

**An analysis of the business judgment rule under Section 76(4)  
of the South African Companies Act 71 of 2008**

by

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### **An analysis of the business judgment rule under Section 76(4) of the South African Companies Act 71 of 2008**

I declare that the above dissertation is my own work and that all the sources that I have used or quoted have been indicated and acknowledged by means of complete references.

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I further declare that I have not previously submitted this work, or part of it, for examination at UNISA for another qualification or at any other higher education institution.



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## **ABSTRACT**

This study examines the relevance and reasons for the limited judicial application of the business judgment rule in section 76(4) of the Companies Act. The rule was introduced to shield directors from personal liability arising from honest decisions that harm the company.

The study finds that the business judgment rule is relevant as it aligns with the purposes of the Companies Act such as promotion of entrepreneurship and good corporate governance. It further finds that the broad scope of the rule and the blending of the fiduciary duty to act in the best interests of the company with the duty of care, skill and diligence limit its application and consign it to legal uncertainty. The study makes several recommendations which include narrowing the definition of business judgment, specifying the scope of the business judgment rule and imposing the burden of proof on the plaintiff.

## **KEY TERMS**

Business judgment rule; corporate governance; directors; personal liability; fiduciary duties; duty of care, skill and diligence; common law; company; business decision; accountability

## ABBREVIATIONS

ALI	American Law Institute
ASIC	Australian Securities and Investment Commission
BJR	Business Judgment Rule
CLERP	Corporate Law Economic Reform Program
DTI	Department of Trade and Industry
L Rev	Law Review
PELJ	Potchefstroom Electronic Law Journal
SA Merc LJ	South African Mercantile Law Journal
SALJ	South African Law Journal
U L Rev	University Law Review
USA	United States of America



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# CHAPTER 1: GENERAL INTRODUCTION AND PROBLEM STATEMENT

## 1.1 Introduction

Directors are entitled to make decisions that may be based on limited information.<sup>1</sup> Whilst making these decisions, directors are exposed to market risks that may not be reasonably foreseen.<sup>2</sup> This is due to the fact that market conditions in which companies operate are defined by competition,<sup>3</sup> globalisation,<sup>4</sup> and corporate failures<sup>5</sup> that require directors to take commercial risks<sup>6</sup> for their companies to remain competitive.<sup>7</sup> Due to these inherent risks, directors' decisions may have severe effects on their companies even if they exercise due care and diligence in making those decisions.<sup>8</sup> The negative outcome of directors' decisions may result in them facing personal liability.<sup>9</sup> To mitigate the untenable situation in which directors confront personal culpability claims for corporate decisions taken with appropriate diligence, the business judgment rule (BJR) was established under the Companies Act 71 of 2008 (hereinafter Companies Act) as a principle of director

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<sup>1</sup> *Re City Equitable Fire and Insurance Co Ltd* [1925] 1 Ch 407 [408]; see also Demetra Arsalidou, 'Objectivity vs Flexibility in Civil Law Jurisdictions and the Possible Introduction of the Business Judgement Rule in English Law' (2003) 24 *Company Lawyer* 228, 232.

<sup>2</sup> *Daniels v Anderson* [1995] 37 NSWLR 438 [503]; see also *King Report on Corporate Governance* (Institute of Directors Southern Africa, 2002) (*King Report II*) 132.

<sup>3</sup> Stephen M Bainbridge, 'The Business Judgment Rule as Abstention Doctrine' (2004) 57 *Vanderbilt Law Review* 83, 122.

<sup>4</sup> Michiel van Meeteren and Jana Kleibert, 'The Global Division of Labour as Enduring Archipelago: Thinking through the Spatiality of "Globalisation in Reverse"' (2022) 15 *Cambridge Journal of Regions, Economy and Society* 389, 390.

<sup>5</sup> Some global corporate collapses such as Enron and Lehman Brothers and South African companies such as Fidentia and Steinhoff exposed markets at a wholesale level. See Dorothy S Lund and Elizabeth Pollman, 'The Corporate Governance Machine' (2021) 121 *Columbia Law Review* 2563, 2610; KE van der Linde, 'The Steinhoff Corporate Scandal and the Protection of Investors Who Purchased Shares on the Secondary Market' (2022) 25 *PELJ* 1, 2; Leviticus Mensah and Murad A Bein, 'Sound Corporate Governance and Financial Performance: Is There a Link? Evidence from Manufacturing Companies in South Africa, Nigeria, and Ghana' (2023) 15 *Sustainability* 1, 2.

<sup>6</sup> Friedrich Hamadziripi and Patrick C Osode, 'The Nature and Evolution of the Business Judgment Rule and its Transplantation to South Africa under the Companies Act of 2008' (2019) 33 *Speculum Juris* 26, 28; see also Jeffrey MacIntosh, 'The Business Judgment Rule, the Public Interest Powers, and the "Fair and Reasonable" Test: Fellow Travellers or Ships in the Night?' (2023) 60 *Osgoode Hall Law Journal* 73, 81.

<sup>7</sup> Bernard S Sharfman, 'The Importance of the Business Judgment Rule' (2017) 14 *New York University Journal of Law and Business* 27, 34.

<sup>8</sup> According to s 76(3) of the Companies Act, directors have an obligation to exercise due care and act in good faith.

<sup>9</sup> Sections 77(2)(a) and (b) of the Companies Act; see also *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd* [2014] ZAWCHC 95 [74].

defence.<sup>10</sup> The BJR is a corporate law concept birthed in United States of America,<sup>11</sup> (hereinafter the USA) where it has remained as a common law principle<sup>12</sup> since 1829,<sup>13</sup> following the case of *Percy v Millaudon*.<sup>14</sup> The rationale underlying the the doctrine is to shield company directors from personal claims stemming from the adverse outcomes of their good faith decisions.<sup>15</sup> The BJR is thus aimed at counterbalancing the risk of liability and the need for commercial risk-taking required in the execution of their duties.<sup>16</sup>

The BJR proffers that directors are better suited to make corporate decisions<sup>17</sup> than courts because of their close proximity to the affairs of the company.<sup>18</sup> As a result of this location advantage which directors have, courts should not challenge directors' decisions<sup>19</sup> unless there is proof of breach of directorial duties.<sup>20</sup>

Notwithstanding its long existence, the BJR has been criticised for lack of a unanimously agreed definition, despite attempts by many scholars to analyse it,<sup>21</sup> an issue which is argued to undermine its credibility as an effective tool for director protection.<sup>22</sup> This researcher submits that this is an important argument. This is because misunderstanding of the doctrine's meaning may jeopardise its legal clarity whilst also harming its value and usefulness for potential rule beneficiaries.

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<sup>10</sup> Wiseman Ubochioma, 'An Examination of the Relevance of the Codification and Application of the American Business Judgment Rule to Nigerian Corporate Law' (2020) 64 *Journal of African Law* 373, 376.

<sup>11</sup> E Jones, 'Directors' Duties: Negligence and the Business Judgment Rule' (2007) 19 *SA Merc LJ* 326, 327.

<sup>12</sup> Hamadziripi and Osode, 'The Nature and Evolution' 26.

<sup>13</sup> Natasha Bouwman, 'An Appraisal of the Modification of the Director's Duty of Care and Skill' (2009) 21 *SA Merc LJ* 509, 523, submitting that the BJR can be traced back to 1829.

<sup>14</sup> *Percy v Millaudon* (1829) 8 *Mart. (n.s.)* 68 (La. 1829) 68.

<sup>15</sup> Linda Muswaka, 'Directors' Duties and the Business Judgement Rule in South African Company Law: An Analysis' (2013) 3 *International Journal of Humanities and Social Science* 89, 89.

<sup>16</sup> FHI Cassim and others, *The Law of Business Structures* (2nd edn, Juta 2021) 375.

<sup>17</sup> Stephen M Bainbridge, 'Making Sense of the Business Roundtable's Reversal on Corporate Purpose' (2021) 46 *The Journal of Corporation Law* 285, 303–304; *In re Solera Holdings Inc Stockholder Litigation* 2017 WL 57839 (Del. Ch. 2017) 16.

<sup>18</sup> Carlos AL Giraldo, 'Factors Affecting Governing the Application of the Business Judgment Rule: An Empirical Study of the US, UK, Australia and the EU' (2006) 55 *Vicepresidencia Juridica Bogota* (Colombia) 115, 121–122.

<sup>19</sup> Giraldo 'Factors Affecting the Application of the Business Judgment Rule' 121.

<sup>20</sup> Ubochioma, 'An Examination of the Relevance of the Codification' 376.

<sup>21</sup> Julian Velasco, 'Fiduciary Judgment Rules' (2021) 62 *William & Mary Law Review* 1397, 1414–1415.

<sup>22</sup> Andrew Key and Joan Loughrey, 'The Concept of Business Judgment' (2018) 39 *Legal Studies* 36, 40.

The BJR has been codified in South African corporate law through section 76(4) of the Companies Act.<sup>23</sup> The section specifies the criteria under which company directors are eligible for the BJR's protection.<sup>24</sup> These conditions include a business decision,<sup>25</sup> an informed decision,<sup>26</sup> absence of material personal financial interest<sup>27</sup> and rationality.<sup>28</sup> Furthermore, section 76(4) of the Companies Act outlines two distinct duties with which directors must demonstrate compliance. The first is the fiduciary duty to act in the best interests of the company<sup>29</sup> and the second is the duty of care, skill and diligence (hereafter the duty of care).<sup>30</sup> By specifying the standards that directors must comply with, the South African BJR appears to impose the onus of proof<sup>31</sup> on directors to show cause why they should not be impeached for breach of their duties.

Although the BJR was established as a legal tool to protect company directors, it has not been widely applied in South African courts.<sup>32</sup> This is evidenced by the paucity of judicial precedent on the rule. The rule's limited use raises concerns about its viability and role in South Africa's corporate governance framework.<sup>33</sup> Therefore, this motivates this study, which seeks to ascertain the relevance of the rule in the South African corporate governance context as well as establish why the rule has not been widely applied in court proceedings to further enhance the analysis of the rule, this study employs a comparative analysis approach by assessing the rule's use in South Africa and Australia. Both South Africa and Australia<sup>34</sup> have codified their BJR provisions, with Australia being the first country

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<sup>23</sup> See s 76(4)(a) of the Companies Act; see Proc 32 in GG 34239 of 19 April 2011, providing the effective operation date of the Companies Act as 01 May 2011; see also Cassim and others, *Law of Business Structures* 373.

<sup>24</sup> Ira M Millstein, Ellen J Odoner and Aabha Sharma, 'Fiduciary Duties of Corporate Directors in Uncertain Times' (2018) 30 *Journal of Applied Corporate Finance* 17, 22.

<sup>25</sup> Section 76(4) of the Companies Act.

<sup>26</sup> Section 76(4)(a)(i) of the Companies Act.

<sup>27</sup> Section 76(4)(a)(ii) of the Companies Act.

<sup>28</sup> Section 76(4)(iii) of the Companies Act.

<sup>29</sup> Section 76(3)(b) of the Companies Act.

<sup>30</sup> Section 76(3)(c) of the Companies Act.

<sup>31</sup> American Law Institute (ALI), *Principles of Corporate Governance: Analysis and Recommendations* (American Law Institute Publishing 1994).

<sup>32</sup> Allens Linklaters, *Advice Regarding the Business Judgment Rule* (Australian Institute of Company Directors, 2020) 1, 20.

<sup>33</sup> For example, see Hamadziripi and Osode, 'The Nature and Evolution' 30.

<sup>34</sup> Section 180(2) of the Corporations Act 50 of 2001.

to codify the BJR<sup>35</sup> in 2001. Although both countries have legislated their BJR, their approaches to enforcement differ. In South Africa, private parties such as shareholders initiate court proceedings against company directors for breach of directorial duties.<sup>36</sup> However, Australia uses a civil penalty model approach in which the state, through the Australian Securities and Investment Commission (ASIC), litigates as the claimant against directors for breach of their duties.<sup>37</sup> ASIC is a regulator tasked with registering and regulating companies, among other roles.<sup>38</sup> The goal of comparing the South African and Australian BJR statutory provisions is to determine the best practices for the rule and contextualise them to South Africa.

## **1.2 Purpose of the Research**

The purpose of this study is to investigate the relevance of the South African BJR in protecting company directors who make honest decisions from personal liability, even if their decisions harm their companies. Additionally, the study also seeks to interrogate the reasons behind the limited judicial application of the BJR in the South African corporate environment.

The study investigates the principles and implications of the BJR as outlined in section 76(4) of the Companies Act. This task is achieved by analysing statutory provisions, existing literature, scholarly articles, case law and legal opinions pertaining to the BJR.

Furthermore, the study analyses and compares the provisions of the statutory BJR in South Africa with the Australian BJR provision in section 180(2) of the Australian Corporations Act, to draw lessons on the interpretation and application of the rule South Africa.

The study also provides recommendations for improved use and interpretation of the rule in South Africa, thus bridging the apparent gap between the statutory provisions of the rule and its practical application.

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<sup>35</sup> Douglas M Branson, 'The Rule That Isn't a Rule – The Business Judgment Rule' (2002) 36 Valparaiso University Law Review 631, 633.

<sup>36</sup> See ss 77(2)(a)–(b) and 77(3) of the Companies Act.

<sup>37</sup> See s 1317E of the Corporations Act 2001; Andrew W Winden, 'Caremark's Climate Failure' (2023) 74 Hastings Law Journal 1167, 1196.

<sup>38</sup> Section 1274 of Corporations Act 50, 2001; Winden, 'Caremark's Climate Failure' 1196.

It is crucial to grasp the nexus between the statutory BJR and its limited application under South African company law. By probing this relationship, the study provides insights that can enhance corporate governance practices and improve directorial decision-making, thus leading to a more cogent and effective legal environment for governing corporate directors. To the extent that the global influence of the BJR is growing,<sup>39</sup> the matter of corporate director defence is becoming increasingly important. An evaluation of the South African statutory BJR and reasons for its limited application provides an opportunity for refining the rule. This may result in increased international appreciation of the South African corporate legal framework and additional foreign investment, as foreign company directors become assured of their protection under the country's BJR provisions.<sup>40</sup>

### **1.3 Problem Statement**

The BJR commenced its existence in the South African corporate law framework more than 14 years ago.<sup>41</sup> Although the BJR was introduced as a legal defence instrument to benefit company directors who face personal liability claims arising from their decisions, a problem has since emerged. There seems to be a significant gap in grasping the relevance of the rule as it has not been commonly used in court proceedings. The limited judicial deployment to date of the BJR points to an underlying problem with the doctrine or its interpretation, which hampers its practical application, thus leaving a practice and knowledge gap on the rule. It also reflects a void between its purpose and its judicial application, resulting in a legal vacuum. This could have the unintended outcome of deterring directors from making risky but necessary commercial decisions, while at the same time inhibiting qualifying persons to serve as directors.<sup>42</sup> Or further still, the situation could lead to the redundancy of the rule. This problem is aggravated by the fact that there are some ambiguities in the legislative construction of the rule which undermine its scope and intentions.

