King III* lists such stakeholder interests to include those of shareholders, employees, suppliers, customers, financiers, the community at large, its regulators etc. See 'Introduction and Background' to *King III Report*.

²⁶⁵ In addition to a right to incorporate a company in s13 of the Act, see the constitutional right of freedom of association - see s18 of the Constitution.

agency theory. In dealing with the key question ‘in whose interests should directors manage the company’, the contractual model answers it with a shareholder-centric view. Managing the company ‘in the best interests of the company’ is understood by this model to mean the interests of the shareholders collectively. Interests of other groups in the life of a corporation such as creditors, employees and the environment for example, are seen as subordinate to those of shareholders. The goal of the model is to maximise shareholder wealth, and shareholders are seen as the best proxy for societal wealth. In case of a clash of interests, primacy must be given to the interests of the shareholders which must as of necessity, trump any other competing interests.

In contrast, the second model, the concessionary model,²⁶⁶ gives primacy to pluralist interests as opposed to a shareholder-centric approach. Even where the so called ‘bottom-up’ variant of the concessionary theory accepts that the company must be run in the interests of the shareholders, taking into account interests of other interest groups is seen as a necessity. The first variant of the ‘bottom-up’ concessionary theory argues that ignoring stakeholder interests will seriously damage shareholder interests, while the second variant holds that considering stakeholder interests in decision-making will directly benefit the company whether in the short-run or in the long run.²⁶⁷

2.4.2 The legal status of a company in South Africa

At common law a company is regarded as a legal person that is capable of acquiring rights and duties distinct from its incorporators, from the time of and by virtue of its incorporation.²⁶⁸ There are legal implications or consequences of this separate legal personality of a company. It was confirmed in the old South African case of *Dadoo v Krugersdoorp Municipal Council*²⁶⁹ that the separate existence of a company is not merely an artificial legal technicality, but that it is a matter of substance. One real implication of such a legal personality is that company property or assets, profits, debts and liabilities vest in the company. They cannot be regarded as the property of shareholders of a company.²⁷⁰ According to the seminal English case *Salomon v Salomon & Co Ltd*,²⁷¹ the motives of incorporators in establishing the company are irrelevant when considering the rights and

²⁶⁶ See Esser *Recognition of Stakeholder Interests* 32-33.

²⁶⁷ *Ibid.*

²⁶⁸ This is called a separate legal personality of a company. See *Airport Cold Storage (Pty) Ltd v Ebrahim* 2008 (2) SA 303 (C).

²⁶⁹ 1920 AD 530.

²⁷⁰ *Ibid* at 550-551. Also see Cassim R ‘The Legal Concept of a Company’ in Cassim et al *Contemporary Company Law* 29.

²⁷¹ [1897] AC 22 (HL).

liabilities of a company.²⁷² Once a company is deemed to be legally existent following incorporation, it should, to the extent that it is applicable, be treated like any other independent person capable of enjoying rights and liabilities flowing from its newly acquired legal personality.²⁷³

Another implication of the legal personality of a company at common law is that incorporation of a company entails limited liability of shareholders in some instances.²⁷⁴ As a general principle, incorporators or shareholders of a company are not liable for the debts of the company.²⁷⁵ The debts and liabilities of a company should be solely borne by the company. Shareholders' assets should not be unfairly burdened by the liabilities of the company. This is one clear consequence of the 'separate legal personality' concept.²⁷⁶ This common law general rule is now subsumed by the Act.²⁷⁷

Two other legal consequences of the separate legal personality of a company, in summary, are that; firstly, as discerned from case law, there is potential for perpetual existence of the company. Thus, the company is not supposed to be affected by changes in terms of shareholding membership within the corporation, either as a result of death of a shareholder or any form of share transfer.²⁷⁸ Lastly, separate legal personality of a company implies that only agents or representatives of the company are authorised by law to manage the affairs of a company. In this connection, shareholders do not qualify as agents of a company, and lack authority or standing to bind the company in terms of contracts or to participate in business transactions affecting the company to the exclusion of duly authorised agents. If it is to be accepted that shareholders are residual claimants to corporate assets, then this legal consequence of separate legal personality of a company has implications for the need to separate ownership and management or control in the corporate form. This also has far-reaching implications of the legal position of and the role of directors in a modern company.²⁷⁹

²⁷² Also see Davis D et al *Companies and other business structures* 23.

²⁷³ *Salomon v Salomon* (supra) para 22.

²⁷⁴ Davis et al *Companies and other business structures* 23.

²⁷⁵ *Airport Cold Storage (Pty) Ltd v Ebrahim* (supra) at para 6. Also see Cassim et al *Contemporary Company Law* 35.

²⁷⁶ The limited liability, where it is applicable, is available for enjoyment by the shareholders, and not the company itself and/or its directors. It has even been argued that it is not correct to describe a company as a limited liability company. See Cassim et al *Contemporary Company Law* 35.

²⁷⁷ S 19(2) of the Act provides that a person is not, solely by reason of being an incorporator, shareholder or director of a company, liable for any liabilities or obligations of the company, except to the extent that the Act or the company's MOI provides otherwise.

²⁷⁸ See *Maasdorp v Haddow* 1959 (3) SA 861 (C) 866; *Stern v Vesta Industries (Pty) Ltd* 1976 (1) SA 81 (W) 85, cited by Cassim et al *Contemporary Company Law* 36.

²⁷⁹ See s66 (1) of the Act in this regard.

There are exceptions to the general rule that shareholders and/or directors have limited liability for the company's debts. Company legislation may provide that certain companies may have a legal personality but that their directors may not enjoy limited liability.²⁸⁰ The Act provides clear examples and instances of such exceptions. The Act appears to suggest that a company's Memorandum of Incorporation (hereafter, MOI) may provide that directors of the company for example, may be liable even if the company is a limited liability company.²⁸¹

The clearest exception to the general rule²⁸² as referred to above, concerns the legal position of personal liability companies as provided for in section 19(3) of the Act. This section provides that in a personal liability company, the directors and the past directors of a company are jointly and severally liable together with the company for its debts and liabilities.²⁸³ ..

With regard to the meaning of the term 'company', the Act defines a company in terms of its juristic personality.²⁸⁴ This is for the reason that the very foundation of our company law rests on the concept of a company's separate legal personality.²⁸⁵ The Act provides a lengthy definition of a 'company' in section 1, which definition takes into account the previous legislative positions. The definition of a juristic person in the same section of the Act includes a foreign company and interestingly, a trust. Under South African common law, a trust is not considered a juristic person.²⁸⁶ The inclusion of a trust within the scope of the definition of a juristic person has implications for appointment of this body onto the board of directors for company groups, as has been the norm under South Africa common law.²⁸⁷ Section 69(7) of the Act will now disqualify trusts from holding a directorship, while other commentators believe that the import of the wording of section 87 (1) (a) and (b) mean that

²⁸⁰ Davis et al *Companies and other business structures* 23.

²⁸¹ That is at least the impression given by a proper reading of part of s19(2) "...except to the extent that this Act or the company's Memorandum of Incorporation provides otherwise."

²⁸² The general rule is that incorporators or shareholders are not liable for the debts and liabilities of companies.

²⁸³ The liability of such directors of personal liability companies is for any debts or liabilities of the company that are or were contracted during the directors' terms of office. Thus s19(3) renders current and past directors co-debtors with the company. In other words the directors are liable *singuli et in solidum* for such contractual liabilities. See *Fundstrust (Pty) Ltd (In Liquidation) v Van Deventer* 1997 (1) SA 710 (A) 715.

²⁸⁴ See s1 of the Act.

²⁸⁵ As established in *Salomon v Salomon* (supra) para 22. Also see Cassim et al *Contemporary Company Law* 23.

²⁸⁶ See *Commissioner for Inland Revenue v MacNeillie's Estate* 1961 (3) SA 833 at 840; *Commissioner for Inland Revenue v Friedman NO* 1993 (1) SA 353 (A) 370; *Land and Agricultural Development Bank of SA v Parker* [2004] 4 All SA 261 (SCA) para 10; *Lupacchini NO v Minister of Safety and Security* [2011] 2 All SA 138 (SCA) para 1, referred to by Cassim R 'The Legal Concept of a Company' in Cassim et al *Contemporary Company Law* 30.

²⁸⁷ See Cassim et al *Contemporary Company Law* 30.

trusts may now be appointed as company secretaries.²⁸⁸ If this is at all correct, such trusts will obviously have to be represented by their employees who satisfy certain requirements set by the Act.²⁸⁹

Section 19(1) of the Act confirms the common law position regarding the legal consequences of incorporation on the legal personality of a company. In this regard the Act provides that from the date of its incorporation, a company -:

...

- (a) is a juristic person which exists continuously until its name is removed from the companies register in accordance with this Act;
- (b) has all of the legal powers and capacity of an individual, except to the extent that
 - (i) a juristic person is incapable of exercising any such power, or having any such capacity, or
 - (ii) the company's Memorandum of Incorporation provides otherwise.²⁹⁰

The above definition of a company, particularly s 19(1) (b) of the Act has implications for a company operating in South Africa where the Constitution²⁹¹ informs every conduct and legal form. S 19(1)(b) (i) appears to affirm the contents of section 8(4) of the Constitution. It similarly provides that a juristic person is entitled to the same fundamental rights as natural human beings, to the extent that such rights can be exercised by legal persons such as companies.²⁹² Impliedly, companies are bound by applicable provisions of the Bill of Rights such as those contained in section 8.²⁹³ Equally, a juristic person can now derive the benefits and protection of the Bill of Rights, and can invoke its provisions. For example, a company may sue for defamation, if its reputation is unfairly affected. This is possible despite the fact that a company is regarded as having 'no feelings to outrage or offend'.²⁹⁴ For the reason that a corporation, just like natural persons 'has a reputation in respect of business or other activities which it is engaged that could be damaged by defamatory statements, it is only proper that [*such*] a corporation should be afforded the usual legal processes for vindicating

²⁸⁸ Ibid at 30.

²⁸⁹ The requirements are set out in s84 (5) of the Act.

²⁹⁰ S 19 (1) of the Act.

²⁹¹ Constitution of the Republic of South Africa, 1996.

²⁹² S8(4) of the Constitution specifically provides that " A juristic person is entitled to the rights in the Bill of Rights to the extent required by the nature of the rights and the nature of that juristic person.

²⁹³ This includes s8(2) of the Constitution which states that a provision in the Bill of Rights binds a natural or juristic person if, and to the extent that it is applicable, taking into account the nature of the right and the nature of any duty imposed by the right.

²⁹⁴ See *Caxton Ltd v Reeva Forman (Pty) Ltd* 1990 (3) SA 547 (A) at 561. Also see *Dhlomo v Natal Newspapers (Pty) Ltd* 1989 (1) SA 945 (A). Further see *Media 24 Ltd and Others v SA Taxi Securitisation (Pty) Ltd* (437/2010) [2011] ZASCA 117; 2011 (5) SA 329 (SCA); [2011] 4 All SA 9 (SCA) (5 July 2011) par 7-17.

that reputation'.²⁹⁵ However in keeping with the tenor of s8(4) of the Constitution, while accepting that a juristic person has a right to be treated equally to other persons,²⁹⁶ the Constitutional Court²⁹⁷ cautioned against equating juristic persons with natural persons in terms of all fundamental human rights contained in the Bill of Rights. For example, a corporation cannot enjoy rights to life and human dignity, and its right to privacy cannot be equated with that of a natural person.²⁹⁸

2.4.3 Legal status of company directors: Are directors agents, trustees, managing partners or is their status sui generis?

The precise nature of the legal relationship between a director and a company remains debatable without concrete agreement on the matter.²⁹⁹ Different analogies have been employed to try and explain this relationship. In this regard, directors have been described as agents, trustees, employees or even managing partners for varying reasons.³⁰⁰ As will be argued in this part, each of these descriptions has serious limitations in giving a precise understanding of the unique role of directors in corporations. The situation has been crying out for a fresh view on the legal relationship between directors and companies.

The limitations of the different descriptions of company directors listed above were considered in an old English case of *Re Imperial Hydropathic Hotel Co.* Bowen L.J while appreciating the use of similes such as agents, servants or managing partners to describe directors' powers and duties, stated firmly that in his view:

...directors are not exactly agents, nor exactly servants, perhaps not servants at all, nor exactly managing partners if by that is meant that they are nothing more and nothing less.³⁰¹

As explained by Bowen L.J there are very good reasons why directors' status can only be said to be analogous to that of agents, trustees, managing partners or servants. However, these expressions cannot, in their singular forms, exhaustively describe the nature of the powers, roles and responsibilities of directors.

²⁹⁵ See the statement of the Appellate Division in *Financial Mail (Pty) Ltd v Sage Holdings Ltd* 1993 (2) SA 451 (A) at 461-462. Words in brackets and italics are my own addition for emphasis.

²⁹⁶ For e.g. corporations, including Non-Profit Companies have an equal right and have a remedy of a defamatory action available to them in case of defamatory statements calculated to cause such entities financial prejudice. See *Dhlomo v Natal Newspaper (Pty) Ltd* (supra) 945.

²⁹⁷ In *Investigating Directorate: Serious Economic Offences v Hyundai Motor Distributors (Pty) Ltd; In re Hyundai Motor Distributors (Pty) Ltd v Smit NO* 2001 (1) SA 545 (CC) para 19.

²⁹⁸ Ibid.

²⁹⁹ See Cassim et al *Contemporary Company Law* 412.

³⁰⁰ Joash Amupitan 'Status of a Company Director- An Agent, Trustee or Employee' (2000) 4 *JPL* 60-70.

³⁰¹ (1882) 23 Ch. D.I.P.P. 12 and 13. Also see a South African case *Cohen v Segal* 1970 (3) 702 (W) for similar comments by the court.

Are directors trustees? This question has been debated for centuries, with the early development of directors' fiduciary duties giving rise to the concept of a director as a trustee. The fiduciary duties themselves were largely moulded in the nineteenth century by the Courts of Chancery in England by way of analogy with duties applicable to trustees.³⁰² The origin of the concept of directors as trustees is to be seen in the pre-1884 era of the deed of settlement companies whose property is said to have been vested in trustees who were often also directors of the companies.³⁰³ The analogy with trustees, as illustrated in *Re City Equitable Fire Insurance Co*,³⁰⁴ came out of the need to impose equitable obligations which had already been developed in relation to trustees. As a result, an understanding was developed that just like trustees, directors are fiduciaries who manage assets or property that belongs to another person. As such, obligations had to be imposed to protect the interests of the beneficiaries. *Re City Equitable Fire Insurance Co*³⁰⁵ confirmed Bowen L.J.'s view in *Re Imperial Hydropathic Hotel Co*³⁰⁶ that it will be misleading to equate directors with ordinary trustees.

Under most common law jurisdictions such as South Africa, it is inappropriate to describe directors only as trustees. In South African trust law, a trustee is deemed 'owner' of the trust property and trust property is vested in the trustee.³⁰⁷ A director on the other hand does not own company property; he simply administers the property on behalf of the company. It is the company, as a legal person which remains owner of the property and/or assets.³⁰⁸ Unlike a trustee, a director's role encourages him to display more entrepreneurial flair and to accept commercial risks to produce a sufficient return on the capital invested, than a trustee is allowed to.³⁰⁹ It can be argued that while a director's status may be analogous to that of a trustee, it is not identical to that of a trustee.³¹⁰

The status of a director has also been equated to that of an agent for good reasons. Indeed the position of a director is analogous to that of an agent. Being a juristic or legal person in terms of law,³¹¹ a company cannot act on its own, and it is necessary that it acts

³⁰² See *Re City Equitable Fire Insurance Co* (supra). Also see Ahern (2012) *L.Q.R* 114.

³⁰³ Amupitan (2000) 4 *JPPL* 61.

³⁰⁴ (1925) Ch.407.

³⁰⁵ See *Re City Equitable Fire Insurance Co* (supra) at 426.

³⁰⁶ *Re Imperial Hydropathic Hotel Co* (supra) paras 12 & 13.

³⁰⁷ Cassim et al *Contemporary Company Law* 413.

³⁰⁸ See *Dadoo Ltd v Krugersdorp Municipal Council* (supra) at 550-551.

³⁰⁹ See *Daniels t/as Deloitte Haskins & Sells v AWA* (1995) 37 *NSWLR* 438.

³¹⁰ See the dicta to the same effect in *Mulkana Corp NL (in Liq) v Bank of New South Wales* (1983) 8 *ACLR* 278 *SC (NSW)* at 279.

³¹¹ See s1 of the Act for a definition of a company.

through the agency of natural persons.³¹² S66 of the Act, as aforementioned, requires that the business of the company must be managed under the direction of its board of directors. Even if this task is to be carried out by other company officers, they do so with delegated authority from and/or on behalf the company's board. Whether the term agent alone aptly captures the unique role of directors in a company is debatable. What is not debatable however is the fact that the relationship of a director to the company is analogous to that of an agent and a principal. Like an agent, a director acts for the benefit of another party (the company), and not for his own benefit.³¹³

In a company set-up, who the principal is, if it is to be accepted that a director is an agent, can give rise to controversy. It seems quite inappropriate to assume that in this construction, the director can be seen as an agent of a shareholder who then may be viewed as a principal. It has been argued that shareholder primacy has been overtaken by legal developments internationally, and in a reformed agency theory, the corporation can now be considered to be the principal – not the shareholder.³¹⁴ Thus if a director is an agent, then he can only be an agent of a company, and not that of a shareholder.³¹⁵ Despite close similarities with agents, directors are however not agents. In the context of the director primacy model, the status of directors is one of 'autonomous fiduciaries' as opposed to being merely agents.³¹⁶ An agent is not accorded original power to manage the assets or property of the principal. As alluded to earlier, directors, acting as a collective (the board) have now been accorded original power to manage and direct the affairs of companies.³¹⁷

If directors are not trustees and if they are not agents, can they be regarded as managing partners in a company then? Once again, it can be said that the roles of directors and managing partners could be analogous, but they are certainly not identical. It has been said that an analogy with managing directors has been drawn especially in the case of a personal liability company where directors are jointly and severally liable, together with the

³¹² This position was made clear in *Ferguson v Wilson* L.R 2 Ch.77 in which Cairns L.J explained it as follows: "They (directors) are merely agents of a company. The company itself cannot act in its own person, for it has no [physical] person; it can only act through directors, and the case is as regards those directors, merely the ordinary case of principal and agent..."

³¹³ Cassim et al *Contemporary Company Law* 412.

³¹⁴ See the argument by Loizos Heracleous and Luh Luh Lan 'Agency Theory, Institutional Sensitivity, and Inductive Reasoning: Towards a Legal Perspective' (2012) 49 *Journal of Management Studies* 223-239 at 230-232.

³¹⁵ See s76(3) of the Act. A director is appointed 'to act in the best interests of the company' and not to serve narrow interests of particular shareholders, even if such a director was nominated by a particular shareholder, or even if such director is known by descriptive terms such as 'nominee' director.

³¹⁶ Heracleous & Lan (2012) *Journal of Management Studies* 231.

³¹⁷ See s66(1) of the Act.

company for debts and liabilities of the company during their periods of office.³¹⁸ Directors have also been likened to managing partners because both types of leaders have a mandate to lead and govern. Regardless of whether this mandate comes from enabling legislation or constitutive documents of corporations, both directors and managing partners are empowered to run business.³¹⁹ The concept of managing partners is more relevant to a situation where the managing partner is a senior partner of a business organisation, has part ownership and a strong financial interest in the business which he manages on behalf of other partners. This is where directors are different from ordinary managing partners. Directors are not *per se* regarded as co-owners of company assets. They do not *per se* have a financial interest, save for situations where a director is also a shareholder in a company.³²⁰

As demonstrated above, expressions such as ‘agents’, ‘trustees’, ‘managing partners’ or ‘employees’ used to describe the role of directors fall short in depicting the real extent of directors’ powers and legal responsibilities. While all these analogies help to explain the common characteristics of the function and role of company directors, they have serious limitations as pointed out above. The limitations in turn only serve as a pointer to the uniqueness of the position of directors and their relationship with the company they are elected to serve. Some even believe that directors, acting as a collective (the board), have now risen to the status of a central organ of a company, with the general meeting of shareholders being another organ.³²¹ As has been argued by some legal commentators, it seems more appropriate to say that the status of company directors is *sui generis*.³²² Directors occupy a unique position, and no single expression with reference to some other legal relationship by way of an analogy can best describe directors’ relationship to the corporation. In South Africa, the Act, unlike its predecessor the Companies Act 61 of 1973 has now given directors original power or mandate to manage companies as already highlighted. This further strengthens the argument that directors have assumed a status akin to an independent managerial organ of the corporation.

³¹⁸ See Cassim et al *Contemporary Company Law* 413.

³¹⁹ MS Blackman et al *Commentary on the Companies Act* vol 2 (2002) (Revision Service 8, 2011) at 8-12, cited in Cassim et al *Contemporary Company Law* 413.

³²⁰ As per s75 (5) (a)-(g) of the Act, if a director has a financial interest in any matter, he is to ‘recuse’ himself from deliberations on the matter and taking decisions as part of the company board during a meeting, and is further barred from executing any document on behalf of the company in relation to that matter in question, except only with the permission of the board.

³²¹ See an argument by Amupitan (2000) 4 *JPPL* 67-70.

³²² See Cassim et al *Contemporary Company Law* 414. Also see Heracleous & Lan (2012) *Journal of Management Studies* 231.

2.5 Meaning of ‘the best interests of the company’ – Does the Enlightened Shareholder Value (ESV) approach provide an answer to the meaning of this phrase under the Act?

Efforts to answer the questions relating to what exactly is meant by the term ‘company’ and the phrase ‘the best interests of the company’ are on-going. At present, the efforts to find answers are represented by at least three theories. These three theories include the Shareholder value approach, which is based on two premises, namely directors’ obligation to ensure wealth maximisation for shareholders³²³ and the now archaic belief that shareholders are sole owners of the corporation.³²⁴ The other two approaches are the Stakeholder/Pluralist and the ESV approaches. These two recently occupied South African debates during the company law reform negotiations which culminated with the DTI Policy Document 2004.³²⁵ Some writers appear convinced and even claim that South Africa has adopted the ESV approach under the Act.³²⁶ The term ‘the best interests of the company’ may still require some unpacking through interpretation to give a meaning which reflects and represents the developments in law, including the spirit, objects and purposes of the Act.³²⁷ This part of the Study will highlight the lack of clarity regarding the exact approach adopted by the Act and will point in the direction of what may need to be done to make the position clearer.

The ESV is an approach which is still grounded within the shareholder value paradigm, but is considered to eschew a shift from a pure shareholder primacy.³²⁸ Like its predecessor the shareholder value approach, the ESV emphasises economic efficiency and maximum returns on shareholder investments.³²⁹ Simultaneously, the ESV considers some stakeholder interests as long as this results in wealth maximisation for shareholders. While

³²³ This approach found formal endorsement in the US case of *Dodge v Ford Motor Company* 170 N.W 668 (Mich. 1919). The court held that the discretion and powers given to company directors should be exercised and employed primarily to achieve one purpose: earning, and by implication, maximising profits for stockholders.

³²⁴ Case law has now accepted that shareholders are not, in the eyes of the law, part owners of the corporation. Ownership of shares is not synonymous with ownership of assets of the corporation. See *Short v Treasury Commissioners* [1948] 1 KB 116 (CA). In South Africa, the common law agrees with this position. In *Stellenbosch Farmers’ Winery Ltd v Distillers Corporation (SA) Ltd* 1962 (1) SA 458 (A) 471-472, the court remarked that entitlement to an *aliquot* share in the distribution of assets at winding-up indicates financial interest in the success of a company only. It does not amount to a right or title to any assets of the company. Also see *Macaura v Northern Assurance Co., Ltd* [1925] AC 619; *The Shipping Corporation of India Ltd v Evdomon*, 1994 (1) SA 550 (A).

³²⁵ See the DTI Policy Document 2004 op cit 6.

³²⁶ See views expressed by authors in Davis et al *Companies and other Business Structures* 11-12. Also see similar views in Cassim et al *Contemporary Company Law* 20-21.

³²⁷ See s5 (1) & s158 (b)(i) of the Act.

³²⁸ L Muswaka ‘Shareholder Value versus Stakeholders’ Interests – A Critical Analysis of Corporate Governance from a South African Perspective’ (2015) 43 (3) *J Soc Scie* 217 at 219.

³²⁹ *Ibid.*

ESV maintains the view that directors have to act in the collective best interests of shareholders, it now eschews what has been described as an ‘exclusive focus on the short-term financial bottom line’ which it seeks to balance with a more inclusive approach that values the building of long-term relationships.³³⁰ This inclusive thrust of the ESV is something akin to a similar sounding concept of enlightened value maximisation espoused by famous author Professor Michael Jensen.³³¹ The ESV approach is more enlightened than the shareholder value theory in the sense that directors are encouraged, and one may even argue, are now clearly required in other jurisdictions such as the UK³³² to take into account interests other than those of shareholders, in decision-making.³³³

Whether the ESV approach in practice results in a paradigm shift that removes it far from pure shareholder value remains unclear, and this opens the ESV to criticisms. A critical look at the ESV reveals that it may essentially be a glorified or ‘repackaged’ shareholder value approach. This is so for the reason that as has been argued, ESV still requires directors to treat shareholders’ interests as paramount and only considers material interests where this advances shareholders’ interests.³³⁴ It can be argued that with an ESV approach, the traditional understanding that directors’ acting ‘in the best interests of the company’ amounts mainly to maximisation of wealth for shareholders refuses to go away. This does little to solve a long standing tension in corporate law as represented by the question: in whose interest do directors manage companies? As already established in 2.4.2, a company as a separate legal person owns its assets and is to be seen apart from its shareholders and incorporators.

³³⁰ A Key ‘Tackling the Issue of the Corporate Objective: An Analysis of the United Kingdom’s ‘Enlightened Shareholder Value Approach’ (2007) 29:577 *Syd. Law Rev* 590.

³³¹ Professor Jensen makes the following argument in support of his enlightened value maximisation concept: “It is obvious that we cannot maximise the long-term market value of an organisation if we ignore or mistreat any important constituency. We cannot create value without good relations with customers, employees, financial backers, suppliers, regulators, communities, and so on”. M Jensen ‘Value Maximisation, Stakeholder Theory and the Corporate Objective Function’ (2001) 14:3 *J. Appl. Corp. Finance* 297 at 309.

³³² The UK Companies Act 2006 has incorporated the ESV approach in s172, and the section uses peremptory words to require directors to consider interests of other constituencies if the board considers that by so doing it will likely promote the success of the company for the benefit of members as a whole. It is not clear whether it can be argued that the UK Act’s s172 is an equivalent to s76 (3) (b) under SA’s Companies Act 2008. S 76 (3) (b) requires a director of a company to “act in the best interests of the company” when acting in the capacity of a director and when exercising the powers and performing the functions of a director. As aforementioned, what is meant by ‘the best interests of company’ still requires unpacking.

³³³ A Key ‘Moving Towards Stakeholderism? Constituency Statutes, Enlightened Shareholder Value, and all that: Much ado about little?’ at 592, electronic copy available at <http://ssrn.com/abstract=1530990> at 5-6, accessed on 19 July 2013.

³³⁴ See the Parliamentary Joint Committee on Corporations and Financial Services, Commonwealth of Australia, *Corporate Responsibility: Managing Risk and Creating Value* (2006), available at www.aph.gov.au/Senate/committee/corporations_ctte/corporate_responsibility/report/report.pdf, referred to by Key op cit 157 at 580.

At this stage it is important to briefly consider the tenets of the Pluralist approach (which is part of the Stakeholder theory) and its relevance to South African modern company law. The first pillar is that those who affect or are affected by the company and contribute to its success are stakeholders. They deserve to be treated as an end and not as the means to an end.³³⁵ The second pillar is inclusion and broader accountability by directors to these stakeholders whose contribution to success of the business enterprise must receive recognition.³³⁶ The third pillar is that, directors thus have a duty to create optimal value for all stakeholders in decision-making and make a company a place where not only shareholders but stakeholder interests are also maximised.³³⁷ The Pluralist approach views the best interests of the company to mean to balance interests of key stakeholders, not only those of shareholders.

South Africa's latest attempt at responding to the question regarding whose interests the company should serve is contained in the Act. S76 (3) (b) simply answers the question by requiring directors to perform their functions (which include decision-making) 'in the best interests of the company'.³³⁸ What is meant by 'the best interests of the company' is not exactly defined or given ready meaning under the Act. It has to be emphasised here that our law (the Act and common law included as established in 2.4.2) views a company as a separate person and its assets are not to be confused with those of shareholders. Yet, there is potential for conflict when one considers the common law interpretation of 'the best interests of the company' which is not properly aligned to the Act. The common law would interpret the phrase to mean interests of the collective body of shareholders, the present and future.³³⁹ This common law interpretation is difficult to reconcile with the understanding that a company stands apart from its shareholders.

The DTI Policy Document 2004 appears to suggest an approach which, though difficult to classify, may provide an answer to the proper interpretation of the 'best interests of the company' properly aligned to the Act. A close reading of the policy document appears to suggest a rejection of the traditional common law understanding of the best interests of the company. Thus according to the policy document, if company law is to remain congruent

³³⁵ Reynolds et al 'Stakeholder Theory and Managerial Decision-Making: Constraints and Implications of Balancing Stakeholder Interests' (2006) 64 *Journal of Bus Ethics* 285-301.

³³⁶ The argument is that even though shareholders vitally provide capital for business, the sharing of the return on investment should not exclude other stakeholders who ultimately contributed to success of business.

³³⁷ R.E. Freeman and R. Phillips, 'Stakeholder Theory: A Libertarian Defense' (2002) 12:3 *Business Ethics Quarterly* 331 at 333.

³³⁸ See Cassim et al *Contemporary Company Law* 20.

³³⁹ See *Greenhalgh v Ardenne Cinemas Ltd* 1951 Ch 286 at 291. Also see Muswaka (2015) *J Soc Scie* 220.

with the Constitution³⁴⁰ and consequential legislation, the interests of the shareholders should be balanced with those of stakeholders.³⁴¹ The company's pursuit of economic objectives should thus be constrained by social and environmental imperatives³⁴² as demanded by relevant constitutional values³⁴³ and legislative enactments.³⁴⁴ The policy document does not seem to be limited to the ESV approach. The policy document does not advocate a consideration of stakeholders' interests only if this ultimately promotes shareholder interests. On the contrary, the policy document provides that an approach properly aligned to a constitutional framework demands that stakeholder interests be given independent value.³⁴⁵ The DTI Policy Document 2004 goes even further to provide that directors in certain situations may have a specific duty to promote the stakeholders' interests as ends in themselves.³⁴⁶

It is therefore clear from the above paragraphs that the ESV cannot be said to be the approach adopted by the Act to provide meaning to what is meant by 'the best interests of the company'. As argued above, it can no longer be business as usual and the common law interpretation is not properly aligned to the constitutional framework as required by the DTI Policy Document 2004. The 'best interests of the company' can no longer be interpreted to only mean the collective interests of the present and future shareholders to the exclusion of other key stakeholders' interests. So how is the tension between an interpretation preferred by common law and the policy aligned to the proper policy direction of the Act and new company law in South Africa to be resolved? Well, the Act provides a way in which its provisions should be interpreted and the position is fully canvassed under Chapter 6, and it is not necessary to get into any more detail here.³⁴⁷ What suffices for the present purposes is to state that if the common law is lagging behind in terms of development, which I am convinced that it is the case here, then the Act points towards a possible solution. It (the Act) gives courts the mandate to develop the common law when applying it to a given set of facts

³⁴⁰ This is in line with s7 of the Act which provides one of the purposes of the Act as 'to promote compliance with the Bill of Rights as provided for in the Constitution, in the application of company law'.

³⁴¹ See DTI Policy Document 2004 op cit 6 p24-27

³⁴² Ibid.

³⁴³ Such as s24 of the Constitution of the Republic of South Africa.

³⁴⁴ A good example of such relevant pieces of legislation would include the National Environmental Management Act 107 of 1998 (the NEMA).

³⁴⁵ In the same manner shareholders are given independent value. See DTI Policy Document 2004 op cit 6 p24-27

³⁴⁶ Ibid at 27.

³⁴⁷ See part 6.3 of Chapter 6. It is pointed out in that part that s5(1) provides for an interpretation of provisions of the Act in a manner that gives effect to the purposes of the Act. Also see s158(b) (i).

if this is necessary to provide a remedy to an injured part.³⁴⁸ If a court is to give s76 (3) (b) a purposive interpretation,³⁴⁹ ‘best interests of the company’ will mean interests of the company as a juristic person.³⁵⁰ It is then both a right and responsibility of this juristic person, acting through its duly authorised agents, the board of directors,³⁵¹ to ensure that it balances interests of shareholders and all other key stakeholders.

An approach that balances interests of shareholders and other key stakeholders is neither an ESV approach to corporate governance nor a pure Pluralist approach. As demonstrated in the paras above, the ESV is not properly aligned to the policy direction preferred by the DTI Policy Document 2004. The Pluralist approach cannot be said to be the preferred approach since stakeholders have not received any formal recognition under the Act, unlike shareholders who are clearly recognised by the Act.³⁵² It cannot be gainsaid however that there is indirect recognition of the importance of certain key stakeholders in the life of the corporation by the Act.³⁵³ For example, in terms of derivative action provisions, the Act recognises clearly the powers of mainly three categories of stakeholders who can serve a demand on the company to commence or continue legal proceedings or to take related steps aimed at protecting the interests of the company. These are shareholders, directors/prescribed officers and registered trade unions representing employees or any other representative of employees. It is also clear from the reading of ss 4 & 22 of the Act that the Act considers the protection of creditors as important to sustainability of companies and promotion of enterprise efficiency. An approach balancing the ESV and the Pluralist approach can be said to be the preferred approach.

³⁴⁸ S 158 (a) provides that ‘when determining a matter brought before it in terms of this Act ...a court must develop the common law as necessary to improve the realisation and enjoyment of rights established by this Act’.

³⁴⁹ See part 6.3 of Chapter 6 for a description of a purposive approach.

³⁵⁰ See s19(1) for an expose of the legal status of companies under the Act.

³⁵¹ See s66(1) which gives the board of directors original authority to exercise all of the powers and perform any of the functions of the company, including supervision of senior executives of the company.

³⁵² See Cassim et al *Contemporary Company Law* 20.

³⁵³ For e.g. in terms of derivative actions under s165 (2) of the Act, the Act recognises clearly the powers of mainly three categories of stakeholders who can serve a demand on the company to commence or continue legal proceedings or to take related steps aimed at protecting the interests of the company. These are shareholders, directors/prescribed officers and registered trade unions representing employees or any other representative of employees. It is also clear from the reading of ss 4 & 22 of the Act that the Act considers the protection of creditors as important to sustainability of companies and promotion of enterprise efficiency.

2.6 The relationship between duty of care and BJR

What is the duty of care, skill and diligence and why is it important in company or corporate law? As already conceptually established in this thesis,³⁵⁴ the company as a juristic person can only act through the ‘agency’ of authorised natural persons, that is, its directors who should represent it and make important decisions on its behalf.³⁵⁵ In discharging their responsibilities, directors should observe two categories of common law duties. The first such category, the fiduciary duties, can be summed up as the composite duty of loyalty to the company. A fiduciary duty imposes on directors what has been described as ‘a largely negative obligation to do nothing which conflicts with the company’s interests’.³⁵⁶ The second category, the composite duty of care, can be described as a duty of directorial competence.³⁵⁷ It has been correctly stated that the paramount duty of directors, individually and collectively, is to exercise their powers bona fide in the best interests of the company.³⁵⁸ Directors’ main role in a company involves decision-making. This demands leadership qualities such as the exercise of necessary or reasonable care, application of relevant skill and appropriate meticulousness. Thus there is little doubt that the duty of care is of paramount importance in decision-making.³⁵⁹

Risk taking is inextricably part of business and entrepreneurship.³⁶⁰ Thus in their decision-making role, directors are expected to take investment risks and even courts of law expect them to display ‘entrepreneurial flair’ in the hope of commensurate rewards for the company and its shareholders.³⁶¹ Courts have maintained for a long time that directors are not liable for mere errors of business judgment.³⁶² As such, it has been observed³⁶³ that courts have been careful to take into account the fact that after the event ‘the knowledge of hindsight

³⁵⁴ Shareholders are recognised through the Act and their rights are clearly provided for, for example through the requirement under Part D of the Act to have shareholders and many other rights in this part and under Part F. Also see 2.4.3 above.

³⁵⁵ See Demetra Arsalidou *The Modern Influences on the Traditional Duties of Care, Skill and Diligence of Company Directors* (2001) 4. Also see s66 (1) of the Act.

³⁵⁶ Bekink (2008) *SA Merc LJ* 95.

³⁵⁷ See Paul L. Davies *Gower and Davies’ Principles of Modern Company Law* 7ed (2003) 432.

³⁵⁸ JS McLennan ‘Duties of Care and Skill of Company Directors and Their Liability for Negligence’ (1996) 8 *SA Merc LJ* 94.

³⁵⁹ See part 1.1 of Chapter 1. Also see Cassidy (2009) *Stell LR* 373.

³⁶⁰ See JJ du Plessis ‘Open sea or safe harbour? American, Australian and South African business judgment rules compared’ (Part 1) (2011) 32 *The Company Lawyer* 345 at 348.

³⁶¹ See *Mulkana Corporation NL v Bank of Wales* (1983) 8 ACLR 278 279 SC (NSW), as confirmed in *Daniels v Anderson* (1995) 16 ACSR 607 665-666 CA (NSW).

³⁶² See *Lagunas Nitrate Co v Lagunas Syndicate* [1899] 2 Ch 392 435 (CA); *Re City Equitable Fire Insurance Co Ltd* [1925] Ch 407 428-429, *Fisheries Development Corp of SA v Jorgensen* (supra) at 166; *Philotex (Pty) Ltd v Snyman* 1998 (2) SA 138 (SCA) 144 & *Du Plessis NO v Oosthuizen* 1999 (2) SA 191 (O) 201..

³⁶³ Blackman, Jooste & Everingham *Commentary on Companies Act* 208 at 192.

can be misleading and give rise to unfair criticism'.³⁶⁴ Courts will avoid second-guessing business judgments of directors provided that the decision in question was, under the circumstances, sufficiently informed and given the information at directors' disposal, it was rational and reasonable.³⁶⁵ Directors' duty of care obligations in the decision-making process and the discretion which the law affords them naturally connects the duty of care with the BJR. The two are inextricably linked as far as directors' decision-making is concerned. The BJR will be discussed in detail in Chapter 5 of this Study, while Chapter 3 considers international best practices as part of a comparative analysis of the Study.

In brief, the essence of the BJR as captured in English case law is that 'directors may exercise their discretion *bona fide* in what they consider- not what a court may consider – is in the interests of the company'.³⁶⁶ English case law has for a long time maintained the understanding that it is not the function of the courts to be the arbiter of commercial decisions. That role was seen as belonging to shareholders and directors.³⁶⁷ The courts are expected to intervene only if the actions of directors indicate lack of good faith, absence of due care and or proper diligence in decision-making.³⁶⁸ As will be demonstrated in Chapter 5, South Africa has adopted the US-style BJR in statute even without incremental development of the rule as was the experience in the Australian³⁶⁹ legal system where the BJR has now been codified in a statute.³⁷⁰ The question that remains to be answered is whether the adoption of the BJR under the Act without something akin to a 'test-drive' will have positive or negative consequences on the enforcement of standards of care, skill and diligence in South Africa.

³⁶⁴ See the remarks of Goldstone JA in *Howard v Herrigel* (supra) at 676.

³⁶⁵ Blackman, Jooste & Everingham *Commentary on Companies Act* 208.

³⁶⁶ See *In Re Smith and Fawcett Ltd* [1942] Ch 304 (CA) at 306.

³⁶⁷ In *Shuttleworth v Cox Brothers & Co (Maidenhead) Ltd* [1927] 2 KB 9 (CA) at 23-24, Scrutton LJ confirmed the dictum in *Re Smith and Fawcett Ltd* and added that 'it is not the business of the court to manage the affairs of the company. That is for the directors. The absence of any reasonable ground for deciding that a certain course of action is conducive to the benefit of the company may be ground for finding lack of good faith...?'

³⁶⁸ *Ibid.*

³⁶⁹ In Australia, the BJR was codified in s 180(2) of the Corporations Act 2001.

³⁷⁰ See Zwinge, Tamo, 'Have Directors' Duties of Care and Skill Become More Stringent? What has Driven this Development? Is this Development Beneficial? An Analysis of the Duty of Care in the UK in Comparison to the German Duty of Care' (October 20, 2009), available at SSRN: <http://ssrn.com/abstract=1591590> or <http://dx.doi.org/10.2139/ssrn.1591590>, accessed on 19 August 2013.

2.7 CONCLUSION

This Chapter has laid down the theoretical foundations or a conceptual framework for an interrogation of the effectiveness of standards of care, skill, diligence and the BJR under the Act. It has been established that these standards are at the heart of the role that directors have to fulfill when discharging their legal responsibility of directing the business and affairs of a corporation.³⁷¹ Directors have to make business decisions, at times under imperfect circumstances and while confronting tensions inherent in the corporate form.³⁷² Not least of these tensions is the pressure to balance the profit maximisation drive from shareholders and accountability for how the directors manage broader stakeholder interests. Implicated in this are standards of care, skill and diligence and the duty to act in the best interests of the company expected of directors during the decision-making process. When allegations of breach of proper conduct are made, the BJR then provides the test a court is to apply when it reviews a director's conduct.³⁷³

Importantly, this Chapter defined key concepts central to this thesis. These key terms include subjective standards; objective standards, dual subjective/objective standards, dual objective/subjective standards; gross negligence; the complex corporate governance concept; the BJR; the terms 'company' and 'director' as defined by the Act and by various theories on the nature of a company.³⁷⁴

A discussion of the standards of care, skill, diligence and the BJR has been properly located within the broad concept of corporate governance which has been adequately defined and explained. How the company is governed is at the heart of this research because I focus here at the director's composite duty of care and the BJR (decision-making). The world-wide global financial crisis has put the spotlight back on directorial competence and attention to the affairs of the company during decision-making processes.³⁷⁵ Hence the importance of focussing on standards of care, skill and diligence plus the BJR in this thesis.

The relevant theories on the nature of the company have been explored with the view of answering questions regarding the legal status of a company and a director in South Africa today. It has been established that a company is a juristic person with a separate legal personality in terms of common law³⁷⁶ and the Act.³⁷⁷ On whether a director is an agent, a

³⁷¹ See s66(1) of the Act.

³⁷² McMillan (2013) *Wm. & Mary Bus. L. Rev* 527.

³⁷³ This point is further canvassed in 5.2.1 and 5.4.1 in Chapter 5.

³⁷⁴ See part 2.2 of this Chapter.

³⁷⁵ See Cassidy (2009) *Stell LR* 373.

³⁷⁶ See part 2.4.2 above.

³⁷⁷ S19(1) of the Act.

trustee, managing partner in a corporation, it has been established that the position of a director is unique from all these descriptions associated with it. It can only be *sui generis*.³⁷⁸ It has also been established that the Act adopts a broader definition of the term ‘director’ to focus more on the exercise of power and the function performed. This is a shift from a traditional focus on title and designation of the person of a director.

Two related key questions needed to be answered through the examination of the theories on the nature of a company, the legal status of the company as well as the legal status of a company director. The first question is ‘in whose interests should directors manage the companies?’ The second question is ‘to whom are the directors’ duties owed, especially the duty of care?’ In the light of the conclusion I reached regarding the legal status of both the company and the director, the logical corollary is that a reading of the Act and the corporate law reform policy objectives³⁷⁹ should lead to the conclusion that our law now demands a departure from a traditional narrow interpretation of ‘the interests of a company’.³⁸⁰ It was demonstrated in this Chapter that the law determines that duties are owed to the company as an independent commercial entity and not to individual stakeholders.

³⁷⁸ See Cassim et al *Contemporary Company Law* 414. Also see Heracleous & Lan (2012) *Journal of Management Studies* 231.

³⁷⁹ See the DTI Policy Paper 2004 p24-27.

³⁸⁰ Or the phrase ‘the company as a whole’.

CHAPTER 3: INTERNATIONAL BENCHMARKS & TRENDS IN EVOLUTION OF STANDARDS OF CARE, SKILL, DILIGENCE & THE BJR

3.1 INTRODUCTION

South Africa's corporate law reforms¹ coincided with similar developments elsewhere in the world, and benefited immensely from evolving international best practices in corporate governance. The DTI Policy Document 2004 spelt out a vision for law reform which resulted in the Act. One of the objectives of law reform was to promote the global competitiveness of South African companies. One of the ways of achieving this was by ensuring compatibility and harmonisation of the new company law with the best practice jurisdictions internationally.² In this regard, South Africa has followed a common trend in the Commonwealth legal systems towards stating in statute the directors' duties which incrementally developed through case law.³ Two such legal systems, Australia and the United Kingdom (hereafter the UK) have probably had the greatest influences on the development of modern standards of care, skill and diligence in South Africa. Both Australia⁴ and the UK⁵ have codified directors' common law duties in their revised company laws.

The purpose of this chapter is to trace the development of the duty of care, skill, diligence and the BJR in the countries selected as comparators of choice for this study, being Australia, the U K and the USA. The chapter further considers how the evolving standards of directors' conduct, distilled from a growing body of case law in these countries, have influenced South African law reform. Even more importantly, this chapter considers how evolving standards from these countries may continue to impact on the future development of relevant jurisprudence in South Africa. The chapter will compare and contrast directors' standards of conduct and review contained in the various pieces of legislation in the selected countries on one hand, and the standards now contained in the Act on the other hand. The success stories or the challenges of interpreting and enforcing standards in those countries will serve as lessons for development of standards in South African law.

Why is a comparative approach important to this study? It is decidedly relevant to this study because the Act and the Constitution encourages such an approach when interpreting its

¹ Best represented by the Act which repealed the Companies Act 61 of 1973.

² See objectives in the Explanatory Memorandum to the Companies Bill 2007 p3.

³ Bouwman (2009) *SA Merc LJ* 509-534.

⁴ See s180 (1) of the Corporations Act 50, 2001.

⁵ See s 174 (1) & (2) of the Companies Act, 2006 (c46).

provisions.⁶ In s 5(2) the Act states that “to the extent appropriate, a court interpreting or applying this Act may consider foreign company law”. Each comparator selected adds a peculiar dimension to understanding the historical as well as the future development of the duty of care, skill, diligence and the BJR in South Africa. As stated earlier, the UK and Australia jointly share South Africa’s experience of codifying directors’ duty of care. South Africa shares a common law heritage with these two Commonwealth legal systems. As such an understanding of any developments in English and Australian company laws has been correctly said to be of great comparative value to understanding development of the broad duty of care in South Africa.⁷

This chapter begins by briefly tracing the traditional or common law standards of care, skill and diligence in the UK, looking at the incremental development of the modern standards through case law and s 214(4) of the Insolvency Act of 1986. Comments will be made on the current standards under the Companies Act 2006 as comparisons will be drawn between the developments in law in the UK and South Africa. The UK set the pace for the development of the duty of care among common law jurisdictions. It is therefore proper that the comparative analysis should begin with a brief study of developments in the UK. Australia will be considered next, as Australian law reforms benefited too from common law developments of the duty of care in the UK during the nineteenth and twentieth centuries. Lessons drawn from the Australian experience of interpreting and enforcing the modern standards of care, skill and diligence will assist in proposing the correct future judicial approach for South Africa and development of standards. The USA law will be examined to give insight into the content of the duty of care, and the historical development of the relationship between the duty of care and the BJR.

3.2 The UK duty of care

The standards within the duty of care, skill and diligence have been incrementally developing (moulded and refined by courts of Chancery) under English law over centuries- from the nineteenth century to the present day. Codification of the duty of care in s 174 of the Companies Act 2006 is largely viewed as a transfer of the evolving modern day standards of care, skill and diligence from case law to a legislative scheme.⁸ It is debatable under English law whether s 174 within the entire scheme of the statutory statement of directors’

⁶ Part 1.7 of Chapter 1 briefly explains how the Constitution encourages a comparative study.

⁷ Bekink (2008) *SA Merc LJ* 103. Also see Havenga (2000) *SA Merc LJ* 25, & Bouwman (2009) *SA Merc LJ* 517.

⁸ See Ahern (2012) *L.Q.R* 114-139.

duties under UK law,⁹ has merely restated in statute the position of the standards of the duties in case law as they existed prior to the Act.

The spot-light at the moment falls on the difficulty of interpreting statutory duties such as the one in s174. Debates have arisen over which method of interpretation is best suited to allow for further growth of the law. The challenge appears to be around understanding the exact relationship between a statutory statement of directors' duties and the pre-existing case law—whether the one overrides the other in interpretation.¹⁰ For purposes of making a case for the best approach in interpreting section 76(3)(c) of the Companies Act 2008, it will be useful to have regard to the debates and challenges the UK is facing regarding interpretation of the standards contained in s174.

The approach to interpretation of s174 of the Companies Act 2006 has naturally generated controversy and debate in the UK as will be revealed below. While that is the case, what is not debatable is the fact that the Companies Act 2006 represents a memorial of the milestones in the development of the standards in English law. By implication, the standards in s 174 can be better understood within the context of the incremental development of the duty of care in the UK over the years. It is vital to briefly consider the common law development of the duty of care under English law prior to the Companies Act 2006.

3.2.1 From a traditional approach to modern standards of care in the UK

Standards of care under English law shifted from low and less demanding standards to the more stringent modern standards encapsulated in the Companies Act 2006. The law relating to the duty of care never remained fossilised at the traditional approach. Different scenarios and commercial realities gave rise to refinements of principles through application by courts of law.¹¹ The traditional approach to the duty of care was that there was little demanded of directors, and the directors of the nineteenth century were liable only for gross errors of judgment amounting to negligence.¹² In *Re Denham & Co*,¹³ the director who had neglected his duties for four years, and had been found guilty of negligence by the court of chancery was inexplicably adjudged not to have breached his duty of care towards the company.¹⁴

⁹ S171-177 of the Companies Act 2006 is a statutory statement of seven directors' common law duties.

¹⁰ See ss 170 (3) & 170 (4).

¹¹ Ahern (2012) *L.Q.R* 116.

¹² A Hicks 'Directors' Liability for Management Errors' (1994) 110 *L.Q.R* 390.

¹³ (1884) LR 25 Ch D 752.

¹⁴ See Bouwman (2009) *SA Merc LJ* 512.

It can be argued that in the earlier cases of the nineteenth century, the courts adopted a lax attitude towards enforcement of the duty of care. This attitude of the courts was informed by a belief that if shareholders appointed ‘half-wits’ or incompetent directors they only had themselves to blame. It was believed to be their duty to take remedial action and not the courts’.¹⁵ In *Turquand v Marshall*,¹⁶ the court declared that as long as the directors kept within the powers in their deed, however ridiculous their actions might seem, it was the misfortune of the company that they had chosen such unwise directors. An equally surprising dictum was made in a fairly recent case *In re Elgindatahad Ltd*,¹⁷ where the court remarked that the shareholders had no right to expect a reasonable standard of general management from the company’s managing director. The court went on to add that it was considered one of the normal risks of investing in a company that its management may not turn out to be of the highest quality.¹⁸

In *Re Cardiff Savings Bank: Marquis of Bute’s Case*,¹⁹ the Marquis of Bute, having been appointed director at six months of age, only attended one shareholders’ meeting in 38 years. Yet despite this clear abdication of duty (at least from a modern perspective), the action for breach of his duty of care was unsuccessful.

In the earlier case of *Overend, Gurney & Co v Gibb*,²⁰ the test developed was that of mere ‘ordinary prudence’, a test which was lower than the prudence expected to be exercised by a man when running his own affairs. Under such a low standard, it has been argued, a director would be exempted from liability where he was not aware of pertinent facts because of his own inattentiveness to company business.²¹

English courts of the early nineteenth century insisted on gross negligence to found liability, and anything short of this would not help litigants in the action for breach of the duty as was ruled in *Lagunas Nitrate Co v Lagunas Nitrate Syndicate Ltd* for example.²² Lindley MR emphatically remarked that directors’ ‘negligence must be not the omission to take all possible care; it must be much more blameable than that; it must be in a business

¹⁵ Davies, Paul L. *Gower and Davies’ Principles of Modern Company Law* 7ed (2003) at 433.

¹⁶ (1896) LR 4 Ch App 379.

¹⁷ [1991] BCLC 959 Ch.

¹⁸ Ibid. Also see Havenga (2000) *SA Merc LJ* 26.

¹⁹ [1892] 2 Ch 100.

²⁰ (1872) LR HL 480.

²¹ See Zwinge, Tamo, ‘Have Directors’ Duties of Care and Skill Become More Stringent? What has Driven this Development? Is this Development Beneficial? An Analysis of the Duty of Care in the UK in Comparison to the German Duty of Care’ (October 20, 2009). Available at SSRN: <http://ssrn.com/abstract=1591590> or <http://dx.doi.org/10.2139/ssrn.1591590>. Accessed on 20 April 2014.

²² 1899 2 Ch 392.

sense culpable or gross'.²³ Thus even in a case of serious misconduct on the part of a director, the directors could escape liability if their misconduct could not be classified as gross negligence. This was the case in *Re Brazilian Rubber Plantations and Estates Ltd.*²⁴ This seemingly lax attitude of the courts during this period towards enforcement of the duty of care led other commentators to argue that the common law of the day operated to give directors a remarkable freedom to run companies incompetently.²⁵ Part of the reason for this lenient approach by the courts was due to the nature of business during the period. There were relatively few companies during those days. Company boards apparently consisted of part-time, non-executive directors who were considered mere figureheads,²⁶ or well-meaning amateurs.²⁷ The courts of Chancery probably felt sorry for this 'species' of directors of the day who lacked in technical ability and did not possess any specialist skills. As 'amateurish' part-timers, the directors (possibly) could not be expected to consistently attend meetings, to participate in company affairs with requisite diligence let alone to exercise a professional skill which they possibly lacked.²⁸

3.2.1.1 Shift from subjective to dual objective/subjective elements

From the lax attitude of the courts during the latter years of the nineteenth century,²⁹ the English courts moved from applying purely subjective elements of the duty of care to what I would call a dual subjective/objective standard or simply a classic subjective standard of the duty of care, skill and diligence.³⁰

²³ Ibid at 392. See also *Overend & Guernsey Co v Gibb* 1872 LR HL 480 487-489, 493, 496, 500; *Re National Bank of Wales Ltd* 1899 2 Ch 629 672; *Re City Equitable Fire Insurance Co Ltd* 1925 Ch 407 referred to in Cassidy (2009) *Stell LR* 384.

²⁴ [1911] 1Ch 425. In this case directors contracted on behalf of a company to purchase a plantation on the basis of a clearly fraudulent report. Despite the fact that the directors were made aware of the discrepancies and misrepresentations in the report, their failure to show diligence by making proper inquiries and to correct the exposed discrepancies did not, in the Court's opinion, amount to gross negligence.

²⁵ Finch (1992) *The Modern Law Review* 179.

²⁶ The directors were often appointed to the company boards because of their reputation and not their business acumen. See Havenga (2000) *SA Merc LJ* 26.

²⁷ See Finch (1992) *M.L.R.* 200.

²⁸ See J Cassidy 'An Evaluation of Section 234(2) of the Corporations Law and the Directors' Duty of Care, Skill and Diligence' (1995) *Australian Business LR* 184 AT 185. Also see Havenga (2000) *SA Merc LJ* 26.

²⁹ Including the earlier years of the twentieth century.

³⁰ See 2.2.4 for the meaning of dual subjective/objective standards, or meaning of subjective standards. Also see Law Commission & Scottish Law Commission *Company Directors: Regulating Conflicts of Interests and Formulating a Statement of Duties* - Law Commission Consultation Paper No 153, Scottish Law Commission Discussion Paper No 105 (1998) Chaps 12 and 15. Further see The Law Commission and the Scottish Law Commission *Company Directors: Regulating Conflicts of Interests and Formulating a Statement of Duties* (LAW COM No 261) (SCOT LAW COM No 173) 1999 par 5.3ff

*Re City Equitable Fire Insurance*³¹ is considered by many to have provided the genesis or roots of the modern law on directors' standards of care, skill and diligence.³² While there is a general agreement regarding this point, there are differences on whether the test applied by Romer J was a purely subjective one or whether it had dual subjective/objective elements. There is a general misunderstanding of the breadth, length and depth of the decision in *Re City Equitable Fire Insurance Co Ltd*. Some believe that Romer J's decision did little to improve standards of care, skill and diligence in the UK from the position left by cases such as *Re Brazilian Rubber Plantations and Estates Ltd*.³³ I submit that this is an inadequate comprehension of the depth to which Romer J went in attempting to improve standards of care, skill and diligence. There is a good reason why *Re City Equitable Fire Insurance Co Ltd* is regarded as having laid the roots for a modern duty of care, skill and diligence. Romer J, in expounding upon a new approach, sought to build upon the foundations laid by earlier cases, while giving a robust approach within which the new standards should be understood.³⁴ A close examination of the judgment reveals elements of objectivity in the standards. Romer J proposed a basic standard of reasonable care,³⁵ which is 'to be measured by the care an ordinary man might be expected to take in his own circumstances on his own behalf'. This is a classical formulation of a reasonable man test, considered to approximate an objective test. Admittedly the standard was not objective enough for modern day business.

Critics have paid attention to the propositions put forward by Romer J in *Re City Equitable Fire Insurance Co Ltd*. The proposition should be understood as a context in which

³¹ [1925] Ch 407 (CA). The brief facts of this case are that the company suffered a great financial loss as a result of fraud by the Chairman, one Bevan. The liquidator brought this action against other directors for negligently failing to detect the fraud. Two of the directors were in the end found negligent, but were saved by a clause in the articles of association which exempted directors from liability for negligence except losses caused by their own 'wilful neglect or default'. Such clauses were subsequently outlawed by the Companies Act 1929. Summary adapted from Dignam *Hicks & Goo's Cases & Materials on Company Law* 386.

³² Finch (1992) *M.L.R* 200, Havenga (2000) *SA Merc LJ* 26, Bouwman (2009) *SA Merc LJ* 510, Dignam *Hicks & Goo's Cases & Materials on Company Law* 385 all agree that *Re City Equitable Fire Insurance Co Ltd* provided the roots for modern day duty of care, skill and diligence.

³³ See Finch (1992) *M.L.R* 41.

³⁴ This robust approach and the contextual presentation of the new standards of care, skill and diligence took the form of the following propositions made by Romer J in *Re City Equitable Fire Insurance Co Ltd* (supra) 407, at 428-430: Proposition 1 was that: a director need not exhibit in the performance of his duties, a greater degree of skill than may reasonably be expected from a person of his knowledge and experience.... Proposition 2: a director is not bound to give continuous attention to the affairs of his company. His duties are of an intermittent nature to be performed at periodical board meetings, and at meetings of any committee of the board upon which he happens to be placed. He is not, however, bound to attend all such meetings, though he ought to attend whenever, in the circumstances, he is reasonably able to do so. Proposition 3: In respect of all duties that, having regard to the exigencies of business, and the articles of association, may properly be left to some other official, a director is, in the absence of grounds for suspicion, justified in trusting that official to perform such duties honestly.

³⁵ Proposed earlier by Neville J in *Re Brazilian Rubber Plantations and Estates Ltd* (supra) at 425.

the new proposed standards of care, skill and diligence were to be understood at the time. The first proposition³⁶ related the subjective elements to the objective standards of a reasonable man. The test of reasonable care shown by an ordinary man when running his own affairs is tempered by the subjective element of a skill that a director actually possesses. Thus, a director was said not to be required to exhibit a greater skill than may reasonably be expected from a person of his knowledge or experience.³⁷ The only difficulty with Romer J's formulation of the standards was that it subordinated the objective standard to the level of skill or even the idiosyncrasy of a director. By implication, executive directors could be more easily liable for breach of duties than non-executive directors. The second proposition was formulated with part-time non-executive directors in mind, given the reality that during those years, the few companies which existed only had non-executive directors on their company boards.³⁸

It became apparent with the effluxion of time that Romer J's propositions made with non-executive directors in mind were no longer appropriate for the demands of modern business. Society's expectations of executive directors have changed, and the tightening of standards is required to be in sync with the exigencies of modern day business.³⁹ The third proposition⁴⁰ related to reliance and delegation, which is most applicable today, given modern day demands of business. The Act has been influenced by developments in English case law and has incorporated delegation and reliance into statutory law.⁴¹ There is a clear supervisory and strategic management role to be played by the company board, while the executive functions can be left to the executive to fulfil. In addition to some other aspects of the standards of care, skill and diligence which require further tightening, what Romer J also failed to emphasise is the role of the board to properly supervise the executive management. This became the object of further incremental development of the standards through case law wherein s214(4) of the Insolvency Act of 1986 was applied by English courts.

