

AN ANALYSIS OF THE DIRECTORS' DECISION-MAKING FUNCTION THROUGH THE LENS OF THE BUSINESS-JUDGMENT RULE

Jan-Louis van Tonder

LLB LLM

Postgraduate Certificate (Competition Law)

Postgraduate Diploma EU Competition Law

Research Associate, Labour and Social Security Unit

Nelson Mandela Metropolitan University

Port Elizabeth

Attorney and Conveyancer of the High Court of South Africa

SUMMARY

The main purpose of this article is to examine the standard of conduct required from a director in the exercise of his decision-making function, through the lens of the business-judgment rule. The business-judgment rule provides the circumstances in which the duty to act in the best interests of the company and the duty of care, skill and diligence will be satisfied by a director. In order to achieve the stated goal the board's statutory managerial authority, the standard of director's conduct required to discharge the duty of care, skill and diligence as provided for in section 76(3)(c), and the features and functions of the business-judgment rule will also be examined. Section 5(2) of the Act provides that, to the extent appropriate, a court interpreting or applying the provisions of the Act may consider foreign-company law. This is complementary to section 5(1) which directs that the Act must be interpreted and applied in a manner that gives effect to the purpose of section 7. The article will refer to the highly developed corporate law in the State of Delaware to assist the research in examining the content and meaning of the decision-making function as a standard of director's conduct. For this reason, the corporate legislative framework of the State of Delaware will also be discussed.

1 INTRODUCTION

During the last two decades there has been a spate of high-profile corporate collapses both nationally¹ and internationally,² cartel activity in the

¹ Eg, Masterbond, Saambou Bank, Fidentia and the construction-collusion scandal. See 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;

² Eg, Enron and WorldCom. See Cunningham "The Sarbanes-Oxley Yawn: Heavy Rhetoric, Light Reform (And It Might Just Work)" 2003 35 *Connecticut LR* 915; Langevoort "Internal

construction industry,³ global financial markets have been turbulent and the global economy seems to have followed this direction. Decisions were made and risks were taken that have resulted in outcomes which the directors and management of companies, on a hindsight basis, would have wanted to avoid. The losses suffered by the various stakeholders in the process have focused more attention on the corporate governance of directors, particularly in the management and supervision of the company.⁴

The management function of directors can be divided into two broad areas, namely decision-making and supervision.⁵ The decision-making function requires the board to determine matters of policy and to make significant decisions that plan the company's future.⁶ The supervision function⁷ requires the board to monitor those assigned to carry out the board's decisions.⁸ Section 76(3)(c) of the Companies Act 71 of 2008⁹ provides for the director's duty of care, skill and diligence in the exercise of his functions or powers within the company.

Section 76(4) introduces the business-judgment rule.¹⁰ The business-judgment rule¹¹ provides the circumstances in which the duty to act in the best interests of the company and the duty of care, skill and diligence will be satisfied by a director.¹² If the director's decision-making process is not tainted by a personal financial self-interest¹³ the business-judgment rule provides a director with a shield from liability, provided certain requirements are satisfied.¹⁴ The business-judgment rule relates to the decision-making function of the duty of care, skill and diligence and presumes that directors,

Controls after Sarbanes-Oxley: Revisiting Corporate Law's Duty of Care as Responsibility for Systems" 2006 31 *Journal of Corporation Law* 949.

³ Gedye "Construction: Firms hit by cartel scam may sue for billions" (15 February 2013) <http://www.mg.co.za/article/2013-02-15-00-firms-hit-by-cartel-scam-may-sue-for-billions> (accessed 2013-03-22).

⁴ DTI *South African Company Law for the 21st Century Guidelines for Corporate Law Reform* 2004; Cunningham 2003 35 *Connecticut LR* 917; Langevoort 2006 31 *Journal of Corporation Law* 949; Olson and Briggs "The Model Business Corporation Act and Corporate Governance: An enabling statute moves towards normative standards" 2011 74 *Law and Contemporary Problems* 31 31–33.

⁵ *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959 (Del. Ch. 1996) 968; see also Committee on Corporate Laws, ABA Section of Business Law 2007 *The Business Lawyer* 1494 provides that "A director's duty of care primarily relates to the responsibility to become informed in making decisions and overseeing the management of the corporation".

⁶ *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959 (Del. Ch. 1996) 968 the court held that "Legally, the board itself [is] required to authorize the most significant corporate acts or transactions: mergers, changes in capital structure, fundamental changes in business, appointment and compensation of the CEO, etc".

⁷ Also known as the duty of oversight.

⁸ *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959 (Del. Ch. 1996) 968.

⁹ Hereinafter "the Act"; the 2008 Act was signed into law by the State President on 8 April 2009 and was gazetted on 9 April 2009, GN 421 in GG 32121 as the Companies Act 71 of 2008. The Act was proclaimed into operation by GN R32 in GG 34239 on 2011-05-01.

¹⁰ Delpont (ed), Vorster, Burdette, Esser and Lombard *Henochsberg on the Companies Act 71 of 2008* 1ed Vol 1 (2011) 298(5) (hereinafter "Henochsberg" in the text to avoid confusion with the editor's other publications).

¹¹ S 76(4)(a); see Delpont *et al Henochsberg on the Companies Act 71 of 2008* 298(5).

¹² S 76(4)(a); see also *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd* 2014 (5) SA 179 (WCC) par 80.

¹³ See s 76(4)(ii) in this regard.

¹⁴ S 76(4)(a).

in making a business decision, complied with their duty to become informed about the matter, and that the decision was made in the best interests of the company.¹⁵ The business-judgment rule therefore sets out the decision-making function of the duty of care, skill and diligence as viewed through section 76(4)(a)(i).

This article will critically examine the standard of conduct required from a director in the exercise of his decision-making function through the lens of the business-judgment rule. In order to achieve this goal the board's statutory managerial authority, the standard of director's conduct required to discharge the duty of care, skill and diligence as set out in section 76(3)(c), and the features and functions of the business-judgment rule will also be examined. Section 5(2) of the Act provides that, to the extent appropriate, a court interpreting or applying the provisions of the Act may consider foreign-company law. This is complementary to section 5(1) which directs that the Act must be interpreted and applied in a manner that gives effect to the purpose of section 7.¹⁶ The article will refer to the highly developed law in the State of Delaware to assist the research in examining the content and meaning of the decision-making function as a standard of director's conduct. For this reason, the corporate legislative framework of the State of Delaware will be discussed first.

2 DELAWARE CORPORATE LAW

While each State in the United States of America has a separate statutory regime and corporate jurisprudence, many companies choose to incorporate in the State of Delaware.¹⁷ More than half of the Fortune 500 companies and more than 45 per cent of NYSE listed companies choose to organize in Delaware.¹⁸ With regards to reincorporation, more than 82 per cent of corporations switch from their initial State of incorporation to Delaware.¹⁹

Although corporations in Delaware are governed by the Delaware General Corporation Law,²⁰ the fiduciary duties of directors are primarily governed by Delaware's common law and case law. The DGCL, common law and case law together form Delaware's corporate law.²¹

The case law created over the years by the Court of Chancery and the Delaware Supreme Court reflects the expertise of Delaware's corporation

¹⁵ S 76(4)(a)(i) and (iii).

