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Title of Dissertation: A thorough examination regarding the standard of skill and care to be exercised by a director in terms of the common and statutory laws and an overview of the business judgement rule: A company law perspective

Contents

Abstract

As a nationally and internationally recognised legal phenomenon the duty of a director to act within and adhere to a required standard of skill and care is of significant importance. Through a number of "tug of war" developments over the past few decades both the common law and statutory law standard of skill and care attached to a director in the midst of such director executing his office embraces somewhat of a settled nature. Subsequently, incorporating in its test both an objective and subjective element a standard of stringency is adopted when determining whether a director's performance of such skill and care meets these objective and subjective requirements. The business judgement rule adopted (of late) in South Africa's regulatory framework, in essence, attempts tirelessly to alleviate the stringent objective and subject tests that have been followed in our law wide eyed. In an attempt to break down and shun decades of developments initiated to improve the standard of skill and care according to which a director is tested the statutory business judgement rule finds its home within the four corners of South Africa's Companies Act 71 of 2008[1] (the act) and thus encourages a means of defending directors from liability, safe harbouring them from their purported breach of the required skill and care that they should be exercising. Amidst to its significant importance at home there are a substantial and extensive number of second-guessing in respect of its application thus paving the way for sharp tongue criticisms to manifest and accumulate. The rationale attached to this dissertation therefore seeks to advance the knowledge of readers the important stance both the common law and statutory law tests play in South African company law, further and in relation to its importance to articulate that the business judgement rule attempts to counter against the stringent standard adopted despite its many years of development.

[1] The Companies Act 71 of 2008.

Chapter One:

1. Introduction

1.1. The title:

A thorough examination regarding the standard of skill and care to be exercised by a director in terms of the common and statutory laws and an overview of the business judgment rule: A Company law perspective

1.2. The topic:

As can be interpreted from the above title, the topic upon which research is conducted involves an area of company law, more specifically the standard of skill and care to be exercised by a director in the midst of such director executing his office and carrying out these duties. In doing so, extensive research is made in respect of the standard of skill and care in terms of both the common law and the statutory law.

In reaching its complicity the penultimate stage is to include in this discussion an analysis in respect of the business judgment rule. The purpose of this analysis is to answer questions concerning its effect and relevance in South Africa's legislative framework as well as whether the business judgment rule should have been adopted and incorporated into South Africa legislation.

1.3. The research design and methodology being applied:

The research methodology for this paper is desk-based.

As a result the research dealing with the the standard of skill and care to be exercised by a director and the purpose and effect of business judgment rule will be based on case law, common law and a legislative analysis. Other literature such as journals, articles and textbooks will be considered as well.

The way in which this investigation will be done involves research within the various databases which are made available. The following databases will be used during the midst of the investigation: Juta; Lexis Nexis; Hein online; SAFLII; Sabinet, amongst others.

Apart from this the research design includes a qualitative approach which will be applied to the study. What this concerns itself with is an exploration of the standard of skill and care that

must be exercised by a director in the midst of such director executing his office (both in terms of the common law and statutory law) as well as case law precedents which may very well apply.

Focus will also be had to the exploration to the business judgement rule, in particular its purpose, effect and acceptance in South African company law. Bearing this in mind and in the midst of this exploration, there will be a conceptualization of the various aspects as well as a descriptive approach of the study at hand.

What can be established by the latter statement is that by an exploration of the standard of skill and care to be exercised by a director as well as the exploration of the business judgment rule and its effect, it will allow for the content of the study to obtain greater clarity, highlighting the application of these laws in the Republic of South Africa both in case law as well as various publications.

1.4. The background of the topic:

In terms of South African company law a director has a duty to exercise skill and care when executing his office.[2] The duty to exercise such skill and care are applicable and regulated both in terms of the common law and statutory law.[3] Digging deeper into the duty of skill and care is the issue of the standard of skill and care that must be exercised by a director in the midst of such director exercising this duty.

In order to understand the numerous amounts of laws regulating the standard according to which a director is to exercise such skill and care a fleshy yet concise examination is again required of both the common law and statutory law.

Bearing this in mind, there have been major developments in both the common and statutory laws in South Africa in order to properly understand the exact standard that is used to test or measure the standard of skill and care exercised by a director of a company.

The common law initially introduced a subjective test according to which a directors skill and care be measured.[4] This subjective test included that the standard of skill and care exercised

[2] R.C. Williams "*Concise corporate and partnership law*." 3rd ed. (2013) 179.
[3] S Howard "Company director's duties and responsibilities." (2005) 13 (3) *Jutas Business Law* 129.
[4] M F Cassim ""*Contemporary Company Law*" 2ed. (2012) 559.

by a director depended on the ability, skill and experience that that specific director possessed.[5] This technique is best illustrated by way of analogy:

X is a director of company A, in the event of X not possessing adequate experience, skill or business acumen the subjective test will come into play. By application of this subjective test, if X is capable only of exercising a minimum amount of skill and expertise while holding office as a director of company A then it is only that minimum amount of skill and care that is attached to director X in order to hold him liable to a breach of this duty. [6]

In other words if the director is unskilled and lacks relevant business acumen then a low standard of skill and care will be attached to that director.[7] As a result, a director who lacks skill and business acumen is in essence protected from liability due to such inexperience.[8] Despite the implementation of the "low standard" subjective test, developments remained to circle around this issue until a more rigorous approach be applied.[9]

Consequently, after such developments the common law did in fact adopt a rigorous approach by including in its subjective test, an objective test, in a situation whereby skill be tested subjectively and care objectively[10] resulting in a dual test to be applied when testing the standard of skill and care to be exercised by a director.[11]

Apart from this, a turning point for South Africa was the persuasive case of *Deloitte Haskins & Sells v Anderson*[12] where it was stated that -"it is no longer appropriate to judge directors conduct by the subjective tests that were applied in outdated precedents."[13] Bearing this in mind, the court emphasised that irrespective of the past situation, an objective approach needs to be incorporated into the standard of skill and care exercised by a director.[14]

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[5] *Ibid* at 559.
[6] *Ibid* at 559.
[7] *Ibid at* 559.
[8] *Ibid* at 559.
[9] *Ibid* at 559.
[10] N Bouwman "An Appraisal of the Modification of the directors duty of care and skill" (2009) 21 (4) *SA Mercantile Law Journal* 510.
[11] *Ibid* at 510.
[12] (1996) 16 ASCR 607 (NSW); (1995)37 NAWLR 438.
[13] *Supra note* 10.
[14] *Supra* note 10.

Inevitably, through extensive developments the common law adopted both the objective and subjective elements to its test, providing a more rigorous approach when determining the actual standard of skill and care of a director.[15]

In relation to the common law and by introduction of the 2008 act[16] the legislative framework purported to codify the common law standards of skill and care and in doing so codified the subjective and objective elements established in the common law. Section 76 (3) (c) of the act stated that [17]-

> (3) 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 [18] -
>
> [. . .]
>
> (c) with the degree of care, skill and diligence that may be reasonably expected of a person[19] –
>
> (i) carrying out the same function in relation to the company as those carried out by that director;[20] and
>
> (ii) having the general knowledge, skill and experience of that director.[21]

By codifying the common law subjective and objective elements a more stringent approach was now adopted. This approach emphasised that in order to test the standard of skill and care exercised by a director a two-fold test be applied. [22]

Firstly, Section 76 3 (c) (i) comprises of an objective test, as a result a "reasonable person" test is applied in order to determine the standard and skill and care of the director in question. Secondly, Section 76 3 (c) (ii) of the act incorporates in it a subjective test in order to determine the standard of skill and care of the director in question.[23] While the objective test is one of a reasonable person the subjective test, like the common law subjective test holds

[15] See note 4: Cassim at 558.
[16] See note 1: the 2008 act.
[17] See note 1: the 2008 act.
[18] See note 1: the 2008 act.
[19] See note 1: the 2008 act.
[20] See note 1: the 2008 act.
[21] See note 1: the 2008 act.
[22] See note 4: Cassim at 555.
[23] *Ibid* at 555.

that if the director is unskilled and lacks relevant business acumen then a low standard of skill and care will be attached to that director.[24]

While this approach seems straight forward, the aspect reaches complexity when the test is extended. Such extension is applied if there is a situation whereby the director has a higher level of skill and experience than usual, that of which is at his disposal [25] in such instance, the test that is applied is: that the objective test be applied in all circumstances to all directors, however the subjective test attached to a director of a company will be applied only if it improves the objective test, [26] hypothesising the very stringent nature that was mentioned to be included in the partial codification of the common law standard of skill and care.

Despite the fact that there is a common law rigorous approach and a statutory law stringent approach according to which tests the standard of a director's duty of skill and care, both the common law and statutory law co-exist.[27] In other words, there is merely a "partial codification" of the common law standard and as a result such partial codification does not render the common law standard redundant.[28]

Grappling with the two concepts of skill and care as well as the content of the common law and statutory law surrounding the standard of skill and care to be exercised by a director, it is important to note that delineating the respective laws are a matter of considerable importance, especially in South Africa. The reason for its considerable importance is due to the major shift and development from a common law lenient approach, to a more rigorous approach and then an extremely stringent approach in terms of statutory law due to the partial codification of the common law approach.

While a delineation of the above seems to be clear in that there is a lenient/semi –lenient approach versus an extreme approach, a topic of considerable debate again surfaces in respect in South Africa due to the implementation of a statutory business judgement rule

The argument preceding the implementation of the business judgment rule is that director will not be held liable on the grounds of having failed to exercise the requisite skill and care if the decision which he made had a reasonable basis and was not taken arbitrarily or mala

[24] *Ibid* at 555.
[25] *Ibid* at 559.
[26] *Ibid* at 560.
[27] See note 2: Williams at 180.
[28] *Ibid at 180.*

fide.[29] Impliedly, it can therefore be said that the aim of the business judgment rule is to ensure that directors of a company are not held to be liable for damages for decisions they took honestly, rationally and which resulted in no personal gain but was merely an error of judgment.[30]

The rule initially developed in the United States of America and dates back to the year 1892.[31] While the American law was persuasive in nature, a number of arguments existed both against and in favour of a statutory business judgement rule. The King I report purported that it would welcome a statutory business judgement rule into South African legislation, the King II and the King III reports on the other hand were of very little regard in defending an introduction a business judgement rule into South African legislation.[32]

Despite its criticisms, the 2007 Companies Bill[33], in particular Clause 91 (2) of the 2007 Companies Bill attempted to incorporate a statutory business judgement rule in South Africa Clause 91 (2)[34] of the Bill held that -

"a directors judgement that an action or decision is in the best interest of, or for the best interest of the company is reasonable is … the director … has taken reasonably diligent steps to become informed about the subject matter of the judgement […,] does not have a personal financial interest in the subject matter of the judgement and … it is a judgement that a reasonable individual in a similar position could hold in comparable circumstances"[35]

Consequently, South African drafters of the 2008 act were adamant on including the business judgement rule into its legislative framework[36] and as a result the business judgement rule found its place within the corners of the South African companies act[37]

According to section 76 (4) (a) of the Companies act "in respect of any particulate matter arising in the exercise of the powers or the performance of the functions of director, a particular director of the company is deemed of presumed to have exercised his or her powers

[29] *Ibid* at 180.
[30] *Ibid* at 180.
[31] See note 10: Bouwman at 523.
[32] *ibid* at 515..
[33] The Companies Bill of 2007.
[34] See note 33: The 2007 Bill.
[35] See note 10: Bouwman at 528.
[36] Ibid at 528.
[37] See note 10: Bouwman at 528 ; See note 1: The 2008 act.

or performed his or her functions in the best interests of the company and with reasonable care, skill and diligence (as contemplated in section 76(3) (b) and (c) if"[38] -

"(i) the director has taken reasonably diligent steps to become informed about the matter[39];

(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;[40] or

(bb) the director complied with the requirements of section 75 with respect to any interest contemplated in subparagraph (aa)[41]; 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"[42]

What the above statutory business judgement rule codification does is that it provides a situation which confirms that if the requirements as stated in terms of section 76 (4) (a) of the act are met, then the director would have subsequently fulfilled the requirements in respect of section 76 3 (c)of the companies act.[43]

While this may be so, a number of authors are against such statutory business judgement rule, Bouwman, Coetzee, McLennan are to name a view, despite the number of criticisms that do in fact exist the statutory business judgement rule does have on its side, its favourites.[44]

1.5. The problems that arise in respect of this topic:

Bearing in mind the discussion put forth above, the first problem or the important question which remains unanswered is whether the common law approach as well as the statutory approach will function successfully in unison.[45]

[38] See note 4: Cassim at 558.
[39] See note 1: the 2008 act.
[40] See note 1: the 2008 act.
[41] See note 1: the 2008 act.
[42] See note 1: the 2008 act.
[43] See note 4: Cassim at 559.
[44] L Muswaka "Directors duties and the business judgment rule in South African Company Law: An Analysis" (2013) 3 (7) *International Journal of Humanities and Social Science* 92.