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<sup>39</sup> See Cassim and others, *Law of Business Structures* 373, providing that South Africa, Australia and Hong Kong are some of the countries that have codified the BJR.

<sup>40</sup> Section 7(b) of the Companies Act, states that one of the objectives of the Act is to foster investments and innovation.

<sup>41</sup> Proclamation 32 in GG 34239 of 19 April 2011 which provides for commencement date of Companies Act 71 of 2008 as 01 May 2011.

<sup>42</sup> Dennis Davis and Walter Geach (eds), *Companies and Other Business Structures in South Africa* (E-book, 5th edn, Oxford University Press 2021) [6.4.2].

In response to this problem, a comprehensive analysis to examine the relevance of the BJR in the South African corporate governance landscape and to make recommendations aimed at improving its judicial application and interpretation, shall be undertaken.

#### **1.4 Research Question**

To this effect, this research seeks to answer the question:

- What is the rationale and relevance of the South African statutory BJR?

In addition, the following supporting research questions are addressed:

- How is the South African statutory BJR under section 76(4) of the Companies Act formulated and intended to function within the corporate governance framework?
- Are there any identifiable shortcomings in the framing of the BJR which may negatively affect its effectiveness?
- What policy and legal reforms can be introduced to make the BJR a more effective defence mechanism for directors who qualify for its protection? Are there any lessons that South Africa can learn from the Australian statutory BJR?

#### **1.5 Research Methodology**

In research, a methodology sheds light on how the researcher seeks to respond to the research question and address the problem under investigation.<sup>43</sup> This research is desktop-based. A literature review research method underpinned by a doctrinal approach is used. A doctrinal approach is relevant in legal research.<sup>44</sup> It is applicable to this research because of its emphasis on legislation, case law and legal theory, all components of legal research.

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<sup>43</sup> Vijay M Gawas, 'Doctrinal Legal Research Method a Guiding Principle in Reforming the Law and Legal System Towards the Research Development' (2017) 3 International Journal of Law 128, 128.

<sup>44</sup> Desmond Manderson and Richard Mohr 'From Oxymoron to Intersection: An Epidemiology of Legal Research' (2002) 6 Law Text Culture 159, 161.

Therefore, to address the research question and supporting questions, the study sourced its information from case law, legislation, corporate and legal reports and scholarly literature in the form of journal articles, as well as business and legal textbooks. In the case of some textbooks, the researcher used both hard copies and e-books that were accessed through the UNISA Library. Use of these sources is supported by Westerman,<sup>45</sup> who submits that the use of legal texts is the most effective way of conducting legal research.

A comparative analysis position is adopted, with Australia being used as a comparator to evaluate the application of the statutory BJR. Comparative analysis was relevant because it assists in critical evaluation and understanding of legal perceptions<sup>46</sup> by comparing legal provisions in different legal systems, resulting in new knowledge that can be used for law reform.<sup>47</sup>

Australia was chosen as a comparator for various reasons. First, Australia was the first country to codify the BJR,<sup>48</sup> which consequently served as a source of reference for South Africa when drafting its own BJR.<sup>49</sup> Second, both South Africa and Australia's corporate frameworks have foundational principles of English law,<sup>50</sup> allowing legal provisions within their company law systems to be interpreted from comparable perspectives. Third, South Africa has had a limited number of court actions that deal with the BJR. Conversely, Australia has enjoyed more judicial application and interpretation of its BJR.<sup>51</sup> To this end, it is hoped that the Australian BJR case law will provide interpretive assistance on South Africa's BJR statutory provisions as well as offer plausible reasons for the rule's limited judicial application in South Africa.

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<sup>45</sup> PC Westerman, 'Open or Autonomous: The Debate on Legal Methodology as a Reflection of the Debate on Law' in M van Hoecke (ed), *Methodologies of Legal Research: Which Kind of Method for What Kind of Discipline?* (Hart Publishing 2011) 87.

<sup>46</sup> Laura Cahillane and Jennifer Schweppe (eds), *Legal Research Methods: Principles and Practicalities* (Clarus Press 2016) 9.

<sup>47</sup> Mathias Siems, *Comparative Law* (3rd edn, Cambridge University Press 2022) 3.

<sup>48</sup> Branson, 'The Rule that Isn't a Rule' 633.

<sup>49</sup> Allens Linklaters, *Advice Regarding the Business Judgment Rule* 5.

<sup>50</sup> Allens Linklaters, *Advice Regarding the Business Judgment Rule* 8.

<sup>51</sup> The cases include *ASIC v Rich* [2009] 75 ACSR 236 FLR 1; *Australian Securities and Investments Commission v Fortescue Metals Group Ltd* [2011] 190 FCR 364.

The introduction of comparative law in this study finds support from the Companies Act,<sup>52</sup> which permits courts to refer to foreign law for legal interpretation or application of the Companies Act.

The study also employs legal historical analysis to present the development of the BJR in South Africa and Australia. In doing so, the researcher's aim was to highlight the factors that influenced the adoption of the BJR and how they shaped its provisions in South Africa and Australia.

## **1.6 *Dissertation Framework***

This study is presented in 5 chapters. Chapter 1 provides a foundational discussion on the study by establishing its objective, problem statement, research problem and the research methodology. Chapter 2 explores the powers, accountability and liability of directors in the South African corporate governance context. Chapter 3 gives a detailed discussion of the BJR including its history, operation and philosophical rationale. It also provides a brief overview of the relevant BJR statutory provisions in South Africa and Australia and further lays a foundation for a comparative analysis of the rule between the two jurisdictions. Chapter 4 provides a critical comparison between the South African and Australian statutory BJR provisions. Chapter 5 presents the findings of the study and provides recommendations for SA.

## **1.7 *Conclusion***

The need for the BJR arises from the fact that company directors may face personal liability exposure arising from the harm their decisions cause to their companies. In the face of such personal liability claims, the South African company law system protects the directors through the BJR provision found in section 76(4) of the Companies Act. This provision establishes specific requirements that directors must meet for them to be eligible for the BJR's protection. Unfortunately, South African corporate directors have under-utilised the BJR defence thus far.

This study is an academic response to the law's limited implementation in South African courts. It entreats the need for an evaluation of the BJR to ascertain the

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<sup>52</sup> See s 5(2) of the Companies Act.

extent of its relevance. The study also interrogates the BJR's formulation and intention as well as its shortcomings and then makes policy and legal recommendations to improve the rule's utility.

In the next chapter the study delves into the powers, accountability and the liability of directors in order to establish the contours of the corporate governance landscape in which directors exercise their managerial discretion and how they are statutorily held accountable.

## CHAPTER 2: POWERS, ACCOUNTABILITY AND LIABILITY OF DIRECTORS IN SOUTH AFRICAN CORPORATE GOVERNANCE

### 2.1 Introduction

This chapter reviews literature on the South African corporate governance environment. First, it examines the powers, duties, accountability and liability of company directors. This is done to determine the central positioning of company directors in the corporate environment and how their powers are counterbalanced by their obligations to their companies. To provide additional context to the directors' ecosystem, the topics of corporate governance, fiduciary duties and the duty of care are explored. This appraisal is essential in locating the role of directors with the corporate framework and in underscoring the risks they face in the performance of their responsibilities.

### 2.2 Directors' powers, accountability, and liability

#### 2.2.1 Defining a director

A company is a legal entity that exists only by virtue of the law and cannot perform human acts.<sup>53</sup> Legal personality grants the company separate rights from its owners and an infinite life span, that can only be ended upon deregistration.<sup>54</sup> However, due to its juridical personality, a company must rely on natural beings to uphold its rights and to advance its goals<sup>55</sup> and interests.<sup>56</sup> The company's operations are carried out by its directors. Given the crucial role that directors play in guiding a company's affairs, it is critical to locate the position of company directors and the powers vested in them within the corporate structure.

Section 1 of the Companies Act defines a company director as being part of its board of directors as envisaged by section 66, as well as an alternate director which includes any other person with the role of director or alternate director regardless

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<sup>53</sup> See *Salomon v A Salomon & Company Ltd* [1897] AC 22 (HL); s 19(1) of the Companies Act; see also s 119 of the Corporations Act 2001.

<sup>54</sup> Piet Delpont *New Entrepreneurial Law* (2nd edn, LexisNexis 2020) 19.

<sup>55</sup> Farouk HI Cassim and others, *Contemporary Company Law* (3rd edn, Juta 2021) 41.

<sup>56</sup> See *Lennard's Carrying Co Ltd v Asiatic Petroleum Co Ltd* [1915] AC 705.

of the title which they may have.<sup>57</sup> The definition implies that any person can be regarded as a director if he performs the duties of a director without a formal appointment.<sup>58</sup> The Companies Act defines the board as the board of directors.<sup>59</sup> The term 'board' or 'board of directors' is thus a collective term that denotes a group of directors.<sup>60</sup> When directors act in concert within the scope of their powers, their actions are considered to be those of the company and not of their personal interests.<sup>61</sup>

The Companies Act specifies several types of directors that are applicable in South African company structures.<sup>62</sup> These directors include directors appointed according to the company's Memorandum of Incorporation,<sup>63</sup> ex officio directors,<sup>64</sup> alternate directors,<sup>65</sup> and directors elected by shareholders.<sup>66</sup> It is submitted that the Companies Act thus provides more room for persons to be directorially liable when compared to other jurisdictions. For example, Australia's Corporations Act<sup>67</sup> states that a director is someone appointed to the position of director or alternative director and who acts in that role.<sup>68</sup> Thus it has a restrictive definition which only considers persons who are formally appointed as directors.

South Africa's broad definition of a director is also indicated in section 76(1) of the Companies Act which provides a more comprehensive definition of the term. It applies the same definition and obligations to all categories of directors, including prescribed officers, non-executive directors, and board committee members.<sup>69</sup> The legislator's intention through this insertion may have been to remove any misconception arising from case law that executive and non-executive directors

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<sup>57</sup> Section 1 of the Companies Act.

<sup>58</sup> FHI Cassim and others, *The Law of Business Structures* (2nd edn, Juta 2021) 275.

<sup>59</sup> Section 1 of the Companies Act.

<sup>60</sup> *R v Kritzinger* 1971 (2) SA 57 (A) 59; s 1 of the Companies Act.

<sup>61</sup> Tshepo Mongalo and Tshepiso Scott, *Corporate Law and Corporate Governance: An Overview of Business Undertakings in South Africa* (E-book, 2nd edn, Van Schaik 2023) [7.1].

<sup>62</sup> For detailed explanation of types of directors, see Cassim and others, *Law of Business Structures* 276–279.

<sup>63</sup> Section 66(4)(a)(i) of the Companies Act.

<sup>64</sup> Section 66(4)(a)(ii) of the Companies Act.

<sup>65</sup> Section 66(4)(a)(iii) of the Companies Act.

<sup>66</sup> Section 66(4)(b) of the Companies Act.

<sup>67</sup> Section 9AC(1) of the Corporations Act.

<sup>68</sup> Section 9(a) of the Corporations Act.

<sup>69</sup> Section 76(1) of the Companies Act.

owe different levels of duty to their companies.<sup>70</sup> This broad definition implies that corporate officers who direct company affairs are classified as directors, even if they have not been formally appointed as directors of the company.<sup>71</sup>

### 2.2.2 Powers of directors

Section 66(1) of the Companies Act specifies that directors have a mandate to manage the affairs and business of the company. This provision confers original powers to manage the company directly on directors. These powers are not proxy powers from shareholders but are statutory powers derived from the Companies Act.<sup>72</sup> Prior to the Companies Act, directors had delegated powers from shareholders which reduced their function to that of fiduciary agents of the shareholders.<sup>73</sup> Despite being vested with wide powers and statutory authority, the directors' powers are not unconstrained.<sup>74</sup> Section 66(1) states that a company's memorandum of incorporation may limit the powers of directors, indicating the intention to hold directors accountable for the exercise of their powers.

The common law position grants directors' wide discretion in exercising their powers without judicial restraint.<sup>75</sup> The statutory powers which section 66(1) of the Companies Act vests in directors thus reinforce this common law position.

There seems to be a lack of consensus on the nature of the directors' authority in the corporate environment, resulting in diverse theories.<sup>76</sup> Two of these theories, namely the director primacy and the agency theories are discussed below.

#### 2.2.2.1 The director primacy theory

According to this theory, directors hold ultimate authority over corporate decision making.<sup>77</sup> It also recognises that their vast powers create opportunities for directors

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<sup>70</sup> *Fisheries Development Corporation of SA Ltd v Jorgensen* 1980 (4) SA 156 (CW) [65].

<sup>71</sup> Cassim and others, *Law of Business Structures* 275.

<sup>72</sup> Cassim and others, *Law of Business Structures* 274.

<sup>73</sup> Cassim and others, *Law of Business Structures* 274.

<sup>74</sup> Section 66(1) of the Companies Act.

<sup>75</sup> *Fisheries Development Corporation of SA Ltd v Jorgensen* 1980 (4) SA 156 (CW) [163]; *S v Shaban* 1965 (4) SA 646 (W).

<sup>76</sup> Cassim and others, *Law of Business Structures* 279.

<sup>77</sup> Ann M Lipton, 'Shareholder Divorce Court' (2018) 44 *Journal of Corporation Law* 297, 299.

to engage in self-dealing and managerial opportunism at the expense of company.<sup>78</sup> This is due to the fact that their powers grant them authority to make financial and operational decisions, such as approving budgets and deciding the company's strategic direction, all of which are vital to the company's success.<sup>79</sup> This view is reinforced by the *King II Report Executive Summary*<sup>80</sup> which states that corporate governance principles were developed to limit the directors' powers by creating an equilibrium between directors' and shareholders' interests.

From this perspective, it can be said that directors are powerful actors in the company because they are not mere agents of shareholders but key decision-makers of the company.<sup>81</sup> This concept reflects the enlightened shareholder value theory, which according to Nettle<sup>82</sup> was codified in section 172 of the Companies Act in the United Kingdom.

According to this approach, directors have an obligation to promote their companies' success while at the same time upholding the interests of various stakeholders of the company such as shareholders, workers, suppliers, the environment and community.

#### 2.2.2.2 The agency theory

The agency theory<sup>83</sup> is another theoretical perspective that seeks to explain the position of the director in the corporate environment. The theory postulates that directors operate as arbiters of the interests of management and shareholders by supervising and directing corporate managers.<sup>84</sup> The theory further posits that directors have the obligation to ensure that companies provide the required disclosures and close any gaps caused by information imbalances that could benefit

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<sup>78</sup> See *Executive Summary – The King Report on Corporate Governance* (Institute of Directors Southern Africa 2002) [9].