¹⁶ In this regard the Act is aimed at balancing the rights and obligations of shareholders and directors within companies (s 7(i)); and encourages the efficient and responsible management of companies (s 7(j)).

¹⁷ Kahan and Rock "Symbiotic Federalism and the Structure of Corporate Law" 2005 58 *Vanderbilt LR* 1573 1574–1584; Bebchuk and Hamdani "Federal Corporate Law: Lessons from History" 2006 6 *Columbia LR* 1–41; Roe "Delaware's Competition" 2003 117 *Harvard LR* 2003 1 41–44.

¹⁸ Dooley and Goldman "Some Comparisons between the Model Business Corporation Act and the Delaware General Corporation Law" 2001 56 *The Business Lawyer* 737 737.

¹⁹ Dooley and Goldman 2001 56 *The Business Lawyer* 738; see also Loewenstein "Delaware as Demon: Twenty-five years after Professor's Cary's Polemic" 2000 71 *University of Colorado Law Review* 497.

²⁰ Title 8, Chapter 1 of the Delaware Code; Hereinafter "the DGCL".

²¹ Loewenstein 2000 71 *University of Colorado LR* 497.

law.²² This highly developed body of case law is a dominant factor in Delaware's corporation law.²³ The amount of judicial opinions relating to fiduciary duties and the business-judgment rule in Delaware are abundant and has been described as the "mushiness of Delaware fiduciary-duty case law".²⁴

Delaware fiduciary law is best understood "as a set of parables or folktales of good and bad managers and directors, tales that collectively describe their normative role".²⁵ Delaware judges, through their judicial opinions, are good storytellers and despite the "fact-specific, narrative quality" of Delaware judicial opinions, over time those decisions "yield reasonably determinative guidelines".²⁶ Through these "corporate-law sermons" Delaware courts generate, in the first instance, legal standards of conduct which influence the development of the social norms of directors, officers and lawyers.²⁷

3 THE BOARD'S STATUTORY MANAGERIAL AUTHORITY

A registered company is a juristic person²⁸ that exists separately from its management and shareholders.²⁹ A company cannot act on its own.³⁰ It conducts its affairs through representatives.³¹ It is now a matter of statutory law that the company's business and affairs must be managed by or under the direction of its board.³² Accordingly the board has the authority to exercise all of the powers and perform any of the functions of the company.³³ The importance of the statutory managerial authority is twofold, namely³⁴ the statutory power to manage the company is now original instead of delegated,³⁵ and the ultimate power to manage the company is now with the board of directors.³⁶ The company will accordingly be subject to a lesser

²² Black Jr. *Why Corporations Choose Delaware* (2007) 7.

²³ *Ibid.*

²⁴ Rock "Saints and Sinners: How does Delaware Corporate Law work?" 1997 44 *UCLA LR* 1009 1101.

²⁵ Rock 1997 44 *UCLA LR* 1106.

²⁶ Rock 1997 44 *UCLA LR* 1017.

²⁷ *Ibid.*

²⁸ See s 19(1).

²⁹ See s 19(1)(a) and (b); Kennedy-Good and Coetzee "The Business-Judgment Rule (Part 1) 2006 27 *Obiter* 62 63.

³⁰ Kennedy-Good and Coetzee 2006 27 *Obiter* 63; Cassim FHI (man ed), Cassim MF, Cassim R, Jooste, Shev and Yeats *Contemporary Company Law* 2ed (2012) 187.

³¹ Kennedy-Good and Coetzee 2006 27 *Obiter* 63; eg, directors and officers. Cassim *et al* *Contemporary Company Law* 187.

³² S 66(1).

³³ Except to the extent that this Act or the company's Memorandum of Incorporation provides otherwise – s 66(1) of the 2008 Act.

³⁴ Delpont *et al Henochsberg on the Companies Act 71 of 2008* 250(2) – (5); Cassim *et al* *Contemporary Company Law* 507.

³⁵ Delpont *et al Henochsberg on the Companies Act 71 of 2008* 250(2) – (5).

³⁶ Cassim *et al Contemporary Company Law* 507.

degree of shareholders' control³⁷ and directors now have a positive duty to manage the company.³⁸

The statutory managerial authority enables the board to direct the management of a company, to monitor its senior officers, and to make business decisions.³⁹ It applies to all decisions directors make, or should, where they exercise their powers to the benefit of the company.⁴⁰ Accordingly the standards of directors' conduct provision provides that, subject to the business-judgment rule⁴¹ and the standard of conduct that relates to the board's ability to manage the business and affairs of the company under its direction,⁴² a director of a company, when acting in that capacity, *must* exercise the powers and perform the functions of director,⁴³ in good faith and for a proper purpose,⁴⁴ in the best interests of the company⁴⁵ and with the degree of care, skill and diligence that may reasonably be expected of a person,⁴⁶ carrying out the same functions in relation to the company as those carried out by that director,⁴⁷ and having the general knowledge, skill and experience of that director.⁴⁸

The fiduciary duties require directors, when acting in that capacity, to exercise their powers and perform their functions in good faith and for a proper purpose in the best interests of the company.⁴⁹ The duty of care, skill and diligence regulates the performance of these duties.⁵⁰ The business-judgment rule provides the circumstances in which the duty to act in the best interests of the company and the decision-making function of duty of care, skill and diligence, will be satisfied by a director.⁵¹ The justifications for the deference aspect of the business-judgment rule is multifaceted, but usually begins with the fact that directors are conferred with a statutory authority to manage the business and affairs of the company on whose boards they serve.⁵² In turn, it is recognized that the exercise of this statutory power carries with it certain fundamental obligations to the company.⁵³ The imposition of fiduciary duties and the duty of care, skill and diligence on

³⁷ Havenga "Director's Exploitation of Corporate Opportunities and the Companies Act 71 of 2008" 2013 2 *TSAR* 257 262; Cassim *et al Contemporary Company Law* 507.

³⁸ Delpont *The New Companies Act Manual* 90 fn 68; Havenga 2013 2 *TSAR* 262; Cassim *et al Contemporary Company Law* 507.

³⁹ Alces "Beyond the Board of Directors" 2011 46 *Wake Forest LR* 783 783.

⁴⁰ Bekink 2008 20 *SA Merc LJ* 95; Havenga "The Business Judgment Rule – Should We Follow the Australian Example?" 2000 12 *SA Merc LJ* 25.

⁴¹ S 76(4)(a)–(b).

⁴² S 76(5).

⁴³ S 76(3).

⁴⁴ S 76(3)(a).

⁴⁵ S 76(3)(b).

⁴⁶ S 76(3)(c).

⁴⁷ S 76(3)(c)(i).

⁴⁸ S 76(3)(c)(ii).

⁴⁹ S 76(2) and (3)(a)(b).

⁵⁰ S 76(3)(c); see Cilliers, Benade, Henning, Du Plessis, Delpont, De Koker and Pretorius *Corporate Law* 3ed (2000) 147.

⁵¹ S 76(4)(a); see also *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd supra* par 80.

⁵² S 66(1).