While it is clear that there is only a partial codification of the common law duty of a director to exercise the required skill and care, a question does in fact arise as to whether both the common law and statutory law will be of workable order, side by side. It has been stated that due to the common law only being partially codified that such codification exists in addition to the common law duty of skill, care and diligence.

The issue however more into play and its importance significantly enhanced due to the fact that the now codified common law duty of skill and care is in force, there is yet to be a judgement or case law precedent that arise in order to such this codification to the testing ground.[46] As it stands, whether the common law and statutory law approach will work in unison remains an unclear one.

Secondly and despite the clear authority for the fact that the business judgment rule ensures that directors are protected from "hindsight bias"[47] and that the business judgment rule encourages innovation as well as risk taking by protecting certain business decisions and other acts of directors, a problem still arises,[48] in that the business judgment rule has been heavily criticized. This is so despite its many advantages.

While the King I[49] report had recommended that the business judgment rule be adopted in the South African companies act of 2008, in that – a director should not be held liable for a breach of their duty of skill, care and diligence if the decision that was made was made in good faith, was a rational one and if there was no self-interest this recommendation of the King I report has been criticized, stating that a statutory business judgment rule will be superfluous.[50]

After considerable assessment and that too being in line with other authorities as support, it has been stated by Williams that the reason for the King Report being subject to criticism to the extent that it is held that the business judgement rule will be superfluous. The reason for this lies in the fact that it has on a number of occasions both in South Africa as well as other

[45] See note 10: Bouwman at 532.
[46] See note 2: Williams at 181.
[47] See note 4: Cassim at 563.
[48] *Ibid* at 563.
[49] King Report on Corporate Governance for South Africa 1994.
[50] See note 49: King report 1994; See note 3:Williams at 181.

jurisdictions been emphasised that directors who are prone to commit or who do in fact commit mere errors of judgement are not liable for such mere errors of judgement.[51]

Apart from this, another issue of considerable importance is that by implementing this new statutory business judgement rule into South Africa the common law as well as the statutory laws which have been extensively developed over the years will be shunned due to the fact that while there are stringent standards in place to test the standard of skill and care of a director, the statutory business judgement rule now counters these developments, to the extent that a director will be able to escape liability even if his business judgement was erroneous and led to an unsuccessful result.

Also it has been particularly emphasized that the business judgment rule has developed in different situations from those in South Africa and accordingly for that reason alone the business judgment rule should be regarded with scepticism and subject to criticism.[52]

Bearing the abovementioned problems or issues in mind, three important questions relating to this area of company law arises and need to be answered in order for one to have a more clear out-look on what the problems really entail. The three questions are made up of the following:

Firstly, what is the standard of skill and care that must be exercised by a director in terms of the common law? Secondly, what is the standard of skill and care that must be exercised by a director in terms of the statutory law? Lastly what is the purpose and effect of the business judgment rule and should have it been incorporated into the South African legislative framework?

In the a foregoing conclusion of current paragraph 1.5 it can be established that both the common law and statutory law principles for the exercise of the duty of skill, care and diligence are of particular importance. Apart from this, it is equally important to note the applicability if the business judgment rule in South Africa, while heavily criticized, finds its home within the corners of the South African statutory law.

[51] See note 2: Williams at 181.
[52] See note 10: Bouwman at 534.

1.6. The rationale or purpose conducting research in respect of this topic:

The purpose of conducting research in respect of this topic, apart from tackling the abovementioned problems that exist is -

Firstly to make clear the standard of skill and care that must be exercised by a director in the midst of such director executing his office.

Secondly, it is important to delineate between both the common law standard and the statutory law standard that is utilized to measure such skill and care. As a result the further rationale behind this research is to understand the standard of skill and care that a director must exercise in terms of the common law and in terms of the statutory law. Further, in order to understand how the common law work together and in isolation.

Thirdly, the rationale behind this research is to make known to readers that there have been developments of the standard of skill and care that must be exercise by a director. For example and as has been stated in paragraph 1.5 and elaborated further in Chapters 2 and 3 the common law initially adopted a lenient test to measure the skill and care of a director, later, developments in the common law allowed for there to be a more rigorous test. In addition to this, a stringent approach was developed in terms of the statutory law.

Fourthly, the rationale behind the research is to make readers understand the origin and purpose of the business judgement rule, also to understand clearly the timeline of events and developments that have taken place over the years which led to the business judgement rule being incorporated within the four corners of the new companies act.

Lastly, the rationale behind this research is to make readers aware of the fact that the now statutory business judgement rule is subjected to an extensive amount of criticisms in that there is now an extra defence for directors to avoid liability in respect of their purported breach.

1.7. Structure of the dissertation:

The most appropriate way in which the problems and purpose of this topic will be tackled is to include a succinct piece of writing that of which is in order of the developments that have taken place. As a result the next chapter, namely chapter two (2) will focus on the common law duty of a director to exercise the requisite skill, care and diligence when necessary. This focus, as mentioned above will involve an intricate discussion of the common law rule which

will in turn allow individuals to gain a proper understanding of the statutory law regime, in particular Section 76 (3) (c) of the Companies Act.[53]

Chapter three (3) will focus on the director's duty of skill and care in terms of the statutory regime. In particular emphasis will be placed on the shift from a lenient common law approach to that of a strict approach in terms of statutory laws. In direct relation to such statutory laws, focus will be placed on the partial codification of the duty of skill, are and diligence in terms of the South African Companies act of 2008[54] as well as the success of such partial codification.

Having established the current situation in respect of the standard of skill and care that a director must exercise both in terms of the common law as well as the statutory law, chapter four (4) will explore the business judgment rule. This chapter will focus particularly on section 76 (4) (a) of the companies act.

After such area has been paid attention to, focus will be surrounded in respect of the effect of the business judgment rule as well as whether the business judgment rule should have been incorporated into the South African statutory law regime.

Finally, chapter five (5) will attempt to bring the abovementioned discussion to a conclusion, in doing so there will be a recap of the standard of care and skill that should be exercise by a director as well as a recap as to whether the business judgment rule being included in the 2008 act was a step in the right direction.

[53] See note 1: The 2008 act.
[54] See note 1: The 2008 act.

Chapter Two

2. A director's duty to exercise skill and care in a company – a common law approach:

2.1. Introduction

It has been thoroughly emphasised in terms of South African company law that before the enactment of the 2008 act a directors' rights as well as his duties were initially derived from sources such as the Companies Act of 1973[55], the common law as well as the companies memorandum and articles of association in the event that a contract was entered into with that particular company.[56]

Bearing this derivation in mind it is significantly important to make reference to the fact that the South African common law, a source from which these right and duties were initially derived, in particular the duty of a director to exercise skill, care and diligence was immensely influenced by English precedent from the late 1800's and early 1900's, as will be shown from further discussions hereafter.[57]

While this historical premise is evident and is in accordance with various authoritative readings and commentaries there is an issue that does in fact arises. This issue, as a result, introduces the manifestation of a "dark cloud" over the actual extent, degree or standard to which the director must exercise these rights and duties in the midst of executing his office.[58]

The content of this "dark cloud" as has been contended comprises of a situation by which a director is obliged to act with the required degree of skill and care,[59]however while this may be so, it has been invariably argued that the required standard according to which this skill and care is measured is a continuous issue in that such standard remains unknown/uncertain[60]

Despite this clouded area being present it is equally important to note that while it is emphasised that the required standard that must be exercised by a director of a company is one which is uncertain, controversy arises as it has been stated with some certainty in obiter

[55] The Companies Act 63 of 1973.
[56] See note 10: Bouwman at 509.S
[57] J. Du Plesis "A comparative analysis of directors duty of care, skill and diligence in South Africa and in Australia: Corporate governance and merges & takeovers: Part II." (2010) *Acta Juridica* 263.
[58] See note 57: Du Plesis at 263.
[59] See note 10: Bouwman at 510.
[60] *Ibid* at 501.

that the degree of skill, care and diligence expected of a director in terms of the common law is exceptionally low.[61]

2.2. The standard of care and skill to be exercised by a director of a company in terms of the common law:

2.2.1. The traditional "lenient" Common Law approach: The controversial issue of whether there is an uncertain or an exceptionally low subjective standard attached to directors when exercising their duty of skill and care:

Considering the above starting point discussion as per paragraph 2.1, it is evident that an individual appointed as a director of a company, when carrying out his duties or exercising his powers in good faith and for the benefit of that company is almost always obliged to act in accordance with a required level of skill and care.[62]

Emphasis has been placed significantly on the fact that this required level of skill and care is subjected to an extensive amount of controversy due to the fact that this level of skill and care in terms of the common law remains considerably unclear.[63]

While this is so other authorities such as Williams, Bouwman and Cassim state that the level of skill and care expected of a director is exceptionally low or is of subjective terms.[64]

Cassim puts forth his legal take on this issue by stating (as a starting point) that he is in agreement with the fact that directors, in the midst of performing their duties will be held liable to the company if there is any negligent conduct attached to that particular director in those particular circumstances.[65] Apart from this, he also assents to the fact that there is an issue that arises. Accordingly and in respect of this issue Cassim states that –

"The issue is the extent to which the directors, whether executive or non-executive directors are liable for loss caused to the company by their incompetence or carelessness."[66]

Cassim however, despite assenting to the fact that the main issue at hand is the extent to which directors will be held liable if in breach of the duty of skill and care makes it clear that

[61] S. Kennedy Good , L Coetzee , "The Business Judgment Rule (Part II)" (2006) *Obiter* 280.
[62] See note 10: Bouwman at 510.
[63] *Ibid* at 510.
[64] See note 81: Kennedy Good at 280.
[65] See note 4: Cassim at 554.
[66] *Ibid* at 554.

he agrees that while a directors fiduciary duties have been enforced strictly the idea surrounding the liability of directors in breach of their duty of skill, care and diligence, particularly in the court stance are considerably lenient or are of a moderate and low degree.[67]

This legal take put forth by Cassim is clearly in support of the contention given by other legal authorities such as Williams and Bouwman, in giving this support he assures and subsequently confirms that the standard of care and skill attached to a director is one that is strikingly low.[68]

In emphasising his point, Cassim holds that the duty of skill and care have been hypothesized in subjective terms, such subjective terms is the very epitome of this low standard of care and skill. In an explanation of what this subjective element comprises of it has been stated that the content of this subjective term was that which very much depended on the ability, skill and experience of that specific director in the circumstances.[69]

In order to demonstrate the application of such subjective terms, it is yet again important to illustrate such by an analogy in order to have a clearer understanding, therefore by analogy:

If director X is a director of a company A, in the event that director X possess an inadequate amount of experience or skill for that matter then it is exactly that level or degree that is attached to director X if he is in fact negligent. In other words, if director X is only capable of exercising a specific amount of experience and skill then director X must exercise that experience and skill, i.e. that which he is capable of and the subsequently be liable for that specific amount of skill and experience.[70]