³⁶ See *Re City Equitable Fire Insurance Co Ltd* (supra) 428-430.

³⁷ It is interesting to see that even current company laws in some of the best practice jurisdictions in the world contain subjective elements to the duty of care which take into account the skill which a director possesses. For example, the UK Companies Act s174 (2) (b) provides for subjective considerations in addition to the objective standards contained in s174(1) by referring to the 'general knowledge, skill and experience that the director has'. Similarly, the Companies Act 2008's s76(3)(c) makes reference to a director 'having the general knowledge, skill and experience of that director.' This is a modern adaptation of the same dichotomy proposed by Romer J in *Re City Equitable Fire Insurance Co Ltd*.

³⁸ *Re City Equitable Fire Insurance Co Ltd* (supra) 428-430.

³⁹ See *Havenga* (2000) *SA Merc LJ* 26.

⁴⁰ See *Re City Equitable Fire Insurance Co Ltd* (supra) 428-430.

⁴¹ See s76(4)(b) and (5) of the Act.

While *Re City Equitable Fire Insurance Co Ltd* sowed the seeds for a dual objective/subjective standard, the decision leaned more towards a subjective standard, even though a basic objective standard of reasonable care could be discerned.⁴² Even though in terms of the society's expectations of executive directors today, the test applied by Romer J may seem to have been somewhat lax, it represented a tightening of the standards in law at the time.⁴³ Latter cases such as *Dorchester Finance Co v Stebbing*⁴⁴ built upon this foundation.

3.2.1.2 Dual Objective/Subjective standards and the UK Law Reform

The case of *Dorchester Finance Co v Stebbing*⁴⁵ in 1989 appears to me to have been the beginning of the modern approach to the duty of care. Forster J recognised the need to distinguish a subjective standard which applies to the duty of 'skill' from an objective one pitched at a high level which applies to 'diligence'. That was the beginning of the dual objective/subjective standards of care. Forster J did not only manage to build upon Romer J's formulations of standards of care, he also succeeded in creating a good problem. The good problem is whether it is possible to easily delineate an objective duty of 'diligence' from the subjective duty to exercise 'skill' as Forster J attempted to do.

The English courts through the work of a commercial judge Hoffman J adopted an upgrade of standards of care in the cases after 1989. In *Norman v Theodore Goddard*,⁴⁶ Hoffman J adopted the view that both elements of the duty of care, namely 'diligence' and 'skill' are to be assessed objectively.⁴⁷ In pronouncing on the objective standard to be expected in the 'skill' to be exercised, the court stated that 'a director who undertakes the management of the company's properties is expected to have reasonable skill in property management, but not in offshore tax avoidance'.⁴⁸ When expounding on the new standards of care in law, Hoffman J relied on s 214 (4) of the Insolvency Act 1986. In Hoffman J's view, this statutory position accurately captured the common law position at the time.⁴⁹ Section

⁴² Dignam *Hicks & Goo's Cases & Materials on Company Law* 385.

⁴³ *Ibid.*

⁴⁴ [1989] BCLC 498.

⁴⁵ *Dorchester Finance Co v Stebbing* (supra). The brief summary of the facts is that the negligent directors, without inquiring into the purpose the money was to be used, were in the habit of simply signing blank cheques to be filled in later by the executive director, which led to fraud.

⁴⁶ [1991] BCLC 1028.

⁴⁷ *Norman v Theodore Goddard* (supra) at 1028. Also see Davies *Gower and Davies' Principles of Modern Company Law* 434.

⁴⁸ *Norman v Theodore Goddard* (supra) at 1030.

⁴⁹ The standard required by section 214(4) of the Insolvency Act 1986 is that of a reasonably diligent person having both:

- (a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as are carried out by that director in relation to the company, and

214(4) of the Insolvency Act 1986 applied specifically to wrongful trading,⁵⁰ but Hoffman J insisted that the standard of care owed is the same, whether or not a company is trading in the zone of insolvency.⁵¹ Two years later, in *Re D'Jan of London Ltd*⁵² Hoffman J reaffirmed his view that the duty of care owed by a director at common law is accurately stated in section 214(4) of the Insolvency Act 1986.

It is clear from the above cases that despite the gains made in the decisions/judgments made by Hoffman J, there was some confusion regarding the exact standards of care expected of directors. Some critics assumed that a more demanding duty of care was developed by Hoffman J in *Norman v Theodore Goddard* and *Re D'Jan of London Ltd*. As a consequence of this misconstruction, some critics were concerned about the severity of a demanding duty of care which could dissuade good people from acting as directors.⁵³ The correct understanding should be that the court could only have espoused a dual objective/subjective standard since s214(4) of the Insolvency Act 1986 emphasised a dual objective/subjective, and not an objective standard. There was also concern raised regarding whether in principle a line should be drawn between the elements of 'skill' and 'diligence' under the duty of care.⁵⁴

The Law Commission in its final report on law reform identified the issue of the clarity of the nature of the standards of care and skill demanded of directors as one of its main focuses under 'Directors' Duties- Codification, or Legislative Restatement'.⁵⁵ Clearly the lack of clarity regarding the applicable standards is a matter which occupied law reform, and needed to be resolved in the new law (namely the Companies Act 2006). The Law Commission considered altering the content of the duty of care to provide clarity on the standards of conduct expected of directors.⁵⁶ When recommending that the duty of care should be set out in statute like other common law duties, the Law Commission appears to have opted to retain the dual objective/subjective test under the common law. Up until the time of the Final Report,⁵⁷ English courts⁵⁸ had developed the common law duty of care

(b) the general knowledge, skill and experience that that director has. See Zwinge op cit at 4-5.

⁵⁰ See Davies *Gower and Davies' Principles of Modern Company Law* 434

⁵¹ *Norman v Theodore Goddard* (supra) at 1030. See Zwinge op cit at 5.

⁵² [1993] BCC 646.

⁵³ C.A Riley 'The Company Director's Duty of Care and Skill: The Case for an Onerous but Subjective Standard' (1999) 62 *Modern Law Review* 697 at 698-699.

⁵⁴ See Davies *Gower and Davies' Principles of Modern Company Law* 434.

⁵⁵ See *Modern Company Law for a Competitive Economy: Final Report* (London: DTI, July 2001). See para 3.5.

⁵⁶ The Law Commission faced difficult choices on whether to alter the content of the duty of care to be included under the Companies Act 2006. They had three choices namely to make standards purely subjective, purely objective or to make them dual objective/subjective. They settled for the dual objective/subjective option. See The Law Commission and Scottish Law Commission op cit para 5.1, 5.19 & 5.20. Also see Dignam *Hicks & Goo's Cases & Materials on Company Law* 392-393.

⁵⁷ See Dignam *Hicks & Goo's Cases & Materials on Company Law* 392-393.

based on section 214(4) of the Insolvency Act 1986. Therefore a dual objective/subjective test represented the common law as it existed at the time of enacting the Companies Act 2006.⁵⁹

South Africa has followed developments in English law and adopted corporate law principles as they developed in the UK. The DTI Policy Document 2004 even acknowledged that company law in South Africa, including the Companies Act 1973 was “still based on the framework and general principles of the English law”.⁶⁰ This is evident in the leading South African case on the duty of care, skill and diligence. As stated earlier, the *Fisheries Development Corporation of SA Ltd v Jorgensen & Another* case summarised the adoption into South African law of milestones in English law developments up to the 1980s.⁶¹ South African authorities agree that English law principles were readily accepted in South African case law, even though English law only has persuasive value and is not binding authority in South African law.⁶²

When English case law moved to dual objective/subjective standards based on s214(4) of the Insolvency Act, South African case law appears to have followed suit. For example in *Howard v Herrigel & Another NNO*,⁶³ the court followed the English approach at the time, and followed the example and approach in *Dorchester Finance Co v Stebbing*⁶⁴ against distinguishing between an executive director and a non-executive director. The court was critical of Margo J’s attempt to distinguish non-executive from executive directors,⁶⁵ and ruled that the standards of care owed were the same for all directors.

3.2.2 Standards of care under s 174 of the Companies Act 2006.

The UK Companies Act 2006 has codified the duty of care, skill and diligence in line with the recommendations of the Law Commission.⁶⁶ The duty to exercise reasonable care, skill and diligence in s 174 provides thus:

⁵⁸ Through cases such as *Dorchester Finance Co v Stebbing* (supra); *Norman v Theodore Goddard* (supra) & *Re D’Jan of London Ltd* (supra).

⁵⁹ See *The Law Commission and Scottish Law Commission* para 5.8. Also see Dignam *Hicks & Goo’s Cases & Materials on Company Law* 395.

⁶⁰ See the foreword by then Minister of Trade and Industry Mandisi Mpahlwa, as well as Chapter 2 of the DTI Policy Document 2004.

⁶¹ See *Fisheries Development Corporation of SA Ltd v Jorgensen & Another* (supra) at 156.

⁶² See Havenga (2000) *SA Merc LJ* 25. Also see Bouwman (2009) *SA Merc LJ* 510; Bekink (2008) *SA Merc LJ* 100-101.

⁶³ *Howard v Herrigel & Another NNO* (supra) at 676.

⁶⁴ *Dorchester Finance Co v Stebbing* (supra) at 498.

⁶⁵ In *Fisheries Development Corporation of SA Ltd v Jorgensen & Another* (supra) at 156.

⁶⁶ See *The Law Commission and Scottish Law Commission* op cit para 5.38.. The specific recommendation regarding the duty of care was as follows:

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

As highlighted earlier, it is evident that the Companies Act 2006 has opted for dual objective/subjective standards of care, skill and diligence in s 174(2). The Law Commission decided against adopting purely subjective or purely objective standards.⁶⁷ Either approach would have resulted in a single standard set for all directors, something that could have failed to take into account the nature of the company, and the specific function performed or power exercised by a particular director.

A closer analysis of s 174 above reveals dual objective/subjective standards of care, skill and diligence, modelled along s 214(4) of the Insolvency Act of 1986. To borrow from the words of Paul L. Davies,⁶⁸ the duty has two limbs. Subsection (2) (a), referred to as Limb 2 (a), sets a standard which all directors must meet. Unlike the subjective standards applied by the courts of Chancery in the nineteenth and twentieth centuries, the standard under this limb is not dependant on the particular director's capabilities.⁶⁹ In other words, this is a minimum irreducible objective standard which all company directors are reasonably expected to meet in the UK. Limb 2(b) adds a subjective standard which can operate to allow reference to be made to the particular characteristics of the directors whose conduct could be under scrutiny.⁷⁰ The subjective elements do not operate to lower the minimum objective standard. Rather, when one reads into the purpose and nature of the standard as framed under s 174, and as recommended by the Law Commission, limb (2)(b) helps to enhance the application of the objective standards.⁷¹ It has been argued that limb (2) (b) may operate to

“To summarise, our recommendations under this Part are (1) that a director's duty of care, skill and diligence to his company should be set out in statute; (2) that the standard should be judged by a two-fold objective/subjective test; (3) that regard should be had to the functions of the particular director and the circumstances of the company; and (4) that there should not be a statutory business judgment rule or statutory provisions dealing with delegation of a director's powers to others or reliance on information provided by others”.

⁶⁷ See The Law Commission and Scottish Law Commission op cit para 5.17 read with paras 5.19 – 5.20. Also see Dignam *Hicks & Goo's Cases & Materials on Company Law* 392-393.

⁶⁸ Davies *Gower and Davies' Principles of Modern Company Law* 435.

⁶⁹ Ibid.

⁷⁰ Dignam *Hicks & Goo's Cases & Materials on Company Law* 392

⁷¹ Ibid at 392-393.

increase the level of care required of the director.⁷² This is achievable through requiring the director to utilise such skill as he has for the benefit of the company in addition to the minimum objective standard required of all directors. It can be argued that this is the essence and effect of limb (2) (b).

There are some very interesting elements of s 174 which could help the interpretation of s 76(3) (c) under the South African Companies Act 2008, but there are also grey areas which need to be clarified by the UK courts when it comes to interpretation. Firstly, s 174 requires a reasonable expectation of the objective standards expected of directors.⁷³ This takes into account the responsibilities of directors of different types and in different situations.⁷⁴ For example, there has to be a difference in what can be expected from an executive director vis-à-vis what can be expected from a non-executive director who is not a full-time employee of the company. Secondly, the standards applicable under s 174 apply to each of the components of the duty of care, namely care, skill and diligence.⁷⁵ There is now no need to delineate between an objective duty of diligence and a subjective duty to exercise skill. The same standard applies to the ‘care’, ‘skill’ and ‘diligence’ components of the duty.

This may raise a question as to what exactly is this minimum irreducible objective standard envisaged under s 174 relating to ‘skill’. How is it to be measured or ascertained? Can this be read to mean something akin to a qualification such as an MBA for example, which is now a requirement for most executive directors in the UK?⁷⁶ The answer appears to lie in the manner in which the standards have been formulated. In addition to there being a reasonable expectation, the director is to be a ‘reasonably diligent person’ who should acquire through diligent means, ‘the general knowledge, skill and experience that may reasonably be expected’ of a person in his/her position.⁷⁷ The objective standard owed by directors, as is discernible, is not and cannot be a specific skill, experience or knowledge, but ‘general knowledge, skill and experience’⁷⁸ which is circumstance-based. This seems like an elastic standard, and not a specific “one-size fits all” objective standard. Admittedly, directors are not a homogenous group and necessary skills vary according to the different nature and purpose served by the companies.⁷⁹ No reasonable person would expect the same standard of skill from an executive director in a multi-national accounting firm and a small fruit and

⁷² See Davies *Gower and Davies’ Principles of Modern Company Law* 435.

⁷³ See s174(2) (a).

⁷⁴ See Dignam *Hicks & Goo’s Cases & Materials on Company Law* 392.

⁷⁵ *Ibid.*

⁷⁶ Dignam *Hicks & Goo’s Cases & Materials on Company Law* 392.

⁷⁷ See s 174 (2) (a) and (b).

⁷⁸ *Ibid.*

⁷⁹ Finch (1992) *M.L.R* 203.

vegetables company from a small town. The legislature should be commended for choosing to adopt dual objective/subjective standards.

A third element that needs to be considered pertains to the difficulties faced by the UK in adopting a proper judicial policy towards interpreting the codified common law duties which include the duty of care, skill and diligence. There are fears in the UK that courts may already have been tempted to subordinate statutory law to pre-existing case law in their recent decisions based on directors duties codified under the Companies Act 2006.⁸⁰ The courts⁸¹ have interpreted s174 as merely encapsulating the hybrid approach previously borrowed by the courts from s 214(4) of the Insolvency Act 1986.⁸² In other words, the judicial approach has been to begin with the pre-existing case law when interpreting the code as opposed to beginning with the s 174 text in the Companies Act 2006, which purports to codify the common law.⁸³ For example in *Gregson v HAE Trustees Ltd*,⁸⁴ the court merely said that s 174 “codifies the existing law”. This is beginning to create confusion given a clear provision in s 170(3) which seems to give the duties in the statute a superior status to the common law duties which it replaces.⁸⁵

The confusion alluded to above is probably caused by s 170(4) which suggests that the duties are to be understood and applied in the same manner as the common law rules they replace.⁸⁶ English courts may need to follow a judicial policy which clearly requires that the judiciary does not unnecessarily subordinate statutory law to common law rules which the Act purports to codify. The proper approach would provide a shift from looking at the policy behind decided cases to approaching the issue as one of statutory interpretation based on the wording of the text.⁸⁷ Rules of interpretation appear to suggest a proper approach to interpreting s 174 which begins by having regard to the natural language of the statute as the first port of call.⁸⁸ As has been convincingly argued, this deference to the statutory wording is

⁸⁰ Deirdre Ahern in her fairly recent work has raised concerns and cites a number of cases as evidence of this trend. See Ahern (2012) *L.Q.R* 130.

⁸¹ See *Gregson v HAE Trustees Ltd* [2008] EWHC 1006 (Ch); [2009] 1 All E.R (Comm) 457

⁸² Ahern (2012) *L.Q.R* 130.

⁸³ *Ibid.*

⁸⁴ *Gregson v HAE Trustees Ltd* supra at 457.

⁸⁵ S170(3) provides that “the general duties are based on certain common law rules and equitable principles as they apply in relation to directors and have effect in place of those rules and principles as regards the duties owed to a company by a director”.

⁸⁶ S170(4) provides that “the general duties shall be interpreted and applied in the same way as common law rules or equitable principles, and regard shall be had to the corresponding common law rules and equitable principles in interpreting and applying the general duties”.

⁸⁷ English and Scottish Law Commissions, *Company Directors: Regulating Conflicts of Interests and Formulating a Statement of Duties* Joint Working Paper LCCP 153, SLC Discussion Paper No. 105 (1998), paras 14.8 – 15.29. See also, Ahern (2012) *L.Q.R* 125-127.

⁸⁸ In *R. v Smurthwaite* [1994] 1 All E.R. 898, at 902 Taylor L.C.J stated that the appropriate approach to

important to ensuring that a code's status as the principal law is not undermined,⁸⁹ and this appears to have the support of English case law on interpretation.⁹⁰

It is suggested and proposed here that English courts should adopt an approach that begins by considering the textual meaning of s 174, and only fall back on the common law rules as an aid to interpretation. Another extrinsic aid to ascertaining the meaning of the text, apart from falling back on pre-existing common law principles, is to make use of the Explanatory Notes accompanying⁹¹ the Companies Act 2006 or the reports of the Law Commission, the Company Law Review's reports and the white papers,⁹² already referred to in this work.⁹³

A fourth element related to the challenge of interpretation as identified by some UK critics, is clarity on the exact relationship between statutory law and common law relating to directors' duties. The issue raised is whether legislative standards should operate in substitution of, or in addition to or whether they override the common law. At least the UK Companies Act 2006 attempted to provide direction in this regard, even though, according to Ahern, subsections 170(3) and 170(4) appear to cause confusion by seemingly detracting from each other.⁹⁴ Contrary to the views of Ahern, s 170(3) appears to give the statutory law a superior status to common law rules. Thus, a court of law should begin with the plain language of the text where there is no ambiguity in the text. Where there is slight ambiguity as suggested and feared by Ahern, then a purposive interpretation in relation to the Act should be employed.⁹⁵ In this construction, s 170(4) appears to suggest that the statutory duties operate in addition to common law rules, and in interpretation, regard shall be had to common law.

The better way of understanding the provision in s170 (4) that 'regard shall be had to common law', is that the common law should be instructive in the interpretation of s174. Surely, a statutory duty of care, skill and diligence has its origin in common law, and there is

interpreting a codifying statute should involve 'simply to examine the language of the relevant provision in its natural meaning and not to strain for an interpretation which either reasserts or alters the pre-existing law'.

Also see *Bank of England v Vagliano Bros* [1891] A.C. 107 at 145.

⁸⁹ See Ahern (2012) *L.Q.R* 127.

⁹⁰ In *Bank of England v Vagliano Bros* supra at 144, Lord Herschel stated as follows:

"I think the proper course is, in the first instance, to examine the language of the statute, and to ask what is its natural meaning, uninfluenced by any considerations derived from the previous state of the law, and not to start with enquiring how the law previously stood, and then, assuming that it was intended to leave it unaltered, to see if the words of the enactment will bear an interpretation in conformity with this view".

⁹¹ These notes can give insight into understanding the purpose of the relevant provisions.

⁹² See Ahern (2012) *L.Q.R* 131.

⁹³ For Law Commission report. For an example of a white paper, see *Modernising Company Law: The White Paper*.

⁹⁴ Ahern (2012) *L.Q.R* 130-131.

⁹⁵ I argue that this purpose is to be found no further than a proper reading of ss170(3) & 170(4).

more benefit to be derived from not disregarding a common law understanding of the purpose of such a duty than to ‘jettison’ or ignore a body of rules developed over centuries. Thus, I submit that there is a symbiotic relationship between s170 (3) and s170 (4). The two subsections should be seen as complementary rather than detracting from each other. In fact, a UK court in a very recent case, *Towers v Premier Waste Management*⁹⁶ lends support to the view expressed here. Mummery LJ explained that the effect of s170 (4) read together with s170 (3) is that the Act did not wish to ‘consign the replaced rules and principles to legal history’.⁹⁷ The apparent confusion as alleged by Ahern, between subsections 170(3) and 170 (4) only needs to be clarified through interpretation, and the correct position in my view should be to understand that statutory law takes precedence and rules of common law should play an aiding role in interpretation. There is therefore no need for the legislature to consider amending either s170 (3) or s170 (4) to remove the purported confusion or tension, as there is no such tension if the subsections are to be read properly.. I am persuaded that South Africa should follow the example of the UK and provide guidance for interpreting its statutory duty of care, skill and diligence and other duties under the statutory statement of directors’ common law duties in s76(3).⁹⁸

The fifth point to note is that the UK opted not to counterbalance the duty of care in s174 with statutory defences for directors such as the BJR, delegation and reliance.⁹⁹ As will be demonstrated below, other jurisdictions such as South Africa have opted to adopt these statutory defences in their statutes.¹⁰⁰

3.2.3 The UK decision to exclude BJR in statute

The UK decided against stating in statute a formulation of the BJR. The UK is content with keeping the BJR in its unwritten form. This was a result of a thorough investigation into whether it was desirable to include a BJR under the Companies Act 2006. The Law Commission, in its public hearings, found no evidence that the directors were concerned by the statement of directors’ duty of care, or evidence that a statutory BJR would manage to raise directors’ standard of behaviour. Thus a decision was made to recommend non-inclusion of the BJR into the Companies Act 2006 as already alluded to in this Chapter.¹⁰¹

⁹⁶ [2011] EWCA Civ 923.

⁹⁷ *Towers v Premier Waste Management* (supra) at 5.

⁹⁸ See Chapter 4, part 4.4.

⁹⁹ See The Law Commission and Scottish Law Commission op cit para 5.38. Also see Dignam *Hicks & Goo’s Cases & Materials on Company Law* 392-393.

¹⁰⁰ See s 76 (4) (a) for the BJR, and s76 (4) (b) for the statutory defences of delegation and reliance.

¹⁰¹ See part 3.2.2 above. Also see Dignam *Hicks & Goo’s Cases & Materials on Company Law* 392-393.

English courts indeed have a judicial policy of not second-guessing honest business or corporate decisions/judgements of company directors.¹⁰² Developments in English case law have had very persuasive value on South African courts. One of the best illustrations of the judicial policy of the British Commonwealth courts (which includes South Africa) towards business judgments is to be found in *Shuttleworth v Cox Brothers & Co (Maidenhead) Ltd*.¹⁰³ The court remarked that “it is not the business of the court to manage the affairs of the company”, adding that “it does not matter whether the court would come to the same decision or a different decision”.¹⁰⁴ The court implied that courts cannot substitute a company board’s decision for its own preferred decision. Years later, Lord Green MR was to express the same judicial policy, which is here taken to be the business judgment doctrine (a judicial policy): “They (company directors) must exercise their discretion *bona fide* in what they consider-not what the court may consider-is in the best interest of the company”.¹⁰⁵ In yet another case in 1974, *Howard Smith Ltd v Ampol Petroleum & Others*, the court ruled that “...there is no appeal to the merits from management decisions to courts of law, nor will courts of law assume to act as a kind of supervisory board over decisions within the powers of management honestly arrived”.¹⁰⁶

3.2.4 Comparing UK and SA law reforms

The South African Companies Act 2008 like the UK statute also adopted what appears like dual objective/subjective standards in the duty of care, skill and diligence contained in s 76(3)(c). What makes it difficult to clearly understand the exact standards under section 76(3)(c) is the absence of Explanatory Notes to the Act, which could aid an understanding of the purpose of this particular duty in the statute. This is unlike the situation in England, where the Explanatory Notes and the easier accessibility to Law Commission reports assist an understanding of the exact standards in statute. A closer reading of s 76(3)(c) shows that the dual objective/subjective standards, as in the case of the Companies Act 2006, appears to be intended to apply to each component of the composite duty of care, namely the ‘care’, ‘skill’, and ‘diligence’ elements.¹⁰⁷ Concerns have been raised regarding the manner in which the standards of care, skill and diligence have been formulated under the Act.

¹⁰² This fact was acknowledged in the Australian case of *Harlowes Nominees Pty Ltd v Woodside (Lakes Entrance) Oil Co* (1968) 121 CLR 483 at 493. See Farrar (2011) *SAC LJ* 756-757.

¹⁰³ [1927] 2 KB 9 (CA).

¹⁰⁴ *Ibid* at 23.

¹⁰⁵ *In re Smith and Fawcett Ltd* [1942] Ch 304 (CA) at 306.

¹⁰⁶ [1974] 1 All ER 1126 (PC) at 1131-1132.

¹⁰⁷ See s76 (3) (c) of the Act.

The focus of critics of the South African statute has been on the relationship between limb subsection 76(3)(c) (i) (hereafter limb 1) and limb 76(3)(c) (ii) (hereafter limb 2).¹⁰⁸ It has been argued that while limb 1 imposes an objective standard, limb 2 subjects the objective standards to subjective elements or considerations, thus transforming the duty into a subjective one.¹⁰⁹ There appears to be a slight yet significant difference in the manner the same duty is captured under section 174 of the Companies Act 2006. As demonstrated above, the equivalent to limb 1 under section 174 of the Companies Act 2006 does not seem to have the effect of subordinating objective standards to subjective elements, due to the careful manner in which the duty was formulated. It is feared by critics that the language employed in section 76(3)(c) shows that there is a danger that the courts may read down the legislative duty of care to the subjective common law standard.¹¹⁰ A cross reference between limb 1 and limb 2 to “...that director and... having the general knowledge, skill and experience of that director”¹¹¹ appears to qualify the objective standard in limb 1 by considerations of the particular director’s subjective personal skill and knowledge in limb 2.¹¹² This could not have been the legislature’s intention. It could boil down to drafting style and formulation, thus creating a worrying gap between legislative intent and the textual content of the duty.

The problematic limb in section 76(3) (c) is limb 2.¹¹³ Just like in the case of the UK standards,¹¹⁴ limb 1 could be interpreted to impose a minimum objective standard by which all directors are to be assessed. The ‘degree’ of standard is that which can be reasonably expected of a person “carrying out the same functions in relation to the company as those carried out by that director”.¹¹⁵ The use of the connecting word “having”¹¹⁶ with reference to the ‘general knowledge, skill and knowledge of that director’,¹¹⁷ appears to be a major turning point, from objective standards to subordinating those minimum standards to the subjective ability of the director. To its credit, subsection 76(3) (c) (i)’s reference to ‘company’ and ‘functions’ recognises that a single standard cannot apply to all directors. There is need for a dual standard which takes into account the various types and sizes of

¹⁰⁸ See part 4.4.2 of Chapter 4 for details regarding s76 (3) (c) of the Act.

¹⁰⁹ See Cassidy (2009) *Stell L.R* 386.

¹¹⁰ *Ibid.* Also see Bekink (2008) *SA Merc LJ* 111.

¹¹¹ See s76 (3) (c) (i) and (ii).

¹¹² See a similar observation in Cassidy (2009) *Stell L.R* 385.

¹¹³ That is s76 (3)(c)(ii).

¹¹⁴ Compare s76 (3) (c) (ii) with s174 (2) (a) of the Companies Act 2006.

¹¹⁵ See s76 (3) (c) (i).

¹¹⁶ In s76 (3) (c) (ii).

¹¹⁷ *Ibid.*

companies plus the nature of the function performed and the power exercised, just like in the case of UK law.¹¹⁸

South Africa's Companies Act does not have a provision similar to section 170(3) and 170(4) which attempts to provide a guide on understanding the relationship between statutory duty of care, skill and diligence and the common law duty. The South African legislature omitted to provide guidance in this regard. Consequently, it is left to conjecture to decipher whether statutory law has a superior status to common law, or whether the two apply and operate together, or whether section 76(3) (c) should be interpreted by reference to common law rules.¹¹⁹ If the Act is not revised to provide clarity in this regard, the judiciary will have to develop its own policy towards interpretation of provisions of s 76. This study will make relevant proposals in the concluding chapter for revision of the law. Alternatively, a proposal shall be made for the appropriate judicial policy which should be adopted by courts towards interpreting statutory duties of directors.¹²⁰

Unlike the UK, South Africa opted to adopt statutory defences to a possible breach of the duty of care, namely the BJR, delegation and reliance. Section 76(4) (a) and (b) is a statutory adoption of the BJR.¹²¹ Subsection 76(4)(b) provides for the twin defences of reliance and delegation. In fact, the defences of reliance and delegation appear to be closely connected to the BJR. The presence of the interlinking word "and" at the end of section 76(4) (a) suggests that the legislature may not have intended that reliance and delegation should be understood apart from the BJR provisions. S 76(5) gives examples of people whom directors may rely on to fulfil their obligations towards the company.¹²² The UK opted against adopting the BJR and the defences of reliance and delegation into statute. It was preferred that such matter be left to the courts to develop them on 'a case-by-case.'¹²³

3.3 Australian standards of care and the BJR

Australia's value to this chapter and to this study generally is the richness of the principles evolved by its legislature and courts in shaping the standards of care and diligence

¹¹⁸ See similar views expressed in Bekink (2008) *SA Merc LJ* 112.

¹¹⁹ As provided by s170(4) of the Companies Act 2006. Even though this subsection creates a confusion in its interaction with s170(3) as already highlighted, at least the UK Act provides guidance to the judiciary and other law users on how to understand the statutory law in light of the pre-existing common law.

¹²⁰ See para 6.3 under Chapter 6.

¹²¹ See Chapter 4 part 4.5.2 for a discussion of reliance & delegation. Also see Chapter 5 for examination of BJR under the Act.

¹²² These range from competent and reliable employees of the company, consultants employed by the company solely for their professional opinions and services and committees of the company board.

¹²³ See The Law Commission and Scottish Law Commission *op cit* para 5.34. Also see Dignam *Hicks & Goo's Cases & Materials on Company Law* 394.

and the adoption of the BJR in the Corporations Act 2001. Apart from the role played by the courts in incremental development of standards of directors' conduct, the role being played by the Australian Securities and Investments Commission (ASIC) in enforcing the statutory duties of directors will be considered. Australia has pursued a robust approach in ensuring the evolution of objective standards of care, and appears to have found a formula which has proven successful in enforcement of directors' standards of conduct. Contrary to Australian success stories, there has been a paucity of cases in South Africa.¹²⁴ Australia is increasingly presenting itself as a model for lessons not only for South Africa, but even for other English-speaking common law countries.

3.3.1 The Australian Standards of care

3.3.1.1 Australian common law duty of care

At common law the development of the duty of care in both Australia and South Africa followed almost identical paths up until about 1992. Both jurisdictions were heavily influenced by the English case law of the nineteenth and twentieth centuries.¹²⁵ This is so despite the fact that South Africa phrased the duty as that of care, skill and diligence, while Australia described it simply as duty of care and diligence.

The standards of care and diligence in Australia up until the famous decision of Roger CJ in *AWA v Daniels*¹²⁶ were subjective. Hopes of an early development of objective standards of care and diligence in form of s 107 of the Victorian Companies Act 1958 and the Australian Uniform Companies Act 1961 were pegged back by a court decision in 1964. In *Byrne v Baker*¹²⁷ the court interpreted s 107(1) of the Victorian Companies Act 1958 to mean that the statutory duty of diligence lowered the standards of care expected of directors.¹²⁸ In *AWA v Daniels*¹²⁹ the court introduced at least minimum objective standards to be observed by executive directors. The brief facts of the case are that AWA Ltd, a listed company, engaged in foreign currency trading. These were managed by Koval, a relatively young

¹²⁴ *Fisheries Development Corporation of SA Ltd v Jorgensen & Another* (supra), a case decided in 1980 remains South Africa's leading case on the duty of care, skill and diligence. See JJ Du Plessis 'A Comparative Analysis of Directors' Duty of Care, Skill and Diligence in South Africa and in Australia' (2010) 1 *Acta Juridica* 263 at 285. It appears that the last time a director was successfully held liable for breach of the duty of care in South Africa was in 1913, in *Niagra Ltd (in liquidation) v Langerman & Others* 1913 WLD 188. See D Botha & R Jooste 'A Critique of the Recommendations in the King Report Regarding a Director's Duty of Care and Skill' (1997) 114 *S. African L.J* 65 at 68.

¹²⁵ Du Plessis (2010) 1 *Acta Juridica* 263.

¹²⁶ (1992) 7 ACSR 759.

¹²⁷ [1964] VR 443.

¹²⁸ Du Plessis (2010) 1 *Acta Juridica* 285.

¹²⁹ *AWA v Daniels* (supra) at 759.

employee who was inadequately supervised, and proper records were not kept. The company made heavy losses in 1986 and 1987 which Koval concealed. The company was audited twice by Deloitte Haskins and Sells, and the auditing partner warned the company of inadequacies in internal controls but failed to warn the board. Instead, he wrote a letter suggesting improvements. The board did not become aware of the extent of the losses until the end of March 1987. The company sued the auditors for negligence. The auditors then counterclaimed for contributory negligence by the company. Roger CJ of the division of the Supreme Court of New South Wales, held that the auditors were negligent, but that the company was also liable for contributory negligence.¹³⁰ Roger CJ ruled that Australian directors were required to possess a minimum degree of competence to allow them to exercise an informed and active discretion and to acquire a basic understanding of company affairs. An example of such basics is a director's ability to read and understand company financial statements.¹³¹

The *AWA v Daniels* decision came about at a time when the government in Australia attempted to usher in more objective standards of care and diligence into law through statute.¹³² Despite this seeming apparent movement towards more objective standards of care and diligence, Roger CJ held in *AWA v Daniels* that the duty of care expected of non-executive directors was subjective in nature.¹³³

The decision of Roger CJ was described by commentators as having been unfortunately conservative at a time when some people expected a shift towards more objective standards of care and diligence for all directors.¹³⁴ In deciding that a subjective duty of care was applicable to non-executive directors, Roger CJ relied on *Re City Equitable Fire Insurance Co Ltd*.¹³⁵ Reiterating the words of Romer J, Roger CJ asserted that “non-executive directors are not bound to give continuous attention to the affairs of the corporation”.¹³⁶ Roger CJ saw no problems with directors readily delegating responsibilities and relying on management for the performance of their obligations.¹³⁷ Interestingly, the reliance by Roger CJ on Romer J's propositions echoed the position which still obtained in

¹³⁰ *AWA v Daniels* (supra) at 759. Summary adapted from Farrar (2011) *SAC LJ* 752.

¹³¹ See *AWA v Daniels* (supra) at 933. Also see Cassidy (2009) *Stell L.R* 389.

¹³² This was attempted through section 11 of the Corporate Law Reform Act 1992. See Du Plessis (2010) 1 *Acta Juridica* 285.

¹³³ *AWA v Daniels* (supra) at 1014-1015. Cassidy (2009) *Stell L.R* 389.

¹³⁴ See Du Plessis (2010) *Acta Juridica* 285 and also see Cassidy (2009) *Stell L.R* 389.

¹³⁵ *Re City Equitable Fire Insurance Co Ltd* (supra) at 428-429.

¹³⁶ See *AWA v Daniels* (supra) at 1014-1015, referred to in Cassidy (2009) *Stell L.R* 389.

¹³⁷ *AWA v Daniels* (supra) at 1014-15.

South Africa by 1992. Margo J in *Fisheries Development Corporation of SA Ltd*¹³⁸ relied on earlier English decisions to state what the position regarding directors' standards was in South Africa in 1980. As pointed out earlier, this leading South African case had introduced or rather confirmed subjective standards of care, skill and diligence into common law.¹³⁹ The state of the law espoused by Roger CJ in 1992 for Australia was therefore comparable to the South African position which obtained at the time.¹⁴⁰

The case of *Daniels v Anderson*¹⁴¹ in 1995 provided a watershed moment for Australian common law. It boldly introduced objective standards of care and diligence into law and espoused far-reaching principles for contemporary Australian law. The case was an appeal¹⁴² by the Chief Executive Officer (CEO) of AWA Ltd and that of AWA Ltd in part, and the auditors in part, which appeal was allowed by the majority of the Court of Appeal.¹⁴³ The Court of Appeal ruled that the auditors were negligent and guilty of a failure to comply with the Companies Code (then in force) in respect of the foreign exchange operations.¹⁴⁴ *Daniels v Anderson* was ground-breaking as an Australian case on duty of care in many respects. Chief among these was a ruling by the court that the general law relating to the tort of negligence was an appropriate basis for the claim of common-law damages against negligent directors.¹⁴⁵ The most outstanding part of the case was the court's ability to articulate principles applicable to the duty of care and diligence and clarifying the content of the relevant standards.¹⁴⁶ The case further clarified other key issues relating to the duty of the board to monitor performance by the executive.¹⁴⁷ The exact contours of delegation and reliance were also clarified.¹⁴⁸ The court expounded on the nature of standards of care and diligence expected of all directors (whether they are described as executive or non-executive directors).¹⁴⁹ All these points had raised great concern following how Roger CJ had dealt

¹³⁸ *Fisheries Development Corporation of SA Ltd v Jorgensen & Another* (supra) 156 at 165-166.

¹³⁹ *Ibid.* Also see *Re City Equitable Fire Insurance Co Ltd* (supra) at 427.

¹⁴⁰ See Du Plessis (2010) 1 *Acta Juridica* 285.

¹⁴¹ (1995) 13 *ACLC* 614.

¹⁴² An appeal from the decision of Roger CJ in *AWA v Daniels* (supra).

¹⁴³ *Daniels v Anderson* (supra) at 614. Also see R Baxt 'The Duty of Care of Directors – Does it Depend on the Swinging of the Pendulum' in *Corporate Governance and the Duties of Company Directors* (I Ramsay ed) (1997) (Centre for Corporate Law and Securities Regulation, University of Melbourne). See chap 7.

¹⁴⁴ See Farrar (2011) *SAC LJ* 752-753.

¹⁴⁵ See *Daniels v Anderson* (supra) at 668. Also see Du Plessis (2010) 1 *Acta Juridica* 272.

¹⁴⁶ See *Daniels v Anderson* (supra) at 661-668. Also see Farrar (2011) *SAC LJ* 753.

¹⁴⁷ *Daniels v Anderson* (supra) at 662.

¹⁴⁸ *Ibid* at 663-664.

¹⁴⁹ *Daniels v Anderson* (supra) at 661-668.

with them in *AWA v Daniels*.¹⁵⁰ In that case the court appeared determined to providing clarity and to settle the confusion. These points will now be briefly explained below.

In *Daniels v Anderson* Clarke JA adopted the “ordinary prudent man” test and concluded that standards of duty of care applicable to Australian directors were objective.¹⁵¹ The court rejected the dominant common law approach in *AWA v Daniels* which leaned more towards subjective than objective standards.¹⁵² Clarke JA took time to clarify the objective standards applicable. Firstly, it was explained that a single standard could not be applied to all directors in all circumstances.¹⁵³ The standard is flexible and cannot be a one-size fits all. Applicable standards will depend on the particular function performed, the power exercised, the circumstances of the specific case, and the terms on which a person has undertaken to be a director, inter alia.¹⁵⁴

Secondly, the court sought to clarify the position regarding whether a different standard was applicable to non-executive directors. Clarke JA ruled that objective standards were applicable to both non-executive and executive directors.¹⁵⁵

Thirdly the basis of liability for negligence by directors espoused has been described as a “very important part of *Daniels v Anderson*”.¹⁵⁶ The Supreme Court of New South Wales ruled that the general law relating to the tort of negligence¹⁵⁷ was an appropriate basis for the claim of common law damages against negligent directors.¹⁵⁸

Fourthly, the court remarked that directors are required to take reasonable steps to place themselves in a position to guide and monitor the management of the company.¹⁵⁹ A fifth and related point which the court emphasised relates to delegation and reliance. The court agreed that delegation was possible, but that however, a prudent director would not rely on the judgment of others blindly, especially where there has been a notice of mismanagement.¹⁶⁰ Directors must take diligent steps and must devote a reasonable amount

¹⁵⁰ Ibid. Also see Cassidy (2009) *Stell L.R*389-392.

¹⁵¹ *Daniels v Anderson* (supra) at 662. See Cassidy (2009) *Stell L.R* 390.

¹⁵² The court also observed that the modern cases, “set in the context of a legislative pattern of imposing greater responsibility upon directors, demonstrate that the director’s duty of care is not merely subjective, limited by the director’s knowledge and experience or ignorance or inaction”. *Daniels v Anderson* (supra) at 664. Also see Farrar (2011) *SACLJ* 753.

¹⁵³ *Daniels v Anderson* (supra) at 164-165.

¹⁵⁴ *Daniels v Anderson* (supra) at 665. See Cassidy (2009) *Stell L.R* 390.

¹⁵⁵ *Daniels v Anderson* (supra) at 662. See Farrar (2011) *SACLJ* 753.

¹⁵⁶ See Du Plessis (2010) 1 *Acta Juridica* 123 at 272.

¹⁵⁷ Based on the *boni mores* of the society at each given time.

¹⁵⁸ *Daniels v Anderson* (supra) at 664-665. Also see Du Plessis (2010) 1 *Acta Juridica* 272.

¹⁵⁹ Farrar (2011) *SACLJ* 753.

¹⁶⁰ Ibid. While agreeing with Romer J in *Re City Equitable Fire Insurance Co Ltd* (supra), and Roger CJ in *AWA v Daniels* (supra) that delegation was permissible, the court in *Daniels v Anderson* did not agree with the low standards allowed in these cases.

of time to place themselves in a better position to understand and oversee the affairs of the company.¹⁶¹ With regards to ‘skill’, the court emphasised that the director must be able to “measure up to the standard of proficiency that can be expected from persons undertaking such work”.¹⁶²

There are merits to the description of *Daniels v Anderson* as representing “the pinnacle in Australia...of the development of directors’ duty of care and skill...”¹⁶³ Australia has been able to raise standards of care considerably from a subjective to an objective level. South Africa has not yet had the opportunity to review the dominantly subjective common law standards established in *Fisheries Development Corporation of SA Ltd*.¹⁶⁴

3.3.1.2 Australian statutory duty of care and diligence

Australia has lately expressed the duty of care and diligence in statute. The Corporations Act 2001 expresses the duty in s 180 as follows:

Care and diligence- directors and other officers

(1) A director or other officer of a corporation must exercise their powers and discharge their duties with the degree of care and diligence that a reasonable person would exercise if they:

- (a) were a director or officer of a corporation in the corporation’s circumstances; and
- (b) occupied the office held by, and had the same responsibilities within the corporation as, the director or officer.

It is debatable whether the purpose of the statutory duty of care and diligence in Australia is to codify the common law duty of care and diligence or not. It can be discerned from the text of the Corporations Act 2001 that the statutory duty in section 180 (1) is not a codification of the common law.¹⁶⁵ There is also a general agreement among authors that section 180 (1) is to be treated differently from a similar statutory duty in the UK and South Africa.¹⁶⁶ In

¹⁶¹ The court relied on the USA case law to espouse the content of the standards of care by clarifying the duty to be informed. By quoting *Francis v United Jersey Bank* 432 A. 2d 814 821-823 (1981), the court explained that the duty to be informed serves the purpose of ensuring that the “board has available means to audit the management of the company so that it can satisfy itself that the company is being run properly”. See *Daniels v Anderson* (supra) at 662.

¹⁶² *Daniels v Anderson* (supra) at 665.

¹⁶³ Du Plessis (2010) 1 *Acta Juridica* 285.

¹⁶⁴ *Fisheries Development Corporation of SA Ltd v Jorgensen & Another* (supra).

¹⁶⁵ S185 of the Corporations Act 2001 provides that sections 180 to 184 “have effect in addition to, and not in derogation of, any rule of law relating to the duty or liability of a person because of their office or employment in relation to a corporation”.

¹⁶⁶ Farrar argues in this regard that the purpose of the statutory duty of care in Canada, New Zealand and the UK is for an entirely different purpose to the purpose intended for s180(1) under the Corporations Act 2001; see Farrar (2011) *SAC LJ* 751. Du Plessis, after analysing the implications of s185, concludes emphatically that

Australia, the duty of care and skill serves a basis for civil penalties for offending directors in Australia as driven by the Australian Securities and Investments Commission (ASIC).¹⁶⁷ In South Africa for example, the cases against offending directors are not necessarily driven or prosecuted by an organisation in the same mould as ASIC. Shareholders may be the plaintiffs or the company itself may be the plaintiffs in delictual claims brought against directors either at common law, or now in terms of s76 (3) (c).¹⁶⁸ In the UK, as already established, s 174, like all other common law duties of directors are now subsumed under the Companies Act 2006,¹⁶⁹ is intended as a restatement of existing law. S 185 of the Corporations Act makes it clear that s 180 (1) applies in “...addition to and not in derogation of any rule of law...”¹⁷⁰ It appears that the aim was to ensure that all the duty of care and diligence principles can be utilised together to develop the legal principles governing directors’ duties.¹⁷¹

As will be established in chapter four, the Act, in contradistinction to the Corporations Act 2001, or the UK’s Companies Act 2006, does not provide clarity as to whether s 76 (3) applies in addition to, in substitution of or together with the common law rules. The Act does not have a provision similar to either s 185 of the Corporations Act 2001 or s170(3) and s170(4) of the UK’s Companies Act 2006.¹⁷² While the Companies Bill 2007 provided that standards of directors’ conduct were to be applied in addition to and not in substitution of any duties at common law,¹⁷³ drafters of the Act chose to omit a similar provision. In future, this may result in more questions regarding clarity of the position under the Act. It is not clear why the legislature chose to leave matters hanging without simply providing clarity on the matter. The absence of Explanatory Notes or what can be termed *travaux préparatoires*/preparatory documents as is the case in the UK and Australia further complicates the situation in South Africa. A proposal will be made in Chapter 7¹⁷⁴ for clarity in this regard in the form of a provision similar to s 185 of Australian law and subsections 170(3) - 170(4) of UK law.

Notwithstanding the provisions of s 185, there is no denying that the standards of care and diligence contained in section 180(1) of the Corporations Act 2001 are comparable to

‘s180 (1)- directors’ statutory duty of care and diligence- is not a codification of directors’ duty of care and diligence’ at common law. See Du Plessis (2010) 1 *Acta Juridica* 278.

¹⁶⁷ See cases like *Australian Securities and Investments Commission v Maxwell* (‘Maxwell’) (2006) 59 ACSR 373 prosecuted by ASIC for e.g.

¹⁶⁸ As envisaged by s77 (2) (a) – (b) of the Act. Also see s77 (3).

¹⁶⁹ See ss171-177 for a list of all common law duties now subsumed by the Companies Act 2006.

¹⁷⁰ See s185 of the Corporations Act 2001.

¹⁷¹ See Bouwman (2009) *SA Merc LJ* 517.

¹⁷² See part 3.2 above.

¹⁷³ See Clause 91(6) of the Companies Bill 2008, see [B 61- 2008] in GG No. 31104 of 30 May 2008.

¹⁷⁴ See part 7.3.1 in Chapter 7.

common law standards in Australia.¹⁷⁵ In fact, the statutory standards in Australia cannot be understood without reference to the incremental development of standards through the evolving case law principles as will be highlighted in 3.2.3 below. In *Daniels v Anderson*, the “ordinary prudent man” test which was applied introduced objective standards applicable to the duty of care for Australian directors. Similarly, s 180 (1) adopts a “reasonable person” test, which translates to an objective statutory duty of care and diligence.¹⁷⁶ This objective standard in s 180(1), just as with the common law duty of care, is said to be so malleable as to mould itself to the peculiar circumstances of the company director. Further to this, this development has been hailed as a positive move which ensures that directors are required to meet the standards required of professionals in the 21st century.¹⁷⁷

One noticeable feature, in the formulation of the duty under s 180(1), is the absence of the “skill” component associated with the duty. It is not clear either from the Explanatory Memorandum¹⁷⁸ or from the text of the Act why there is no reference to any standard of skill in s 180(1). There was hope that the matter would receive attention from the court in *Australian Securities and Investments Commission v Vines*.¹⁷⁹ Sadly the court did not address the rationale of the absence of the ‘skill’ component from the formulation of the duty under Australian statutory law. Austin J only stated that despite the absence of a skill requirement, if a director is appointed because of a skill, for example as a Chief Financial Officer, the test to be applied is what a reasonably competent person in the position of such an officer would do under the circumstances. .¹⁸⁰

In the earlier case of *Re Property Force Consultancy Pty Ltd*,¹⁸¹ the court observed that unlike the common law, the Corporations Act 1989 did not envisage an objective but rather a subjective ‘skill’ component in s232 (4).¹⁸² Derrington J bemoaned the potential divergence in standards between common law and statutory law as a result of this absence of ‘skill’ from s180(1).¹⁸³ In *Daniels v Anderson*, Clarke JA also noted the absence of reference

¹⁷⁵ In *Australian Securities and Investments Commission v Maxwell* (‘*Maxwell*’) (2006) 59 ACSR 373 at 397-398, Brereton remarked that the statutory duty of care and diligence is akin to that at common law.

¹⁷⁶ See Du Plessis (2010) 1 *Acta Juridica* 287.

¹⁷⁷ See See Cassidy (2009) *Stell L.R* 393.

¹⁷⁸ See the Explanatory Memorandum to the Corporations Act 2001, entitled ‘Corporations Bill 2001’ available at <http://www.comlaw.gov.au/Details/C2004B00937/Explanatory%20Memorandum/Text>, accessed on 09 June 2014.

¹⁷⁹ (2004) 48 ACSR 322.

¹⁸⁰ *Ibid.* See also Farrar (2011) *SAC LJ* 751.

¹⁸¹ 1995 13 ACL 1051.

¹⁸² *Ibid* at 1056

¹⁸³ *Ibid.* Derrington J arrived at this conclusion, when he considered that the predecessor to s180(1), that is, s 232(4) of the Corporations Act 1989, appeared to have required a subjective element of skill. Consequently, the interpretation adopted by the court was that the absence of skill in s180(1) could equally amount to

to ‘skill’ in subsection 180(1)’s predecessor, subsection 232(4) of the Corporations Act 1989.¹⁸⁴ Clarke JA was of the opinion that despite this omission of ‘skill’ from the statutory formulation of the duty, directors are nonetheless expected to meet an objectively-determined minimum degree of competency required to undertake the duties of a director.¹⁸⁵ The court in *Daniels v Anderson* rejected the old English common law notion that ‘a director need not exhibit a greater degree of skill than may reasonably be expected of a person of that director’s knowledge and ability’.¹⁸⁶ Clarke JA further remarked that ‘the duty of care is not merely subjective, limited by the director’s knowledge and experience or ignorance or inaction’.¹⁸⁷ Impliedly, if a director lacks the skill to comply with the demanding duty of care, they have to work hard to acquire that skill or choose not to take up the position of director.¹⁸⁸

It can be argued, that if courts will interpret s180(1) in the same manner they did in *Daniels v Anderson*, the fears of unnecessary divergence of standards in Australian law such as expressed by some writers could be avoided.¹⁸⁹ The interpretation should be that directors are expected to meet an objectively determined minimum degree of competency required to undertake the duties of a director in Australia.¹⁹⁰

In contrast to s 180(1), s 76(3)(c) of the South African Act clearly makes reference to ‘skill’ in its formulation of the statutory duty of care, skill and diligence.¹⁹¹ However, on closer scrutiny, and as established through the case law cited above, Australian courts have, since *Daniels v Anderson* in 1995, developed a tradition of imposing objective standards. When the situation presents itself, courts are more likely to interpret s 180(1) by reference to case law. However, while, s 76(3)(c)(i) appears to introduce objective elements, subsection 76(3)(c)(ii) undermines the objectivity of the ‘skill’ test by asserting that the director need only meet the standard of a person having the ‘skill and experience of that director’. This has been criticised for being ‘inappropriate in the modern commercial world’.¹⁹² As will be

subjective standards being applicable.

¹⁸⁴ This section was amended by way of s 11 of the Corporate Law Reform Act 1992 to read as follows: “In the exercise of his or her powers and the discharge of his or her duties, an officer of a corporation must exercise the degree of care and diligence that a reasonable person in a like position in a corporation would exercise in the corporation’s circumstances.”

¹⁸⁵ *Daniels v Anderson* (supra) at 665. Also see Cassidy (2009) *Stell L.R* 391.

¹⁸⁶ *Daniels v Anderson* (supra) at 663. Clarke JA rejected this notion or sentiment expressed by Romer J in *Re City Equitable Fire Insurance Co Ltd*.

¹⁸⁷ *Daniels v Anderson* (supra) at 664

¹⁸⁸ Also see Cassidy (2009) *Stell L.R* 392.

¹⁸⁹ See Cassidy (2009) *Stell L.R* 393.

¹⁹⁰ See *Daniels v Anderson* (supra) at 665.

¹⁹¹ See part 4.4.2 of Chapter 4.

¹⁹² See Cassidy (2009) *Stell L.R* 386.

highlighted in Chapter 4, s 76 (3) appears to have been designed to provide for dual objective/subjective standards.

3.3.1.3 Emerging case law principles in Australia post 2001 – duty of care

Evolving international corporate governance best practice principles suggest that directors are increasingly expected to discharge their responsibilities in a careful and competent manner.¹⁹³ Recent court decisions in Australia have revealed that courts no longer tolerate underperformance or dereliction of duty by directors.¹⁹⁴ I will briefly look at principles emerging from a few select cases between 2003 and 2011 in Australia where the duty of care and diligence was applied by courts. A sizeable body of case law has emerged chiefly through the work of the ASIC.¹⁹⁵ ASIC has done a tremendous amount of work in enforcing the statutory duty of care and diligence in Australia in some high profile cases reported between 2001 and 2011.

It is suggested here that the evolving case law principles in Australia may prove instructive to the interpretation of s 76(3)(c) of the Act. The standards of care, skill and diligence under South Africa's relatively new law are yet to be tested. As mentioned above, the Act fortunately opens the door for the enriching of corporate governance jurisprudence through the infusion of comparative foreign law principles. In this regard the Act provides that 'to the extent appropriate, a court interpreting or applying this Act may consider foreign company law'.¹⁹⁶

The following are some of the principles evolving in Australian case law:

(i) Nature of standards of care and diligence expected of directors and test to be applied.

In *Maxwell*,¹⁹⁷ the court made important statements regarding the law in this regard. The court stated that 'in determining whether a director has exercised reasonable care and

¹⁹³ A Hargovan 'Australian Securities and Investments Commission v Macdonald [NO 11]: Corporate Governance Lessons From James Hardie' (2009) 33 *Melbourne Univ. Law R.* 984-1021.

¹⁹⁴ As demonstrated by Gzell J's ruling in *Australian Securities and Investments Commission v Macdonald [NO 11]* (2009) 256 ALR 199 (hereafter *ASIC v Macdonald* or simply *Macdonald*). The court held that 10 directors and officers of James Hardie Industrial Ltd (hereafter JHIL) breached their statutory duty of care and diligence under s180(1) of the Corporations Act 2001 by approving the false or misleading and deceptive public announcement. Gzell J refused to accept the directors' chorus of denial of responsibility and the defence that they had relied on the advice of management and external advisors. The court reasoned that the board could only delegate the details of their overall responsibility, but could not delegate its role of monitoring and supervising the executive management, which role was reserved only for the board.

¹⁹⁵ ASIC was established by the ASIC Act 2001. See V Comino 'Effective Regulation by the Australian Securities and Investment Commission: The Civil Penalty Problem' (2009) 33 *Melbourne Univ. Law R.* 803-832 for the functions of ASIC.

¹⁹⁶ See s5 of the Act.

¹⁹⁷ *ASIC v Maxwell* (supra) at 397.

diligence...the circumstances of the particular corporation concerned are relevant to the content of the duty'.¹⁹⁸ The court further remarked that the statutory duty of care and diligence in s 180(1) can be contravened 'even if there was no actual damage [so long as] it was reasonably foreseeable that the relevant conduct might harm the interests of the company'.¹⁹⁹

It appears then that the standard of care and diligence required of directors from time to time depends on the nature of the company business or economic interests involved. In *Macdonald*²⁰⁰ for example, Gzell J held that the failure of directors (both non-executive and executive) to discharge their monitoring role constituted a breach of the statutory duty of care and diligence.²⁰¹ The directors had approved the publishing of a defective, false, misleading or deceiving draft ASX announcement to the effect that the JHIL had sufficient funds to meet all legitimate asbestos compensation claims, when they knew or ought to have known that this was not true.²⁰² According to Gzell J, publishing false or misleading statements had the potential to expose JHIL to legal action and that the directors ought to have known that JHIL's '...reputation would suffer and there would be a market reaction...' to the company's listed securities.²⁰³ Thus the sensitivity of the interests involved required that the directors should have given closer attention to the draft ASX statement.²⁰⁴ The directors should have scrutinised the statement thoroughly to check if it corresponded with the financial position of the company as they knew it to be or ought to have known. There is a demanding duty of care and diligence and a need for directors of multinational companies or large conglomerates to apply a basic skill such as they have [or ought to have] in the discharge of their duties in a modern company. Santow J in *Australian Securities and Investments Commission v Adler* (hereafter *ASIC v Adler* or simply *Adler*)²⁰⁵ expounded on an important principle regarding this. The court held that a director should become familiar with the fundamentals of the company's business and is under a continuing obligation to ensure that they are informed about the company's activities.²⁰⁶ For example, modern day directors are expected to approve

¹⁹⁸ The circumstances include, *inter alia*, the type of the company, size and nature of the company's business, the composition of the board, the director's position and responsibilities within the company, the particular function the director is performing, the experience or skills of the particular director, including circumstances of the specific case. See *ASIC v Maxwell* (supra) at 397.

¹⁹⁹ *ASIC v Maxwell* (supra) at 397.

²⁰⁰ *ASIC v Macdonald* (supra) at 261.

²⁰¹ *Ibid.*

²⁰² *Ibid.*

²⁰³ *Ibid* at 250-251.

²⁰⁴ *Ibid* at 259.

²⁰⁵ (2002) 168 FLR 253.

²⁰⁶ *Adler* (supra) at 347.

financial reports and statements which require knowledge of the financial performance of a company.²⁰⁷

Approving financial statements is a task which requires conscientious consideration of detail and the exercise of the prudence expected of stewards of company resources. This was confirmed in *Australian Securities and Investments Commission v Healey* (hereafter the *Centro* case).²⁰⁸ The key question before the court was whether directors of big publicly listed entities are required to apply their own minds to, and carry out a careful review of proposed financial statements and the directors' report.²⁰⁹ This was in order to determine if information contained therein is consistent with the director's own knowledge of the company's affairs and to check for any discrepancies with the company's financial position the director knows or ought to know about.²¹⁰ The court ruled that there is a positive duty on directors to have the basic financial literacy to enable them to read and understand financial statements.²¹¹ Such basic skill should enable directors to ask the right questions when reviewing financial statements.²¹² For example in the *Centro* case, there was a need for a basic understanding of classification of liabilities. Middleton J held that each of the directors had breached the statutory duty of care and diligence towards the *Centro* entities by failing to have apparent errors in the financial report and financial statements corrected.²¹³

Further, Middleton J in the *Centro* case, espoused the principle that directors are an important cog in the governance of companies.²¹⁴ At the core directors are subject to irreducible requirements to be involved in management of the company and to take all reasonable steps to be in a position to guide and monitor it.²¹⁵ This includes directors' duty to '...carefully read and understand financial statements before they form their opinions which are to be expressed in the declaration required by s 295(4)'.²¹⁶ The said s 295(4) of the

²⁰⁷ Ibid.

²⁰⁸ [2011] FCA 717.

²⁰⁹ The *Centro* case (supra) at 13.

²¹⁰ Ibid at 13

²¹¹ Ibid at 16-17.