⁵³ S 76.

directors thus provides an underlying premise for the separation of legal control from ownership.⁵⁴

4 THE DUTY OF CARE, SKILL AND DILIGENCE

According to section 76(3)(c) when a director of a company exercises the powers and/or performs the functions of a director,⁵⁵ it must be done with the degree of care, skill and diligence that may reasonably be expected of a person⁵⁶ carrying out the same functions in relation to the company as those carried out by that director,⁵⁷ and having the general knowledge, skill and experience of that director.⁵⁸

Bouwman,⁵⁹ Davis,⁶⁰ Bekink,⁶¹ Botha,⁶² Esser and Delpport,⁶³ McLennan,⁶⁴ Cassim,⁶⁵ Henochsberg,⁶⁶ Du Plessis,⁶⁷ Stein and Everingham⁶⁸ and Cassidy⁶⁹ all agree that section 76(3)(c) introduces both objective and subjective standards into the statute.

4.1 The objective standard

Section 76(3)(c)(i)⁷⁰ provides the objective standard and requires a director to exercise the degree of care, skill and diligence that may reasonably be

⁵⁴ S 19(1), 66(1) read with s 76 and 77(2).

⁵⁵ S 76(3).

⁵⁶ S 76(3)(c).

⁵⁷ S 76(3)(c)(i).

⁵⁸ S 76(3)(c)(ii).

⁵⁹ Bouwman "An Appraisal of the Modification of the Director's Duty of Care and Skill" 2009 21 *SA Merc LJ* 509 513.

⁶⁰ Davis, Cassim (eds) and Geach (man ed) *Companies and other Business Structures in South Africa: Commercial Law 2ed* (2012) 115.

⁶¹ Bekink 2008 20 *SA Merc LJ* 111.

⁶² Botha "The Role and Duties of Directors in the Promotion of Corporate Governance: A South African Perspective" 2009 30 *Obiter* 710.

⁶³ Esser and Delpport "The Duty of Care, Skill and Diligence: The King Report and the 2008 Companies Act" 2011 74 *THRHR* 449 453.

⁶⁴ McLennan "Directors' Fiduciary Duties and the 2008 Companies Bill" 2009 1 *TSAR* 184 186.

⁶⁵ Cassim *et al Contemporary Company Law* 558–559.

⁶⁶ Delpport *et al Henochsberg on the Companies Act 71 of 2008* 295.

⁶⁷ Du Plessis "A Comparative Analysis of Directors' Duty of Care, Skill and Diligence in South Africa and in Australia" 2010 *Acta Juridica: Modern Company Law for a Competitive South African Economy* 263 269.

⁶⁸ Stein and Everingham *The New Companies Act Unlocked* (2011) 245.

⁶⁹ Cassidy "Models for Reform: The Director's Duty of Care in a Modern Commercial World" 2009 3 *Stell LR* 373 385.

⁷⁰ According to Stein and Everingham *The New Companies Act Unlocked* 244 the first leg contains two different objective tests. It is submitted that the first objective test is found in section 76(3)(c), "with the degree of care, skill and diligence that may reasonably be expected of a person". This amounts to the "reasonable-person" standard. The second objective test is found in section 76(3)(c)(i), "carrying out the same functions in relation to the company as those carried out by that director". This amounts to "a person who does the same job as that director". In this regard Stein and Everingham submit that this is not "a common-law requirement and imposes a stricter duty on directors which the [common law] usually reserves for professionals such as doctors, namely to ensure that they are adequately qualified and experienced to perform their functions".

expected of a person carrying out the same functions in relation to the company as those carried out by that director. The standard provided for is that of a reasonable person,⁷¹ but ultimately takes cognizance of the fact and links the reasonable person in the situation to a reasonable director⁷² with the words “carrying out the same functions in relation to the company as those carried out by that director”. This does not alter the position that the standard of conduct expected of executive and non-executive directors are the same.⁷³ An examination of the wording of section 76(3)(c)(i) and (ii) indicates that the objective standard provided for by the provision, sets the minimum baseline standard with which all directors are expected to comply with.⁷⁴ The objective standard is not limited by the lack of knowledge or experience or the ignorance of the director in question.⁷⁵ Although there is no uniform standard of care for directors, section 76(3)(c) provides for a minimum standard.⁷⁶ The standard of care imposed by section 76(3)(c)(i) is fair and equitable in so far as it is assessed against the standard that may reasonably be expected to be exercised by a person in a like position under similar circumstances.⁷⁷

4 2 The subjective standard

Section 76(3)(c)(ii) provides the subjective standard and requires that the knowledge, skill and experience of that director must also be taken into account. The effect of section 76(3)(c)(ii) is that, if a director possesses a higher quality of skills, experience or knowledge, the level of the subjective standard whereby he will be measured, will be higher.⁷⁸ This will require a more skilled, knowledgeable and experienced director to exercise a level of care and skill that will match his stature.⁷⁹ On the other hand if a director does not possess a high quality of skills, experience or knowledge, a lower level of care and skill will be expected of him, provided that he exercises the minimum reasonable level of care and skill.⁸⁰ The subjective standard of skill, knowledge and experience is only taken into account if it improves or increases upon the objective standard.⁸¹ This will occur if the person has

⁷¹ Stein and Everingham *The New Companies Act Unlocked* 244; Cassim *et al Contemporary Company Law* 559; Botha 2009 30 *Obiter* 710; Cassidy 2009 3 *Stell LR* 385; Du Plessis 2010 *Acta Juridica* 269.

⁷² Cassidy 2009 3 *Stell LR* 385; Davis, Cassim (eds) and Geach (man ed) *Companies and other Business Structures in South Africa: Commercial Law* 115; Delpont *et al Henochsberg on the Companies Act 71 of 2008* 295; Bekink 2008 20 *SA Merc LJ* 111.

⁷³ See also *Philotex (Pty) Ltd v Snyman; Braitex (Pty) Ltd v Snyman* (1998) JOL 1881 (A) 13–14; *Dorchester Finance Co Ltd v Stebbing* (1989) BCLC 498 505, where it was held that in English law there is no distinction between the duties of executive and non-executive directors.

⁷⁴ Bekink 2008 20 *SA Merc LJ* 111; Cassim *et al Contemporary Company Law* 559; Bouwman 2009 21 *SA Merc LJ* 513; Du Plessis 2010 *Acta Juridica* 288; Delpont *et al Henochsberg on the Companies Act 71 of 2008* 295; McLennan 2009 1 *TSAR* 186; Botha 2009 30 *Obiter* 710; Esser and Delpont 2011 74 *THRHR* 453.

⁷⁵ Cassim *et al Contemporary Company Law* 559.

⁷⁶ *Ibid.*

⁷⁷ *Ibid.*

⁷⁸ Cassidy 2009 3 *Stell LR* 385; Du Plessis 2010 *Acta Juridica* 269.