Therefore in considering this, the less experienced and skilled director X is the lower the standard of skill, care and diligence may be expected of director X, while this may be so the opposite is also conceivably true, in a sense that if director X has a great amount of knowledge and skill then in that instance the higher the standard of skill, care and diligence is to be expected of director X.[71]

As can be seen, it is absolutely clear that what the subjective term/subjective test of skill, care and diligence does is that it protects a particular director from liability in the event that that

[67] See note 2: Williams at 183; See note 4: Cassim at 554.
[68] See note 4: Cassim at 554.
[69] *Ibid* at 555.
[70] *Ibid* at 555.
[71] *Ibid* at 555.

director is inexperienced or does not possess any required or suitable skills when executing his office. [72] To be put more plainly, the more that a director knows, the more is expected from him, also, the less a director knows, the less is expected from him.[73]

In applying this subjective test it is evident that such is applicable and also enforceable due to the fact that it is extremely difficult for the legislature as well as courts to pin-point a single objective standard in respect of all directors of companies.[74] It is important to note, for future reference that the reasons for an objective test not being welcomed as much as the subjective test is based on the fact that a director of a company is not a professional individual, there is no set test according to which a directors skill and care is to be measure. It is for that reason that an objective test is not applicable to directors.[75]

Apart from this directors vary and so too do the types of companies that are in existence and for this reason as well it is equally difficult to pin point a single objective test, it makes the situation one of complete difficulty to include a single objective test when there is such a vast range of directors and companies that are in existence.[76]

Apart from Cassims' legal take on this issue, Williams also instantly tackles this controversial issue, concerning himself with what degree of care and skill is required of a director in terms of South African common law.[77]

By making himself prone to this controversial question Williams states with authority and is in agreement with the obiter dictums that the South African common law places a somewhat moderate/low/subjective burden on directors when exercising the duty of care, skill and diligence.[78]

Consequently and in support of this statement, he confirms that there are in fact a various amount of rationale for imposing such a moderate, low burden or subjective on these directors.

Firstly, and echoing the point made by Cassim, he states that there arises a situation in terms of which the position of a director in a company is compared to that of an employer in a

[72] *Ibid* at 555.
[73] *Ibid* at 555.
[74] *Ibid* at 555.
[75] *Ibid* at 555.
[76] *Ibid* at 555.
[77] See note 2: Williams at 182.
[78] *Ibid* at 182.

company.[79] While a director has no contract with the company it is insurmountable to imply that there is a contractual promise by such director that he will act diligently or with certain required skills.[80]

In making his point clear, he holds that the opposite is expected from employees, for example accountants, secretaries and auditors. In such situation employees guarantee that skills for which they are employed are in fact present.[81] As a result, due to the fact that a director of a company has no contract with such company and does not possess the same obligations as regular employees for example, the low burden attached to such directors is seemingly welcomed.

Secondly, another comparison comes to play, the comparison of a director of a company versus that of a professional person.[82]Williams states that the low/moderate burden attached to directors to exercise care, skill and diligence in the midst of their duties follow from an example of such comparison. He emphasises this point by putting forth an example of a medical practitioner.

By analogy if X is in the medical profession and is in fact a medical doctor then the courts in this regard can in fact inquire as to whether X (being a medical doctor) was negligent in the midst of his profession.

Subsequently by doing so the court may very well determine whether X's omission and or conduct while performing in the midst of his medical profession was made up of the negligent component that they are in fact testing.[83]

Bringing this comparison into light, Williams states that being in a specific profession and being a director of a company are of two extreme opposites, while being a medical doctor requires practical experience and an entrance examination the director of a company is not subject to such requirements.

In that instance what is required in order for them to be a director is to be elected by way of majority to become a director of that company irrespective of whether the possess experience

[79] *Ibid* at 182.
[80] *Ibid* at 182.
[81] *Ibid* at 182.
[82] *Ibid* at 183.
[83] *Ibid* at 183.

or knowledge in that particular business or company. [84]Again, by such analogy and example he makes clear that the reason for the low burden attached to directors are for this very reason.

Thirdly, due to the fact that there are numerous amounts of directors of different titles and with different skills as well as different types of companies it is of particular difficulty to assign a single objective standard that will be applicable to all types of directors and all types of companies.[85] It is also for that reason there is such a low or moderate standard that is applicable in this regard.[86]

Apart from the above and lastly, in court proceedings judges asses, consider and ultimately decide whether a director has acted truthfully and honestly, despite doing so judges are averse to answer any questions as to whether a directors business judgment was negligent or not. It is for this reason, amongst the other mentioned above that there is in fact a low burden on directors when exercising their skill and care in the midst of carrying out the office.[87]

Evidently so, from the abovementioned rationale there is almost no argument against Williams and other such authorities for stating that the level required of directors to exercise skill, care and diligence is of a low or moderate degree.

Despite the common law subjective test being well structured so as to include in it a specifically defined yet broad approach to the extent to which a director must exercise his duty of skill and care and despite the rationale for the existence of the subjective approach or low burden put forth by Williams, the common law subjective test is in fact exposed to a number of practical difficulties.[88]

2.2.2. The source of practical difficulty associated with the low subjective test:

The main source of such practical difficulty is unveiled in a context whereby there is favouritism in respect of the inexperienced, incompetent director [89]in a sense that, and as

[84] *Ibid* at 183.
[85] See note 4: Cassim at 555.
[86] *Ibid* at 555.
[87] See note 2: Williams at 183.
[88] *Ibid* at 183.
[89] See note 4: Cassim at 556.

mentioned above that the less experienced and skilled the director is then there is a lower the standard that is attached to that particular director.[90]

In support of this contention, reference must be had to the case of *in re rubber plantations & estates ltd*[91] which is the epitome and leading case with regard to such favouritism in respect of the inexperienced and incompetent director. In this case, the directors while being subject to fraudulent and false reports in respect of rubber plantations made a catastrophic decision which led to losses as a result of such decision.[92]

As a result, they were sued for such losses but which were held to be unsuccessful due to the fact that the court had stated that the duty of a director to exercise care must be one that is reasonably expected of such director taking into consideration both that specific directors experience as well as his knowledge[93]

Expressly so, the court had emphasised that a director need not bring any sui generis skill, experience or qualifications to his position as a director. [94] In this instance the court held that a director may very well be in charge of the management of a rubber plantation, be completely ignorant of such rubber business and accordingly not be held liable for any negligent conduct practiced due to the absolute fact that such director was in fact ignorant about what the rubber business entailed.[95]

As can be seen, the practical difficulty does in fact exist in a sense that due to the low/subjective test that is being applied there is a wide gap for directors to use their inexperience as an excuse to avoid liability when in breach of performing such duties with skill and care.

Considering the above practical difficulties and despite it has been thoroughly emphasised that there is a subjective test that needs to be applied, Bouwman, following other authority in her article states that the test may be such that care be tested objectively and skill be tested subjectively, due to the fact that it varies from person to person.[96] This alone can be seen as a

[90] *Ibid* at 555.
[91] (1911) Ch 425 (CA) 437.
[92] Supra note 81.
[93] Supra note 81.
[94] Supra note 81.
[95] See note 4: Cassim at 556.
[96] See note 10: Bouwman at 510.

step in the right direction so as to reform the common law and apply a stricter approach as opposed than a lenient subjective approach.

2.2.3. A dual approach – a mixed objective and subjective test?

In applying authority to this contention, Bouwman makes reference to the courts judgement in this respect holding that the court in this case had held that skill refers to the technical competence of a particular director while care refers to the way in which that particular skill (the former) is applied in a particular situation[97] Consequently, skill is assessed subjectively and care objectively.[98] Accordingly, the importance of the above distinction between the test for skill and the test for care plays a role in the developments that occurs.[99]

Despite the importance of the distinction between the test to be applied in respect of care and skill the case of *In re Equitable fire insurance*[100] cited with much approval the subjective test applied in the case of *in re Brazilian Rubber Plantations*[101] which was subsequently adopted in the case of *Fisheries Development corporation of south Africa ltd v Jorgensen; Fisheries Development corporation of SA Ltd v AWJ investments (pty) ltd* [102]after over 50 years.

Following from the *In re Brazilian Rubber plantations* case, the case of *In re equitable fire insurance co ltd* adopted three legal propositions: in respect of their support in respect of the subjective test[103]–

The first being that there is no single objective standard test of a reasonable director that is present[104] in other words in the midst of performing his duties, a director need not exhibit a considerable amount of skill than may reasonably from a person of his experience and knowledge.[105]

[97] See note 4: Cassim at 556.
[98] *Ibid* at 556.
[99] See note 10: Bouwman at 510.
[100] (1925)Ch 407.
[101] *Supra* note 100.
[102] (1980) 4 SA 156 (W).
[103] *Supra* note 102.
[104] *Supra* note 102.
[105] *Supra* note 102.

Accordingly the less knowledgeable and experience the director is the lower the standard that is expected from him whereas the more knowledgeable and skilled the director is the higher the standard that is expected of him (subjective test)[106]

In support of this, Cassim states that the test here is a subjective one and excludes any test bearing the notion of a "reasonable director" having stated so, Williams agrees with this, stating that the director's conduct is tested according to a formula as to what may be reasonably expected of him in those circumstances.[107]

Secondly, the standard attached to an executive and a non-executive director are said to be worlds apart. A non-executive director does not have the obligation to continuously and consistently give attention to the company or its affairs, in addition to this, what this non-executive director is tasked with is to perform his or her duties at the board meetings.[108]

In this case, the non-executive director may attend these meetings if he is reasonably able to so.[109]Bearing this in mind and in application of the principle mentioned above it is important to note that the difference between an executive and a non-executive director is worthy of such distinction.[110]

The reason for it being worthy of such distinction stems from the fact that there are different obligations are attached to that of an executive director and that of a non-executive director[111]. In the case of an executive director, such director is a full time director and applies his or her duties to the everyday management of such company, such director participates in his occupation in terms of normal working hours from "nine to five" a non-executive director on the other hand does not at any stage give his or her attention to the company or the affairs of that company instead he merely attends monthly or quarterly meetings.[112] As a result different standards of care and skill must be adopted in order to measure what is expected from these different types of directors.

While this is so, Cassim states that despite this distinction between an executive and a non-executive director being appropriately fit in the past, especially the defining duties of that of a

[106] See note 2: Williams at 183; See note 4: Cassim at 555.
[107] See note 2: Williams at 183; see note 4: Cassim at 557.
[108] See note 4: Cassim at 557.
[109] See note 2: Williams at 183
[110] See note 4: Cassim at 557.
[111] See note 10: Bouwman at 511.
[112] *Ibid* at 511.

non-executive director, in modern company law this legal principle is somewhat redundant due to the fact that this very principle does not mirror what is expected even of a non-executive director.[113]

Williams supports the contention put forth in the case of *Howard v Herrigel*[114] where it was stated that both executive as well as non-executive directors are subject to the same line of duties in respect of negligence.[115]

Thirdly, a director may delegate his duties or certain functions and tasks to employees of that particular company[116]this may be done so accordingly only if the director does not have any suspicions in trusting that employee.[117] In the case of *Dovey v Cory*[118] the court stated that – "the business of life could not go on if people could not trust those who are put in a position of trust for the express purpose of attending to the details of management" (11:561)

This principle was approved and accepted in the case of *Jorgensen ltd.* [119] The court in this case cited with approval the following –

"in respect of all the duties that may properly be left to some official, a director is in the absence of grounds for suspicion, justified in trusting that official to perform such duties honestly is entitled to accept and rely on the judgement, information and advice of the manager unless there are proper reasons for querying such. Similarly, he is not bound to exam entries in the company's books … obviously, a director exercising reasonable care will not accept information and advice blindly"[120]

While the above developments are clear and emphasize the low standard attached to directors who are in breach of their duty to exercise skill and care in the midst of carry out their appropriate duties the propositions are still subject to a number of criticisms.