²¹² Ibid at 17-20

²¹³ The errors in the report were not just a question of mere technical oversight. There were fundamental errors in the reports. The 2007 annual reports of Centro Properties Group ('CNP') and Centro Retail Group ('CER') failed to disclose significant matters. In the case of CNP, the report failed to disclose some \$1.5 billion of short-term liabilities by classifying them as non-current liabilities, and failed to disclose guarantees of short-term liabilities of an associated company of about US\$1.75 billion that had been given after the balance date. In the case of CER, the 2007 annual reports failed to disclose some \$500 million of short-term liabilities that had been classified as non-current. See the *Centro* case (supra) at 9-10.

²¹⁴ The *Centro* case (supra) at 19.

²¹⁵ Ibid at 14.

²¹⁶ Ibid at 17.

Corporations Act 2001 required that such opinions be expressed in form of a declaration made by directors.²¹⁷

(ii) Delegation and reliance on others for performance- case law principles

Australia has included statutory defences of reliance and delegation. There are extensive provisions under the Corporations Act dealing with directors' ability to delegate and rely on others for their performance.²¹⁸ The English common law view that the 'business of life could not go on if people could not trust those who are put into a position of trust for the express purpose of attending to the details of management',²¹⁹ appears to be acknowledged in Australia. The common law in Australia operated to allow very low standards of delegation and reliance,²²⁰ until *Daniels v Anderson* introduced higher standards. Clarke JA rejected the lower standards suggested by Rogers CJ in *AWA Ltd v Daniels* as inappropriate in modern company law.²²¹ He went on to espouse the rule that directors should properly monitor and supervise the exercise of delegated authority.²²² Now s 190(1) of the Corporations Act 2001 generally requires directors to remain responsible and accountable for the exercise of delegated authority by the delegates.²²³ The only exception to the rule is when a director can prove on reasonable grounds that he believed that the delegate was competent enough to act in a manner that conforms to the duties of directors.²²⁴

In recent cases, that is, post the Corporations Act 2001, courts have sought to clarify questions regarding delegation and reliance. Courts have confirmed the maxim *delegatus non potest delegare* – meaning that a fiduciary may not delegate his job, especially the ultimate responsibility to be accountable for the exercise of powers given to him by law when fulfilling the role of a director.. When directors have delegated tasks to responsible company officials, they do not cease to be accountable ultimately. The board of directors is required by law to supervise those who have received delegated powers, and it is expected to continually

²¹⁷ Ibid.

²¹⁸ See ss 189, 190 and 198D of the Corporations Act 2001.

²¹⁹ As remarked by the Earl of Halsbury LC in *Dovey v Cory* 1901 AC 477.

²²⁰ In *AWA Ltd v Daniels* (supra) at 933, Rogers CJ ruled that a 'director is entitled to rely without verification on the judgment, information and advice of the officers so entrusted...Reliance would only be unreasonable where the director was aware of circumstances of such a character, so plain, so manifest and so simple of appreciation that no person, with any degree of prudence, acting on his behalf, would have relied on the particular judgment information, and advice of the officers'.

²²¹ See *Daniels v Anderson* (supra) at 663. Also see Cassidy (2009) *Stell L.R* 396.

²²² *Daniels v Anderson* (supra) at 663-664.

²²³ S 190 (1) provides as follows:

‘ If the directors delegate a power under section 198D, a director is responsible for the exercise of the power by the delegate as if the power had been exercised by the directors themselves.’

²²⁴ See s190 (2) of the Corporations Act 2001. Also see Cassidy (2009) *Stell L.R* 397.

appraise the effectiveness of the ‘checks and balances’ put in place by companies to enable it to fulfil its monitoring role.²²⁵ In *Macdonald and Vines v Australian Securities and Investments Commission*²²⁶ (hereafter *Vines v ASIC*) the courts accepted that directors are entitled to rely on others for performance where there is no cause for suspicion or circumstances demanding detailed attention.²²⁷ In *Macdonald* Gzell J confirmed the principle espoused by Santow J in *Vines v ASIC* that what is expected ‘is a level of scrutiny as befits supervision, not the detailed direct involvement that is associated with operational responsibility’.²²⁸ Thus case law now confirms the modern approach to reliance and delegation. Directors cannot substitute reliance upon the advice of management in place of their own attention and examination of a strategic matter that falls within the board’s responsibility.²²⁹ This principle appears to be generally shared by Australian courts, as confirmed by the recent *Centro* case.²³⁰ Thus in *Macdonald*, Gzell J rejected the directors’ defence premised on reliance on experts. It was Gzell J’s strong view that once management referred the draft ASX statement to the board members for approval, ‘none of them was entitled to abdicate responsibility by delegating his or her duty to a fellow director’.²³¹ Gzell added that the matter of approving a statement referred was the sole strategic responsibility of the board, and ‘...that is not a matter of reliance upon management or outside experts’.²³² Case law in Australia has thus delineated between matters where directors can rely on and/or delegate to others and where this is inappropriate.

(iii) The test applied for determining liability in terms of s180 (1)

Australian courts have recently confirmed the modern objective test in s 180(1). As stated earlier, s 180 (1) imposes an objective ‘reasonable person’ test. Such a test takes into account the particular context or circumstances of the company within which a director

²²⁵ See views expressed by Clarke JA in *Daniels v Anderson* (supra) at 663-664. Also see Cassidy (2009) *Stell L.R* 396.

²²⁶ (2007) 62 ACSR 1, 149

²²⁷ See *Macdonald* (supra) 248-249.

²²⁸ *Macdonald* (supra) at 251.

²²⁹ *Ibid* 248-249. Also see Hargovan (2009) *Melbourne Univ. Law R* 179.

²³⁰ See the *Centro* case (supra) at 175. At 20, Middleton J stated that while directors may delegate to others the task of preparation of books and accounts, ‘...each director is expected to...take a diligent and intelligent interest in the information available to him or her, to understand that information, and apply an enquiring mind to the responsibilities placed upon him or her.’

²³¹ *Macdonald* (supra) at 251.

²³² *Ibid* at 259.

exercises the powers given and fulfils the responsibility expected. In approving the objective test in *Adler*,²³³ Gzell J expressed the test in *Macdonald* as follows:

In determining whether a director has exercised reasonable care and diligence one must ask what an ordinary person with the knowledge and experience of the defendant might be expected to have done in the circumstances if he or she was acting on their own behalf.²³⁴

Thus, Gzell J in applying the objective ‘reasonable person’ test, found the actions of directors of JHIL to have fallen below the required standards of care and diligence. The court held that a reasonable person with similar responsibilities would not have voted in favour of the resolution that the company approve and release the draft ASX announcement.²³⁵

(iv) Different standards of performance between executive and non-executive directors?

The question whether the law differentiated between the standard of performance expected of executive and non-executive directors has received the attention of the courts. As confirmed in the *Centro* case, an objective standard of care and diligence is now applicable to both non-executive and executive directors.²³⁶ *Gamble v Hoffman*,²³⁷ cited by Middleton J in the *Centro* case with approval,²³⁸ is authority for an assertion that the courts are not prepared to subjectify the duty and standards of care and diligence even for non-executive directors. The test applied to either a non-executive or an executive director is essentially the same. The test is whether the director exercised the degree of care and diligence that a reasonable person in a like position in a corporation would exercise in the corporation’s circumstances.²³⁹ In *Macdonald*, Gzell paid particular attention to the question whether the law differentiated between the standard of performance expected of executive and non-executive directors. Gzell J, like Middleton J in the *Centro* case also held that the same objective standard of care now applies to all directors.²⁴⁰

²³³ *Adler* (supra).

²³⁴ *Macdonald* (supra) at 247.

²³⁵ That is, in its defective, misleading or deceptive state. See Hargovan (2009) *Melbourne Univ. Law R* 179, citing *Macdonald* (supra) at 261.

²³⁶ *Centro* case (supra) at 171-173.

²³⁷ (1997) 24 ACSR 369.

²³⁸ See the *Centro* case (supra) at 173.

²³⁹ See the *Centro* case (supra) at 173.

²⁴⁰ *Macdonald* (supra) at 249-250.

3.3.1.4 Brief comment on lessons for SA from emerging case law principles in Australia

The South African Act is yet to be fully tested at this stage as far as standards of care, skill, diligence and the BJR are concerned. The leading case on directors' duty of care, skill and diligence was decided in 1980.²⁴¹ This case touched on a number of aspects discussed above which have recently received attention in Australian courts. For example Margo J's ruling compares fairly well with the Australian principle that standards of care, skill and diligence expected of directors depend on the nature of the company's business. There is a difference though regarding clarity of the extent of competence and diligence standards, for example, demanded of directors of publicly-listed entities. In *Macdonald* and the *Centro* case for example, courts made it clear that a modern director of a big entity owes a duty to have the basic ability to read and understand financial reports and financial statements.

There is also a demanding duty for company directors to apply diligence and keep themselves informed of the financial performance of the company they serve. There is a possibility that such an extent of a duty of care, skill and diligence could be seen to be too demanding in a developing country like South Africa. Fears could be raised that companies may struggle to attract people willing to serve as board members if the bar is raised too high. This explains why respected academic Du Plessis has defended the possibility that s 76(3)(c) may have elements which prevent a purely objective approach in interpreting the provision.²⁴² Du Plessis opines that such an approach (open to criticism as it is) may not be inappropriate for South Africa given the limited skills-pool in the country. The argument by Du Plessis is vital in two ways. Firstly, coming from a member of the International Reference Group in the writing of the Act, this can be an indication of the reason why s 76(3)(c) does not contain purely objective standards of care, skill and diligence. Secondly, the argument could help demonstrate that it may take a while for case law in South Africa to impose standards as demanding as the duty of directors of publicly listed entities in Australia to have a basic financial literacy to read and understand financial statements in order to make informed decisions.

Du Plessis's argument can be criticised for subjectifying standards under s 76(3) (c). This may work against the DTI Policy Document 2004's goal of promoting the global competitiveness of South African companies and the economy by ensuring compatibility and

²⁴¹ *Fisheries Development Corporation of SA Ltd v Jorgensen & Another* (supra) at 156.

²⁴² Du Plessis (2010) 1 *Acta Juridica* 287.

harmonisation of the Act with the best practice jurisdictions internationally.²⁴³ The Act has incorporated the common law defences of delegation and reliance.²⁴⁴ Australian case law has clarified the contours regarding when directors are entitled to rely on others for performance and when it is inappropriate to do so. On the other hand, South African courts have not yet had the opportunity to interpret section 76(4)(b). The position espoused in South African common law appears to compare fairly well with the recent case law in Australia.²⁴⁵ The emphasis in recent Australian case law that delegated authority should be properly supervised, could be used to enrich standards of reliance and delegation in South Africa. It seems though that the statutory requirement in South Africa that directors are entitled to delegate ‘functions that are delegable under applicable law’²⁴⁶ can be interpreted by courts in future to be in line with the maxim *delegatus non potest delegare*.²⁴⁷ In this vein, directors in South Africa could be held to be accountable for the exercise of delegated authority. While the Act is to be applauded for incorporating statutory defences of delegation and reliance, the clarity offered by Australia’s sections 189, 190 and 198D is preferable in some respects. There are clear provisions on reliance under the Corporations Act 2001 in s189, and clear provisions on delegation in s198D. S 190 in particular sets Australian law apart in that it clearly reminds directors that they remain accountable for the exercise of delegated authority.²⁴⁸ The South African Act does not have an equivalent provision under s76 (4) (b). It is preferable to make the position as clear as is the position under the Corporations Act 2001.

With regards to the applicable test, as established above, Australia has an objective duty of care and diligence, and courts have applied an objective test in interpreting the s 180(1). On the other hand the duty of care skill and diligence under s 76(3)(c) is not as purely objective as the Australian duty. In the same vein, the interpretation of the South African statutory duty is likely to involve a dual objective/subjective test. If an objective test is to be applicable, then the duty will have to be amended first. The problematic part as highlighted in

²⁴³ See objectives of the DTI Policy Paper 2004 part 4.2.3 of Chapter 4.

²⁴⁴ See s76(4)(b).

²⁴⁵ In *Fisheries Development Corporation of SA Ltd v Jorgensen & Another*, Margo J held that in respect of all duties that may be left to some official, a director is, in the absence of suspicion, justified in trusting that official to perform such duties honestly. A director is also entitled to rely on the judgment, information and advice of the management unless proper reasons exist for querying such.

²⁴⁶ See s76(4)(b)(i)(bb).

²⁴⁷ Meaning- that while a fiduciary may delegate aspects of his function, he remains ultimately accountable for proper monitoring and ensuring the proper exercise of delegated authority.

²⁴⁸ S 190 (1) of the Corporations Act 2001 provides:

‘If the directors delegate a power under section 198D, a director is responsible for the exercise of the power by the delegate as if the power had been exercised by the directors themselves.’

3.2 above, is s 76(3)(c)(ii) which could perhaps be read to allow for lowering of the objective standard introduced by s 76(3)(c)(i). Traditionally a subjective test was followed in South Africa but there may be some indications that the law was moving to an objective/subjective approach.²⁴⁹

Courts in Australia have settled the question whether different standards of performance are applied between executive and non-executive directors.²⁵⁰ In South Africa, Margo J drew a distinction between executive and non-executive directors in *Fisheries Development Corporation of SA Ltd*. He held that a non-executive director is not bound to give continuous attention to the affairs of the company.²⁵¹ This out-dated approach in modern times was corrected in *Howard v Herrigel & Another NNO*.²⁵² In criticising Margo J's remarks, the court emphasised that the standards applicable to directors are the same for all directors whether the inquiry was one in relation to negligence, recklessness or fraud. This decision demonstrates that South African case law now compares fairly well with Australian case law.

3.3.2 The Australian BJR - s 180(2)

Section 180 (2) of the Corporations Act 2001 adopts into statute what is considered a legislative modification of the US's BJR.²⁵³ The subsection provides that a director or officer who makes a business judgment is considered to have met the requirements of s 180(1) of the Corporations Act 2001, and their equivalent duties at common law and equity, if he:

- (a) makes a business judgment in good faith for a proper purpose;
- (b) does not have a material personal interest in the subject matter of the judgment;
- (c) informs himself/herself about the subject matter of the judgment to the extent they reasonably believe to be appropriate and
- (d) rationally believes that the judgment is in the best interests of the corporation.²⁵⁴

It is important to note that s180 (2) is a standard of review which has a relationship with the standard of conduct provided in s180 (1).²⁵⁵ The subsection applies to officers and other

²⁴⁹ See *Fisheries Development Corporation of SA Ltd v Jorgensen & Another* (supra) at 156. Also see *Philotex (Pty) Ltd & Others v Snyman & Others* (1998) (2) SA 138 (SCA) where the court held that an objective standard measured against a notional reasonable person needed to be balanced by subjective elements which take into account the knowledge possessed by the particular director.

²⁵⁰ See *Macdonald* (supra) and the *Centro* case (supra).

²⁵¹ *Fisheries Development Corporation of SA Ltd v Jorgensen & Another* (supra) at 156.

²⁵² (1991) (2) SA (660).

²⁵³ See Cassidy (2009) *Stell L.R* 403.

²⁵⁴ See s 180 (2) (a) - (d) of the Corporations Act 2001. Also see Havenga (2000) *SA Merc LJ* 33.

²⁵⁵ The relevant standard of conduct in s180 (1) was discussed in Chapter 3 part 3.3.1.

managers, not only directors as s180 (2) clearly refers to ‘a director or other officer who makes a business judgment’. It applies to the statutory duty of care and diligence and the equivalent duties at common law and in equity. Conditions (a) to (d) which are based on the American Law Institute (ALI) Draft have to be fulfilled.²⁵⁶ One of the requirements of the rule is that a ‘business judgment’ must have been made. S 180 (3) defines a ‘business judgment’ to mean ‘any decision to take or not to take action in respect of a matter relevant to the business operations of the corporation’. This should be distinguished from an omission to act where there is a positive duty to act, which could qualify as negligence, and negligence is a ground which may exclude application of the BJR. This provision (s180 (3)) distinguishes the Australian BJR formulation from either the ALI Draft or the South African BJR formulation. The latter formulations, unlike the Australian rule, do not define ‘business judgment’.²⁵⁷ S 76 (4) (a) of the Act in particular makes no specific reference to a ‘business judgment’ and does not seem to emphasise that a ‘business judgment’ must have been made for the rule to apply.²⁵⁸ Another interesting feature in s180 (2) is the reference to “good faith and for a proper purpose” which differentiates it from the ALI Draft and the Act - s76 (4) (a). The South African BJR formulation interestingly excludes “good faith and for a proper purpose” in its reference to conditions in s76 (3) which must be satisfied for directors to enjoy protection of the rule in South Africa. It is also important to note s180 (2)’s reference to “reasonableness” of the informed decision and the requirement of “rationality” in (d), just like s76 (4) (a). The fact that the reference to “proper purpose” in s180 (2) has rendered the subsection inapplicable to insolvent trading in Australia perhaps may warrant consideration in view of the application of the rule in South Africa.

Section 180 (2) may be criticised for the divergence of standards between the standards of conduct and standard of review. While the standard of care in s180 (1) is clearly objective, it appears that the standard of review in s180 (2) threatens to limit the objectivity of s180 (1). S 180 (2) appears to leave it up to the director to decide the appropriateness and reasonableness of his diligence in ensuring that the business judgment is an informed one. Whether the decision is in the best interest of the corporation is also left to the director to decide. The standard in this regard has been said to be ‘rationality’ as opposed to ‘reasonableness’ as standard of conduct under s180(1) and the common law.²⁵⁹ There is thus

²⁵⁶ See Farrar (2011) *SAC LJ* 758

²⁵⁷ See a discussion of the ALI Draft under part 3.4.2 below.

²⁵⁸ See part 5.4 under Chapter 5 for reference to s76(4)(a) and for an examination of the BJR in SA..

²⁵⁹ Cassidy (2009) 3 *Stell L.R* 404.

a *prima facie* divergent standard of review in s180 (2), unless the court decides to read this seemingly lower standard through the lens of the objective standard of conduct in s 180(1).

Challenges in the application of the rule apparently surfaced in Australia a few years after the Corporations Act 2001 was enacted, where the rule was found to be inapplicable to insolvent trading.²⁶⁰ The challenges of incompatibility with the Australian legal system were raised long before the adoption of the rule.²⁶¹ It is believed that not enough research was done to understand the nature of the development of the rule and what it applies to in the US, a country which has decided against codifying the common law rule and where the rule's application is specified. It has been argued that s 180(2) which adopts the rule is defective. This is probably for reason of alleged incompatibility of the BJR to the Australian legal system as argued by the Australian government prior to adoption of the rule under the Corporations Act 2001.²⁶² After 2001, Australian courts are said to have adopted a hardened or even pessimistic stance towards application of the BJR, leaving the future of the rule in doubt given its alleged ineffectiveness.²⁶³

Between 2009 and 2011 the BJR was considered by Australian courts, but could not successfully apply to protect directors against liability. In *Australian Securities and Investments Commission v Fortescue Metals Group Ltd*,²⁶⁴ the Federal court had ruled that the BJR attached to protect the defendant director against liability claims. However the full bench of the court overturned the decision for the reason that the director could not rely on the BJR protection after failing to provide evidence that he had made a business judgment in good faith. In another case, *Australian Securities and Investments Commission v Macdonald*,²⁶⁵ the BJR could not attach to protect the defendant director Macdonald for alleged breach of duty of care. The reason for the finding was that there was no evidence that Mr McDonald rationally believed that a business judgment made was in the best interest of the company.

²⁶⁰ See *ASIC v Adler* (supra) at 74; *Gold Ribbon (Accountants Pty Ltd v Sheers* [2006] QCA 335; *Australian Securities and Investments Commission v Rich* (2010) 75 ACSR 1 (hereafter *ASIC v Rich*) referred to as authority for Farrar's argument that BJR has not found favour with Australian judges. See Farrar (2011) *SACLJ* 759-761.

²⁶¹ See G Santow "Codification of Directors' Duties" (1999) *Australian LJ* 336 at 347-348, referred to in Havenga (2000) *SA Merc LJ* 33.

²⁶² See Botha & Jooste (1997) *SALJ* 75. See also du Plessis (2010) *Acta Juridica* 272-273 for the arguments of the Australian government.

²⁶³ See K Santow "Codification of Directors' Duties (1999) 73 *ALJ* 336 at 347-351 referred to in Farrar (2011) *SACLJ* 759. BJR was also not successful in the *Adler* case & in *Australian Securities and Investments Commission v Rich* (2010) 75 ACSR 1.

²⁶⁴ [2011] FCAFC 19 (Full Federal Court).

²⁶⁵ [NO 11] (2009) 256 ALR 199.

As respected author Farrar points out, it would nevertheless be mistaken to think that the BJR has not found favour with Australian judges.²⁶⁶ The fact that the BJR could not apply to protect directors as per their plea for protection in some cases considered above, does not necessarily translate to failure of the BJR in Australia. Evidence that the BJR is not dead in Australia²⁶⁷ is to be seen in most of the cases cited above but more especially in the outcome of the recent case of *ASIC v Rich*.²⁶⁸ Austin J dismissed ASIC's application to persuade the court to hold defendant directors liable for breach of their statutory duty of care and diligence in terms of s180 (1) of the Corporations Act 2001. Even though the court found it unnecessary to invoke the BJR, Austin J intimated that if the defendant directors (Jodee Rich and Mark Silbermann) had breached s180(1) they could have been able to successfully invoke protection of the rule in any case.²⁶⁹

3.4 United States of America

American law is relevant to this study not so much because s 76(3) (c) borrows from USA law, but because the BJR adopted in s 76(4)(a) essentially derives from US common law.²⁷⁰ Some South African critics have long dismissed the value of the US duty of care in enriching standards under s 76(3)(c)²⁷¹ and much has been written about how the South African duty is essentially different from the US duty.²⁷² The discomfort around the US duty of care and the BJR stems from the fact that it regards the duty of care as a fiduciary duty and sometimes further conflates the duty of care and the duty of loyalty in the context of the BJR.²⁷³ The argument of South African authors is therefore that adopting any principle relating to the duty of care and the BJR will result in blurring the celebrated distinction

²⁶⁶ Farrar (2011) *SAC LJ* 759.

²⁶⁷ It appears that some people in Australia had 'written the obituary' for BJR. See A Lumsden 'The business judgment defence: Insights from *ASIC v Rich*' (2010) 28 *C&SLJ* 164.

²⁶⁸ *ASIC v Rich* (supra) 1.

²⁶⁹ *ASIC v Rich* (supra) 637. Also see M Hooper 'The Business Judgment Rule: *ASIC v Rich* and the Reasonable-Rational Divide' (2011) *BondCGeJI* 1.

²⁷⁰ Jones (2007) *SA Merc LJ* 327.

²⁷¹ See Botha & Jooste (1997) *SALJ* 74; Havenga (2000) *SA Merc LJ* 35-36; Jones (2007) *SA Merc LJ* 336 and McLennan (1996) *SA Merc LJ* 100.

²⁷² Jones argues that the development of the duty of care has been hampered by the fact that case law in the USA has blurred the distinction between a fiduciary duty and the duty of care. See Jones (2007) *SA Merc LJ* 327.

²⁷³ There is a commonplace perversion of language in the USA where there are descriptions such as 'a fiduciary duty of care' used by courts and commentators. This is prevalent in the state of Delaware's courts. Even the Uniform Partnership Act (1997) s 404 (a) adopts the very confusing rhetoric of conflating duty of care with loyalty duty. See WA Gregory 'The Fiduciary Duty of Care: A Perversion of Words' (2005) 38 *Akron L.Rev* 181-183. Further see the works of the following authors referred to in Chapter 5 under 5.2 - Robert J. Rhee, 'The Tort Foundation of Duty of Care and Business Judgment', (2012) 88 *Notre Dame L. Rev.* 1139, 1139; J Velasco 'A Defense of the Corporate Law Duty of Care' (2015) 40:3 *J. Corp. L* 648 & Christopher M. Bruner, 'Is the Corporate Director's Duty of Care A "Fiduciary" Duty? Does It Matter?', (2013) 48 *Wake Forest L. Rev.* 1027, 1039.

between the duty of care and fiduciary duties. While there may be merits to this argument, some elements under the duty of care in US law may prove instructive to the interpretation of the standards under s 76(3)(c) by the courts.

3.4.1 The duty of care in the USA

There are two well-known formulations of the duty of care in the USA today. The latest one is the American Law Institute's *Principles of Corporate Governance: Analysis and Recommendations* (1994) (hereafter the *ALI Principles of Corporate Governance*). This is based on the earlier Revised Model Business Corporation Act 1984 (hereafter, the Model Act).

Section 4.01 of the *ALI Principles of Corporate Governance* presents the duty of care as closely linked to some fiduciary duties in the following manner:

A director or officer has a duty to the corporation to perform the director's or officer's functions in good faith, in a manner that he or she reasonably believes to be in the best interests of the corporation, and with the care that an ordinary prudent person would reasonably be expected to exercise in a like position and under similar circumstances.²⁷⁴

While it appears that there is limited focussing on the different facets of the duty of care in the USA formulations when compared to other common law jurisdictions,²⁷⁵ the known content of the duty in the formulations is interpreted to reveal standards of care and diligence. Cassidy is of the view that the tests in both the *ALI Principles of Corporate Governance* and the Model Act contain both elements of subjectivity and objectivity. The author makes an important point, when she argues that the 'ordinary prudent person' test in both formulations leads to an objective test in the final scheme of things.²⁷⁶ The objectivity of the test from both formulations is reinforced by the requirement that the conduct be that of a 'prudent person...in a like position and under similar circumstances'.²⁷⁷ In other words, just like the duty in Australia and South Africa, the USA duty of care takes into account the

²⁷⁴ This section was based on s 8.30 (a) of the Model Act which provides as follows:

“(a) A director shall discharge his duties as a director...

(1) in good faith;

(2) with the care an ordinary prudent person in a like position would exercise under similar circumstances;
and

(3) in a manner he reasonably believes to be in the best interests of the corporation”.

²⁷⁵ See s76 (3) (c) of the Companies Act 2008.

²⁷⁶ Cassidy (2009) *Stell. L.R* 387.

²⁷⁷ *Ibid.* Also see s 4.01 of the *ALI Principles of Corporate Governance*.

circumstances within which the directorial function is performed and power conferred is exercised.

Eisenberg²⁷⁸ has provided an interpretation of the content of the duty of care in the USA which breaks down into four sub-duties with an emphasis on care and diligence, namely: the duty to monitor; the duty to inquire, the duty to be informed; and the duty to make reasonable decisions.

The sub-duty to monitor entails a supervisory role of a director to ‘take reasonable steps to keep abreast of the information that flows to the board as a result of monitoring procedures and techniques’.²⁷⁹ In the USA all directors are expected not to abdicate their responsibility of providing oversight since ‘all directors are responsible for managing the business and affairs of the corporation’.²⁸⁰

The sub-duty to inquire requires directors firstly to have a continuing obligation to keep informed of the affairs of the corporation. Secondly, based on that knowledge, directors and officers are therefore expected to critically apply their minds to information presented to them for approval. For example in *Francis v. United Jersey Bank* this duty to have an inquiring mind was held to be critical during a review of financial statements.²⁸¹ Directors should have the care to be alert to any suspicion raised in the documents placed before them, and they cannot be so negligent as to ‘shut their eyes’ to possible evil going on around them.²⁸² In fact if a director shuts his eyes to evil which he is aware of, that could be viewed as a sign of bad faith. A director who sleeps on the wheel and is not alert to his duty of care was held to add no value to the corporation.²⁸³

The sub-duty to be informed has very interesting elements which appear to have influenced recent Australian case law. The sub-duty involves the need to make an informed-decision, a directors’ obligation to place himself or herself in a position to do so, and a duty to acquire basic competence to discharge normal responsibilities of directors.²⁸⁴ Thus in the recent Australian *Centro* case discussed in 3.2 above, it was held that a director of a large corporation had a duty to acquire a basic ability to read and understand financial reports and

²⁷⁸ MA Eisenberg ‘The Duty of Care of Corporate Directors and Officers’ (1990) 51 *Uni of Pitt L. Rev* 945.

²⁷⁹ *Ibid* at 951-952.

²⁸⁰ See *Francis v. United Jersey Bank*, 432 A.2d 814 (N.J. 1981) at 823-824.

²⁸¹ *Ibid*.

²⁸² See *Rankin v Cooper* 149 F. 1010 (1907) at 1013.

²⁸³ *Francis v. United Jersey Bank*, 432 A.2d 814 (N.J. 1981) at 1982.

²⁸⁴ *Ibid*. See Pollock J’s remark at 821-822 where he stated: “As a general rule, a director should acquire at least a rudimentary understanding of the corporation...”

statements.²⁸⁵ This sub-duty could prove instructive to the interpretation of the duty of care, skill and diligence in s 76(3)(c) of Act.

While the general duty of care in the USA has elements which could prove useful to any common law jurisdiction, it is not without its challenges. Some authors²⁸⁶ in the USA have warned that the distinction between the duty of care and a fiduciary duty is not always clearly delineated, leading to concerns about conflation of the two concepts. Another challenge complained of by USA authors relate to the acceptance of gross negligence as a standard of review, as was held in various cases.²⁸⁷ Such a standard is arguably not suitable as a general standard of review given the modern commercial realities and international best practises in corporate governance.

3.4.2 The US BJR experiences

3.4.2.1 Approaches to and rationale for the BJR

Different approaches to the BJR were developed in the USA between the nineteenth century and the present day in a manner that can be potentially confusing to any jurisdiction planning to incorporate the BJR into statutory law for the first time. US case law, as will be illustrated below has applied the BJR to similar situations in different ways and with different outcomes. For example, in one approach used,²⁸⁸ the onus or burden of proof rests on the defendant director.²⁸⁹ In another approach,²⁹⁰ the plaintiff shareholder carries a heavy burden of proof. In the *Shlensky v Wrigley* case²⁹¹ the application of the BJR resulted in a strong presumption against judicial review of board room decisions. In a more recent situation, in *Cede & Co. v Technicolor, Inc.*,²⁹² the BJR was applied as a standard of review and permitted the court to examine the substantive merits of the board's decision. The above demonstrates the extent of the variations in the approaches to the BJR in the USA. At times there may even be nuances in the manner the same approach to the BJR.

²⁸⁵ See the *Centro* case at 16-17. Also see *ASIC v Macdonald*

²⁸⁶ See Gregory (2005) *Akron L.Rev.*

²⁸⁷ For example in *Smith v Van Gorkom* 488 A.2d 858 873 (1981) the standard of review was held to be gross negligence as opposed to mere negligence. Also see *Godbold v Branch Bank Mobile* 11 Ala. 191 (1847); *Washington Bancorporation v Said* 812 F. Supp 1256 1265-1267 (1997).

²⁸⁸ That is the American Law Institute ('ALI') formulation of the rule.

²⁸⁹ See Branson (2011) *SAC LJ* 692.

²⁹⁰ Namely the Delaware BJR formulation.

²⁹¹ 237 N.E. 2d 776 (III. App. Ct 1968).

²⁹² 634 A.2d 345 (Del. 1993).

This part considers the traditional formulations of the BJR in the USA, and the current competing conceptions of the BJR in the US generally. Before considering the traditional formulations, it may be necessary to consider the purpose and policy rationales for the BJR in the USA. It must be conceded that this may not be an easy task given the contestable nature of the BJR in the USA.

3.4.2.2 Purposes of and policy rationale for the BJR in the USA

The purposes and policy rationale for the BJR can be discerned from the traditional formulations of the rule which are discussed in this Chapter below, from US case law and also the literature which explores it.

Drafters of the American Law Institute's *Principles of Corporate Governance*, posit that the BJR is necessary to protect 'directors and officers from the risks inherent in hindsight reviews of their business decisions'. In addition it helps to avoid 'the risk of stifling innovation and venturesome business activity'.²⁹³ The rationale appears to be to encourage optimal risk-taking by directors.²⁹⁴ Thus the BJR ensures that decisions made by directors in good faith are protected even though, in retrospect, they may prove to be unsound or results may turn out badly.

With the understanding that people are generally risk-averse, if directors had to worry about liability regardless of the circumstances, they would insist 'on playing it completely safe'.²⁹⁵ The consequence, if this were to happen is that shareholders, as the firm's residual claimants,²⁹⁶ would not get a good return on their investment. Shareholders are known to prefer maximisation of their wealth. For example in some jurisdictions like the USA, there is even an implied obligation for directors to maximise the wealth of shareholders.²⁹⁷ Yet the reality is that there is a general correlation between risk and return. Business decisions rarely involve black-and-white issues.²⁹⁸ Decisions have to be made under pressure and imperfect circumstances given factors such as information asymmetry²⁹⁹ and bounded rationality³⁰⁰

²⁹³ See American Law Institute *Principles of Corporate Governance: Analysis and Recommendations* (1994), hereafter the ALI *Principles* as adapted from P Lipton & A Herzberg *Understanding Company Law* 6th ed (1995) at 393, referred to in Havenga (2000) *SA Merc LJ* 28. Also see Bainbridge (2004) *Vand. L. Rev* 99.

²⁹⁴ Bainbridge (2004) *Vand. L. Rev* 123.

²⁹⁵ See McMillan (2013) *Wm. & Mary Bus. L. Rev* 527-528.

²⁹⁶ See Bainbridge (2004) *Vand. L. Rev* 113-119.

²⁹⁷ *Dodge v Ford Motor Co.*, 170 N.W. 668, 684 (Mich. 1919) is authority to the effect that a corporation is organised and carried on primarily for the profit of the stockholders.

²⁹⁸ See McMillan (2013) *Wm. & Mary Bus. L. Rev* 527.

²⁹⁹ This refers to a situation where one party has more or better information which results in an imbalance of power.

³⁰⁰ The essence of bounded rationality is that rationality of individuals during the decision-making process is affected by some factors. These are:

which factors affect the quality of decisions made.³⁰¹ As has been argued by Bainbridge, given the vagaries of business, even carefully made business choices among alternatives may still turn out badly.³⁰²

Hindsight bias³⁰³ is one of the known results of judicial review of a business decision, especially in circumstances where a jury is aware of the connection between the plaintiff's injury and the impugned conduct of the defendant.³⁰⁴ It has been argued that hindsight bias will take place even if, viewed *ex ante*, there was a very low probability that such an injury would occur and taking precautions against such an injury was not cost effective.³⁰⁵ Hence the desire by drafters of the *ALI Principles of Corporate Governance* to provide a mechanism to prevent the spectre of hindsight bias through the BJR. This is where the descriptive 'safe-harbour' concept of the ALI formulation of the BJR comes from.³⁰⁶

A further rationale for the BJR is provided by the Delaware formulation. In this formulation, the BJR is seen as a presumption of good faith in favour of a director.³⁰⁷ This is a director-centred rationale.³⁰⁸ To fully understand the policy rationale of the Delaware

-
- (i) limited available information regarding possible alternatives and consequences;
 - (ii) cognitive limitations of people's minds &
 - (iii) time constraints or pressures in decision-making.

³⁰¹ In *Joy v North*, 692 F. 2d 880, 885-886 (2d Cir. 1982), this point was supported by the court. Ralph Winter J captured the essence of this as follows:

'Courts recognise that after-the-fact litigation is a most imperfect device to evaluate corporate business decisions. The circumstances surrounding a corporate decision are not easily reconstructed in a courtroom years later, since business imperatives often call for quick decisions, inevitably based on less than perfect information. The entrepreneur's function is to encounter risks and to confront uncertainty, and a reasoned decision at the time made seem a wild hunch viewed years later against a background of perfect information'.

³⁰² See Bainbridge (2004) *Vand. L. Rev* 113-114.

³⁰³ Hindsight bias can be described as the belief after an event has occurred that the event and its attendant consequences were more predictable than it actually was. When observers and armchair critics look back, through the prism of the undesirable results of a decision-made, they tend to judge the inadequacy of the action at the time it was made, based on new information now available, the benefit of which was not available to the decision-maker at the time the impugned decision was made. The effect of hindsight bias was underscored and probably better explained by a US court in *In re Citigroup Inc. Shareholder Derivative Litigation*, 964 A.2d 106, 126 (Del. Ch. 2009) where the court remarked as follows: 'There is a substantial risk that suing shareholders and reviewing judges will be unable to distinguish between competent and negligent management because bad outcomes often will be regarded *ex post*, as having been foreseeable and, therefore, preventable *ex ante*. If liability results from bad outcomes, without regard to the *ex ante* quality of the decision or the decision-making process, however, managers will be discouraged from taking risks.' Also see Bainbridge (2004) *Vand. L. Rev* 114-115 from where these statements were borrowed by the court.

³⁰⁴ See McMillan (2013) *Wm. & Mary Bus. L. Rev* 535. Also see C Jolls 'A Behavioral Approach to Law and Economic' (1998) 50 *Stan. L. Rev* 1471 at 1523-1527.

³⁰⁵ Jolls (1998) *Stan. L. Rev* 1523-1527.

³⁰⁶ See Branson (2011) *SAC LJ* 692.

³⁰⁷ In *Cede & Co. v Technicolor, Inc.* 634 A.2d 345 (Del. 1993), BJR was presented as a presumption in the following way:

'...As a rule of evidence, it creates a 'presumption that in making a business decision, the directors of a corporation acted on an informed basis [i.e., with due care], in good faith and the honest belief that the action taken was in the best interest of the company.'

³⁰⁸ L.P.Q. Johnson 'Unsettledness in Delaware Corporate Law: Business Judgment Rule, Corporate Purpose' (2013) 38 *Del. J. Corp. L* 405 at 412.

formulation of the rule, one needs to understand the role or purpose of the rule as elucidated in case law and in the Delaware General Corporate Law. In *Smith v Van Gorkom*, the role of the BJR was explained as follows:

Under Delaware law, the business judgment rule is the offspring of the fundamental principle, codified in [Delaware General Corporation Law] § 141 (a), *that the business and affairs of a Delaware corporation are managed by or under its board of directors...The business judgment rule exists to protect and promote the full and free exercise of the managerial power granted to Delaware directors.*³⁰⁹

Directors' freedom to manage companies is a revered corporate law principle in Delaware, hence the protection. This policy rationale of the BJR begins with the recognition of directors' legal mandate or authority to manage the corporation.³¹⁰ It recognises directors, and not the courts, as experts in deciding on the best course of action when directing the business and affairs of a corporation. This point has been strongly underscored in US case law. In *Shlensky* the court remarked that '...the directors' [board] room rather than the courtroom is the appropriate forum for thrashing out purely business questions...'³¹¹ Directors' legal right to exercise authority and power to manage assets of absentee owners, as of necessity implicates or has to be constrained by a duty to be accountable.³¹² Thus the unavoidable tension between authority and accountability has to be balanced within corporate governance.³¹³ This study is based on a conviction that the BJR can contribute to ensuring that this compromise is struck so as to balance competing interests within a corporation.

Two more rationales for the BJR are discussed in more detail in Chapter 5. One such frequently cited policy argument for the rule claims that courts as public officials, unlike directors, are not business experts,³¹⁴ and as such are incompetent to review business

³⁰⁹ *Smith v Van Gorkom*, 488 A. 2d 858, 872 (Del. 1985). The italics are my own additions for purposes of emphasis only. Also see DEL. CODE ANN.tit.8, § 141 (a) (2012). Further see *Cede & Co. v Technicolor, Inc.* supra at 360 & *Citron v. Fairchild Camera & Instrument Corp.*, 569 A.2d 53, 64 (Del. Ch. 1989) referred to in Johnson (2013) *Del. J. Corp. L* 412.

³¹⁰ See *In re Cox Commc'ns S'holder Litig.*, 879 A.2d 604, 614 (Del. Ch. 2005) where the court noted that the board's role exemplifies centralised management. The court also acknowledged that the authority of the board can be delegated to subordinate officers in the discretion of the board.

³¹¹ *Shlensky v Wrigley* (supra) at 776. The words in italics are my own addition for purposes of emphasis.

³¹² In *Brehm v Eisner* 746 A.2d 244, 264 (Del. 2000), the court stated that the directors' decisions will be respected by the courts unless the directors' decisions were infected by conflict of interest issues which could have disabled the directors' independence of their decision-making; if directors fail to act in good faith, act in a manner that cannot be attributed to a rational business purpose, or if they reach their decision by a grossly negligent process that includes failure to take into account all material facts reasonably available.

³¹³ See Bainbridge (2004) *Vand. L. Rev* 84-85.

³¹⁴ L Johnson 'Corporate Officers and the Business Judgment Rule' (2005) 60 *Bus. Law.* 439 at 456-457.

decisions.³¹⁵ The other rationale for the BJR is the divergence of standards in corporate law explanation. These two rationales are critically discussed in detail in Chapter 5.³¹⁶

3.4.2.3 US traditional formulations of the BJR

There are thus two well-known traditional formulations of the BJR in the USA, namely the American Law Institute ('ALI') formulation of the rule,³¹⁷ and the Delaware courts formulation.³¹⁸

The ALI formulation is said to be the formulation with wider currency in the US since it has been adopted by the highest courts of several states.³¹⁹ ALI formulates the rule as follows:

A director or officer who makes a business judgment in good faith fulfils [the duty of care] if the director or officer:

- (1) is not interested in the subject of his business judgment;
- (2) is informed with respect to the subject of the business judgment to the extent the director or officer reasonably believes to be appropriate under the circumstances; and
- (3) rationally believes that the business judgment is in the best interests of the corporation.³²⁰

This ALI formulation is what has come to be known as the safe harbour provisions of the BJR. For the BJR protection to apply, firstly a director must have made a business judgment/decision. The decision should not have been tainted by conflicts of interest. Secondly, the directors must have exercised some measure of care (not necessarily an exercise of reasonable care) by informing themselves properly of the subject matter of the decision. Thirdly the directors should have had a rational basis for believing that the decision arrived at is in the company's best interests.

The Delaware formulation is not set out in statute. In this construction, the BJR is formulated as a presumption of good faith in favour of directors. In some circles this

³¹⁵ R J Rhee 'The Tort Foundation of Duty of Care and the Business Judgment Rule' (2013) 88:3 *Notre Dame LR* 1139 at 1151.

³¹⁶ See part 5.2 (ii) & (iii) of Chapter 5.

³¹⁷ Promulgated in 1994. See Branson "The Rule that isn't a Rule- The Business Judgment Rule" (2002) 36 *Val. U. L. Rev* 631 at 635.

³¹⁸ Branson (2011) *SAC LJ* 691.

³¹⁹ *Ibid.*

³²⁰ American Law Institute *Principles of Corporate Governance: Analysis and Recommendations* (1994), hereafter the ALI *Principles* as adapted from P Lipton & A Herzberg *Understanding Company Law* 6th ed (1995) at 393, referred to in M Havenga "The Business Judgment Rule-Should We Follow the Australian Example?" (2000) 12 *SA Merc LJ* 25 at 28.

formulation is viewed as a presumption against judicial review of negligence claims arising from the merits of a company board's decision.³²¹ This formulation was aptly captured in *Aronson v Lewis*. The BJR is said to be a "presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith, and in the honest belief that the action taken was in the best interests of the company".³²²

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

Thus, a shareholder plaintiff challenging a board decision has the burden at the outset to rebut the rule's presumption. To rebut the rule, a shareholder plaintiff assumes the burden of providing evidence that directors, in reaching their challenged decision, breached any one of the triads of their fiduciary duty – good faith, loyalty or due care. If a shareholder plaintiff fails to meet this evidentiary burden, the business judgment rule attaches to protect corporate officers and directors and the decisions they make, and our courts will not second-guess these business judgments. If the rule is rebutted, the burden shifts to the defendant directors, the proponents of the challenged transaction, to prove to the trier of fact the 'entire fairness' of the transaction to the shareholder plaintiff.³²³

There are similarities between the elements that the Delaware courts look for and those the courts applying the ALI formulation look for. The similar requirements for the BJR were captured by Weng as follows: (1) that directors must have made a decision, generally the rule is inapplicable to an omission, (2) directors may not have an interest, financial or familial, in the subject matter of the business decision, if the interest will reasonably be expected to affect their judgment, the standard of review will be heightened and the business judgment will not apply, (3) the decision-maker must have rationally believed that he made the decision in the best interests of the corporation (4) decisions should be made in good faith, and if the decision does not meet this requirement, the BJR is inapplicable.³²⁴

There are however important differences regarding the approaches of these formulations to the BJR. For example, there is a difference in terms of where the burden or onus of proof of facts lies. In South Africa and many other common law jurisdictions, the person who alleges a fact must prove it. However, in the ALI formulation, the burden of

³²¹ Bainbridge (2004) *Vand. L. Rev* 90.

³²² 473 A 2d 805 at 812 (Del, 1984).

³²³ *Cede & Co. v Technicolor, Inc.* supra n42 at 361.

³²⁴ Weng (2010) *Fordham Int'l L.J.* 129.

establishing the presence of the BJR elements lies with the defendant directors.³²⁵ If the directors discharge this onus, they become unassailable and are safe. In contrast, the presumption, as demonstrated above, operates to give a plaintiff a heavy burden to prove that the board, in making the disputed decision, breached one or more of its fiduciary duties of loyalty and good faith or failed in process due care. Where the plaintiff fails to meet this burden, the BJR applies to protect the directors. In case of successful rebuttal of the presumption, a reverse onus applies as explained in the *Technicolor* case cited above.

3.5 CONCLUSION.

This chapter set out to consider international best practices for purposes of enriching the standards in s76(3)(c) and s76(4)(a) of the Act . It was stated that the UK and Australian laws share a rich common law heritage and that experiences in those countries post their respective corporate reforms would be most instructive of the development of South African company law jurisprudence.³²⁶ In addition to the UK³²⁷ and Australia,³²⁸ this chapter further considered the USA³²⁹ experiences in the development of standards of care, skill and diligence as well as the BJR.

During the comparative analysis drawn with the UK and Australia, certain strengths of the Companies Act 2006 and the Corporations Act 2001 respectively were extracted and comparisons were made with the Companies Act 2008. Differences were acknowledged and explained too. Proposals were thus made for improving the interpretation of subsections 76(3)(c) and 76(4) (a) of the Act . For example, it has been established that there are some gaps and ambiguities in section 76(3) and especially subsection 76(3)(c), which could be cured by learning from certain strengths in the UK and Australian laws. The Act lacks a provision which clarifies the relationship between the common law duty of care, skill and diligence and the statutory duty under section 76(3)(c). As stated above, it is not clear under section 76(3), whether statutory law has a superior status to common law, or whether the two apply and operate together, or whether section 76(3) (c) should be interpreted by reference to common law rules. This will prove problematic for courts when interpreting the law in a

³²⁵ Branson (2011) *SAC LJ* 691.

³²⁶ See 3.1 above.

³²⁷ See 3.2 above

³²⁸ See 3.3 above.

³²⁹ In 3.4 above.

given situation in future. Lessons can be drawn from the UK and Australian laws which have provisions which clarify the relationship between common and statutory law in this regard.³³⁰

The UK Companies Act 2006's section 174(1) and (2) may provide lessons on how section 76(3)(c) could possibly have been drafted, or how it should be redrafted. The same can be said of the simplicity with which subsection 180(1) of the Australian Corporations Act 2001 was drafted. Both these provisions from UK and Australian laws could prove instructive to the revision of subsection 76(3)(c), as will be proposed in chapter 7.

As noted in this Chapter, with regards to reliance and delegation, South African courts can learn from jurisprudence being developed in international best practices such as Australia and the USA. South Africa can learn from Australia when it comes to emphasising the maxim *delegatus non potest delegare*,³³¹ and to emphasise the fact that the exercise of delegated authority needs to be properly supervised by a director.

With regard to the BJR, USA and Australian law has been analysed to provide comparisons with the BJR formulation under the Act. It has been established that there are similarities regarding the scope and content of the USA and Australian versions of the BJR. The USA provides lessons from case law, the ALI Draft and the Delaware formulation. There are some similarities regarding the content of the USA, Australian and South African BJR versions. One such similarity is the fact that BJR serves as a standard of review to provide a test a court is to apply when reviewing a director's conduct.³³² The only major difference between the content of the BJR versions from these countries and that of South Africa is the absence of the good faith requirements in the South African BJR formulation. Thus foreign law can provide a good aid to analyse s76(4) (a).

One of the purposes of the Act is to promote the global competitiveness of the South African companies and economy by ensuring international harmonisation of corporate law. Now that the Act is in place and has clear influences from countries such as the UK, Australia and the USA, now is the time for the second phase of harmonisation. This can be achieved through the mechanism provided for in the Act – the interpretation clause of the Act. S 5(1) envisages an interpretation and application of the provisions of the Act which seek to promote its purposes. S 76(3)(c) of the Act remains fairly untested. The Australian, UK and USA experiences afford South Africa with an opportunity to incorporate international best practices through interpretation.

³³⁰ See 3.3 above.

³³¹ See part 3.3 above.

³³² See 3.4.2 with regards to USA law and 3.3.2 with regards to Australian law.

CHAPTER 4: MODERN STANDARDS OF CARE, SKILL & DILIGENCE IN SA: AN ANALYSIS OF SECTION 76(3) OF THE COMPANIES ACT 71 OF 2008

4.1 INTRODUCTION

This Study seeks to answer the central question whether the Act has made the standards of care, skill and diligence comprehensively clearer, more accessible and more enforceable than before. This inquiry is made in the light of the adoption of the BJR. Some relevant questions in this regard include an inquiry into the exact standards established in South African law by s 76(3) (c) of the Act and whether s76 (3) (c) introduces into the law a purely objective test or rather perpetuates a dual objective/subjective test for the duty of care, skill and diligence. These questions cannot be answered without establishing first what *lacunae* the law reform process sought to close or resolve.¹ This will necessitate briefly tracing the development of the law through case law in South Africa, and establishing policy goals for law reform in this regard.

The major aim of Chapter 4 is to provide a critical analysis of s76 (3) (c) within the context of the key research question and relevant sub-inquiries sketched in the above paragraph. Section 76(3)(c) will be analysed partly in light of relevant goals of law reform outlined in the DTI Policy Document 2004 in tandem with the purposes of the Act² and international best practices already considered in Chapter 3.

Chapter 4 begins by considering the state of the law prior to the Act, and the need for law reform. Thereafter, the contribution of the *King Reports*' recommendations will be briefly considered. After highlighting the policy goals for law reform and considering the Companies Bills of 2007³ and 2008,⁴ the crucial task of critically analysing s76 (3) (c) will follow.

¹ See part 1.3 of Chapter 1.

² See s7 of the Act.

³ The Companies Bill, 2007 was published as GN 166 in GG 29630 of 12 February 2007.

⁴ Companies Bill, 2008. [B 61- 2008] in GG 31104 of 30 May 2008.

4.2 Duty of care, skill and diligence prior to 2008: The need for reform

4.2.1 The common law duty in SA before 2008

Under the South African common law, it is generally accepted that a director's paramount duty is to undertake all actions and make decisions in good faith for the benefit of the company.⁵ In so exercising his powers and discharging his functions, a director is expected to act with the required degree of care, skill and diligence.⁶ The composite duty of care⁷ is vital to corporate governance. It is viewed in this work as the vehicle through which directors perform their functions and exercise their powers. As has been argued, the duty of care has a broad reach.⁸ It applies to all decisions directors make or should make were they to act in the best interests of the company.⁹ Despite the importance of this requirement, the common law faced and still faces the challenge of a low standard of review for duty of care. In fact, the exact standards of care, skill and diligence applicable at common law do not seem to be crystal clear.¹⁰

As pointed out in Chapter 3, English law greatly influenced the development of South African common law standards of care, skill and diligence.¹¹ While English case law principles remain persuasive and not binding on South African court, English they appear to have been readily accepted in our law.¹² A perfect example of this is to be seen in how Margo J incorporated English law principles in *Fisheries Development Corporation of SA Ltd v Jorgensen & Another*.¹³ A decision delivered in 1980, this case remains the leading case on applicable standards of care, skill and diligence in South Africa. A more detailed discussion of principles adopted into South African common law was done in Chapter 3.¹⁴ It is thus not considered necessary to repeat that discussion here.

⁵ *Fisheries Development Corporation of SA Ltd v Jorgensen & Another* (supra) at 163. Also see a similar view expressed by various South African authors - Bouwman (2009) *SA Merc LJ* 510; Bekink (2008) *SA Merc LJ* 99 and Havenga (2000) *SA Merc LJ* 33-34.

⁶ Ibid.

⁷ The duty of care, skill and diligence may from time to time be referred to as the 'composite duty of care' or simply as 'the duty of care' in this chapter.

⁸ Havenga (2000) *SA Merc LJ* 25.

⁹ Bekink (2008) *SA Merc LJ* 95.

¹⁰ Bouwman (2009) *SA Merc LJ* 510.

See part 3.1 of Chapter 3, where principles from some influential English cases which were assimilated into SA law were considered. The influence of the following cases was noted in part 3.1: *Re Cardiff Savings Bank: Marquis of Bute's Case* [1892] 2 Ch 100; *Re Brazilian Rubber Plantations and Estates Ltd* [1911] 1 Ch 425 (ChD); *Re City Equitable Fire Insurance Co Ltd* [1925] Ch 407 (CA), among others.

¹² Havenga (2000) *SA Merc LJ* 25.

¹³ *Fisheries Development Corporation of SA Ltd v Jorgensen & Another* (supra) at 156.

¹⁴ See part 3.1.

The adoption of English standards in *Fisheries Development Corporation of SA Ltd* had implications for the state of South African common law even prior to the Act. One such implication is that a subjective approach has been followed at common law in South Africa.¹⁵ This is the result of Margo J adopting principles from cases such as *Re City Equitable Fire Insurance Co Ltd*,¹⁶ *Re Brazilian Rubber Plantations and Estates L*¹⁷ and *Lagunas Nitrate Co v Nitrate Syndicate Lt*.¹⁸

The South African common law, as is evident from Margo J's ruling in *Fisheries Development Corporation of SA Ltd*,¹⁹ employed a dominantly subjective approach/test to the duty of care, skill and diligence. There is a striking difference in this case between the demanding duties of loyalty and good faith and the less onerous common law duties of care, skill and diligence.²⁰ The overly lenient approach to the common law duty of care was premised on assumptions that no longer find support in a modern commercial world. The assumptions stemmed from the view where directors were regarded as benevolent amateurs who lacked specialist skills or technical talent.²¹ Thus the directors could not be expected to maintain involvement in company affairs or even exercise any skill they were not required to possess. In addition, this subjective test failed to require directors to ensure diligent attendance to their duties. Hence Margo J ruled that directors were not required to give continuous attention to the affairs of a company.²² This principle which was borrowed from *Re City Equitable Fire Insurance Co Ltd* was developed with non-executive directors in mind. These directors were considered mere figureheads or ornaments. With regards to standards of skill, the leading South African case subjectively required the directors to exercise the knowledge and experience such as they possessed.²³ This is now out-dated and inappropriate in a modern commercial world.

¹⁵ See J Cassidy 'Models For Reform: The Directors' Duty of Care in a Modern Commercial World' (2009) 3 *Stell LR* 373 at 384.

¹⁶ *Re City Equitable Fire Insurance Co Ltd* (supra).

¹⁷ In this case even the most extreme form of negligence saw directors escape the classification of their conduct as 'gross negligence'. In this case, the directors based their decision on a fraudulent report where the price of immovable property was valued at £ 150 000 instead of £ 15 000. Notwithstanding the discrepancy in the report and price exaggerations, directors' failure to make proper inquiries and the consequent loss to the company, Neville J held that the conduct of the directors did not amount to gross negligence.

¹⁸ Lindley MR remarked, surprisingly, that, "Directors are not liable for all the mistakes they may make, although if they had taken more care they might have avoided them...Their negligence must be not the omission to take all possible care; it must be much more blameable than that; it must be in a business sense culpable or gross".

¹⁹ *Fisheries Development Corporation of SA Ltd v Jorgensen & Another* (supra) at 156.

²⁰ Bekink (2008) *SA Merc LJ* 95 at 100. Also see Cassim et al *Contemporary Company* 2ed (2012) 554.

²¹ Cassidy (2009) *Stell LR* 373 at 384.

²² See Bekink (2008) *SA Merc LJ* 95 at 100. Also see *Fisheries Development Corporation of SA Ltd v Jorgensen & Another* (supra) at 156 – 160.

²³ *Fisheries Development Corporation of SA Ltd v Jorgensen & Another* (supra) at 156.

To its credit, the court in *Fisheries Development Corporation of SA Ltd v Jorgensen & Another* ruled that the extent of a director's standard of care and diligence required is circumstance-based. Such circumstances include the nature of the company business or economic interests involved, the size of the company and the particular obligation assumed by or assigned to the specific director.²⁴ The court in *Howard v Herrigel & Another NNO*, where part of the ruling of Margo J was quoted with approval, stated that "one of the circumstances may be whether he [*the director*] is engaged full-time in the affairs of the company".²⁵ The need to judge a case on its own merits has been accepted as being consistent with modern standards in recent case law in Australia.²⁶

Common law in South Africa appears to have been following the trends of development in English law as is evident in the manner South African law has treated the question whether different standards should apply to executive and non-executive directors. In *Fisheries Development Corporation of SA Ltd*, Margo J ruled that a differentiation of standards must be done. When English case law moved to dual objective/subjective standards based on section 214(4) of the Insolvency Act, 1986, it appears that South African case law followed suit. For example in *Howard v Herrigel & Another NNO*,²⁷ the court followed the English approach at the time, and even adopted a view expressed in *Dorchester Finance Co v Stebbing*²⁸ against distinguishing between an executive director and a non-executive director. The court in *Howard v Herrigel & Another NNO* appears to have taken a different view. The court regarded as unhelpful or even misleading such a classification of directors for purposes of ascertaining their duties to the company.²⁹ The court ruled that the standards of care owed were the same for all directors.³⁰ The court also appeared to have adopted into South African common law, the principle espoused in *Dorchester Finance Co v Stebbing* that where a director has specialised skill and experience, standards of care and skill expected are even higher.³¹

²⁴ Ibid.

²⁵ See *Howard v Herrigel & Another NNO* (1991) (2) SA 660 (A) at 678 A-F. The words in italics are my own addition, for purposes of clarity only. Also see *Philotex (Pty) Ltd & Others v Snyman & Others* (1998) (2) SA 138 (SCA).

²⁶ See part 3.3.3 of Chapter 3 where this was discussed in relation to the Australian *Macdonald* case referred to in Chapter 3.

²⁷ *Howard v Herrigel & Another NNO* (supra) at 678.

²⁸ [1989] BCLC 498.

²⁹ See *Howard v Herrigel & Another NNO* (supra) at 676. Also see Havenga (2000) SA *Merc LJ* 35 and Bekink (2008) SA *Merc LJ* 101.

³⁰ *Howard v Herrigel & Another NNO* (supra) at 676.

³¹ Ibid. Also see Bekink (2008) SA *Merc LJ* 99.

It is not clear whether the court in *Howard v Herrigel & Another NNO* overruled *Fisheries Development Corporation of SA Ltd* regarding the differentiation of standards applicable to executive and non-executive directors. There are two possibilities. The first one is that the A.D could have realised the error in the leading case³² and sought to correct it, which could imply overruling that case.³³ The alternative view is that the A.D only put into perspective³⁴ the circumstances when a court of law would distinguish the extent of the duty of care and standard of skill expected. This understanding stems from the fact that Margo J had attempted to explain that the extent of the director's duty of care and skill depends to a considerable extent on the nature of the company's business and the role assumed by the director in the company. While the exact position regarding this is not crystal clear, what is clear is that the post 1990s cases in South Africa followed the position in *Howard v Herrigel & Another NNO*. This was the case with *Philotex (Pty) Ltd & Others v Snyman & Others*.³⁵

There are some indications in *Philotex (Pty) Ltd & Others v Snyman & Others* that the courts were moving towards a dual objective/subjective test when it comes to the common law duty of care and skill as applied in English law at the time.³⁶ The court held that the test for recklessness is an objective standard measured against the standard of a notional reasonable person, but balanced by subjective elements which take into account the knowledge possessed by the particular director.³⁷ Thus the subjective elements required that considerations be made of the additional knowledge, experience and determinable skills which evidence revealed that the director had.³⁸ In this case, the court held that directors were personally liable for recklessly increasing the debts of the company.³⁹ The court also related

³² The leading case in this case is *Fisheries Development Corporation of SA Ltd v Jorgensen & Another* (supra).

³³ See Bekink (2008) *SA Merc LJ* 101. Bekink appears to hold this view.

³⁴ See Havenga (2000) *SA Merc LJ* 34-35. Havenga, without clearly making the exact argument, seems to agree that the matter was put into perspective in *Howard v Herrigel & Another NNO*.

³⁵ *Philotex (Pty) Ltd & Others v Snyman & Others* (supra) at p14.