⁷⁹ *Ibid.*

⁸⁰ *Ibid.*

⁸¹ Cassidy 2009 3 *Stell LR* 385; Du Plessis 2010 *Acta Juridica* 269.

some special skills or expertise, for example, an accountant, economist or attorney. The directors will then not be judged by the minimum objective standard, which is the baseline standard expected of directors, but by a more stringent subjective standard.⁸²

4 3 The combined effect of the two standards

The combined effect of the two subsections appears to put aside the individual director's personal skill level in favour of an objective test of what can reasonably be expected of a reasonable, diligent individual performing the same functions, so that if an incompetent director fails to match this minimum threshold, he will be liable.⁸³ But if a person is appointed to exhibit a special or higher professional or technical competence, his own liability threshold is placed above that of the reasonable director and must be judged by the standards of a reasonably competent exponent of his particular industry.⁸⁴

For example, a director of a company is also an attorney. If his conduct were challenged on grounds relating to, for example, general management he would be judged by the normal objective/subjective criterion. However, if his conduct is challenged on grounds such as, a breach of the law, of which it was expected of him to be aware of, the director will be judged by a more stringent subjective standard.⁸⁵ With regards to the element of knowledge it is submitted that the imputed knowledge "duties"⁸⁶ are qualified by "reasonably", which would indicate that the test for the actions considered in relation to section 76(2) is an objective test.⁸⁷ However, if that knowledge and experience is required for purposes of section 76(3), which according to Henochsberg⁸⁸ it clearly is, the subjective element would have the effect that the level would be much higher. All these factors must be taken into consideration when determining whether the particular director has exercised reasonable care and skill and, read as a whole, has complied with the requirements of section 76(3)(c).

Cassidy⁸⁹ and Bekink⁹⁰ submit that the subjective standard may overshadow or undermine the objective standard. The subjective standard of skill, knowledge and experience is only taken into account if it increases or improves upon the objective standard of care or skill that may be expected of a director.⁹¹ If the particular director's skill or knowledge exceeds that of a reasonably diligent person the higher level of knowledge, skill and experience must be taken into account in deciding whether the particular director has exercised reasonable care and skill and has complied with the

⁸² Cassidy 2009 3 *Stell LR* 385; Du Plessis 2010 *Acta Juridica* 269.

⁸³ *Ibid.*

⁸⁴ *Ibid.*

⁸⁵ McLennan 2009 1 *TSAR* 186 provides an example with different facts.

⁸⁶ Delpont *et al Henochsberg on the Companies Act 71 of 2008* 28–28(2).

⁸⁷ Delpont *et al Henochsberg on the Companies Act 71 of 2008* 28–28(2); Cassim *et al Contemporary Company Law* 552–553 is also of the opinion that it is an objective test.

⁸⁸ Delpont *et al Henochsberg on the Companies Act 71 of 2008* 28–28(2).

⁸⁹ Cassidy 2009 3 *Stell LR* 386.

⁹⁰ Bekink 2008 20 *SA Merc LJ* 111.

⁹¹ Cassim *et al Contemporary Company Law* 560.

requirements of section 76(3)(c).⁹² According to Cassim⁹³ the objective standard is thus a flexible and reasonable standard. The objective standard sets the baseline, minimum and irreducible standard with which all directors are expected to comply with, before the subjective elements are taken into consideration.⁹⁴ According to McLennan⁹⁵ the use of the word “reasonably” throughout seems to conflate the duties into one objective standard. The subjective elements under section 76(3)(c) thus do not overshadow or undermine the objective elements, and are in addition to the objective elements.⁹⁶ No longer will incompetents, figureheads and lunatics be able to utilize the subjective standard to circumvent the objective standard to escape liability.⁹⁷

If the right balance between the two subsections is maintained proper results will follow.⁹⁸ The duty of care, skill and diligence indirectly reflects the importance that the legislature has attached to corporate governance and best practices.⁹⁹ A high standard of contemporary corporate governance is not achievable if this provision is structured in lenient terms.¹⁰⁰ The provision has to be interpreted in accordance with commercial realities and not outdated precedents.¹⁰¹

The word “diligence” is introduced into the statutory provision as part of the director’s duty of care and skill. This represents an extension of the common-law duty of care and skill.¹⁰² According to Cassim¹⁰³ the wording of the provision suggests that “care and “skill” is different from “diligence”.

4 4 The meaning of “care” and “skill”

“Skill” refers to the knowledge and experience that a particular director brings to his office.¹⁰⁴ It refers to the technical competence that a director may possess, while “care” refers to the manner in which the skill is applied.¹⁰⁵ Care may be assessed objectively but skill varies from person to person.¹⁰⁶ Skill is that special competence which is not part of the ordinary equipment of the reasonable man but the result of aptitude developed by special training and experience.¹⁰⁷

⁹² Cassim *et al Contemporary Company Law* 560.

⁹³ *Ibid.*

⁹⁴ Bekink 2008 20 *SA Merc LJ* 111; Cassim *et al Contemporary Company Law* 559; Bouwman 2009 21 *SA Merc LJ* 513; Du Plessis 2010 *Acta Juridica* 288; Delpont *et al Henochsberg on the Companies Act 71 of 2008* 295; McLennan 2009 1 *TSAR* 186; Botha 2009 30 *Obiter* 710; Esser and Delpont 2011 74 *THRHR* 453.

⁹⁵ McLennan 2009 1 *TSAR* 186.

⁹⁶ See Bekink 2008 20 *SA Merc LJ* 114; Havenga 2000 12 *SA Merc LJ* 27.

⁹⁷ Cassim *et al Contemporary Company Law* 559; McLennan 2009 1 *TSAR* 186.

⁹⁸ Bekink 2008 20 *SA Merc LJ* 114.

⁹⁹ Cassim *et al Contemporary Company Law* 558.

¹⁰⁰ *Ibid.*

¹⁰¹ *Ibid.*

¹⁰² Du Plessis 2010 *Acta Juridica* 268; Cassim *et al Contemporary Company Law* 559.

¹⁰³ Cassim *et al Contemporary Company Law* 559.

¹⁰⁴ Cassim *et al Contemporary Company Law* 556.

¹⁰⁵ *Ibid.*

¹⁰⁶ Cilliers *et al Corporate Law* 147.

¹⁰⁷ Cassim *et al Contemporary Company Law* 556.

Utilizing the tests set out above in determining the degree of care and skill that may be reasonably expected of a director, the courts should have regard to the nature and size of the company, the nature of the particular decision being challenged, the position of the director and the nature of the responsibilities undertaken by him.¹⁰⁸ But it is not required of directors to take all possible care, only reasonable care is required.¹⁰⁹ Errors or mistakes may occur, but provided the director has acted honestly and exercised reasonable care and skill he/she is not likely to incur liability for negligence.¹¹⁰

Whether a director has entered into an employment contract with the company must be taken into consideration.¹¹¹ A director who derives his remuneration from agency, and is accordingly expected to exercise due performance of specific functions towards the company, will likely be expected to exercise a higher degree of care and skill, as opposed to a director who derives his remuneration from the Memorandum of Incorporation and is not employed for specific or special expertise.¹¹²

For example, a director can be appointed as an expert to the board because he possesses specific knowledge of the particular business in question and would thus be bound to exercise such knowledge for the benefit of the company's interests.¹¹³ A director may also be appointed because he specializes in a certain part of the company's administration, for example, economists, accountants, attorneys or actuaries. It is submitted that persons falling into the latter group must show such a degree of skill as a reasonably competent practitioner would have in that industry. Thus, a stringent, higher subjective standard will be employed, but an element of objectivity remains present because the director is trusted with a specific task or function by virtue of his professional qualifications and experience.¹¹⁴ The company regards the person as capable of fulfilling the task or function and the board will accordingly rely on the person to perform such tasks or functions.¹¹⁵ It is not expected of the person by the mere implication of a possession of skill that he must necessarily exercise the highest degree regarding that skill but it should be above that of the ordinary person.¹¹⁶ The

¹⁰⁸ Cassim *et al Contemporary Company Law* 560.