In such respect, it has been put forth by Cassim that the propositions examined and adopted by the courts in the case of both *in re equitable fire insurance ltd*[121] and in the case of

[113] See note 4: Cassim at 557.
[114] 1991 (2) SA 660 (A) 678D.
[115] *Supra* note 114.
[116] See note 4: Cassim at 557 & 561.
[117] *Ibid* at 557.
[118] 1901 AC 477 (HL) 485-6.
[119] *Supra* note 118.
[120] *Supra* note 118.
[121] *Supra* note 118.

Jorgensen[122] had been examined and adopted at such a time when directors were appointed as directors due to their title as status despite the lack of business acumen that they were prone to or did in fact possess.[123] For this reason, the above developments have been criticised.

Apart from this and in relation to the above, the South Africa law approach as well and the English law approach in respect of these matters both adopt in their system of law that it is not necessary for directors to have any sui generis experience, knowledge or skill when executing their office.[124]

2.2.4. A shift from a common law lenient approach (subjective test) to an application of a more rigorous approach (an objective and subjective test): a step in the right direction:

Despite there being extensive controversy surrounding the standard according to which directors must exercise skill and care in the midst of exercising their office this did not prevent developments from being underway.

Accordingly, the importance of the above distinction between the test for skill and the test for care plays a unique role in the developments that occur, in that the standards attached to care and skill were hypothesized in English law precedents during the nineteenth and twentieth centuries.

In consideration and irrespective of the lenient stance that both South African law and English law have taken, it is English law that moved toward a more rigorous approach, so as to include both a dual objective and subjective standard according to which the skill and care performed by directors were to be measured.[125]

Initially, English law embraced the lenient approach as can be seen by the approach adopted in the case of In *Re Denham & co*[126] where the court held that despite the director did not performing his duties at all during the period of four years that this was not sufficient to hold that director to be in breach of his duty of skill and care.[127] What was being emphasised here

[122] *Supra* note 118.
[123] See note 4: Cassim at 556.
[124] *Ibid* at 557.
[125] *Ibid* at 557.
[126] 1884 LR 25 Ch D 752.
[127] *Supra* note 128.

was that only seriously gross or culpable negligent conduct would amount to a director being in breach of his duty of care and skill.[128]

Evidently, there was dire need for there to be reform in respect of the lenient common law approach as this approach was not one that adhered to public policy of the needs of the society.[129] The case of *In Re D'Jan of London Ltd* [130] was the reform that made an excellent example whereby the court held that the test to measure the standard of skill and care of a director include both objective as well as subjective elements mirroring a more rigorous approach[131]

In light of the English law, the proposition that came to surface was that South Africa adopt such rigorous approach in suitable instances.

The case of Deloitte[132] is of considerable importance in this instance due to the fact that it was held in this case that the concepts of both skill and care not borne from the same piece of cloth. – In the Australian case of Deloitte it was correctly held that –

"it is no longer appropriate to judge directors conduct by the subjective tests that were applied in outdated precedents."[133] The court emphasized that a more objective approach to the directors' duty to exercise care and skill should be adopted and that whatever the position was previously that directors are no longer ornaments or figureheads.[134]

The implication of the *Deloitte* case is that an objective test should be applied, in that there be a test in terms of which a standard be tested in respect of a reasonable person[135] This proposition is supported not only by English law, impliedly due to the more rigorous approach that they have adopted but is also supported by various international standards.

Reference in this respect can be made to the US Model Business Corporation Act[136], having being revised through the year 2002 holds that directors in the midst of carrying out their duty

[128] *Supra* note 128.
[129] *Supra* note 128.
[130] 1993 BCC 646 (Ch D (Companies Court).
[131] Supra note 25.
[132] Supra note 12.
[133] Supra note 12.
[134] See note 4: Cassim at 558.
[135] See note 51: Du Plesis at 263.
[136] US Model Business Corporation Act 1984.

of skill and care shall do so with the appropriate care that a person in such position would believe to be reasonably suitable in such situation.[137]

Having adopted such approach in the United States, it can be emphasized that what this set of legal regime envisages is that there is an objective standard that is to be applied[138], cleverly so, while applying this objective standard as set of in the United States legal regime there is almost another advantage that arises, as one may say there is a situation in which there is "a killing of two birds with one stone" – such idiom makes it clear that while an objective standard is adopted in the United Stated that in adopting this standard the extent as well as the nature of the obligations of directors in a company are recognised.[139]

Apart from this, the Canada Business Corporations Act of 1985[140], in particular section 122 (1) of the act also adopts an objective approach by providing that directors, in the midst of executing their office and exercising their powers must do so with the required skill, care and diligence that a person possessing a reasonably good judgment would conduct in circumstances of a comparable nature.[141]Bearing in mind the above developments in terms of the English law, American law as well as Canadian law it is clearly evident that the common law approach in South African in respect of company law is absolutely inept in modern South African company law.[142]

Taking the above jurisdictional approaches into consideration as well as the distinction between both the standards attached to care and skill being an objective test and subjective test respectively, it is clear that a more strict approach should be adopted in South African company law.

Apart from this there needs to be a shift in the lenient common law approach to include not only a subjective test imposed on directors to exercise their duty of skill, care and diligence in their office but also to include a more objective standard.[143]

Despite the large amount of international support given in favour of the more rigorous and objective approach, and while being persuasive in nature, it was by means of the Banks

[137] See note 4: Cassim at 558.
[138] *Ibid* at 558.
[139] *Ibid* at 558.
[140] Canada Business Corporations Act of 1985
[141] See note 4: Cassim at 558.
[142] *Ibid* at 558.
[143] *Ibid* at 558.

Amendment Act 19 of 2003[144] that actually made way for South Africa to enforce such rigorous approach. [145]This act, in particular section 40 (c) and (d) of the act paved the way for a major change in the South African common law approach adopted by South Africa, the way in which this was done was by creating stricter rules for individuals in banks who held the position of managers, directors as well as chief executives. [146]

It was only at this given point that the "dark cloud" over what was expected of directors in executing their duties was cleared, allowing for a rigorous approach in terms of the common law, so as to include in its test both an objective and subjective test to be applied.

It is equally important to note that while the common law adopts the rigorous approach of both an objective and subjective test, so too does the companies act (the statutory law) of South Africa adopt such rigorous approach.

2.3. Conclusion:

As a closure to the abovementioned discussion there needs to be a highlight of the various important points that were put forth, in doing so it is clearly shown that the aspect relating to the common law approach in respect of a directors duty to exercise skill and care in the midst of performing his duties is of a controversial nature.

Going back to the process of highlighting this aspect it is therefore evident that the controversial nature of such duty stems from the fact that while some commentators explain that the cardinal point reflects a situation in which the main issue is that the extent to which a director may be held liable for a breach of his duty of skill and care is unclear, other authorities such as Williams and Cassim make their legal take known, emphasising that the extent to which a director is liable for a breach of his duty of skill and care comprises of a moderate or seemingly low component. [147]

In the midst of doing so there have been various developments to the common law lenient approach that was initially initiated and followed by South African company law so as to include a rigorous approach. South Africa, in need of such development found the rigorous approach worthy of its application not only because the previous laws regulating such duty was inadequate but also due to the fact that other jurisdictions were making major shifts in

[144] Banks Amendment Act 19 of 2003
[145] See note 4: Cassim at 558.
[146] *Ibid* at 558.
[147] *Ibid* at 558; See note 2: Williams at 183.

their approaches as well. This was evident by the approach of Canada, America as well as the United Kingdom. [148]

Inevitably so, it is evident that while the issue of the common law lenient approach was an issue of quite some time, the more rigorous common law approach is welcomed in South Africa so to include both an objective as well a subjective test.

A major source of its development, while being influenced by the international jurisdictions found its major influence in the very heart of the South African legislation, in particular the Banks Amendment Act 19 of 2003.[149] Despite a rigorous approach being implemented, South seem to be "a ray of sunshine" due to such rigorously incorporated rule, this paved the way for further developments in respect of the statutory laws.

[148] See note 4: Cassim at 558.
[149] See note 144: the 2003 Banks act.

Chapter Three:

3. A director's duty to exercise skill and care in a company – a statutory law approach:

3.1 Introduction

Taking into consideration the above common law discussion as per Chapter two the striking controversy in respect of the standard to which directors should exercise their duty of skill and care in terms of this common law, as can be suggested is somewhat settled. The situation which initially found itself in dire straits subsequently found clarity in the various amounts of developments that were followed and adopted both at home and internationally.

In doing so, the reform was approached by applying a more rigorous standard in a number of case law precedents, statutory legislation as well as national and international laws, so as to include a test of both a subjective and an objective nature. Due to the major developments that were advanced in respect of the common law relating to the standard of skill and care that should be exercised by a director, one could almost hope that no controversy lurks in terms of the statutory law.

After extensive assessment, it is unfortunate that despite there being a properly-structured approach in respect of the common law standards according to which a director exercise his duty of skill and care, controversy does in fact once again strike in respect of the statutory law. The controversy is in this regard finds is application in respect of the difference between the standard of skill and care to be exercised by a director of a company in terms of the common law versus the standards adopted in respect of the statutory law.

Consequently, despite the fact that both common and statutory laws co-exist, to the extent that the common law is not substituted by the statutory law, the statutory law welcomes and thus embraces in its test a more stringent approach as opposed to the rigorous common law approach.

As a matter of lending foresight to the controversy at hand, it is held that while the common law adopts both an objective and subjective test to determine the skill and care performed by a director of a company while carrying out his duties, the statutory law while adopting the same objective and subjective tests is seemingly distinct to that of the common law. This distinct component is due to the fact that the test made use of in the statutory law is extended so as to include in it a situation whereby there is a less subjective test that is applied and a

more demanding criterion for care and skill that is imposed on the directors of a company thus making its approach that much more stringent.

3.2. The standard of care and skill to be exercised by a director of a company in terms of the statutory law:

3.2.1 The now stringent statutory law approach: a codification of the common law duty of a director to exercise skill and care:

In order to properly attack this area in terms of which the legislative framework applies, it is important to make reference to the spirally developments that occurred within the South African parliament and internationally. Being a nationally and internationally recognised legal phenomenon it is therefore important to understand the stance which allowed for such stringent elements to be incorporated into the standard of skill and care to be exercised by a director.

To state briefly, in the United Kingdom the duties of directors were mainly incorporated in terms of its common law, the position being analogous to the initial approach adopted in South Africa before the codification of the common law duty of skill and care.[150] Bearing this in mind, the United Kingdom approached the situation head on, attempting to incorporate the duties of a director concise manner.[151] Through its developments, the United Kingdom companies act came into being emphasising the point that the codification of director's duties is acceptable not only in South African company law but that too internationally.[152]

Bearing this in mind, the South African position was emphasised in respect of the 2007 Companies Bill[153] as well as the fragmented codification of the common law duty of skill and care. Subsequently in placing such emphasis in these areas of development a clearer understanding as how and why such stringent elements were couched in the statutory law

Taking into consideration the timeline of events in respect of such developments it is evident that the 2007 Companies Bill in fact canvassed a situation in which the subjective test of the

[150] See note 10: Bouwman at 517.
[151] *Ibid* at 516.
[152] *Ibid* 517.
[153] See note 34: The 2007 Bill.

skill component and the objective test of care component of the common law was in fact retained or incorporated by such statutory codification.[154]

Following from this the 2008 act [155]also enhanced the situation by emphasising that just like the 2007 companies bill that it also incorporated a codification (partial) of the common law duty of skill and care, and impliedly so including in its partial codification a retention of both an objective and subject test.[156] In support of this contention reference is to be made to the 2008 act, in particular Section 76(3) (c) which is the epitome of such partial codification.[157]

In relation to this and lending insight to the content of this section, Bouwman states in her 2009 article that the partial codification of a directors duty of skill and care that is contained in this 76 (3) (c) section of the companies act holds that a director in performing his duty of care and skill in the midst of his office or when acting in the capacity of a director must execute the functions of a director and also exercise such powers.[158]

While this may be so, despite the fact that both the objective and subjective elements are retained in respect of the statutory law and still includes a rigorous approach. Cassim holds that the 2008 act, in particular section 76 3 (c)[159] encourages and adopts a more stricter test in respect of the standard to be exercised by a director when performing his duty of skill and care.[160]

In this sense Cassim emphasises that the statutory law, in adopting such approach placed a great deal of attention to the modern commercial situation that exists, that is, directors in the modern commercial world are professional individuals with a lot of business experience.[161] In doing so, he shuns the initial approach taken in terms of the common law which stated that directors, as it stood years ago, did not have within them proper skills and experience and emphasises that the position now is that directors do in fact have extensive business experience.[162]

[154] See note 10: Bouwman at 512.
[155] See note 1: the 2008 act.
[156] See note 10: Bouwman at 512.
[157] See note 1: the 2008 act.
[158] See note 8: Bouwman at 512.
[159] See note 1: the 2008 act.
[160] See note 4: Cassim at 558.
[161] *Ibid* at 558.
[162] *Ibid* at 558.