<sup>79</sup> Lipton, 'Shareholder Divorce Court' 299.

<sup>80</sup> *King II Report Executive Summary* [9].

<sup>81</sup> Lipton, 'Shareholder Divorce Court' 299.

<sup>82</sup> See Geoffrey Nettle, 'The Changing Positions and Duties of Company Directors' (2018) 41 *Melbourne University Law Review* 1402, 1410.

<sup>83</sup> Filippo Vitolla, Nicola Raimo and Michele Rubino, 'Board Characteristics and Integrated Reporting Quality: An Agency Theory Perspective' (2020) 27 *Corporate Social Responsibility and Environmental Management* 1152, 1153–1154.

<sup>84</sup> Albert H Choi and Geeyoung Min, 'Contractarian Theory and Unilateral Bylaw Amendments' (2018) 104 *Iowa Law Review* 1, 7.

management at the expense of shareholders.<sup>85</sup> This theory thus frames directors as agents of shareholders.<sup>86</sup>

The agency theory, however, appears to contradict statutory provisions that relate to directors' powers. For instance, section 66(1) of the Companies Act accords statutory powers to directors to govern the affairs of the company subject to the provisions of the company's memorandum of incorporation. This puts to question the agency theory's approach of 'subordinate powers' where directors are agents of shareholders and whose primary goal is to promote shareholder profit interests.

### 2.2.3 *Directors' accountability and liability*

#### 2.2.3.1 Directors' Accountability

The Companies Act explicitly regulates directorial accountability. First, the provisions of fiduciary duties of good faith, proper purpose and best interests of the company in sections 76(3)(a) and (b) of the Companies Act provide a standard of conduct mechanism to ensure that directors are held accountable. Second, to further mitigate against directors becoming conflicted due to personal financial interests, section 75 of the Companies Act provides for the disclosure of directors' personal financial interests as well as those of related parties.<sup>87</sup> Third, section 76(2)(a)(i) of the Companies Act prohibits a director or another person from using their position or information derived from their duties, to take advantage of the company or its wholly owned subsidiary. This reflects the common law principle of no profit-rule<sup>88</sup> which prohibits directors from using their office to benefit at the expense of the company.<sup>89</sup> Section 76(2)(a)(ii) of the Companies Act broadens the scope of conflict of interest accountability by prescribing that the directors may not cause harm to the company or its subsidiary.<sup>90</sup> The researcher submits that the

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<sup>85</sup> Friedrich Hamadziripi and Patrick C Osode, 'The Nature and Evolution of the Business Judgment Rule and its Transplantation to South Africa under the Companies Act of 2008' (2019) 33 *Speculum Juris* 26, 28; Vitolla, Raimo and Rubino, 'Board Characteristics' 1153–1154.

<sup>86</sup> Lipton, 'Shareholder Divorce Court' 300.

<sup>87</sup> See s 75(5) of the Companies Act.

<sup>88</sup> Cassim and others, *Law of Business Structures* 360.

<sup>89</sup> Cassim and others, *Law of Business Structures* 360.

<sup>90</sup> Dennis Davis and Walter Geach (eds), *Companies and Other Business Structures in South Africa* (E-book, 5th edn, Oxford University Press 2021) [6.4.3].

inclusion of the company's subsidiary demonstrates the intention of the Companies Act to create a more accountable environment for directors.

As previously stated, the Companies Act empowers directors to direct the affairs of the company.<sup>91</sup> The directors' powers may be limited by the Companies Act or by the company's memorandum of incorporation.<sup>92</sup> Directors have an obligation to account to their companies for the performance of their duties which include the duties of good faith, loyalty and avoiding conflicts of interest.<sup>93</sup>

#### 2.2.3.2 Directors' Liability

Directors who violate their duties or act recklessly may be held personally liable.<sup>94</sup> Director liability for breach of duties has existed for a long time and has its roots in English case law.<sup>95</sup> However, under this legal regime directors had extensive discretion in performing their duties, a situation that allowed them to avoid accountability for breach of their duties except in the most egregious cases of negligence.<sup>96</sup> For example, the case of *Re Brazilian Rubber Plantations & Estates Ltd*,<sup>97</sup> affirmed this view, holding that the capacity and skill of a particular director should be adjudicated from the standpoint of a person with the same level of expertise and capacity. In this case, directors were duped by a Mr Meiter who fabricated a report to influence their decision to invest in a Brazilian rubber plantation business venture. The court determined that that the directors had not breached their duty of care because they had made a decision on the strength of their experience and from the information at their disposal and not out of gross negligence.<sup>98</sup>

The Companies Act sanctions breach of directorial duties and thus ensures that the accountability of directors is buttressed by the risk of personal liability. Section 20(6)

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<sup>91</sup> Section 66(1) of the Companies Act.

<sup>92</sup> Section 66(1) of the Companies Act.

<sup>93</sup> Edward B Rock, 'For Whom is the Corporation Managed in 2020? The Debate over Corporate Purpose' (2021) 76 *The Business Lawyer* 363, 381.

<sup>94</sup> See s 20(6) of the Companies Act.

<sup>95</sup> See for example *Lagunas Nitrate Co v Lagunas Syndicate* [1899] 2 Ch 392 (CA); *Re National Bank of Wales Ltd* [1899] 2 Ch 626 (CA).

<sup>96</sup> Vanessa Finch, 'Company Directors: Who Cares about Skill and Care?' (1992) 55 *The Modern Law Review* 179, 179.

<sup>97</sup> *Re Brazilian Rubber Plantations and Estates Ltd* [1911] 1 Ch 425 (Ch D) [436]–[437].

<sup>98</sup> *Re Brazilian Rubber Plantations and Estates Ltd* [1911] 1 Ch 425 (Ch D) [436]–[437].

of the Companies Act grants shareholders the right to claim for damages against any person who through intention, fraud or gross negligence causes the company to deviate from the provisions of the Companies Act or any restraint unless the shareholders ratify the inconsistency in terms of section 20(2). Section 20(2) provides for ratification of breach of action, authority or purposes restricted by the company's memorandum of incorporation.

Section 77 penalises directors who breach their duties that may include the breach of not acting in good faith and for a proper purpose, or failure to act in the best interests of the company or to uphold their duty of care.<sup>99</sup> Violation of fiduciary duties may result in claims for damages and financial loss by the offending director.<sup>100</sup>

Section 77(2)(b) of the Companies Act states that a director may be held liable under common law for any loss, damages or costs suffered by the company as a result of breach of the duty of care provided in section 76(3)(c), or for infringing any provision of the Companies Act or the company's memorandum of incorporation. The ground for action for a breach of duty of care is delictual in nature.<sup>101</sup> Section 214 of the Companies Act stipulates that any person who commits fraud against the company, its suppliers or employees will be guilty of a crime, thus indicating the risk of criminal sanction against directors. The Companies Act also provides in section 162 that a director or someone who was a director in the immediate past 2 years may be declared a delinquent director or placed under probation for misconduct, wilful negligent or breach of trust, if a relevant application is made to the court by the company, shareholders or other parties.<sup>102</sup>

The liability regime of the Companies Act is further entrenched by the unrestricted threat of liability in section 218(2) of the Companies Act which provides that any person who violates any provision of the Companies Act shall be liable for the harm suffered by another person as a result of the breach. It is argued that the presence of such a seemingly indeterminate personal liability exposure places directors in an untenable position. This follows that they do not only have to contend with the civil

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<sup>99</sup> Cassim and others, *Law of Business Structures* 383.

<sup>100</sup> Companies Act, s 77(3).

<sup>101</sup> Section 77(2)(b) of the Companies Act.

<sup>102</sup> See s 162(2) of the Companies Act.

liability sanctions in sections 20(6) and 76 of the Companies Act or the criminal liability risk prescribed in section 214 but the harm suffered by any person as a result of their directorial breach as well.

From this discussion, it is clear that to enhance corporate governance, the Companies Act provides for a varied liability system that includes civil and criminal sanction in addition to the threat of an unbounded liability in section 218(2).

### **2.3 Corporate Governance**

The term 'corporate governance' originated in the 1970s.<sup>103</sup> Section 7(b)(iii) of the Companies Act regulates corporate governance into South African company law for the first time stating that one of the objectives of the Act is to foster South Africa's national economic development by promoting openness and good corporate governance. Corporate governance can be simplified as a performance management system that assesses whether directors perform their duties robustly.<sup>104</sup> It ensures the profitability and growth of companies<sup>105</sup> as it emphasises exemplary conduct by directors. It also seeks to hold directors accountable for the exercise of the powers vested in them.<sup>106</sup>

The inclusion of corporate governance under the Companies Act can be deduced to indicate the growing influence of the principle within the South African corporate environment.

However, despite its widespread use, the word 'corporate governance' lacks definitional consensus.<sup>107</sup> Due to the ambiguity of its meaning, some commentators argue that the term is undefinable.<sup>108</sup> For example, Owen J commented on this

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<sup>103</sup> Dorothy S Lund and Elizabeth Pollman, 'The Corporate Governance Machine' (2021) 121 *Columbia Law Review* 2563, 2572.

<sup>104</sup> Cassim and others, *Law of Business Structures* 323.

<sup>105</sup> Ramani Naidoo, *Corporate Governance: An Essential Guide for South African Companies* (3rd edn, LexisNexis 2016) 6.

<sup>106</sup> Mongalo and Scott, *Corporate Law and Corporate Governance* [7.1].

<sup>107</sup> Susan McLaughlin, *Unlocking Company Law* (4th edn, Routledge 2018) 5.

<sup>108</sup> Jean Jacques du Plessis, Anil Hargovan and Mirko Bagaric, *Principles of Contemporary Corporate Governance* (4th edn, Cambridge University Press 2018) 3.

stating that corporate governance risked becoming senseless jargon due to the abuse of the term.<sup>109</sup>

Despite these inconsistencies, corporate governance is often understood to refer to how natural persons manage and control business organisations.<sup>110</sup> The *King Report on Corporate Governance for South Africa, 2016 (King IV Report)*<sup>111</sup> defines corporate governance as the manner in which governing bodies apply principled and effective governance resulting in decent culture, outstanding performance, efficient management and credibility.<sup>112</sup> In the *Executive Summary – King Report on Corporate Governance for South Africa, 2002 (Executive Summary – King II Report)*,<sup>113</sup> corporate governance principles were described as a mechanism for investors to address the power imbalances that favour directors.<sup>114</sup> Corporate governance therefore relates to how directors govern their companies and the matters they prioritise in their decision making.<sup>115</sup> Du Plessis, Hargovan and Bagaric<sup>116</sup> describe corporate governance as the act of directing corporate behaviour while harmonising the company stakeholders' interests.

From a South African perspective, it is also worth noting that in addition to legislative attention, corporate governance has also garnered significant judicial recognition. For example, in *Minister of Water Affairs and Forestry v Stilfontein Gold Mining*<sup>117</sup> the court ruled that strong corporate governance was critical to safeguarding the welfare of the company. In *South African Broadcasting Corporation Ltd v Mpofu*,<sup>118</sup> the court determined that the strength of corporate governance was dependant on ethical conduct and personal integrity of the board of directors. In *Mthimunye-*

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<sup>109</sup> Report of the HIH Royal Commission (Owen Report), *The Failure of HIH Insurance – Volume 1: A Corporate Collapse and its Lessons* (Canberra, Commonwealth of Australia, 2003) xxxiii.

<sup>110</sup> Mervyn E King, 'The Synergies and Interaction Between King III and the Companies Act 71 of 2008: Enforcement and Regulatory Regime: Part IV' [2010] *Acta Juridica* 446, 446.

<sup>111</sup> Institute of Directors South Africa *King Report on Corporate Governance (King IV Report)* (Institute of Directors Southern Africa 2016).

<sup>112</sup> *King IV Report* 11.

<sup>113</sup> See *Executive Summary – King II Report*.

<sup>114</sup> See *Executive Summary – King II Report* [9].

<sup>115</sup> Friedrich Hamadziripi and Patrick C Osode, 'A Critical Analysis of Zimbabwe's Codified Business Judgment Rule and its Place in the Corporate Governance Landscape' (2021) 25 *Law, Democracy and Development* 575, 579; see also Owen Report, *The Failure of HIH Insurance – Volume 1* xxxiii.

<sup>116</sup> Du Plessis, Hargovan and Bagaric, *Principles of Contemporary Corporate Governance* 10.

<sup>117</sup> *Minister of Water Affairs and Forestry v Stilfontein Gold Mining* 2006 (5) SA 333 (W) [16.7].

<sup>118</sup> *South African Broadcasting Corporation Ltd v Mpofu* [2009] 4 All SA 169 (GSJ) [64].

*Bakoro v Petroleum Oil and Gas Corporation of South Africa (SOC) Limited*,<sup>119</sup> the court ruled that the role of corporate governance was to make company directors and senior management accountable because they enjoyed expansive powers. The preceding judgments thus demonstrate judicial acceptance of corporate governance as an important corporate framework tool. This attention reflects the increasing importance of the concept in the South African corporate environment. The significance is heightened by the fact that corporate governance encompasses additional concepts such as the BJR that entail directorial decision-making.<sup>120</sup>

Corporate governance has been theorised from a variety of angles, some of which are discussed below.

### 2.3.1 Shareholder primacy theory

This notion is viewed as fundamental to corporate governance,<sup>121</sup> having its roots in the American corporation framework.<sup>122</sup> It postulates that directors act in a subservient role to shareholders who are their principals<sup>123</sup> and that they are appointed to enhance shareholder profits and interests.<sup>124</sup> In *Dodge v Ford Motor Co*<sup>125</sup> the court supported this viewpoint, ruling that the company exists to serve its shareholders.<sup>126</sup> The shareholder primacy theory is underpinned by contractarianism, a corporate idea that states that the company's objective is to

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<sup>119</sup> *Mthimunya-Bakoro v Petroleum Oil and Gas Corporation of South Africa (SOC) Limited* 2015 (6) SA 338 (WCC) 12.

<sup>120</sup> Hamadziripi and Osode, 'A Critical Analysis' 580.

<sup>121</sup> Grant M Hayden and Matthew T Bodie, 'The Corporation Reborn: From Shareholder Primacy to Shared Governance' (2020) 61 Boston College Law Review 2419, 2421; Robert J Rhee, 'A Legal Theory of Shareholder Primacy' (2017) 102 Minnesota Law Review 1951, 1956.

<sup>122</sup> Rhee, 'A Legal Theory of Shareholder Primacy' 1956.

<sup>123</sup> Lipton, 'Shareholder Divorce Court' 300.

<sup>124</sup> Amanda Wise, 'Corporate Law and the Business Roundtable: Adding to the Debate on Shareholder Primacy vs. Stakeholder Theory' (2021) 49 Capital University Law Review 499, 501.