¹⁰⁹ *Ibid.*

¹¹⁰ *Ibid.*

¹¹¹ Bekink 2008 20 SA Merc LJ 113.

¹¹² See *Howard v Herrigel* (1991) 2 All SA 113 (A) 130-130(1); *Fisheries Development Corporation of SA Ltd v Jorgensen; Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd* (1980) 4 All SA 525 (W) 535.

¹¹³ *Re Brazilian Rubber Plantations and Estates Ltd* (1911) Ch 425 (CA) 437.

¹¹⁴ Bekink 2008 20 SA Merc LJ 111-112.

¹¹⁵ Bekink 2008 20 SA Merc LJ 112.

¹¹⁶ *Lister v Romford Ice and Cold Storage Co Ltd* (1957) 1 All ER 125 130 citing the proposition of Willes J, in *Harmer v Cornelius* (1858) 5 CBNS 236 246, which has never been questioned, held that "[w]hen a skilled labourer, artizan, or artist is employed, there is on his part an implied warranty that he is of skill reasonably competent to the task he undertakes, – *Spondes peritiam artis*. Thus, if an apothecary, a watchmaker, or an attorney be employed for reward, they each impliedly undertake to possess and exercise reasonable skill in their several arts ... An express promise or express representation in the particular case is not necessary"; see also *Kuwait Asia Bank EC v National Mutual Life Nominees Ltd* (1990) 3 All ER 404; in *Voli v Inglewood Shire Council* (1963) HCA 15 (8) Windeyer J, held that "[a]n architect undertaking any work in the way of his profession accepts the ordinary

degree of care and skill to be exercised is to be assessed by virtue of persons in a similar industry and is a question of fact.¹¹⁷ This could imply that the stringent subjective standards are still assessed objectively in relation to a person with equal calling, with experience and skill therein, whether he would or would not have come to the same conclusion as the person in question did.¹¹⁸

A director may also incur liability if he holds himself out as being suitable or competent to do a particular task or function, or performs it with a particular degree of skill, even if he is not professionally qualified.¹¹⁹

4 5 The meaning of “diligence”

The provision extends the common law by introducing the word “diligence” along with care and skill into statute.¹²⁰ As Du Plessis notes, the word “diligence” has hardly ever been used by South African commentators or South African courts.¹²¹ “Diligence” according to the Oxford Dictionary¹²² means “careful and persistent work or effort”. According to *Black’s Law Dictionary*¹²³ “diligence” means “[p]rudence; vigilant activity; attentiveness; or care, of which there are infinite shades, from the slightest momentary thought to the most vigilant anxiety”.¹²⁴

liabilities of any man who follows a skilled calling. He is bound to exercise due care, skill and diligence. He is not required to have an extraordinary degree of skill or the highest professional attainments. But he must bring to the task he undertakes the competence and skill that is usual among architects practising their profession. And he must use due care. If he fails in these matters, and the person who employed him thereby suffers damage, he is liable to that person. This liability can be said to arise either from a breach of contract or in tort”.

¹¹⁷ In *Chapman v Walton* (1833) 10 Bing 57 the court held that “The point, therefore, to be determined, is not whether the defender arrives at the correct conclusion upon reading the letter, but whether upon the occasion in question, he did or did not exercise a reasonable and proper care, skill and judgment. This is a question of fact, the decision of which appears to us to rest upon this further inquiry, viz. whether other persons exercising the same professional calling, and being men of experience and skill therein, would or would not have come to the same conclusion as the defender”; *Voli v Inglewood Shire Council* (1963) HCA 15 (8).

¹¹⁸ Bekink 2008 20 SA Merc LJ 111–112.

¹¹⁹ *Esso Petroleum Co Ltd v Mardon* (1976) 2 All ER 5.

¹²⁰ Du Plessis 2010 *Acta Juridica* 268 asserts, without providing authority, that “[a]s far as general noteworthy aspects are concerned, first, it should be noted that the word ‘diligence’, hardly ever used by South African commentators or South African courts, is also included in s 76(3)(c). There is little doubt that this has been derived from the Australian legislation – s 180(1) of the Australian Corporations Act 2001”. Du Plessis participated as a member of the international reference team in the legal-reform process – see Mongalo “An Overview of Company Law Reform in South Africa: From the Guidelines to the Companies Act 2008” 2010 *Acta Juridica: Modern Company Law for a Competitive South African Economy* xiv fn 12.

¹²¹ Du Plessis 2010 *Acta Juridica* 268.

¹²² *Oxford Dictionaries* (undated) <http://www.oxforddictionaries.com/definition/English/diligence?q=diligence> (accessed 2013-08-27).

¹²³ Garner (ed in chief) *Black’s Law Dictionary* 8ed (2004) 544.

¹²⁴ *Black’s Law Dictionary* 544 provides further that “[t]he law recognizes only three degrees of diligence: (1) Common or ordinary, which men, in general, exert in respect of their own concerns; the standard is necessarily variable with respect to the facts, although it may be uniform with respect to the principle. (2) High or great, which is extraordinary

A director will be required to understand the company's affairs.¹²⁵ He must attend properly to his duties.¹²⁶ This would include attendances at board and other meetings¹²⁷ and attention to related paperwork, devoting attention to the company's affairs and the proper supervision and general monitoring of corporate affairs and policies.¹²⁸

The degree of diligence required under section 76(3)(c) is that diligence that may reasonably be expected of a person carrying out the same functions, in relation to the company as those carried out by that director, and having the general knowledge, skill and experience of that director. Diligence will be assessed in accordance with the objective and subjective standards of which the minimum baseline standard will at the very least be reasonable diligence.¹²⁹ The degree of diligence may vary depending on the nature and business of the company and the position of the director.¹³⁰

5 THE BUSINESS-JUDGMENT RULE AND THE DIRECTORS' DECISION-MAKING FUNCTION

5.1 The business-judgment rule

The business-judgment rule was developed in the United States of America as a common-law rule relating to the directors' duty of care.¹³¹ The business-judgment rule has been described as a standard of liability for the duty of care,¹³² an abstention doctrine,¹³³ an immunity doctrine,¹³⁴ a defence and as

diligence, or that which very prudent persons take of their own concerns. (3) Low or slight, which is that which persons of less than common prudence, or indeed of no prudence at all, take of their own concerns".

¹²⁵ *Fisheries Development Corporation of SA Ltd v Jorgensen; Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd supra* 535.

¹²⁶ Cassim *et al Contemporary Company Law* 560.

¹²⁷ In *Charitable Corporation v Sutton* (1742) 26 ER 642 644–645 Lord Hardwicke held that, "[i]f directors] are guilty of gross non-attendance and leave the management entirely to others, they may be guilty by this means of the breaches of trust that are committed by others".

¹²⁸ Cassim *et al Contemporary Company Law* 560.