As a result of attention being placed in respect of the skills and experience attached to modern company director a less subjective and a more demanding degree of skill and care is required of directors of companies as opposed to what is required by the common law.[163]

Consequently so, it can be said that while it has been emphasised both in respect of the 2007 bill[164] as well as the 2008 act[165] that both an objective and subjective test, so as to retain the common law elements of an objective and subjective test, the standard in the statutory law is however twitched to the extent that the test now includes in it a more demanding degree of skill and care of directors due to the fact and as has been stated that in the modern commercial scenario, directors of today are said to be of a highly professional and skilled background with an extensive amount of expertise in the work done as a director of that company[166]

It must therefore be noted that despite the stringent statutory approach, the common law rigorous approach still is in working order, it is not considered to be redundant. In fact it the statutory law preserves the common law standard used to measure the skill and care performed by a director.

3.2.2. Understanding the statutory stringent approach more clearly:

The stricter, more rigorous approach in respect of the statutory law is found in terms of section 76 (3) (c) of the companies act that of which common law is codified as follows -

"[A] director of a company, when acting in that capacity, must exercise the powers and perform the functions of director [167] –

(a) in good faith and for a proper purpose[168];

(b) in the best interests of the company[169]; and

(c) with the degree of care, skill and diligence that may reasonably be expected of a person[170] –

[163] See note 10: Bouwman at 512.
[164] See note 34: The 2007 Bill.
[165] See note 1: the 2008 act.
[166] See note 4: Cassim at 558.
[167] See note 1: the 2008 act.
[168] See note 1: the 2008 act.
[169] See note 1: the 2008 act.
[170] See note 1: the 2008 act.

(i) carrying out the same functions in relation to the company as those carried out by that director[171]; and

(ii) having the general knowledge, skill and experience of that director."[172]

Accordingly, it is evident that the above section welcomes the statutory regimes and criteria according to which the skill and care of a director be measured. Williams states that despite the statutory law being reformed so as to include the content of section 76 (3) (c), there is yet to be case law that surfaces and applies the codified laws relating to the duty of a director to exercise skill and care in the midst of carrying out his office.[173] Despite this lack of case law authority, Cassim attacks the statutory laws head on, disintegrating the complicated interpretation and emphasising what is actually meant by and how such laws in respect of section 76 3 (c) should be considered in light of any circumstances that may arise.[174]

In the midst of interpreting its very stance, Cassim states that s 76 (3) (c) of s 76 (3)[175] imposes a compulsory duty on a director to exercise powers and perform the duties of a director with the degree of skill and care that may reasonably be expected of a person.[176]

Further Section 76 3 (c) (i)[177] emphasises a situation in terms of which while there being a compulsory requirement on a director to exercise such reasonable skill and care that such director must do so as it would be exercised by a person carrying out the same function as a director and with the same general skill, knowledge and experience of that director as per s 76 3 (c) (ii). [178]

Being more inclined to what the stringent approach offers to South African company, Cassim expressly states that the statutory law places a dual or twofold standard in its approach.[179] He states that on one hand there exists the first leg of the test to be applied, one that occupies an objective nature and that such objective test is found in respect of section 76 (3) (c) (i) of the companies act.[180]

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[171] See note 1: the 2008 act.
[172] See note 1: the 2008 act.
[173] See note 2: Williams at 181.
[174] See note 4: Cassim at 558.
[175] See note 1: the 2008 act.
[176] See note 4: Cassim at 558.
[177] See note 1: The 2008 act.
[178] See note 4: Cassim at 558.
[179] *Ibid* at 558.
[180] *Ibid* at 558.

Elaborating more on this aspect, he holds that the objective test is as such, to the extent that it requires a director of a company to exercise the standard of skill and care that may be reasonably expected of a person carrying out the same functions of a director.[181] In making this objective, "reasonable person" test clear, he holds that the test is not one of a reasonable director but is in fact a test of a reasonable person.[182]

On the other hand, section 76 (3) (c) (ii) incorporates a more subjective test that is to be applied. In this sense, the skill as well as the knowledge and experience of the particular director in question must be made reference to. [183] In doing so, the approach here is that if the director in question has any special knowledge or skill at his disposal or if he is in fact more knowledgeable and experience in respect of such business acumen then the standard to which that particular directors skill and care is measure will be against that of a higher standard.[184]

Impliedly so, Cassim states that what can be interpreted from the above twofold dual approach is that the objective test incorporated in section 76 (3) (c) (i)[185]of the companies act is the minimum requirement that all directors are subjected to and must comply with [186]and that due to the fact that the test which is being applied is an objective one, there need not be an inquiry as to the personal skill, experience or expertise that the director actually has at his disposal. [187]

Subsequently, by having made this clear, despite there being no uniform or structured approach in respect of care in particular, there is now however a minimum standard in section 76 (3) (c) (i) that must be complied with by all directors.[188]

Cassim states profusely that section 76 (3) (c) (i) of the companies act is that the approach that is adopted is one that is both equitable and fair in the circumstances.[189] In making his point clear, he states that such contention can be supported by the fact that the test that is

[181] *Ibid* at 559
[182] *Ibid* at 559.
[183] *Ibid* at 559.
[184] *Ibid* at 559.
[185] See note 1: the 2008 act.
[186] See note 4: Cassim at 559.
[187] *Ibid* at 559.
[188] *Ibid* at 559.
[189] *Ibid* at 559.

applied is measured against the standard that may be reasonably expected of a person in a like position in such situations.[190]

While the objective, reasonable person test finds its application in law reference must be had to the content that is included in respect of the subjective approach. As is evident by the wording of section 76 (3) (c) (ii) it is clear that the effect of such section is that the more skilled or knowledgeable a director is the higher the standard that is expected of him when performing his duty of skill and care.[191]

3.2.3 The crux of the stringent approach:

The climax is that as a director of a company there is firstly, a required standard of skill and care that must be carried out by such director.[192] The actual standard according to which this test is to be applied is an objective one.[193] The point that is trying to be made here is that all directors of all companies (taking into consideration the size, nature of that company and the responsibilities of the director in question) has a compulsory duty in terms of section 76 (3) (c) (i) of the companies act to act reasonably when performing they duty of skill and care in the midst of carrying out their office.[194]

While this approach seems straight forward, the aspect reaches complexity when the test is extended. Such extension is applied if there is a situation whereby the director has a higher level of skill and experience than usual, that of which is at his disposal.

Secondly and bearing the above in mind, the situation is subject to being more stringent in the event that the director of a company has a higher level of skill and care at his disposal. In other words, while the mandatory duty that a director act reasonably should be complied with, in the event that such director has a higher level of skill and expertise the section 76 (3) (c) (ii) will come into play, side by side with the section 76 (3) (c) (i) statutory law.[195]

By analogy, If X is a director of company A then such director has a mandatory duty imposed on him or herself to exercise his duty of skill and care so as to include a situation that may be reasonably expected of a person carrying out the same functions of such director. Therefore,

[190] *Ibid* at 559.
[191] *Ibid* at 559.
[192] *Ibid* at 559.
[193] *Ibid* at 559.
[194] *Ibid* at 559.
[195] *Ibid* at 559.

it is by default that section 76 (3) (c) (i) will apply to X as this is the general standard that is tested against all directors.

Once this objective test has accordingly been applied, the section 76 (3) (c) (ii) will come into play. This section will only come into play if the director in question has any higher level of skill and expertise at his or her disposal.

Therefore, by analogy if X is a director of a company A and, while being a director that company is also an admitted attorney of the High Court to which he has a high level of skill and expertise in legal matters then such expertise and skill will be taken into account when measuring his duty to exercise skill and care in respect of such office.

Further, and in relation to the second aspect mentioned above, it must be highlighted that the subjective standard of skill and care attached to a director of a company will only be taken into account in the event that such higher level of skill and expertise of the director would improve the objective standard of skill and care of the director.[196] Bearing this in mind, the objective standard is accordingly stated to be one that is of a general nature and that of which possesses a flexible characteristic [197] the reason for such flexibility is due to the fact that directors are not a homogenous group of persons. [198]

The case of *Dorchester Finance Co Ltd v Stebbing* [199] is of particular importance in understanding the flexible approach of the subjective test[200]

In this case, the court had held that the directors of the company had a higher level of skill and knowledge attached to them due to the fact that they were accountants.[201] In such instances the directors who were also qualified accountants were held to be negligent in signing blank cheques without making any enquiries.[202]

As a result, the court had stated that because of the higher skill attached to the directors in that they were qualified accountants with business experience that a high standard of skill and care was therefore expected of them.[203] Consequently so, they were held liable for being

[196] *Ibid* at 560
[197] *Ibid* at 560.
[198] *Ibid* at 560.
[199] 1989 BCLC 498 (Ch).
[200] See note 4: Cassim at 560.
[201] Supra note 199
[202] Supra note 199.
[203] Supra note 199.

negligent is signing these blank cheques because a person being a director as well as a qualified accountant would have exercised the required skill and care before signing such blank cheque.[204]

A similar stance was taken in the case of *in Re D'Jan of London Ltd*[205] where it was held that a director had been negligent and did not carry out the required standard of skill and care expected of him when he signed a fire insurance proposal form that of which contained wrong information without reading its contents.[206]

3.2.4 Clarifying what the stringent statutory law test comprises of:

Adding clarity to the situation that exists: in terms of the statutory law Section 76 (3) (c) (i) of the act will apply to all directors, however section 76 (3) (c) (ii) of the act will only come into play when such director has a higher level of skill at his disposal. In this event both legs of the test will be applied. If in the event the director does not have any special business acumen then only the first leg of the test will be applied.

It is however important to note that in the event that the director does have a higher level of skill and expertise then this will only be taken into account if it improves the objective test i.e. if the high level of skill and expertise improves the situation to such an extent that that the reasonable person test will also be improved.

Bearing the above discussions and analogies, the common law while merely defining the objective and subjective test is codified by statutory law to the extent that the objective and subject test is given life and content. Clearly so, the statutory law does in fact add to the content of the common law duty of skill and care, making the approach in respect of the statutory law more stringent.

3.2.5 Is the codification of the common law duty of skill and care required by to be performed by a director necessary? : The criticisms against and arguments in favour of the partial codification:

Bearing the above analogies (as per paragraph 2.2.3) in mind, the common law while merely defining the objective and subjective test is codified by statutory law to the extent that the objective and subject test is given life and content. Clearly so, the statutory law does in fact

[204] Supra note 199.
[205] 1994 1 BCLC 561 (Ch).
[206] Supra note 205.

add to the content of the common law duty of skill and care, making the approach in respect of the statutory law more stringent.

Bouwman states in her 2009 article that the common law decisions in respect of the standard of skill and care to be exercised by a director when executing his duty as well as the statutory take in respect of such duty stated above strikes a perfect balance.[207] In support of her view, she states that having such position made accessible makes it that much more easy for both stakeholders and directors to be informed and have a clear understanding of the content and standard of care and skill that is attached to such director and stakeholder.[208] The approach of the partial codification she states eliminates any sort of confusion that exists within the common law.[209]

While emphasising her views as such, Bouwman does in fact find concern in the aspect of whether both the statutory law and common law, despite being in tandem with each other, will actually function in a successful unison manner.[210]

Apart from her take on the aspect as to whether the codification is necessary, being in support of such partial codification Bouwman highlights the disadvantages and advantages that exist in having such partial codification in working order. She states that, in the event that the common law and statutory law do work in unison then the partial codification does have in it a number of disadvantages and advantages.