<sup>125</sup> *Dodge v Ford Motor Co* [1919] 170 NW (Mich. 1919) 668 [684].

<sup>126</sup> *Dodge v Ford Motor Co* [1919] 170 NW (Mich. 1919) 668 [684].

maximise shareholder returns<sup>127</sup> and that a company is a legal mechanism illusion that regularises the commercial contract with shareholders.<sup>128</sup>

The relevance of the shareholder primacy theory has been questioned in corporate law since it demotes directors to mere agents of shareholders unable to exert their own will and authority in their corporate functions.<sup>129</sup> In South Africa, the shareholder supremacy theory is challenged by statutory provisions such as section 66(1), which confers statutory rights on company directors rendering the concept of shareholder delegated powers inappropriate. The proximity of directors and managers as the drivers of the company also undermines the position of shareholders as principals. This follows that directors and management have better access to company information, making their role more influential as ownership and control of the company are separated.<sup>130</sup>

### 2.3.2 Stakeholder theory

The stakeholder theory emerged in the 1970s and 1980s.<sup>131</sup> It recommended a broader stakeholder focus to balance the competing interests of various corporate stakeholders.<sup>132</sup> The theory submits that the fiduciary relationship that exists between shareholders and directors (under the shareholder primacy theory) is not special. This is because directors and management have a fiduciary duty to the company which is a juristic person that has interests, duties and obligations to other stakeholders that may conflict with shareholders' interests.<sup>133</sup> The stakeholder theory asserts that directors owe fiduciary obligations to multiple parties.<sup>134</sup> Employees, shareholders, creditors, suppliers, consumers and the community, are

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<sup>127</sup> William Wilson Bratton, 'Shareholder Primacy versus Shareholder Accountability' [2023] University of Pennsylvania Institute for Law & Economics 1, 11; Lipton, 'Shareholder Divorce Court' 300.

<sup>128</sup> See Lynn S Paine and Suraj Srinivasan, 'A Guide to the Big Ideas and Debates in Corporate Governance' (*Harvard Business Review*, 14 October 2019) <<https://hbr.org/2019/10/a-guide-to-the-big-ideas-and-debates-in-corporate-governance>> accessed 18 July 2025.

<sup>129</sup> Rhee, 'A Legal Theory of Shareholder Primacy' 1953.

<sup>130</sup> Michael Bradley and others 'The Purposes and Accountability of the Corporation' (1999) 62 *Law and Contemporary Problems* 9, 39.

<sup>131</sup> Abhilasha Gokulan, 'Increasing Board Diversity: A New Perspective Based in Shareholder Primacy and Stakeholder Approach Models of Corporate Governance' (2021) 96 *New York University Law Review* 2136, 2161.

<sup>132</sup> Wise, 'Corporate Law and the Business Roundtable' 501.

<sup>133</sup> Wise, 'Corporate Law and the Business Roundtable' 501.

<sup>134</sup> Gokulan, 'Increasing Board Diversity' 2161.

all stakeholders with interests that must be protected.<sup>135</sup> The *King Report on Corporate Governance 2009 (King III Report)* states that directors must consider the interests of their various stakeholders when making decisions,<sup>136</sup> thus suggesting a stakeholder-theory orientation. It is submitted that despite the seemingly positive intentions of the stakeholder theory, it may be difficult to satisfy the diverse interests of the company's stakeholders as they are often in competition with each other.

## **2.4 Director's duties**

One notable aspect of the Companies Act is the partial codification of directorial duties.<sup>137</sup> Partial codification refers to a situation in which key aspects of a legal doctrine are reduced to writing.<sup>138</sup> Directors' fiduciary duties such as good faith,<sup>139</sup> and acting for a proper purpose<sup>140</sup> and in the best interests of the company have been partially codified under the Companies Act.<sup>141</sup> The Companies Act has also codified the duty of care, found in section 76(3)(c).

The partial codification of director duties means that common law duties of directors remain binding on directors in cases where their duties are legislated.<sup>142</sup> The effect is that directors will now be required to comply with both their common law duties and statutory duties,<sup>143</sup> which has been lauded as critical to the preservation<sup>144</sup> and development of the common law.<sup>145</sup> In weighing the merits of partial codification, Coetzee and Van Tonder<sup>146</sup> have noted that the requirement for directors to comply with both common law and statutory duties may also lead to confusion.<sup>147</sup> The court

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<sup>135</sup> Gokulan, 'Increasing Board Diversity' 2161.

<sup>136</sup> Institute of Directors South Africa *King Report on Corporate Governance (King III Report)* (Institute of Directors Southern Africa, 2009) [8.3].

<sup>137</sup> Anna Elizabeth Oost, 'A "Safe Harbour" for Directors in South Africa? A Comparative Study of the Business Judgment Rule' (LLD thesis, University of South Africa 2020) 208.

<sup>138</sup> Lindi Coetzee and Jan-Louis van Tonder, 'Advantages and Disadvantages of Partial Codification of Directors' Duties in the South African Companies Act 71 of 2008' (2016) 41 *Journal for Juridical Science* 1, 3.

<sup>139</sup> Section 76(3)(a) of the Companies Act.

<sup>140</sup> Section 76(3)(a) of the Companies Act.

<sup>141</sup> Section 76(3)(b) of the Companies Act.

<sup>142</sup> Coetzee and Van Tonder, 'Advantages and Disadvantages of Partial Codification' 3.

<sup>143</sup> Cassim and others, *Law of Business Structures* 345.

<sup>144</sup> Coetzee and Van Tonder, 'Advantages and Disadvantages of Partial Codification' 5.

<sup>145</sup> See s 158(a) of the Companies Act.

<sup>146</sup> Coetzee and Van Tonder, 'Advantages and Disadvantages of Partial Codification' 5.

<sup>147</sup> Coetzee and Van Tonder, 'Advantages and Disadvantages of Partial Codification' 5.

in *Carmichele v Minister of Safety and Security*<sup>148</sup> determined that the primary benefit of partial codification is that it enhances the common law and ensures its application where relevant, resulting in improved application. However, one effect of partial codification is that the flexibility associated with common law may be lost due to the written nature of the partially codified parts of the law which may limit judicial interpretation.<sup>149</sup>

#### 2.4.1 *Fiduciary duties*

The term 'fiduciary' originates from '*fiducia*', a Latin phrase which means trust.<sup>150</sup> A fiduciary relationship is established when one party is placed in charge of the property of another person.<sup>151</sup> A fiduciary duty is discharged when the party in control of the other party's property acts honestly and faithfully for the benefit of the owner of the assets.<sup>152</sup>

A director's fiduciary duty comes into effect from the moment they are appointed to the position of director. This was determined in the case of *Howard v Herrigel*<sup>153</sup> where the court held that a director's fiduciary duties commence upon accepting the appointment. The core obligation of company directors is to act in good faith in what they believe to be in the company's best interests.<sup>154</sup>

Directors have an exclusive fiduciary duty to the company.<sup>155</sup> However, this duty may extend to creditors if the company is nearing insolvency or is already in bankruptcy.<sup>156</sup> The Companies Act in section 76(3) states that company directors owe fiduciary obligations to their companies. This section codifies the fiduciary duties of good faith, purpose<sup>157</sup> and best interests of the company as well as the

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<sup>148</sup> *Carmichele v Minister of Safety and Security (Centre for Applied Legal Studies Intervening)* 2001 (4) SA 938 (CC).

<sup>149</sup> Irene-Marie Esser and Johan Coetzee, 'Codification of Directors' Duties: An Option for South Africa' (2004) 12 *Juta Business Law Journal* 26, 30.

<sup>150</sup> Cambridge Dictionary, '*fiducia*' (n.d.) <<https://dictionary.cambridge.org/dictionary/italian-english/fiducia>> accessed 07 October 2024.

<sup>151</sup> Cassim and others, *Contemporary Company Law* 690.

<sup>152</sup> HS Cilliers and others *Corporate Law* (3rd edn, LexisNexis 2007) 139.

<sup>153</sup> See *Howard v Herrigel* 1991 (2) SA 660 (A) 678.

<sup>154</sup> Cassim and others, *Contemporary Company Law* 692; see also Mongalo and Scott, *Corporate Law and Corporate Governance* [7.8.2].

<sup>155</sup> Mongalo and Scott, *Corporate Law and Corporate Governance* [7.8.2].

<sup>156</sup> *Charterbridge Corp Ltd v Lloyds Bank Ltd* [1970] Ch 62.

<sup>157</sup> Section 76(3)(a) of the Companies Act.

duty of care.<sup>158</sup> Section 76(3)(b) clarifies that directors' fiduciary duties are to the company and not to shareholders. This follows that the Act requires directors to act in the best interests of the company. This means that directors are prohibited from advancing shareholders' interests at the expense of the company. Conversely, shareholders do not owe fiduciary obligations to their companies.<sup>159</sup>

The duties of good faith and acting for a proper purpose as well as in the best interests of the company are discussed below. The rationale for this is that the 3 duties feature prominently in the Companies Act. For example, section 78(6) of the companies provides that breach of duties of good faith and proper purpose, best interests of the company and the duty of care in section 76(3)(a)–(c) of the Companies Act, cannot be indemnified with insurance like other duties. This shows the importance of the duties and possibly the intention of the legislator to insist on compliance therewith, and sanction of their breach. In addition, South African and Australian statutory BJR provisions jointly apply to these fiduciary duties and to the duty of care such that an analysis of these duties becomes important in understanding the BJR.

#### 2.4.1.1 The duty to act in good faith and in the best interests of the company

This duty to act in good faith and in the best interests of the company has existed in common law as one fused fiduciary duty.<sup>160</sup> The duty is also provided for in the Companies Act,<sup>161</sup> where it is split between section 76(3)(a), requiring directors to act in good faith and for a proper purpose and section 76(3)(b), requiring directors to act in the best interests of the company.

Directors have an obligation to act in good faith and in the best interests of the company, otherwise failure to do so may result in their decisions being invalidated.<sup>162</sup> The standard for assessing good faith on the part of the director is subjective because the test is dependent on the director's judgment of what is the

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<sup>158</sup> Section 76(3)(b) of the Companies Act.

<sup>159</sup> Davis and Geach (eds), *Companies and Other Business Structures* [6.4.1].

<sup>160</sup> *Da Silva v CH Chemicals (Pty) Ltd* 2008 (6) SA 620 (SCA) 627 [18].

<sup>161</sup> Sections 76(3)(a) and (b) of the 2008 Act.

<sup>162</sup> Davis and Geach (eds), *Companies and Other Business Structures* [6.4.2].

best for the company.<sup>163</sup> This is supported by *Re Smith & Fawcett*<sup>164</sup> which found that the critical aspect in reviewing the director's compliance with the duty to act in good faith is to assess what the director considered to be in the best interests of the company and is not based on the court's consideration.

#### 2.4.1.2 Proper purpose

Despite section 76(3)(a) prescribing that directors use the powers vested in them for a proper purpose, it does not clarify what proper purpose means.<sup>165</sup> However, at common law, the term proper purpose means the exercise of power by company directors for the purpose the power was vested to them and not for any other reason.<sup>166</sup> The assessment for proper purpose is objective in that it seeks to determine whether the power was used for the reason it was conferred or not.<sup>167</sup>

#### 2.4.2 Duty of care, skill and diligence

South Africa's corporate law framework originates from English company law<sup>168</sup> dating back to the 1800s and 1900s.<sup>169</sup> English case law sheds light on the duty of care and how it evolved in company jurisprudence. In this regard, it is critical to begin this discussion with a brief discussion on the duty of care under English company law as well as the development of South Africa's directors' duty of care.

##### 2.4.2.1 English common law position

English courts reviewed alleged breach of the duty of care subjectively and inconsistently.<sup>170</sup> One of the earliest verdicts which highlighted this approach was made in *Re Denham & Co*<sup>171</sup> where one of the company's directors was exonerated for failing to observe that another director had siphoned company funds and

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<sup>163</sup> Cassim and others, *Law of Business Structures* 353.

<sup>164</sup> *Re Smith & Fawcett* [1942] Ch 304 (CA) 306.

<sup>165</sup> Maleka Femida Cassim and Farouk HI Cassim, *Law of Corporate Finance* (1st edn, Juta 2021) 186.

<sup>166</sup> Mongalo and Scott, *Corporate Law and Corporate Governance* [7.8.2].

<sup>167</sup> *Extrasure Travel Insurances Ltd v Scattergood* [2003] 1 BCLC 598 [613].

<sup>168</sup> Neels Kilian, 'Legal Implications Relating to Being "Entitled to Serve" as a Director: A South African-Australian Perspective' 2020 (23) PELJ 1, 20.

<sup>169</sup> Jean J du Plessis, 'A Comparative Analysis of Directors' Duty of Care, Skill and Diligence in South Africa and in Australia' (2010) 1 Acta Juridica 263, 263.

<sup>170</sup> Du Plessis, 'A Comparative Analysis of Directors' Duty of Care' 263.

<sup>171</sup> *Re Denham & Co* [1884] 25 (Ch) 752.

tampered with the records to generate a fictitious profit. Despite finding that the director had not reviewed the financial records or attended board meetings<sup>172</sup> and holding him culpable of 'considerable negligence', the court acquitted him for breach of the duty of care. The court referred to the director as a 'country gentleman and not a skilled accountant'<sup>173</sup> who could not have understood the import of the information contained in the financial records.<sup>174</sup> The position of the court regarding the duty of care thus appeared to be that a breach of the duty of care had to be severe in order for a director to be found liable.<sup>175</sup>

In *Re City Equitable Fire Insurance Co*,<sup>176</sup> the court ruled in favour of directors who allegedly breached their duty of care for failed investments and acts of fraud by the board chairman.<sup>177</sup> The court reasoned that it would be unfair to expect directors to demonstrate skills beyond their knowledge and experience to prevent another director from committing acts of fraud against the company.<sup>178</sup>

In later years, the courts appeared to gravitate toward the view that directors were obligated to exhibit the same degree of care as a reasonable director in their situation and with their experience. For example, in *Norman v Theodore Goddard*,<sup>179</sup> the court decided that directorial action should be assessed from a reasonable person perspective with questions posed on how a reasonable person would have done when confronted with the same situation. In *Dorchester Finance Co v Stebbing*,<sup>180</sup> the directors who were also qualified accountants were found liable for negligence for signing blank cheques because the court reasoned that as qualified accountants, they were required to exercise a higher level of care.

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<sup>172</sup> *Re Denham & Co* [1884] 25 (Ch) 752.

<sup>173</sup> *Re Denham & Co* [1884] 25 (Ch) 752 [767].

<sup>174</sup> *Re Denham & Co* [1884] 25 (Ch) 752 [766].