¹²⁹ In *African Claim and Land Co Ltd v W J Langermann* 1905 TS 494 504 Innes CJ, held that an ordinary director is bound "to render that amount of diligence which an ordinary prudent and careful man would display under the circumstances". In *Trustees of the Orange River Land and Asbestos Company v King* 1890 HCG 260 285 Laurence JP, held that "[t]hey are ... at the very least, bound to take such precautions and show such diligence in their office as a prudent man of business would exercise in the management of his own affairs". In *Charitable Corporation v Sutton supra* 644–645 Lord Hardwicke held that "[b]y accepting a trust of this sort, a person is obligated to execute it with fidelity and reasonable diligence".

¹³⁰ In *Re Forest of Dean Coalmining Co* (1878) 10 Ch D 450 452 Jessell MR, held that directors are required "[t]o use reasonable diligence having regard to their position, though probably an ordinary director, who only attends at the board occasionally, cannot be expected to devote as much time and attention to the business as a sole managing partner of an ordinary partnership, but they are bound to use fair and reasonable diligence in the management of the company's affairs, and act honestly".

¹³¹ Kennedy-Good and Coetzee 2006 27 *Obiter* 64; Jones "Directors' Duties: Negligence and the Business Judgment Rule 2007 19 *S A Merc LJ* 326.

¹³² *Zapata Corp. v. Maldonado* 430 A.2d 779 (Del. 1981) 782; Velasco "Structural Bias and the Need for Substantive Review" 2004 82 *Washington University Law Quarterly* 821 828–829; But see Committee on Corporate Laws, ABA Section of Business Law 2007 *The Business Lawyer* 1499.

a presumption. The rule has been called “one of the least understood concepts in the entire corporate field.”¹³⁵

It still is acknowledged as widely misunderstood, “[c]ountless cases invoke it and countless scholars have analysed it. Yet, despite all of this attention, the business judgment rule remains poorly understood.”¹³⁶

In terms of section 76(4), 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 company¹³⁷ will have satisfied his duty to exercise his powers or performed his functions in the best interests of the company and with reasonable care, skill and diligence if:¹³⁸

- “(i) the director has taken reasonably diligent steps to become informed about the matter;¹³⁹
- (ii) either—¹⁴⁰
 - (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;¹⁴¹ or
 - (bb) the director complied with the requirements of section 75 with respect to any interest contemplated in subparagraph (aa);¹⁴² 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.”¹⁴³

The business-judgment rule thus provides the circumstances in which the duties imposed by subsection (3)(b) and (c) of the standards of directors’ conduct provision, will be satisfied by a director.¹⁴⁴ If the director’s decision-making process is free from any self-interest, the business-judgment rule provides a director with a shield from liability provided certain requirements are satisfied.¹⁴⁵ The business-judgment rule relates to the decision-making function of the duty of care, but presumes that directors, in making a business decision, complied with their duty to become informed about the

¹³³ Bainbridge “The Business Judgment Rule as Abstention Doctrine” 2004 57 *Vanderbilt LR*, 83 89–90 arguing that the business-judgment rule is best understood as an “abstention doctrine” that creates a presumption against duty-of-care claims.

¹³⁴ McMillan “The Business Judgment Rule as an Immunity Doctrine” 2013 4 *William and Mary Business LR* 521.

¹³⁵ Johnson “Corporate Officers and the Business Judgment Rule” 2005 60 *The Business Lawyer* 439 454 indicating that “Manne’s statement about the rule remains as true in 2005 as when first made in 1967: the business judgment rule is one of the least understood concepts in the entire corporate field”; Manne “Our Two Corporation Systems: Law and Economics” 1967 53 *Vanderbilt LR* 259 270.

¹³⁶ Bainbridge 2004 57 *Vanderbilt LR* 83–84.

¹³⁷ S 76(4).

¹³⁸ S 76(4)(a).

¹³⁹ S 76(4)(a)(i).

¹⁴⁰ S 76(4)(a)(ii).

¹⁴¹ S 76(4)(a)(ii)(aa).

¹⁴² S 76(4)(a)(ii)(bb).

¹⁴³ S 76(4)(a)(iii).

¹⁴⁴ S 76(4)(a); see also *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd supra* par 80.

¹⁴⁵ S 76(4)(a).

matter and that the decision was made in the best interests of the company.¹⁴⁶

5 1 1 *The features of the business-judgment rule*

The two principle features of the business-judgment rule are: firstly, that a court will presume that in making a business decision the directors of a company acted on an informed basis, in good faith and with a rational basis that an action, or inaction, was taken in the best interest of the company;¹⁴⁷ and secondly, unless a plaintiff can rebut the presumptions created firstly, that is, unless it can be shown that a board of directors did not act on an informed basis, in good faith, and with a rational basis that an action, or inaction, was taken in the best interests of the company, the board of directors will not incur any liability as a result of its decision, and a court will not disturb the decision itself, so long as the decision can be attributed to any rational business purpose.¹⁴⁸

5 1 2 *The functions of the business-judgment rule*

This indicates that the business-judgment rule functions as a procedural rule as well as a substantive rule of law. On the procedural level, the business-judgment rule creates a presumption of an informed business decision, in good faith and was made with a rational belief that the decision was taken in the best interests of the company.¹⁴⁹ In other words, the rule presumes the directors have complied with their duty to become informed about the matter, and that the decision was made in the best interests of the company.¹⁵⁰ The procedural aspect thus requires the plaintiff to establish facts to prove the elements of a breach of duty.¹⁵¹ At this point the substantive aspect of the rule requires the court to defer to a business judgment made by the directors, provided their decision is not completely irrational.¹⁵² This aspect prevents judicial review of the merits of the decision and protects the decision from being challenged.

¹⁴⁶ *Orman v Cullman*, 794 A.2d 5 (Del. Ch. 2002) 19–20; *Aronson v Lewis*, 473 A.2d 805, (Del. 1984) 811–812; *Cede & Co. v Technicolor, Inc.*, 634 A.2d. 345 (Del. 1993) 361; *In re Walt Disney Co. Derivative Litigation (Disney V)*, 906 A.2d 27 (Del. 2006) 52.

¹⁴⁷ S 76(4)(a).

¹⁴⁸ S 76(4)(a)(i) and (iii).

¹⁴⁹ S 76(4)(a)(iii).

¹⁵⁰ *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd supra* 73.

¹⁵¹ *Ibid.*

¹⁵² *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd supra* 73; see also Veasey “The Defining Tension in Corporate Governance in America” 1997 52 *The Business Lawyer* 393 394, noting that under the business-judgment rule, it is difficult to demonstrate that a decision was irrational; see also Rosenberg “Galactic Stupidity and the Business Judgment Rule” 2006 32 *Journal of Corporation Law* 301 321–322, arguing that review for rationality should be expanded to reach extremely stupid decisions.

5 2 The decision-making function

5 2 1 An informed business decision

Section 76(4)(a)(i) provides that directors are required to take reasonably diligent steps to become informed about the particular matter requiring consideration. Before making a business decision it is required that directors inform themselves, prior to making a business decision, of all material information reasonably available to them.¹⁵³ Section 76(4)(b) and (5) allow that, for a director to become informed, a board can retain consultants or other advisors, and can be protected by relying on statements, information and reports furnished by those advisors, if reliance upon such advisors is in good faith and the advisors were selected with reasonable care.