The disadvantages of the partial codification that she seeks to highlight are that it is will not resolve the uncertainty of the legal position attached to directors and stakeholders.[211] Apart from this the partial codification does not have within its means to resolve issues regarding simplicity, accessibility and clarity.[212] She states lastly, that the partial codification will also not resolve issues concerning reducing effort, time and legal fees thereof.[213]

While the disadvantages are those which are important to make reference to, Bouwman states that despite such disadvantages that there are also a number of advantages that accordingly exist. Being inclined to give her synopsis of the advantages, Bouwman states that the partial

[207] See note 10: Bouwman at 533.
[208] *Ibid* at 533.
[209] *Ibid* at 533.
[210] *Ibid* at 533.
[211] *Ibid* at 523.
[212] *Ibid* at 523.
[213] *Ibid* at 523.

codification that has been adopted does not stop the growth of the common law.[214] She supports this view by stating that –

"the common law principles are reserved to function in tandem with the partial statutory codification. This allows us to reach for answers in the treasure chests of the common law if the statute cannot provide us with guidance or an answer in a set of complicated factual circumstances that requires a decision based on the application of the principles of the duty of care and skill" [215]

Consequently a total codification of the common law is left redundant so as to embrace the partial codification[216] as a result the common law remain flexible, there are no loopholes that are present when applying the common law despite its partial codification and the common can still be strictly applied to cases of complexity.[217]

While it is clear that the actual and general content of the partial statutory codification is welcomed and embraced in South African company, a controversial issue does in fact surface. This controversial issue consists of criticisms that exist in respect of the statutory objective and subjective tests that are applied against a director who has a duty to exercise a required standard of care and skill in the midst of executing his office.

Consequently, it is equally important to make reference to the various criticisms in such respect. Bekink makes his legal take on such issue known by stating that the subjective test which includes a test against the general skill, knowledge and experience of such director may in fact overshadow the objective test, by having a situation like such this may very well confuse the courts when tasked with the job of interpreting the directors duties.[218]

Apart from Bekink, Du Plesis emphasises that the phrases used in section 76 (3) (c), in particular the phrase "in the capacity of" and "must exercise the powers and perform the functions of director" implies a situation whereby directors will, in future argue that they did not act in such capacity or did not exercise such powers and functions, in the event that they are sued.[219]

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[214] *Ibid* at 523.
[215] *Ibid* at 523.
[216] *Ibid* at 523.
[217] *Ibid* at 523.
[218] MM Botha. "The role and duties of directors in the promotion of corporate governance: a South African perspective" (2009) 30 (3) *Obiter* 702-715.
[219] See note 57: Du Plesis at 268.

Du Plesis states that the content of section 76 (3) (c) (ii) incorporates a major deviation from the phrases used by both English and South African courts, to the extent that the term "knowledge" as used by such court now incorporates in it the phrase "general knowledge" which is used by the statute.[220] Du Plesis makes his or her criticism explicit by emphasising that the aim of such extension of phrase remains unclear.[221] Further, and again criticising the phrases incorporated into the statute, Du Plesis adds that section 76 (3) (c) did not do a proper task of making it clear the content of the objective test, she accordingly muddles the waters by stating that the standard of skill and care expected of a director in respect of the objective test is not that of a "reasonable person" as has been assumed but in fact comprises of a situation of what is required or "reasonably expected of a person"[222]

Further and due the fact that section 76 3 (c) (ii) of the act incorporates a subjective test, so as to assess the general skill, knowledge and experience of that director, it is implied by Du Plesis therefore that it is almost impossible to have wanted to include the test of a reasonable person in section 76 (3) (c).[223] She states that what must have been intended that there be a "reasonable expectation that directors should act with the general knowledge, skill and experience of persons with comparable general knowledge, skill and experience" [224]

Mr Mevin King, in the King II report held that codifying the common law director's duties, in particular the duty of a director to exercise skill and care is the wrong way to go.[225]Further, he states that directors are under continuous pressure and that despite parliament having good intentions by codifying the common law duty of skill and care and thus applying a more stringent test, the results that will follow will lead to a number of pit falls.[226]

It is therefore evident that while the codification of the common law duty of skill and care finds its home in the South African legislative framework and despite the arguments in favour of its partial codification there still exists an extensive amount of criticism as to its application at home.

The penultimate criticism is the fact that the test in terms of the statutory law is in effect far too stringent. In support of this view that the approach is stringent is the business judgement

[220] *Ibid* 269.
[221] *Ibid* at 269.
[222] *Ibid* at 269.
[223] *Ibid* at 269.
[224] *Ibid* at 269.
[225] See note 10: Bouwman at 519.
[226] *Ibid* at 520.

rule which holds that in certain, limited situations that a director, despite having the strict rule incorporated into the statutory law may and will in fact escape liability in such limited situations.

Consequently, In the midst of determining the standard of skill and care that is to be attached to a director of a company when he executes his office, it is equally important to note that directors are not obliged to take all possible care when executing their office, as has been codified and stated in the common law only a reasonable amount of skill and care is expected of such direct.[227]

Be that as it may, it is evident therefore that while adhering and carrying out such reasonable care it must be borne in mind that directors, despite holding such office are in fact infallible and are very often prone to making mistakes when carrying out their office.[228] As a result a distinction must therefore be made in respect of a director carrying out his duty of skill and acre negligently as opposed to the director making a mere error of judgment this aspect, namely the business judgment rule will be discussed in further detail in the next chapter namely Chapter four (4)

3.3. Conclusion:

It is evident that the standard according to which a director exercises his duty of skill and care contains a strict assessment as opposed to that of this common law. Paying heed in respect of such, this is not to say that the common law approach is any less rigorous than what was initially proven in chapter two (2).

Consequently, the partial codification of the common law duty of skill and care and the standard or measurement which is attached to such is of a more stringent premise. The reason for this gathering is that the partial codification does in fact retain the common law duty of skill and care as well as the objective and subjective test used to measure a directors performance of such skill and care, the difference however is that such partial codification gives life and adds content to the common law approach.

This can be emphasised by the strict interpretation of both section 76 (3) (c) (i) and section 76 3 (c) (ii). While the standard according to which a director's duty of skill and care is tested is made clear there are a number of criticisms that do in fact exist. Bearing this in mind, one can

[227] See note 4: Cassim at 560.
[228] *Ibid* at 560.

hold that the twofold dual objective and subjective test is welcomed in South Africa it is however subjected to a number of criticisms.

Despite the criticisms that exist many authors embrace the partial codification with open arms, holding that despite such partial codification, both the common law as well as the statutory law coexist with each other and that courts are, as a result privileged to have access to both common and statutory laws in the mist of applying such to various circumstances that they may be faced with.

While this may be so, the business judgement rule comes into play, shunning the very stringent application of the partial codification of the common law duty of skill and care.

Chapter Four

4. The business judgment rule: a safe harbour from liability of directors

4.1. Introduction

In order to properly understand the concept of the business judgment rule and its application in South Africa it is absolutely vital that there be a recap of the previously discussed common and statutory laws. This recap is of particular importance as reference will be made to both the common law and statutory law in some parts of the discussions.

In terms of the common law, the standard according to which the required skill and care of a director was to be measured initially involved a subjective test, through a number of developments it was later held that the common law incorporated both and objective and subjective test to measure the skill and care of a director when he executed out his office.

Further, and in relation to this the statutory law codified the common law approach so as to include in it a partial codification of the objective and subjective tests. While this may be so, emphasises is placed on the fact that the partial statutory codification of the common law approach involved a more stringent approach when compared to the common law standard used to measure the skill and care exercised by a director.[229]

The stringent approach incorporated a situation in terms of which a twofold dual objective and subjective test existed and invariably that which needed to be applied in applicable situations.[230] Bearing this in mind, the content of the objective test involved a more general test. This objective test needed to be applied to all directors, emphasising that a minimum standard needed to be adhered. [231]This objective test requires that a director "exercise the degree of care, skill and diligence that may be reasonable expected of a person carrying out the same functions as a director."[232] Further, the subjective test requires that "the knowledge, skill and experience of the director in question" must also be taken into account.[233]

It is evident from the above that while a rigorous approach is adopted in respect of the common law, a more stringent approach is adopted in respect of the statutory law.

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[229] See note 4: Cassim at 559.
[230] *Ibid* at 559
[231] *Ibid* at 559.
[232] *Ibid* at 559.
[233] *Ibid* at 559.

Cassim, in his writings states that while the rigorous and stringent approach of both common and statutory law is welcomed into the South African company law it must be emphasised that the standards attached in respect of the common and statutory law is that only "reasonable" skill and care needs to be exercised by such director.[234]

Impliedly so, directors need not exercise all possible skill and care in the midst of carrying out their office, they only need to exercise a reasonable amount of skill and care. [235] The contention behind this idea is that directors are not infallible.[236] Directors do in fact make mistakes during the course of their office, however if a reasonable amount of skill and care is utilized by such director and despite this there are mistakes that follow the director will be protected from being liable for negligence.[237]

As a result, there must be a distinction between a director being negligent to that of a director making a mere mistake or error of judgment in the course of his office.[238]

This distinction introduces the business judgment rule which states with authority that in the event that a director exercises reasonable skill and care he will not incur liability if the decision he made was one which included a mistake or a mere error of judgment.[239]

4.2. The origin and purpose of the business judgment rule:

The business judgment rule was first developed in the United States of America, founded almost 170 years ago and accordingly dates back to the year 1892.[240] The implementation of the business judgment rule was sparked by the fact that there was an imminent desire to safe harbour directors from liability in the event that they were honest in their dealings during the execution of their office. [241]

[234] *Ibid* at 560.
[235] *Ibid* at 560.
[236] *Ibid* at 560.
[237] *Ibid* at 560.
[238] *Ibid* at 560.
[239] Ibid at 560.
[240] See note 10: Bouwman at 523.
[241] See note 10;Bouwman at 523; Kennedy Good S, Coetzee L, "The Business Judgment Rule (Part I)" (2006) *Obiter* 62.

Bearing this in mind and to illustrate: the business judgment rule applies when such honest dealings of directors are prone or inherent to hindsight to the extent that the approach that they took, despite being honest led to an unsuccessful decision.[242]

The penultimate focus here is that the business judgment rule will take its course and apply if a director, while executing his office makes a decision that lacks any component of fraud on his part and embraces good faith in the making of such decision. In the event that this takes place that director will be excluded from liability for any loss which resulted to the company.[243]

Seemingly so, while it is event that the purpose of the business judgment rule acts as a safe harbour from liability of honest directors, there are a number of other purposes that are established and that which effectively come to light.[244] Consequently, the business judgment rule finds its application in law for a number of valid reasons, author Stephen Kennedy – Good states that the purpose of the business judgment rule is that it supports and encourages the component of risk taking in a company, that it welcomes competent individuals to undertake the duty of a director with confidence [245]and that it allows for there to be a prevention or to render redundant any judicial second guess that may very well exist, to avoid any sort of shareholder management in the company. Lastly, he states that the business judgment rule is to encourage well-structured market mechanisms to manage a director's behaviour.[246]

Despite its origin and purpose being implemented at both at home and internationally, the business judgment rule has, in effect been subject to a number of criticisms, making its implementation prone to scepticism. Authors like Bouwman, Havenga, McLennan and Coetzee to name a few have tackled the incorporation of the business judgment rule in South Africa and in having done so argued profusely against the business judgment rule being incorporated into South African laws.[247]

[242] See note 10: Bouwman at 523.
[243] See note 241: Kennedy Good & Coetzee at 64.
[244] See note 4: Cassim at 559.
[245] See note 241: Kennedy Good & Coetzee at 65.
[246] *Ibid* at 65.
[247] See note 44: Muswaka at 92.