³⁶ In *Dorchester Finance Co v Stebbing* (supra) Forster J followed a dual objective/subjective approach in line with s214(4) of the Insolvency Act of 1986. In the latter cases, in *Norman v Theodore Goddard* [1991] BCLC 1028 and *Re D'Jan of London Ltd* [1993] BCC 646, Hoffman J appeared to be applying purely objective standards. The correct view however is that since Hoffman J also based his decisions on s214 (4) of the Insolvency Act 1986 it could only be interpreted or concluded that he applied a dual objective/subjective approach. For a fuller discussion of the English position in this regard, see part 3.2.1 of Chapter 3.

³⁷ *Philotex (Pty) Ltd & Others v Snyman & Others* (supra) at p8.

³⁸ See Bekink (2008) *SA Merc LJ* 95 at 101.

³⁹ The summary of the case and findings are as follows: The Supreme Court of Appeal (SCA) action of the appellants was based on allegations that the directors had breached s424 of the Companies Act 61 of 1973. The directors were charged with carrying on the business of the company recklessly, leading to the liquidation of Wolnit Limited on 20 November 1989. This prejudiced creditors of the company who instituted action against the directors of Wolnit. The action failed in the court *aquo*, leading to the successful appeal in the SCA. The main prayer of the appellants was for an order declaring respondents personally liable for the debts of Wolnit incurred after 1 July 1987. This was a breach of the duty of care, skill, and diligence. It was a result

the test for recklessness to the common law duty of care and skill of a director and implied that the test for negligence in both cases would be the same.⁴⁰ This case was, based on allegations that the directors had breached s424 (4) of the Companies Act, 1973. It does not appear that South African common law applies gross negligence as the standard of liability for breach of the duty of care. The correct view should be that, while directors are not liable for mere errors, they are liable for negligence.⁴¹ This matter is further canvassed in part 4.4.3 below. The basis of liability for breach of the duty of care as per the Act is further discussed in part 6.2.1 of Chapter 6.

4.2.2 *King Reports*' contribution to law reform

The *King Reports* were discussed in detail in Chapter 2 as part of the overall corporate governance regulatory framework of South Africa.⁴² The first two *King Reports* (namely *King I Report* and *King II Report*) sow the seeds for law reform, specifically the partial codification of directors' common law duties and statutory adoption of the BJR. These two reports got South Africa debating about the pros and cons of law reform. At the end of a raging debate regarding the compatibility of the BJR with South African law, one fierce critic of adoption of the BJR into statute reluctantly conceded defeat to the influence of the *King Reports* which, contrary to South African academics, pushed for statutory adoption of the BJR. Jones bemoaned the fact that contrary to the views of the majority of South African legal writers, the BJR became part of the Act.⁴³ There is thus evidence that the *King Reports*' influence bore some fruits. The Act now contains a statutory duty of care, skill and diligence, and counts the BJR among its numerous innovations.

King III, unlike *King I* and *King II*, does not contain recommendations for law reform. Part of the purpose or function of *King III* is to provide a clear link or synergies between governance principles⁴⁴ and the law.⁴⁵ The *Report* notes that South Africa now follows a

of carrying on company business recklessly, even though the claimants in this case were the company's creditors. See *Philotex (Pty) Ltd & Others v Snyman & Others* (supra). See the judgment of Howie JA at p2.

⁴⁰ See *Philotex (Pty) Ltd & Others v Snyman & Others* (supra) 134. The court in *Heneways Freight Services (Pty) Ltd v Grogor* 2007 (2) SA 561 (SCA) at 564D-E accepted that the statutory requirement of recklessness as set out in s424 of the Act would also embrace the common law concept of gross negligence.. This is only with reference to reckless trading in terms of s424(1) of the Companies Act, 1973.

⁴¹ See Blackman, Jooste & Everingham *Commentary on Companies Act* 190.

⁴² See part 2.2.2 of Chapter 2.

⁴³ Jones (2007) *SA Merc LJ* 326. Also see Bekink (2008) *SA Merc LJ* 110.

⁴⁴ Contained in the *King III* as a corporate governance code.

⁴⁵ As represented by the Act. To gain more insight into the synergies between the Act and *King III*, see M King 'The synergies and interaction between *King III* and the Companies Act 71 of 2008' (2010) *Acta Juridica* 446-455.

hybrid system of corporate governance. There is a legislated basis of governance compliance, premised on legal rules in the Act on one end. On the other end, there is voluntary basis of governance compliance based on recommended principles in the *King III*.⁴⁶ The value of *King III* is that it promotes a link between good governance and legal compliance, making it ‘inappropriate to unhinge governance from the law’.⁴⁷ Implication of the symbiotic relationship between *King III* and the Act is that courts of law are likely to refer to principles in *King III* and its Code when interpreting relevant provisions of the Act.

4.2.3 Corporate law reform objectives- the DTI Policy Paper 2004

Corporate law reform was undertaken with the understanding that company law plays a critical role in the development of the South African economy in the 21st century.⁴⁸ Consistent with this understanding was the need by government to ensure that regulation of business entities was consistent, effective, predictable, transparent, fair, comprehensive and understandable.⁴⁹ The law reform process envisaged development of a “clear, facilitating, predictable and consistently enforced law”.⁵⁰ Closely linked to this was a desire that company law would provide “a protective and fertile environment for economic activity.”⁵¹ The DTI Policy Document 2004 thus highlights broad objectives of law reform linked to the global competitiveness and development of the national economy. Discussing these in detail is beyond the scope of this chapter.⁵² Discussion in this part shall be limited to three specific objectives (extracted from the broad objectives) which have relevance to the focus of this Study and this chapter. These specific goals include; firstly, the need for a clear, facilitating, predictable and consistently enforced law. The second goal relates to the need to establish a simple yet comprehensive, transparent and accessible legal framework. The third goal is the need for harmonisation of law with the best practice jurisdictions internationally.

⁴⁶ See the ‘Introduction and Background’ to the *King III* Report.

⁴⁷ See the ‘Introduction and Background’ to the *King III* Report.

⁴⁸ See the DTI Policy Paper 2004 op cit para 1.2.

⁴⁹ Ibid.

⁵⁰ See the Explanatory Memorandum to the Companies Bill, 2007, op cit p3.

⁵¹ Ibid.

⁵² The DTI Policy Paper 2004 op cit para 1.2 lists the broad objectives as follows: 1. Encouraging entrepreneurship and enterprise diversity by simplifying the formation of companies and reducing costs associated with the formalities of forming a company and maintaining its existence, thereby contributing to the creation of employment opportunities; 2. Promoting innovation and investment in SA markets and companies by providing a predictable and effective regulatory environment and flexibility in the formation and the management of companies; 3. Promoting the efficiency of companies and their management; 4. Encouraging transparency and high standards of corporate governance, recognising the broader social role of enterprises and 5. Ensuring compatibility and harmonisation with the best practice jurisdictions internationally.

The goal to have a law that provides for clarity, predictability, consistent enforcement and a law that is facilitating has implications for the duty of care.⁵³ In relation to the duty, it can be deciphered that the desire was to create clear, unambiguous and easily enforceable standards of care, skill and diligence. Coupled with the decision to opt for partial as opposed to total codification, the objective was to avoid stunting growth of the common law fiduciary duties and the duty of care, skill and diligence. This would allow for continued incremental development of common law duties through application to different arising situations by courts of law. It has been correctly stated that directors' common law duties have "endured remarkably, subject to incremental refinement by the courts to meet new factual scenarios and changing societal expectations".⁵⁴ The DTI Policy Paper envisaged that the judiciary would continue to play its obligatory role of developing the common law where it is found wanting.⁵⁵ Courts are under a general obligation to develop the common law by applying constitutional values as mandated by sections 8(3), 39(2) and 173 of the Constitution.⁵⁶ It is true that courts have a role to develop law through interpreting it in given scenarios. The Act also acknowledges this role.⁵⁷ While this is true, it is equally correct to say that an Act 'should not leave matters of fundamental importance to its schedules or to common law'.⁵⁸

Whether s76 (3) generally, and specifically s 76(3) (c) of the Act have made the statement of directors' common law duties a clear or facilitating legislative statement of directors' common law duties is debatable. As will be argued in this chapter, s76 (3) (c) is couched in an ambiguous manner and there are gaps which make it difficult to understand the exact standards established. For example, it is difficult to understand the status of the statutory duty of care. Does s76 (3) (c) establish new and improved standards of care, skill and diligence? Or does the section propose to be simply declaratory of the common law position without amending common law in any way? Does the statement of common law

⁵³ See s76 (3c) of the Act.

⁵⁴ See D Ahern 'Directors' duties, Dry Ink and the Accessibility Agenda' (2012) 128 *L.Q.R.* 114.

⁵⁵ DTI Policy Paper 2004 op cit 5 at para 3.3.

⁵⁶ B Mupangavanhu 'Yet another Missed Opportunity to Develop the Common Law of Contract? An Analysis of *Everfresh Market Virginia (Pty) Ltd v Shoprite Checkers (Pty) Ltd* [2011] ZACC 30' (2013) 1 *Speculum Juris* 148. See abstract to the article. Also see the following cases quoted in this article which confirm this point:

Carmichele v Minister of Safety and Security (Centre for Applied Legal Studies Intervening) 2001 4 SA 938 (CC) paras 54-6; *Napier v Barkhuizen* 2006 4 SA 1 (SCA); *Barkhuizen v Napier* 2007 5 SA 323 (CC) paras 28-9; *Brisley v Drotzky* 2002 4 SA 1 (SCA).

⁵⁷ See s158 (a) of the Act. It states as follows:

When determining a matter brought before it in terms of this Act, or making an order contemplated in this Act—

(a) a court must develop the common law as necessary to improve the realisation and enjoyment of rights established by this Act.

⁵⁸ DTI Policy Paper 2004 op cit 5 at para 3.3.

duties in s76 (3) apply in place of, in addition to or together with common law equivalent duties? These are questions which indicate both a lack of clarity and possible interpretative difficulties courts and all users of law are likely to encounter.. This chapter will attempt to provide answers to these questions which call for clarity.

Predictability of regulation as part of the goals of law reform is confirmed by the Act.⁵⁹ This implies two closely related issues. The first issue is the decriminalisation of company law sanctions where possible, as envisaged by the Companies Bill, 2007.⁶⁰ Once this happens, the gap created by scrapping criminal sanctions should be filled by civil sanctions. The second related issue is the DTI Policy Paper 2004's proposal that company law should be enforced through appropriate bodies and mechanisms, either existing or newly introduced.⁶¹ This study will consider whether the Act has responded appropriately to this sub-goal by creating a clearly specialised enforcement agency. The Australian Securities and Investment Commission (ASIC) is an example of such a specialised agency with a specific role of enforcing statutory duties of directors. It appears like the Act envisages the newly established Companies and Intellectual Property Commission (CIPC) to perform some kind of a role of an enforcement agency,⁶² but maybe, not exactly in the mould of ASIC. It remains to be seen if the CIPC will be as effective as ASIC has proven to be in Australia. While ASIC is a specialised enforcement agency, the CIPC appears to have wide functions which could encumber its effectiveness as an enforcement agency.⁶³ As noted in Chapter 3, Australia has been fairly successful since 2001 in prosecuting breaches of statutory duties by company directors.⁶⁴

The second goal- the need to establish a simple yet comprehensive, transparent and accessible legal framework, is related to the first goal discussed above. The goal of simplicity takes into account the language used and the manner in which provisions are drafted.⁶⁵ This relates to clarity and the need for law to be enabling and facilitating. There is always a risk that in trying to keep with the objective of simplicity, provisions could be drafted in an unclear and ambiguous manner which can confuse readers and end-users of the law. There is

⁵⁹ In this regard s7 (1) provides that one of the purposes of the Act is to "provide a predictable and effective environment for the efficient regulation of companies."

⁶⁰ See Companies Bill 2007, op cit 8 at p5.

⁶¹ Ibid.

⁶² In Chapter 8 of the Act, the CIPC is listed as the main regulatory agency, with wide functions.

⁶³ See s186(1) (a)-(e) and s187(2) (a)-(i), for the many objectives the CIPC has to fulfil. It is expected to carry out numerous functions with respect to the administration of the Act. See s187 for the CIPC's enforcement function. For further details see Chapter 6.

⁶⁴ See the body of case law emerging in Australia in this regard, discussed in part 3.3.3 of Chapter 3.

⁶⁵ DTI Policy Paper 2004 op cit 5 at para 3.3.

also the objective of accessibility of the duties. Just like the situation in the UK leading to the Companies Act 2006,⁶⁶ accessibility of duties was associated with transparency in the law and ease of reference for the user. There was also a tacit assumption of a positive correlation between accessibility of the law and compliance.⁶⁷ The argument was that before the Companies Act 2008, directors of companies found it difficult to access their duties which were locked up in case reports. Such duties, it was contended, require quite advanced legal expertise to be comprehensively understood.⁶⁸ The accessibility policy objective is also closely linked to the broad 2004 DTI policy paper goal of “encouraging transparency and high standards of corporate governance...” in the country.⁶⁹ This goal has since been incorporated by the Act and forms part of the purposes of the Act listed under section 7.⁷⁰

In the UK, empirical research revealed widespread support among directors who believed that codification would help them readily access what is required of them. It was somehow hoped that a statutory statement of duties would be the panacea for issues of clarity of the law.⁷¹ Similarly in South Africa, research showed that directors welcomed a statutory statement of their duties on the back of the belief that codification (partial or total) would save them time, effort and money in ascertaining the law.⁷² It is highly likely that some directors in South Africa, prior to the adoption of the Companies Act 2008, did not know what their common law duties are and to whom such duties are owed.⁷³

The need for harmonisation of law with best practice jurisdictions internationally as a goal was partially discussed in Chapter 3 and is confirmed by the Act.⁷⁴ Harmonisation has the twin goals of reducing costs of doing business and increasing certainty in regulation for overseas companies and investors. It also reduces costs of applying company law locally. The understanding was that where there is clarity, an enabling environment is created, a great

⁶⁶ C45 of 2006.

⁶⁷ Ahern (2012) *L. Q. R* 114.

⁶⁸ See Cassim et al *Contemporary Company* 2ed (2012) 508.

⁶⁹ DTI Policy Paper 2004 op cit 5 at para 1.2.

⁷⁰ See s7(b)(iii) of the Act.

⁷¹ See The (English) Law Commission and The Scottish Law Commission, *Company Directors: Regulating Conflicts of Interests and Formulating a Statement of Duties* Law Com No. 261, Scot Law Com No. 173 (1999) paras 4.27- 4.41, available at http://www.open.gov.uk/law_comm/ visited on 25 November 2013.

⁷² Bekink (2008) *SA Merc LJ* 113, quoting I Esser & J Coetzee “Codification of Directors’ Duties” (2004) *Juta’s Business Law* 12 at 26.

⁷³ This is exactly what a survey in the UK by the UK Institute of Directors established. See *Modernising Company Law* (2002) CM 5553-1, para 3.2 at 26, referred to in Cassim et al *Contemporary Company Law* 508.

⁷⁴ S7 (e) the Act

range of judicial precedent is developed and it minimises litigation, thus saving money and time.⁷⁵

4.3 The Companies Bill 2007

The Companies Bill 2007 (hereafter the Bill) was referred to in the discussion of corporate law reform objectives in 4.2 above. Three key aspects particularly from the approach adopted in certain provisions of the Bill are very relevant to this study.

The first aspect concerns the manner in which the Bill clarifies the relationship between the proposed new company legislation's provisions and the common law duties of directors. The Bill's Explanatory Memorandum also reveals that the policy rationale for law reform included introduction of a 'new law in the form of a codified regime of directors' duties'.⁷⁶ The codified common law duties are referred to as 'standards of directors' conduct' under both the Bill and the Act.⁷⁷ The Bill provided that its provisions on standards of directors' conduct were to apply in addition to, and not in substitution of, any of the directors' common law duties.⁷⁸ In this regard the Bill's provisions are reminiscent of the position adopted by the Corporations Act 2001 of Australia as discussed in Chapter 3.⁷⁹ The UK Companies Act 2006 provides that the statutory duty of care in s174 has 'effect in place of' the common law duty which it seeks to replace.⁸⁰ While the Bill provides clarity regarding the relationship between standards of directors' conduct in the Act and at common law, the Act is conspicuous by its omission and silence. It has to be repeated here that it was vital for the Act to provide the same clarity as the Bill offered on this matter. It is a very helpful global trend as seen in the best practice international jurisdictions, to provide such clarity. A provision in the mould of Clause 91(6) of the Companies Bill 2007 could have clarified the relationship between the statutory standards of care, skill and diligence and the common law position. Importantly this could have also ascertained the status of statutory law vis-à-vis common law. It was preferable to have this matter clarified in the Act rather than for it to be left to the courts of law to provide clarity through interpretation.

The second issue which stands out from the Bill is the manner in which the duty of care, skill and diligence was framed. If ever there were doubts regarding the enduring

⁷⁵ DTI Policy Document 2004 para 3.5.

⁷⁶ See the Companies Bill 2007 p12.

⁷⁷ See the similar titles of Cl 91 of the Companies Bill 2007 & s76 of the Act.

⁷⁸ See Cl 91 (6) of the Companies Bill 2007. Also see Bouwman (2009) *SA Merc LJ* 513.

⁷⁹ See part 3.3.2 which refers to provisions of s185 of the Corporations Act 2001, which is comparable to Cl 91(6) of the 2007 Bill.

⁸⁰ See part 3.2.2 of Chapter 3.

influence of English company law on South African law even up to the point of law reform, then those doubts can be put to rest when one closely looks at the Bill.⁸¹ It is clear that the test proposed in the Bill is a dual objective/subjective test. It has been correctly said that the formulation of this proposed test is similar to the test proposed in English case law of the 1990s, especially in *Re D'Jan of London Ltd.*⁸² This case applied s214(4) of the Insolvency Act, 1986 of the UK which sets out a dual objective/subjective test to be considered by a court when assessing whether or not a director breached the duty of care during wrongful trading. The Companies Bill 2007 thus gives the biggest hint that the intention of the legislature in formulating standards of care, skill and diligence under the Act, was to follow the English example of a dual objective/subjective test. As pointed out in 3.2.2 above, this test was transposed to the Companies Act 2006 from s214(4) of the Insolvency Act 1986.

The third aspect relevant to this study is the formulation of the BJR, which appears from the wording of the Bill to have been initially intended to relate only to the breach of the fiduciary duty to act in the best interests of the company.⁸³ This formulation excluded the possibility of limiting directors' liability for breach of their duty of care, skill and diligence.⁸⁴ A detailed examination of the BJR follows in Chapter 5.

I now turn to the task of critically analysing s 76(3) (c) and the related s 76(4) (b). The latter section relates to the statutory defences of reliance and delegation.

4.4 Analysis of s76 (3) (c) of the Act

Section 76(3) (c) will be analysed to establish the exact standards introduced into law by the statutory duty of care, skill and diligence. The analysis will be presented, as mentioned earlier, in the light of policy objectives for law reform⁸⁵ in tandem with the purposes of the Act.⁸⁶ International perspectives examined in Chapter 3 will be employed to offer perspective to the probable future interpretation of the subsection by courts and possible amendment of

⁸¹ Cl 91 (1) (a) of the Companies 2007 Bill provides as follows:

‘(1) Each director of a company, when acting in that capacity, or as a member of a committee of directors, or when gathering information or similarly preparing to act in either of those capacities, is subject to -

(a) a duty to exercise the degree of care, skill and diligence that would be exercised by a reasonably diligent individual who had both-

(i) the general knowledge, skill and experience that may reasonably be expected of an individual carrying out the same functions as are carried out by that director in relation to the company; and

(ii) the general knowledge, skill and experience of that director.’

⁸² [1993] BCC 646 (Ch D). The test applied was based on s214 (4) of the Insolvency Act, 1986. This test included both objective elements (of care and diligence) and subjective elements of skill. Also see Bouwman (2009) *SA Merc LJ* 512.

⁸³ See Cl 91(2) of the Companies Bill 2007.

⁸⁴ As was feared by critics of BJR. See Bouwman (2009) *SA Merc LJ* 528.

⁸⁵ See 4.2.3 above for a discussion of the law reform policy objectives based on the DTI Policy document 2004.

⁸⁶ See s7 of the Act.

the Act. It is also vital to consider the context within which the subsection is presented. Subsection 76(3) (c) forms part of s76 (3) which partially codifies the common law duties of directors for the first time in South Africa. The Companies Act 1973 did not contain any statement of directors' common law duties. This subsection codifies two fiduciary duties namely duties to 'act in good faith and for a proper purpose' and to act 'in the best interests of the company'⁸⁷. It also codifies the duty of care, skill and diligence. As has been discussed above there are important policy motivations for this partial codification of common law duties under the Act,⁸⁸ the main objective being to establish a simple yet comprehensive, transparent and accessible legal framework.

4.4.1 S 76 (3) (c) in context and implications thereof

Before analysing provisions of s76 (3) (c), it is important to consider the implications of the fact that subsection 76(3) (c) is presented in the context of s76 and especially subsection 76 (3). Subsection 76(3) simply begins by stating that "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 a director..." Section 76 defines a director, for purposes of the section, to include an alternate director, a prescribed officer, a member of the committee or audit committee of a company. It does not matter whether such a person is a member of the company board of directors or not.⁸⁹ Impliedly, a director in terms of this section includes any person acting in the capacity of a director.⁹⁰ The use of the word 'includes' in reference to the ambit of the term 'director' has been said to mean that the term is inclusive rather than exclusive.⁹¹ The wide ambit of the person of a 'director' contemplated by the section pulls in an alternate director, a prescribed officer,⁹² or even a member of the sub-committee of a company board, whether the person sits on the board or not.⁹³ As will be explained in more detail in Chapter 6, there is a purpose to the widening of the ambit of a 'director'.

What is the implication of the phrase "when acting in that capacity"? Part of this is to ensure that anyone who exercises the powers of a director is held accountable for any breach

⁸⁷ See s76 (3) (a) & (b).

⁸⁸ See Bouwman (2009) *SA Merc LJ* 521-523 for a discussion of some of the merits and demerits of total versus partial codification.

⁸⁹ See s76(1).

⁹⁰ See s76 (3).

⁹¹ Cassim *et al Contemporary Company Law* 404.

⁹² A prescribed officer is defined in s1 of the Act to mean "the holder of an office, within a company, that has been designated by the Minister in terms of section 66(11)".

⁹³ See the definition of a director given in s76 (1) (a)-(b).

of directors' duties, including breach of a duty to act with a degree of care, skill and diligence.⁹⁴

Does s76 provide clarity in the relationship between the statutory duty and the common law duty of care, skill and diligence? In that regard, it is commented that another implication of the location of s76 (3) (c) under s76 is the limited clarity of the status of the statutory duty vis-à-vis the common law duty of care, skill and diligence. Where Australian and UK company legislation provide for clarity regarding the relationship between statutory and common law in this regard, the position under s76 is not crystal clear. For example, the UK Companies Act 2006 provides that while the statutory duties are based on common law, they apply or have effect in place of comparable common law duties.⁹⁵ Similarly, the Australian Corporations Act 2001 attempts to provide clarity regarding the relationship between statutory law and common law. The duty of care and diligence in s180 (1) applies together with, and not in substitution of the common law rules.⁹⁶ Unfortunately s76 (3) does not bring about the same clarity regarding the status of s76 (3)(c) and relationship with the common law. It may be inferred from s77 (2) (b)⁹⁷ that the legislature might have intended s76 (3) (c) to be merely declaratory of the common law. As will be discussed shortly, this presents some difficulties because a closer analysis of s76 (3) (c) appears to reveal an attempt to amend the common law.

It is preferable to provide clarity on matters of the relationship between common law and the statutory duty where there has been partial codification. An omission to provide for a clear provision under s76 which clarifies this matter is an anomaly. It is not clear whether the legislature intended s77 (2)(b) to be used as a door way to infer that the legislature intended to make s76(3) merely declaratory of the common law without amending the standards of care, skill and diligence applicable at common law. It was important to make the position clearer especially given the absence of an explanatory memorandum to the Act. Clarity could have been achieved by providing a subsection under s76 in the mould of s170 (3) of the UK statute or s185 of the Australian statute to clarify the said relationship.⁹⁸ Consequently, the absence of such clarity will mean potential future difficulties for courts when interpreting provisions of s76 (3) (c) in given scenarios.

⁹⁴ See s77 (a)-(e) of the Act.

⁹⁵ See s170(3) of the UK Companies Act 2006 as discussed in Chapter 3's part 3.2.2.

⁹⁶ See s185 the Corporations Act 2001 referred to in part 3.3 of Chapter 3.

⁹⁷ S 77(2) explains that the liability for breach of s76(3)(c) is in accordance with the principles applicable at common law. This appears to be one of the best ways of understanding the status of the statutory duty or the relationship between the statutory duty of care and the common law duty.

⁹⁸ The legislature had provided such clarity in Cl 91(6) of the Companies Bill 2007 as alluded to earlier. See Chapter 7 for a proposed amendment to s76 of the Act along similar lines.

4.4.2 Provisions of s76 (3) (c)

Section 76(3) (c), as part of s76 (3) provides as follows:

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 the degree of care, skill and diligence that may reasonably be expected

of a person—

- (i) carrying out the same functions in relation to the company as those carried out by that director; and
- (ii) having the general knowledge, skill and experience of that director.

A critical analysis of the standards of care, skill and diligence introduced by the Act now follows.

4.4.3 A critical analysis of the standards in s76 (3) (c)

As set out above one of the main questions is what the exact standards introduced into law by s76 (3) (c) of the Act are.⁹⁹ This question is asked in light of the fact that prior to the Act South African common law is said to have applied a subjective approach to the duty of care, skill and diligence.¹⁰⁰ The emphasis in this part focuses on the test to be applied under s76 (3) (c) and whether the standards of conduct applicable are dual objective/subjective standards.

A brief comment needs to be made about the implications of the phrase ‘a director of a company when acting in that capacity, must exercise the powers and perform the functions of a director...’ This long phrase should be read in the context of the expansive definition of a director given in s76.¹⁰¹ The definition of a director in s76 (1) focusses on the individual when acting in the capacity of a director. The purpose appears to have been to capture into the ambit of s76 (3), including s76 (3) (c), the exercise of directorial power or the performance of the directorial functions, regardless of the title of the person playing this role. It appears that the legislative intent was to protect the integrity of the office of a director by ensuring good governance through holding persons accountable for the exercise of powers

⁹⁹ See part 4.1 of this Chapter.

¹⁰⁰ See Cassim et al *Contemporary Company* 2ed (2012) 554. Also see Bekink (2008) *SA Merc LJ* 95 at 100.

¹⁰¹ See s 76(1) for a wide definition of a ‘director’.

and performance of functions of the director's office. Directors are accorded authority by law as now expressed by the Act 'to exercise all of the powers and perform all of the functions of a company' except as specifically limited by the Act or the MOI.¹⁰² Hence s77 holds accountable/liable anyone who exercises directorial power or acts in the capacity of a director 'irrespective of whether or not the person is also a member of the company's board'.¹⁰³ Thus section 77 can be read to imply that liability in certain circumstances will be incurred not only by members of the board but also by anyone who may act in the capacity of a director.¹⁰⁴ For this reason I agree with the analysis of respected author du Plessis that even non-directors who serve on board committees, are brought within the ambit of the statutory duties under s76(2) and (3).¹⁰⁵ As this analysis demonstrates, if such persons breach the duty in s76(3)(c) while acting in the capacity of a director, they will be held liable in terms of s77.

(i) '...degree of care, skill and diligence that may be reasonably expected of a person...'

The first observation to be made with respect to the phrase above is that the standards of directorial conduct in s76 (3) (c) appear to apply to all components of the statutory duty, namely 'care', 'skill' and 'diligence'. Unlike the Australian statutory duty which mentions only 'care and diligence'¹⁰⁶ the South African duty is reminiscent of the UK duty in this regard.¹⁰⁷ It is to be noted that South African courts prior to the Act, rarely described the duty as 'duty of care, skill and diligence'.¹⁰⁸ Often there was reference only to the duty of 'care and skill'.¹⁰⁹ Occasionally, when determining whether there was recklessness on the part of defendant directors, courts would refer to 'reasonable skill and diligence' as was the case in *Howard v Herrigel & Another NNO*.¹¹⁰

It is not clear whether the phraseology adopted under the statutory duty in s76 (3) (c) envisages the duty of 'care, skill and diligence' as a composite term. Or are there different expectations regarding 'care and diligence' on one hand and 'skill' on the other hand? In other words, is this duty to be viewed as one indivisible duty or are these three different duties lumped together? It is submitted that while there could be little difference between the

¹⁰² See s66(1) of the Act.

¹⁰³ See s77 (1) of the Act.

¹⁰⁴ S 77(3) lists the instances when a 'director' or any person acting in that capacity, will be liable for any loss, damages or costs sustained by the company as a direct or indirect consequence of their actions when acting that capacity.

¹⁰⁵ Du Plessis (2010) *Acta Juridica* 267.

¹⁰⁶ See part 3.3.1 of Chapter 3.

¹⁰⁷ See s174 of the Companies Act 2006 discussed in part 3.2.2 of Chapter 3.

¹⁰⁸ See Du Plessis (2010) *Acta Juridica* 268.

¹⁰⁹ See *Fisheries Development Corporation of SA Ltd v Jorgensen & Another* (supra) at 156.

¹¹⁰ *Howard v Herrigel & Another NNO* (supra) at p44.

effect of ‘care and diligence’, there are different implications when it comes to the ‘skill’ component of the duty. In *Daniels v Anderson*,¹¹¹ a clear distinction between care and skill was explained. According to Roger CJ, skill means the knowledge and experience a director brings to the performance of his function and exercise of his powers. It (skill) is the technical competence of a director, a result of aptitude developed by special training and experience, while care is the manner in which that skill is applied.¹¹² Another important difference between care and skill is that while care may be objectively assessed, skill varies from person to person.¹¹³ This understanding appears to have been alive in the minds of drafters of the Act. Impliedly it is for this reason that there is a clear distinction between expectations of a director in s76 (3) (c) (i) and s76 (3) (c) (ii) of the Act.

When one thinks of the term ‘diligence’, synonyms which come to mind include meticulousness, conscientiousness, thoroughness and carefulness in applying oneself to the task at hand. Diligence can be seen as a good link or chain that connects ‘care’ and ‘skill’. While care and diligence have a symbiotic relationship, they are not necessarily the same thing. Care is the manner of execution, while diligence may relate to the length to which a director, as a fiduciary, goes in fulfilling his obligations towards the company. The legislature should have intended that the inclusion of the word ‘diligence’ to the description of the duty under s76(3)(c) should have implications. As pointed out earlier, ‘diligence’ was not a common part of the duty under common law.¹¹⁴ The duty was commonly referred to as duty of care and skill. The statutory duty now contains the word ‘diligence’. The clearest implication of the requirement for diligence is to be seen in association with the BJR.¹¹⁵ In this connection diligence has to do with a directors’ continuing obligation to keep themselves informed of the affairs of the company. This should engender an inquiring mind, which in turn should place the director in a position to make a reasonably informed decision. In the USA case law, a director with a sluggish disposition to duty, or a director who sleeps on the wheel and is not alert to his ‘diligence’ obligations, was held to add no value to the corporation.¹¹⁶

When the occasion arrives, South African courts of law are likely to apply the same meaning to diligence as has been applied under foreign law. Foreign case law has interpreted

¹¹¹ (1996) 16 ASCR 607 (NSW); (1995) 37 NSWLR 438.

¹¹² Ibid.

¹¹³ See Cassim et al *Contemporary Company* 556.

¹¹⁴ See Du Plessis (2010) *Acta Juridica* 268.

¹¹⁵ See s76(4)(a)(i). One of the conditions necessary for the satisfaction of BJR is that the director should have taken diligent steps to become informed about the matter.

¹¹⁶ See *Francis v. United Jersey Bank*, 432 A.2d 814 (N.J. 1981) at 1982.

the diligence requirement to imply the meticulous and at times continuous attention given by directors to company affairs. Each situation or circumstance or the nature of the business of the company at any given time determines the amount of focussing a director is required to give to company affairs. In *Re Barings plc (No 5)* directors were found to have failed in their duty to act diligently in managing the affairs of the company.¹¹⁷ Diligence as a requirement demands that directors must acquire and maintain sufficient knowledge and understanding of the company's business to enable them to properly discharge their duties.¹¹⁸ Recently, Australian courts have interpreted the statutory duty of care and diligence in similar ways. In the *Adler* case¹¹⁹ Santow J held that a director should become familiar with the fundamentals of the company's business. In addition, a director is under a continuing obligation to keep informed about the company's activities.¹²⁰

As was the experience in Australia a short while ago, South African courts are likely to be called upon to make a decision regarding the level of diligence expected of directors at multinational companies operating in the country. The *Centro* case¹²¹ gave Australian courts probably their most recent experience with interpreting the 'diligence' requirement. The key question before the court was whether directors of big publicly listed entities are required to diligently apply their own minds to review proposed financial statements and reports. The court answered this question in the affirmative. Despite the fact that the South African statutory duty of care, skill and diligence is not as objective as its Australian counterpart, there is potential for a similar interpretation when the occasion presents itself. As shall be established below, the seemingly dual objective/subjective standards under s76 (3) (c) can operate to demand more from experienced directors, depending on the nature of the business of their corporation.¹²²

¹¹⁷ *Sub Nom Secretary of State for Trade and Industry v Baker and others* (No 5) [1999] 1 BCLR 433 (Ch D), referred to in Cassim et al *Contemporary Company* 560.

¹¹⁸ *Ibid.*

¹¹⁹ See 3.3.1 under Chapter 3.

¹²⁰ *Adler* (supra) at 347.

¹²¹ [2011] FCA 717.

¹²² In terms of s76(3)(c)(i) read with s76(3)(c)(ii), the subjective general knowledge, skill and experience which a director actually possesses, compared to a director in a similar position and under comparable circumstances, will be taken into account when reviewing the conduct of the director to determine whether it falls short of the requirements or standards of conduct under s76(3)(c).

(ii) Implications of omission of the emphasis that a director be a ‘reasonably diligent person’

The Act states that a director of a company in South Africa is expected to exercise that degree of care that ‘may reasonably be expected of a person’ carrying out the same functions in relation to a company as those carried out by the director whose conduct is under scrutiny.¹²³ The subsection conveys a sense of ‘reasonable expectations’ in terms of the standard of conduct expected of directors when they exercise their powers and perform their functions as directors. As already pointed out in 3.2.2 under Chapter 3, s76 (3) (c) is comparable to the UK’s statutory duty of care in s174 of the Companies Act 2006. Also as pointed out in Chapter 3, use of reasonable expectations allows courts, when deciding whether the requisite standard of conduct has been met, to take into account the responsibilities and circumstances of directors of different types and in different situations. This allows an approach akin to comparing apples with apples.¹²⁴ In the UK and Australian acts, the use of a ‘reasonable person’ phrase,¹²⁵ amounts to a reasonable person test. The UK reform policy never intended the standards of care to be completely objectified. The UK statutory duty applies dual objective/subjective standards. Australian law on the other hand followed the common law developments and thus the reasonable person test under the statutory duty translates to objectified standards of care and diligence.¹²⁶ The question is whether s76 (3) (c) can be read to include a reasonable person test.

The exact implications of the phrase ‘may reasonably be expected of a person’, used in s76 (3) (c) may be difficult to establish with certainty. The reason for such difficulties may be found in the manner the subsection was drafted and the language used. It cannot be gainsaid that the intention must have been to draft s76 (3) (c) along the lines of the UK law. This can be discerned from the manner in which its forerunner, Cl 91(1) (a) of the Companies Bill 2007 was drafted.¹²⁷ While the Companies Bill 2007 imposes on directors ‘a duty to exercise the degree of care, skill and diligence that would be exercised by a reasonably diligent individual...’,¹²⁸ s76 (3) (c) phrases the duty differently and omits the requirement that a director be ‘a reasonably diligent individual’. It is to be noted that the Bill and the UK’s Companies Act 2006’s inclusion of the phrase ‘a reasonably diligent person’ gives the statutory duty under both the Companies Act 2006 and Companies Bill 2007 formulations a

¹²³ That is s76 (3) (c) (i) of the Act, which can be referred to as Limb 1 of the subsection.

¹²⁴ This point is amplified in 3.2.2 under Chapter 3.

¹²⁵ See parts 3.2.2 and 3.3.2 of Chapter 3.

¹²⁶ See parts 3.3.1 and 3.3.2 of Chapter 3.

¹²⁷ See part 4.3 above.

¹²⁸ Who has both the elements listed in s76 (3) (i) & (ii).

reasonable person test flavour. Without that phrase it may be more difficult to read an objective standard into the s76 (3) (c).

It is Du Plessis's view that not much should be read into the phrase 'may reasonably be expected of a person' and impliedly, to the exclusion of the phrase 'a reasonably diligent individual'. Du Plessis adds, 'except that s76(3)(c)(ii) introduces subjective elements, making it impossible to have used the 'reasonable person' concept'.¹²⁹ Indirectly or even quite clearly Du Plessis suggests that the phrase 'may reasonably be expected of a person' instead of the requirement that the director be 'a reasonably diligent individual', does have an impact on the standards of care, skill and diligence under s76(3)(c). May be Du Plessis's argument meant to communicate that the test is subjective because of the wording of s 76(3)(c)(ii) and not necessarily because of the use of the phrase 'reasonably be expected'. Hence the explanation that not much should be read into the phrase.

Another writer Cassidy, appears to believe that the 'person' referred to in the phrase is a 'reasonable director'.¹³⁰ There appears not to be consensus among authors regarding the exact meaning of the phrase. Cassim et al for example, disagree with Cassidy and provide an opposite view and argue that the standard of a director envisaged under s76(3)(c)(i) "is that of a reasonable person and not that of a reasonable director".¹³¹ The term 'director' under s76 is defined to include not only members of the company board but also prescribed officers and the board's sub-committee members. These different views by different authors may at first glance seem like just a question of semantics, but they are not. They are disagreements based on substance regarding difficulties of interpreting s76(3)(c). The duty has not been formulated in a manner that is free from ambiguities.

It is to be noted that where the Companies Bill 2007 strikes a balance between reasonable expectations and the requirement that a director has to be a 'reasonably diligent individual', the Act is unclear.¹³² S 76(3)(c),¹³³ without the requirement that a director ought to be 'a reasonably diligent individual' could be read to betray what appears to be the true intention of the legislature – which is to introduce clearly a reasonable person test in the context of a dual objective/subjective standards along the lines of s174 of the UK's Companies Act 2006. The present formulation of the standard of conduct under s76 (3) (c) could be read to mean that it does not equally emphasise the reasonableness of the conduct to be expected of directors. To

¹²⁹ Du Plessis (2010) *Acta Juridica* 269.

¹³⁰ Cassidy (2009) *Stell LR* 373 at 385.

¹³¹ See Cassim et al *Contemporary Company* 559.

¹³² See part 4.3 above.

¹³³ Particularly the phrase 'may reasonably be expected of a person'.

this end, the Act differs from its UK and Australian counterparts that use the phrases ‘reasonably diligent person’ and ‘reasonable person’ respectively. Use of the phrase reasonably diligent person in the UK, as was argued in Chapter 3, clearly results in dual objective/subjective standards of care, skill and diligence.¹³⁴ The subjective elements of this duty do not operate to limit the irreducible minimum objective standard, but rather enhances it. It is also important to highlight that in the UK reasonable expectations of directors are balanced with the ‘reasonable person’ test.¹³⁵ Retention of the phraseology of CI 91 (1) (a) of the Companies Bill 2007 will solve the ambiguities currently experienced with s76 (3) (c). Australia applies a clear objective ‘reasonable person test’ which takes into account the context in which directorial powers are exercised.¹³⁶ The UK applies clear dual objective/subjective standards and phrases its statutory duty of care under s174 in a manner as free of ambiguity as is the position under the South African Companies Bill 2007. The current ambiguity under the Act is possibly a consequence of a drafting style which went wrong. The omission of the requirement that a director should be ‘a reasonably diligent person’ from s76 (3) (c) is very unfortunate.

(iii) Dual objective/subjective or dominantly subjective standards of review retained?

At first glance, s76 (3) (c) appears to have introduced into law objective standards of care, skill and diligence which take into account the context in which the directorial powers are exercised and the function of a director performed. At least this is the *prima facie* impression created by the reading of s76 (3) (c) (i). However, on closer scrutiny, it is clear that s76(3)(c), unlike Australia’s s180 (1) of the Corporations Act 2001, has not introduced purely objective standards of care, skill and diligence as acknowledged by some South African authors.¹³⁷ Like the UK Act, it seems apparent that the legislative intent was to introduce a type of a hybrid system of standards of conduct under the Act (Companies Act 2008). The UK’s hybrid standards of conduct have been referred to throughout this Study as dual objective/subjective standards.¹³⁸ However, South African statutory standards of care, skill and diligence in their present state, cannot be clearly and confidently be classified as

¹³⁴ See part 3.2.2 in Chapter 3.

¹³⁵ Ibid.

¹³⁶ See a discussion of the reasonable person test applied in *Macdonald* (supra) at 247, in part 3.3.3(iii) of Chapter 3.

¹³⁷ See Du Plessis (2010) *Acta Juridica* 269 who also shares the sentiment that s76 (3) (c) has not objectified directors’ duties of care, skill and diligence. Also see Cassidy (2009) *Stell LR* 373 at 385 who comments on the effect of s76 (3) (c)(ii) on s76(3)(c)(i).

¹³⁸ Where objective standards are dominant and subjective considerations do not operate to subordinate objective standards.

dual objective/subjective standards as intended, when one considers Cl 91 (1) of the Companies Bill 2007. While standards in s76(3)(c) appear to have been intended to have an objective flavour, the subsection's wording is not crystal clear. This makes the subsection susceptible to at least two different interpretations, to which I will now turn.

One way of looking at this is that s76(3)(c)(i) or limb 1 appears to introduce into law, objective standards of 'care and diligence' while limb 2¹³⁹ imposes subjective standards of skill. Limb 1 states that the degree of standards is to be reasonably expected of a person 'carrying out the same functions in relation to the company as those carried out by the director'. The intention appears to have been to impose an irreducible objective standard of care for directors by comparing apples with apples. That is, to expect standards which can be reasonably expected of a director in similar circumstances as the director whose action is under review. There is recognition in limb 1 that the circumstances within which the power is exercised and function performed by the 'director' should be taken into account. Under Australian case law this has been held to mean the type of the company, size and nature of the company's business.¹⁴⁰ It also includes the composition of the board, the director's position and responsibilities within the company, the particular function the director is performing, the experience or skills of the particular director, including circumstances of the specific case.¹⁴¹ In this construction, limb 1 recognises the need for a standard flexible enough to accommodate a variety of positions which may exist, given the variety of business entities doing business in South Africa today.¹⁴²

In keeping with this view, limb 2 (s76 (3) (c) (ii)) can be interpreted to have been designed to impose subjective standards of skill. There is emphasis in limb 2 on 'the general knowledge, skill and experience of that director'. Use of the word 'skill' would have been enough to capture the 'knowledge and experience' aspects, as highlighted above. Use of the phrase appears to have been borrowed from s174 of the UK Companies Act. General knowledge is to be differentiated from specific skill. Therefore, by implication, the standard of skill expected in s76(3)(c) appears not to be a specific skill, experience or knowledge, but 'general knowledge, skill and experience'. The purpose could have been to emphasise the fact that directors are not a homogenous group and cannot be regarded as a separate

¹³⁹ S 76(3)(c)(ii) which refers to the 'general knowledge, skill and experience of that director'.

¹⁴⁰ See *ASIC v Maxwell* (supra) at 397.

¹⁴¹ See the *ASIC v Maxwell* (supra) case referred to in 3.3.1 under Chapter 3..

¹⁴² See Cassidy (2009) *Stell LR* 373 at 385 and Cassim et al *Contemporary Company* 559.

profession like lawyers and accountants. As such, necessary skills vary according to the different nature and purpose served by the companies.¹⁴³

The alternative view is that as opposed to the dual objective/subjective standards as described above, s76 (3) (c) imposes hybrid standards of the duty of care, skill and diligence with subjective elements which detract from the objectivity of standards. The objective element, as per limb 1 is that the director is expected to exercise a degree of care, skill and diligence that may reasonably be expected of a person in a similar position and under similar circumstances, which implies equity or a measure of objectivity. The objectivity of this test in limb 1 is on this approach is undermined by subjective considerations of limb 2, that is, ‘the general knowledge, skill and experience’ which that director possesses. Several authors suggest that a lower standard will be required from a director who has general knowledge, skill¹⁴⁴ and experience that are lower than those that could generally be expected from a person who carries those functions.¹⁴⁵ It can potentially be argued that this is the import of the subsection in its present state. If this alternative view is to be taken, then good corporate governance will be undermined rather than be tightened up.

It is important to add that the first view, that South Africa has introduced dual objective/subjective standards of care appears to be the view better aligned to the legislative intent. As already established in this part of the Chapter, Cl 91 (1) of the Companies Bill 2007 was drafted alongside s214 (4) of the UK’s Insolvency Act 1986 which clearly imposes dual objective/subjective standards. These standards in the UK were then transposed into s174 of the Companies Act 2006. Thus by way of looking at the Companies Bill 2007, one can deduce that the legislature must have intended to model s76 (3) (c) along the present UK statutory standards of care and impose dual objective/subjective standards. It should be stressed that the language used to express the statutory duty of care in s76 (3) (c) betrays the legislative intent because it is ambiguous and appears to emphasise subjective considerations. Thus at present, s76 (3) (c) can be read to be more on the subjective/objective side than it is on the dual objective/subjective standards side it was intended to be at.

There is something to learn from foreign law, as permitted by the Act.¹⁴⁶ Australian courts in particular, have even interpreted s180(1) of the Corporations Act 2001 to determine the

¹⁴³ Finch (1992) *M. L. R* 203.

¹⁴⁴ That is, the competence, the knowledge and experience of the director.

¹⁴⁵ See Cassim et al *Contemporary Company* 560. Cassidy understandably sounds unsure of the exact relationship between s76(3)(c)(i) and s76(3)(c)(ii). See Cassidy (2009) *Stell LR* 373 at 383-386.

¹⁴⁶ Section 5(2) of the Act to be discussed in Chapter 6 below.

standard of skill required, despite exclusion of the ‘skill’ component from the subsection.¹⁴⁷ Thus, there is potential to interpret s76(3)(c) to mean that there is a minimum objective standard to be met by each type of a director, taking into account the context in which the powers are exercised and function performed.¹⁴⁸ The subsection does not seem to impose a uniform type of standard. The dual objective/subjective approach intended under s76 (3) (c) can allow the courts to take into account the circumstances of each company and the context in which a director acts in this capacity. It is possible to interpret s76 (3) (c) (i) as imposing an objectively determinable minimum standard to be expected of any director on a case to case basis. Courts should be encouraged to adopt a judicial policy of interpretation of s76 (3) (c), which is flexible enough to deal with the merits of each case. A case will be made in Chapter 6 for a purposive interpretation approach which takes into account the purposes of the Act.

(iv) What is the test to be applied for breaching the s76(3)(c) duty?

Importantly, the Act needs to be amended to clearly provide for a reasonable person test flavour which is currently missing from s76 (3) (c). It is beyond comprehension why the requirement that a director needs to be ‘a reasonably diligent individual’ as reflected in C1 91 (1) (a) was omitted under the Act. There is a case to be made for amendment of s76 (3) (c) and the rephrasing of the section to reflect that requirement. After such a requirement, it can then be said with confidence that the section reflects a reasonable person’s test.

Having made the above observations with regards to the gaps in s76(3)(c), it is nonetheless important to point out that there remains potential to improve the subsection to be interpreted to include a reasonable person’s test. There are two ways of doing this. The first method is to amend the entire s76(3)(c) to be based on clearly determinable reasonable person’s test. Limb 1 for example requires that when reviewing the conduct of a director, comparison be made with a person ‘carrying out the same functions in relation to the company as those carried out by that director’.¹⁴⁹ This shows great potential for a reasonable person’s test. This is possible if the entire s76(3)(c) assumes a flavour that strikes a balance between emphasising the reasonableness of the conduct of the director and the reasonable

¹⁴⁷ See *Australian Securities and Investments Commission v Vines* (2004) 48 ACSR 322.

¹⁴⁸ The authors in Cassim et al *Contemporary Company* 560 also appear convinced that it is clear that the subsection imposes a minimum objective standard. It is submitted that this appears only possible through purposive interpretation, and that it is not apparent from the manner the subsection is drafted.

¹⁴⁹ See s76 (3) (c) (i).

expectations.¹⁵⁰ Much can be borrowed from the manner s174 of the Companies Act 2006 was formulated or Clause 91(1)(a) of the Companies Bill 2007. This will allow for application of a flexible standard premised on subjective considerations of the context in which a director acts in that capacity balanced with objective elements under s76(3)(c).

The second method is for the courts to give meaning to s76 (3) (c) through a policy of interpretation premised on the relevant purposes of the Act. One of the purposes of the Act is to ‘promote the development of the South African by-...encouraging transparency and high standards of corporate governance as appropriate given the significant role of enterprises within the social and economic life of the nation’.¹⁵¹ The objects of the Act can be to promote high standards of corporate governance can be clearly discerned from the Companies Bill 2007 as highlighted above. Thus even before amendment of the Act, courts could give a more generous interpretation of the Act to with respect to s76 (3) (c) to promote higher standards of care, skill and diligence than the standards currently imposed by the subsection in its unambiguous state. In terms of the Act, a court of law or any forum, when determining a matter before it, must as of necessity prefer an interpretation of the Act which best promotes the spirit, purposes and objects of the Act.¹⁵² Even where a provision of this Act is capable of two meanings, the court must prefer the meaning which is more aligned to promotion of objects of the Act than one which is not.¹⁵³ Part 4.2.3 above has examined policy objectives and linked them to the purposes of the Act. That part pointed the way towards the context within which s76 (3) (c) should be interpreted. Chapter 6 will examine the appropriate interpretation based on considerations sketched above.

(v) Different standards of performance between executive and non-executive directors?¹⁵⁴

In South Africa this question has been addressed by courts between the 1980s and late 1990s, but the matter has not received direct attention from the Act. In *Fisheries Development Corporation of SA Ltd*¹⁵⁵ the court, as per Margo J, at first glance appeared to have adopted a differentiated approach to standards applicable to executive and non-

¹⁵⁰ See 4.4.3 (ii) above.

¹⁵¹ S 7 (b) (iii) of the Act.

¹⁵² See s158 (b)(i) of the Act. There were already indications that the courts were moving to an dual objective/ subjective test. See *Philotex (Pty) Ltd & Others v Snyman & Others* (supra) at 138.

¹⁵³ Ibid, s158 (b) (ii).

¹⁵⁴ Some relevant discussions in this regard are to be found in the following parts of this Study: parts 2.2.2; 3.2.1 which discusses dual objective/subjective standards in the UK, 3.3.1 entitled ‘Emerging case law principles in Australia post 2001 & 4.2.1

¹⁵⁵ *Fisheries Development Corporation of SA Ltd v Jorgensen & Another* (supra) at 156.

executive directors. Margo J's attempt to draw a distinction between an executive and a non-executive director is susceptible to misinterpretation and certainly requires clarification and to be located in its proper context.¹⁵⁶ It is unlikely that Margo J implied that the standard or level of care expected of non-executive directors is less onerous than the one required of executive directors. Unfortunately, this is the impression created on some writers by Margo J's statement.¹⁵⁷ The message that Margo J intended to convey was that 'the extent of a director's duty of care and skill depends to a considerable degree on the nature of the company's business and on any particular obligations assumed' by or assigned to the director.¹⁵⁸ The general rule is that once a person accepts an appointment as a director, he becomes a fiduciary in relation to the company.¹⁵⁹ The application of such a rule to any particular director is dependent on the facts of each case or the circumstances in which the power given to a director is exercised and a directorial function performed. An example of such circumstances could be whether the director was engaged by the company on a part-time or full-time (executive) basis, director's access to information relevant for his/her performance and justification for reliance on reports received from others or reliance on relevant expertise.¹⁶⁰ Thus according to Margo J the level of care expected of a full-time director is more onerous than that of a part-time non-executive director who was not obliged to give continuous attention to company affairs-

The confusion that might have arisen as a result of remarks made by Margo J in *Fisheries Development Corporation of SA Ltd* regarding the application of standards to either executive or non-executive directors was clarified in *Howard v Herrigel & Another NNO*.¹⁶¹ The court considered it unhelpful or even misleading to classify company directors as executive and non-executive for purposes of ascertaining their duties to the company and the expected standard of conduct. Whether the inquiry is one that relates to negligence, reckless conduct or fraud, it was held that the standard of care expected of directors (executive or non-

¹⁵⁶ In *Fisheries Development Corporation of SA Ltd* (supra) 165, Margo J remarked, '...In that regard there is a difference between the so-called full-time or executive director, who participates in the day to day management of the company's affairs or of a portion thereof, and the non-executive director who has not undertaken any special obligation. The latter is not bound to give continuous attention to the affairs of his company...'

¹⁵⁷ See Bekink (2008) *SA Merc LJ* 101.

¹⁵⁸ See Margo J's statement in *Fisheries Development Corporation of SA Ltd* (supra) 165-166.

¹⁵⁹ As a fiduciary, a director is expected to observe the utmost good faith towards his company, and in discharging that duty he is required to exercise an independent judgment (that is reasonable care, skill and diligence) and to take decisions according to the best interests of the company as his principal. See *Fisheries Development Corporation of SA Ltd* (supra) at 163.

¹⁶⁰ See *Howard v Herrigel & Another NNO* (supra) at 676 where this point was better articulated than in *Fisheries Development Corporation of SA Ltd* (supra). See also Bekink (2008) *SA Merc LJ* 101.

¹⁶¹ *Howard v Herrigel & Another NNO* (supra) at 676.

executive) is the same.¹⁶² These views were accepted as good law and confirmed seven years later in *Philotex (Pty) Ltd & Others v Snyman & Others*.¹⁶³

As set out above, the Act in s76(3)(c) considers the context within which the directorial power is exercised and the function of a director is performed.¹⁶⁴ Based on this construction, the standards applicable should be what ‘may reasonably be expected of a person’ of a director within the context of a directorship he/she holds. If expectations are to be reasonable, it means that one cannot expect a non-executive director to apply a similar standard of skill for example, as would be expected of a specially-skilled full-time director.

4.5 Reliance and delegation in s76 (4) (b)

To delegate means to transfer some powers which a director is given by law to another person, a prescribed officer for example, to enable the delegatee to perform a task for the benefit of the delegator. This of course has to take place within the bounds permitted by applicable law.¹⁶⁵ Reliance means acting upon information supplied or guidance given by a person who is considered to be in a position to give quality information and/or advice as a basis for decision-making. In corporate governance, directors make strategic decisions for the benefit of companies. The quality of decision-making will depend on quality information available to members of the board. The business of large corporations makes it unavoidable that directors have to delegate their powers to others and rely on information supplied by others to fulfil their leadership role.¹⁶⁶ In South Africa, reliance and delegation are now regulated by both common law and the Act.

4.5.1 Common law reliance and delegation

South African common law borrows principles on reliance from English law. Directors’ need to rely on others for performance was underscored in an early English case of *Dovey v Cory*.¹⁶⁷ The Earl of Halsbury LC made an important point when he remarked that ‘the business of life could not go on if people could not trust those who are put into a position of trust for the express purpose of attending to the details of management’.¹⁶⁸ It needs to be acknowledged that there has been a paucity of cases which have dealt with reliance and

¹⁶² Ibid.

¹⁶³ *Philotex (Pty) Ltd & Others v Snyman & Others* (supra) at 145.

¹⁶⁴ See the formulation of this duty as captured in part 4.4.2 above.

¹⁶⁵ The Act in this case, s76 (4) (a) in particular, and the common law.

¹⁶⁶ See Cassim et al *Contemporary Company Law* 561.

¹⁶⁷ 1901 AC 477. Also see part 3.3.1 (ii).

¹⁶⁸ Ibid at 486.

delegation under South African law, and principles from English law have been helpful in the development of jurisprudence. *Fisheries Development Corporation of SA Ltd v Jorgensen*,¹⁶⁹ adapted English law principles on reliance and delegation into South African common law. Margo J remarked that in the absence of suspicion, directors are entitled to trust in and rely on the information supplied by relevant company officers who are employed by the company.¹⁷⁰ There is also an understanding at common law that a director's reliance and/or delegation needs to be reasonable, thus making reliance on these defences to be on rational basis.¹⁷¹ Margo J relied on the English case of *Re City Equitable Fire Insurance Co Ltd*¹⁷² to lay down the common law position in South Africa in this regard.

The English law's earlier position on delegation, which in turn influenced the South African position, is considered to have been lax and far too lenient to be appropriate in a modern world.¹⁷³ The requirement that there be 'absence of grounds for suspicion' has been criticised in this regard for paying little attention to the competence and trustworthiness of the person receiving the delegation, or even more importantly, to the monitoring of the delegation by the fiduciary.¹⁷⁴ International trends¹⁷⁵ confirm the maxim *delegatus non potest delegare* – meaning that a fiduciary may not delegate his duty, but powers necessary to performing it.¹⁷⁶ A director's duty to exercise care, skill and diligence in overseeing the affairs of the company according to USA common law, cannot be met solely by relying on other persons.¹⁷⁷ Where directors have delegated authority to company officers, they are required in Australian common law, to supervise the performance of such delegated authority. In *Daniels v Anderson*,¹⁷⁸ Clarke JA rejected Romer J's 'absence of grounds for suspicion'¹⁷⁹ test as being outdated and unsuited to modern commercial requirements.

The leading case on director liability for supervision of delegated authority in South Africa today is *Barlows Manufacturing Co Ltd v RN Barrie (Pty) Ltd*.¹⁸⁰ Principles enunciated therein compare very well with international trends as reflected in foreign case

¹⁶⁹ *Fisheries Development Corporation of SA Ltd v Jorgensen & Another* (supra) at 156.

¹⁷⁰ Ibid at 160-166.

¹⁷¹ Ibid. Hence the remark by Margo J that a director exercising reasonable care would not accept information and advice blindly but would give it his/her due consideration and exercise his own judgment accordingly. Ibid. Also see Bekink (2008) *SA Merc LJ* 100.

¹⁷² [1925] Ch 407 (CA).

¹⁷³ See Cassidy (2009) *Stell LR* 373 at 394. See also part 3.3.1 (ii).

¹⁷⁴ Ibid. See also part 3.3.1 (ii).

¹⁷⁵ Considering in particular best practice jurisdictions such as the USA, the UK and Australia.

¹⁷⁶ See part 3.3.3 of Chapter 3.

¹⁷⁷ See the remark by Lee J in *Federal Deposit Insurance Corporation v Stanley* 770 F. Supp 1281 N.D.Ind. (1991).

¹⁷⁸ *Daniels v Anderson* (supra) at 663.

¹⁷⁹ In *Re City Equitable Fire Insurance Co Ltd* (supra) at 407. Further see part 3.3.1 (ii).

¹⁸⁰ 1990 (4) SA 608 (C) at 610-611.

law¹⁸¹ or even foreign legislation.¹⁸² Conradie J considered it a fundamental principle of company law, that a director may delegate some or even all of his powers to others, but may not delegate his duty or abdicate his/her ultimate responsibility towards the company.¹⁸³ The implication of this common law principle is that directors remain fiduciaries even after delegating authority to sub-committees of the company board or to some servants of the company. A director is accountable to the company for the exercise of powers delegated to officers of the company. It is the director who owes a duty to his/her company and cannot divest himself of that duty while he remains a director.¹⁸⁴ Thus a director cannot shield behind delegation to escape from liability where he failed to monitor the exercise of delegated powers.

4.5.2 Reliance and delegation in ss76 (4) (b) and 76(5) - A commentary

South Africa has adopted into statute standards of reliance and delegation which compare favourably with standards in the best practice jurisdictions. The statutory principles of reliance and delegation are fairly comprehensive, clearer and more in line with modern commercial demands when compared to the common law. It is noteworthy that the standards of directors' conduct under the Act¹⁸⁵ are subject to statutory defences listed in subsection s76(4) and 76(5) of the Act. This shows the close connection between principles of reliance and delegation and the standards of care, skill and diligence under s76(3)(c).