More than a passive acceptance of information presented to the board is required.¹⁵⁴ Directors must proceed with a “critical eye” in assessing information in order to protect the interests of the company.¹⁵⁵ Directors who rely on work prepared by experts, cannot exclusively rely on their expertise and experience to display an informed decision.¹⁵⁶ Hence, in this regard, it is required that directors make a reasonable inquiry into any reports submitted to the board.¹⁵⁷ However, directors are not required to “read *in haec verba* every contract or legal document”,¹⁵⁸ or to verify the calculations of the company’s accountants in preparing financial statements.¹⁵⁹

5 2 2 The standard of director’s conduct

Breaches of the duty of care occur when directors engage in conduct that is grossly negligent, act with reckless disregard to shareholder concerns, or act in a manner that is completely irrational with respect to their decision-making process.¹⁶⁰ “Gross negligence” has been defined as “reckless indifference to or a deliberate disregard of the whole body of [shareholders], or actions which are without the bounds of reason”.¹⁶¹ This indicates an objective test is used to assess, from the perspective of the honest and reasonable person in the position of the director, whether a director could reasonably have believed that he sufficiently informed himself about the subject matter of his

¹⁵³ *Aronson v Lewis supra* 812; *Smith v. van Gorkom* 488 A.2d 858 (Del. 1985) 872.

¹⁵⁴ *Smith v van Gorkom supra* 872.

¹⁵⁵ *Ibid.*

¹⁵⁶ *Smith v Van Gorkom supra* 875, 880.

¹⁵⁷ *Smith v Van Gorkom supra* 875.

¹⁵⁸ *Smith v Van Gorkom supra* 883 fn 25

¹⁵⁹ *ASIC v Rich* (2009) NSWSC 1229 par 7204.

¹⁶⁰ *Smith v van Gorkom supra* 872–873.

¹⁶¹ Allen, Jacobs and Strine Jr. “Realigning the Standard of Review of Director Due Care with Delaware Public Policy: A Critique of Van Gorkom and its Progeny as a Standard of Review Problem” 2002 96 *Northwestern University LR* 449 463; However, where the board is not operating under a going concern assumption, such that the directors are being asked to determine if a merger of the corporation is in the best interests of the shareholders, then gross negligence means a “significant indifference” to the interests of shareholders – see Sharfman “Being Informed does matter: Fine tuning gross negligence twenty plus years after Van Gorkom” 2006 62 *The Business Lawyer* 135 157.

decision.¹⁶² The director's belief about the best interests of the company is to be formed, and its rationality assessed, on the basis of the information obtained through compliance with this requirement.¹⁶³ It is not to be assumed, for the purpose of applying section 76(4)(a)(iii) that the director knows everything that he ought to have known, but only the things that he reasonably believed to be appropriate to find out.¹⁶⁴ In this regard the imputed knowledge duties contained in section 1 need to be taken into consideration.¹⁶⁵ However, the director is responsible only for considering material facts that are reasonably available to him, not those that are immaterial or out of his reasonable reach.¹⁶⁶ An action "not to take action" is also a business decision as long as the decision-making process which led to the decision that action will not be taken, was conducted in good faith and on an informed basis.¹⁶⁷

The business-judgment rule does not apply in matters where the directors fail to adequately carry out their monitoring and oversight function.¹⁶⁸ The business-judgment rule only applies where the directors have exercised a business judgment,¹⁶⁹ while in most oversight matters the directors have failed to act.¹⁷⁰ The presumption of the business-judgment rule does not apply where the board abdicates its responsibility to oversee the affairs and business of a corporation, or where it fails to act absent a conscious decision not to act.¹⁷¹

Conversely, it has been stated that, where a board consciously decides not to act, this decision does in fact amount to a business decision.¹⁷²

5 2 3 Factors that may prove a breach

In *Smith v Van Gorkom*¹⁷³ the court held that the board of Trans Union had breached its duty of care in approving a merger agreement.¹⁷⁴ Van Gorkom was Trans Union's Chairman and CEO and was helped by Bruce Chelberg, an inside director, who together brought about the sale.¹⁷⁵ The remainder of the board was not informed of the proposal until the day before the buyer's deadline to accept it.¹⁷⁶ The board approved the sale based on a twenty-

¹⁶² *ASIC v Rich supra* par 7283.

¹⁶³ *ASIC v Rich supra* par 7291.

¹⁶⁴ *Ibid.*

¹⁶⁵ S 1.

¹⁶⁶ *Brethem v Eisner*, 746 A.2d 244 (Del. 2000) 259.

¹⁶⁷ *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959 (Del. Ch. 1996) 967-968.

¹⁶⁸ *Aronson v Lewis supra* 813.

¹⁶⁹ *Aronson v Lewis supra* 813; *In re Walt Disney Co. Deriv. Litig.*, 907 A.2d 693 (Del. Ch., 2005) 748, the court held that "in instances where directors have not exercised business judgment, that is, in the event of director inaction, the protections of the business-judgment rule do not apply".

¹⁷⁰ Davis Jr. "Once More, The Business Judgment Rule" 2000 *Wis. L. Rev.* 573 576 notes that in matters in which "directors are charged with negligence in failing to detect or respond to a problem" are "often referred to as the directors' 'oversight function'".

¹⁷¹ *Aronson v Lewis supra* 813.

¹⁷² *Ibid.*

¹⁷³ 488 A.2d 858 (Del. 1985).

¹⁷⁴ *Smith v Van Gorkom supra* 893.

¹⁷⁵ *Smith v Van Gorkom supra* 865-868.

¹⁷⁶ *Smith v Van Gorkom supra* 867-868.

minute presentation by Van Gorkom, supported by Chelberg, as well as the advice of Trans Union's legal counsel and the directors' "knowledge of the market history of the Company's stock".¹⁷⁷

The court held that the Trans Union board was not entitled to the presumption of the business-judgment rule because the board had failed to act on an informed basis.¹⁷⁸ Hence the Trans Union directors had breached their duty of care in approving the sale of the corporation.¹⁷⁹ The Delaware Supreme Court took "the unprecedented step" of holding all of Trans Union's directors jointly and severally liable for more than \$23 million.¹⁸⁰ This indicates corporate decision-making under the business-judgment rule focusing on the decision-making process.¹⁸¹ As long as directors act in good faith and with due care in the decision-making process, the director will not be found liable even if the decision itself is not one that would have been made by an ordinarily prudent person.¹⁸²

To prove a breach of the duty of care, reliance is placed on objective facts.¹⁸³ Factors that will, or have been considered by courts, include the amount of preparation time available to directors for the meeting,¹⁸⁴ the extent of the directors' preparation for the meeting,¹⁸⁵ time spent by the directors at the meeting,¹⁸⁶ the type and quality of the advice available to the directors,¹⁸⁷ the directors' participation in the meeting,¹⁸⁸ the documents the directors reviewed,¹⁸⁹ and whether or not material information is reasonably available to the director.¹⁹⁰ Proof of these facts alone is sufficient to establish a breach of the duty of care.¹⁹¹

6 CONCLUSION

The director-centric model of corporate governance attempts to discourage the notion of a passive director.¹⁹² The need for a stricter provision is

¹⁷⁷ *Smith v Van Gorkom supra* 869.

¹⁷⁸ *Smith v Van Gorkom supra* 893.