4.2.1 The timeline of events leading up to the business judgment rule being incorporated into South Africa:

With reference to the above stated it is clearly evident that the initialization of the business judgement rule was the work of the American court professionals[248] The American common law approach is therefore a cornerstone importance in order to understand the timeline of events leading up the implementation of the business judgement rule in South Africa.

Accordingly the American common law principle embraces a situation in which a director, who acted reasonably, in good faith and for the benefit of that particular company, will not be liable for mere errors of judgement. [249] The way in which this was tested was in terms of the rule illustrated and adopted in the case of *Foss v Harbottle*[250]The court in this case synchronized in its American law four (4) requirements that its directors needed to meet before they could escape liability on the basis that the decision that they made was one which was made in good faith, in the best interest of the company despite such decision having an unsuccessful result.[251]

Therefore, to provide insight as to the approach adopted in the case, the court's decision is of empirical importance, it was stated by the court that if in the event a director is sued for being negligent in his dealings while executing his office he may very well escape liability if the following requirements (also referred to as the business judgment rule elements) were adhered to by such director [252] –

Firstly, that the decision made by the director of that company related to business related matter.[253] Secondly, that the directors, in making their decision were not interested in the transaction, in this sense meaning that they did not have any personal gain from making such decision.[254] Thirdly, that in the process of making their decision they did in fact apply due care and lastly that the directors acted in good faith in making that decision.[255]

Consequently, the business judgement rule elements adopted and illustrated in the case of *Harbottle* are indicative of the fact that American courts were of a welcoming nature to such

[248] See note 10: Bouwman at 523.
[249] See note 2: Williams at 180.
[250] (1843) 2 Hare 461, 67 ER 189.
[251] *Supra* note 250.
[252] *Supra* note 250.
[253] *Supra* note 250.
[254] *Supra* note 250.
[255] *Supra* note 250.

elements and as a result had no problem with the fact that it was incorporated into the American common law. Subsequent to the Americans including in their common law a business judgement rule there was further discussions and suggestions in South Africa that such business rule be incorporated into South African law, in particular the 2008 act.[256]

The first suggestion to incorporate the business judgment rule in to South Africa was the work of the king committee. In the year 1994, the King Committee took steps to defend that they wished to have the business judgement rule incorporated at home, specifically in terms of statutory law.[257] Their defence being that a director, in the midst of executing his office should not be held liable for negligence in applying his skill and care if they exercised an adequate amount of business judgement to their decision that of which was made in good faith, of a rational nature and lacked an interest in personal gain.[258]

Bearing this in mind, it is implied therefore that what is to be expected by implementing the business judgement rule is that there be a limitation of the standard of care and skill to be exercised by a director when executing his office. As a result and impliedly so, directors should be safe harboured from this onerous test adopted in terms of the common law and statutory laws adopted in South Africa.[259] Recapping this aspect, both the common law and the statutory law apply a rigorous and stringent test in order to test the required skill and care performed by a director of a company, hence by implementing the business judgement rule in South Africa will alleviate the very objective and subjective tests that have been developed.

The King committee in King I had purported to defended the potential implementation of the business judgement rule in South Africa due to the fact that adopted such rule would encourage and motivate various companies to be engaged in clean competition.[260] Further and in addition to this, it was also stated by the King committee that the test to measure the standard of skill and care of a director in terms of the common law and statutory law was too strict and as a result there needed to be some protection on the part of directors.[261]

[256] See note 1: the 2008 act.
[257] See note 10: Bouwman at 525.
[258] *Ibid* at 525.
[259] *Ibid* at 525.
[260] *Ibid* at 525.
[261] *Ibid* at 525.

Despite its defence, the King I recommendations and suggestions to incorporate the business judgement rule into South Africa has been subject to a number of criticisms.[262]

The first criticism that was established against King I's reasoning was that by King I emphasising that the standard used to measure the skill and care of a director is one which is onerous creates two impressions that are not entirely correct.[263]In the first place by stating that the standard of skill and care is one which is onerous is indicative that the standard is one which could easily be achieved or that which attaches liability to directors immediately without reasoning. [264] This is incorrect, in support of this Finch states that –

"the common law operates to give directors a remarkable freedom to run their companies incompetently. Provided that their behaviour falls short of the grossest negligence they are unlikely to be held to account"[265]

Apart from this Gower states that the common law duty of skill and care of directors in a company are of a "lax" nature emphasising the point made my Finch and further criticising the King I reasoning for the implementation of the business judgement rule.[266]

Apart from this, the second impression put forth by King I is that in the event that there is a breach of a directors duty of skill and care that they will almost immediately be subjected to litigation in respect of such breach [267] this however is not true. Evidence in support of this is found on the case of *Niagara v Langerman & Others*,[268] the only reported South African case which has been reported holding that a director is liable for breaching the standard of skill and care.[269] This implies that King I's impression that a director will be immersed into litigation immediately when he breaches his duty of skill and care is incorrect.[270]

The final criticism made was that while King I states that there should be an incorporation of the business judgement rule into South African law to increase and encourage business risk taking is also incorrect.[271]

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[262] *Ibid* at 526.
[263] *Ibid* at 526.
[264] *Ibid* at 526.
[265] *Ibid* at 526.
[266] *Ibid* at 526.
[267] *Ibid* at 526.
[268] 1913 WLD 188.
[269] See note 10: Bouwman at 526.
[270] *Ibid* at 526.
[271] *Ibid* at 526.

As is stated above and impliedly so it is evident that the fact that there are a "lax" set of rules that are implemented (as emphasised by Finch and Gower) illustrates that there is in fact a situation in which risk taking in South African company law is encouraged and enforced, despite this the King I report does not take cognisance of this fact.[272]

The King II report is also worthy of its decision as to whether the business judgement rule should be incorporated into South African law, consequently the King II report emphasised that in considering whether the business judgement rule be incorporated into South Africa there must be an investigation by the Standing Advisory committee on company law in respect of such[273] In stating so, the King II report did not place any valued argument as to whether the business judgement rule should be implemented in South Africa and for this reason it has been criticized. [274]

While a number of extensive criticisms have been in place in respect of incorporating a statutory business judgment rule in South Africa, the 2007 Bill took steps and was realized to be the first to attempt to include a statutory business judgment rule into South Africa.[275] In support of this, Clause 91 (2) of the 2007 Bill held that[276] –

"a director's judgement that an action or decision is in the best interest of, or for the benefit of the company is reasonable if … the director … has taken reasonably diligent steps to become informed about the subject matter of the judgement […,] does not have a personal financial interest in the subject matter of the judgement and … it is a judgement that a reasonable individual in a similar position could hold in comparable circumstances."[277]

With its considerable stance, the 2007 Bill encouraged law makers, to a certain extent to include it its statutory law a codified business judgement rule. As a result, despite there being a "tug of war" in respect of whether the business judgement rule should be incorporated into South African statutory law or not, the decision of law makers to proceed further and in fact adopt a statutory business judgement rule left some, not many extremely welcoming of its codification in the year 2008.

[272] *Ibid* at 526-527.
[273] *Ibid* at 527.
[274] *Ibid* at 527.
[275] *Ibid* at 528.
[276] See note 34: the 2007 bill.
[277] See note 34: the 2007 bill.

4.2.2. The 2008 statutory business judgement rule:

After the 2008 act came into force, it was evident that drafters of the company act were adamant on including in its statutory law a section regulating the business judgement rule.[278]As a result, having fought for its place in the statutory world the business judgement rule now confirms that in the event that a director makes a decision in good faith, in the best interest of the company and which includes a lack of any potential person financial gain in such transaction that that director will not be held liable if the decision he made was an unsuccessful one to the extent that he is negligent.[279]

In support of this contention, reference must be made to the particular section that gave such business law statutory life. According to section 76 (4) (a)[280] "in respect of any particulate matter arising in the exercise of the powers or the performance of the functions of director, a particular director of the company is deemed of presumed to have exercised his or her powers or performed his or her functions in the best interests of the company and with reasonable care, skill and diligence (as contemplated in section 76(3)(b) and (c) if" [281]-

"(i) the director has taken reasonably diligent steps to become informed about the matter;

(ii) either[282]-

(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;[283] or

(bb) the director complied with the requirements of section 75 with respect to any interest contemplated in subparagraph (aa)[284]; 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"[285]

[278] See note 10: Bouwman at 528.
[279] *Ibid* at 528.
[280] See note 1: the 2008 act.
[281] See note 4: Cassim at 564.
[282] See note 1: the 2008 act.
[283] See note 1: the 2008 act.
[284] See note 1: the 2008 act.
[285] See note 1: the 2008 act.

What the above statutory business judgement rule codification does is that it provides a situation which confirms that if the requirements as stated in terms of section 76 (4) (a) of the act are met, then the director would have subsequently fulfilled the requirements in respect of section 76 3 c of the companies act.[286]

Bouwman states therefore, that it is evident that in a director avoiding liability in the breach of his duty of skill and care, which was done so mistakenly, Section 76 (3) (c) (i) and (ii) of the companies act will be of immense held, subsequently in the event that both section 76 3 c (i) and (ii) are proven as may be suitably done, that the statutory business judgement rule plays a further role in assisting a director in avoiding such liability[287] – recommendations late

Bearing the above in mind, in order to make clear the implementation of the statutory business judgement rule, it is important that a break-down of the sections incorporated into section 76 (4) (a) of the act be emphasised.

Cassim emphasises in his writing that under the companies act, the statutory business judgement rule will allow for a situation which will counter the less objective and more rigorous duty of directors to exercise skill and care in the midst of executing their office. [288]In an attempt to break-down and understand the content of the statutory business judgement rule he states that in considering the requirements in respect of the statutory business judgement rule it is immediately evident that there is in fact a safe harbour from liability for directors of a company.[289]

In support of this contention he states that the first requirement for the business judgement rule to find application in a particular situation is that there must be an informed decision, secondly that there must be no personal financial interest when transacting and thirdly that the director, when making his decision must have had a rational basis for believing that taking that approach and proceeding with that particular decision was in fact in the best interest of the company.[290]

Be that as it may, and in relation to his realization, Cassim states that the third requirement, namely that the director, when making his decision must have had a rational basis for believing that taking that approach and proceeding with that particular decision was in fact in

[286] See note 1: the 2008 act.
[287] See note 10: Bouwman at 528.
[288] See note 4: Cassim at 564.
[289] *Ibid* at 564.
[290] *Ibid* at 564.

the best interest of the company is of particular importance and needs further interpretation.[291]

He holds that, this third requirement (s 76 (4) (a) (iii) involves a test of rationality, it is stated that this test is in essence of an objective nature,[292]therefore an "objectively unreasonable" decision made by a director will not be protected by the statutory business judgement rule.[293]Further, it is stated that the requirement that the decision made by the director be a rational one is a "pivotal ingredient" and as a result of this the decision of the director must not be irrational or unreasonable, instead the directors decision must be of a rational and reasonable nature. [294]

The court will, after considerable assessment of whether the three requirements have been met will accept it as such and therefore not replace their judgement with those of the director's business judgement when he made his decision.[295]

The basis for putting this incentive forth is that an irrationally or unreasonably made decision implies that the director is executing his office mala fide.[296]

The case of *Shuttleworth v Cox Brothers & Co (Maidenhead) Ltd*[297] illustrates such situation. In this case the court had held that –

"while it is not the business of the court to manage the affairs of the company, the absence of any reasonable ground for deciding that a certain course of action is for the benefit of the company may be a ground for finding lack of good faith"[298]

Subsequently, it can therefore be held that it is only rational and reasonable decisions of the director that will protect him from liability. [299]As a result, if all the requirements of s 76 (4) (a) of the companies act are met then the director will be free from liability for any mistakes or errors of judgement that he may have made in the course of executing his office, apart