Generally, a director is permitted by the Act to rely, for their own performance, on certain persons designated by the Act. The board might reasonably have delegated to these persons formally or informally the authority to perform the board's functions which are delegable under the law.¹⁸⁶

Section s76 (5) provides a list of the persons and/or professionals who merit confidence and whom directors can rely on for their performance.¹⁸⁷ A director can delegate some of or all his powers or may rely on guidance from others provided the director believes

¹⁸¹ See the Australian position reflected in *Daniels v Anderson* (supra) at 663. For the US position, see *Federal Deposit Insurance Corporation v Stanley* (supra) at 770.

¹⁸² I have in mind s190 (1) of the Corporations Act 2001 of Australia, already referred to in part 3.3.1 of Chapter 3.

¹⁸³ *Barlows Manufacturing* (supra) at 611.

¹⁸⁴ *Ibid.*

¹⁸⁵ See s76 (3) (a) – (c).

¹⁸⁶ See s76(4)(b)(i).

¹⁸⁷ See s76(5)(a)-(b).

the persons are reliable, have necessary skills and competence to be in a position to advise, perform or guide.

Directors may also rely on information, official company documents, expert opinions or advice provided by those who are employed by the company or those engaged by the company for a specialised service that is outsourced.¹⁸⁸ Examples of specialist services directors may rely upon for their own performance include the skills or expertise of legal counsel, accountants, or other professional persons retained by the company, the board or a committee.¹⁸⁹ The statutory principles of reliance and delegation confirm the common law understanding that a director should make a good judgment call in utilising the human resources, skills and competences at his or her disposal.¹⁹⁰ Reliance and delegation apply to all directors' duties under s76(3), including the duty to act in the best interest of the company in s76(3)(b). These defences or principles are discussed here in connection with part of the major focus of this study – the duty of care, skill and diligence. Employment of such care and diligence as are demanded by the statutory reliance and delegation principles will enable directors to discharge their functions effectively.

While a director is entitled to rely on performance of others and information supplied, advice given by employees and/or expert opinion, the Act has put in place a mechanism for delineating between acceptable reliance/delegation and what may not be acceptable. These are interesting principles which will surely enrich corporate governance in South Africa. A few observations need to be made in this regard.

- (i) There is a strong emphasis in s76(4)(b)(i) and s76(5) the fact that a director's reliance on performance of an employee should be reasonable.
- (ii) A director should have believed that the employee so delegated to perform a function is reliable and competent to perform functions so delegated. If there are any 'red flags'¹⁹¹ or anything not to warrant trust, then the reliance on such an employee, or information provided will be found by a court of law to have been unreasonable. If reliance is placed on a board committee or even experts, the requirement is that the committee, employee or expert should 'merit confidence'.¹⁹² Even reliance on experts

¹⁸⁸ See s76(4)(b)(ii). This may include any information, opinions, recommendations, reports or statements, including financial statements and other financial data, prepared or presented by any of the persons specified in s76(5).

¹⁸⁹ S 76(5)(b).

¹⁹⁰ See *Dovey v Cory* (supra) at 486 discussed in 4.5.1 above.

¹⁹¹ See Cassim et al *Contemporary Company* 562.

¹⁹² See 76(5)(b)(ii)-(c).

for specialist skills, should be based on a director's reasonable belief that the matters for which advice is sought fall within a person's area of competence. Blind or presumptive reliance might be found by a court to be irrational and unjustifiable, and protection of the statutory defences will be excluded.

(iii) Reasonable reliance/delegation test and implications: This test requires a director to have a rational basis for trusting the reliability or competence of the employee delegated to perform a task, or the information or advice given.¹⁹³ If reliance satisfies the requirement of reasonableness, then the director will not incur liability.¹⁹⁴

(iv) Subsection 76(4)(b),

apart from requiring that the delegation must be reasonable, states that the functions delegated should be those functions 'that are delegable under applicable law'.¹⁹⁵ South Africa has now joined nations like Australia in delineating between matters where directors can rely on and/or delegate to others and where this is inappropriate. A director should not abdicate responsibility by delegating his or her duty to a fellow director or an employee. For example, a director of a multinational company may delegate the task of preparing financial statements to a finance manager, but the duty to scrutinise those statements to ensure that they are not misleading remains the non-delegable duty of the director.¹⁹⁶ Similarly in the Australian *Centro* case,¹⁹⁷ the court rejected the directors' defence premised on reliance on experts because it was inappropriate to rely on others in a matter which needed directors' focussing on the matter. Directors thus cannot substitute reliance upon the advice of management in place of their own attention or examination of a strategic matter that falls within the board's responsibility.¹⁹⁸

Subsections 76(4) (b) and 76(5) now compare well with standards in the best practice jurisdictions. In fact, South African statutory principles of reliance/delegation now go even further than Australian standards. For example, Australian provisions do not require reliance and delegation to be reasonable as s76 (4) (b) and s76 (5) do.¹⁹⁹ Australian statutory law also does not seem to specify the persons to whom directors may delegate their powers, whereas the Act has extensive provisions in this regard in s76 (4) (b) and s76 (5). It would have been

¹⁹³ See similar views expressed by Cassim et al *Contemporary Company* 562.

¹⁹⁴ Under s76(3)(c).

¹⁹⁵ See s 76(4)(i)(bb).

¹⁹⁶ Compare this position to the common law position in *Barlows Manufacturing* (supra) at 610-611 discussed in part 4.5.1 above.

¹⁹⁷ See the *Centro* case (supra) at 175.

¹⁹⁸ See *Macdonald* case (supra) at 199.

¹⁹⁹ See Cassidy (2009) *Stell LR* 373 at 395.

preferable for s76 (4) (b) to have clarified if delegation is only permitted if it is done at board level or whether an individual director is also permitted to delegate. As it stands, s76(4)(b) gives the impression that reliance on employees by directors is only possible once the board has delegated those functions which are delegable under law, to employees. Nonetheless, the depth of the reliance and delegation principles under the Act is commendable. Any gaps in s76 (4) (b) can easily be filled up through purposive interpretation, in line with the spirit, purpose and objects of the Act.²⁰⁰ One proposal which can be made for the sake of completeness though, is to add a statutory provision which emphasises that directors remain accountable for the exercise of a delegated power by the delegate if the requirements of s 76(4)(b) and (5) are not met. While this principle may be read into s76 (4)²⁰¹ (b) and (5), it is preferable to explicitly provide for it in the Act. Chapter 7 includes a proposal to this effect.

4.6 CONCLUSION

This chapter critically analysed the standards of care, skill and diligence under s76 (3) (c) in light of the corporate law reform objectives and²⁰² the purposes of the Act²⁰³ and international benchmarks. The analysis sought an answer to the central question whether the Act has made the standards comprehensively clearer, more accessible and more enforceable than before.²⁰⁴

The chapter has established²⁰⁵ that the standards at common law in South Africa were not crystal clear, but that they were predominantly subjective. Even though later cases attempted to incorporate principles from English law as they developed, these cases did not move the common law much further than *Fisheries Development Corporation of SA Ltd*. Hence the need for the Act to provide clear standards of care, skill and diligence expected of directors in s76 (3) (c) as read with ss76 (4) (a) - (b) and 76(5).

A critical analysis of s76 (3) (c), s76 (4) (b) and s76 (5) has revealed several worrying gaps and ambiguities but also many positive aspects. Recommendations to deal with these will be made in Chapter 7. Some of the positives include firstly, the codification of

²⁰⁰ As required by s158.

²⁰¹ Through an interpretation that gives effect to the purposes of the Act in terms of s5 (2) of the Act. Such an interpretation, if seen also through the prism of *Barlows Manufacturing (supra)* at 611, will ensure that courts do not countenance any delegation of power which may result in an abdication of a director's ultimate responsibility towards the company.

²⁰² As outlined in the DTI Policy Paper 2004.

²⁰³ See s7.

²⁰⁴ As was envisaged by the law reform objectives. See s7 (b)(iii) of the Act.

²⁰⁵ See part 4.2 above.

directors' standards of care, skill and diligence in s76 (3) (c).²⁰⁶ Secondly, inclusion of an interpretation clause, s5 read with s7 and s158, enhances the potential of the provisions of s76 (3) (c) through interpretation.²⁰⁷ Thirdly the reliance/delegation provisions in s76 (4) and s76 (5) are competent and clear, and thus can be used to make a case for clarity of standards in s76 (3)(c).²⁰⁸

²⁰⁶ See part 4.2.3 above.

²⁰⁷ See part 4.4 above.

²⁰⁸ See part 4.5 above.

CHAPTER 5: BUSINESS JUDGMENT RULE IN SOUTH AFRICA

5.1 INTRODUCTION

One of the many innovations and novelties introduced by the Act into corporate law in South Africa is the BJR. S 76(4) (a) introduces the BJR into company legislation within the context of s76 of the Act.¹ While the Act does not use the phrase ‘business judgment’ in s76 (4) (a) and does not define the phrase, the subsection undoubtedly has elements of the US-style BJR as will be demonstrated in this chapter. The BJR originated in the USA almost two centuries ago, and developed alongside the duty of care as a common law standard of review.² As will be further demonstrated below, in its relationship with the duty of care, the BJR relates specifically to the decision-making aspect of the duty.³ S 76 presents the BJR as part of standards of directors’ conduct and relates to two directors’ statutory duties, namely, the fiduciary duty to act in the best interests of the company,⁴ and the duty of care, skill and diligence.⁵ This study adopts the view that the BJR, though classified as part of ‘standards of conduct’ in s76, is rather, a standard of review as will be clarified later.

In this study, the BJR is examined specifically with regard to its relationship with the standards of care, skill and diligence, already analysed in Chapter 4. Prior to the Act, a lot was written about the BJR, and the majority of South African academic commentators argued against inclusion of the BJR in statute. This was due to a shared mistrust of the BJR. The rule was suspiciously viewed as a ‘transplant’ from ‘a foreign legal regime’ (namely the USA),⁶ a jurisdiction criticised by some writers for what has been termed ‘conflation of a fiduciary duty and the duty of care’.⁷ Therefore the argument in South Africa was that the introduction of the BJR was unnecessary for two reasons. The first was the fear that an introduction of the BJR would blur the celebrated distinction between fiduciary duties and the duty of care in South Africa because of said conflation of duties in US law.⁸ The differences between USA corporations law and South African company law were also raised; especially in the manner

¹ S 76 is entitled ‘Standards of directors’ conduct’.

² Weng (2010) *Fordham Int’l L.J* 124-147. In this chapter, different conceptions of the BJR will be briefly considered.

³ Havenga (2000) *SA Merc LJ* 25-27.

⁴ See s76(3)(b) of the Act.

⁵ S 76(3)(c) of the Act.

⁶ Botha & Jooste (1997) *SALJ* 73.

⁷ See fn 278 for the views of Gregory (2005) *Akron L. Rev* 181. Also see Jones (2007) *SA Merc LJ* 326-336 at 327.

⁸ Jones (2007) *SA Merc LJ* 326-336 at 327.

US law treats a fiduciary duty and duty of care.⁹ It was contended that prior to the Act, the duty of care was a tenuous ground on which to found a legal claim against directors. The argument went further to say that the BJR was an added means to further limit the duty of care, and that this would further lower standards of care.¹⁰ Secondly, inclusion of the BJR into statute was criticised for the reason that South African courts had demonstrated a culture of not second-guessing the decisions of the courts. It was argued that our (South African) courts have in the past allowed directors to make decisions in a spirit of enterprise and have not sought to usurp the power of management where decisions are justifiable.¹¹ This Study demonstrates that there is no legislative intent in the Act that s76 (4) (a) should lead to a conflation of a fiduciary duty and the duty of care. While I do not share the sentiments expressed by my fellow South African writers prior to the Act, I appreciate what influenced the apprehensions about adoption of the US-style BJR under the Act. It is demonstrated in this chapter that even US writers acknowledge the potential for conflation of duties under the framework of the BJR that exists under the Delaware state law in the US. In part 5.2 below, the modern challenges associated with the BJR are explored

There are some important principles to consider when analysing s76 (4) (a). Firstly, it's vital to note that the Act now recognises the board of directors as the legitimate organ to manage company affairs.¹² Secondly, there are instances of added liability under the Act.¹³ Important to consider also is the spirit, purport and objects of the Act, in this case the need to 'balance the rights and obligations of shareholders and directors within the company' as required by the Act.¹⁴ Another purpose of the Act relevant to BJR includes the promotion of the South African economy by encouraging entrepreneurship and enterprise efficiency.¹⁵

In a nutshell, the purpose of this chapter is to analyse the adoption of the BJR under the Act in light of relevant international experiences,¹⁶ the spirit, purport and objects of the Act¹⁷ and corporate law reform objectives as outlined in the DTI Policy Document 2004.

⁹ Havenga (2000) *SA Merc LJ* 36. Also Gregory, an American author who bemoans the anomaly that 'American courts and commentators have conflated the duty of care and the duty of loyalty'. He attributes this anomaly to ignorance or mere confusion in America, and further states that his argument regarding conflation of duties is not a mere matter of semantics, but that this tendency threatens to obfuscate legal reasoning. Gregory goes on to cite an example of how the use of a term 'fiduciary duty of care' has become commonplace in America. See Gregory (2005) *Akron L. Rev* 181-182.

¹⁰ Jones (2007) *SA Merc LJ* 327. Also see

¹¹ See Botha & Jooste (1997) *SALJ* 74.

¹² See s 66 (1) of the Act.

¹³ See s77 (2) (b) & s77(3)(a)-(e).

¹⁴ See s7 (i) of the Act.

¹⁵ See s7 (b) of the Act.

¹⁶ See parts 3.3 & 3.3. of Chapter 3.

¹⁷ Given in s7(a)-(l) of the Act.

Given that this is a post-law reform examination of the BJR, this analysis will inter alia seek to establish three broad aspects. The first aspect is the scope and content of the BJR. The second aspect relates to the debate regarding the effect of the BJR on the relationship between a fiduciary duty and the duty of care: Is there any chance that the BJR could operate to conflate or blur the distinction between the two duties? Closely related to this is the question whether the BJR operates to limit or dilute the effectiveness of standards of care, skill and diligence under the Act. Thirdly, does the BJR have a positive impact on corporate governance in South Africa, for example by striking a delicate balance between interests of shareholders and directors' freedom to manage companies? In addition to the three broader key aspects aforementioned, there are many other specific inquiries or important issues which this Study has to establish through an analysis of s76 (4) (a) of the Act. For example, a preliminary issue is to explore the question whether there is a South African common law business judgement rule, and if so, what its role is post the Act.

Another important matter to determine is the proper characterisation of the BJR under Act.¹⁸ The relationship between the BJR and the duty of care will obviously receive attention. Another important issue which requires clarification is whether the BJR in s76 (4) (a) is presented as a presumption in favour of a director or as 'safe harbour provisions'.¹⁹ A related issue, also vital to South African law, is to provide clarity as to who should bear the onus of establishing the requirements of the BJR as set out in s76 (4) (a) (i) to (iii). Another point which certainly requires attention is the possible policy motivation for and implications of the non-inclusion of a good faith element in the BJR formulation in s76 (4) (a). Yet another important issue to consider is the effect of the requirement of a rational belief²⁰ that a decision referred to in s76 (4) (a) (iii) was made in the best interest of the company. Interestingly some of the seven sub-inquiries highlighted above received the attention of Austin J in the Australian case of *ASIC v Rich*.²¹ Background issues relating to the BJR were introduced by the previous chapters and this Chapter builds upon such a foundation. Chapter 2 has already established the meaning of the BJR,²² and this Chapter²³ will correctly characterise the BJR as a standard of review in its relationship with the duty of care, skill and diligence. This study agrees with a definition which views the BJR as a standard of judicial

¹⁸ See 5.2.1 and 5.2.2 below for an attempt to answer this question.

¹⁹ See part 3.4.2 of Chapter 3 for an examination of the two US formulations of or approaches to BJR, namely the Delaware formulation (presumption of good faith) & the ALI formulation (safe harbour provisions).

²⁰ As opposed to a reasonable belief.

²¹ See *ASIC v Rich* (supra) referred to in part 3.3.2 of Chapter 3.

²² See part 2.2.3 of Chapter 2.

²³ In 5.2.1 below.

review providing for some review of business decisions.²⁴ In this construction, the duty of care is a standard of conduct, while the BJR provides a standard of review, and thus must not be confused with a standard of conduct.²⁵ Chapter 3 traced the origins and objects of the BJR in the USA. It also analysed the adoption of the BJR into Australian statutory law and briefly considered emerging case law principles. Such international experiences will be employed in this chapter when analysing the adoption of the BJR under the Act.

This chapter begins by looking at the modern challenges relating to the BJR in practice. Reference will be made to the most instructive US case law in this regard. The aim of this part is to answer the question whether the BJR is a standard of conduct, a standard of review/ liability or whether there is any room for it to be viewed as a presumption against judicial review as argued by others. Thereafter the focus shifts to the analysis of s76 (4) (a).

5.1.2 BJR in practice: varying approaches and modern challenges

Any jurisdiction that intends to incorporate the BJR into statutory law²⁶ has to gain an understanding of the shape and form that the BJR takes in practice. The BJR in practice can be best seen through the window provided by US common law, but it has to be admitted that the view through that window is not crystal clear. The US experiences were chiefly dealt with in Chapter 3.²⁷ In this part of the Chapter, I seek to briefly recapture aspects of US case law which reveal variations in the approaches adopted by US courts when applying the BJR in cases brought by litigants and the attendant challenges. The BJR is a concept which invokes different opinions and approaches as already established.²⁸ It is for this reason that there is not one, but two formulations of the BJR in US law.²⁹ Also, there are at least two different approaches or competing conceptions of the BJR in US case law. There is a more modern conception which views the BJR as a standard of review.³⁰ The other conception looks at the BJR as a presumption against judicial review of duty of care claims.³¹ There are at least two more conceptions of the BJR which will be mentioned in passing, but the discussion will focus on whether the BJR is a standard of conduct or a standard of review. This is relevant to the analysis of s76 (4) (a). . Before I consider the various conceptions of the BJR, it is

²⁴ See D Branson 'A Business Judgment Rule for Incorporating Jurisdictions in Asia?' (2011) 23 *SAC LJ* 687.

²⁵ Also see the views of M Eisenberg 'The Divergence of Standards of Conduct and Standards of Review in Corporate Law' (1993) 62 *Fordham L. Rev.* 437 at 444-445.

²⁶ Such as South Africa.

²⁷ See part 3.4.2 of Chapter 3.

²⁸ See part 2.2.3 of Chapter 2.

²⁹ The ALI formulation and the Delaware formulation discussed in part 3.4.2 of Chapter 3.

³⁰ The best example of the court treating the BJR as a standard of review/liability is *Cede & Co. v Technicolor, Inc* 634 A.2d 345 (Del. 1993) at 360. Also see Bainbridge (2004) *Vand. L. Rev* 90-91.

³¹ What Bainbridge calls an 'abstention doctrine'. See Bainbridge (2004) *Vand. L. Rev* 95.

important to give an outline of the modern challenges with the BJR which incorporating jurisdictions must take cognisance of so as to take measures to mitigate against them. These challenges stem from the ‘inconsistent and confusing’ state of US case law which gives the impression that to this day, the BJR, especially in Delaware, remains ‘work in progress’.³²

5.1.2.1 Modern Challenges associated with BJR

There are various challenges associated with the modern BJR as can be gleaned from US case law and literature. These challenges range from lack of consensus on the theory of the proper relationship between the BJR and the duty of care, to the problem of putting the cart before the horse – that is, the overemphasising of the BJR and the concomitant diminishing in importance of directors’ duties - a legacy of the development of the Delaware corporate law.

(i) Lack of consensus on theory of the proper relationship between duty of care and the BJR.

It is generally agreed that the BJR is intimately associated with or closely related to the duty of care.³³ Others describe the BJR as a corollary to the duty of care.³⁴ While there is this general acceptance that the BJR developed concomitantly with the duty of care close to two centuries ago,³⁵ there is no general consensus on exactly what the BJR’s function should now be vis-à-vis the duty of care in the face of liability claims before a court. As will be shortly highlighted in this work, the concept of the BJR appears to be so malleable as to lead one to think that it is still undergoing evolution of some sort. Hence the conflicting views about what function/purpose the BJR should serve, and the backlash it has endured from some quarters.³⁶

No less than four conceptions have emerged over the years to try and answer the question regarding the proper function of the BJR broadly, as well as what its proper relationship with the duty of care should be. Each of these conceptions, to be considered below, enunciates a different approach to the BJR and the differences in emphasis have

³² See G. D. Smith, ‘The Modern Business Judgment Rule (June 19, 2015). Research Handbook on Mergers and Acquisitions’, Forthcoming ; BYU Law Research Paper Series No. 15-09. Available at SSRN: <https://ssrn.com/abstract=2620536> p4.

³³ R. J. Rhee ‘The Tort Foundation of the Duty of Care and the Business Judgment Rule’ (2013) 88:3 *Notre Dame L.R.* 1139 at 1147. Also see Bainbridge (2004) *Vand. L. Rev.* 88.

³⁴ D. M. Bramson ‘Intracorporate Process and the Avoidance of Director Liability’ (1989) 24 *Wake Forest L. Rev.* 97.

³⁵ Weng (2010) *Fordham Int’l L.J.* 124-147.

³⁶ The BJR has been criticised by Gevurtz who described it as a ‘misguided notion’ for the reason that it requires ‘greater fault than ordinary negligence’. Franklin A. Gevurtz, ‘The Business Judgment Rule: Meaningless Verbiage or Misguided Notion?’ (1994) 67 *S. Cal. L. Rev.* 287 at 295.

resulted in conflicting outcomes of cases in the US.³⁷ Should the application of the BJR in duty of care claims result at all in judicial scrutiny/ review of the board's decision-making process or should courts always abstain from judicial review? If it is to be accepted that application of the BJR may result in some form of judicial review, where do we draw the line between when judicial scrutiny begins and ends, and where the policy should simply be judicial deference/judicial non-review in case of duty of care claims?

To Bainbridge, the answer to the questions posed above is simple. He argues that 'the whole point of the business judgement rule is to prevent courts from even asking the question: did the board breach its duty of care?'³⁸ For this reason Bainbridge criticised the Delaware Supreme court for allowing judicial review of substantive merits of the board's decision in *Technicolor*.³⁹ Johnson too is critical of Delaware's formulation of the BJR as 'a centrepiece for corporate fiduciary analysis'.⁴⁰ The author argues that the BJR would be 'better understood as a narrow-gauged policy of *non-review* than as an overarching framework for affirmatively shaping judicial review of fiduciary performance'.⁴¹ Implied in Bainbridge's arguments is that courts should be particularly precluded from reviewing directors' observance of their duty of care obligations in decision-making. In stark contrast to the argument for judicial non-review of duty of care obligations, US courts are not precluded from reviewing the substance of director decisions in cases of fraud, illegality, conflict of interests or irrationality.⁴²

Other writers are differently persuaded, and believe that courts have 'in fact reviewed directors' business decisions to some extent from a quality of judgment point of view...and will continue to do it because directors are fiduciaries'.⁴³ So quite clearly, there appears to be

³⁷ US case law presents conflicting outcomes in the application of BJR due to different approaches followed by the courts. For e.g. in *Kamin v. American Express Co.*, 383 N.Y.S. 2d 807 (1976), aff'd, 387 N.Y.S. 2d 993 (App. Div. 1976) at 810-811, the court, upon application of the BJR, dismissed the applicant's case despite a demonstrably wrong decision by the board. In contrast, in a later case in *Cede & Co. v Technicolor* (supra) 367, the Delaware Supreme Court, in applying the BJR as a procedural guide to the facts before it, gave the plaintiffs/litigants the opportunity to rebut the presumption (of good faith in favour of directors) by allowing them to present evidence that the board had failed to exercise due care in their decision-making process. When the plaintiff successfully rebutted the presumption, the court did not only review the process by which the decision was made, but ultimately also the substance of the directors' decision.

³⁸ Bainbridge (2004) *Vand. L. Rev* 95.

³⁹ *Ibid* 95-102.

⁴⁰ L Johnson, 'The Modest Business Judgment Rule' (2000) *55 Bus. Law.* 625.

⁴¹ *Ibid*.

⁴² *Ibid* at 97-99. See reference to the decision in *Kamin v. American Express Co.*, 383 N.Y.S. 2d 807 (1976), aff'd, 387 N.Y.S. 2d 993 (App. Div. 1976) at 810-811. Also see *Shlensky v Wrigley* 237 N.E. 2d 776 (III. App. Ct 1968) at 780.

⁴³ William T. Quillen, 'Trans Union, Business Judgment, and Neutral Principles' (1985) *Del. J. Corp. L.* 465 at 492.

no consensus on the theory of the proper relationship between the BJR and duty of care. This challenge creates uncertainty in the law relating to the BJR.

(ii) Justification of the dichotomy/divergence of standard of conduct and standard of review in corporate law as a rationale for the BJR

The fact that standards of conduct and review⁴⁴ diverge in corporate law has been put forward as a possible rationale for the BJR.⁴⁵ The clearest example of this dichotomy is to be seen in the relationship between the BJR and the duty of care. Just as a reminder, when directors accept appointment as fiduciaries of a company, they make an affirmative undertaking of a good faith-inspired intention to care for companies.⁴⁶ This includes obligations to exercise business judgments, to monitor, and generally to assume the mantle of authority and responsibility.⁴⁷ There is a correct mode of ascertaining whether an agent was at fault. It is by enquiring whether the fiduciary neglected the reasonable exercise of that diligence and care, which was necessary to a successful discharge of the affirmative duty imposed on him/her.⁴⁸ Under South African common law, the standard used to determine liability for breach of the duty of care is one of negligence, and not gross negligence.⁴⁹ In the context of decision-making by directors, the BJR gives substance to the question: What does it mean when we say that a director has been negligent and failed to meet the standard of care?⁵⁰

In most areas of law, the standard of conduct and standard of review tend to conflate. However with respect to corporate decision-making, the standard of conduct for duty of care, which is ordinary negligence, diverges with the standard of review – gross negligence under the BJR. US courts have ruled that gross negligence and not ordinary negligence is the appropriate standard of review in duty of care claims in the context of decision-making.⁵¹ Information asymmetry and bounded rationality have been cited as [explanations](#) why there is divergence of standards of conduct and review.⁵² The effect of the dichotomy of standards in

⁴⁴ Standard of conduct and standard of review are defined in 5.2.1 below

⁴⁵ Rhee (2013) *Notre Dame L.R* 1152–1156..

⁴⁶ *Ibid* at 1168.

⁴⁷ *Ibid*.

⁴⁸ See *Percy v Millaudon*, 8 Mart. (n.s) 68, 74-75 (La. 1829).

⁴⁹ Blackman, Jooste & Everingham *Commentary on Companies Act* 190. Stegmann J confirmed the standard in *Ex parte Lebowa Development Corporation Ltd* 1989 (3) SA 71 (T) 106. Also see *Du Plessis NO v Phelps* 1995 (4) SA 154 (C) 170.

⁵⁰ Rhee (2013) *Notre Dame L.R* 1169.

⁵¹ See *Smith v Van Gorkom* 488 A.2d (supra) at 873.

⁵² Eisenberg (1993) *Fordham L. Rev* 437-438.

the application of the BJR in Delaware is that it has curtailed the scope of enforcement of the duty of care to process due care only.⁵³

(iii) The generally accepted claim that courts are incompetent to review business decisions

Another motivation or rationale for the BJR is the oft-made claim in US case law that the complexity of business decisions is beyond the reach of judges (that judges are not business experts), and therefore they are incompetent to review corporate decision-making.⁵⁴ This view has been correctly criticised. Rhee argues that such a view is misleading in that it ‘elevates the business profession to some rarefield level of incomprehensibility’ and disingenuously suggests that courts must not even attempt a review of corporate decisions.⁵⁵ It is misleading to suggest that courts are incompetent to review a corporate governance issue. Courts have been reviewing business decisions for years and courts continue to review other even more complex issues such as healthcare legislation, the economics of antitrust law, inter alia.⁵⁶ This claim threatens to limit the courts’ role to provide judicial review to the conduct of directors during the decision-making process. It also raises fears of trivialising the role of courts and enforcement of laws. As correctly observed by Rhee, the fundamental role of courts is to apply rules of law, determine wrongs and assigning liability.⁵⁷ Determination of liability for breach of duty is a legal question which must be settled in a neutral forum such as a court. If courts ever feel that any matter is beyond their reach, they can call upon the assistance of assessors or even of their own accord enlist expert guidance or assistance.

⁵³ See *Brehm v Eisner*, 746 A.2d 244, 264 n.66 (Del.2000). As per the court in *In re Caremark Int’l Inc. Derivative Litig.*, 698 A. 2d 959, 967 (Del. Ch.1996), what matters is whether correct process was followed in decision-making in order to advance corporate interests. Whether that decision was ‘egregious’, ‘stupid’ or ‘irrational’ is immaterial.

⁵⁴ It is surprising, at least to me, that it is the judges themselves who seem to be at the forefront of propagating the notion that they are incompetent to review corporate decision-making. See the following comments by judges in the following US cases: *Dodge v. Ford Motor Co.* (supra) at 684 – ‘The judges are not business experts’; *Auerbach v. Bennett* (supra) at 1000 – ‘The business judgment doctrine, at least in part, is grounded in the prudent recognition that courts are ill-equipped and infrequently called on to evaluate what are and must be essentially business judgments’; *Brehm v Eisner* (supra) at 263 – ‘Courts are ill-fitted to attempt to weigh the ‘adequacy’ of consideration under the waste standard or, *ex post*, to judge appropriate degrees of business risk’; *Daniels v. Thomas, Dean & Hoskins, Inc.*, 804 P.2d 359, 367 (Mont. 1990) – ‘Judges are not business experts and therefore should not substitute their judgement for the judgment of the directors’; *Cuker v. Mikalauskas*, 692 A.2d 1042, 1046 (Pa. 1997) – ‘The business judgment doctrine prevents courts from becoming enmeshed in complex corporate decision-making, a task they are ill-equipped to perform’.

⁵⁵ Rhee (2013) *Notre Dame L.R* 1151.

⁵⁶ *Ibid* at 1152.

⁵⁷ *Ibid* at 1153.

The language employed to justify the BJR rationale that the judiciary is incompetent to review business decisions is puzzling, worrying and potentially misleading.⁵⁸ BJR is justified with the explanation that because judges are not business experts, they should not ‘review’ or ‘second-guess’ the substance of business decisions,⁵⁹ absent a showing by the plaintiff of a breach of directors’ duties.⁶⁰ There could be something mischievous or misleading in the language of ‘judicial non-review’ and not ‘second-guessing’ directors’ business decisions. It’s not only non-American writers like myself who seem to have quite a problem with such language used by US courts and other commentators to justify the elevation of the BJR above directors’ duties. Some American writers too are critical of the language used in arguing that judges are incompetent to review business decisions or the call not to ‘second-guess’ boards’ business judgment calls. Johnson for example, agrees that the phraseology misleadingly suggests that there is ‘some jurisprudential basis for interfering (or not) in a business decision when there is no such basis apart from a duty breach’.⁶¹ Thus Johnson disagrees with the view that courts ‘review’ or ‘second-guess’ the substance of business decisions by directors. The author correctly explains that rather than arguing that courts ‘review’ or ‘second-guess’ directors’ business decisions, the correct view is that courts ‘simply proceed with the analysis under the fiduciary duty principles’.⁶²

When a plaintiff asserts a claim, the ‘clarion call’ is not for the court to review the board of directors’ or a director’s business decision. The plaintiff basically requests a court to determine whether a director has breached his affirmative duty towards the company. A good case in point is the claim brought before the Delaware Supreme Court by the plaintiff Cinerama in the *Technicolor* case.⁶³ Cinerama’s case against the directors of Technicolor arose out of a shareholder’s duty-of-care-based challenge to the Technicolor board of directors’ decision to approve a merger.⁶⁴ The plaintiff alleged that the defendant directors

⁵⁸ Refer to comments captured in n54 above.

⁵⁹ L P.Q Johnson ‘Unsettledness in Delaware Corporate Law: Business Judgment Rule, Corporate Purpose’ (2013) 38 *Del. J. Corp. L* 405 at 426.

⁶⁰ See a similar comment made by the court in *Cede & Co. v Technicolor, Inc* (supra) at 361.

⁶¹ Johnson (2013) 38 *Del. J. Corp. L* 426.

⁶² Ibid.

⁶³ See *Cede & Co. v Technicolor, Inc.* (supra) at 345.

⁶⁴ Ibid. Cinerama Inc., a minority shareholder which owned 4.4 percent of Technicolor Inc.’s outstanding stock was the plaintiff in the matter. Technicolor was the defendant. The Technicolor board approved a merger with and to become a subsidiary of the MacAndrews and Forbes Group, Inc. (MAF). In the merger so concluded, Technicolor shareholders received \$ 23 cash per share. Cinerama dissented from the merger, filed an appraisal proceeding and brought a separate suit for damages. The action for equitable relief arose from its claim that the Technicolor board of directors violated its duty of care obligations when approving the merger. Also see Bainbridge (2004) *Vand. L. Rev* 91.

had violated their duty of care obligations towards the company.⁶⁵ In other words, the plaintiff's pleading amounted to a claim that directors had breached their affirmative obligations towards the company. Thus when analysing directors' performance during decision-making, the focus of the Delaware Supreme Court was on directors' duty of care obligations, which courts are legally competent to address.⁶⁶ From the premise of duty analysis, the court in *Technicolor* identified five decision-making 'process failures amounting to a breach of the duty of care'.⁶⁷ The gross negligence finding by the court was based on the conclusion it reached that the plaintiff successfully showed that the defendant Technicolor directors failed to inform themselves fully concerning all material information reasonably available prior to approving the merger agreement.⁶⁸ Thus it can be argued that the Delaware Supreme Court did not exactly set out to review the substance of directors' business decision. The court applied what can be termed the *Van Gorkom* test, which is a procedural or process due care test – a prerequisite for invoking the BJR.⁶⁹ According to this test, directors who fail to 'act in an informed and deliberate manner' may not assert the BJR as a defence against duty of care claims.⁷⁰ Hence the BJR could not be successfully invoked to protect the Technicolor directors.

While courts may not be competent to review the merits of directors' business judgments, they are competent to address the question whether or not a fiduciary has breached his/her affirmative duties towards the principal – the company. This is true particularly when it comes to courts' role to evaluate director performance in decision-making, for purposes of assigning liability, especially where pleadings are rooted in duty of care claims. Care⁷¹ is entirely process-oriented.⁷² Hence the view that there is no substance to duty of care reviews.⁷³ In any case, due care in the context of decision-making is procedural or process due care only.⁷⁴ When it comes to evaluating procedural issues, it is difficult to

⁶⁵ Ibid.

⁶⁶ Johnson (2013) 38 *Del. J. Corp. L* 426.

⁶⁷ See *Cede & Co. v Technicolor, Inc.* (supra) at 369 for a detailed presentation of the five decision-making process failures by the Technicolor board which resulted in the Delaware Supreme Court making a finding of gross negligence by the board of directors. Also see Bainbridge (2004) *Vand. L. Rev* 93.

⁶⁸ *Cede & Co. v Technicolor, Inc.* (supra) at 371.

⁶⁹ See *Smith v Van Gorkom* 488 A.2d (supra) at 873.

⁷⁰ Ibid.

⁷¹ At least in the decision-making context.

⁷² See similar comment made by author Johnson, in Johnson (2013) 38 *Del. J. Corp. L* 425.

⁷³ Ibid.

⁷⁴ *Brehm v Eisner* (supra) at 264. Also see *In re Caremark Int'l Inc. Derivative Litig.* (supra) at 967.

find any singular person or institution with better expertise than courts of law.⁷⁵ For these reasons, it may sound unfair, if not absurd, to insist that courts are incompetent to review directors' decision-making process.

(iv) Overemphasising the BJR and the concomitant de-emphasising of the duty of care – the proverbial danger of putting the cart before the horse

A unique aspect of corporate governance in the US, especially in the state of Delaware,⁷⁶ is the primacy accorded to the BJR over directors' duties in the analysis and evaluation of director performance by the courts.⁷⁷ The BJR should be utilised as a standard of review.⁷⁸ However, in Delaware the rule has been assigned a bigger role than simply as a standard of review. The BJR has been deployed as a 'doctrinal artefact for both conceiving and reviewing director compliance with' their duties as fiduciaries.⁷⁹ Instead of elevating the directors' duties to be the focal point in judicially analysing director conduct,⁸⁰ the Delaware Supreme Court has subordinated the duty of care for example, to become a mere 'element of the rule'.⁸¹ With '...care and loyalty alike relegated to secondary status as mere reflections of the BJR...',⁸² the most significant aspect of the *Technicolor* case was its ultimate resolution.⁸³ The directors were ultimately not held liable despite a finding of gross negligence because the transaction was apparently found to be nevertheless entirely fair.⁸⁴ It has been argued, understandably, that the effect of this decision was to subordinate or even erode the importance of the duty of care and the duty of loyalty.⁸⁵ The duty of care in particular has been consistently underenforced in Delaware,⁸⁶ and even its few celebrated gains such as *Van Gorkom*⁸⁷ are in danger of being reversed through a backlash from the legislature. As a

⁷⁵ Velasco similarly remarks that 'courts are particularly skilled at evaluating procedural issues, which are less likely (although not entirely unlikely) to be issues about which reasonable minds would differ'. See J Velasco 'A Defense of the Corporate Law Duty of Care' (2015) 40:3 *J. Corp. L* 648 at 661

⁷⁶ This is somewhat of a misnomer.

⁷⁷ Johnson (2013) 38 *Del. J. Corp. L* 424.

⁷⁸ See Velasco (2015) 40:3 *J. Corp. L* 681-682.

⁷⁹ Johnson (2013) 38 *Del. J. Corp. L* 424

⁸⁰ *Ibid* at 427.

⁸¹ *Cede & Co. v Technicolor, Inc.* (supra) at 366.

⁸² See CM Bruner 'Is the Corporate Director's Duty of Care a 'Fiduciary' Duty? Does it Matter?' (2013)48 *Wake Forest L. Rev* 1027 at 1040.

⁸³ See Velasco (2015) 40:3 *J. Corp. L* 682.

⁸⁴ See *Cinerama, Inc. v. Technicolor, Inc.*, 663 A.2d 1156, 1179 (Del. 1995).

⁸⁵ See Velasco (2015) 40:3 *J. Corp. L* 682

⁸⁶ *Ibid* at 680.

⁸⁷ *Smith v Van Gorkom* 488 A.2d (supra).

response to *Van Gorkom*, the Delaware legislature enacted exculpation provisions⁸⁸ directed at limiting the duty of care.⁸⁹

The fact that what should be a standard of review enjoys a pride of place and has analytical pre-eminence in analysing director conduct in Delaware⁹⁰ over directors' duties should be confusing to corporate lawyers from other common law jurisdictions. It is for the simple reason that directors' duties are and should be very central to corporate governance.⁹¹ The duties are broader in scope and in their reach than the BJR.⁹² Whereas the BJR only applies to business decision-making,⁹³ the duties apply whether or not a director's conduct is reviewed in court later.⁹⁴ It is important to note that a corporate law duty, such as care, affirmatively requires action on the part of the fiduciary.⁹⁵ If there are questions regarding whether that affirmative obligation has been fulfilled or not, it is at that point that the BJR as a standard of review becomes relevant and applicable. Thus, duties should retain a central focus and should be showcased, not obscured, whether in jurisprudence or when judicially analysing director performance.

While objectionable but certainly not excusable, the primacy of the BJR over duties in Delaware is nonetheless understandable from a historical perspective. Apparently the BJR was a forerunner to the arrival or recognition of the duty of care in Delaware.⁹⁶ Thus the BJR became so predominant in Delaware to the extent that it essentially became a doctrinal vessel into which the directors' duties⁹⁷ became fitted and subsumed.⁹⁸ For that reason Johnson

⁸⁸ Exculpation provisions are provisions which allow companies to eliminate or limit personal liability of a director. See DEL. CODE ANN. tit 8, s 102 (b) (7) (2014) which authorises corporations to add provisions to their charters which protect directors against personal liability for breach of their duty of care – also see Velasco (2015) 40:3 *J. Corp. L* 652. Interestingly, such provisions could not eliminate or limit directors' liability for breach of duty of loyalty or aspects of the duty of good faith.

⁸⁹ Velasco suggests that the exculpation provisions came about in response to the Delaware Supreme Court's decision in *Smith v Van Gorkom* 488 A.2d (supra). See Velasco (2015) 40:3 *J. Corp. L* 657.

⁹⁰ See Johnson (2013) 38 *Del. J. Corp. L* 425.

⁹¹ *Ibid.*

⁹² *Ibid* at 424.

⁹³ BJR is applicable only if an identifiable business judgment is made. See *Aronson v. Lewis*, 473 A.2d 805, 813 (Del. 1994).

⁹⁴ Johnson (2013) 38 *Del. J. Corp. L* 424.

⁹⁵ See Velasco (2015) 40:3 *J. Corp. L* 678.

⁹⁶ See an article by Justice Henry Ridgely Horsey 'The Duty of Care Component of the Delaware Business Judgment Rule' (1994) 19 *Del. J. Corp.* 971. In this article Justice Horsey, who has the distinction of having been on the bench in the *Cede & Co. v Technicolor, Inc* (supra) 345., explores the history of the development of the BJR and the duty of care in Delaware. According to Justice Horsey, the Delaware Supreme Court only came to recognise the duty of care in 1963, i.e. in the *Graham v. Allis – Chalmers Mfg. Co.*, 188 A2d 125, 130 (Del. 1963) – The correctness of this claim by Justice Horsey that the duty of care only appeared on the Delaware scene in 1963 is doubtful though, given the fact that in 1961, a Delaware court had held independent directors liable for gross negligence in *Lutz v. Boas*, 39 Del. Ch. 585 (1961). The BJR, adds the claim by Justice Horsey, had been a key feature of Delaware jurisprudence decades before the recognition of duty of care in 1963.

⁹⁷ Such as the duty of loyalty & the duty of care.

⁹⁸ Johnson (2013) 38 *Del. J. Corp. L* 424

aptly describes the domineering role of the BJR vis-à-vis the directors' duties when judicially assessing directors' performance in Delaware as 'an accident of history'.⁹⁹ A situation where affirmative obligations are less emphasised while a standard of review is over-emphasised should be seen to be jurisprudentially and doctrinally flawed.¹⁰⁰

While Delaware is struggling to shake-off the effects of 'the accident of history',¹⁰¹ other jurisdictions such as South Africa who recently incorporated the BJR, should endeavour to avoid repeating the mistake of subordinating the duties of care and loyalty to the BJR. A director's duty, as a standard of conduct, should not be mistaken to be an element or 'reflection' of BJR.¹⁰² The BJR, itself a narrowly applicable doctrine,¹⁰³ is better off viewed as a standard of review¹⁰⁴ than as an umbrella concept for the broader reaching duties.¹⁰⁵ Conceptualising the BJR as a model for enforcement of the directors' duties¹⁰⁶ and thus according it primacy while casting a shadow that pales duties into insignificance, is a mistake and it is indeed tantamount to putting the cart before the horse as explained above.

5.2.1 BJR: A standard of conduct or a standard of review?

It is appropriate at this stage of the study to distinguish between the standards of conduct on one hand and standards of review on the other hand in the context of decision-making in a company. This is vital given the fact that the central focus of this study is an inquiry into the effectiveness of standards of care, skill and diligence in the light of adoption of the BJR provisions under the Act.

While the BJR is closely connected to directors' observance of certain aspects of their fiduciary duties¹⁰⁷ and the duty of care, it will be incorrect to confuse it with a standard of conduct. A standard of conduct informs how a director should conduct himself when

⁹⁹ Ibid.

¹⁰⁰ Ibid.

¹⁰¹ As described by Johnson (2013) 38 *Del. J. Corp. L* 424. The overemphasis on the BJR in Delaware which has resulted in diminished emphasis on the directors' duties such as the duty of care is a result of the fact that the duty of care is a doctrinal late comer in Delaware and together with the duty of loyalty has become subordinated or even subsumed into the BJR.

¹⁰² See the criticism of *Cede & Co. v Technicolor, Inc* (supra) 345 by Bruner for making duties of care and loyalty a subspecies or elements of the BJR – see Bruner (2013)48 *Wake Forest L. Rev* 1040.

¹⁰³ Johnson (2013) 38 *Del. J. Corp. L* 424.

¹⁰⁴ See Velasco (2015) 40:3 *J. Corp. L* 682.

¹⁰⁵ Johnson (2013) 38 *Del. J. Corp. L* 424.

¹⁰⁶ Or as an organising framework

¹⁰⁷ In the US, as is the case elsewhere, the duties to avoid a conflict of interest and to act in the best interest of the company coalesce to form the broader duty of loyalty to the company. Under the Act, the fiduciary duties involved are the duty to act in the best interest of the company (s76 (3) (b)), and the duty to avoid conflict of interest in s75.

exercising the powers of a director, or when fulfilling the function of that role.¹⁰⁸ A standard of review provides the test a court is to apply when it reviews a director's conduct.¹⁰⁹ In the context of the BJR, this is done with the view of determining whether to impose personal liability or not on a director in the face of duty of care claims.¹¹⁰ The BJR was recently acknowledged as one of the standards of review available in Delaware.¹¹¹

The BJR is triggered when due-process allegations are raised against directors regarding their decision-making process. This happens when a litigant (usually a disgruntled shareholder) is unhappy with the results of past decisions taken by directors. A case before the court challenges the standard of conduct and allegations of failure of the expected standard of conduct are made. Due care,¹¹² good faith (absence of conflict of interests) and a rational basis for decision-making (for example, a decision made in the best interests of the company) are examples of the expected standard of conduct. The court will have to apply a standard of liability test to determine whether a director indeed failed to meet the required standard of conduct in a manner that gives rise to personal liability.¹¹³ If the party that bears the burden of proof discharges that burden and proves the directors' failure to meet the expected standard of conduct, the BJR will not apply to protect the directors. However, if the party fails to discharge the onus of proof, then the BJR will apply. Now, in a nutshell, the above is the relationship between a standard of conduct and a standard of review.¹¹⁴ Recent cases in the US confirm the view that the BJR offers a standard of review.¹¹⁵ How this works out exactly in practice is discussed below as I explore two conceptions of the BJR I alluded to above.

¹⁰⁸ S 76(3) of the Act is a clear example of a standard of conduct. It provides for how an actor should conduct a given activity or play a given role. See part 4.4.2 of Chapter 4. Alternatively standards of conduct can be defined to mean 'rules addressed to actors, specifying expectations regarding their behaviour...' – see Velasco (2015) 40:3 *J. Corp. L.* 651.

¹⁰⁹ See McMillan (2013) *Wm. & Mary Bus. L. Rev.* 529. Standards of review can also be understood to mean rules addressed to courts, specifying how actions are to be judged – see Velasco (2015) 40:3 *J. Corp. L.* 651.

¹¹⁰ Eisenberg (1993) *Fordham L. Rev.* 437.

¹¹¹ See *Reis v. Hazelett Strip-Casting Corp.*, 28 A.3d 442, 457 (Del. Ch. 2011).

¹¹² Due care, not slight care or gross negligence is the standard of conduct expected, according to Branson. See Branson (2011) *SAC LJ* 695.

¹¹³ McMillan (2013) *Wm. & Mary Bus. L. Rev.* 529.

¹¹⁴ See an illustration of how this relationship works out in practice given by Branson. Branson (2011) *SAC LJ* 691.

¹¹⁵ In *Omincare, Inc. v. NCS Healthcare Inc.*, 818 A.2d 914, 927 (Del. 2003), BJR as a standard of judicial review was said to amount to a common law recognition of the statutory authority to manage a corporation that is vested in the board of directors.

5.2.2 The BJR: A standard of liability, presumption of good faith in favour of directors or a presumption against judicial review?

There are many suggested conceptions of the BJR which seek to provide an understanding of the philosophy behind and the approach to the BJR. There are at least four conceptions, and there is no space to consider all of these conceptions. Just to mention a few, there is the conception of the BJR as a standard of conduct or standard of review;¹¹⁶ the BJR as a standard of liability; the BJR as a presumption of good faith in favour of directors or the BJR as a presumption against judicial review. This discussion below will mainly focus on the conception of the BJR either as a standard of liability¹¹⁷ or as presumption against judicial review, because the two are clear opposites.

Standard of liability as a conception basically means that the BJR entails some objective review of the quality of the company board's decision.¹¹⁸ A cursory peep at recent court decisions in the US supports the view that modern case law tends to look at the BJR as a standard of liability.¹¹⁹ The *Technicolor* case is one of the best recent illustrations of the BJR as a standard of liability.¹²⁰ The court in this case applied the Delaware formulation of the BJR -as 'a presumption that in making a business decision, the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company'.¹²¹ . A plaintiff has to 'rebut the presumption by introducing evidence either of director self-interest, if not self-dealing, or that the directors either lacked good faith or failed to exercise due care'.¹²² The plaintiff in *Technicolor* , Cinerama, carried the burden to rebut the rule's presumption that the directors had acted with due care, in good faith and with loyalty. After the shareholder plaintiff had successfully rebutted the presumption, the burden shifted to the defendant directors to prove to the trier of fact the 'entire fairness' of the transaction to the plaintiff.¹²³ At that point, it appears as if the Technicolor board would be found liable of breach of their duty of care. The application of the 'entire fairness' test to what were essentially duty of care claims could have confused

¹¹⁶ Already considered in 5.2.1 above.

¹¹⁷ The brief examination of the conception of BJR as a standard of liability does not exclude the presumption of good faith in favour of directors as will be demonstrated in the paras that follow..

¹¹⁸ Bainbridge (2004) *Vand. L. Rev* 91.

¹¹⁹ See *Omincare, Inc. v. NCS Healthcare Inc.*, (supra) 818; also *Cede & Co. v Technicolor, Inc* (supra) 345. Also see McMillan (2013) *Wm. & Mary Bus. L. Rev* 529.

¹²⁰ See *Cede & Co. v Technicolor, Inc* (supra) at 345..

¹²¹ See *Aronson v. Lewis* (supra) 812.

¹²² See *Citron v. Fairchild Camera & Instrument Corp.*, 569 A. 2d 53, 64 (Del. 1989).

¹²³ *Cede & Co. v Technicolor, Inc* (supra) at 371. Also see McMillan (2013) *Wm. & Mary Bus. L. Rev* 530.

matters, and hence the ultimate failure to enforce duty of care in the case against grossly negligent Technicolor directors.¹²⁴

In coming to its decision, the court in *Technicolor* emphasised its approach to BJR as a standard of liability and relied for its process on *Van Gorkom*¹²⁵ as precedent. The plaintiff's claim was also premised on the fact that directors of Technicolor had failed to comply with their *Van Gorkom* obligations. *Van Gorkom* had established what can be termed the BJR requirement of procedural or process due care.¹²⁶ To be precise, the court in *Van Gorkom* ruled that directors who 'fail to act in an informed and deliberate manner' in their decision-making process may not assert the BJR as a defence to duty of care claims.¹²⁷ It is for this reason that the Technicolor directors were denied the protection of the BJR given the finding by the Supreme Court of Delaware that they had failed the process due care test. Thus the BJR operated in the *Technicolor* and *Van Gorkom* as both a procedural guide for litigants and a substantive rule of law.¹²⁸ This is evident in that after respective plaintiff shareholders had successfully rebutted the presumption in favour of directors, duty of care claims were initially successful in preventing the BJR to apply to protect the Technicolor directors against liability.¹²⁹

Proponents of the doctrine of judicial abstention have been critical of the outcomes of most modern cases that approach the BJR as a standard of review. According to this doctrine, the court should abstain from reviewing the substantive merits of the directors' conduct, unless plaintiff can rebut the BJR's presumption of good faith. Using *Brehm v Eisner* as their basis, the proponents argue that courts should apply the BJR only in the absence of self-interest, lack of independence relative to the decision and gross negligence.¹³⁰ Bainbridge has led such a chorus of criticism by going further to argue that the BJR should be applied to prevent litigants from arguing that directors violated their duty of care.¹³¹ Bainbridge is of the conviction that the duty of care elements should not form part of the triad of the traditional

¹²⁴ See part 5.2.1 above for reference to the ultimate outcome of the matter as reported in *Cinerama, Inc. v. Technicolor, Inc.*, 663 A.2d 1156, 1179 (Del. 1995)

¹²⁵ *Smith v Van Gorkom* 488 A.2d (supra) at 871-872.

¹²⁶ Bainbridge (2004) *Vand. L. Rev.* 92.

¹²⁷ *Ibid.* Also see *Smith v Van Gorkom* 488 A.2d supra at 871-872.

¹²⁸ See confirmation of this principle by the Delaware Supreme Court in *McMullin v. Beran* 765 A.2d 910, 916 – 917 (Del. 2000).

¹²⁹ Also see *McMillan v Beran* 755 A.2d 910, 916-917 (Del. 2000). As aforementioned in 5.2.1 above, the directors were ultimately not held liable despite an initial finding of gross negligence against them because the transaction was at the end of the day, nonetheless found to have been fair. See *Cinerama, Inc. v. Technicolor, Inc.*, 663 A.2d 1156, 1179 (Del. 1995),

¹³⁰ 746 A.2d 244, 264 n.66 (Del. 2000).

¹³¹ See Bainbridge (2004) *Vand. L. Rev.* 95.

considerations before a court decides whether the BJR is applicable or not.¹³² Bainbridge buttresses this point by emphatically stating that ‘the whole point of the business judgment rule is to prevent courts from even asking the question: did the board breach its duty of care?’¹³³ Bainbridge further posits that the approach to the BJR as a standard of liability as adopted in *Technicolor* and *Van Gorkom* puts ‘the cart before the horse’ in that it allows for a substantive review of directors’ conduct.¹³⁴ The argument goes further to say that with authority resting in the directors to run the affairs of corporations, judicial review by courts should be the exception, rather than the norm.¹³⁵ Limited judicial review in fact, it is argued, should be the norm.¹³⁶ It is further argued that excessive judicial review would shift true authority from the directors to the court room.¹³⁷

The doctrine of judicial abstention can be criticised for good reasons. Firstly, the rule appears misguided in its appreciation of the origin of the BJR. While there is now what the Delaware Supreme Court has taken to calling a ‘triad’ of fiduciary duties,¹³⁸ the BJR developed alongside the duty of care as a common law standard of review.¹³⁹ Hence the BJR is said to be most intimately associated with the duty of care.¹⁴⁰ Therefore taking duty of care elements out of the equation is tantamount to destroying the very original motivation for the BJR. Secondly, the argument by Bainbridge that judicial abstention should be the norm rather than the exception, threatens to confuse matters. The essence of BJR is that a court of law should decide, based on presumed conditions whether the rule should apply to protect directors against personal liability or not. Whichever approach to be adopted should lead to either a successful or unsuccessful rebuttal of a presumption by plaintiffs, which should lead to either application of the BJR or a result that the matter should proceed to trial.

Despite its limitations, the BJR conception as a standard of liability or standard of judicial review is a better approach than a conception of the BJR as an abstention doctrine. There is a clear relationship between a standard of conduct and a standard of review, making

¹³² This point is reinforced by reference to *Shlensky v Wrigley* 237 N.E. 2d 776 (III. App. Ct 1968), a case celebrated by proponents as authority for the view that the BJR should be approached as a doctrine of judicial abstention. The court in this case appeared to deliberately exclude duty of care considerations when applying the BJR by accepting the argument of defendant directors that ‘courts will not step in and interfere with honest business judgment of directors unless there is a showing of fraud, illegality or conflict of interest’.

¹³³ Bainbridge (2004) *Vand. L. Rev* 95.

¹³⁴ *Ibid* at 94.

¹³⁵ *Ibid* at 96.

¹³⁶ McMillan (2013) *Wm. & Mary Bus. L. Rev* 534.

¹³⁷ Bainbridge (2004) *Vand. L. Rev* 103-104. Also see McMillan (2013) *Wm. & Mary Bus. L. Rev* 534.

¹³⁸ Namely care, good faith and loyalty.

¹³⁹ Weng (2010) *Fordham Int'l L.J* 124.

¹⁴⁰ D Branson ‘Intracorporate Process and the Avoidance of Director Liability’ (1989) 24 *Wake Forest L. Rev* 97.

it easier for courts to apply BJR as a standard of review than as abstention doctrine. Under the BJR as a standard of review, there is at least clarity as to the process to be followed. It is known which party bears the onus of proof, and what follows after failure of the rebuttal of a presumption in favour of directors, or after the plaintiff successfully rebuts the presumption.¹⁴¹ The only criticism which may be levelled against the conception of the BJR as a standard of liability concerns the level or standard of negligence required. The rule, as can be discerned from case law,¹⁴² is said to move the liability bar from ordinary negligence to a lower standard such as gross negligence.¹⁴³ Johnson is critical of gross negligence which he describes as a ‘permissive recklessness standard’.¹⁴⁴ This standard may however be explained by the fact that the original purpose of the rule was to protect directors from personal liability for mere negligence during the decision-making process. Otherwise, there is no protection for egregious violations of duty of care such as failure to be properly informed where information is readily available to inform decision-making, as was the case in *Technicolor*. In addition the standard of gross negligence is the standard applicable for liability in case of violation of duty of care under US law, especially in Delaware.¹⁴⁵ A jurisdiction that chooses to incorporate the BJR like South Africa will have to establish the standard of negligence applicable.

5.3 SA courts’ experience with the BJR, international influence and law reform

South Africa was influenced by English case law in its earlier limited application of business judgment doctrine. Developments in many parts of the world regarding adoption of the US-style BJR into statute, also got South Africa to debate the pros and cons of incorporating the BJR into statute, leading to law reforms as evidenced by the Act.

¹⁴¹ See the procedure laid down in *McMillan v Beran* 755 A.2d supra at 910 and *Cede & Co. v Technicolor, Inc* 634 supra at 346. Also see part 5.3.2 above.

¹⁴² See *Brehm v Eisner*, 746 A.2d 244 supra at 266 where it was remarked that one caveat of the BJR is that decisions that are grossly negligent will not be protected.

¹⁴³ In *Aronson v Lewis*, 473 A.2d 805, supra at 812 it was confirmed that in America, under the BJR, ‘director liability is predicated upon concepts of gross negligence’.

¹⁴⁴ Lyman Johnson ‘Unsettledness in Delaware Corporate Law: Business Judgment Rule, Corporate Purpose’ (2013) 38 *Del. J. Corp. L.* 405-451 at 426.

¹⁴⁵ Lawrence A Hamermesh & A. Gilchrist Sparks III ‘Corporate Officers and the Business Judgment Rule: A Reply to Professor Johnson’ (2005) 60 *The Bus. Lawyer* 865-876 at 868.

5.3.1 Business judgment doctrine in SA prior to 2008: the common law

Even prior to 2008, South African courts followed the same approach as English law regarding the BJR, namely that the courts did not second-guess or substitute its opinion for management decisions made in good faith.¹⁴⁶ In addition, South African courts accepted that a director is not liable for mere errors of business judgment.¹⁴⁷ Courts further acknowledged the spectre of hindsight bias in the judiciary's *ex post* review of a risky business decision taken by directors *ex ante*, in the hope of reaping commensurate rewards for their companies.¹⁴⁸ From a number of obiter statements by courts one can decipher from the common law a principle of judicial restraint and deference to the business judgment of directors.¹⁴⁹

In *Levin v Felt and Tweeds*,¹⁵⁰ the court expressed the view that 'it is not part of the business of a court of justice to determine the wisdom of a course adopted by a company in the management of its own affairs'. The South African courts have in the past therefore, albeit in just a handful of cases, demonstrated preparedness not to unjustifiably interfere with business decision-making of a company. This appears to be the case whether a business decision was made by directors, shareholders or creditors during a time when a company engages in insolvent trading as was underscored in recent cases. In *Howard v Herrigel*,¹⁵¹ and in another similar case,¹⁵² the courts confirmed a policy of deference to directors' business judgments where this is desirable and justifiable in order to promote a spirit of enterprise.

Given the statements as cited above, is there scope to ever think or assume that there is something that can be referred to as a South African common law BJR? Although it can be

¹⁴⁶ See *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821 at 832.

¹⁴⁷ See *Philotex (Pty) Ltd v Snyman* (supra) 138; *Du Plessis NO v Osthuizen* (supra) 201. Also see Blackman, Jooste & Everingham *Commentary on Companies Act* 192.