<sup>175</sup> *Overend & Gurney Co v Gibb* [1872] UKLawRpHL 3; [1872] LR 5 HL 480, [493] (Lord Hatherley LC).

<sup>176</sup> *Re City Equitable Fire Insurance Co Ltd* [1925] 1 (Ch) [407].

<sup>177</sup> *Re City Equitable Fire Insurance Co Ltd* [1925] 1 (Ch) [407].

<sup>178</sup> *Re City Equitable Fire Insurance Co Ltd* [1925] 1 (Ch), [407], [428]–[429].

<sup>179</sup> *Norman v Theodore Goddard* [1991] BCLC 1028 [1030].

<sup>180</sup> *Dorchester Finance Co v Stebbing* [1989] BCLC 498.

#### 2.4.2.2 The development of the common law duty of care in South Africa

South African courts reviewed cases of alleged breach of the duty of care on a subjective and lenient basis, an approach supposedly inherited from the country's English company law foundations.<sup>181</sup> For example, the court in *Fisheries Development Corporation of SA Ltd v Jorgensen*,<sup>182</sup> ruled that executive and non-executive directors incurred different levels of liability in relation to their duty of care with executive directors bearing a heavier burden because they were actively involved in the affairs of the company on a daily basis, in contrast to non-executive directors whose involvement was irregular.<sup>183</sup> This decision shed light on the subjective level of care required from directors under common law lowering the requirement for non-executive directors due to their limited involvement in company affairs.<sup>184</sup> The decision in *Howard v Herrigel*,<sup>185</sup> took a different stance. The court held that the rules applicable to directors were similar regardless of whether a director had an executive role or not. It is reasoned that this was a more objective approach, as it reflected on the unitary status of the office of director.

#### 2.4.2.3 The South African statutory duty of care

The preceding discussion in paragraphs 2.4.2.1 and 2.4.2.2 of this study demonstrates that the interpretation of the duty of care under common law was subjective and inconsistent. Section 76(3)(c) of the Companies Act prescribes a more objective and onerous duty of care<sup>186</sup> which considers the director's knowledge, skill and experience.<sup>187</sup> It also injects a comparative norm to the duty of care by prescribing that a director has an obligation to exercise his duties with the level of care, skill and diligence that may be rationally expected of a person<sup>188</sup> with the director's knowledge, skill and experience.<sup>189</sup>

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<sup>181</sup> See Natasha Bouwman, 'An Appraisal of the Modification of the Director's Duty of Care and Skill' (2009) 21 SA Merc LJ 509, 511.

<sup>182</sup> *Fisheries Development Corporation of SA Ltd v Jorgensen* 1980 (4) SA 156 (CW) [165H].

<sup>183</sup> *Fisheries Development Corporation of SA Ltd v Jorgensen* 1980 (4) SA 156 (CW) [165H].

<sup>184</sup> Du Plessis, 'A Comparative Analysis of Directors' Duty of Care' 285.

<sup>185</sup> *Howard v Herrigel* 1991 (2) SA 660 (A) [678].

<sup>186</sup> Mongalo and Scott, *Corporate Law and Corporate Governance* [7.8.3].

<sup>187</sup> See s 76(3)(c)(i)–(ii).

<sup>188</sup> Section 76(3)(c) of the Companies Act.

<sup>189</sup> Section 76(3)(c)(ii) the Companies Act.

## **2.5 Conclusion**

In this chapter, the study examined interrelated concepts that exist in the director's ecosystem in the form of corporate governance, directors' powers, duties, accountability and liability. The purpose was to examine the ecology in which company directors operate. The chapter posited that directors are required to balance their managerial discretion and accountability by exercising their statutory powers within prescribed parameters. Failure to do so will subject them to claims grounded on breach of their directorial obligations. The chapter further delved into the evolution of the duty of care. It argued that South African company law is rooted in English company law as developed from the 1800s and 1900s. The duty of care demanded from directors under English company law was subjective, resulting in relatively low standards being required from directors while exercising their duty of care. This approach began to evolve as courts began to apply an objective assessment for alleged breach of directorial duties. As with English company law, South Africa's common law position on directorial conduct was largely subjective. However, in later years, courts started to demand a more objective assessment of director conduct. When the Companies Act was promulgated in 2008, it partially codified directors' duties in section 76 and provided for an objective probe based on the reasonable expectation of someone doing the same duties and with the same degree of skill and experience.

The next chapter introduces the BJR. It provides a nuanced discussion of the BJR. It begins with a discussion of the meaning and rationale of the BJR which serves as framework for a thorough evaluation of the rule. It will examine the contours and structures of the South African and Australian statutory BJR with the goal of providing the groundwork for a comparative examination of the BJR provisions in the two jurisdictions, which will be conducted in chapter 4.

## CHAPTER 3: THE BUSINESS JUDGMENT RULE

### 3.1 Introduction

This chapter begins by examining the meaning and justification of the BJR, to lay the groundwork for a thorough investigation of the rule. It then discusses two primary versions of the BJR: the American Law Institute (ALI) and the Delaware formulations. This is done to demonstrate the rule's larger views and where the burden of proof falls under each of the versions. The chapter then delves into three doctrines of the BJR: the immunity doctrine, the abstention doctrine, and the standard of liability doctrine. This is done to emphasise the doctrinal nuances of the BJR and how each of the doctrinal positions determines the extent to which the BJR is interpreted. Finally, the chapter examines the outlines and structures of the South African and Australian statutory BJR with the goal of establishing the groundwork for a comparative examination of the BJR provisions in the two jurisdictions, which will be conducted in chapter 4.

### 3.2 Meaning of the BJR

It is not easy to adequately define the BJR as there is no consensus on its meaning,<sup>190</sup> compromising the principle's legal certainty.<sup>191</sup> Extensive judicial and academic effort has been invested in the matter over the years, resulting in a plethora of definitions and nuances aimed at defining the BJR. In *Miller v American Telephone & Telegraph Co*,<sup>192</sup> the court argued that the BJR is a tool that precludes the interference of courts in business decisions if specific conditions are met. In *Aronson v Lewis*,<sup>193</sup> it was held that the BJR applied to situations in which a business decision is taken. In *Panter v Marshall Field & Co*<sup>194</sup> the court ruled that the absence of fraud was a prerequisite for the BJR defence to be available.

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<sup>190</sup> Dennis Davis and Walter Geach (eds), *Companies and Other Business Structures in South Africa* (E-book, 5th edn, Oxford University Press 2021) [6.4.2]; Julian Velasco, 'Fiduciary Judgment Rules' (2021) 62 *William & Mary Law Review* 1397, 1416.

<sup>191</sup> Andrew Keay and Joan Loughrey, 'The Concept of Business Judgment' (2018) 39 *Legal Studies* 36, 40.

<sup>192</sup> See *Miller v American Telephone & Telegraph Co* 507 F.2d 759 (3d ar. 1974).

<sup>193</sup> *Aronson v Lewis* 473 A.2d 805, 812 (Del. 1984).

<sup>194</sup> *Panter v Marshall Field & Co* 646 F.2d 271, 293 (7th Cir. 1981).

The BJR has also been defined as a concept of corporate law that balances the authority of directors and their accountability.<sup>195</sup> According to this viewpoint, the BJR is a mechanism that reconciles the tension between directors' authority to govern their companies and their obligation to account for how they exercise that authority.<sup>196</sup> However, some scholarly discussions on the subject of BJR dispute this interpretation favouring a one-dimensional perspective that it is simply a device that allows directors to evade responsibility for their decisions.<sup>197</sup> Another interpretation of the BJR is based on the refutable assumption that the director performed his duties in good faith, without conflict of interest and with reasonable care.<sup>198</sup>

However, other academics criticise the BJR claiming that it undermines the directors' responsibility to account to shareholders and displays a superficial approach to director accountability in the corporate world.<sup>199</sup> According to this viewpoint, the BJR reduces the high standards of conduct imposed by the duty of care.<sup>200</sup> As a result, the BJR has been criticised as a scheme that benefits the wealthy and powerful at the expense of average citizens and other professionals such as medical doctors and attorneys, who are held accountable for negligence.<sup>201</sup> Gevurtz<sup>202</sup> contends that the BJR should be revoked as a corporate law principle so that the directors' conduct can be determined by the same negligence rules that apply to other occupations.<sup>203</sup> The researcher contends that the argument that the BJR undermines directors' accountability to shareholders fails to reflect the risky

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<sup>195</sup> Wiseman Ubochioma, 'An Examination of the Relevance of the Codification and Application of the American Business Judgment Rule to Nigerian Corporate Law' (2020) 64 *Journal of African Law* 373, 374–375.

<sup>196</sup> Lucie Josková, 'The Business Judgment Rule in the Czech Republic' (2022) 68 *Acta Universitatis Carolinae Iuridica* 37, 40.

<sup>197</sup> Farouk HI Cassim and others, *Contemporary Company Law* (3rd edn, Juta 2021) 762; Jeffrey MacIntosh, 'The Business Judgment Rule, the Public Interest Powers, and the "Fair and Reasonable" Test: Fellow Travellers or Ships in the Night?' (2023) 60 *Osgoode Hall Law Journal* 73, 78.

<sup>198</sup> Cynthia A Williams, 'Fiduciary Duties and Corporate Climate Responsibility' (2021) 74 *Vanderbilt Law Review* 1875, 1889.

<sup>199</sup> Davis and Geach (eds), *Companies and Other Business Structures* [6.4.2].

<sup>200</sup> Davis and Geach (eds), *Companies and Other Business Structures* [6.4.2]; Julian Velasco, 'Fiduciary Judgment Rules' (2021) 62 *William & Mary Law Review* 1397, 1419.

<sup>201</sup> Franklin A Gevurtz, 'The Business Judgment Rule: Meaningless Verbiage or Misguided Notion?' (1994) 67 *Southern California Law Review* 287, 288.

<sup>202</sup> Gevurtz, 'The Business Judgment Rule' 287.

<sup>203</sup> Gevurtz, 'The Business Judgment Rule' 287.

environment in which directors operate which can be adversely affected by external factors such as market forces. It is also crucial to note that the BJR only protects directors' honest decisions that end up being harmful to the company. On that basis, the BJR is critical as it balances the director's position against risk in cases where corporate harm emanates from good faith decision-making, thus encouraging directors to make calculated commercial risks.<sup>204</sup>

From a South African company law perspective, it has been argued that the BJR complies with the provisions of section 66(1) of the Companies Act which provides that a company must be managed by its directors.<sup>205</sup> The researcher concurs with this view and submits that the BJR vests company directors with the freedom to govern their companies without interference from the courts thus inhibiting judicial intrusion in business decisions.

Based on the foregoing, it is reasonable to conclude that there is tension between the BJR and the directors' accountability.<sup>206</sup> This is because in corporate law, directors are generally held accountable for the harm which their decisions cause to the company, whereas the BJR exculpates directors' errors of judgment if there are no exceptional circumstances.<sup>207</sup> In *Smith v Van Gorkom*<sup>208</sup> the Appellate Court affirmed the importance of directors upholding their duty of care. The court found against directors who severely undervalued the company's shares, stating that the directors did not apply informed business judgment.<sup>209</sup> The court also rejected the validity of a 20 minute presentation by director Van Gorkom as inadequate to sufficiently inform the board to make the right decision.<sup>210</sup> *Smith v Van Gorkom* therefore characterises decision making as a core component of directorial duties.<sup>211</sup> Given that decisions that directors make are often beset by risk,<sup>212</sup> it is

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<sup>204</sup> Davis and Geach (eds), *Companies and Other Business Structures* [6.4.2].

<sup>205</sup> Friedrich Hamadziripi and Howard Chitimira, 'A Comparative Analysis of Company Directors' Accountability and the Statutory Duty of Care, Skill and Diligence in South Africa and Zimbabwe' (2021) 10 *Perspectives of Law and Public Administration* 38, 45.

<sup>206</sup> Martin Winner, 'The Duty of Care and Business Judgment Rule in Austrian Company Law' (2022) 68 *Acta Universitatis Carolinae Iuridica* 9, 16.

<sup>207</sup> Winner, 'The Duty of Care and Business Judgment Rule' 16.

<sup>208</sup> *Smith v Van Gorkom* 488 A 2d 858, 872–873 (Del 1985).

<sup>209</sup> *Smith v Van Gorkom* 488 A 2d 858, 873 (Del 1985).

<sup>210</sup> *Smith v Van Gorkom* 488 A.2d 858, 873 (Del. 1985).

<sup>211</sup> Keay and Loughrey, 'The Concept of Business Judgment' 36.

<sup>212</sup> Yaru Chia, 'The Business of Judging Directors' Business Judgments in Singapore Courts' (2016) 28 *Singapore Academy of Law Journal* 428, 428.

critical for directors to apply necessary care, informed decision-making, and good faith to mitigate the risks associated with their decisions.<sup>213</sup>

### 3.3 *Rationale of the BJR*

In 1829, the court in *Percy v Millaudon*<sup>214</sup> held that directors' errors of judgment could be exonerated if they exercised due care and diligence. This judgment marked the beginning of the BJR<sup>215</sup> in the United States<sup>216</sup> and its eventual spread to other parts of the world.<sup>217</sup> The application of the BJR in the USA has however not been uniform, resulting in the rule lacking a standardised approach or codification.<sup>218</sup> The doctrine has thus remained as a common law rule of corporate governance. In some cases, the directors have borne the onus of proof to prove compliance with their duties.<sup>219</sup> However, in others, plaintiffs have had to bear the onus of proof to convince courts of the directors' alleged breach.<sup>220</sup> As a result, it has been argued that the theory that underpins BJR is contestable.<sup>221</sup>

Despite the concerns about BJR's practicality, the rule plays a crucial role in corporate governance and its existence can be justified as detailed below.

#### 3.3.1 *Protect risk taking by directors*

The key proposition of the BJR is to outline circumstances under which directors can be exonerated from the consequences of their honest decisions that harm the interests of their companies.<sup>222</sup> Therefore, the BJR strives to protect company directors from informed business decisions made with due care that result in

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<sup>213</sup> See Stephen M Bainbridge 'The Bishops and the Corporate Stakeholder Debate' 2002 (4) Villanova Journal of Law & Investment Management 1, 20; see also generally, Chia, 'The Business of Judging Directors' 428.

<sup>214</sup> *Percy v Millaudon* (1829) 8 Mart. (n.s.) 68, 77–78 (La. 1829).

<sup>215</sup> Ubochioma, 'An Examination of the Relevance of the Codification' 377.

<sup>216</sup> Friedrich Hamadziripi and Patrick C Osode, 'The Nature and Evolution of the Business Judgment Rule and its Transplantation to South Africa under the Companies Act of 2008' (2019) 33 Speculum Juris 26, 27.

<sup>217</sup> FHI Cassim and others, *The Law of Business Structures* (2nd edn, Juta 2021) 373.