[291] *Ibid* at 564.
[292] Ibid at 564.
[293] *Ibid* at 564.
[294] *Ibid* at 564.
[295] *Ibid* at 564.
[296] *Ibid* at 564.
[297] 1927 2 KB (CA) 23.
[298] *Supra* note 297.
[299] See note 4: Cassim at 565.

from this once these requirements are met, it therefore follows that the requirement to act with skill and care will be met (as contemplated in s 76 3 c of the companies act)[300]

It is equally important to note that in the evident the three requirements in terms of s 76 4 a are met, the court will not attempt to replace their judgement of whether the directors business decision was correct or not with their decision. [301]The reason for this, and it must be emphasised, flows from the fact that the court and judicial persons are in fact not business experts, therefore if in the event the three requirements are met and it includes a decision which is rational and reasonable then that director would be seen as exercising his duty of skill and care against the required standard that need be adhered to.[302]

In accordance with this, an extract in the Cassim writing is note-worthy –

"On compliance with these three requirements, the merits and the wisdoms of the business decisions fall outside the scope of judicial review. The courts are not business experts. They do not have the expertise to review the commercial merits of business decisions."[303] In support of this contention, it has been emphasised in American law that only in egregious situations where there is an application of irrationally bad decisions, mala fide actions of the part of the director or dishonest and fraudulent decision are made by the director, only then will the judicial persons attempt to second guessing such judgement of the director, so as to replace the judgement with that director with their own judicial judgement"[304]

By illustration, if for example there is a decision by the directors of the company to sell the business of the company at a low price which only at a later stage turns out to in fact be undervalued price, that it, the undervalued price became available ex post facto then this decision will not hold the directors who made this decision liable if they meet the three requirements in terms of section 76 4 (a) of the companies act.[305]

In complete contrast to this, the case of *Smith v Van Gorkum*[306] is of importance –

[300] *Ibid* at 565.
[301] *Ibid* at 565.
[302] *Ibid* at 564.
[303] *Ibid* at 565.
[304] *Ibid* at 565.
[305] *Ibid* at 566.
[306] 488 A 2d 858.

In this case there was an attempt to sell the business of the company, the board of directors in making their decision did not consider that selling the business of a company is serious matter and includes thorough, critical thinking before a decision is to be made to in fact sell the business of such company. [307] Bearing this in mind the court had held that the board's decision to sell the business of the company was in essence not one that included an informed decision.[308]Apart from this, they did not take any steps to understand and measure the value of the business of the company[309] instead, the decided and that too uncritically to sell the business of the company.[310]

In the midst of making their decision, the court made reference to the lack of effort that the board of directors put into making such an important decision. The court stated that the directors approved of a sale of the company's business after only a two hour meeting.[311]

4.2.3 The now controversial statutory business judgement rule: The criticisms

As can be seen from the above information as per paragraph 2.2.2 the statutory business judgement rule has made a number of inroads in respect of the various situations that a court may be faced with. Despite this, the Kings III report criticises the implementation of the business judgement rule into the corners of the South African statutory legislation, in doing so it was held in the King III report that "the 2008 act has introduced a new defence for the advantage of directors who are purportedly in breach of their duty of care and skill".[312]

In making its views against such statutory business judgement rule, the King III report did not defend or provide any guidance in respect of section 76 4 (a) of the companies act.[313]Apart from this, writers such as Bouwman, Botha and Jooste, Havenge, McLennan and Coetzee tackle the areas of company law relating to the statutory business judgement rule incorporated in South Africa, in doing so Muswaka holds that in general, the above authors do not favour or welcome the introduction of a statutory business judgement rule.[314]

[307] See note 4: Cassim at 566.
[308] *Ibid* at 566.
[309] *Ibid* at 566.
[310] *Ibid* at 566.
[311] *Ibid* at 566.
[312] See note 10: Bouwman at 528.
[313] *Ibid* at 528.
[314] See note 44: Muswaka at 92.

Bouwman in particular is seen to have a sharp tooth in relation the implementation of the business judgement rule being incorporated into the South African legislation. In her writing, a particular lengthy extract is worth quoting –

"In a society where corporate scandals are not few; where competent directors are highly sought after; where our courts usually have afforded (and will continue to afford) directors the benefit of the doubt; where court decisions show that South African society does not have a history of succeeding against directors due to breach of their duty of care and skill; and where the 1973 Act currently contains, and the 2008 Act proposes, equivalent provisions to provide defences for directors against liability, it hardly makes sense to extract a principle (that has the effect of providing an extra defence to directors against being found in breach of their duty of care) in isolation from a legal system that does not much resemble ours and to incorporate such a principle into South African company law."[315]

Apart from this Bouwman emphasises the criticisms put forth by the King III report and sternly states that she is of the opinion that the business judgement rule should not have been included in South African legislation.[316] In addition, she criticises that international laws that follow the business judgement rule should not be so strictly adhered to stating that the business judgement rule was subjected to a different sort of climate in its development from those in South Africa.[317]

In support of her legal take on this issue, Bouwman cites as authority the stance taken in the state of Delaware, emphasising that the approach in Delaware is that which somewhat alleviates, to an extent, the protection offered to directors by the implementation of the business judgement rule.[318] Being uncritical of the approach in Delaware, Bouwman profusely encourages that the business judgement rule should not have found place in South African statutory laws.

Bearing this in mind and in addition to her many contentions, she argues in favour of the recent judgement that have been held in Delaware, stating that –

"Recent decisions by the Supreme Court of Delaware thus demonstrate a movement away from the sympathy toward directors and the liberal application of the rule that curbs the

[315] See note 10: Bouwman at 533-534.
[316] *Ibid* at 534.
[317] *Ibid* at 534.
[318] *Ibid* at 534.

enforcement of directors' duties. This trend is observed in the very country in which the business judgment rule originated, and shows that the rule perhaps does not cater for modern society's needs."[319]

While Bouwman fiercely argues against the implementation of the statutory business judgement rule in South Africa, and despite the many criticism that the statutory business judgement rule is prone to it has been emphasised by Muswaka in a 2013 article that Davis holds that the business judgement rule is utilized to further the goals and objectives of the companies act of 2008.[320]

Serving as authority for this contention it has been stated that - "Read as a whole, the 2008 Act promotes the objective that there should not be an over-regulation of company business. The Act grants directors the legal authority to run companies as they deem fit, provided that they act within the legislative framework."[321] In other words, directors should run their businesses as they deem fit so long as they adhere to the rules within the four walls of section 76 4 (a) of the companies act of 2008.[322]

Further, it has been stated by Jones that the existence of the statutory business judgement is more often than not welcomed by directors due to the fact that such directors are faced with making decisions in respect of black economic empowerment partnerships and that in essence by being faced with such decisions there is a risk that potential decisions regarding empowerment partnership deals are of a harmful nature, making such company prone to more risks than usual.[323]

4.3. Conclusion:

Bearing in mind the common law and the statutory law test attached to a director in measuring the standard of skill and care he should exercise, it seems rather daunting that despite the various developments that have been extensively argued to adopt stricter and more rigorous approaches to the standard to which to test such skill and care that the business judgement rule now take over so as to alleviate the developments that have occurred,

[319] *Ibid* at 534.
[320] See note 44: Muswaka at 92.
[321] Ibid at 92.
[322] *Ibid* at 93.
[323] E Jones "Directors duties: Negligence and the business judgment rule." (2007) 19 (3) *SA Mercantile Law Journal* 326-336.

shunning away years of arguments and writings to hold directors liable for their mistakes, especially in South Africa where "mistakes" are excuses to hide behind corporate scandals.

While the origin of the business judgement rule is clearly understood and its purpose welcomed in American laws it makes no practical sense that the statutory business judgement rule be incorporated into the South African legislature. Having stated so, there are a number of criticisms circling the area of the business judgement rule and the place it occupies in the statutory world.

Apart from this, the business judgement rule is somewhat superfluous due to the fact that even despite the implementation of the statutory business judgement rule it has been held that irrespective, directors will not be held liable for mere errors of judgement and mistakes taking into consideration the situation at hand.

What then is the need to incorporate such a strict set of rules in favour of directors to the extent that they are free from liability in the event that they exercise minimum skill and care? This question remains to be one which is left unanswered, consequently the need for a statutory business judgement rule remains unclear and unsupported due to its superfluous nature and due to the fact that it shuns years of extensively argued developments in favour of a more stringent, rigorous standard against which a directors skill and care be measured.

Chapter Five

5. Conclusion

5.1. The Conclusion:

As a closure to the abovementioned discussions as per chapters two, three and four there needs to be a recap of the various important points that were accumulated.

In doing so it is precisely evident that the aspect relating to the common law approach in respect of a directors duty to exercise skill and care in the midst of performing his duties was of a controversial nature. Going back to the process of highlighting this aspect it is therefore important to note that the controversial nature of such duty arises from the fact that while some authorities purport to explain that the main issue is that the extent to which a director may be held liable for a breach of his duty of skill and care is unclear, other commentators such as Williams and Cassim make their legal stance confidently known, putting emphasis in the fact that the extent to which a director is liable for a breach of his duty of skill and care comprises of a moderate or seemingly low component.

In the midst of doing so there have been a various number of extensive developments that have taken place, making such developments prone to the common law lenient approach that was initially initiated and followed by South African company law so as to include a rigorous approach.

South Africa, in need of such development found the rigorous approach worthy of its application not only because that the past laws which regulated such duty were inadequate but also due to the fact that other jurisdictions were making major shifts in their approaches as well. This international shift was made evident by the approach of Canada, America as well as the United Kingdom.

Consequently, in articulating the number of developments that have taken place over the past few decades, one can confirm that that standard of skill and care in respect of the common law is not of a more rigorous test, implementing in it both an objective and subjective test. While the common law, initially being a matter of debate, finds it standing in the South Africa's legal framework due to the developments that it had been subjected to.

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The aspect pertaining the common law is seen to be one which can be viewed in a positive light, due to the change from its initial lenient approach to measure the skill and care of a director to a now more rigorous approach.

Despite the fact the common law standard is seen in such positive lights, the South African legislature embraced to option to have the common law duty of skill and care partially codified thus complicating the system.

The statutory law, in partially codifying the common law duty of skill and care retains both the objective and subjective elements similar to the common law. The issue however comes in when such objective and subjective test are now of a more stringent nature. As it has been established above directors have a mandatory duty to meet the requirements in terms of s (76) (3) (c) (i) of the 2008 act.[324] While this is clear, Section 76 (3) (c) (ii) of the 2008 [325] will only come into play in the event the director in question has a higher level of skill or expertise at his disposal. In the event the director does have such extra skills and expertise at his disposal then he must in fact meet both requirements in s 76 (3) (c) (i) and (ii) of the 2008 act.[326]

As can be seen as more stringent approach is now developed, complicating the common law rules, having emphasised this it is important to make clear that this partial codification while having been criticised by many, being favoured by many more.

Such criticism, as indicated above is welcomed by those individuals who are in favour of the now statutory business judgement rule. Bearing this in mind the high level of objective and subjective standards that must be met by a director who has the duty to exercise a required standard of skill and care it is absolutely daunting that the business judgement rule be incorporated into South African legislature.

The business judgement rule as can be seen from chapter 4 holds that if a director make an error in his judgement then he is able to hide behind the statutory business judgement rule so as to escape liability. It has been emphasised by a large number of authorities that the statutory business judgement rule should not have been incorporated in South Africa.

Bearing in mind the number of years of development that has taken place so as to include a more stringent standard to test the skill and care of a director it is evident that what the

[324] See note 1: The 2008 act.
[325] See note 1: The 2008 act.
[326] See note 1: the 2008 act.

business judgement rule intends doing is to shun what developments have occurred and protect directors who may have breached their duty of skill and care. Whethere or not the approach of the South African legislature was one of considerable thought is one which is left unanswered.

It is important to note that in South Africa company law the purpose of such legal development that has been adopted over the years is in essence to acquire a better economic stance. By incorporating a statutory business judgement rule within the four corners of its legislative framework it seems as if South Africa is looking more behind than forward.

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