¹⁴⁸ Especially if the risky decision ends with bad results. See dicta by Goldstone JA in *Howard v Herrigel* (supra) at 676. In any case, it is expected of directors, and indeed one may even say that it is part of their job to take risks, or to display entrepreneurial flair. As has been remarked by du Plessis, risk-taking is 'inextricably part of business and entrepreneurship that they can be considered fundamental principles'. JJ Du Plessis 'Open sea or safe harbour? American, Australian and South African business judgment rules compared (Part 1)' (2011) 32 *The Company Lawyer* 348.

¹⁴⁹ This view is shared by South African academic and renowned researcher Professor JS McLennan who quotes the words of Lord Greene M.R in *Re Smith and Fawcett Ltd* [1942] Ch. 304 CA: 'They [directors] must exercise their decision bona fide in what they consider – not what a court considers – is in the interests of the company.' McLennan too believes that this case, accepted in South African law as good law mirrors the common law's principle of judicial restraint and deference to directors' business judgment. See McLennan (1996) *SA Merc L.J* 94. Also see part 2.6.

¹⁵⁰ 1951 (2) SA 401 (A) 414.

¹⁵¹ *Howard v Herrigel* (supra) at 676.

¹⁵² See *Lordon v Dusky Dawn Investments (in liquidation) (Pearmain Intervening)* 1988 (4) SA 519 (SECLD) 521 B-D, quoted by L Mswaka 'Directors' Duties and the Business Judgment Rule in South African Company Law: An analysis' (2013) 3 *I'J of Humanities & Social Science* 89.

said that prior to 2008 South African courts followed a business judgment doctrine,¹⁵³ it is difficult to state that courts followed the BJR as applied now in Australia or in the US. Where the BJR is applied, it is my conviction that a jurisdiction must develop a clear approach. It must be easy to establish (from the empowering legislation) a relationship between the BJR as a standard of review and a standard of conduct. Statements made by judges during decision-making to the effect that courts do not second-guess management decisions, may only qualify as a business judgment doctrine, and not the BJR as established in earlier parts of this chapter. Therefore prior to 2008, South Africa did not formally provide for the application of the BJR.¹⁵⁴ In fact the term the ‘BJR’ was not used in South African case law.¹⁵⁵ Thus, it is safer to insist that there is no South African common law BJR to talk about prior to the Act.¹⁵⁶ South Africa followed a business judgment doctrine, a watered down version of BJR. Nonetheless, South African common law’s demonstrable preparedness to follow a principle of judicial restraint and deference to the business judgment of directors (as indicated above) is very important for the interpretation of s76 (4) (a).¹⁵⁷ The BJR which was only introduced by the Act, will be discussed shortly.

5.3.2 The BJR debate and rationale for inclusion in the Act

There were basically two contrasting views regarding the suitability and necessity of adopting the BJR in modern South African company legislation in the late 1990s to early 2000s. The *King Reports* represented a view in favour of including the BJR in a statute. All three reports contained references to the BJR, with the first two reports particularly advocating for inclusion of the BJR into statute. That the BJR is now part of the Act¹⁵⁸ is clear evidence that the advocacy of the *King Reports* bore fruit.

The motivation for the proposal for inclusion of the BJR by *King I* triggered an immediate and strong opposition to the prospect of a BJR in South African company law.

¹⁵³ Farrar agrees that some Commonwealth jurisdictions, and I am sure he had South Africa in mind as well, ‘pay attention to what might be described as the Business Judgment Doctrine’ and not necessarily BJR. See J.H Farrar ‘Business Judgment and Defensive Tactics in Hostile Takeover Bids’ in D.B. King (ed) *Essays on Comparative Commercial and Consumer Law* (Fred B Rothman & Co., 1992) 173-206.

¹⁵⁴ See similar views expressed by Lombard prior to 2008, in S. Lombard ‘Importation of a Statutory Business Judgment Rule in South African Company Law: Yes or No?’ (2005) 68 *THRHR* 625.

¹⁵⁵ See du Plessis (Part 1) (2011) *The Company Lawyer* 346.

¹⁵⁶ Clearly, whatever form of BJR SA followed had not ‘developed to a state of sophistication sufficient to make it a common law rule of any significance or a rule comparable to the American business judgment rule’. See du Plessis (Part 1) (2011) *The Company Lawyer* 346.

¹⁵⁷ Most recently, Rodgers J of the Western Cape High Court reflected this common law principle of judicial restraint when he commented that ‘a court should be wary of substituting its own business judgment for that of the persons entrusted with that decision by the corporate constitution’. See *Visser Citrus (Pty) Ltd v Goede Hoop Citrus (Pty) Ltd and Others* 2014 (5) SA 179 (WCC) para 64.

¹⁵⁸ See s76 (4) (a).

Most academic writers represented this opposite view, a view clearly not in favour of the inclusion of the BJR for various reasons. The reasons ranged from the perceived ability of the law not to second-guess corporate decisions to *inter alia*, concerns about the incompatibility of an American “legal transplant” with South African law.¹⁵⁹ Firstly, those who were opposed to the BJR were united in the view that the rule was unnecessary in South African company law. It was argued that South African courts have, over the years, allowed directors to make business decisions in a spirit of enterprise and have not sought to usurp the power of management where decisions are justifiable.¹⁶⁰ It was further argued that the King Committee conveniently ignored this fact in making its recommendation in *King I*.¹⁶¹

Secondly, the academic commentators were also in agreement that the motivation for limiting the duty of care by including a BJR in statute was premised on the King Committee’s wrong understanding of the South African legal position. In *King I* the committee had argued that ‘particularly in the case of non-executive directors, their appointment is onerous in the context of the present tests of a breach of the duty of care and skill’.¹⁶² It was thus argued that the King Committee had wrongly concluded that an onerous duty was imposed on company directors by the duty of care, skill and diligence. As argued, the fact that there is a paucity of cases where the duty of care was successfully enforced is well-known.¹⁶³

Thirdly, there were serious doubts as to whether a proper study of the legal position relating to the USA and the unique South African law on the duty of care had been properly done to safely import a “legal transplant” in form of a BJR into South African company law without consequences.¹⁶⁴ Fourthly, there was opposition to statutory adoption of the BJR in South Africa without a trial run. In the BJR’s place of origin (the USA) attempts at codification of the BJR, a common law rule, had failed twice. It was thus seen as spelling future disaster caused by challenges such as a likelihood of incompatibility. A related point (fifth) is the different approach to directors’ common law duties in the USA and in South Africa. South African law insists on the distinction between fiduciary duties and the duty of care, skill and diligence. Unlike other common-law jurisdictions, the USA is said to blur the boundaries almost with reckless abandon by lumping the two duties under a ‘fiduciary’

¹⁵⁹ See Botha & Jooste (1997) *SALJ* 73.

¹⁶⁰ See Botha & Jooste (1997) *SALJ* 74; Havenga (2000) *SA Merc LJ* 35-36; Jones (2007) *SA Merc LJ* 336 and McLennan (1996) *SA Merc LJ* 100.

¹⁶¹ *King I* p9 for a statement by the King Committee in this regard.

¹⁶² *King I* Report, para 3.3 on p9.

¹⁶³ See Jones (2007) *SA Merc LJ* 326-327.

¹⁶⁴ See Botha & Jooste (1997) *SALJ* 73.

duty,¹⁶⁵ something which distinguishes South African and USA company laws. Transplanting of a legal doctrine and importing it into a jurisdiction without proper investigation was said to be a risky affair.¹⁶⁶

The proposal made by *King I* to provide the BJR in order to limit the duty of care, was sure to raise obvious criticisms and fears. The concern here was that a limitation of a duty which had already proved to be “a very tenuous and risky foundation on which to found a legal claim against a director...” was a sure gateway to the further lowering of standards and limit enforcement of the duty of care, skill and diligence.¹⁶⁷ The South African standards of care at common law were believed to have failed to meet commercial realities at the time.¹⁶⁸

The DTI Policy Document 2004’s policy motivations for adoption of the BJR and general law reform leading to the Act were discussed in Chapter 4.¹⁶⁹ The objectives form part of the rationale for adoption of the BJR under the Act.¹⁷⁰ It was also believed that introducing the BJR was in line with the need to encourage particularly aspiring candidates from designated groups to become company directors, and thus increase the South African pool.¹⁷¹

5.4 Analysis of s 76(4) (a) of the Act – BJR provisions

Despite the misgivings and pessimism with which the possibility of inclusion of the BJR into statute in South Africa was debated by scholars, the Act can now count among its many novelties, the BJR provisions, thus following in the footsteps of jurisdictions like Australia.¹⁷² Section 76(4) (a), it can be argued, partly contains a South African version of the BJR. It provides 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

¹⁶⁵ Christopher M. Bruner ‘Is the Corporate Director’s Duty of Care a ‘Fiduciary’ Duty? Does it Matter?’ (2013) 48 *Wake Forest L. Rev* 1027-1054 at 1028-1029.

¹⁶⁶ See Farrar (2011) *SAC LJ* 761.

¹⁶⁷ Jones (2007) *SA Merc LJ* 326.

¹⁶⁸ Cassidy (2009) *Stell L.R* 384. Also see N Bouwman ‘An Appraisal of the Modification of the Director’s Duty of Care and Skill’ (2009) 21 *SA Merc LJ* 510.

¹⁶⁹ See part 4.2.3 of Chapter 4.

¹⁷⁰ Also see purpose of the Act in s7 (i) – (j).

¹⁷¹ Hence reference in the DTI Policy Paper 2004 to ‘Black Economic Empowerment initiatives in para 1.3. Also see reference to the ‘two economies’ which still persist in South Africa, the first, ‘...an advanced, sophisticated economy, based on skilled labour, which is becoming more globally competitive. The second...a mainly informal, marginalised, unskilled economy, populated by the unemployed and those unemployable in the formal sector...’ DTI Policy Paper 2004 para 1.2.

¹⁷² See s180 (2) of the Corporations Act 2001.

about the matter;

(ii) either—

(aa) the director had no material personal financial interest in the subject matter of the decision, and had no reasonable basis to know that any related person had a personal financial interest in the matter; or

(bb) the director complied with the requirements of section 75 with respect to any interest contemplated in subparagraph (aa) and

(iii) the director made a decision, or supported the decision of a committee or the board, with regard to that matter, and the director had a rational basis for believing, and did believe, that the decision was in the best interests of the company.

To say that s76 (4) (a) evinces a BJR (which, arguably is correct) is a matter of interpretation really, based on the presence of the BJR elements akin to the BJR versions found in US and Australian laws.¹⁷³ There is very little doubt that subsection 76 (4) (a) (i) – (iii) contains the BJR elements. It has to be noted, however, that s76 (4) (a), while it contains the typical BJR elements, appears to be distinguishable from the American and Australian versions. For example, whereas the latter two versions of the BJR focus on protecting ‘business judgments’,¹⁷⁴ s76 (4) (a) appears to offer a wider protection¹⁷⁵ and protects much more than business decisions.¹⁷⁶ This is evident from the introduction to s76 (4) (a). That part provides that the subsection applies to ‘any particular matter arising in the exercise of the powers or the performance of the functions of a director’. Impliedly the scope of application of s76 (4) (a) extends beyond what the traditional BJR seeks to protect – business judgments. For that reason the drafters of the Act appear to have carefully avoided use of the phrase ‘business decision’ and simply refer to ‘a decision’ in s76 (4) (a) (iii).¹⁷⁷ The fact that s76 (4)

¹⁷³ Already dealt with in Chapter 3 and referred to in this present chapter.

¹⁷⁴ Provided the rule’s requirements are met

¹⁷⁵ Protection of the decisions made by the directors in the exercise of their powers and in the performance of their functions as per the law – see the opening to s76 (4) (a).

¹⁷⁶ See a similar view expressed by du Plessis (Part 2) (2011) 32 *The Company Lawyer* 381

¹⁷⁷ It therefore follows logically, why the Act, unlike the Corporations Act 2001 of Australia (in s180 (3)), does not include a definition of a ‘business decision/judgment’. Perhaps the drafters of the Act wanted to avoid the complexities which come with an attempt to define a ‘business decision/judgment’ as is the case with the interpretation of s180 (3) of the Corporations Act which is fraught with difficulties because of the complexity

(a) appears to provide wider protection to ‘any matter arising in the exercise of power or the performance of functions of a director’ does not mean it excludes a BJR. What it could simply mean is that 76 (4) (a) cannot simply be limited to a traditional, American style BJR. With every analysis, it gets clearer that s76 (4) (a) applies to more than a traditional BJR. Thus care has to be taken to ensure that the subsection is not ‘boxed’ into the same frame of interpretation given to the American traditional rule. The focus of the analysis below falls only on the BJR elements of s76 (4) (a).

5.4.1 Relationship of the BJR to standards of conduct in s76 (3) (b) and 76(3) (c)

It is clear from s76 (4) (a) that the BJR relates to only two of the three codified directors’ common law duties under the Act. These are the duty to act in the best interests of the company in s76 (3) (b) and the duty of care, skill and diligence in s76 (3) (c). It is to be noted that s76(4)(a), read on its own, appears to provide requirements which a director should meet when exercising powers given or performing her function as director in order to satisfy the obligations imposed by the two duties.¹⁷⁸ In other words, as a fiduciary, the director ‘will have satisfied obligations of subsections (3) (b) and (c)’ if he fulfils the requirements of the South African version of the BJR.¹⁷⁹

By expressing the link between obligations on directors imposed by subsections 76(3) (b) and (c) and requirements of the BJR, the Act is, arguably, revealing a relationship between a standard of conduct and a standard of review.¹⁸⁰ In this context, subsections 76(3) (b) and (c) provide standards of conduct, while s76 (4) (a) provides the standards of review. For example, s76(3)(b)¹⁸¹ is a fiduciary duty of loyalty to the company. This standard of conduct seeks to ensure that the overriding factor in decision-making by directors should be the promotion of the best interests of the company or the success of the company. Thus, a decision tainted or infected by conflict of interests will not meet the requirement that the director must exercise the powers and performs her function in the best interests of the company.¹⁸² What is in the best interests of the company however, is a matter to be decided by company directors in the board room, and not necessarily by judges in the courtroom.¹⁸³ Thus the BJR requires the director to show that he believed rationally that his decision was likely to promote the best interests of the company. It is difficult to conceive of how the

of director decision-making processes. See du Plessis (Part 2) (2011) 32 *The Company Lawyer* 381.

¹⁷⁸ S 76(3)(b) and (c).

¹⁷⁹ Part 5.4.2 will further articulate the BJR requirements.

¹⁸⁰ See 5.2.1 for a distinction between the two terms.

¹⁸¹ A duty to act in the best interests of the company.

¹⁸² See s76 (4) (a) (ii).

¹⁸³ See *Re Smith and Fawcett Ltd* [1942] Ch 304 (CA) at 306.

requirement for rationality can exclude good faith.¹⁸⁴ It does not appear as if the rationality requirement at present would necessarily cover cases of bad faith. The absence of a rational basis can be considered under English and as accepted in South African law, to be indicative of the directors' lack of good faith when making a decision.¹⁸⁵ For the reason that a failure to meet the obligations to act in the best of interests of a company may indicate bad faith, it is unfortunate that s76 (3) (a)¹⁸⁶ does not form part of the BJR scheme in s76 (4) (a). The point being made above, if it is to be summarised, is that the link between good faith and the duty to act in the best interests of the company shows that the legislature was wrong in not including good faith as a requirement for reliance on the BJR.

With regard to obligations imposed by s76 (3) (c), the standard of conduct should be reasonable care, not slight care or anything less.¹⁸⁷ Some writers have expressed concern that the BJR when viewed as a standard of review or liability moves the liability bar from mere negligence to a lower standard – namely gross negligence.¹⁸⁸ An important question needs to be asked: Will the application of the BJR on the basis of s76 (4) (a) result in the divergence of standards as is the case in the USA? In Delaware,¹⁸⁹ for example, because of the strongly non-interventionist philosophy underpinning the BJR,¹⁹⁰ the rule is worded as a presumption in favour of directors.¹⁹¹ To succeed in a duty of care claim, a Delaware plaintiff carries a heavy burden of upsetting the presumption¹⁹² by proving that a board's conduct amounted to gross negligence, not just ordinary negligence.¹⁹³ A closer examination of s76 (4) (a) however does not seem to suggest that a lower standard of review is envisaged under the

¹⁸⁴ In the English case of *Item Software (UK) Ltd v Fassihi* [2004] EWCA Civ. 1244, a director of IS encouraged a distributor company dealing with IS to make its terms more stringent and to consider dealing with him directly. In the event the negotiations between IS and the distributor collapsed, as a result of the director's interference. In this example it is clear that the director was not acting in the best interests of the company.

¹⁸⁵ See the views expressed by Scrutton LJ in *Shuttleworth v Cox Brothers & Co (Maidenhead) Ltd* [1927] 2 KB 9 (CA). Also see *Dorchester Finance v Stebbing* [1989] BCLC 498.

¹⁸⁶ That is the requirement that a director acts in good faith and for a proper purpose.

¹⁸⁷ See Branson (2011) *SAC LJ* at 689. Branson expressed this view with reference to the US Model Business Corporation Act.

¹⁸⁸ See McMillan (2013) *Wm. & Mary Bus. L. Rev* 534.

¹⁸⁹ Delaware is dubbed the home of American corporate jurisprudence.

¹⁹⁰ See the reflection of this philosophy in *Re Dow Chemical Company Derivative Litigation*. (Court of Chancery of Delaware, Consolidated Civil Action No. 4349-CC (11 January 2010).

¹⁹¹ See *Aronson v Lewis*, 473 A.2d 805, supra at 812 where the rule is presented as a presumption 'that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company'. As a presumption in favour of directors, the BJR is designed to protect the authority of the board to govern the corporation without judicial 'second-guessing' of its decisions.

¹⁹² *Ibid*.

¹⁹³ In *Smith v Van Gorkom* 488 A.2d (supra) at 873, the Delaware Supreme Court ruled that the appropriate standard of review or standard of liability was gross negligence. In practice, this heavy burden may prove a barrier to a plaintiff's prospects of success.

subsection. The subsection demands that a director should take ‘reasonably diligent steps to become informed about’ the subject matter of the business decision.¹⁹⁴ It can thus be argued that the standard of review is couched in more objective terms. As already stated, the standard of conduct under South African common law is negligence.¹⁹⁵ Despite the ambiguities associated with the drafting of s76 (3) (c) as observed in Chapter 4, the statutory duty can be interpreted to be equally providing for negligence as a standard of conduct. On this basis, courts of law should interpret and apply both s76 (3) (c) and s76 (4) (a) not to result in a divergence of standards.

When it is alleged that a board’s decision did not satisfy the obligations of subsections 76(3) (b) and (c), a court of law will apply a standard of review in s76 (4) (a). This is a standard of liability or standard of review test whose purpose is to determine whether a director indeed failed to meet the required standard of conduct in a manner that gives rise to personal liability.¹⁹⁶ If the directors meet the standard of review under s76 (4) (a), then that becomes their defence against liability claims. This is the essence of the BJR. I now turn to the requirements (components) of the BJR or the standard of review which must be satisfied either by a plaintiff or defendant.

5.4.2 The components or requirements of the BJR under s76 (4) (a)

For a defendant director to enjoy protection of the BJR against liability claims, or for a plaintiff to succeed in liability claims against defendant directors in South Africa, about three to four requirements of the BJR in s76 (4) (a) should be satisfied. These requirements are – informed decision-making; absence of disabling conflicts of interest (that is personal and familial interests); that a decision/ was made and that there was a rational basis for the decision, which amounts to a decision made in the best interests of the company. A brief discussion of each of these components follows below.

(i) Informed decision-making

Subsection 76(4) (a) (i) requires that the decision made by the director in the context of the company board should be an informed decision – a result of reasonably diligent steps taken by the director. The director and his colleagues are expected to have considered material information that any reasonable director in the shoes of the director(s) involved

¹⁹⁴ See s76(4)(a)(i).

¹⁹⁵ See Blackman, Jooste & Everingham *Commentary on Companies Act* 190.

¹⁹⁶ See McMillan (2013) *Wm. & Mary Bus. L. Rev* 529.

should have taken into account before making a decision.¹⁹⁷ If no reasonable person in the shoes of the directors could have omitted the information which the directors whose conduct is impugned omitted, then the directors would have failed the test. The due care process requirement is that directors should carefully consider matters, including carefully scrutinising alternatives.

Where directors' knowledge is limited, the Act allows directors to consult experts and get expert guidance in order to make informed decisions.¹⁹⁸ The board should also make a diligent search for information by requiring employees of the company to supply relevant information to guide decision-making by the board. If there are allegations that directors failed to take into account material information at their disposal, the inquiry is whether the directors should have 'taken reasonably diligent steps to become informed'.¹⁹⁹ Therefore a defence by the defendant directors such as that they had little information to consider because company employees did not volunteer information is not a defence that can avail directors facing duty of care claims.²⁰⁰ Directors are expected to employ diligent means to ensure that they place themselves in a position to make an informed decision which serves the best interests of the company. The US case of *Van Gorkom* is persuasive authority for the assertion that directors who fail to act in an informed and deliberate manner may not assert the BJR as a defence against duty of care or other liability claims.²⁰¹

The use of reasonableness in s76(4)(a) means that an objective test is employed when reviewing the standard of conduct of a director who faces claims of breaching his/her duty of care. It should be noted that 76 (4) (a) (i) is phrased differently from s180 (2) (c) of Australia's Corporations Act 2001. Unlike the Australian subsection, s76 (4) (a) (i) does not necessarily require a director/prescribed officer to inform himself about the subject matter of the decision to the extent to which they reasonably believe appropriate. The phrase 'to the extent to which they [*the directors*] reasonably believe appropriate' is not part of s76 (4) (a). The South African subsection requires a director to 'have taken reasonably diligent steps to become informed about the subject matter' of the decision.²⁰² This purely objective test is not

¹⁹⁷ A reasonable person's test is the test to be applied in the standard of review under s76(4)(a)(i).

¹⁹⁸ See the reliance & delegation provisions in s76 (4) (b).

¹⁹⁹ See s 76 (4) (a) (i).

²⁰⁰ In the US case of *Cede & Co. v Technicolor, Inc* 634 supra at 371, the Delaware Supreme Court identified several process failures by Technicolor (defendant directors), which amounted to a breach of duty of care. The court ruled that Technicolor directors failed to inform themselves fully concerning all material information reasonably available prior to approving the merger agreement with MAF. This failure included failure to make 'prudent search for alternatives' and failure to acquire relevant information reasonably within the directors' reach before making a decision which affected the company.

²⁰¹ *Smith v Van Gorkom* 488 A.2d supra at 871-872.

²⁰² See s 76 (4) (a) (i).

diluted by subjective considerations regarding a director as is the position in terms of s180 (2) (c). S 76(4) (a) (i)'s reasonableness requirements must be juxtaposed with s76 (4) (a) (iii)'s rationality requirement which sets down a more subjective rationality requirement. Thus, s76 (4) (a) (i) imposes a requirement that a director must employ diligent means to gather information and must be reasonably informed for decision-making purposes.

(ii) Absence of disabling conflict of interests (familial interests included)

S76(4)(a)(ii) lists as one of the components of the BJR under the Act, the requirement that a director must not have a 'material personal financial interest in the subject matter'²⁰³ of the decision. Materiality of a 'personal financial interest' speaks to a significant interest with potential to colour or affect the quality of judgment or even sway judgment in a particular direction during a decision-making process.²⁰⁴ The interest should be 'direct', to the exclusion of what may be indirect. It (the interest) should be 'material' as defined in s1 of the Act. Impliedly, in order to determine what is material a court will need to make an objective assessment, and the outcome will depend on the facts and circumstances of a particular case under consideration. Alternatively, a director, in line with s75, should make proper and honest disclosures. S 75 in particular requires that if a director has a personal financial interest in the subject matter of the decision-making process, or knows that a related person²⁰⁵ is so interested, he/she is expected to make certain disclosures regarding such interests before the board meeting.²⁰⁶ The conflicted director is not allowed by law to participate in decision-

²⁰³ The term 'material personal financial interest' is not defined as a composite term. However parts of the term are defined in s1 of the Act. 'Material' in this context means significant in the circumstances of a particular matter, to a degree that might reasonably affect a person's judgment or decision-making. 'Personal financial interest' is defined in s1 to mean 'a direct material interest of that person, of a financial, monetary or economic nature, or to which a monetary value may be attributed'. Such personal financial interest however excludes interests held in unit trusts or collective investment schemes in terms of the Collective Investment Schemes Act 45 of 2002.

²⁰⁴ If this were to happen, it would be contrary to the spirit of the fiduciary nature of the position of a director. As stated by Mason J in the Australian case of *Hospital Products Ltd v United States Surgical Corp* (1994) 156 CLR 41 at 103, 'the fiduciary's duty may be more accurately expressed by saying that he is under an obligation not to promote his interest by making or pursuing a gain in circumstances in which there is a conflict or real substantial possibility of a conflict between his personal interests and those of the persons whom he is bound to protect'.

²⁰⁵ The term 'related person' is defined in s2 (1) of the Act and includes natural persons romantically related, such as married couples or even co-habitants. It further includes people separated by no more than two degrees of natural or adopted consanguinity or affinity, & natural persons in such a position in relation to a juristic person, as to enable those persons to exercise direct or indirect control of the juristic person concerned. A juristic person is related to another if either of them directly or indirectly controls the other, or the business of the other.

²⁰⁶ This may also be possibly done after the board meeting where circumstances justify this. See s75(5) (a)-(g) of the Act for e.g.

making regarding a matter in respect of which he is conflicted,²⁰⁷ and should not even execute any document on behalf of the company in relation to that matter.²⁰⁸ If the company allows such a director to execute such a document, the company should have carefully considered the consequences of such indulgence or allowance. The purpose of s76(4)(a)(ii) is to prevent conflicts of interest which can disable the independent ability of a director and the entire board to make decisions which are in the best interest of the company.

It has often been held in the common law that officers and directors are not permitted to use their position of trust and confidence to further their private or related persons' interests. The rule that requires an undivided and unselfish loyalty to the company demands that self-interest should not compromise or taint execution of duty.²⁰⁹ Directors are expected to be influenced only by what is in the best interests of the corporation when making business decisions. They should have the independence to decide in the best interests of their company rather than in any other person's or group of persons' interests.²¹⁰

Under the South African common law,²¹¹ a director's duty to avoid a conflict of interest is seen to be at the heart of fiduciary duties of directors.²¹² A director who owes his company a duty to perform in its favour should never place himself in a situation where his interests conflict with his duty.²¹³ Conflicts that are known to potentially disable independent decision-making include direct pecuniary interests of the director, family interests, interests of business associates²¹⁴ or interest in another company affected by a decision to be made by the board.²¹⁵

A subspecies of conflict of interest cases of relevance to the BJR in South Africa involve cases where directors lack independence when making business decisions.²¹⁶ In the

²⁰⁷ In other words, the director should recuse himself from the relevant board deliberations. See s75(5)(e).

²⁰⁸ See s75(5)(g).

²⁰⁹ See the US case of *Guth v Loft, Inc.*, 5 A. 2d 503, 510 (Del. 1939).

²¹⁰ A director's duty in South Africa is to exercise an independent judgment and to take decisions in the best interests of the company. See *Fisheries Development Corporation of SA Ltd v Jorgensen & Another* (supra) at 163.

²¹¹ Ibid.

²¹² Even though, *Keech v Sanford* (1726) Sel Cas Ch 61 is related to trust law, it has influenced South African legal principles with regard to conflict of interest involving a fiduciary. Also see *Imageview Management Ltd v Jack* [2009] BCLC 725 at 739 (CA).

²¹³ See *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168 at 178-179.

²¹⁴ See Branson (2011) *SACLJ* 698.

²¹⁵ For a perfect example in South Africa, see *Da Silva v CH Chemicals (Pty) Ltd* 2008 (6) SA 620 (SCA).

²¹⁶ The tricky and possibly difficult cases involve nominee directors. Nominee directors represent the interests of the persons who nominated them to sit on the board of directors. In law, however, even such directors are nonetheless expected to promote the best interests of the company to the exclusion of interests of even those they represent. In *S v Shaban* 1965 (4) 646 (W) 651 the court strongly discouraged nominee directors from acting like 'puppets' of those who nominated them, cautioning that South African law is not prepared to countenance such conduct from fiduciaries.

USA these cases are referred to as ‘dominated director’ cases.²¹⁷ A plaintiff in a matter where a defendant director faces conflict of interest allegations may allege that some or all directors are dominated by a shareholder with a controlling interest or are under the sway of a domineering CEO. In the US case of *Shlensky v Wrigley*,²¹⁸ the plaintiff Shlensky decided to challenge Philip Wrigley’s refusal to install lights in Chicago’s Wrigley Field baseball stadium. He opted against taking the entire board of Chicago National League Ball Club, Inc. to court. Shlensky’s motivation to take on only Wrigley, the majority shareholder and president of the company²¹⁹ was that the other directors were so dominated by Wrigley that they improperly acquiesced in his business decisions.²²⁰ Such influence on decision-makers disables independent decision-making. This becomes a conflict of interest because directors will make decisions which tend to favour a ‘related person’ and not for the purpose of advancing interests of the corporation. This falls under the purview of the BJR requirements under s76 (4) (a) (ii).

In the context of s76(4)(a)(ii) the Act covers conflicts of interests and requires a director not to be influenced by material personal and/or familial financial interests. Alternatively, a director should comply with disclosure of financial interests as required in terms of s75. If a director does not comply with requirements of s76 (4) (a) (ii) (aa) or s75, he/she will lose protection of the BJR.

(iii) A ‘decision’ must have been made

Under the South African version of the BJR the requirement is that in order for the BJR to apply to protect directors in case of say duty of care claims, a decision or judgment must have been made by the board. Alternatively, a director should have ‘supported the decision of the committee or the board’ with regard to a decision in question. The import of the suggestion that the director should have supported the decision of the board is not very clear. It could capture within its ambit a situation where a director who was not present at the meeting, may throw his weight behind a decision of the board, expressing his support, perhaps in writing.

Regarding the ‘decision’, s76 (4) (a) (iii) does not specify that it should be a ‘business judgment’²²¹, but simply a ‘decision’. Can a business decision be said to be envisaged by the

²¹⁷ Branson (2011) *SaCLJ* 700.

²¹⁸ 237 N.E. 2d 776 supra at 777-778.

²¹⁹ This company owned the Chicago Bulls.

²²⁰ See Bainbridge (2004) *Vand. L. Rev* 96.

²²¹ The Australian BJR version is clearer in this regard as it makes specific reference to a ‘business judgment’ in

subsection nonetheless? Du Plessis makes the point that s76 (4) (a) provides a wider statutory protection to ‘decisions’ of directors which ‘extend beyond business judgments associated with directors’ duty of care, [*skill*] and diligence’.²²² I agree with that view. Indeed, s76 (4) (a) provides broader protection to directors’ ‘decisions’ than only business judgments. Nonetheless, business judgments/decisions are envisaged in the subsection.

Is a decision not to make a decision, a decision by default under the Act? Some authors believe that a decision to refrain from deciding is a decision for purposes of the rule.²²³ It is however not crystal clear whether s76 (4) (a) (iii) can be read to imply that a decision not to make a decision is a decision.²²⁴ What is clear though is the fact that cases of inaction of the board where action is required or even a decision not to make a decision where this is unreasonable, will amount to an abdication of duty by directors. As a form of negligence or dereliction of duty, this falls squarely within the purview of breach of the duty of care.²²⁵ The BJR is thus inapplicable in such instances.²²⁶ The rule does not protect directors who have abdicated their position or directors who have not made a conscious decision.²²⁷

Part of the purpose of the BJR under South African law as is the case elsewhere, is the promotion of the quality and integrity of decision-making by company boards. This is of course in addition to such goals as allowing directors the freedom to manage companies in a manner that enhances productivity within companies. The Act expresses this goal as promotion of entrepreneurship and enterprise efficiency, given the significant role of enterprises within the social and economic life of the nation.²²⁸ The corollary to the importance of integrity of decision-making by a board is the need for the decision to be an independent decision or judgment. This means that rubber-stamping a powerful or domineering figure’s wish as was alleged in *Shlensky v Wrigley* discussed above, does not render the decision an independent decision. Under the South African common law, there are

s180 (2) (a) of the Corporations Act 2001.

²²² See du Plessis (Part 2) (2011) 32 *The Company Lawyer* 381. The words in italics and brackets are my own additions for purposes of emphasis only.

²²³ See Branson (2011) *SAC LJ* 697.

²²⁴ This is to be differentiated from Australian law which clearly defines a ‘business judgment’ in s180 (3) as any ‘decision to take or not to take action’ in respect to a matter relevant to the company’s business operations. See Cassidy (2009) *Stell L.R* 403.

²²⁵ Which is a violation of the statutory duty in s76 (3) (c).

²²⁶ In the US case of *Miller v Schreyer* 683 NYS 2d 51 at 54 (App Div, 1999), it was remarked that ‘where the wrong alleged is inaction of the board rather than a conscious decision...the business judgment rule is inapplicable’.

²²⁷ In this regard s76 (4) (a) (iii) is in agreement with US case law. See *Cf Brane v Roth* 590 NE 2d 587 at 592. (Ind. App, 1992).

²²⁸ See s7 (b) (i) & (iii).

a number of types of directors known to be active within companies who may fall foul of the requirement that they should exercise independent judgment during the decision-making process of the board. Nominee directors²²⁹ and puppet directors in practice find themselves following the instructions of their controllers during board meetings. This could result in either conflicts of interests as discussed in (ii) above, or could affect the quality of the decision-made by directors, if the majority of the directors could not exercise an independent judgment. In *S v Shaban* the court remarked that failure to exercise independent discretion in decision-making for the benefit of the company will be punished by courts as fraud in South Africa.²³⁰ The reason being that it will infect the ‘decision’ of the board.

(iv) Rational basis for believing that the decision was in the best interest of the company

Closely connected to the BJR requirement that a business decision must have been made, is the requirement that there should be a rational basis for the decision, and for believing that that decision was made in the best interests of the company. The Act appears to treat this as a species of the requirement that a decision must have been made. This Study follows an international pattern of separating the two requirements. Both the USA²³¹ and the Australian²³² versions of the BJR deal with the two aspects separately. The South African version of the BJR is reminiscent of the ALI version which requires that for a director to be protected, a court must find that the director rationally believed that the business judgment is in the best interests of the corporations’.²³³ In other words, the business decision or simply ‘decision’ must have been actuated by a rational or legitimate business purpose. The BJR will not apply where the director or company board acts in a manner that cannot be attributed to a business purpose.²³⁴

The ‘rationality’ requirement under s76(4) (a) (iii) can have implications for the standard of review applicable. The subsection requires that a director should have a ‘rational basis’ which is distinguishable from a ‘reasonable basis’ to believe that the decision taken serves the best interests of the company. It is inconceivable that the legislature could have loosely employed a rationality requirement in s76 (4) (a) (iii)²³⁵ when it might have intended

²²⁹ A nominee director can be defined as a director who was nominated by a shareholder or an entity which has to sit on the board of directors.

²³⁰ *S v Shaban* 1965 (4) SA 646 (W) 652-653.

²³¹ See Branson (2011) *SACLJ* 696 who deals with the two requirements separately.

²³² See s180 (2) (a) & (d) of the Corporations Act 2001 which presents these as two separate requirements of the BJR version under Australian law.

²³³ See the American Law Institute Principles of Corporate Governance and Structure § 401 (c) (3).

²³⁴ Similar reasoning was made by a US court in *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del.1971).

²³⁵ Through the use of the phrase ‘rational basis’.

to employ the phrase ‘reasonable basis’. In s76 (4) (a) (i) and (ii), the legislature carefully employed the ‘reasonableness’ requirement before intentionally shifting to the rationality requirement in s76 (4) (a) (iii). While the difference between ‘rationality’ and ‘reasonableness’ may *prima facie* seem more apparent than real,²³⁶ it matters in corporate law. By ‘rational basis’ is conveyed the sense of being simply logical, with the result that one may even make an unreasonable judgment, objectively speaking, but one which is not wholly illogical.²³⁷ Thus rationality is said to be rather a permissive test²³⁸ and may even be more accommodating of decision-makers’ idiosyncrasies than the concept of reasonableness is prepared to. To be reasonable means to be objective, judicious and to be prepared to see the bigger picture or to consider other view-points.²³⁹ Reasonableness provides a more exacting (an objective) standard which demands a sharpened and tightened scrutiny than rationality.²⁴⁰

There is room to argue that s76(4) (a) (iii)’s requirement that there be a ‘rational basis’²⁴¹ for believing that a decision is in the best interests of the company, imposes a lower standard as compared to subsections 76(4) (a) (i) and (ii). For example, s76(4) (a) (i) requires that a director should take reasonably diligent steps to become informed. S 76(4) (a) (ii), in addition to the director avoiding conflict of interest regarding personal financial interests, requires that the director must have had no ‘reasonable basis’ to know that a related person had a personal interest in the subject matter of the decision. Thus the first two subsections employ reasonableness as a standard of review, while s76 (4) (a) (iii) employs the lower rationality standard.

What was the rationale for framing the standard of review with regards to the fiduciary duty to which it applies, namely the duty to act in the best interests of the corporation,²⁴² in the manner it was framed? In a recent judgment in *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd and Others* Rogers J confirms that the correct view of s76 (4) (a) (iii) is that the duty imposed by s 76(3)(b) to act in the best interests of the company is not an objective one.²⁴³ Thus, the duty cannot in a sense entitle a court, if a board decision is

²³⁶ See Cassidy (2009) *Stell L.R* 400.

²³⁷ Tunc, A ‘The Judge and the Businessman’ 1986 (102) *LQR* 560, quoted in Cassidy (2009) (2009) *Stell L.R* 400.

²³⁸ Bainbridge, S *The difference between reasonableness and rationality in corporate law* available at <http://www.professorbainbridge.com/professorbainbridgecom/2010/09/the-difference-between-reasonableness-and-rationality.html> .

²³⁹ *Ibid.*

²⁴⁰ *Ibid.*

²⁴¹ As differentiated from a reasonable basis.

²⁴² See s76 (3) (b) of the Act.

²⁴³ *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd and Others* (supra) at 74.

challenged, to determine what is objectively speaking in the best interests of the company.²⁴⁴ The rationale appears to have been intended to serve two purposes. It was, firstly, to couch s76 (3) (b) in subjective terms to ensure that it remains the company board which has to decide what is in the best interests of the company, and not the judges or the court room.²⁴⁵ The result being that even if with the benefit of hindsight, judges do not agree with the wisdom of directors' judgment after the fact, they are not entitled to substitute the board's judgment for their preferred choices.²⁴⁶ This is only the case if the director had a rational basis for believing that the decision was made in the best interest of the company. The standard in this regard²⁴⁷ is not reasonableness but rationality. In other words, the belief that the decision is in the best interests of the company need only be rational, not necessarily reasonable. To prove that the decision was in the best interests of the company,²⁴⁸ the defendant director need only to demonstrate that his/her belief is justified by a sensible reasoning process. It is important to note that the concept of rationality does not necessarily exclude elements of 'reasonableness'.²⁴⁹ However, a director's sensible reasoning process may be accepted as meeting the requirements of s76 (4) (a) (iii) even if it is not, objectively speaking, a convincing one.²⁵⁰ The second reason for the employment of the rationality requirement in s76 (4) (a) will demonstrate that the rationality criterion to be adopted by South African courts will have an objective flavour.²⁵¹ This however does not imply that the courts will objectively determine what is in the best interests of the company.²⁵² That would be second-guessing the business judgments of directors and our law will not countenance

²⁴⁴ Ibid.

²⁴⁵ This flows from the fact that the Act now formally recognises directors as the legitimate organ to provide strategic leadership to a company, and thus to make executive or day to day decisions affecting a company. See s66(1) of the Act.

²⁴⁶ This is one instance where the BJR recognises that judges are not business experts, and the decision as to what is in the best interests is better left to directors who have the requisite mandate or expertise to make such decisions (see the US cases of *Cuker v. Mikalauskas* (supra) at 1046 & *Dodge v. Ford Motor Co.* (supra) at 684). Hence the rationale of the traditional BJR to avoid second-guessing the business judgments of directors. In a South African case *Howard v Herrigel* (supra) at 676, Goldstone JA accepted that a court will always be careful to take into account the fact that after the event 'the knowledge of hindsight can be misleading and give rise to unfair criticism' of the directors' decision by the court.

²⁴⁷ That is, in term of s76 (4) (a) (iii).

²⁴⁸ In line with the matrix of s76 (4) (a).

²⁴⁹ Interestingly, s180 (2) of the Corporations Act 2001 provides that 'the director's or officer's belief that the judgment is in the best interests of the corporation is a rational one unless the belief is one that no reasonable person in their position would hold'.

²⁵⁰ A belief is subjective yet explainable and justifiable, and the law does not expect that directors should make decisions which the judges are to always agree with. See *Re Smith and Fawcett Ltd* [1942] Ch. 304 CA.

²⁵¹ See the remarks by Rogers J in *Visser Citrus (Pty) Ltd v Goede Hoop Citrus (Pty) Ltd and Others* (supra) at para 76.

²⁵² Ibid.

that.²⁵³ This is a decision that only directors can make, but of course they [the directors] should give a reasonable explanation of how they arrived at that decision.

The second rationale for the rationality requirement in s76 (4) (a) (iii) is to reveal the nexus between the ‘decision’ by directors and the purpose for which a directorial power exercised was given.²⁵⁴ The relevant inquiry has been held to be whether the decision or the means employed was rationally connected to the purpose for which the power was given.²⁵⁵ As argued earlier in this part, the decision must have been actuated by a rational or legitimate business purpose. This brings s76 (3) (a) squarely into the purview of s76 (4) (a). Rogers J demonstrates the symbiotic relationship between the ‘duty to act in good faith and for a proper purpose’ and the rationality requirement under s76 (4) (a). In the words of the court in *Visser Citrus*, there exists ‘a close relationship between the requirement that the power should be exercised for a proper purpose and the requirement that the directors should act in what they consider to be the best interests of the company’.²⁵⁶ Interestingly in *Visser Citrus* the court employed s76 (3) (a) as if the ‘duty to act with good faith and for a proper purpose’ was a natural part of s76 (4) (a) and the BJR. This further goes to justify why this Study proposes to include s76 (3) (a) to be part of the BJR formulation subsumed under s76 (4) (a). My point is that the requirement of good faith and proper purpose should be part of the requirements of the BJR as is the case in the US and Australia as already outlined elsewhere in this Study in 3.3.2 and 3.4.2.

In a nutshell, the standard of review in s76(4) (a) is therefore not a uniform objective standard of review. It is partly objective,²⁵⁷ and partly subjective²⁵⁸ as demonstrated above.

An ancillary question which may need consideration is whether the standard of review in s76(4)(a) is more objective than it is subjective and with what consequences for corporate governance in South Africa. At this stage (and based on the above analysis), it appears that the BJR provisions have what can be termed a dual objective/subjective standard of review. Subsections 76(4)(a)(i) and (ii) emphasise considerations of reasonableness, which leads to an objective standard, while s76(4)(a)(iii) imposes rationality as a standard. As demonstrated above, the rationality requirement in s76(4)(a)(iii) imposes a less exacting

²⁵³ See confirmation of this by Chaskalson P in *Pharmaceutical Manufacturers Association of SA & Another: In re Ex parte President of the Republic of South Africa & Others* 2000 (2) SA 674 (CC) para 90.

²⁵⁴ *Visser Citrus (Pty) Ltd v Goede Hoop Citrus (Pty) Ltd and Others* (supra) at para 77.

²⁵⁵ See *Association of Regional Magistrates of Southern Africa v President of the Republic of South Africa & Others* [2013] ZACC 13; 2013 (7) BCLR 762 (CC) paras 49-50. Also see *Minister of Defence and Military Veterans v Motau & Others* [2014] ZACC 18 para 69.

²⁵⁶ *Visser Citrus (Pty) Ltd v Goede Hoop Citrus (Pty) Ltd and Others* (supra) at para 80.

²⁵⁷ See s76 (4) (a) (i) &(ii).

²⁵⁸ See s76 (4) (a) (iii).

standard as compared to a standard of reasonableness in subsections 76(4)(a)(i) and (ii). It should, nonetheless, be noted that the subjective elements in s76(4)(a) do not have the effect of undermining the objective elements of the BJR in the subsection.²⁵⁹ If anything, the subjective elements have great potential to be interpreted to enhance the entire standard of review in s76(4)(a). The requirement that a rational basis must exist for believing that the decision is in the best interest of the company will have a positive impact on the standard of review as demonstrated above. A rational belief may be interpreted to be one that no reasonable person in the position of the director can conclude or hold²⁶⁰

Where a court is called upon to apply a standard of review in a given case it will combine objective and subjective elements to espouse an exacting standard of review like Rogers J did recently in *Visser Sitrus*. For example, the process of being informed must not only be preceded by “reasonably diligent steps”.²⁶¹ The director should have no reasonable basis to know that a related person had a personal financial interest in the matter.²⁶² In addition there should be a “rational basis” to believe that the decision taken is in the best interests of the company.²⁶³

5.4.3 A summary critique of the BJR provisions in s76 (4) (a)

While s 76(4) (a) undoubtedly shows great potential to enhance corporate governance in South Africa through an interpretation which is in line with the spirit, purpose and objects of the Act, some worrying gaps, inconsistencies and lack of clarity need to be resolved first. Where the criticisms which can be levelled against the BJR provisions under the Act have been alluded to in the above illustration, they will only be briefly explained below.

The first criticism against the BJR provisions under the Act is that the rule is wrongly classified as a standard of conduct instead of being captured as a standard of review. This wrong classification of the BJR does not necessarily stem from provisions of s 76(4) (a) as demonstrated earlier in this Chapter. S 76 is under the heading ‘Standards of conduct’, and as already demonstrated in this Chapter, that title aptly captures the standards under s76(3), but incorrectly classifies standards under s76(4)(a).²⁶⁴ Those are standards of review and must be

²⁵⁹ Unlike s76(3)(c)(ii) which has the effect of undermining the objectivity of the standards of conduct in s76(3)(c)(i), the subjective elements of the standards of review do not operate to undermine the objective elements. In other words, the subjective elements in s76(4)(a) can be seen to be enhancing the objective elements.

²⁶⁰ In any case, in *Shuttleworth v Cox Brothers & Co (Maidenhead) Ltd*[1927] 2 KB 9 (CA) 23, case law applicable in South Africa, it was held that an irrational or unreasonable decision is indicative of bad faith.

²⁶¹ See s 76(4)(a)(i).

²⁶² See s 76(4) (a) (ii).

²⁶³ See s 76(4) (a) (iii).

²⁶⁴ See part 5.2.1 of this chapter.

distinguished from standards of conduct under s76 (3) as already explained in parts 5.2.1 and 5.4.1 of this Chapter. As will be proposed in Chapter 7, the title needs to be amended to read ‘Standards of conduct and review’.

Secondly, the absence of a ‘good faith’ requirement is a noticeable and inexplicable²⁶⁵ omission in the formulation of the BJR in s76 (4) (a). One glaring difference between the USA and South African versions of the BJR is the emphasis on the requirements of good faith elements in the USA rule formulation.²⁶⁶ S 76(4)(a) on the other hand tacitly excludes the requirement to fulfil the statutory duty of acting in “good faith and for a proper purpose”.²⁶⁷ S 76(4)(a) only makes reference to the duty of care²⁶⁸ and duty to act in the best interests of the company.²⁶⁹ By excluding “good faith” elements, s 76(4) (a) also differs from Australia’s Corporations Act s180(2) which explicitly makes reference to “making judgment in good faith and for a proper purpose”.

The intention of the legislature in excluding good faith elements as a requirement of the BJR is somewhat surprising, when one considers the fact that reasonableness and rationality are intrinsic requirements of the South African version of the BJR. The lack of rationality or reasonableness in decision-making may be indicative of bad faith,²⁷⁰ which makes the requirement of good faith and acting for a proper purpose an important element of the rule formulation. Thus the omission of s 76(3)(a) from the formulation of the BJR under s 76(4) (a) is unfortunate, in the absence of a justifiable rationale for excluding such a requirement. Good faith is a cornerstone of the presumption of no liability in favour of the director. Good faith and the general duty of loyalty to the company are like Siamese twins. It can serve as an effective test to determine the absence or presence of most of the requirements listed under s76(4)(a) (i)- (iii). Having good faith as a requirement will not only be useful to judges who have to determine whether the BJR is applicable. It can be useful to

²⁶⁵ Inexplicable especially in the absence of Explanatory notes or an Explanatory Memorandum in the Act to clarify the justification or rationale for the exclusion.

²⁶⁶ In the USA formulation and application of the BJR, good faith is considered an umbrella requirement. Good faith has been described as a ‘surrogate of sorts’ for the test to be applied in order to determine the presence or absence of key elements/requirements of the rule. Good faith e.g. is a test to be applied when determining presence or absence of conflict of interests, other ill-motives for the business decision-made as opposed to making a decision in the best interests of the corporation, and is useful in ‘dominated directors’ cases- where directors are accused of not having made an independent business decision. The allegation is usually that the directors merely rubber-stamped the decision of controlling shareholders or that directors had a disabling conflict of interest which so infected their decision-making to the extent that the decision made was not theirs- that is, the directors lacked independence (and good faith). See Branson (2011) *SAC LJ* 702-704.

²⁶⁷ See ss76(3) (a).

²⁶⁸ In s76(3) (c).

²⁶⁹ See s76(3)(b).

²⁷⁰ As already highlighted above, it is accepted in South African law that an irrational decision may be indicative of bad faith. See *Shuttleworth v Cox Brothers & Co (Maidenhead) Ltd* (supra) at 23.

attorneys when advising their client companies on whether they satisfied a BJR test or not since it is easier to develop a checklist of the presence of the BJR requirements using good faith. Therefore any future amendment of the Act should, in the absence of a rationale for exclusion, consider adding the requirements of “good faith and acting for a proper purpose”²⁷¹ under the formulation of the BJR in s76(4) (a).

The scope of application of the BJR under s76(4) (a) remains unclear. The scope is undefined and so wide that as has been argued by others, it “applies to the exercise by directors of any power or the performance by them of any of their functions”.²⁷² Despite the wide wording of the type of decisions that will be covered by the BJR, its application is limited to breaches of clearly circumscribed duties. Breaches of s 22, for example or the provisions where solvency and liquidity test is relevant²⁷³, it appears, will not be covered by the BJR. The mere fact that s 22 deals with reckless conduct and that recklessness is determined with reference to negligence would not invoke the BJR. In this sense the law in South Africa is the same as in Australia. As in the US the BJR will apply in favour of directors where actions are brought against them on the basis of breaches of s 76(3)(b) and (c), even if this occurs in the context mergers.²⁷⁴

In Australia, the rule is said not to have been successfully applied to insolvent trading.²⁷⁵ It is however probably premature to come to a cursory finding that the same challenge will be experienced in South Africa. Only time will tell if there will be any future challenges with the application of the rule in any way. In the USA the rule has been very useful in take-over and merger cases.²⁷⁶ South Africa has had its fair challenges in this area, and of the law will prove useful in insolvent trading cases. The Act has provisions relating to solvency and liquidity test under the Act.²⁷⁷ It also has provisions which specifically prohibit insolvent trading.²⁷⁸ It is predicted that the BJR will be useful in this regard. It is vital at this stage to repeat the caution sounded in 5.4 above regarding s76 (4) (a). As observed therein, s76 (4) (a) provides a wider protection to ‘decisions’ made by directors/officers in the exercise of their powers and the performance of their functions. The protection offered

²⁷¹ S 76 (3) (a) of the Act.

²⁷² Cassim *Contemporary Company Law* 566.

²⁷³ See ss 44,45,46 & 48 of the Act.

²⁷⁴ See s113 (1) where the Act requires that the requirement of solvency and liquidity test should be satisfied following the merger.

²⁷⁵ Farrar (2011) *SAC LJ* 761.

²⁷⁶ See Branson (2011) *SAC LJ* 707-709.

²⁷⁷ S4 of the Act.

²⁷⁸ See s22 (1) (b) of the Act.

extends beyond the traditional business judgments associated with directors' common law and statutory duty of care. This explains why the scope of application of s76 (4) (a) is wide.

5.4.4 The BJR provisions- Highlighting the positives

Despite the gaps and challenges identified above, the South African version of the BJR has some commendable features. For example, the BJR as a standard of liability or review goes a long way in promoting the objectives of the Act. The purposes of the Act which include the promotion of entrepreneurship and enterprise efficiency²⁷⁹ as well as the need to encourage high standards of corporate governance²⁸⁰ find expression and meaning through the BJR provisions. The BJR provisions in s76 (4) (a) seek to achieve this by promoting the integrity of decision-making through ensuring that directors are accountable for the exercise of their statutory and common law powers. The BJR also encourages informed risk taking, without unnecessarily discouraging the spirit of enterprise, and without stifling innovation, entrepreneurial activities and growth of local companies.²⁸¹

The BJR in South Africa can be interpreted and applied to serve as a fulcrum to solve the long-standing tension in corporate law between shareholders' interests of profit maximisation and directors' freedom to manage companies. Interestingly this forms part of the purposes of the Act. In this regard the Act aims to 'balance the rights and obligations of shareholders and directors within companies'.²⁸² How do the BJR provisions in s76(4)(a) propose to achieve this? Importantly, subsections 76(4)(a)(i)-(iii) provide for requirements which must be met by directors if their business decision is to be protected against liability claims for breaching standards contained in subsections 76(3)(b) and (c). Directors are held accountable for breach of their affirmative duties under the Act.²⁸³

Section 76(4)(a) can be read to be more stringent than the USA BJR version. For example, in the USA, a director and his/her decisions are protected from legal attack if inter alia, the director and his/her colleagues, in making a business decision, 'exercised some (not necessarily reasonable) care in informing themselves about the matter decided'.²⁸⁴ The South African BJR adopts a tightened approach, and requires that a director, whose conduct

²⁷⁹ See s7 (b) (i) of the Act.

²⁸⁰ See s7(b) (iii).

²⁸¹ This is possible through ensuring that the bona fide decisions of directors are protected from unnecessary judicial scrutiny, provided that certain requirements listed in s76(4)(a) (i)-(iii) are met, including the fact that any decision taken by the company board is actuated by a legitimate business purpose.

²⁸² S 7(i) of the Act.

²⁸³ See s76 (3) of the Act.

²⁸⁴ See Branson (2011) *SAC LJ* 691.

is under review, should have “taken reasonably diligent steps to become informed about the matter”²⁸⁵ in order for the protection of the rule to apply.

5.5 South African BJR version in practice—a guide to application and administration

The BJR provisions will be applied by directors, attorneys or legal advisors when advising their clients on corporate governance or in a case before the court. Courts will also apply s76 (4)(a) provisions to resolve disputes brought before them. The BJR provisions under the fairly new Act remain untested at this stage. It thus becomes imperative for this Study to predict how the application of the rule will pan out in practice and to ultimately propose a judicial policy towards interpretation of the BJR by courts. This part briefly considers points which are critical to the application and administration of the BJR in South Africa. The first point pertains to the need to understand the BJR legal framework in South Africa. The second issue concerns *locus standi*. The third issue is about who bears the burden of proof when directors’ business decisions are challenged before the courts. The fourth issue deals with the approach to be adopted by the courts – an inquiry into the approach which is decidedly in line with the BJR formulation in s76 (4) (a). In Chapters 6 and 7, this Study points towards the development of a judicial policy for interpretation and application of BJR by South African courts.

5.5.1 Provisions relevant to application of BJR – the legal framework

This work has already alluded to provisions which will be applied in tandem with the BJR provisions in s76(4)(a). This key subsection itself makes reference to obviously relevant provisions pertaining to the standards of conduct which it implicates. Thus a proper understanding of the standards of conduct such as the duty to act in the best interests of the company in s76(3)(b) and the duty of care, skill and diligence in s76(3)(c) is vital. The Act also makes specific reference to s75 as an alternative to the requirement that the director had no material personal financial interest in the subject matter of the decision.²⁸⁶ S75 deals with the requirement that a director makes appropriate and timely disclosures regarding personal financial interests or interests of related persons which he/she is aware of. Of relevance to the BJR, such disclosures become necessary if the personal or familial financial interests will have a bearing or potentially will have a bearing on the matter to be decided at a board meeting.²⁸⁷ The manner of disclosure, the extent, the timing of the disclosure and the fact that

²⁸⁵ See s76 (4) (a) (i) of the Act.

²⁸⁶ See s76 (4) (a) (ii) (aa) of the Act.

²⁸⁷ See s75 (5) of the Act.

the interested director must not take part in business relevant to the subject matter of the meeting are all governed by s75.²⁸⁸

Section 66(1), as constantly alluded to throughout this Study, is a critical part of the provisions relevant to the BJR application in South Africa.²⁸⁹ This section posits the board of directors as the legitimate organ to run the affairs of the company and to make strategic decisions affecting the business of the company. Decision-making is often a risky exercise, and the reality is that even carefully made business choices may result in unintended outcomes.²⁹⁰ It is a known fact that judicial review of decisions made by directors, where the bad results are already known by the trier of the fact, may result in hindsight bias.²⁹¹ Such a situation can be prejudicial to a well-meaning director who acted in good faith. The rationale of the rule is thus to protect company directors and officers from the risks inherent in hindsight reviews of their business decisions. S 66(1) is reminiscent of the policy rationale for one of the USA BJR formulations, namely the Delaware formulation.²⁹² To the extent that the BJR in Delaware exists to protect and promote the full and free exercise of the managerial powers granted to Delaware directors,²⁹³ it is similar to the purpose of the BJR under the Act. Thus s66 (1) recognises directors, and not the court, as experts in deciding on the best course of action when directing the business and affairs of a corporation. Hence the use of the subjective elements of rationality in relation to the director's belief that the decision made was in the best interests of the company.²⁹⁴

The decision regarding what is in the best interests of the company is the directors' to make, and is not necessarily reserved for the court of law.²⁹⁵ As long as some of the requirements of the BJR are objectively met,²⁹⁶ the requirement that the decision is in the best interests of the company is to be protected if made on a rational basis. This is so in order to protect and promote the full and free exercise of managerial powers by directors. In light of

²⁸⁸ See s 75(5) (a) - (g).

²⁸⁹ S66(1) provides as follows:

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

²⁹⁰ See Bainbridge (2004) *Vand. L. Rev* 113-114.

²⁹¹ See McMillan (2013) *Wm. & Mary Bus. L. Rev* 535. Also see Jolls (1998) *Stan. L. Rev* 1523-1527.

²⁹² Under Delaware law, the BJR is the offspring of the fundamental principle, codified in [Delaware General Corporation Law] § 141 (a), that the business and affairs of a Delaware corporation are managed by its board of directors. Clearly ss66(1) was influenced by USA law.

²⁹³ See *Smith v Van Gorkom*, 488 A. 2d 858, 872 (Del. 1985).

²⁹⁴ See part 5.4.2 (iv) above.

²⁹⁵ Courts only have the power of judicial review in light of the requirements set in s76(4)(a)(i)-(iii).

²⁹⁶ That is informed decision-making and absence of disabling conflict of interests. See s76(4)(a)(i) & (ii) respectively.

the above expose, an attorney, a director or even a court of law needs to understand the full implications of s66(1) and its relationship with s76(4)(a) before applying the BJR provisions.

Provisions relating to interpretation,²⁹⁷ liability²⁹⁸ and enforcement²⁹⁹ of the BJR and standards of care, skill and diligence are more relevant to Chapter 6 of this study, and a more detailed discussion is reserved for that chapter.

5.5.2 BJR in practice in SA: form, burden of proof & an approach in line with s76(4) (a)

South African courts will have to establish which approach towards the application of the BJR in a case-situation is in line with s76(4)(a) of the Act. This implicates a good number of preliminary issues which need to be established first. In this regard it matters to establish first, the form to be followed by the BJR proceedings. Another important consideration in this connection is the question regarding who has *locus standi* (legal standing) to challenge directors' business decisions before the courts. This matter is more relevant to the question of enforcement mechanisms relating to the BJR and the duty of care, skill and diligence and is reserved for Chapter 6. Thirdly the question regarding who bears the onus/burden of proof in such circumstances also needs to be settled.