<sup>218</sup> See Lori McMillan 'The Business Judgment Rule as an Immunity Doctrine' (2013) 4 William & Mary Business Law Review 521, 526.

<sup>219</sup> See the decisions in *Shlensky v Wrigley* 237 N.E.2d 776, 780 (Ill. App. Ct. 1968).

<sup>220</sup> See *Aronson v Lewis* 473 A.2d 805, 812 (Del. 1984).

<sup>221</sup> Davis and Geach (eds), *Companies and Other Business Structures* [6.4.2].

<sup>222</sup> Cassim and others, *Law of Business Structures* 374.

negative results for their companies.<sup>223</sup> Failure to protect directors reduces their appetite for risk taking, which may be detrimental to their companies as a key element of their duties involve risk-taking which is necessary for corporate success.<sup>224</sup>

However, there has been a disagreement over the protection that the BJR accords directors. For example, Simson<sup>225</sup> has argued that by protecting directors, the BJR frustrates corporate governance by allowing directors to avoid accountability for their actions. The researcher contends that the BJR is a crucial director defence mechanism because without it, the degree to which directors can be exonerated for their business decisions or to which courts can defer to directors' business judgment is unclear, a situation which may discourage directors from taking calculated risks for fear of liability.

### 3.3.2 *Limiting judicial intervention*

The BJR seeks to restrict courts from second-guessing director decisions<sup>226</sup> by imposing judicial restraint<sup>227</sup> in boardroom matters while protecting directors' authority<sup>228</sup> to direct their companies. It thus allows directors to make business decisions with limited judicial interference and retrospective review of their decisions.<sup>229</sup> The exception is when there is a breach of directorial duties such as lack of good faith, conflict of interest or crimes like fraud.<sup>230</sup> The rule thus prevents shareholders from managing the affairs of the company through the courts by usurping directorial authority.<sup>231</sup>

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<sup>223</sup> Davis and Geach (eds), *Companies and Other Business Structures* [6.4.2].

<sup>224</sup> Cassim and others, *Contemporary Company Law* 762.

<sup>225</sup> Tara Simson, 'The Duty to Care: Progressive Judicial Interpretation of the Directors' Duty of Care and Diligence' (2022) 4 *University of South Australia Law Review* 76, 86.

<sup>226</sup> Keay and Loughrey, 'The Concept of Business Judgment' 36–37.

<sup>227</sup> Tshepo Mongalo and Tshepiso Scott, *Corporate Law and Corporate Governance: An Overview of Business Undertakings in South Africa* (E-book, 2nd edn, Van Schaik 2023) [7.8.1].

<sup>228</sup> Mongalo and Scott, *Corporate Law and Corporate Governance* [7.8.1].

<sup>229</sup> Adina Ponta, 'The Business Judgement Rule – Approach and Application' (2015) 5 *Juridical Tribune* 25, 37.

<sup>230</sup> Cassim and others, *Law of Business Structures* 374.

<sup>231</sup> Cassim and others, *Law of Business Structures* 374.

### 3.3.3 *Encouraging competent people to be directors*

By protecting director decisions and exonerating directors who comply with their directorial duties, the BJR encourages competent people to serve as directors.<sup>232</sup> This is because they would be assured of protection from liability for their honest decisions that may harm the company.<sup>233</sup>

### 3.3.4 *Promoting entrepreneurship*

The BJR's goal is to promote entrepreneurship<sup>234</sup> which justifies the lenience that directors seem to be afforded by the BJR.<sup>235</sup> As a result, the BJR has been hailed as a principle that fosters economic freedom and encourages directors to take informed corporate risks.<sup>236</sup> It is suggested that this rationale of the BJR compliments the Companies Act in so far as it states in section 7(b)(i) that it aims to foster South Africa's economic growth by promoting entrepreneurship.

### 3.3.5 *Balancing the authority and accountability of directors*

The BJR recognises directors' authority to govern their companies.<sup>237</sup> It fosters the correct use of directorial powers by defining what conduct qualifies for protection<sup>238</sup> and prescribing liability for directors who breach their duties.<sup>239</sup> The BJR is thus a tool used in the corporate landscape to balance the use of directorial powers and the accountability of directors when exercising those powers.<sup>240</sup>

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<sup>232</sup> Davis and Geach (eds), *Companies and Other Business Structures* [6.4.2].

<sup>233</sup> Davis and Geach (eds), *Companies and Other Business Structures* [6.4.2].

<sup>234</sup> See s 7(b) of the *Companies Act*, see also Davis and Geach (eds), *Companies and Other Business Structures* [6.4.2].

<sup>235</sup> Vanessa Finch, 'Company Directors: Who Cares about Skill and Care?' (1992) 55 *The Modern Law Review* 179, 179; Andrew Keay and others, 'Business Judgment and Director Accountability: A Study of Case-Law Over Time' (2020) 20 *Journal of Corporate Law Studies* 359, 360; see also Chia, 'The Business of Judging Directors' 470.

<sup>236</sup> Velasco, 'Fiduciary Judgment Rules' 1419; Keay and others, 'Business Judgment and Director Accountability' 360; Chia, 'The Business of Judging Directors' 470.

<sup>237</sup> Section 66 of the *Companies Act*; Mongalo and Scott, *Corporate Law and Corporate Governance* [7.8.1].

<sup>238</sup> Davis and Geach (eds), *Companies and Other Business Structures* [6.4.2]; see also generally Keay and Loughery, 'The Concept of Business Judgment' 40.

<sup>239</sup> Ponta, 'The Business Judgement Rule' 42.

<sup>240</sup> Keay and Loughery, 'The Concept of Business Judgment' 40.

### 3.4 BJR Formulations

There are two widely recognised versions of the BJR<sup>241</sup> and these are the American Law Institute's Principles of Corporate Governance (ALI formulation)<sup>242</sup> and the Delaware Chancery Court (Delaware formulation).<sup>243</sup>

#### 3.4.1 ALI formulation

The ALI formulation emerged in 1992 from the American Law Institute's efforts to standardise the BJR.<sup>244</sup> It provides that directors are protected from liability if they make informed business decisions that exclude personal interest.<sup>245</sup> This concept of the ALI formulation finds support in the court's decision in *Smith v Van Gorkom*<sup>246</sup> where it was held that gross negligence invalidated informed decision making.<sup>247</sup> The formulation also provides that directors are more competent to make business decisions than courts and that directors' errors of judgment must be safeguarded.<sup>248</sup> The ALI formulation underwrites a safe harbour under which it protects directors from personal liability claims provided that they meet certain preconditions, such as informed business judgment.<sup>249</sup> According to the ALI formulation, directors bear the onus of proof to rebut the allegations of breach by the plaintiff demonstrating that their business judgment is informed.<sup>250</sup>

#### 3.4.2 Delaware formulation

It operates from the default position that directors make informed decisions and that the decisions are made in good faith. The position was reiterated in the Delaware

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<sup>241</sup> Friedrich Hamadziripi and Patrick C Osode, 'A Critical Analysis of Zimbabwe's Codified Business Judgment Rule and its Place in the Corporate Governance Landscape' (2021) 25 Law, Democracy and Development 575, 577.

<sup>242</sup> ALI, *Principles of Corporate Governance*.

<sup>243</sup> *Aronson v Lewis* 473 A 2d 805 (Del 1984), 812, the Delaware formulation is based on presumption.

<sup>244</sup> Section 4.01 (c) of ALI *Principles of Corporate Governance*.

<sup>245</sup> Section 4.01 (c) of ALI *Principles of Corporate Governance*.

<sup>246</sup> *Smith v Van Gorkom* 488 A.2d 858, 872 (Del. 1985).

<sup>247</sup> See also McMillan 'The Business Judgment Rule as an Immunity Doctrine' 530.

<sup>248</sup> Section 4.01 (c) of ALI *Principles of Corporate Governance*.

<sup>249</sup> Cassim and others, *Law of Business Structures* 374; Andrew W Winden, 'Caremark's Climate Failure' (2023) 74 Hastings Law Journal 1167, 1196.

<sup>250</sup> Section 4.01 (c) of ALI *Principles of Corporate Governance*; Chia, 'The Business of Judging Directors' 443.

case of *Aronson v Lewis*<sup>251</sup> where the court held that the BJR was rather a presumption that when arriving at a decision, directors would have done so from an informed position, in good faith and belief that the decision promotes the best interests of the company.<sup>252</sup> This position was further confirmed by the court in *Strassburger v Earley*,<sup>253</sup> which held that the BJR insulates directors for decisions they make in good faith even if they turn out to be errors of judgment. On this basis, the Delaware formulation of the BJR places the onus on the plaintiff to refute the presumption that the director violated his directorial duties.<sup>254</sup> This means that under this doctrine, The BJR acts as a presumption<sup>255</sup> for the benefit of directors that they make decisions in the best interests of the company, in good faith, and with reasonable care and diligence unless proven otherwise.<sup>256</sup>

This discussion has shown that the ALI and Delaware versions locate the burden of proof differently.<sup>257</sup> Under ALI version, the defendant directors bear the onus of proof. Conversely, the Delaware formulation locates the burden on the claimant.<sup>258</sup>

### **3.5 BJR Doctrines**

#### **3.5.1 Immunity doctrine**

There is a theoretical view that the BJR provides immunity aimed at protecting directors in the performance of their functions.<sup>259</sup> This view is referred to as the immunity doctrine.<sup>260</sup> The literature suggests that under the BJR immunity doctrinal approach, the director bears the burden of proving that they deserve the protection of the BJR because they have complied with certain preconditions.<sup>261</sup> There must

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<sup>251</sup> *Aronson v Lewis* 473 A.2d 805, 812 (Del. 1984).

<sup>252</sup> See *Aronson v Lewis* 473 A.2d 805, 812 (Del. 1984).

<sup>253</sup> *Strassburger v Earley* 752 A.2d 557, 582 (Del. 2000).

<sup>254</sup> Winden, 'Caremark's Climate Failure' 1197; Chia, 'The Business of Judging Directors' 442.

<sup>255</sup> Maleka Femida Cassim, *The New Derivative Action under the Companies Act: Guidelines for Judicial Discretion* (Juta 2016) 102–103; Steven L. Schwarcz, 'Corporate Governance and Risk-taking: A Statistical Approach' (2023) 3 *The University of Chicago Business Law Review* 149, 151.

<sup>256</sup> Section 76(4) of the Companies Act; *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd* 2014 (5) SA 179 (WCC) [87].

<sup>257</sup> Ubochioma, 'An Examination of the Relevance of the Codification' 382.

<sup>258</sup> Ubochioma, 'An Examination of the Relevance of the Codification' 382.

<sup>259</sup> *MMS Cos Liquid Audio Inc* 813 A.2d 1118 (Del 2003) 1127.

<sup>260</sup> See McMillan, 'The Business Judgement Rule as an Immunity Doctrine' 564–566.

<sup>261</sup> McMillan 'The Business Judgment Rule as an Immunity Doctrine' 569.

be a business decision<sup>262</sup> which is informed.<sup>263</sup> The director's decision must be rational<sup>264</sup> in the given circumstances. The director must also have a reasonable belief that the decision is in the best interests<sup>265</sup> of the company.

Velasco<sup>266</sup> has suggested that the immunity doctrinal approach can encourage persons with integrity and relevant competences to serve as directors by providing assurance that their informed decisions made in good faith are immunised against personal liability.

### 3.5.2 *Abstention doctrine*

The abstention doctrine provides that courts have no reason to review directors' decisions unless specific violations occur.<sup>267</sup> This theoretical standpoint recognises that business decisions must be made in the boardroom and not in the courtroom where 'judges' may have limited knowledge.<sup>268</sup> It promotes the separation of business control and ownership, creating a foundation for accountability and efficiency.<sup>269</sup> The abstention doctrine places the burden of proof on the plaintiffs, who must prove that the directors do not deserve the protection of the BJR.<sup>270</sup> However, because of the limited access to information that plaintiffs may have, it may be difficult for them to successfully refute the presumption that directors performed their duties in good faith and in the best interests of the company.<sup>271</sup> Proponents of the abstention doctrine have argued that it is necessary for directors' decision to be excused from judicial scrutiny because directors operate in an environment replete with risks and complexities that require them to make business decisions under pressure with limited time.<sup>272</sup> This position was cemented in *Joy v North*<sup>273</sup> where the court reasoned that courts are ill-equipped to review business

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<sup>262</sup> Section 4.01 (c) of ALI *Principles of Corporate Governance*.

<sup>263</sup> Section 4.01 (c) of ALI *Principles of Corporate Governance*.

<sup>264</sup> Section 4.01 (c) of ALI *Principles of Corporate Governance*.

<sup>265</sup> Section 4.01 (c) of ALI *Principles of Corporate Governance*.

<sup>266</sup> Velasco, 'Fiduciary Judgment Rules' 1419.

<sup>267</sup> Bainbridge, 'Making Sense of the Business' 303–304.

<sup>268</sup> Stephen M Bainbridge, *The New Corporate Governance in Theory and Practice* (Oxford University Press 2008) 111.

<sup>269</sup> Bainbridge, *The New Corporate Governance* 111.

<sup>270</sup> Hamadziripi and Osode, 'The Nature and Evolution' 37.

<sup>271</sup> Hamadziripi and Osode, 'The Nature and Evolution' 38.

<sup>272</sup> MacIntosh, 'The Business Judgment Rule' 81.

<sup>273</sup> *Joy v North* 692 F.2d 880, 886 (2d Cir. 1982).

decisions because business decisions are made in circumstances that are different to the courtroom and oftentimes with limited time and information.<sup>274</sup>

The court in *Schlensky v Wrigley*,<sup>275</sup> ruled that the plaintiff had to convince it of the necessity of violating the abstention rule and intervene in a matter where directors were alleged to have violated their duty of care.<sup>276</sup> Fraud, gross negligence and illegality are some of the violations that may necessitate the involvement of courts in reviewing director decisions.<sup>277</sup> In *Auerbach v Bennett*,<sup>278</sup> the New York Court of Appeals took the same approach, stating that it was not competent to review business decisions.<sup>279</sup>

The abstention doctrine finds support from certain scholarly arguments which submit that it is to the directors' advantage that they govern their companies with due care.<sup>280</sup> This follows that directors do not want to jeopardise their reputation, which would result in them having poor reputations and being disqualified to hold the position of director.<sup>281</sup>

### 3.5.3 *Standard of liability doctrine*

Another theoretical perspective on BJR is the standard of liability doctrine. According to Bainbridge,<sup>282</sup> this BJR doctrinal point of view approaches the BJR as a standard of liability although there is no consensus on whether conduct such as lack of rationality or gross negligence is adequate to determine liability. In *Aronson v Lewis*, the court ruled that gross negligence is a feasible measure of breach and as such held that the liability of directors under the BJR was based on gross negligence.<sup>283</sup>

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<sup>274</sup> *Joy v North* 692 F.2d 880, 886 (2d Cir. 1982).