¹⁷⁹ *Ibid.*

¹⁸⁰ Ibrahim "Individual or Collective Liability for Corporate Directors?" 2008 93 *Iowa LR* 929 935.

¹⁸¹ Hansen "The Duty of Care, the Business Judgment Rule, and the American Law Institute Corporate Governance Project" 1993 48 *The Business Lawyer* 1355 1357; Manning "The Business Judgment Rule and the Director's Duty of Attention: Time for Reality" 1984 39 *The Business Lawyer* 1477-1501; Manning "Reflections and Practical Tips on Life in the Boardroom After Van Gorkom" 1985 41 *The Business Lawyer* 1-14.

¹⁸² Hansen 1993 48 *The Business Lawyer* 1356.

¹⁸³ Lafferty, Schmidt and Wolf Jr. "A Brief Introduction to the Fiduciary Duties of Directors under Delaware Law" 2012 116 *Penn State LR* 837 842.

¹⁸⁴ See *Smith v Van Gorkom supra* 880.

¹⁸⁵ *Cede & Co. supra* 371.

¹⁸⁶ *Smith v Van Gorkom supra* 874.

¹⁸⁷ *Sealy Mattress Co. v Sealy, Inc.* 532 A.2d 1324 (Del. Ch. 1987) 1337.

¹⁸⁸ *Ibid.*

¹⁸⁹ *Smith v Van Gorkom supra* 882-884.

¹⁹⁰ *Smith v Van Gorkom supra* 872.

¹⁹¹ See *Cede & Co supra* 367; *Smith v Van Gorkom supra* 874.

¹⁹² Lipton "Some Thoughts for Board of Directors in 2013 – The Harvard Law School Forum on Corporate Governance and Financial Regulation" (undated) <http://www.blogs.law>.

required by modern commercial society, recognizing that, in the modern commercial environment we operate in, and in particular listed companies, directors are more often than not highly-skilled professionals with some degree of business experience and savvy.¹⁹³

The duty of care, skill and diligence imposes a less subjective test, a more demanding standard of care and a duty of diligence in the management of the company.¹⁹⁴ Section 76(3)(c) introduces an objective and subjective standard. The objective standard is contained in section 76(3)(c)(i). Section 76(3)(c)(i) and (ii) provide an objective minimum baseline standard with which all directors are expected to comply.¹⁹⁵ The subjective standard is contained in section 76(3)(c)(ii) and requires that the knowledge, skill and experience of that director must also be taken into account. If the director has any special skill, or is more knowledgeable or experienced, the director's conduct will be assessed against that higher standard.¹⁹⁶

A director may not act as a mere dummy.¹⁹⁷ He may not be indifferent to the company's business, nor shelter behind culpable ignorance nor failure to understand the company's affairs.¹⁹⁸ It is no longer appropriate to assess directors' conduct by the subjective tests that were applied in outdated precedents.¹⁹⁹ Directors are no longer ornaments or figureheads.²⁰⁰ Directors are subject to a positive obligation to keep informed about the affairs of a company.²⁰¹

The main features of the business-judgment rule are that it functions as a procedural rule, as well as a substantive rule of law.²⁰² On the procedural level, the business-judgment rule creates a presumption²⁰³ of an informed decision, in good faith and in the honest belief that the decision has been taken in the best interests of the company.²⁰⁴ The substantive aspect of the

harvard.edu/corpgov/2012/12/31/some-thoughts-for-boards-of-directors-in-2013/ (accessed 2016-03-22).

¹⁹³ Cassim *et al Contemporary Company Law* 558.

¹⁹⁴ *Ibid.*

¹⁹⁵ Cassidy 2009 3 *Stell LR* 385; Du Plessis 2010 *Acta Juridica* 269.

¹⁹⁶ *Ibid.*

¹⁹⁷ *Fisheries Development Corporation of SA Ltd v Jorgensen; Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd supra* 535.

¹⁹⁸ *Ibid.*

¹⁹⁹ Cassim *et al Contemporary Company Law* 558.

²⁰⁰ *Ibid.* See, eg, in *Re Brazilian Rubber Plantations and Estates Ltd supra* 427 "Sir Arthur Aylmer was absolutely ignorant of business. He only consented to act because he was told the office would give him a little pleasant employment without incurring any responsibility. H W Tugwell was partner in a firm of bankers in a good position in Bath; he was seventy-five years of age and very deaf; he was induced to join the board by representations made to him in January 1906. Barber was a rubber broker and was told that all he would have to do would be to give an opinion as to the value of rubber when it arrived in England. Hancock was a man of business who said he was induced to join by seeing the names of Tugwell and Barber, whom he considered good men".

²⁰¹ *Howard v Herrigel supra* 126; Farrar "Directors' Duties of Care: Issues of Classification, Solvency and Business Judgment and the Dangers of Legal Transplants" 2011 23 *Singapore Academy of Law Journal* 745 748; see *Niagara Ltd (In Liquidation) v Langerman* 1913 WLD 188 195, 201.

²⁰² *Cede & Co. supra* 360; *Cinerama, Inc. v Technicolor, Inc* 663 A.2d 1156 (Del. 1995) 1162.

²⁰³ The presumption approach, like the other approaches and interpretations, is not free from criticism.

²⁰⁴ *Aronson v Lewis supra* 812.

rule requires the court to defer to a business judgment made by the directors, provided their decision is not completely irrational.²⁰⁵ This aspect prevents judicial review of the merits of the decision and protects the decision from being challenged.

Section 76(4)(a)(i) governs the director's decision-making function and requires directors to take reasonably diligent steps to become informed about the particular matter requiring consideration. Before making a business decision it is required that directors inform themselves of all material information reasonably available to them.²⁰⁶ Section 76(4)(b) and (5) allow a director to become informed; a board can retain consultants or other advisors and can be protected by relying on statements, information, and reports furnished by those advisors, if their reliance is in good faith and the advisors were selected with reasonable care.

Unless the circumstances would permit a reasonable director to conclude that he/she is already sufficiently informed, the standard of care requires every director to take steps to become informed about the background facts and circumstances before taking action on the matter at hand.²⁰⁷ The process typically involves review of written materials provided before or at the meeting, as well as attention to/participation in the deliberations leading up to a vote.²⁰⁸ It can involve consideration of information and data generated by persons other than legal counsel or public accountants, for example, review of industry studies or research articles prepared by unrelated parties could be very useful.²⁰⁹ It can also involve direct communications, outside of the boardroom, with members of management or other directors.²¹⁰ There is no one way for "becoming informed," and both the method and measure – "how to" and "how much" – are matters of reasonable judgment for the director to exercise.²¹¹ As long as directors act in good faith and with due care in the decision-making process, the director will not be found liable even if the decision itself is not one that would have been made by an ordinarily prudent person.²¹²

²⁰⁵ Veasey 1997 52 *The Business Lawyer* 394; see also Rosenberg 2006 *Journal of Corporation Law* 321–322.

²⁰⁶ *Aronson v Lewis supra* 812; *Smith v van Gorkom supra* 872.

²⁰⁷ Hansen 1993 48 *The Business Lawyer* 1356.

²⁰⁸ *Ibid.*

²⁰⁹ *Ibid.*

²¹⁰ *Ibid.*

²¹¹ *Ibid.*

²¹² Hansen 1993 48 *The Business Lawyer* 1356.