The BJR is applied whenever a question is raised regarding the exercise of powers or performance of the functions of a director.³⁰⁰ Section 76(4) (a) commences by stating that a director would have satisfied his/her duties to act in the best interests of the company and the duty of care, skill and diligence, if that particular director satisfies the BJR requirements listed in s 76(4)(a)(i)-(iii). The phrasing of s76(4)(a) is critical to interpretation and application. Thus, whenever it is alleged that the statutory duties in subsections 76(3) (b) and (c) have been violated, preliminary inquiries in line with the BJR provisions must be made. Doctrinally the primary focal point (in s76(4)(a)) in judicially analysing director conduct has to be on standards of conduct in form of relevant directors' statutory duties. South African courts, when analysing director performance should avoid the error of according analytical pre-eminence to the rule. In the USA, this doctrinal error has unfortunately led to a diminished emphasis on directors' duties such as the duty of care, which is critical to corporate governance.³⁰¹ In any event, in terms of s76(4)(a) the grounds for a court to impose

²⁹⁷ See ss5, 7, and 158 of the Act for e.g.

²⁹⁸ See s77 of the Act.

²⁹⁹ See Chapter 7 of the Act, especially s 156.

³⁰⁰ See ss76(3)(b) & (c).

³⁰¹ See Johnson (2013) *Del. J. Corp. L* 424-427.

liability on a director or for overturning a board's decision is proof by a plaintiff of a director's violation of a duty in either s76(3)(b) or (c) or both.

The question regarding who bears the burden of proof in the application of the BJR in South Africa is an important one. It should be answered by paying careful attention to the language used in s76(4)(a). That subsection provides that a director 'will have satisfied the obligations of subsection 76 (3) (b) and (c)' if the director has fulfilled the requirements of the BJR in 76(4) (a) (i)-(iii) as highlighted above. Thus the BJR becomes a statutory defence to be raised by directors who are facing litigation where allegations of breach of s76 (3) (b) and (c) duties are made against them. S76 (4) (a), unlike the Delaware BJR formulation, is not exactly framed as a presumption.³⁰² The South African version of the BJR should rather be seen as a defence available to a director facing claims of negligence and breach of duty to act in the company's best interests. If the BJR is to be construed as a defence available to the director, then it follows logically that the director should bear the onus to prove the existence of one or all of the requirements of the BJR under the Act.³⁰³ Once the director has satisfied the existence of the BJR requirements, then the rule attaches to protect the director against allegations of violating s76 (3) (b) and (c). Once the BJR requirements have been satisfied, the director escapes into an 'impregnable safe harbour'³⁰⁴ and is protected against a full-blown trial pertaining to claims of breaching the said director's duties. In this approach, once the accused director meets the burden of proof, the matter is closed and it will not proceed to full trial.

The South African BJR provision, s76 (4) (a) shares similarities with Australia's s180 (2) and the ALI Draft,³⁰⁵ both of which are safe harbour provisions. The nature of safe harbour provisions or statutory defences to liability claims is that they impose on directors the onus of establishing the presence of the rule's elements.³⁰⁶ In a recent Australian case, *ASIC v Rich*, Austin J ruled that directors should bear the onus to establish the preconditions in order to access the s180 (2) defence against duty of care claims.³⁰⁷ The court gave important reasons for clarifying the position regarding who bears the onus of proof in this regard. Of

³⁰² The Delaware formulation is 'a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith, and in the honest belief that the action taken was in the best interests of the company'. See *Aronson v Lewis* 473 A 2d 805 at 812 (Del, 1984).

³⁰³ See s76(4)(a)(i)-(iii).

³⁰⁴ See Branson (2011) *SAC LJ* 692.

³⁰⁵ With some few differences as already highlighted. For example, while the Ali Draft does not require that a director must have exercised some reasonable care to be informed of the subject matter of the decision-making process, s76 (4) (a) (i) requires exactly that – that a director takes reasonably diligent steps to become informed.

³⁰⁶ See Branson (2011) *SAC LJ* 692.

³⁰⁷ *ASIC v Rich* (supra) at 7269.

relevance to South Africa are two reasons. The first one is that since the preconditions³⁰⁸ are matters within the knowledge or reach of the director as a business manager, it was appropriate or even fair to require directors/officers to provide evidence of compliance with requirements.³⁰⁹ This onus of proof has positive implications for corporate governance. For example, this will build a culture where managers or directors will need to maintain accurate records to support the adequacy of the processes followed to arrive at particular business decisions. In the long run, this culture, it is hoped, will enhance the integrity of corporate decision-making processes. The second reason put forward by Austin J is that imposing the onus on directors was compatible with policy rationale of encouraging managers to engage in responsible risk-taking.³¹⁰

If the BJR under s76(4)(a) had been framed as or if ever it is to be interpreted to amount to a presumption of good faith in favour of the director, then the burden of proof would fall on the one who is challenging a board's decision. Thus, a plaintiff challenging a board decision, for example, has the burden at the outset to rebut the rule's presumption. To rebut the rule, a plaintiff assumes the burden of providing evidence that directors, in reaching their challenged decision, breached subsections 76(3)(b) and (c). Evidence would have to be adduced that the decision made was not an informed decision,³¹¹ that there was a presence of disabling conflict of interests³¹² and that the decision was not in the best interests of the company.³¹³ Under this approach, if a shareholder plaintiff fails to meet this evidentiary burden, the BJR applies to protect directors including corporate officers, and the decision they made. If the rule is rebutted, the burden shifts to the defendant directors who should prove before the court or trial judge the 'entire fairness' of the transaction to the shareholder plaintiff.³¹⁴

There is a risk or disadvantage associated with the 'presumption' approach especially in the USA. Presumptions can be upset, with the implication that directors will have to go through the ordeal of a full-trial in an attempt to vindicate their decision.³¹⁵

³⁰⁸ That, is the elements of the defences provided e.g. in Australia's s180 (2) (a) – (d) or SA's s76 (4) (a) (i) – (iii) of the Act.

³⁰⁹ See *ASIC v Rich* (supra) at 7270..

³¹⁰ Ibid.

³¹¹ That is, that the decision does not satisfy the requirements of s76(3)(c) of the Act.

³¹² See s76(4)(a)(ii)(aa)-(bb) of the Act.

³¹³ See s76(3)(b) of the Act.

³¹⁴ This is the approach which was followed by a Delaware court in the famous case of *Cede & Co. v Technicolor, Inc* supra at 361.

³¹⁵ See Branson (2011) *SAC LJ* 692.

I have already made an observation in this part that s76 (4) (a) is not framed as a presumption in favour of a director. The subsection could be termed ‘safe-harbour’ provisions in the mould of the ALI Draft or the statutory defence of s180 (2) of the Australian Corporations Act. Thus at the outset of the hearing, say into liability claims against a director for breach of s76 (3) (b) or (c), the defendant director may bear the onus to establish preconditions in s76 (4) (a) (i) –(iii) in order to access protection of his/her decision permissible under s76 (4) (a).

5.6 CONCLUSION

The purpose of this chapter was stated as being to analyse the BJR provisions in s76(4)(a) of the Act in light of international experiences and the purposes of law reform and the Act.³¹⁶ Three interconnected aspects had to be established, namely, the scope and content of the South African version of the BJR, and secondly, its implications on the relationship between a fiduciary duty and the duty of care. The corollary to this was an inquiry into whether the co-existence of a fiduciary duty and duty of care under the BJR could lead to a conflation of the duties³¹⁷ with the concomitant consequence of diluting the effectiveness of standards of conduct. Thirdly, this chapter sought to establish whether the BJR provisions have potential to enhance corporate governance by providing a mechanism to balance interests of shareholders and the directors’ freedom to manage companies as required by s66(1).

With regards to the scope and content of the BJR under s76(4)(a), this work has clarified what the South African BJR version is and what it is not. The BJR requirements³¹⁸ compare favourably with formulations from international best practice jurisdictions. It has been established that the BJR in s76(4)(a) is a standard of review and not necessarily a standard of conduct.³¹⁹ As a standard of review, the BJR provides a test to be applied when reviewing a director’s conduct. It is applied in order to determine whether to impose personal liability or not to a director who faces claims of breaching duties in s76(3)(b) and (c). Therefore, as argued in this work, the BJR is wrongly classified as a standard of conduct, and the title of s76 should thus be amended to read ‘Standards of conduct and review’. With

³¹⁶ See part 5.1 above.

³¹⁷ See part 5.3.2 above.

³¹⁸ Analysed in part 5.4.2 above.

³¹⁹ See part 5.4.1 above.

regards to scope, it has been established that there appears not to be any limitation as to the scope of application of the BJR under s76(4)(a).³²⁰

Part 5.4.3 identified several gaps in the BJR formulation in s76(4)(a) and that pointed towards possible amendments and an appropriate judicial policy to interpretation which is properly aligned to the purposes of the Act.. For example, the omission of the ‘good faith’ requirements from the BJR formulation in s76(4)(a) and the fact that the scope of the BJR has not been made crystal clear require reconsideration by the legislature.

Despite the challenges highlighted above, South Africa has a BJR formulation which incorporates international best practice standards. The BJR in s76 (4) (a) has great potential to enhance corporate governance in several ways as highlighted in 5.4.4 above. There is an effective BJR legal framework in place aligned to the purposes of the Act which can be interpreted to encourage informed risk-taking without unnecessarily stifling innovation and enterprise efficiency.

The BJR provisions in s76 (4) (a) are a fulcrum for balancing the usually competing interests of shareholders’ profit maximisation drive and directors’ need for freedom to manage. This is achieved through ensuring that the board of directors’ position as the legitimate organ to direct the affairs of the company is statutorily secured in terms of s66 (1). Directors’ freedom to manage companies is as of necessity counterbalanced by the need for them to be accountable for the exercise of the powers accorded to them in terms of law. It is also important that the Act also gives shareholders the right to challenge directors’ business decisions, including instances of indecision.³²¹

³²⁰ With the concomitant implication that BJR could potentially apply to all aspects of decision-making involving company directors and officers.

³²¹ See derivative actions permitted by s165 (2).

CHAPTER 6: LIABILITY, INTERPRETATION & ENFORCEMENT OF STANDARDS UNDER THE COMPANIES ACT 2008

6.1 INTRODUCTION

This Study has hitherto analysed standards of care, skill and diligence in Chapter 4 and juxtaposed the same with the standards of review (that is the BJR) as analysed in Chapter 5. For these standards of conduct and review to be effective, they should be capable of application and enforcement. There is little point in formulating appropriate standards if such standards cannot be used as a means to improve directorial competence or if they cannot be made effective in order to enhance corporate governance generally.¹ There are preconditions and/or correlatives for effective enforcement of standards. Apart from the need for clarity of standards,² enforcement demands knowledge of consequences of breach of the standards of behaviour,³ hence the basis of liability forms part of this Chapter. Enforcement also demands, as a pre-condition, a clear and effective legal framework for interpreting the empowering provisions of relevant legislation and related common law principles. There is also a need to identify enforcement mechanisms in the form of potential enforcers or those persons accorded *locus standi*⁴ by the Act to enforce standards.

To this end, this chapter will focus on three correlatives, namely enforcement mechanisms for standards of conduct, the interpretation legal framework and the basis of liability for breach of standards.

Where company directors fail to meet the standards of care, skill and diligence, they will be liable for breaching their duties in terms of common law as now subsumed by the Act.⁵ Directors, when exercising their powers and when fulfilling their functions in terms of common law and the Act,⁶ are expected to meet the requisite standards of conduct.⁷ This Chapter will partly analyse the legal basis for liability in South Africa for breach of directorial standards of care, skill and diligence, including added instances of liability under the Act.

The standards in subsections 76(3)(c) and 76(4)(a) require legal interpretation for ease of application. Various law users and especially courts of law will have to give meaning and

¹ To this end I agree with a similar view expressed Finch. See Finch (1992) *M.L.R* 179.

² Clarifying standards of conduct and standards of review were the twin goals of Chapters 4 and 5.

³ Finch (1992) *M.L.R* 180.

⁴ Legal standing.

⁵ See s77 (2) (b) (i) of the Act.

⁶ See s76 (3) of the Act.

⁷ See ss76 (3) (c) & 76 (4) (a) of the Act.

clarity to the relevant provisions when dealing with legal challenges. The standards of conduct and review are yet to be tested. As such there is very little case law to analyse in order to establish if courts' interpretation of subsections 76 (3) (b) – (c) and 76(4)(a) is in line with the purposes of the Act. There is now one case, namely, the *Visser* case which has already been referred to in this Chapter 5.⁸ This Study has undertaken to predict how courts are likely to interpret the standards in line with the interpretation matrix provided for under the Act and in tandem with rules of interpretation of statutes under South African law. A judicial policy towards interpretation will be suggested, and this will naturally form part of the recommendations of this Study.⁹

With regard to enforcement mechanisms, this Chapter attempts to identify possible enforcers of the standards established in Chapters 4 and 5. Focus will also be on *locus standi* as provided for in the Act, and how effective enforcement can enhance corporate governance in South Africa.

It is important to note that while this chapter may adopt more of a narrative approach; it lays a foundation for a proposal or a prediction of the future judicial approach or policy towards interpretation of standards of conduct and review under the Act.

6.2 Liability of directors and other company officers under the Act

The liability of directors and prescribed officers is discussed with the understanding that this work focuses on standards of care, skill and diligence and the BJR. As demonstrated in Chapter 5, the BJR also entails in its scope a fiduciary duty component.¹⁰ To that extent, where the BJR is ruled to be inapplicable by the court following a challenge of the board's decision, which challenge is predicated upon breach of a fiduciary duty, liability for breaching a fiduciary duty is thus implicated. Therefore, while the main focus will be on liability for breach of standards of care, skill and diligence, reference will also be made to the basis of liability for breach of a fiduciary duty.

It is also vital to point to the legal provisions relevant to matters of liability under the Act, and implications of the language employed in the different provisions. It is clear from the reading of the Act that instances of directors' personal liability have been broadened beyond common law. The consequences or implications of such a wider ambit is that

⁸ See 5.4.2 above.

⁹ See Chapter 7 below.

¹⁰ See s76 (4) (a) (ii) & (iii) which entail such fiduciary duties as conflict of interests and duty to act in the best interests of the company respectively.

directors will find themselves potentially liable not only to the company, but to shareholders and any other person who is now permitted by law to enforce a legitimate right.¹¹

The main provision on director liability is s77, which generally provides a basis of liability of directors and prescribed officers. The ambit of who can be liable for breach of directors' duties under this section has been widened. Liability now attaches to members of the audit committee, alternate directors, any member of a committee of the board, regardless whether such persons are members of the board.¹²

In terms of s218 (2), any person who contravenes any provision of the Act is liable to 'any person' who has suffered an injury or loss as a result of such contravention. The ambit of s218 (2) is so wide that it can be applied to any person who contravenes the Act. Attention should be drawn to the use of the phrase 'any person'.¹³ Enforcement of a right following an injury to an interest is, by implication, not only reserved for the company as a separate legal entity and its shareholders. 'Any person' who has suffered loss as a result of contravention of any provision of the Act can sue for damages as permitted by s218 (2). This provision is to be juxtaposed with s20 (6), which is a right only reserved for and to be enforced by shareholders, and is relevant to either a breach of a duty of care or a fiduciary duty.¹⁴

6.2.1 Bases of liability for breach of the duty of care, skill and diligence

(i) Common law basis as subsumed by the Act

At common law, a director's liability for breach of the duty of care, skill and diligence is based on delict. The most applicable type of delict in this regard is the *Actio Legis Aquilae*. In terms of this delict, damages are claimed for the wrongful and culpable (intentional or negligent) causing of patrimonial loss. Proof of the following elements is required; conduct; wrongfulness, fault, loss suffered and causation.¹⁵ This position was confirmed in fairly recent cases. In *Du Plessis NO v Phelps*, for example, Friedman J confirmed the English law

¹¹ See ss218(2) and 165(2) of the Act which will be referred to below.

¹² See the expanded definition of 'director' given for purposes of liability of directors in s 77 (1) (a) – (b) of the Act.

¹³ S 218 (2) provides that 'any person who contravenes any provision of this Act is liable to any other person for loss or damage suffered by that person as a result of the contravention'.

¹⁴ S 20 (6) reads as follows:

'Each shareholder of a company has a claim for damages against any person who intentionally fraudulently or due to gross negligence causes the company to do anything inconsistent with –

(a) this Act; or

(b) a limitation, restriction or qualification contemplated in this section, unless that action has been ratified by the shareholders in terms of subsection (2).'

¹⁵ See J Neethling, JM Potgieter & PJ Visser *Law of Delict* 6 ed (2010) 4. Also see N Bouwman 'An Appraisal of the Modification of the Director's Duty of Care, Skill and Diligence' (2009) 21 *SA Merc L.J* 510.

derivative principle regarding liability for breach of duty of care as based on delict.¹⁶ Where there is a contract between a director and the company, liability is based on breach of contract.¹⁷ The company can recover damages flowing from either the intentional or negligent conduct of the director.¹⁸

The common law position has now been subsumed under s77 (2) (b) of the Act. This subsection provides that a director may be held liable in accordance with the principles of the common law relating to delict for any loss, damages or costs sustained by the company as a consequence of any breach by the director of the duty of care, skill and diligence.¹⁹ It has to be noted that in terms of the common law bases of liability of directors under s77(2) (a) and (b), the company is the primary enforcer of affected interests. The director may also be held liable for breach of any other provisions of the Act such as s218(2) and s20(6) as discussed above, or any provision of the Memorandum of Incorporation (hereafter MOI).²⁰ As such, it is not only the company that has legal standing to seek redress for injury to any of its interests. The common law right of any person to bring proceedings on behalf of the company has been abolished. However, a statutory derivative action now provides for expanded legal standing to compel the company to commence and continue legal proceedings or take related steps in order to protect the company's interests. Moreover, stakeholders have also been given wide-ranging personal remedies in terms of provisions such as s 218(2) and s 20(6).²¹ This has been made possible by s165 which provides for expanded legal standing to allow stakeholders or interested persons to compel the company to commence, continue legal proceedings or take related steps in order to protect the company's legal interests.²²

(ii) Other statutory bases of liability for breach of standards of care under the Act

Subsection 77 (3) provides an expansive list of instances when a company may recover losses, damages or costs arising from a director's failure to meet the required standard of conduct when exercising his/her powers and performing functions set out in the law.²³ This is in addition to the common law basis of liability for breaching directors'

¹⁶ (1995) (4) SA 165 (C) at 170.

¹⁷ See HS Cilliers, ML Benade, JJ Henning, JJ du Plessis, PA Delpont, L de Koker & JT Pretorius *Corporate Law* 3 ed (2000) at 148.

¹⁸ Bouwman (2009) *SA Merc LJ* 510.

¹⁹ See s77 (b) (i) of the Act.

²⁰ See s77 (b) (ii)- (iii) of the Act.

²¹ See *Rabinowitz v Van Graan and Others* (2012/26217) [2013] ZAGPJHC 151; 2013 (5) SA 315 (GSJ) (26 April 2013) for application of s218 (2) of the Act.

²² See s165 (2)(a) – (d) of the Act.

²³ See s76(3) of the Act.

duties.²⁴ The statutory bases of director's personal liability for breach of statutory duties are in line with the scheme of the Act.

The bases of a director's liability to the company for injury suffered to its interests, listed in s77(3)(a)- (e) in some instances combine consequences for violations of both a fiduciary duty and a duty of care, skill and diligence. Where this happens, it does not necessarily imply that the legislature deliberately intended to conflate the duties.²⁵ This simply shows that there are situations which reveal breach of both classes of directors' duties. This is evident in the many instances provided for under s77(3) circumstances listed from (a) to (e). These are instances where a company may recover loss, damages or costs as a direct or indirect consequence of a director's actions which fall short of specific standards set out in the Act.

6.2.2 Liability for breach of a fiduciary duty

For the reason that this Study has considered the BJR, a brief consideration of the basis of liability for breach of a fiduciary duty is necessary. If a defendant director fails in his/her defence against claims that a board decision was not in the best interests of the company, then the matter has to proceed to a full trial.²⁶ Where it is alleged that in coming to a decision, a director failed to satisfy one of the requirements for raising the BJR as a statutory defence, namely requirement of s76 (3) (b), then the director will face liability claims for breach of a fiduciary duty.

It is important to note that the Act has broadened instances of director liability²⁷ in as much as it has broadened the fiduciary duties of directors.

As similarly indicated in part 6.2.1 above, the Act now confirms the common law basis of liability for breach of a fiduciary duty. In this regard s 77(2) (a) provides that a director is liable in accordance with the principles of the common law relating to breach of a fiduciary duty, for any loss, damages or costs sustained by the company. The injury suffered by the company, which gives the company *locus standi* to enforce its rights against the miscreant director, must arise from breach of duties contemplated in s76 (2), s76 (3) (a)-(b)²⁸

²⁴ See confirmation of this in s77 (2) (b).

²⁵ See part 5.3.2 under Chapter 5 for a discussion of the debate against inclusion of the BJR. One of the reasons raised by critics against inclusion of BJR in the Act was fear that it would result in the blurring of the distinction between a fiduciary duty and the duty of care. It has since been argued in this work that these fears are unfounded.

²⁶ See part 5.5 under Chapter 5 above.

²⁷ See s77 (3) of the Act as discussed above.

²⁸ The duty to act in good faith and for a proper purpose and duty to act in the best interests of the company respectively.

or s75.²⁹ It appears that the company is the proper plaintiff in case of loss, damages or costs suffered as a result of breach of the above-stated fiduciary duties. The corollary of this is that the director who is guilty of breach of such duties is liable to the company only and not to any other person. This position is distinguishable from the situation envisaged in s218(2) as noted in 6.2 above. Should any stakeholder desire to seek redress in respect of corporate wrongs arising from breach of any of subsections 75, 76 (2) and 76(3) (a) – (b), this is only possible through derivative action,³⁰ but not personal action. This is the legal implication of s77 (2) (a).³¹

6.3 Interpretation of s76 standards of conduct and review – the legal framework

The Act only became operational in May 2011. S 76 remains untested at this stage. To the knowledge of the writer very little case law has developed... Interpretation of provisions will play a key role in clarifying meaning.

. In Chapters 5 and 6, this Study promised a discussion of an interpretation that is aligned to the purposes of the Act. The task here is to clarify the method of interpretation adopted in this Study. This Study points towards the judicial policy for interpreting standards which South African courts are likely to follow when dealing with relevant cases in future. It is argued in this part that interpretation of provisions of the Act must not only be aligned to the purposes of the Act. Interpretation should be contextual in the widest sense, and it must also be in sync with the normative value-laden constitutional framework given expression through objectives set in s39 (2) of the Constitution of South Africa. It should also be harmonised with international standards.

6.3.1 Relevant provisions for interpreting standards

The Act has provisions relevant to the interpretation of standards of conduct and review. "Section 5(1), which concerns the "General interpretation of the Act" requires that the Act must be interpreted with reference to its purposes. Those purposes are set out in s7. Even though Chapter 7 of the Act³² is relevant to enforcement of standards (to be discussed in 6.4 below), a part of the chapter, that is, s158 which is entitled 'Remedies to promote purposes of

²⁹ S 75 provides for the requirements of disclosure of a director's (or any person who can be presumed to be a director in terms of s75 (1) (a)) personal financial interests. S 75 provides for directors' standards of conduct, despite the fact that ss75 (3)-(4) are not couched in peremptory terms unlike ss75 (5) - (6), and also despite the fact that s75 is not classified under standards of directors' conduct in s76.

³⁰ In terms of s165(2) of the Act.

³¹ See a similar view expressed in Cassim et al *Contemporary Company Law* at 584.

³² Entitled 'Remedies and Enforcement'. See the *Company Legislation Handbook* 6 ed (2014) p168, published by LexisNexis.

the Act³³ is relevant to interpretation too. It provides guidance on what courts must do or consider when determining matters brought before them by litigants in terms of the Act.

(i) A purposive/contextual interpretation is envisaged by the Act

Section 5 provides for interpretation of provisions of the Act to take place *ex visceribus actus* (from the bowels of the Act) or as part of the more encompassing legislative instrument in which it has been included.³⁴ S 5(1) in this regard states that the Act ‘must be interpreted and applied in a manner that gives effect to the purposes set out in section 7’.³⁵ This is a text-in-context approach or a purposive approach distinguishable from the time-honoured and now outdated orthodox text-based/literal approach to statutory interpretation.³⁶ In terms of the contextual approach, a statutory provision is viewed through the lens of the purpose of the legislation (the entire legislative scheme), and should not be construed on its own.³⁷ The purposes or objects of the legislation are paramount considerations in the process of constructing meaning of statutory provisions. Thus the provisions of the Act at the centre of this study, viz, subsections 76(3)(c) and 76(4)(a) should not be interpreted in isolation, but in the context of the entire Act, as guided by the objects of the Act.³⁸

It is also vital to note that ‘context’ is so elastic a concept that it demands a holistic approach to the task of constructing meaning of a statutory provision. The dictum of Schreiner JA in *Jaga v Donges NO and Another; Bhana Donges NO and Another* is instructive in this regard. The court remarked that context is ‘not limited to the language of the rest of the statute regarded as throwing light of a dictionary kind on the part to be interpreted. Often of more importance is the matter of the statute, its apparent scope and purpose, and, within limits, its background’.³⁹ It is for this reason that when interpreting the subsections under review in this Study, the courts will be required to look beyond words, phrases or definitions within these provisions. Regard should also be had to the following

³³ Ibid at 169.

³⁴ The term ‘the bowels of the Act’ is an expression used by de Ville. See JR de Ville *Constitutional and Statutory Interpretation* (2000) at 142.

³⁵ Discussed in part 4.2.3 of Chapter 4.

³⁶ In terms of the text-based approach, the interpreter concentrates on the literal meaning of the provision to be interpreted. The primary rule is that if the meaning of the text is clear, such a plain meaning should be applied and it is equated with the intention of the legislature - as remarked by the court in *Principal Immigration Officer v Hawabu* 1936 AD 26. In terms of the golden rule, courts can only deviate from this where there is ambiguity in words. For more, see C Botha *Statutory Interpretation: An Introduction for Students* 5 ed (2013) at 91.

³⁷ De Ville *Constitutional and Statutory Interpretation* 142. Also see Botha *Statutory Interpretation* 97.

³⁸ As set out in s7 (a) – (l) of the Act.

³⁹ 1950 (4) SA 653 (A) 662.

important considerations: the history of the legislation;⁴⁰ the common law prior to the enactment of the Act; law reform or policy objectives;⁴¹ defects in the law not provided for by the common law;⁴² new remedies provided by the legislature and motivations for such remedies.

A consideration of most of these factors is necessary were a court of law to arrive at the ‘mischief’ that the legislature intended to deal with when enacting a particular statute. Here we encounter the ‘mischief rule’. In terms of one of the common law presumptions of statutory interpretation, the legislature does not intend to enact invalid or purposeless provisions.⁴³ In order to ascertain the ‘mischief’ intended to be cured by a piece of legislation, it is thus unavoidable to view a provision which requires interpretation in the light of its contextual environment. In this construction, not only are the purposes of the Act in s7 critical, but also what Botha refers to as the ‘intra-textual and extra-textual factors’⁴⁴ which must be ‘accommodated in the continuing time-frame within which legislation operates’.⁴⁵ This is particularly important when interpreting subsections 76(3)(c) and 76(4)(a) of the Act. Both subsections contain critical innovations in the Act, namely codification of the common law duty of care and adoption for the first time ever of a US-style BJR.

When interpreting these provisions to establish their purpose and the mischief intended to be cured, the courts will have to apply a holistic approach to statutory interpretation.⁴⁶ This means that the courts will as of necessity, have to consider overarching constitutional values, international experiences in the interest of the future development of corporate governance standards in South Africa. Legislation is forward looking and not back-ward looking and interpretation should take this into account.

(ii) A court’s role to harmonise the Act with relevant international experiences

Section 5 provides that ‘to the extent appropriate, a court interpreting or applying this Act may consider foreign company law’.⁴⁷ The exact scope of the phrase ‘foreign company

⁴⁰ That is background to the Act, which may include the debates prior to the enactment of the legislation. See part 5.3.2 of Chapter 5 for the relevant debate prior to the Act.

⁴¹ Chapter 4 of this study discusses the policy objectives for law reform in part 4.2.3 as alluded to above.

⁴² Deficiency in the common law or existing statute is usually a strong motivation for law reform.

⁴³ According to de Ville, this presumption is also referred to as ‘the presumption against redundancy’. See *Dorbyl Vehicle Trading & Finance Co (Pty) Ltd v Klopper* 1996 (2) SA 237 (N) 241, referred to in de Ville *Constitutional and Statutory Interpretation* 167.

⁴⁴ This refers to inside the statute’s text and factors which lie outside and beyond the text.

⁴⁵ Botha *Statutory Interpretation* 98.

⁴⁶ A purposive approach will not only be resorted to in a case where a literal approach has failed.

⁴⁷ S 5(2) of the Act.

law' may not be crystal clear. It should nonetheless be construed to include relevant foreign case law. It also includes reference to the persuasive value of foreign legislation .

The purpose of s5 (2) is to bring an international contextual dimension to interpretation of provisions of the Act. It stretches beyond the national context, background of the Act or its objects – that is, the international experiences relevant to development of jurisprudence in South Africa. This facilitates the comparative aspect in statutory interpretation. Hitherto, this Study has considered international best practices in Chapter 3. South African standards of conduct and review have been compared with standards in Australia, the UK and USA. A point was made in Chapter 3 that given similarities between standards of care in South Africa and Australia, South African courts may be able to draw some lessons from recently decided Australian cases on duty of care and diligence, as well as on BJR.⁴⁸

Even though s5 (2) is not couched in peremptory terms,⁴⁹ it can be interpreted to give effect to one of the policy objectives for law reform, and indirectly, part of the objects of the Act. The relevant policy objective, as discussed in Chapter 4, is the objective of harmonisation of South African corporate law with the best practice jurisdictions internationally.⁵⁰ This policy goal can be linked to one of the purposes of the Act, namely 'to continue to provide for the creation and use of companies in a manner that enhances the economic welfare of South Africa as a partner within the global economy'.⁵¹

(iii) Important considerations for courts when applying standards in s76

Section 158 is an important provision for statutory interpretation of standards in two critical ways. The first is the promotion of the spirit, purport and objects of the Act. The second one is courts' duty to develop common law beyond precedent.

Section 158 requires that whenever a court or any other forum applies standards to resolve a case before it, it must do so in a manner that best promotes the spirit, purport and objects of the Act.⁵² This ties in well with the purposive approach provided for by the Act in s5 (1) as discussed above. It is noteworthy that the Act borrowed the phrase 'the spirit,

⁴⁸ See part 3.3 of Chapter 3 in this regard.

⁴⁹ Note the use of the optional word 'may' instead of the peremptory word 'must' in s5 (2).

⁵⁰ See part 4.2.3 of Chapter 4 of this study.

⁵¹ See one of the purposes of the Act listed in s7(e).

⁵² See s158 (b) of the Act.

purpose and objects’⁵³ from the interpretation clause in the Constitution.⁵⁴ This is just one of the numerous examples of how the legislature sought to align provisions of the Act with the normative framework of values under the Constitution.⁵⁵

The second issue is the obligation of the courts to develop common law whenever it is clear to the court that the law is deficient to meet arising needs or new situations in the commercial world.⁵⁶ Subsection 158(a) is couched in peremptory words, and provides that:

When determining a matter brought before it in terms of this Act, or making an order contemplated in this Act –

(a) a court must develop the common law as necessary to improve the realisation and enjoyment of rights established by this Act.⁵⁷

It can be argued that in terms of s158 (a), the duty of the court to develop the common law of company law is obligatory, and not optional. It may not even be necessary to derive this obligation in terms of s39 (2) of the Constitution. The broad thrust of the Act also leads to the conclusion that a court has a mandate to develop the common law. The value judgment must obviously be made by the court as the situation demands. While a court will have room to exercise discretion, there shall arise situations when this duty to develop the common law is obligatory, giving the court little leeway to opt out.

The effect or rather implications of these two subsections is that the judiciary’s inherent law-making discretion during statutory interpretation of provisions of the Act is recognised by the Act. The courts may tweak or adapt the language and meaning of the text in order to align it with the purposes of the legislation.⁵⁸ The first option in this regard is provided in s158 (b) (ii). In terms of this subsection, where a statute is capable of two meanings, the court ‘must prefer the meaning that best promotes the objects of the Act’.

6.3.2 Teleological interpretation–Impact of the Constitution’s normative framework

A teleological interpretation implies that the Constitution of the Republic, which is the supreme law of the land, provides a normative value system (or the context) against which all law, all actions, including decision-making processes are evaluated and measured.⁵⁹

⁵³ As employed in s158 (b) (ii).

⁵⁴ S 39(2) of the Constitution of the Republic of South Africa, which will be discussed in 6.3.2 below.

⁵⁵ The first such sign of alignment with the enduring principles contained in the Bill of Rights is to be seen in the purposes of the Act. S 7 (a) provides that the Act must ‘promote compliance with the Bill of Rights as provided for in the Constitution, in the application of company law’.

⁵⁶ See s158 (a) of the Act.

⁵⁷ The underlining of the word ‘must’ is my own for purposes of emphasis only.

⁵⁸ Botha *Statutory Interpretation* 99.

⁵⁹ *Ibid* at 108.

There is authority in case law for the assertion that the adjudication and interpretation of any statutes in South Africa must be done ‘through the prism of the Bill of Rights’ (hereafter, BOR).⁶⁰

A combination of constitutional provisions demonstrates why the Constitution provides overarching values and a broader context to guide interpretation of statutes. In terms of s2, ‘the constitution is supreme law...law or conduct inconsistent with it is invalid...’ This provision is supported by sections 7, 8(1) and 8(2). S 7 provides that the BOR is the cornerstone of democracy in South Africa and that the state is required to respect, protect, promote and fulfil the rights contained therein. In terms of s8 (1), the BOR applies to all law and binds the legislature, the executive, the judiciary and all organs of the state. The BOR, according to s8 (2) applies to bind natural persons as well as juristic persons such as corporations. Finally, the Constitution provides the interpretation clause (*viz*, s39 (2)), applicable to the interpretation of all legislation in South Africa since the advent of the constitutional era. All these relevant constitutional values collectively posit the BOR as the very embodiment of the value system against which the adjudication process and interpretation of statutes is to be evaluated. They find expression through s39 (2).

6.3.2.1 The interpretation clause s39 (2) – ‘the spirit, purport and objects’ of the BOR

The Constitution is said to have changed the ‘context’ of all legal thought and decision-making in South Africa.⁶¹ It has done this through a very key provision which now guides all statutory interpretation in South Africa – the interpretation clause in s39 (2). This clause contains fundamental values to interpretation of legislation and provides as follows:

When interpreting any legislation, and when developing the common law or customary law, every court, tribunal or forum must promote the spirit, purport and objects of the Bill of Rights.

Important to note is the fact that s 39(2) provides for interpretation of ‘any legislation’. This means that s39(2)’s scope of application goes beyond the BOR. The interpretation clause applies to all statutory interpretation in South Africa. Section 39(2) thus provides ‘the starting point in interpreting any legislation’, as pointed out by Ngcobo J in *Bato Star Fishing (Pty) Ltd v Minister of Environmental Affairs and Tourism*.⁶² It is further noteworthy that the

⁶⁰ See Langa DP’s remarks in *Investigating Directorate: Serious Offences v Hyundai Motor Distributors (Pty) Ltd: In re Hyundai Motor Distributors (Pty) Ltd v Smit* 2001 (1) SA 545 (CC) at para 21.

⁶¹ See *Holomisa v Argus Newspapers Ltd* 1996 (2) SA 588 (W) 618.

⁶² 2004 (4) SA 490 (CC) paras 72, 80 and 90, quoted in *Botha Statutory Interpretation* 101.

interpretation clause is couched in peremptory terms. Every court, tribunal or forum is obligated to and indeed *must* ‘promote the spirit, purport and objects’ of the BOR during adjudication, when interpreting any legislation or when developing the common law. Whether a provision in a statute appears clear and unambiguous or not, the s39 (2) mandate finds application and must be fulfilled. In terms of s239 of the Constitution, where the BOR imposes a mandate, such a constitutional obligation must be performed diligently, timeously and without fail. This mandate is directed to ‘every court, tribunal or forum’⁶³ tasked with ‘determining a matter brought before it in terms of this Act’.⁶⁴

While the Act provides its own ‘General interpretation of Act’ provision,⁶⁵ this legislative scheme or context is not the be-all-end-all of interpretation of provisions of the Act. It has been persuasively argued that the ‘spirit, purport and objects of the Bill of Rights’⁶⁶ must be the starting point of all statutory interpretation in South Africa.⁶⁷ What does the phrase ‘spirit, purport and objects’ of the BOR mean exactly? Fully unpacking the scope of the phrase is beyond the scope of this Study. Suffice it to say though for purposes of this part, that this phrase refers to the fundamental values embodied in the BOR, which values must inform every action, legal thought and decision-making in South Africa. These fundamental values are inter alia; values such as freedom, equality, human dignity,⁶⁸ non-racialism and non-sexism.⁶⁹ These are values which underlie ‘an open and democratic society based on freedom, human dignity and equality’.⁷⁰ South Africa has had a chequered past characterised by discrimination, unfair treatment and exclusion of parts of the population from certain services or part of the life of the unconstitutional state of apartheid. The Constitution now contains aspirations to right the wrongs of the past.⁷¹ As such, now every law, conduct and decision making which can potentially affect people’s enjoyment of rights, must pass the constitutional muster.⁷²

Since the spirit, purport and objects of the BOR must be promoted during interpretation of every statute, the courts fulfill a critical role as envisaged by the s 39 (2).

⁶³ Phrase used in s39 (2) of the Constitution.

⁶⁴ Meaning the Companies Act 2008. See s158 of the Act.

⁶⁵ In the form of s5 of the Act.

⁶⁶ See s39 (2) of the Constitution.

⁶⁷ See Botha *Statutory Interpretation* 101.

⁶⁸ See s7 (1) of the Constitution.

⁶⁹ See s1 (b) of the Constitution.

⁷⁰ This phrase was employed in s36 (1) of the Constitution, and was repeated in s39 (1).

⁷¹ In this regard, see the Preamble to the Constitution.

⁷² Impliedly, if a statute is not properly aligned to the normative value-laden framework in s39(2), such a law or conduct based on such a law can be declared by a court of law, a tribunal or any similar forum to be invalid for inconsistency with s2 of the Constitution.

Judges are no longer mere referees whose task during statutory interpretation is limited to a mere ‘mechanical reiteration of what was supposedly intended by Parliament’ as was the case during the days of parliamentary sovereignty.⁷³ As guardians and enforcers of the values underlying the Constitution, the courts have to ensure that interpretation of provisions of the Act fulfils the objectives of s39 (2).⁷⁴ In other words interpretation has to begin from s39 (2) and must comply with the normative value-laden framework of the constitution.⁷⁵ The Act acknowledges the impact of the Constitution in interpretation of its provisions. This is axiomatic and manifest in that the first among the twelve purposes listed in s7 provides that the Act must ‘promote compliance with the Bill of Rights as provided for in the Constitution, in the application of company law’.⁷⁶

6.4 Enforcement mechanisms for standards & remedies

Having established the standards of conduct and review, liability of directors and other officers for breaching such standards, and the interpretation of relevant provisions, the next logical step is to consider enforcement of standards. Indeed it serves little point to formulate appropriate standards of care and review if such standards will not be enforced effectively.⁷⁷ Part of the aspirations of the Act⁷⁸ was to ‘provide a predictable and effective environment for the efficient regulation of companies’.⁷⁹ Predictability and effectiveness cannot only be predicated on clarity of standards and clarity of remedies. Other factors must be put in place. For example, it is vital to have sufficiently empowered potential enforcers. Such enforcers⁸⁰ should be aware of the availability of civil or administrative remedies and/or criminal offences applicable for breach of standards.

Enforcement usually takes place through appropriate forums or an apparatus which promotes efficient administration and resolution of complaints. In South Africa today, compliance with standards of conduct prescribed for company directors and officers is either on a voluntary or legislated basis. Under the old Companies Act of 1973, there was reliance on criminal sanctions to ensure legislated compliance. The new Act has however sought to

⁷³ See Botha *Statutory Interpretation* 102-103.

⁷⁴ In terms of Schedule 2’s item 6 (1) every judge of a court in South Africa, when taking an oath of office, is required to swear/affirm that he/she ‘will uphold and protect the Constitution and the human rights entrenched in it, and will administer justice to all persons alike without fear, favour or prejudice, in accordance with the Constitution and the law.’ This is a serious undertaking by judges to be guardians and enforcers of the Constitution.

⁷⁵ Ibid at 108.

⁷⁶ See s7 (a) of the Act.

⁷⁷ Finch (1992) *The Modern Law Rev* 179.

⁷⁸ See s7(i) & (j) of the Act.

⁷⁹ See s7(l) of the Act.

⁸⁰ Usually those with vested interests.

depart from a steadfast reliance on criminal sanctions, in preference for what has been referred to as a ‘system of administrative enforcement’.⁸¹ While the Act has sought to decriminalise company law, it cannot be gainsaid that it has not scrapped criminal sanctions *in toto*. The Act has retained minimum number of criminal sanctions. This is in addition to administrative enforcement⁸² and civil remedies made available to certain persons upon infringement of their rights.⁸³

In this part, and in line with the theme of this Study, I will look into factors which can potentially facilitate effective enforcement of standards as provided for by the Act. To this end, I will firstly consider potential enforcers or enforcement agencies. In this connection, an interesting development in the Act is the aspect of extended *locus standi* and how this could benefit enforcement of standards. Secondly, I give an overview of dispute resolution forums or avenues for addressing complaints on alleged contraventions of the Act. The Act provides for multiple means (forums) for enforcing rights or standards to ensure compliance with the Act.⁸⁴

6.4.1 Extended *locus standi*⁸⁵, derivative action & effect on enforcement

The Act contains provisions which have extended legal standing in form of s157 as read with s165 of the Act. Extended *locus standi* permits a wide range of aggrieved parties or complainants to bring matters or disputes before courts, the Companies Commission, the Companies Tribunal or the Takeover Regulation Panel (the Panel). The phenomenon of widened legal standing before courts or similar forums may be novel to company law in South Africa.⁸⁶ It is however not entirely new to South African law in general. This approach was chiefly introduced by the South African Constitution in 1996. With reference to the BOR, s38 broadened the approach to *locus standi*. It introduced aspects such as class actions,⁸⁷ permits an association to act in the interest of its members,⁸⁸ allows a person to act

⁸¹ Companies Bill, 2007 p 15. Also see Cassim et al *Contemporary Company Law* 825.

⁸² See the *Memorandum on the objects of the Companies Bill, 2008*, Companies Bill [B 61D-2008] para 1 referred to in Cassim et al *Contemporary Company Law* at 825.

⁸³ See ss218(2) and 20(6) of the Act which were briefly discussed in 6.2.1 above.

⁸⁴ In a nutshell, the four means of enforcing rights provided for by the Act are the following: application to the High Court; filing of a complaint with the Companies and Intellectual Property Commission (the CIPC or Companies Commission); applying to the Companies Tribunal for adjudication and alternative dispute resolution.

⁸⁵ Including derivative actions. *Locus standi* simply refers to the right or capacity to bring an action before court.

⁸⁶ It is new in the sense that it did not form part of the previous Companies Act of 1973.

⁸⁷ See s38 (c) of the Constitution.

⁸⁸ See s38 (e).

in public interest⁸⁹ and provides for the possibility of a litigant to act on behalf of a person who cannot otherwise act in their own name.⁹⁰

Now s157 of the Act is comparable to s38 of the Constitution in that it has considerably widened *locus standi*. In this regard, the subsection provides as follows:

- ...the right to make an application or bring a matter [*before courts or any other forum identified in the above paragraph*] may be exercised by a person –
- (a) directly contemplated in the particular provision of this Act;
 - (b) acting on behalf of a person contemplated in paragraph (a), who cannot act in their own name;
 - (c) acting as a member of, or in the interest of, a group or class of affected persons, or an association acting in the interest of its members; or
 - (d) acting in the public interest, with the leave of court.⁹¹

In addition to the categories of people identified in s157 (1) who can enforce rights or standards before courts or other forums, s157 (2) extends *locus standi* to the Companies Commission or the Panel. These regulatory or enforcement agencies can exercise the right to enforce standards or to protect rights of individuals or interests of a company before courts in two ways. Firstly, a Commission or Panel in its discretion, may, upon request by a complainant, bring a matter before a court in order to protect affected interests.⁹² Subsection 157(2) (a) envisages within its ambit, a situation where the Commission or Panel may commence proceedings before the court in favour of a party who filed a complaint with the regulatory body. The wording of s157 (2) appears to imply that this can happen even if the complainant may not have specifically requested the Commission or Panel to commence proceedings before the court or tribunal on its behalf. This is the implication of the phrase ‘the Commission or the Panel, acting in either case on its own motion and in its absolute discretion’, used in s157 (2) (a). However it seems logical that the Act should require a complaint and request from a complainant before intervention, and that the Commission should retain a discretion not to intervene despite a request and/or complaint. Secondly, in terms of s157 (2) (b), the Commission or Panel may apply for leave to intervene as a plaintiff in proceedings before a court or tribunal. Such intervention can be justified by an allegation

⁸⁹ See s38 (d).

⁹⁰ See s38 (b).

⁹¹ See s157 (1) (a) – (d) of the Act. Words in brackets and italics are my own addition for purposes of emphasis.

⁹² See s157 (2) (a).

by the Commission or the Panel that it is necessary in order to represent any interest that would not otherwise be adequately represented in those proceedings.⁹³

Section 165 creates further opportunities for the enforcement of standards of conduct through derivative action.⁹⁴ While s157 provides extended legal standing to apply for remedies, s 165 grants the right of derivative action to a category of persons who are deemed by the Act to be sufficiently interested in enforcing or protecting company interests. These persons include: a shareholder or any person entitled to be registered as such;⁹⁵ a director or prescribed officer;⁹⁶ a registered trade union or other employee representatives;⁹⁷ or any person granted leave by the court to serve a demand upon the company to commence proceedings to enforce the company's rights.⁹⁸ In terms of s165 (2), these persons are entitled to serve a demand upon a company to commence or continue proceedings against or to take related steps to protect the legal interests of the company. For example, if there is a director whose action⁹⁹ is prejudicial to the company, and yet there is no initiative from the executive/board to take remedial action, a sufficiently interested person may serve a demand on the company to take steps to protect its threatened interests in terms of s165 (2).

A company may not ignore such a demand served on it in terms of s165 (2) without just cause. The Act permits the company to apply to court within 15 days of receipt of such demand, for the setting aside of the demand, if it so wishes. A court may only set aside the demand if it is satisfied that the grounds for the demand are frivolous, vexatious or without merit.¹⁰⁰ If the company does not make an application to the court to set aside the demand, the Act prescribes that the company must institute an independent investigation into the merits of the demand. The results of the independent investigation should be reported to the company board.¹⁰¹ The Act sets time-limits for the board to take decisive action after results of an independent investigation have been communicated to it. The company has 60 business days after being served with the demand to either comply with the demand or to serve a

⁹³ See s157 (2) (b). Also see the *Uniform Rules of Court* (High Courts of South Africa), Rule No. 12 which provides for 'Interventions of persons as Plaintiffs or Defendants' in GN R516 and GN R518 of 8 May 2009.

⁹⁴ In terms of the Act, a derivative action can be understood not to only mean a right to bring or prosecute legal proceedings on behalf of the company. The Act gives a transformed meaning in that a derivative action can now be understood to be a right of any person placed in the category under s165(2) (a) – (d), to serve a demand on a company to commence or continue legal proceedings, or take steps to protect the legal interests of the company.

⁹⁵ See s165 (2) (a).

⁹⁶ See s165 (2) (b).

⁹⁷ See s165 (2) (c).

⁹⁸ See s165 (2) (d).

⁹⁹ Which action might fall short of a standard of care, skill and diligence envisaged in s76 (3) (c).

¹⁰⁰ See s 165 (3).

¹⁰¹ See s165 (4) (a) (i) - (iii).

notice to the person who made the demand indicating its decision to refuse to comply with the demand.¹⁰² This naturally opens the door for a process which may culminate with the person who made a demand commencing legal proceedings on behalf of the company to protect its interests.

Extended legal standing and derivative actions are two clear ways through which the Act seeks to enhance the enforcement of standards of directors' conduct. The persons listed in the categories under subsections 157 (1) – (2) and 165(2) can thus be viewed as enforcers of standards. I call these persons potential enforcers of standards because the Act permits them to take action to enforce their rights¹⁰³ or to cause the company to protect its interests, say, against miscreant directors.¹⁰⁴ Subsections 157 and 165, by increasing avenues for enforcement have the effect of discouraging non-compliance with standards. Secondly, this makes companies accountable for violating provisions of the Act. This is certainly in the interests of enhancing corporate governance in South Africa.

6.4.2 Remedies & enforcement of standards under the Act: An overview

The Act has restructured old regulatory agencies and created new ones in an attempt to promote effective enforcement of its provisions. The Companies Intellectual Property Registration Office (CIPRO) has now been revamped to become the Companies Commission or CIPC. The Act has sought to decriminalise company law. It now predominantly uses a 'system of administrative enforcement' which is driven by the CIPC,¹⁰⁵ while minimal criminal sanctions have been retained by the Act.¹⁰⁶ The Act has designed a system of multiple forums for resolution of disputes, ensuring that those seeking remedies or to enforce their legitimate interests have a wide choice of forums. There is now the Companies Tribunal¹⁰⁷ which is an innovative new central dispute resolution forum which serves as the adjudication arm within the new system of administrative enforcement of the Act. Other new regulatory agencies include the restructured Takeover Regulation Panel (the Panel)¹⁰⁸ and the

¹⁰² See s165 (4) (b) (i) - (ii).

¹⁰³ This refers to personal interests in terms of s 157.

¹⁰⁴ Through the re-conceptualised derivative actions.

¹⁰⁵ See Companies Bill, 2007 p15.

¹⁰⁶ The offences retained by the Act broadly include - breach of confidence (s213); falsification of records, reckless conduct & non-compliance (s214) & hindering administration of the Act (s215).

¹⁰⁷ Established in terms of s193 of the Act.

¹⁰⁸ Formerly the Securities Regulation Panel.

Financial Reporting Standards Council (FRSC).¹⁰⁹ The High Court though, remains the primary forum for remedies, interpretation and enforcement of the Act.¹¹⁰

In tandem with its main goals of ensuring compliance with and enforcement of the Act,¹¹¹ the CIPC administers investigations of complaints regarding alleged contraventions. The CIPC can either receive complaints from individuals for non-compliance with the Act (including directives from the Minister to investigate allegations) or it can initiate investigations on its own.¹¹² At the end of its investigations, if the CIPC has not decided to end the matter, it can do any of the following to ensure compliance and enforcement of the Act:

- (i) Issuing of a compliance notice to a natural or juristic person to require the person to take necessary steps to correct or cease a reported contravention of the Act.¹¹³ Issuing a notice signifies that the CIPC is satisfied that a *prima facie* case exists, but that the contravention cannot otherwise be addressed by the court or Tribunal.
- (ii) The CIPC may refer the matter to the National Prosecuting Authority (NPA) for prosecution if it is an alleged offence in terms of s214 (3).
- (iii) The CIPC, the Tribunal or an entity accredited in terms of s166 may apply to High Court for a consent order (confirming its resolution of the matter).¹¹⁴ The CIPC may also apply to court for commencement of proceedings on behalf of a complainant against contravention of the Act.
- (iv) CIPC may refer a complaint to the Tribunal for resolution, if the matter falls within the Tribunal's jurisdictional competence. The Tribunal fulfils a dual role as an enforcement agency. It adjudicates on disputes referred to it,¹¹⁵ and facilitates alternative dispute resolution (ADR) upon application by aggrieved parties for mediation, conciliation or arbitration.¹¹⁶
- (v) The Act provides for notice of non-referral of complaint.¹¹⁷ Where no *prima facie* case has been established following a complaint, the CIPC will give this notice to a

¹⁰⁹ The FRSC is established in terms of s 203 of the Act. It is responsible for setting financial reporting standards for companies and ensuring alignment with international best practices – see s204.

¹¹⁰ Companies Bill, 2007 p15.

¹¹¹ See s186 (d)-(e).

¹¹² See s187 (2) (c)-(d).

¹¹³ See s170(1) (g).

¹¹⁴ See s167 (1) (a) read with s 173(1) (a).

¹¹⁵ See s195 (1) (a).

¹¹⁶ See s166 (1).

¹¹⁷ In prescribed form. See Reg 140 (2) & Form CoR 140.2.

complainant, declining to take any further action.¹¹⁸ This does not in way affect a complainant's right to directly refer the matter to court.¹¹⁹

6.5 CONCLUSION

The importance of this chapter is that it has explored ways in which the standards of conduct and review established in the earlier parts of this study can be effectively enforced. To this end, the chapter discussed the correlatives for effective enforcement. These include knowledge of consequences of breach of standards – liability; the legal framework for interpretation of relevant provisions of the Act and the enforcement mechanisms under the Act.¹²⁰

With respect to liability for breach of standards, this chapter has established that the Act has broadened instances of directors' personal liability. S 77 has confirmed the common law liability for breach of the standards of care, skill and diligence as well as breach of a fiduciary duty. The Act has opened room for more enforcers to enforce the Act whenever their rights are violated. The company is no longer the only enforcer of rights violated when a director contravenes a provision of the Act. Shareholders¹²¹ and any person¹²² who has a legitimate interest and/or has been injured can enforce their rights against a director for breach of standards of conduct.¹²³ This development, together with the fact that the ambit of who can be a director has been expanded,¹²⁴ can potentially assist in enhancing standards of corporate governance in the country.

This Chapter has predicted the judicial policy towards interpreting provisions of the Act¹²⁵ in light of the fact that there is no big body of case law based on the Act as yet.¹²⁶ It has been established that the purposive/contextual approach is the most appropriate method to

¹¹⁸ See s173.

¹¹⁹ S 218 (2) – (3) ensure that there is no unfair limitation to the remedies available to an aggrieved party.

¹²⁰ See part 6.1 above.

¹²¹ In terms of s20 (6) of the Act.

¹²² See s218 (2).

¹²³ See part 6.2 above.

¹²⁴ See definition of director in s76 (1) of the Act.

¹²⁵ Including standards of conduct and review.

¹²⁶ See introduction to part 6.3 above. This does not suggest that there have been no cases in which interpretation of the provisions of the Act generally has been considered. A few cases have been decided where courts have considered interpretation of the Act. Examples include the recent *Ex Parte: Gore NO and Others* (18127/2012) [2013] ZAWCHC 21; [2013] 2 All SA 437 (WCC) (13 February 2013), which case considered the interpretation of s20 (9). See e.g. para 32. The most relevant case to part of the Study is *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd and Others* 2014 (5) SA 179 (WCC) as aforementioned in Chapter 5. However, when applying s76 (4) (a) in analysing directors' decision-making when exercising their right to refuse to transfer shares, the court did not clearly articulate the judicial policy towards interpretation of provisions of the Act. The court probably found it unnecessary to do so.

employ when interpreting provisions of the Act.¹²⁷ Section 5 provides for interpretation of the Act from the bowels of the Act, and in a manner that gives effect to the purposes of the Act in s7. The contextual interpretation provided for by the Act ensures that the approach takes into account context in its elastic form. The context includes the entire legislative scheme, the background which includes the defects at common law which necessitated law reform. The appropriate interpretation method imposes on the courts the obligation to develop the common law whenever it is found to be necessary to do so in order to improve the realisation of rights under the Act.¹²⁸ Consideration of the normative value-laden constitutional framework given expression through objectives set in s39 (2) of the Constitution is also key. It is a starting point to statutory interpretation in South Africa.¹²⁹ It was further argued and established in this Chapter that contextual interpretation will give the courts a role to harmonise the Act's provisions with relevant international experiences or evolving international standards.¹³⁰

This Chapter has briefly analysed the apparatus put in place by the Act for purposes of enforcing provisions of the Act, and thus improve corporate governance. To this end, this chapter has analysed the effectiveness of the multiple forums established by the Act to enforce rights and standards in order to ensure compliance with the Act. These means of enforcing standards include the revamped CIPC and the newly established Companies Tribunal.¹³¹ As established, these are means of ensuring administrative enforcement of the Act. While the Act places more reliance on administrative enforcement, which it is hoped will be more effective, it has retained a few criminal sanctions for selected contraventions of the Act.¹³² It has been suggested in this work that the Act has put in place, on paper, potentially effective means of enforcing provisions of the Act to fulfil one of the purposes of the Act. This purpose is to 'provide a predictable and effective environment for the efficient regulation of companies'.¹³³ To this end, the CIPC will provide administration of enforcement of the Act. The Tribunal will fulfil a dual role. The first one is as the administrative adjudication body following contraventions of the Act. The second role is to provide a forum for conducting ADR processes.¹³⁴ This is progressive and innovative in that

¹²⁷ See part 6.3.1 (i) above.

¹²⁸ See part 6.3.1 (iii) above.

¹²⁹ See part 6.3.2 above

¹³⁰ See part 6.3.1 (ii) above.

¹³¹ Analysed in part 6.4.2 above.

¹³² See part 6.4.3 above.

¹³³ See s7 (1) of the Act.

¹³⁴ See part 6.4.2 (a) & (b) above.

it ensures quicker resolution of disputes. This is a welcome development given the reality that the South African court system is battling to clear a backlog of cases.

CHAPTER 7: CONCLUSIONS – SUMMARY AND RECOMMENDATIONS

7.1 INTRODUCTION

This Study set out to answer the central research question whether the new Act can be said to have made the standards of care, skill and diligence more accessible, clearer, ascertainable and more enforceable in light of the incorporation of BJR.¹ In this concluding chapter, the results of this investigation, including the steps followed to reach the conclusions arrived at, will be crisply presented. This should naturally culminate in specific proposals for law reform. The importance of each chapter in contributing towards an attempt to find solution(s) to the key research question and sub-inquiries will be outlined in part 7.2, a part that provides chapter summaries. Part 7.3 presents recommendations or proposals for law reform. Part 7.4 provides a brief commentary on the outlook of corporate governance in South Africa in light of law reforms and recommendations made in this study.

7.2 Summary of Chapters: Highlights, Challenges and Opportunities

7.2.1 The research focus (the legal problem) and Hypothesis

Chapter 1 introduced the key research question, and further outlined the motivation² and justification³ for the Study. It was considered significant to have this Study at a time when South Africa, for the first time in history, has codified the duty of care, skill and diligence in a statute. In addition, the Act adopted a US-style BJR despite criticisms such as that the concept was a foreign legal transplant that was bound to negatively impact on standards. As already pointed out, these two aspects⁴ relate to decision-making, which is a critical role that a director has to play in the life of a corporation. Chapter 1 justified this Study by pointing out that the duty of care, skill and diligence is vital to corporate law. The duty's importance is evident in that it applies to all decisions directors make or should make were they to exercise their powers for the benefit of the company and its key stakeholders.⁵

¹ See part 1.3 of Chapter 1.

² See part 1.4.1 of Chapter 1.

³ See part 1.4.2 of Chapter 1.

⁴ That is, the duty of care, skill and diligence and BJR.

⁵ Especially the shareholders, considered to be the residual claimants of the assets of the corporation. See part 1.4.1 of Chapter 1.

The sub-inquiries to the key question identified in Chapter 1⁶ formed building blocks to the development of the main focus of the thesis as will be demonstrated under this part below.

Every study begins with a supposition based on limited evidence as a starting point for further investigation. Thus my hypothesis was that BJR under the Act was undesirable for the reasons that it was incompatible with South African company law. I further assumed that BJR would operate to limit the effective enforcement of the duty of care, skill and diligence. My assumption had two bases. The first one being that even though the standard according to which the duty of care was measured under South African common law was not crystal clear,⁷ the law largely perhaps employs a less objective standard of liability than is to be expected in a modern era.⁸ This standard is a low standard, hence the paucity of cases where the duty of care was successfully enforced in South Africa.⁹ The second basis of my assumption was that BJR, itself a foreign concept from the USA, would be incompatible with South African law, given the USA's history of conflating a fiduciary duty and the duty of care.¹⁰ Hence the assumption that BJR would operate to blur the distinction between these two duties. This is something alien to South African corporate law wherein such distinction is celebrated.¹¹ My hypothesis was tested by the evidence from the research and a critical analysis of relevant provisions of the Act.¹² The present Chapter will demonstrate why the hypothesis could not completely stand the test of a critical examination of the research question.