<sup>275</sup> *Schlensky v Wrigley* 237 N.E.2d 776 (Ill. App. Ct. 1968).

<sup>276</sup> *Schlensky v Wrigley* 237 N.E.2d 776 (Ill. App. Ct. 1968).

<sup>277</sup> McMillan 'The Business Judgement Rule as an Immunity Doctrine' 529.

<sup>278</sup> *Auerbach v Bennett* 419 NY.2d 920 (1979).

<sup>279</sup> *Auerbach v Bennett* 419 NY.2d 920, 926 (1979).

<sup>280</sup> Keay and others, 'Business Judgment and Director Accountability' 360.

<sup>281</sup> Keay and others, 'Business Judgment and Director Accountability' 360.

<sup>282</sup> Stephen M Bainbridge, 'The Business Judgment Rule as Abstention Doctrine' (2004) 57 *Vanderbilt Law Review* 83, 90–91.

<sup>283</sup> *Aronson v Lewis* 473 A.2d 805, 812 (Del. 1984).

The BJR is therefore applied as a measure to determine whether a director can be held liable for a breach of directorial duties.<sup>284</sup> This position was affirmed in *Cede & Co. v Technicolor, Inc*<sup>285</sup> when the court decided to review the merits of a directorial decision through the lens of due care, good faith and best interests of the company.

### **3.6 Overview of the South African BJR**

The legislative history of South Africa's BJR date back to the 1990s when the debate over its implementation arose.<sup>286</sup> This debate continued until after the codification of the BJR. In 1994, the *King Report on Corporate Governance for South Africa (King I Report)*<sup>287</sup> advocated that South Africa should introduce a legislative restriction on directors' duty of care into its company legal framework.<sup>288</sup> It was also argued that a statutory limitation would promote entrepreneurship and encourage competent persons to serve as directors.<sup>289</sup> The report also advocated that directors be exonerated from liability if they made rational and informed decisions that did not consider personal interest.<sup>290</sup> The *King Report on Corporate Governance for South Africa, 2002 (King II Report)*<sup>291</sup> briefly mentioned the BJR before recommending that the Standing Advisory Committee on Company Law investigate the feasibility of implementing the BJR in South Africa.<sup>292</sup>

The Department of Trade and Industry (DTI) published a report under the title *South African Company Law for the 21st Century: Guidelines for Corporate Law Reform (DTI Policy Document)*<sup>293</sup> in 2004. The report argued that the South African

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<sup>284</sup> Winden, 'Caremark's Climate Failure' 1185.

<sup>285</sup> *Cede & Co v Technicolor Inc* 634 A.2d 345 (1993).

<sup>286</sup> Derek Botha and Richard Jooste, 'A Critique of the Recommendations in the King Report Regarding a Director's Duty of Care and Skill' (1997) 114 SALJ 65, 68.

<sup>287</sup> Institute of Directors Southern Africa, *King Report on Corporate Governance for South Africa (King I Report)* (Institute of Directors Southern Africa, 1994).

<sup>288</sup> *King I Report* 9 [3.5].

<sup>289</sup> *King I Report* 9 [3.2].

<sup>290</sup> *King I Report* 1 31 [24.6].

<sup>291</sup> Institute of Directors Southern Africa, *King Report on Corporate Governance for South Africa (King II Report)* (Institute of Directors Southern Africa, 2002).

<sup>292</sup> *King II Report* 73.

<sup>293</sup> Department of Trade and Industry South Africa, *South African Company Law for the 21st Century: Guidelines for Corporate Law Reform* (GN 1183 in GG 26493 of 23 June 2004).

company law framework required urgent legislative reform. This report became the template for the Companies Act 71 of 2008.<sup>294</sup>

The report stated that the reason for the reform was that the local and international corporate environments had changed dramatically, rendering many provisions of the Companies Act 61 of 1973 irrelevant.<sup>295</sup> It further stated that there was a need to establish a legislative standard of directors' duties, thus indicating preference for an objective review of director duties.<sup>296</sup> The researcher contends that this proposal was critical in underwriting the statutory directors' duties and the BJR now found in section 76 of the Companies Act, a section which the Act refers to as 'Standards of directors' conduct'.

Some experts argued that a legislative BJR was irrelevant for the South African corporate environment. For instance, Jones<sup>297</sup> opposed the introduction of the BJR arguing that the duty of care was straightforward and that the BJR would create an opportunity for directors to evade liability.<sup>298</sup> Havenga<sup>299</sup> contended that a statutory BJR lacked validity because the common law effectively provided for director conduct review. Havenga further proposed that instead, a general statutory directory of director duties should be enacted.<sup>300</sup> Botha and Jooste<sup>301</sup> contended that grafting the BJR, a common law creation from the United States into the South African corporate law framework would result in legal tensions because the countries had different legal doctrinal foundations. The researcher submits that the arguments against the BJR were misplaced as they failed to appreciate that the BJR was not a blanket cover for director conduct but that it could only be validly invoked in circumstances where honest director decisions cause harm to the company.

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<sup>294</sup> GN 421 in GG 32121 of April 2009; see also DTI Policy Document (GN 1183 GG 26493 of 23 June 2004) 49.

<sup>295</sup> DTI Policy Document (GN 1183 in GG 26493 of 23 June 2004) 14.

<sup>296</sup> DTI Policy Document (GN 1183 in GG 26493 of 23 June 2004) 38.

<sup>297</sup> E Jones, 'Directors' Duties: Negligence and the Business Judgment Rule' (2007) 19 SA Merc LJ 326, 327.

<sup>298</sup> See Jones, 'Directors' Duties' 327.

<sup>299</sup> Michele Havenga, 'The Business Judgment Rule – Should We Follow the Australian Example' (2000) 12 SA Merc LJ 25, 25.

<sup>300</sup> See Havenga, 'The Business Judgment' 37.

<sup>301</sup> Botha and Jooste, 'A Critique of the Recommendations' 68.

Despite these debates, South Africa introduced a statutory BJR in the Companies Act of 2008.

### **3.7 Analysis of the South African Statutory BJR provision**

The Companies Act introduced a statutory BJR through section 76(4)(a) which is cited below verbatim to preserve its precise meaning:

In respect of any particular matter arising in the exercise of the powers or the performance of the functions of a director, a particular director of a company-

- (a) will have satisfied the obligations of subsection (3)(b) and (c) if–
  - (i) the director has taken reasonably diligent steps to become informed about the matter;
  - (ii) either–
    - (aa) the director had no material personal financial interest in the subject matter of the decision, and had no reasonable basis to know that any related person had a personal financial interest in the matter; or
    - (bb) the director complied with the requirements of section 75 with respect to any interest contemplated in subparagraph (aa); and
  - (iii) the director made a decision, or supported the decision of a committee or the board, with regard to that matter, and the director had a rational basis for believing, and did believe, that the decision was in the best interests of the company.

The consequence of the South African BJR under section 76(4)(a) of the Companies Act is that it provides instances under which a director is deemed to have qualified for the BJR's protection. The director should have taken an informed business decision<sup>302</sup> in the best interests of the company<sup>303</sup> exercising due care, skill and diligence.<sup>304</sup> The director is prohibited from holding a material personal financial interest in relation to an issue they will decide on<sup>305</sup> and if such interest exists, the director is required to make necessary disclosures under section 75 of the Companies Act. The BJR also requires that the director has a rational belief that the decision he discharges is in the best interests of the company.<sup>306</sup> This condition

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<sup>302</sup> Sections 76(4) and 76(4)(a)(i) of the Companies Act.

<sup>303</sup> Section 76(4)(a) of the Companies Act.

<sup>304</sup> Section 76(4)(a) of the Companies Act.

<sup>305</sup> Section 76(4)(a)(ii)(aa) of the Companies Act.

<sup>306</sup> Section 76(4)(a)(iii) of the Companies Act.

implies that any decision that passes the BJR muster must be rationally discharged with the belief that it will serve the company's best interests.

The South African BJR prescribes the duty to act in the best interests of the company together with the duty of care<sup>307</sup> as prerequisites for a successful BJR defence. However, a closer examination of the placement and phrasing of section 76(4)(a) reveals several troubling issues that merit analysis. First, section 76 of the Companies Act is positioned under the heading, 'Standards of directors' conduct which may be very fitting for the duties outlined in section 76(3)(a)–(c), but problematic when it comes to section 76(4)(a) which is the BJR provision. The effect is that by including the BJR under standards of director conduct, the drafters of the legislation may have inadvertently compromised the vital role of the BJR as the location places it in the same category as director duties specified in section 76(3)(a)–(c). Second, there appears to be lack of clarity on the role of common law in the application of the BJR. This follows that the duty of care in section 76(3)(c) and section 76 in its entirety do not mention common law, leading to uncertainty whether the statutory duty replaces the common law or augments it.<sup>308</sup> Reference to the application of common law to the duties in section 76(3) of the Companies Act is found in section 77(2) which relates to liability for breach of fiduciary duties and the duty of care. While admittedly this gives some clarity, the result of this later reference to common law makes the BJR provision in section 76(4) somehow incomplete and confusing because the BJR provision itself does not state position of common law in its application.

Although section 76(4)(a) is the BJR provision, the scope of the rule is not clear.<sup>309</sup> The Companies Act's failure to mention it or to place it under a stand-alone subheading as the case is, may lessen the BJR prominence and applicability. This leaves open several crucial questions; is the BJR a standard of conduct? Or is it a standard of review? In relation to the matter, it is critical to note that Australia's BJR provision in section 180(2) of the Corporations Act, is clearly marked that it is the BJR, thus making it evident to the reader.

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<sup>307</sup> Section 76(4)(a) of the Companies Act.

<sup>308</sup> Section 76 of Companies Act.

<sup>309</sup> See for example, Cassim and others, *Law of Business Structures* 375; Mongalo and Scott, *Corporate Law and Corporate Governance* [7.8.1].

Furthermore, the BJR clause in section 76(4)(a) does not specify the extent of its application, for example, whether it can be specifically applied to certain scenarios such as corporate anti-takeover strategies or if, in fact, it can be generally applied.<sup>310</sup> Closely related to that finding is the fact that it is unclear whether the BJR is restricted to procedural aspects of the directors' business judgment or whether can also address substantive matters of the business judgment.<sup>311</sup>

### **3.8 Overview of the Australian BJR**

In the 1990s, Australian company directors were concerned that they could be held accountable for making decisions that caused harm to their companies.<sup>312</sup> The directors feared civil and criminal liability as they viewed the interpretations of their common law duty of care and skill as subjective and uncertain.<sup>313</sup> This resulted in proposals for a statutory BJR.<sup>314</sup> Despite these concerns, judicial and legislative developments toward an objective assessment of the directors' duty of care appeared to be already underway. For instance, the 1987 case of *Whitehouse v Carlton Hotel Pty Ltd*<sup>315</sup> seemed to signal a change by Australian courts towards a more intrusive approach. The court ruled that directors could be held liable for breaching the duty to act for a proper purpose even if they believed they were acting in the best interests of the company.<sup>316</sup> In this matter, the court invalidated a secret allotment of Carlton Hotel Pty Ltd shares by a father to his sons which was intended to deprive his ex-wife and daughters of the company's control.

There were additional statutory developments<sup>317</sup> aimed at further legislating the directors' duty of care.<sup>318</sup> For example, in 1981, the Companies Act (Cth)<sup>319</sup> was passed. Section 229(2) of this Act prescribed that a director must perform his duties

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<sup>310</sup> Cassim and others, *Contemporary Company Law* 761.

<sup>311</sup> Hamadziripi and Osode, 'The Nature and Evolution' 36.

<sup>312</sup> Robert Baxt, 'Company Law Reform by No Half Measures! The CLERP Program Really Takes Off' (1998) 26 *Australian Business Law Review* 217, 218.

<sup>313</sup> Michael Legg and Dean Jordan, 'The Australian Business Judgement Rule after ASIC v Rich: Balancing Director Authority and Accountability' (2014) 34 *Adelaide Law Review* 403, 404–405.

<sup>314</sup> Legg and Jordan, 'The Australian Business Judgement Rule' 404–405.

<sup>315</sup> *Whitehouse v Carlton Hotel Pty Ltd* [1987] 162 (CLR) [285].

<sup>316</sup> *Whitehouse v Carlton Hotel Pty Ltd* [1987] 162 (CLR) [285].

<sup>317</sup> See s 107 of Victoria Companies Act of 1961.

<sup>318</sup> See Geoffrey Nettle, 'The Changing Positions and Duties of Company Directors' (2018) 41 *Melbourne University Law Review* 1402, 1410.

<sup>319</sup> Companies Act 89 of 1981 (Cth).

and use his powers with due care and diligence. The provision provided a penalty of A\$5000 for breaching the duty of care. A penalty of A\$20 000 or 5 years imprisonment or both was prescribed for directors who contravened their fiduciary duties and were found to be criminally liable for fraud or deception.<sup>320</sup> The Act also prescribed that directors could be held liable and required to pay restitution for the loss or damage that the company suffered as a result of their actions or omission that established the offence.<sup>321</sup> In 1989, the Cooney Report proposed the enactment of an objective duty of care applicable to all Australian company directors.<sup>322</sup> In 1992, the Corporations Act (Cth) repealed the Companies Act (Cth) whose section 229(2) was retained with minimal modification as section 232(4) of the Corporations Act, 2001 (Cth).

The Cooney Committee recommended the adoption of a BJR provision in the Australian corporate law framework<sup>323</sup> which stated that directors should be informed in their decisions or perform their duties with reasonable care.<sup>324</sup>

The government rejected the proposal, arguing that the BJR was an American common law rule that no American state had considered worthy to codify.<sup>325</sup> It proposed that the BJR matter should be left to the courts to develop relevant corporate law principles.<sup>326</sup> The Corporate Law Reform Act 1992 (Cth) was thus introduced with a revised provision 232(4) that required an officer to conduct his duties with the same diligence a person in the same situation would do.

This amended section 232(4) was intended to strengthen the position that directors had an objective duty of care to their companies.<sup>327</sup> In 1955 the court in *Daniels v Anderson*,<sup>328</sup> appeared to confirm the move towards an objective duty of care. The court's decision established that in addition to their statutory duty of care, directors

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<sup>320</sup> Section 229(1)(b) of Companies Act 89 of 1981 (Cth).

<sup>321</sup> Section 229(6) of the Companies Act 89 of 1981 (Cth).

<sup>322</sup> Senate Standing Committee on Legal and Constitutional Affairs, Parliament of Australia, *Company Directors' Duties: Report on the Social and Fiduciary Duties and Obligations of Company Directors* (Report, November 1989) (*Cooney Report*) 29 [3.28].