7.2.2 Conceptual Framework - Directors' Standards of Conduct and BJR

Chapter 2 laid down a conceptual framework to the overall focus of the Study, namely the standards of care, skill and diligence and the BJR. Important concepts such as corporate governance and BJR were defined. In addition, the expansive meaning of directors was given,¹³ while their legal status¹⁴ in a transforming corporate law landscape in the country was examined.

⁶ As outlined in part 1.3 of Chapter 1.

⁷ See Bekink (2008) *SA Merc LJ* 95.

⁸ See part 4.2.1 of Chapter 4.

⁹ *Ibid.*

¹⁰ See Gregory (2005) *Akron L. Rev* 181.

¹¹ See Jones (2007) *SA Merc LJ* 327.

¹² See part 4.2.3 of Chapter 4.

¹³ See part 2.2.2 of Chapter 2.

¹⁴ See part 2.4.3 of Chapter 2.

Corporate governance provides the context within which to discuss the focus of this study. Decision-making which implicates standards of conduct and BJR is a governance issue. As already highlighted,¹⁵ integrity of the leadership role of directors in companies in the decision-making process is a critical principle underpinning corporate governance regulation in South Africa.¹⁶ Directors have to make business decisions, at times under imperfect circumstances and while confronting tensions inherent in the corporate form.¹⁷ Not least of these tensions is the pressure to balance the profit maximisation drive from shareholders and accountability for how the directors manage broader stakeholder interests. It was pointed out¹⁸ that BJR is increasingly being seen as a fulcrum used to balance these competing concerns in the corporate form.¹⁹ Thus BJR provides a platform for the interaction of a standard of conduct (the duty of care) and a standard of review in the director's role to direct the business and affairs of a corporation.²⁰

The various definitions of BJR considered in Chapter 2²¹ agree that the concept refers to a standard of review whereby courts of law review directors' conduct using a set criterion provided for in the empowering legislative framework.²² It is left to Chapter 5 to make a case for a proper delineation between a standard of conduct and a standard of review.²³

7.2.3 International best practices on standards of care and BJR: Lessons for South Africa?

Chapter 3, a comparative study, provided invaluable insights or lessons which could enrich South African jurisprudence on standards of conduct and review, including interpretation thereof. Lessons for law reform or for improving the enforcement of standards have been drawn from comparators of choice in this study. The international experiences were drawn from Australia, the UK and USA.

¹⁵ See part 2.2.1 of Chapter 2.

¹⁶ See *South African Broadcast Corporation Ltd v Mpofu* (supra) at 447.

¹⁷ See McMillan (2013) *Wm. & Mary Bus. L. Rev.* 527.

¹⁸ See part 2.2.3 of Chapter 2.

¹⁹ See Norman & Di Guglielmo (2005) *U. PA. L. Rev.* 1399 at 1424-1425. Also see McMillan (2013) *Wm. & Mary Bus. L. Rev.* 528.

²⁰ See s66(1) of the Act.

²¹ See part 2.2.3 of Chapter 2.

²² See part 2.2.3 of Chapter 2.

²³ See parts 5.2.1 and 5.4.1.

Possible lessons on standards of care, skill and diligence

As already stated in Chapter 3,²⁴ South African law shares a common law inheritance with both Australia and the UK. As such, law reforms in these jurisdictions will continue to provide lessons for the possible enrichment of standards of conduct in South Africa. The content of the duty of care in the USA and case law principles also have the potential to enrich the interpretation of the duty under s76 (3) (c) of the Act. Lessons from international best practices will now be briefly presented below.

(i) Codification of the duty of care – lessons on clarity of the standards adopted

South Africa has followed the examples of the UK and Australia of expressing in a statute directors' common law duties, as is the case in s76(3)(c).²⁵ The difference is that while standards of the statutory duty of care under the UK's Companies Act 2006 and Australia's Corporations Act 2001 are clear, the similar standards under the Act are not as clear. As already established,²⁶ due to the manner in which s76 (3) (c) was formulated, it is not easy to decipher what the exact standards are that have been introduced by the statutory duty of care. Can it be said that the standards are dual objective/subjective as is the case with UK law? Clearly, the standards are not purely objective as is the case with Australia's s180 (1). Hence the conflicting views in literature about the exact standards introduced into South African law by s76 (3) (c) as stated in Chapter 3.

It is not easy to say whether a reasonable person standard/test applies in s76(3)(c) or not. While subsection 76(3)(c)(i) appears to introduce objective elements of care, subsection 76(3)(c)(ii) undermines the objectivity of the skill test by asserting that the director need only meet the standard of a person having 'the skill and experience of that director'.²⁷ This has the danger of reading even the objective elements of care down to the common law subjective standard. In contrast, law reform in the UK clearly identified the issue of the clarity of standards of care, skill and diligence demanded of directors as one of the aspects of law requiring reform.²⁸ It was decided by the Law Commission that the dual objective/subjective standards developed at common law and through s214 (4) of the Insolvency Act 1986 were

²⁴ See part 3.1 of the Chapter.

²⁵ Ibid.

²⁶ See parts 3.2.3 and 3.3.5.

²⁷ See part 3.3.2.

²⁸ See part 3.2.1 of Chapter 3.

the preferred standards.²⁹ That fact is clearly reflected in s174 of the Companies Act 2006. Limb 2 in s174 as argued in Chapter 3, does not have the effect of undermining the objective standards in limb 1.³⁰ A point was made in Chapter 3 that South Africa can learn from the UK in terms of providing clarity in the formulation of standards of care in s76(3)(c). As it stands and as already argued and established in Chapter 4, given the ambiguous drafting of s76 (3) (c), the current standards may be read to be subjective/objective. This appears to be contrary to what appears to have been the legislative intent as can be deciphered from the forerunner to s76 (3) (c), which was drafted alongside the UK's s174 of the Companies Act 2006. Since the UK standards are objective/subjective, and Cl 91 (1) (a) was drafted alongside the UK statute, then the legislative intent must have been to introduce dual objective/subjective as opposed to subjective/objective standards. To bring s76 (3) (c) in line with what appears to be the true legislative intent, it is to be proposed under 7.3 below to amend s76 (3) (c) accordingly to give effect to the legislative intent.

(ii) Clarity of the relationship between the statutory and common law duty of care

A consequence of partial codification of common law duties is the need for a clear judicial approach on handling the relationship between the two duties during interpretation. The question which confronts the judiciary often is whether the statutory duty has superior status to the common law duty. Courts of law should not be unfairly left to deal with this dilemma on their own without proper guidance from the legislature. After all it is the primary duty of the legislature to make laws, while the courts have a duty to interpret the law when applying it to a given situation. It was pointed out in Chapter 3 that the Act lacks a provision to clarify the exact relationship between the statutory duty of care and the equivalent common law duty.³¹ This is in stark contrast to international trends. Elsewhere where these two duties co-exist in the legal system, there is a clear provision to guide the judiciary on how it is to treat the two duties.³² S 77 (2) makes it quite clear that the relevant common law principles to both the fiduciary duty and the duty of care retain utility in terms of assigning liability to parties in case of breach of the duties.³³ I am thus convinced that the common law principles will apply concurrently with the statutory duty. The role of the common law principles is to

²⁹ Ibid.

³⁰ Ibid.

³¹ See part 3.2.3.

³² See parts 3.2.2 and 3.3.2 of Chapter 3 for an analysis of how UK and Australian law has provided guidance on how the judiciary is to interpret or treat the interaction of these duties in a legal system.

³³ See s77 (2) (a) – (b) of the Act.

serve as an aid to the interpretation of the statutory duty. Interestingly, with respect to the validity of company actions in s20 (7), the drafters of the Act demonstrated awareness of the need to provide clarity regarding the relationship between a statutory provision and the relevant common law principle.³⁴ A relevant amendment is necessary for purposes of clarity.

In Australia, s185 of the Australian Corporations Act clearly provides that the partially codified common law duties³⁵ apply together with the common law and not in derogation to or impliedly also not subordinate to equivalent common law rules. Thus the duty of care in s180 (1) for example is an independent statutory duty and has equal status to the common law or any equivalent duty. In the UK, s170 (3) similarly seeks to clarify the relationship between the statutory and common law duties of care. It states that even though all the codified directors' statutory duties are based on relevant common law rules or equitable principles; they 'have effect in place of those rules and principles'. Thus under UK law, in case of any conflict between the common and statutory law rules, regard must be had to the natural language of the statute as the port of first call.³⁶ This deference to statutory law has been held to be important in order to preserve the code's status as the principal law and not allow it to be undermined.³⁷

South Africa needs a subsection in the mould of s185 or s170 (3) to clarify the relationship between the statutory duty of care and relevant common law rules. Such a subsection should clarify whether statutory directors' standards in s76 (3) operate in substitution of, in addition to or whether they will override the common law. The question whether the common law still applies and what role it plays post partial codification of basic directors' duties is very important for interpretation of s76 (3) (c). This question is also important for the application of s76 (4) (a) which encapsulates the BJR. Will the BJR which clearly applies to statutory duties of care and to act in the best interests of the company also apply to the equivalent duties at common law? A relevant proposal to close the gap in law will be made in this regard under part 7.3 below.

(iii) Better understanding of the content of the statutory duty of care – lessons from USA and Australia

³⁴ S 20 (8) brings about this clarity of the relationship between the statutory provision in subsection (7) and the common law. It achieves this by providing that 'subsection (7) must be construed concurrently with, and not in substitution for, any relevant common law principle relating to the presumed validity of the actions of a company in the exercise of its powers'.

³⁵ See ss180-184 of the Corporations Act 2001.

³⁶ D Ahern 'Directors' duties, Dry Ink and the Accessibility Agenda'(2012) 128 *L.Q.R* 114 at 131.

³⁷ See *Bank of England v Vagliano Bros* [1891] A.C. at 107.

There are lessons to be drawn from US law and Australian case law on a proper understanding of the content of the statutory duty in s76(3)(c). Proper understanding of the content of the duty has a bearing on liability of a director who faces claims for breaching his duty of care, skill and diligence towards a company.

In American law, the duty of care in s4.01 of the *ALI Principles of Corporate Governance* has been interpreted in line with case law principles to illustrate the leadership thrust of the duty. It has been demonstrated in US case law that the standard of conduct is about a director's managerial responsibilities towards the company. Such responsibilities include the duty to care for the business of the company. This includes but is not limited to taking reasonable steps in playing a monitoring role to executive management using the monitoring procedures put in place by the company. Thus directors are expected to provide such care as an ordinary prudent man would be reasonably expected to give in a similar situation. All directors are responsible for managing the business and affairs of the corporation.³⁸ As such, no director should abdicate their responsibility to provide oversight.³⁹

The sub-duty to act with diligence can be interpreted in US law to impose a continuing obligation on directors to keep themselves informed of the affairs of the company. In both US law⁴⁰ and Australian law,⁴¹ this has been held to be an obligation to keep abreast of developments such as the financial performance of the company at material times.

The sub-duty of skill under South African law can be equated to the content of the American sub-duty to be informed. This sub-duty entails an obligation of a director to place herself in a position to make an informed decision by being literate through acquiring the basic competence to discharge normal responsibilities of a director. As the work of a director involves reading financial reports and approving financial statements relating to a company's financial performance, this includes a basic ability to read and understand such documents.⁴² Thus even in a developing country like South Africa, a member of the BRICS,⁴³ there is a

³⁸ See *Francis v. United Jersey Bank*, (supra) at 823-824.

³⁹ See Eisenberg (1990) *Uni of Pitt L. Rev* 945.

⁴⁰ See *Rankin v Cooper* (supra) at 1013.

⁴¹ See the *Adler* case (supra) at 253 referred to in part 3.3.1 of Chapter 3.

⁴² See *Francis v. United Jersey Bank* (supra) at 821-822 where Pollock J remarked that as a general rule a director (in America) should acquire at least a rudimentary understanding of the corporation. In the Australian *Centro* case the court similarly held that there is a positive duty on directors to have a basic financial literacy to enable them to read and understand financial statements.

⁴³ BRICS is an acronym of five emerging economies in the world. It stands for Brazil, Russia, India, China and South Africa. The common characteristics include the fact that these are large, fast-growing developing or newly industrialised economies or countries. See 'BRICS - Objectives, Summits, Need and Disparities' available at <http://www.careerride.com/view.aspx?id=19744> accessed on 26 July 2015.

demand for high corporate governance practices as a prerequisite for investment promotion.⁴⁴ It can no longer be business as usual. South Africa has since recognised the need to provide for a predictable and effective regulatory environment. This is vital to enable the country to be globally competitive and attract the much-needed investment inflows into the country. The sub-duty of skill should be interpreted to include a positive duty on all directors of big corporations in South Africa to acquire basic competences to place themselves in a position to effectively guide and monitor company affairs.

This way of looking at the content of the duty of care, skill and diligence in American and Australian case law will certainly influence positively the interpretation of the statutory duty in s76(3)(c) by South African courts. The Act has a mechanism which allows courts of law to look to foreign case law during interpretation of provisions of the Act,⁴⁵ as will be highlighted in part 7.2.6 below.

(iv) Delegation and reliance on others for performance – lessons from foreign case law

It is vital to point out that South Africa has confirmed in the Act the common law position regarding delegation and reliance.⁴⁶ Australian courts have recently confirmed a modern approach to reliance and delegation. The maxim *delegatus non potest delegare* – meaning that a fiduciary may not delegate his job or duty, but only some powers/authority to company servants necessary for performing it, has been confirmed in various Australian cases. The firm approach is that directors cannot substitute reliance upon the advice of management in place of their own attention and examination of a strategic matter that falls within the board's responsibility.⁴⁷ South African case law also seems to agree that a director remains accountable for the exercise of delegated authority.⁴⁸ The Act also confirms this, even though the relevant subsection may need to be phrased more clearly.⁴⁹

⁴⁴ See s 7 (b)(iii) & (c).

⁴⁵ See part 6.3.1 in Chapter 6.

⁴⁶ See part 4.5 for a discussion of delegation and reliance under the Act.

⁴⁷ See the *Centro* case (supra) at 175. Also see part 3.3.1 of Chapter 3 for a discussion of other cases which confirm the position in the *Centro* case.

⁴⁸ See *Barlows Manufacturing* (supra) at 611 referred to in part 4.5.1 under Chapter 4.

⁴⁹ S 72 (3) provides that 'the creation of a committee, delegation of any power to a committee, or action taken by a committee, does not alone satisfy or constitute compliance by a director with the required duty of a director to the company, as set out in section 76'.

Lessons from the BJR international experiences

As highlighted in this study,⁵⁰ the BJR provision is a new innovation in South African statutory law. No case law has developed to gauge how the provisions of s76(4)(a) will be applied and to see the results of the BJR's interaction with standards of care, skill and diligence. Therefore international experiences regarding the scope, rationale for and application of the BJR will prove instructive to the development of jurisprudence in South Africa. Australian experiences with the adoption of BJR and the case law principles evolving from application of the rule provide a useful guide to South African courts. The USA is the place of origin of BJR and has a rich source of case law principles to learn from.

In a snapshot, the following are lessons South Africa can derive from international experiences with application of BJR:

(i) The requirements or content of BJR (good faith, care and loyalty)

International trends point towards the content or triad of the BJR as concerning the closely related elements of good faith, care and loyalty towards the company. In the Australian BJR version, a director's duty to act in 'good faith for a proper purpose' is a key part of the requirements of the rule formulation.⁵¹ Similarly, the traditional American BJR formulations reveal the central role that good faith plays in the rule.⁵² Good faith is conspicuously absent in the BJR formulation under 76(4) (a). In fact, a proper reading of s76 (4) (a) reveals a deliberate intention by drafters to specifically exclude good faith from the BJR formulation. This exclusion of good faith under the Act is inexplicable, especially given the absence of rationale to justify the exclusion. Good faith is considered an umbrella requirement. It has also been aptly described as a 'surrogate of sorts' for the test to be applied when determining the presence or absence of key BJR elements such as conflict of interests or ill-motives for the business decision.⁵³ Absence of good faith in the conduct of a director has been held by English cases to be indicative of the possibility of a director not having acted in the best interests of the company. Thus it is very unfortunate that s76 (4) (a) excludes good faith in the formulation of BJR. With the benefit of these international experiences and

⁵⁰ See part 5.1 of Chapter 5.

⁵¹ See s180 (2) (a) of the Corporations Act 2001 discussed in part 3.3.2 of Chapter 3 as part of the Australian statutory BJR formulation.

⁵² See part 3.4.2 of Chapter 3 for a discussion of the 'USA traditional formulations of BJR'. In the ALI formulation, it is assumed that a director must make a business judgment in good faith. Under the Delaware formulation of the rule, BJR is formulated as a presumption of good faith in favour of directors. Further see *Aronson v Lewis* (supra) at 812.

⁵³ Branson (2011) *SACLJ* 702-704.

trends it will be proposed that good faith be added to the rule formulation to form part of the requirements for the BJR.

If the rationale for exclusion of good faith is for fear that the ‘proper purpose’ part of the duty in 76(3)(a) may affect the applicability of BJR to insolvent trading as happened in Australia,⁵⁴ there is a way of avoiding that anomaly. One way of doing this would be to decouple the elements of the duty in s76 (3) (a) and thus present the two duties as separate, just as the duties are at common law. Then the good faith element can become part of the BJR formulation without fears of the consequence of including the proper purpose element. However, as demonstrated in a recent judgment in *Visser Citrus (Pty) Ltd v Goede Hoop Citrus (Pty) Ltd and Others* even the ‘proper purpose’ part of s76 (3) (a) may prove to be very useful in the review of directors’ decision-making process.⁵⁵ Rodgers J ruled that there exists a close relationship between the requirement that the power⁵⁶ should be exercised for a proper purpose and the requirement that the directors should act in what they consider to be the best interests of the company’.⁵⁷

(ii) Characterisation of BJR as a standard of review

As already established in this work, when allegations of breach of duty are made, BJR provides the test a court is to apply when it reviews a director’s conduct. Thus the duty of care for example, is the standard of conduct, while BJR provides a standard of review. This is how BJR has been characterised in the Australian⁵⁸ and US⁵⁹ empowering legal frameworks.

(iii) Specifying that a ‘business judgment’ or ‘business decision’ was made, necessary?

Australian and US formulations use the descriptive term ‘business judgment’⁶⁰ while s76 (4) (a) intimates the same thing without clearly specifying it. In Australia, a ‘business

⁵⁴ See Farrar (2011) *SAC LJ* 761.

⁵⁵ *Visser Citrus* (supra) at paras 80 – 85. .

⁵⁶ See the power to be exercised by directors referred to in the opening statement to s76 (4) (a).

⁵⁷ *Visser Citrus* (supra) at para 80.

⁵⁸ See part 3.3.2 of Chapter 3.

⁵⁹ See part 3.4.2 of Chapter 3.

⁶⁰ See s180 (2) of the Corporations Act 2001 and the ALI formulation of the rule in the US respectively.

judgment’ is also clearly defined.⁶¹ Does South Africa need to specify that the decision referred to especially in s76 (4) (a) (iii) is a ‘business decision’?. As already established in this work, s76 (4) (a) differs from the Australian and US laws in the scope of protection offered to ‘decisions’ of directors in the exercise of their powers and performance of their functions. S 76 (4) (a) can be read to provide wider protection to the ‘decisions’ of the director beyond the traditional limitations of BJR – which focuses on protection of business judgments.⁶² I thus conclude in this respect, that it was unnecessary and indeed out of character of what appears like a legislative design, for the legislature to have specified that the decision is a business judgment. A business judgment is subsumed in the wider application of s76 (4) (a) nonetheless.

7.2.4 A critical analysis of standards of care, skill and diligence under the Act

Chapters 4 and 5 are critical in answering the central question whether the Act has made standards of care, skill and diligence clearer, more accessible and enforceable than before in the light of the adoption of BJR. Chapter 4 tackled the question regarding the standards of conduct. Chapter 5 considered the impact of BJR on application and enforceability of the standards of care, skill and diligence in the context of decision-making. Chapter 4 was analysed in light of law reform objectives⁶³ in tandem with the purposes of the Act. It was established that the Act set out to achieve various purposes. The most relevant are the need to promote transparency, high standards of corporate governance⁶⁴ and the need to provide for a predictable and effective environment for the efficient regulation of companies.⁶⁵

Chapter 4 established that the relevant goals of law reform referred to above were partly achieved by the Act. For example, the fact that South Africa now has a statutory duty of care, skill and diligence should be hailed, and this is in line with the purpose of promoting transparency of relevant standards. Transparency through a code also means improvement of accessibility of the law to users such as company directors, prescribed officers, inter alia. The adoption of the statutory defences of delegation and reliance is also a positive development in the law as argued in Chapter 4.⁶⁶ Apart from it being desirable in a modern economy to

⁶¹ See s180 (3) of the Corporations Act 50 2001.

⁶² See part 5.4.2 (iii) of Chapter 5.

⁶³ See the DTI Policy document 2004.

⁶⁴ See s7 (b) (iii) of the Act.

⁶⁵ See s 7 (l).

⁶⁶ Part 4.5.

promote enterprise efficiency, the presence of these defences strengthens the argument that corporate governance standards need to be tightened up and promotes enterprise efficiency. Therefore in a nutshell, there is little doubting that the Act has achieved the goal of accessibility and transparency in the law.⁶⁷ The Act has provided an excellent starting point for modernisation of standards of care. There appears to be a legislative intent to put in place a predictable and effective environment for the regulation of companies.

However, a critical analysis of s 76(3)(c) as part of s76 revealed worrying ambiguities in the formulation of the standards of care, skill and diligence. The question of the status of or the relationship between the statutory duty and common law has already been dealt with under 7.2.3 above.⁶⁸ The main concern revealed in Chapter 4, pertains to lack of clarity of the standards established by s76(3)(c).⁶⁹ It is not clear what test is applicable due to the manner the standards were formulated. If the test cannot be easily ascertained, this affects enforcement of the duty. It is not very clear whether the Act has improved from the dominantly subjective elements at common law. The purpose discernible from the law reform objectives and purposes of the Act was to ensure better standards. Yet s76(3)(c) does not make it clear if the legislature has simply confirmed the subjective standards at common law, or has achieved an upgrade from the common law. There is therefore a case to be made for clearer standards of care, skill and diligence in line with the purposes of the Act.

7.2.5 BJR under the Act – a standard of review

Chapter 5's contribution to answering the central question of this study is two-fold. Firstly, the chapter analysed s76 (4) (a) to establish the scope, content and rationale for BJR under the Act. Secondly, the chapter investigated whether BJR could have the effect of limiting the enforcement of the duty of care, skill and diligence. Chapter 5 highlighted some positives⁷⁰ as well as criticisms which could be levelled against s76 (4) (a).⁷¹

Adoption of BJR is one of the many innovations of the Act, and there are many positives to be drawn from s76 (4) (a).⁷² The South African version of BJR can be said to be comparable to international best practice standards. It has incorporated aspects from the US

⁶⁷ See part 4.6 of Chapter 4.

⁶⁸ Also see an examination of the matter in part 4.4.1 of Chapter 4.

⁶⁹ See part 4.4.3.

⁷⁰ See part 5.4.3 of Chapter 5.

⁷¹ See part 5.4.4.

⁷² See part

and Australian versions of the BJR.⁷³ A closer look at the purposes of the Act and provisions of s76(4)(a) reveal a recognition in South Africa of international thinking about business and its leadership. Companies are increasingly being seen as a means of growing national economies, as well as a means of achieving economic and social benefits.⁷⁴ Directors in their leadership role are encouraged to promote enterprise efficiency.⁷⁵ The Act acknowledges that directors have to make business decisions, at times under imperfect circumstances and while confronting tensions inherent in the corporate form.⁷⁶ As such the Act sought to encourage informed risk-taking and to avoid the excessive limiting of entrepreneurial flair. The Act counterbalanced this by putting in place measures to encourage responsible management of companies.⁷⁷ BJR represents the best of these measures under the Act to ‘balance the rights and obligations of shareholders and directors within companies’.⁷⁸ Directors’ right or freedom to govern the company⁷⁹ is constrained by the need for them to be accountable for the exercise of the powers accorded them under the Act.

One way in which shareholders can make directors accountable is through institution of liability claims in case of alleged violation of a director’s duty towards the company.⁸⁰ Thus BJR provides a standard of review or a test to be applied when a director’s conduct is reviewed by a court.⁸¹ The standard of review established by s76 (4) (a) is an objective one as argued under Chapter 5.⁸² There is nothing that suggests that the purpose of the BJR is to dilute the effectiveness of the duty of care under the Act. As already stated, BJR provides a standard by which the duty of care, skill and diligence (standard of conduct) can be reviewed.

While there are positives regarding the adoption of BJR under the Act, some criticisms can be levelled against s76 (4) (a). Most of these criticisms against the BJR provisions under the Act have already been aptly captured under 7.2.3 above.⁸³

⁷³ See parts 3.3.2 & 3.4.2 respectively of Chapter 3.

⁷⁴ See s7 (d) of the Act.

⁷⁵ See s7 (b) (i) of the Act.

⁷⁶ Not least of these tensions is the pressure to balance the profit maximisation drive from shareholders and accountability for how the directors manage broader stakeholder interests. See McMillan (2013) *Wm. & Mary Bus. L. Rev* 527.

⁷⁷ See s 7(j) of the Act.

⁷⁸ See s 7(i) of the Act.

⁷⁹ Guaranteed by s66 (1) of the Act.

⁸⁰ Liability claims can be brought by shareholders against directors through derivative actions provided for under s165 (2) of the Act.

⁸¹ See parts 5.2.1 & 5.4.1. The Study makes a case for a proper characterisation of s76(3) as providing a standard of conduct distinguishable from a standard of review in s76(4)(a).

⁸² See part 5.4.2 of Chapter 5.

⁸³ Also see part 5.4.3 under Chapter 5.

7.2.6 Legal framework for liability, interpretation and enforcement of standards

The question that Chapter 6 attempted to answer is whether the Act has put in place sufficient mechanisms to ensure effective application and enforcement of standards. The chapter has analysed and established the three correlatives for effective enforcement of standards. These include knowledge of consequences of breach of standards – liability issues, a potentially effective framework for interpretation of standards and multiple dispute resolution fora. This chapter observed that the Act has put in place a legal framework to ensure effective enforcement of standards. The chapter analysed the Act and re-affirmed what is the appropriate method for interpreting the standards of care, skill, diligence and BJR.⁸⁴

7.3 Recommendations and proposals for law reform.

Gaps in law and ambiguities in the standards of care, skill and diligence under s76 (3) (c) and standards of review under s76 (4) (a) have been highlighted in this Chapter⁸⁵ as also noted throughout this Study. Recommendations and/or proposals to improve the law will now be made below. The approach is to make separate proposals for amendment of standards of care, skill and diligence under s76 (3) (c), as well as amendments to s76(4)(a) and to also make general recommendations.

7.3.1 Proposals for improving standards of care, skill and diligence

A proposal to clarify the status of s76 (3) (c) vis-à-vis common law

It is proposed that a subsection be inserted in s76 (3) to clarify the relationship between s76 (3) (c) and the common law as follows:

‘The provisions of this section have effect in addition to, and not in derogation of any duties of the director of a company under the common law or any other law’

Or

‘The provisions of this section must be construed concurrently with, and not in substitution of any relevant common law principles and in line with provisions of s77 (2).’

⁸⁴ See part 6.3 of Chapter 6.

⁸⁵ See parts 7.2.3, 7.2.4 & 7.2.5 above.

Amendment of subsection of s76(3)(c) to ensure that the duty imposes a reasonable person test or at least dual objective/subjective standards, and should read as follows:

...with the degree of care, skill and diligence

(i) which may be expected from a reasonably diligent director carrying out similar functions in relation to the company; and

(ii) taking cognisance of the general knowledge, skill and experience that the director has

7.3.2 Proposals for improving standards of review or BJR provisions in s76(4)(a)

Amendment of parts of s76 (4) (a) to include the ‘good faith and for a proper purpose’ elements and thus ensuring that s76 (3) (a) becomes part of the BJR formulation and to ensure that the common law also forms part of the BJR formulation,⁸⁶ as follows:

...a particular director of a company –

(a) will have satisfied the obligations of subsection (3) (and delete (b) and (c)) and the comparable obligations at common law if –

(i) the director has taken reasonably diligent steps to become informed about the subject matter of the decision

...

(iii) the director made a decision including a business judgment in good faith and for a proper purpose...

7.3.3 General Recommendations

As a consequence of the proposed amendments to subsections 76(3)(c) and 76(4)(a) made in parts 7.3.1 and 7.3.2 above, the following proposals are made to give proper effect to the suggested improvements in the law:

Proposed amendment to the title of s76 to reflect the proper characterisation of the BJR subsection (s76 (4) (a)) as a standard of review, to avoid it being confused with a standard of conduct as is the case currently.⁸⁷ The amendment will read as follows:

⁸⁶ See part 7.2.3 above under title ‘Lessons from BJR international experiences’ where this point was fully canvassed

7.3.4 Recommendations on interpretation of and approach to standards

It needs to be re-emphasised here that given the fact that the Companies Act 2008, which became effective only in May 2011 is still fairly new, no body of case law has evolved regarding the interpretation of s76(3)(c) and s76(4) (a). The best thing that can be done, as we prepare for the first case to ‘break the ice’, is to propose the best approach that is aligned to the ‘spirit, purposes and objects’ of the Act.⁸⁸

Suggested judicial policy/approach towards interpretation of standards

This approach is premised on the following five pillars:

I. Need for proper understanding of the relationship between standards of conduct and review

As demonstrated throughout this study,⁸⁹ the Act presents directors’ duty of care, skill and diligence as a standard of conduct, while BJR is a standard of review. Thus BJR is a test used to review a director’s standard of conduct whenever a director faces liability claims for breaching his duty of care, skill and diligence as well as the fiduciary duty to act in the best interests of the company. This work has already proposed the inclusion of s76 (3) (a) of the Act as part of the BJR formulation under s76 (4) (a)..

II Contextual approach to interpretation of s76 (3) (c) and s76 (4) (a)

As established in Chapter 6, a proper examination of s5 and s158 shows that the most appropriate approach towards interpretation of provisions of the Act is the purposive or contextual approach. This approach ensures that the judiciary, the Commission or the Tribunal should interpret standards of care, skill and diligence and standards of review in a manner that best promotes the spirit, purposes and objects of the Act.⁹⁰ It is very clear that the

⁸⁷ Ibid.

⁸⁸ See part 6.3 of Chapter 6. It was highlighted in that part that in terms of s158 (b) of the Act, a court of law, the Companies Commission or Tribunal must promote ‘the spirit, purpose and objects of this Act’ when determining a matter brought before it in terms of the Act.

⁸⁹ See parts 7.2.3 of this chapter, 2.5.2 of Chapter 2 and 5.2 of Chapter 5.

⁹⁰ See s 158 (b) (ii).

Act demands an interpretation of its provisions in a manner that promotes high standards of corporate governance.⁹¹ Thus, in line with proposals made in 7.3.1 above, the Act cannot be interpreted to have imposed the standards of care, skill and diligence which are as low as s76 (3) (c) in its current form suggests. It is also clear that the Act intended to promote enterprise efficiency while at the same time ensuring responsible management of companies, as well as balancing the rights and obligations of directors and shareholders. Hence the standards represented by s76 (3) and s76 (4) (a) should be interpreted by courts of law to be geared towards promotion of informed risk-taking by directors. In other words, there should be a balance between enterprise efficiency promotion and responsible management.

III Teleological interpretation and courts' duty to develop common law

Consideration of the normative value-laden constitutional framework given expression through objectives set in s39 (2) of the Constitution is key and a starting point to statutory interpretation in South Africa as demonstrated in this study.⁹² The appropriate interpretation method imposes on the courts the obligation to develop the common law whenever it is found to be necessary to do so in order to improve the realisation of rights under the Act.⁹³ This is in line with the spirit, purport and objects of the Act as reflected in s158 (a) of the Act, read with the objectives of s39 (2) of the Constitution.

IV Courts' role to harmonise national corporate governance standards with international standards

It is further suggested and predicted here that South African courts are encouraged or mandated by the Act to contribute towards the harmonisation of provisions of the Act with relevant international experiences or evolving international standards.⁹⁴

V. Use of codes of corporate governance – especially King III as an aid for interpretation

Given the fact that the codes of corporate governance developed by the King Committee in South Africa have made a contribution to law reform, there is no reason why these reports should not be relied upon by the judiciary as an aid to statutory interpretation. The partial codification of directors' duties and the adoption of the BJR in a statute (in this case under the present Act) received support from *King I* and *King II* as demonstrated in this

⁹¹ See s7 (b) (iii).

⁹² See part 6.3.2 of Chapter 6

⁹³ See part 6.3.1 (iii) of Chapter 6.

⁹⁴ See part 6.3.1 (ii) of Chapter 6.

study.⁹⁵ *King III* does not contain any recommendations unlike its predecessors. *King III* was developed specifically to be supportive of principles contained in the Act and to usher evolving international corporate standards or trends into South African corporate governance. Thus the report provides a link between those matters that were recommendations in the previous King reports but are now matters of the law under the Act.⁹⁶ Hence *King III* could boldly suggest that the criteria of good governance, governance codes and guidelines will be relevant to determine what is regarded as an appropriate standard of conduct for directors.⁹⁷ In two very recent cases, South African courts demonstrated that corporate governance codes have potential to play a very meaningful role as interpretation aids during adjudication of matters.⁹⁸ Therefore *King III* in particular will have to form part of the judicial policy towards interpretation of provisions of the Act.

7.4 CONCLUDING REMARKS: The Future of Corporate Governance in South Africa

This Study has demonstrated that subsections 76(3) (c) and 76(4) (a) can be analysed and interpreted to reveal strengths as well as shortcomings. Despite the weaknesses for which proposals for law reforms have been made, there is no doubting that the overall legal framework under the Act provides potentiality for promoting high standards of corporate governance. For example, as demonstrated above and throughout this Study, the purposes of the Act can be a basis for making a case for tightening up standards where they are weak. Standards of conduct and review can and indeed should be interpreted in a manner that gives effect to the spirit, purposes and objects of the Act. A contextual interpretation of standards under the Act for example, should reveal that s76(3)(c) and s76(4)(a) complement each other as demonstrated. It is perhaps too early to make judgment as to whether the application of the BJR will detract from the effectiveness of the statutory or common law duty of care or not. Evidence from the *Visser Sitrus* case appears to indicate that directors' decisions are likely to enjoy a safe harbour where elements of s76 (4) (a) are satisfied.⁹⁹ *Visser Sitrus* is just one of many decisions to come, and different courts may adopt a different attitude. Indications are that courts may follow a policy of deference to business judgments of directors where

⁹⁵ See part 2.3 of Chapter 2.

⁹⁶ See the 'Introduction and Background' to *King III*.

⁹⁷ *Ibid* at p5.

⁹⁸ See *South African Broadcast Corporation Ltd v Mpofo* (supra) referred to in part 7.2.2 above. Also see the *Stilfontein* case referred to in part 2.2.1 of Chapter 2 where the court referred with approval to provisions of *King II* when holding that directors were in dereliction of duty.

⁹⁹ *Visser Sitrus* (supra) 98. Rogers J dismissed the application by a shareholder who challenged the decision of the company board to refuse transfer of shares. The applicant had prayed for relief from oppressive or prejudicial conduct or from abuse of separate juristic personality of a company in terms of s163 of the Act.

requirements of s76 (4) (a) are satisfied, even if they may lead to a limitation of the rights of affected parties as was the result in *Visser Sitrus*. The Act itself mandates courts and any forum interpreting and applying provisions to prefer an interpretation which best promotes values underpinning the Act.¹⁰⁰ As aforementioned, the Act permits courts to enrich jurisprudence by infusing local standards with evolving international standards when interpreting and applying the Act.¹⁰¹

The further potential of the Act is to be seen in the multiple forums for resolving disputes established by the Act. As stated previously, there is no point in establishing good standards, if those standards will not be effectively enforced. The Act has strengthened the liability regime for breach of standards. Another important factor to consider is the extended *locus standi* in s157 of the Act.

All the factors stated above point towards the potentiality of increasing chances of incremental development of standards through future case law and effective application of standards. Courts of law have a critical role to play in further shaping the standards of corporate governance in the country. Given the potential that exists under the Act, and the proposals made in this study, South Africa has reason to believe that corporate governance has been set on a trajectory for future growth.

¹⁰⁰ See s158 of the Act.

¹⁰¹ See s5 (2).

BIBLIOGRAPHY

Books

Arsalidou Demetra *The Impact of Modern Influences on the Traditional Duties of Care, Skill and Diligence of Company Directors* Kluwer Law International, The Hague/London/Boston 2001

Cassim FHI *et al Contemporary Company Law* 2 ed. (Juta Claremont, 2012)

Cilliers HS and Benade ML (ed) *et al Corporate Law* 3 ed. (Butterworth's, Durban, 2000)

Davies PL *Davies and Gower's Principles of Modern Company Law* 7 ed (London Sweet & Maxwell, 2003)

Davis D *et al Companies and Other Business Structures in South Africa* 2nd ed (Oxford University Press, Southern Africa Pty Ltd, Cape Town, 2011)

Dignam A *Hicks & Goo's Cases & Materials on Company Law* 7ed (Oxford University Press, 2011).

du Plessis JJ, Hargovan, Bagaric M, *Principles of Contemporary Corporate Governance* 2nd ed (Cambridge University Press, 2011)

Girvin S, Frisby S, Hudson A *Charlesworth's Company Law* 18th ed (Sweet and Maxwell, 2010)

Kellaway E *Principles of Legal Interpretation of Statutes, Contracts & Wills* (Butterworth Publishers Pty Ltd, South Africa, 2006)

Lipton P and Herzberg A *Understanding Company Law* 6th ed (Sydney: LBC Information Services, 1995)

Mitchel PLR *Insider Dealing and Directors' Duties* 2nd ed (Butterworths, London, 1989)

Mongalo TH (ed) *Modern Company Law for a Competitive South African Economy* (Juta Cape Town 2010)

Neethling J, Potgieter JM & Visser PJ *Law of Delict* 6ed (Lexis Nexis, 2010)

Parkinson JE *Corporate Power and Corporate Responsibility- Issues in the Theory of Company Law* (Clarendon Press, 1995)

Pretorius JT and Delpont PA *South African Company Law Through the Cases-A Source Book* 6th ed (Juta & Co. Ltd, 1999)

Pretorius JT, Delpont PA, Havenga M and Vermaas M *Hahlo's South African Company Law Through The Cases* 5th ed (Juta Cape Town 1991).

Tricker B *Corporate Governance: Principles, Policies and Practices* 2ed (Oxford University Press, 2012)

Van Dorsten JL *Rights, Powers and Duties of Directors* (Obiter Publishers CC, 1992)

Cases

Australia

Australian Securities and Investments Commission v Adler (2002) ACSR 72

Australian Securities and Investments Commission v Healey and Others [2011] FCA 717,
Australian Securities and Investments Commission v Healey and Others (No.2) [2011] FCA
1003 (Federal Court of Australia, Middleton J, 27 June 2011, 31 August 2011).

Australian Securities and Investments Commission v Fortescue Metals Group Ltd [2011]
FCAFC 19 (Full Federal Court).

Australian Securities and Investments Commission v Macdonald [NO 11] (2009) 256 ALR

Australian Securities and Investments Commission v Maxwell (2006) 59 ACSR

Australian Securities and Investments Commission v Rich (2010) 75 ACSR 1.

Australian Securities and Investments Commission v Vines (2004) 48 ACSR 322.

AWA v Daniels (1992) 7 ACSR

Byrne v Baker [1964] VR 443.

Daniels (formerly practising as Deloitte Haskins & Sells) v Anderson (1995) 16 ACSR 607 (NSW); (1995) 37 NSWLR 438.

Gamble v Hoffman (1997) 24 ACSR 369

Harlowes Nominees Pty Ltd v Woodside (Lakes Entrance) Oil Co (1968) 121 CLR

Mulkana Corp NL (in Liq) v Bank of New South Wales (1983) 8 ACLR 278 SC (NSW).

The Bell Group Ltd v Westpac Banking Corporation (No.9) [2008] WASC 239 (28 October 2008) [4362].

Re Property Force Consultancy Pty Ltd 1995 13 ACLC

Vines v Australian Securities and Investments Commission (2007) 62 ACSR 1, 149

White v Jones [1995] 2 AC 207.

United Kingdom

Bank of England v Vagliano Bros [1891] A.C.

Bristol and West Building Society v Mothew [1998] Ch 1.

Corporate Affairs Commission v Drysdale (1978) 141 CLR.

Dorchester Finance Co v Stebbing [1989] B.C.L.C 498.

Dovey v Cory 1901 AC 477.

Earl of Halsbury LC in *Dovey v Cory* 1901 AC 477.

Ferguson v Wilson L.R 2 Ch.77.

Foss v Harbottle (1843) 67 ER 189.

Gregson v HAE Trustees Ltd [2008] EWHC 1006 (Ch); [2009] 1 All E.R (Comm)

Henderson v Merrett Syndicates Ltd [1995] 2 AC 145

Howard Smith Ltd v Ampol Petroleum & Others [1974] 1 All ER 1126 (PC)

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

In re Elgindatahad Ltd [1991] BCLC 959 Ch.

In Re Smith and Fawcett Ltd [1942] Ch 304 (CA)

Item Software (UK) Ltd v Fassihi [2004] EWCA Civ. 1244.

Keech v Sanford (1726) Sel Cas Ch 61.

Lagunas Nitrate Co v Lagunas Syndicate [1899] 2 Ch 392.

Niagra Ltd (in Liquidation) v Langerman & others 1913 WLD 188.

Norman v Theodore Goddard [1991] BCLC 1028

Overend, Gurney & Co v Gibb (1872) LR HL 480.

Principal Immigration Officer v Hawabu 1936 AD 26.

Re Barings plc (No 5)

Re Brazilian Rubber Plantations and Estates Ltd [1911] 1 Ch 425 (ChD).

Re Cardiff Savings Bank: Marquis of Bute's Case [1892] 2 Ch 100

Re City Equitable Fire Insurance Co Ltd [1925]

Re Denham & Co (1884) LR 25 Ch D 752.

Re D'Jan of London Ltd [1993] BCC 646

Re Elgindata Ltd 1991 BCLC 959.

Re Hydrodam (Corby) Ltd [1994] BCC 161.

Re Imperial Hydropathic Hotel Co (1882) 23 Ch. D.I.PP.

Re Mea Corporation Ltd [2007] BCC 288

Salomon v Salomon & Co Ltd [1897] AC 22 (HL).

Secretary of State for Trade and Industry v Tjolle [1998] BCC 282.

Shuttleworth v Cox Brothers & Co (Maidenhead) Ltd [1972] 2 KB 9 (CA).

Sub Nom Secretary of State for Trade and Industry v Baker and others (No 5) [1999] 1 BCLR 433 (Ch D)

Turquand v Marshall (1896) LR 4 Ch App 379.

United States America

Aronson v Lewis, 473 A.2d 805, 812 (Del. 1984)

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

Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 367 (Del.1993).

Cf Brane v Roth 590 NE 2d 587 at 592. (Ind App , 1992).

Godbold v Branch Bank Mobile 11 Ala. 191 (1847)

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

Federal Deposit Insurance Corporation v Stanley 770 F. Supp 1281 N.D.Ind. (1991).

Francis v United Jersey Bank 432 A. 2d 814 821-823 (1981)

Joy v North, 692 F. 2d 880, 885-886 (2d Cir. 1982)

McMillan v Beran 755 A.2d 910, 916-917 (Del. 2000).

Miller v Schreyer 683 NYS 2d 51 at 54 (App Div, 1999).

Omincare, Inc. v. NCS Healthcare Inc., 818 A.2d 914, 927 (Del. 2003).

Rankin v Cooper 149 F. 1010 (1907) at 1013

Shlensky v Wrigley case 237 N.E. 2d 776 (Ill. App. Ct 1968).

Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del.1971).

Smith v Van Gorkom 488 A.2d 858 873 (1981)

Washington Bancorporation v Said 812 F. Supp 1256 1265-1267 (1997)

South Africa

Airport Cold Storage (Pty) Ltd v Ebrahim 2008 (2) SA 303 (C).

Barkhuizen v Napier 2007 5 SA 323 (CC).

Bato Star Fishing (Pty) Ltd v Minister of Environmental Affairs and Tourism 2004 (4) SA 490 (CC).

Ben-Tovim v Ben-Tovim and Others 2001 (3) SA 1074 (CPD).

Brisley v Drotsky 2002 4 SA 1 (SCA).

Carmichele v Minister of Safety and Security (Centre for Applied Legal Studies Intervening) 2001 4 SA 938 (CC).

Caxton Ltd v Reeva Forman (Pty) Ltd 1990 (3) SA 547 (A).

Cohen v Segal 1970 (3) 702 (W).

Commissioner for Inland Revenue v Friedman NO 1993 (1) SA 353 (A) 370.

Commissioner for Inland Revenue v MacNeillie's Estate 1961 (3) SA 833.

Corporate Affairs Commission v Drysdale (1978) 141 CLR 236.

Dadoo v Krugersdoorp Municipal Council 1920 AD 530.

Da Silva & Others v CH Chemicals (Pty) Ltd 2008 (6) SA 620 (SCA).

Dhlomo v Natal Newspapers (Pty) Ltd (1) SA 945 (A).

Dorbyl Vehicle Trading & Finance Co (Pty) Ltd v Klopper 1996 (2) SA 237 (N) 24.

Du Plessis NO v Phelps (1995) (4) SA 165 (C).

Everfresh Market Virginia (Pty) Ltd v Shoprite Checkers (Pty) Ltd [2011] ZACC 30.

Financial Mail (Pty) Ltd v Sage Holdings Ltd 1993 (2) SA 451 (A).

Fisheries Development Corporations of SA Ltd v Jorgensen & another; Fisheries Development Corporations of SA Ltd v AWJ Investments (Pty) Ltd & others 1980 (4) SA (W).

Heneway Freight Services (Pty) Ltd v Klaus Grogor [2006] SCA 116 (RSA)

Holomisa v Argus Newspapers Ltd 1996 (2) SA 588 (W) 618.

Howard v Herrigel NNO (1991) (2) SA 660 (A).

Investigating Directorate: Serious Offences v Hyundai Motor Distributors (Pty) Ltd: In re Hyundai Motor Distributors (Pty) Ltd v Smit 2001 (1) SA 545 (CC).

Jaga v Donges NO and Another; Bhana Donges NO and Another 1950 (4) SA 653 (A) 662.

Land and Agricultural Development Bank of SA v Parker [2004] 4 All SA 261 (SCA).

Levin v Felt and Tweeds 1951 (2) SA 401 (A) 414.

Lordon v Dusky Dawn Investments (in liquidation) (Pearmain Intervening) 1988 (4) SA 519 (SECLD) 521 B-D.

Lupacchini NO v Minister of Safety and Security [2011] 2 All SA 138 (SCA).

Maasdorp v Haddow 1959 (3) SA 861 (C) 866.

Minister of Water Affairs and Forestry v Stilfontein Gold Mining Co Ltd 2006 5 SA 333 (W).

Napier v Barkhuizen 2006 4 SA 1 (SCA).

Niagra Ltd (in liquidation) v Langerman & Others 1913 WLD 188.

Philotex (Pty) Ltd & Others v Snyman & Others (1998) (2) SA 138 (SCA)

PPWAWU National Provident Fund v Chemical, Energy, Paper, Printing, Wood and Allied Workers' Union 2008 (2) SA 351 (W).

Robinson v Randfontein Estates Gold Mining Co Ltd 1921 AD 168.

S v De Jager 1965 (2) SA 616 (A).

S v Hepker 1973 (1) SA 472 (W) 484.

S v Shaban 1965 (4) SA 646 (W) 652.

South African Broadcast Corporation Ltd v Mpofo [2009] 4 All SA 446.

Stern v Vesta Industries (Pty) Ltd 1976 (1) SA 81 (W) 85.

Theses

Esser Irene-Marie *Recognition of Various Stakeholder Interests in Company Management* (unpublished PhD thesis, UNISA, 2008).

Moyo NJ *South African Principles of Corporate Governance: Legal and Regulatory Restraints on Powers and Remuneration of Executive Directors* Published LLM Thesis (UNISA 2010).

Journal Articles

Ahern D, "Directors' duties, Dry Ink and the Accessibility Agenda" (2012) *Law Quarterly Review* Vol.128.

Bainbridge S 'The Business Judgment Rule as an abstention Doctrine' (2004) *57 Vand. L. Rev.* 83 at 84.

Barnard J, "Corporate Boards and the New Environmentalism" (2006-2007) *31 William & Mary Environmental Law and Policy Review* 291-316.

Bekink M, 'An Historical Overview of the Director's Duty of Care and Skill: From the Nineteenth Century to the Companies Bill of 2007 (2008) *South African Law Journal*.

Blair Margaret M. & Stout Lynn A. 'A Team Production Theory of Corporate Law (1999) *85 Virginia Law Review* 288.

Botha D & Jooste R, 'A critique of the Recommendations in the King Report regarding a Director's Duty of Care and Skill' *South African Law Journal* Vol. 114 65-76

Bouwman N, 'Modification of the Director's duty of care and skill' (2009) *21 SA Mercantile Law Journal* 509-534.

Branson D, 'A Business Judgment Rule for Incorporating Jurisdictions in Asia?' (2011) *23 Singapore Academy of Law Journal* 687-713

Branson D, 'The Rule that isn't a Rule- The Business Judgment Rule' (2002) *36 Valparaiso University Law Review* 631-654.

Bruner CM, 'Is the Director's Duty of Care a 'Fiduciary' Duty? Does it Matter?' (2013) *48 Wake Forest Law Review* 1027-1054.

Cassidy J, 'Models for Reform: The Directors' Duty of Care in a Modern Commercial World' (2009) 3 *Stellenbosch Law Review* 373-406.

Cassidy J 'An Evaluation of Section 234(2) of the Corporations Law and the Directors' Duty of Care, Skill and Diligence' (1995) *Australian Business LR* 184.

Comino V 'Effective Regulation by the Australian Securities and Investment Commission: The Civil Penalty Problem' (2009) 33 *Melbourne Univ. Law R.* 803-832.

DeBow Michael E. & Lee Dwight R., 'Shareholders, Nonshareholders and Corporate Law: Communitarianism and Resource Allocation', (1993) 18 *Delaware Journal Corporate Law* 397.

du Plessis JJ 'A comparative analysis of directors' duty of care, skill and South Africa and Australia' (2010) 1 *Acta Juridica* 263-289.

Eisenberg MA, 'The Divergence of Standards of Conduct and Standards of Review in Corporate Law' (1993) 62 *Fordham L. Rev.* 444-445.

Eisenberg MA, 'The Duty of Care of Corporate Directors and Officers' (1990) 51 *Uni of Pitt L. Rev* 945

Esser I & Coetzee J "Codification of Directors' Duties" (2004) *Juta's Business Law* 12.

Esser IM & Delpont P 'The Duty of Care, Skill and Diligence: The King Report and the 2008 Companies Act' (2011) 74 *THRHR* 449-455.

Farrar J, 'Directors' duties of care: Issues of Classification, Insolvency and Business Judgment and the Dangers of Legal Transplants' (2011) 23 *Singapore Academy of Law Journal* 745-761.

Finch V 'Company Directors: Who Care About Skill and Care?' (1992) 55 *The Modern Law Review* 179-214.

Freeman R.E. 'The Politics of Stakeholder Theory: Some Future Directions' (1994) 4 *Business Ethics Quarterly* 409.

Gill A 'Corporate Governance as Social Responsibility: A Research Agenda' (2008) 26:2 *Berk. J. Int. Law* 452.

Gregory William A, 'The Fiduciary Duty of Care: A Perversion of Words' (2005) 38 *Akron L.Rev* 181-183

Hamermesh LA & Gilchrist S III 'Corporate Officers and the Business Judgment Rule: A Reply to Professor Johnson' (2005) 60 *The Business Lawyer* 865-876.

Hargovan A, 'Australian Securities and Investments Commission v Macdonald [NO 11]: Corporate Governance Lessons From James Hardie' (2009) 33 *Melbourne Univ. Law R.*

Havenga M, 'The Business Judgment Rule-Should we Follow the Australian Example?' (2000) *South African Mercantile Law Journal*.

Hazen Thomas Lee 'The Corporate Persona, Contract (and Market) Failure, and Moral Values' (1991) 69 *North Carolina Law Review* 278.

Heracleous Loizos and Lan Luh Luh 'Agency Theory, Institutional Sensitivity, and Inductive Reasoning: Towards a Legal Perspective' (2012) 49 *Journal of Management Studies* 223-239.

Jensen Michael 'Value Maximisation, Stakeholder Theory and the Corporate Objective Function' (2001) 14:3 *Journal of Applied Corporate Finance* 297.

Johnson L, 'Unsettledness in Delaware Corporate Law: Business Judgment Rule, Corporate Purpose' (2013) 38 *Delaware Journal of Corporate Law* 406-451.

Jolls C, 'A Behavioral Approach to Law and Economic (1998) 50 *Stan. L. Rev* 1471 at 1523-1527

Jones E, "Directors' Duties: Negligence and the Business Judgment Rule" (2007) 19 *South African Mercantile Law Journal* 326-336.

Joash Amupitan 'Status of a Company Director- An Agent, Trustee or Employee' (2000) 4 *JPPL* 60-70

Keay Andrew "Tackling the Issue of the Corporate Objective: Ana Analysis of the United Kingdom's 'Enlightened Shareholder Value Approach' " (2007) 29:577 *Sydney Law Review* 590.

Manne HG 'Our Two Corporation Systems: Law and Economics' (1967)53 *VA. L. Rev* 259.

McLennan JS, “Duties of Care and Skill of Company Directors and Their Liability for negligence” (1996) 8 *South African Mercantile Law Journal* 94-102.

McMillan L ‘The Business Judgment Rule as an Immunity Doctrine’ (2013) 4 *Wm. & Mary Bus. L. Rev.* 521.

Michael Bradley et al ‘The Purposes and Accountability of the Corporation in Contemporary Society: Corporate Governance at a Crossroads (1999) 62 *LAW & CONTEMP. PROBS*

Mildred Bekink ‘An Historical Overview of the Director’s Duty of Care and Skill: From the Nineteenth Century to the Companies Bill of 2007’ (2008) 20 *SA Merc LJ* 95 at 97.

Millon David ‘Communitarians, Contractarians, and the Crisis in Corporate Law (1993) 50 *Washington and Lee Law Review* 1378.

Millon David, ‘Theories of the Corporation’, (1990) *Duke Law Journal* at 205-232.

Norman E & Di Guglielmo CT ‘What happened in Delaware Corporate Law and Governance from 1992- 2004? A Retrospective on Some Key Developments’ (2005) 153 *U. PA. L. Rev* 1399.

Reisberg A, “Corporate Law in the UK after Recent Reforms: The Good, the Bad and the Ugly” (2010) 63 *Current Legal Problems* 315-374.

Santow K, “Codification of Directors’ Duties (1999) 73 *ALJ* 336

Sneirson, Judd F ‘Doing Well By Doing Good: Leveraging Due Care for Better, More Socially Responsible Corporate Decision-making’ (2007) 3 *Corporate Governance Law Review*.

Tunc, A ‘The Judge and the Businessman’ 1986 (102) *Law Quarterly Review* 560.

Velasco Julian ‘The Fundamental Rights of the Shareholder’ (2006) 40:407 *University of California Davis Law Review* 412.

Velasco Julian ‘Shareholders Ownership and Primacy’ (2010) 3 *University of Illinois Law Review* 898-956.

Weng C “Assessing the Applicability of the Business Judgment Rule and the “Defensive” Business Judgment Rule in the Chinese Judiciary: A Perspective on Takeover Dispute Adjudication” (2010) 34 *Fordham International Law Journal* 124-146.

Reports

American Law Institute (ALI) *Principles of Corporate Governance and Structure: Restatement and Recommendations*, 1982 (United States of America).

The King Report on Corporate Governance for South Africa (The Institute of Directors in Southern Africa), King I, 1994.

The King Report on Corporate Governance for South Africa (The Institute of Directors in Southern Africa), King II, 2002

The King Report on Corporate Governance for South Africa (The Institute of Directors in Southern Africa), King III, 2009.

Report of the Committee on The Financial Aspects of Corporate Governance (the Cadbury Report), (published on 1 December 1992, Gee and Co. Ltd).

Legislation, Policy Papers & other Regulatory Instruments

Auditing Profession Act 26 of 2005 (South Africa).

Close Corporation Act 69 of 1984 (South Africa).

Companies Act, Cap.46 of 2006 (United Kingdom)

Companies Act 61 of 1973 (South Africa).

Companies Act 71 of 2008, GN 421 2009 in GG 32121, April 2009 (South Africa).

Consumer Protection Act 68 of 2008, (South Africa).

Corporations Act 2001 (Australia).

Financial Intelligence Centre Act 38 of 2001 (South Africa).

German Stock Corporations Act 2005 (Germany)

National Credit Act 34 of 2005 (South Africa).

Securities Services Act 36 of 2004

South African Company Law for the 21st Century: Guidelines for Corporate Reform, 2004, GN 1183 in GG 2004-06-23 (South Africa).

Reducing Greenhouse Gas Emissions: The Carbon Tax Option, December 2010 (South Africa).

Internet Sources

‘A renewed EU strategy 2011-14 for Corporate Social Responsibility’ available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0681:FIN:EN:PDF> accessed on 4 March 2013.

Cooper SM, *Corporate Governance in Developing Countries: Shortcomings, Challenges and Impact on Credit*, a paper presented at the Modern Law for Global Commerce Congress of UNCITRAL, Vienna 9-12 July 2007, available at http://www.uncitral.org/pdf/english/congress/Cooper_S_rev.pdf

Edelman James ‘Directors and Fiduciary Duties: The Story of Nocton v Lord Ashburn’ (May 23, 2012) available at http://www.supremecourt.wa.gov.au/files/Directors_and_Fiduciary_Duties_20120523.pdf , accessed on 19 August 2013

JSE Listings Requirements available at http://www.jse.co.za/listing_requirements.jsp , accessed on 20 February 2013.

Keay Andrew ‘Moving Towards Stakeholderism? Constituency Statutes, Enlightened Shareholder Value, and all that: Much ado about little?’ electronic copy available at <http://ssrn.com/abstract=1530990> at 5-6, accessed on 19 July 2013.

Kershaw, David, ‘The Rule in Foss v Harbottle is Dead; Long Live the Rule in Foss v Harbottle’ (January 30, 2013). LSE Legal Studies Working Paper No. 5/2013. Available at SSRN: <http://ssrn.com/abstract=2209061> or <http://dx.doi.org/10.2139/ssrn.2209061> accessed on 02 September 2013.

Linda Mswaka ‘Corporate governance under the South African Companies Act: A critique’, available at <http://ssrn.com/abstract=2184678> accessed on 19 February 2013.

Lindsay KH, “Codification of directors’ duties- Between the devil and the deep blue sea”, available at <http://www.hrfuture.net/governance/codification-of-directors-duties.php?Itemid=153>

McCarthy, C.2009. *The global financial and economic crisis and its impact on Sub-Saharan economies.* tralac Trade Brief 1. Available at <http://www.tralac.org/wp-content/blogs.dir/12/files/2011/uploads/TB012009GlobalCrisis20090401Fin.pdf>

OECD Principles of Corporate Governance 2004 document, available at www.oecd.org/corporate/ca/corporategovernanceprinciples/31557724.pdf, accessed on 16 February 2013.

Reducing Greenhouse Gas Emissions: The Carbon Tax Option, December 2010- A South African Discussion paper, available at <http://www.treasury.gov.za/public%20comments/Discussion%20Paper%20Carbon%20Taxes%2081210.pdf>

ITime files for liquidation, available at <http://www.iol.co.za/business/companies/itime-has-filed-for-liquidation-1.1416938#.UNOD52edJRw>

‘What is responsible investment?’ available at <http://www.unpri.org/about-ri/introducing-responsible-investment/> accessed on 4 March 2013.

Zwinge T, *Have Directors Duties Of Care And Skill Become More Stringent? What Has Driven This Development? Is This Development Beneficial- An analysis of the Duty of Care in the UK in Comparison to German Duty of Care*, available at <http://ssrn.com/abstract=1591590>