<sup>323</sup> *Cooney Report* 30 [3.30].

<sup>324</sup> *Cooney Report* 31 [3.35].

<sup>325</sup> John H Farrar, 'Corporate Governance, Business Judgment and the Professionalism of Directors' (1993) 6 *Corporate and Business Law Journal* 1, 23.

<sup>326</sup> See Explanatory Memorandum, Corporate Law Reform Bill 1992 (Cth) 26 [89].

<sup>327</sup> See Explanatory Memorandum, Corporate Law Reform Bill 1992 (Cth) 25 [82].

<sup>328</sup> *Daniels v Anderson* [1955] 37 NSWLR 438 [503].

also had a burden to comply with the common law duty of care, which went beyond a subjective review of the director's knowledge.<sup>329</sup> The court reasoned that the common law duty of care obliged directors to act in good faith and to perform their duty of care to the level that a reasonable person would do in the same situation.<sup>330</sup> The verdict had the consequence of rendering the long-accepted common law defence of ignorance ineffective, as directors were suddenly required to become acquainted with relevant knowledge of their business.

Following the *Daniels v Anderson* case, the courts became more intrusive and more prone to second-guessing directors' decisions such that Australian directors were uncertain of their legal position in relation to their duty of care.<sup>331</sup>

In 1997, the Corporate Law Economic Reform Program (CLERP) proposed a statutory BJR that would grant presumption in favour of directors' business decisions and insulate them from challenge for business decisions made in good faith.<sup>332</sup> This resulted in the CLERP Bill in 1998 whose explanatory memorandum submitted that the objective of the BJR was to safeguard directors' decision-making discretion and not to shield them from accountability.<sup>333</sup> The BJR was initially introduced into the Australian corporate law framework in 1999 through section 180(2) of the Corporate Law Economic Reform Program Act 156 of 1999 which was later succeeded by the Corporations Act 50 of 2001.

### **3.9 Analysis of the Australian statutory BJR provision**

The Australian statutory BJR which is provided for in section 180(2) of the Corporations Act is directly quoted below to ensure the accuracy of its statutory text:

A director or other officer of a corporation who makes a business judgment is taken to meet the requirements of subsection (1), and their equivalent duties at common law and in equity, in respect of the judgment if they:

- (a) make the judgment in good faith for a proper purpose; and
- (b) do not have a material personal interest in the subject matter of the judgment; and

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<sup>329</sup> *Daniels v Anderson* [1995] 37 NSWLR 438 [503].

<sup>330</sup> *Daniels v Anderson* [1995] 37 NSWLR 438 [503].

<sup>331</sup> Nettle, 'The Changing Positions and Duties' 1413.

<sup>332</sup> See CLERP, *Directors' Duties and Corporate Governance: Facilitating Innovation and Protecting Investors* (Proposals for Reform: Paper No 3, 1997) 22–3 [5.2.2].

<sup>333</sup> See Explanatory Memorandum, Corporate Law Economic Reform Program Bill 1998 (Cth) 17 [6.3].

- (c) inform themselves about the subject matter of the judgment to the extent they reasonably believe to be appropriate; and
- (d) rationally believe that the judgment is in the best interests of the corporation. The director's or officer's belief that the judgment is in the best interests of the corporation is a rational one unless the belief is one that no reasonable person in their position would hold.

The Australian BJR provision under section 180(2) of the Corporations Act implies that directors can only be exonerated from liability if their business judgment complies with their duty of care stipulated under clause 180(1) and its corresponding duty in common law and equity.<sup>334</sup> Such judgment must be taken in good faith and for a proper purpose.<sup>335</sup> It must also be informed, rational and promote the best interests of the company.<sup>336</sup>

### **3.10 Conclusion**

This chapter presented a foundational discussion of the BJR commencing with the rule's meaning and rationale. It further provided a discussion of the two formulations of the BJR, namely, the ALI and Delaware formulations. It also offered a discussion of the three common doctrines of the BJR, that is, immunity, abstention and standard of liability doctrines. The chapter concludes with an overview discussion of the statutory BJR in South Africa and Australia thus establishing the groundwork for a more nuanced comparative analysis of the South African and Australian BJR provisions.

In the following chapter, the study compares the South African and Australian statutory BJR provisions to identify similarities and differences between the two jurisdictions.

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<sup>334</sup> Section 180(2) of the Corporations Act.

<sup>335</sup> Section 180(2)(a) of the Corporations Act.

<sup>336</sup> Section 180(2)(c)–(d) of the Corporations Act.

## CHAPTER 4: A COMPARATIVE ANALYSIS OF THE STATUTORY BJR IN SOUTH AFRICA AND AUSTRALIA

### 4.1 Introduction

This chapter compares the BJR's statutory framework in South Africa and Australia. It begins by first comparing the preconditions of the BJR in each jurisdiction. The chapter then proceeds to explore how the BJR works in both countries, contrasting the rule's application in South Africa and Australia. Lastly, the chapter addresses the functional challenges and relevance of South Africa's BJR with the aim of identifying the rule's shortcomings and significance.

### 4.2 Comparative analysis of the BJR pre-conditions in South Africa and Australia

As noted in the previous chapter, the BJR does not grant directors a defence without consideration of their conduct.<sup>337</sup> To qualify for the protection of the BJR, directors must meet certain requirements.<sup>338</sup> These preconditions will be discussed in this section.

#### 4.2.1 Business judgment

The South African BJR provision under section 76(4) of the Companies Act does not expressly mention business judgment but instead refers to it as 'any particular matter arising in the exercise of the powers or the performance of the functions of a director'.<sup>339</sup> Referring to a business decision as 'any particular matter' has the impact of broadening the scope of the South African BJR beyond what section 180(2) of the Corporations Act provides for the Australia's BJR. As a result of this definition of business decision, South Africa's BJR as outlined in section 76(4) seems to include any decision made by the board of directors or of a board committee that has received board approval. This follows that the provision is not explicit.<sup>340</sup> It is however worth mentioning that there are references to a 'decision' in

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<sup>337</sup> FHI Cassim and others, *The Law of Business Structures* (2nd edn, Juta 2021) 374.

<sup>338</sup> Farouk HI Cassim and others, *Contemporary Company Law* (3rd edn, Juta 2021) 760; Dennis Davis and Walter Geach (eds), *Companies and Other Business Structures in South Africa* (E-book, 5th edn, Oxford University Press 2021) [6.4.2].

<sup>339</sup> Section 76(4) of the Companies Act.

<sup>340</sup> Davis and Geach (eds), *Companies and Other Business Structures* [6.4.2].

section 76 of the Companies Act but it is not explicitly stated that it is a business decision. For example, section 76(4)(a) makes mention of 'subject matter of the decision' and a director who 'made a decision'. The researcher argues that these loose references to a decision implies that the legislator's intention was to reference decisions made by company directors while performing their directorial tasks.

Section 180(2) of the Corporations Act stipulates that the BJR applies to a business decision. This is illustrated by the text, 'A director or other officer of a corporation who makes a business judgment is taken to meet the requirements of...'. This provision mandates directorial decision making. Section 180(3) limits the ambit of the Australian BJR by submitting a definition of business judgment that provides that not every directorial decision is eligible to be called a business judgment. The definition states that a business decision refers to any decision to take or not to take action in a matter involving the operations of the company.<sup>341</sup> This narrow definition of business judgment was echoed by Austin J in *ASIC v Rich*<sup>342</sup> who ruled that the 'oversight duties' of a director such as reviewing business affairs, company policies or financial statements were not protected by the BJR.<sup>343</sup> The *ASIC v Rich* judgment confirms the limit of decisions that qualify as business judgments under the Australia BJR, narrowing the scope compared to the South African BJR. Some of the decisions that Austin J found appropriate to refer to as business judgment in *ASIC v Rich* included; decisions that involve planning to make a business decision, decisions relating to the employees of the company, decisions pertaining to the cancellation of litigation involving the company, decisions involving the policies of the company, decisions on duties and responsibilities of directors and executive management and also budgeting and planning.<sup>344</sup>

#### 4.2.2 *Informed decision*

Section 76(4)(a)(i) of the Companies Act requires the director to make 'reasonably diligent' efforts to be 'informed about the matter' under consideration. Section 76(4)(b) specifies how a director may diligently seek information concerning a

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<sup>341</sup> Section 180(3) of the Corporations Act.

<sup>342</sup> *ASIC v Rich* [2009] 75 ACSR 236 FLR 1 [7272].

<sup>343</sup> *ASIC v Rich* [2009] 75 ACSR 236 FLR 1 [7278].

<sup>344</sup> *ASIC v Rich* [2009] 75 ACSR 236 FLR 1 [7273]–[7274].

problem. This is done through gathering information from people delegated by the board, employees of the company and various professionals such as attorneys or accountants.<sup>345</sup> It also encompasses sources of information such as opinions and recommendations from financial statements and reports prepared by various professionals and employees.<sup>346</sup>

Section 180(2)(c) of the Corporations Act states that directors must be informed about a matter they decide on to the degree they think is relevant.<sup>347</sup> In *ASIC v Rich*,<sup>348</sup> the court was not persuaded by the argument that it was expected to further its inquiry of the director's knowledge to include what the director was supposed to know. Regardless, this approach provides an objective test to determine whether the director complied with the requirement of being informed. While section 180(2)(c) includes the phrase 'reasonably believe', it may be difficult for a director to objectively establish whether he has adequately informed himself on a matter. The involvement of experts may alleviate this challenge by providing the director with the perceptions and knowledge needed to make informed decisions.<sup>349</sup> Both case<sup>350</sup> and statutory<sup>351</sup> law protect against the risk that the director surrenders his judgment to experts by stipulating that even if a director consults experts, the director remains accountable for the exercise of his directorial authority. The South African BJR requirement to be informed as outlined in section 76(4) differs from the Australian BJR in that the Companies Act seems to focus on the integrity of the process, requiring the director to make diligent efforts to be informed whereas the Corporations Act appears to place its attention on the quality of the decision. This disparity suggests that South Africa's emphasis on the process restricts its BJR. The fixation with the process and not the decision's quality undermines the South

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<sup>345</sup> Tshepo Mongalo and Tshepiso Scott, *Corporate Law and Corporate Governance: An Overview of Business Undertakings in South Africa* (E-book, 2nd edn, Van Schaik 2023) [7.8.1].

<sup>346</sup> See s 76(4)(b) of the Companies Act; Mongalo and Scott, *Corporate Law and Corporate Governance* [7.8.1].

<sup>347</sup> Corporations Act 2001, s 180(2)(c).

<sup>348</sup> *ASIC v Rich* [2009] 75 ACSR 236 FLR 1 [7284].

<sup>349</sup> Andrew Lumsden, 'The Business Judgement Defence - Insights from *ASIC v Rich*' (2010) 28 *Companies and Securities Law Journal* 1, 13.

<sup>350</sup> *Barlows Manufacturing Co Ltd v RN Barrie (Pty) Ltd* 1990 (4) SA 608 (C) 610–611.

<sup>351</sup> See s 72(3) of Companies Act; s 189 (b)(ii) of the Corporations Act.

African BJR's requirement for informed decisions to a mere formality rather than a probe into the business judgment's value.

#### 4.2.3 *Personal interest*

According to section 76(4)(a)(ii)(aa) of the Companies Act, the South African BJR requires the director to have no material personal financial interest in any matter on which they make business judgments.<sup>352</sup> If there is a conflict, the director must make an appropriate disclosure in accordance with section 75(5) of the Companies Act or disclose beforehand in accordance with section 75(4) of the Companies Act. As a result, a director cannot make a business judgment on behalf of the company if the decision benefits him personally.<sup>353</sup> The director cannot profit personally from information obtained as a result of holding the position of director, nor may he make any decision that results in him gaining or having an advantage over the company.<sup>354</sup>

Section 180(2)(b) of the Corporations Act prohibits Australian directors from having a conflict of interest in a business decision made on behalf of the company. According to *McGellin v Mount King Mining NL*<sup>355</sup> the issue of material interest necessitates an objective assessment to show whether the personal interest of the director was significant enough to influence his decision.

The Australian business judgment rule is stricter in that it prohibits material personal interests, whereas South Africa's business judgment rule prohibits material personal financial interests.<sup>356</sup> However, it is important to acknowledge that the South African provision dealing with conflict of interest, namely, section 76(4)(a)(ii)(aa) includes the personal financial interests of related parties as well, making it more rigorous.<sup>357</sup> At the same time, section 76(4)(a)(ii)(bb) of the Companies Act provides relief by allowing disclosure in compliance with section 75

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<sup>352</sup> See also Cassim and others, *The Law of Business Structures* 374.

<sup>353</sup> William M Lafferty, Lisa A Schmidt and Donald J Wolfe, 'A Brief Introduction to the Fiduciary Duties of Directors under Delaware Law' (2012) 116 *Dickinson L Rev* 837, 842.

<sup>354</sup> Lafferty, Schmidt and Wolfe, 'A Brief Introduction to the Fiduciary Duties' 842.

<sup>355</sup> *McGellin v Mount King Mining NL* [1998] 144 *FLR* 288 [303].

<sup>356</sup> Anna Elizabeth Oost, 'A "Safe Harbour" for Directors in South Africa? A Comparative Study of the Business Judgment Rule' (LLD thesis, University of South Africa 2020) 347.

<sup>357</sup> Oost, 'A "Safe Harbour" for Directors in South Africa' 334.

of the Companies Act. The provision deals with disclosure and provides various ways for making disclosures in respect of the personal interest of a specific director or those of a related person, who can be natural or juristic as per definitions provided in section 2 of the Companies Act. The Corporations Act lacks corresponding provisions that address these issues.

The researcher submits that the requirement that a director must have no conflict of interest in a business decision is difficult to implement in practice because some directors are compensated with share incentives. Their decisions could be swayed by self-interest and managerial opportunism.<sup>358</sup>

#### 4.2.4 Rationality

Section 76(4)(a)(iii) of the Companies Act requires the director to have a rational belief that their decision will promote the company's interests.<sup>359</sup> Although the rule does not specify the basis on which directors are expected to have this rational belief, the researcher contends that the absence of personal interest may strengthen the rational belief that the business decision is aimed at promoting the company's interests.

Section 180(2)(d) of the Corporations Act requires that the director should have a rational belief that their business judgment is in the best interests of the company. This rationality assessment requires the director to justify why they believed that their decision would promote the best interests of the company.<sup>360</sup> According to Lumsden<sup>361</sup> this rationality test requires the director's rational belief backed by a reasoning process that the director's decision serves the company's best interests.<sup>362</sup> This condition has an equivalent in the South African BJR which is found in section 76(4)(a)(iii) of the Companies Act, as previously noted.

The absence of rationality in business decisions might also be a sign of lack of good faith. The court in *Shuttleworth v Cox Brothers & Co (Maidenland) Ltd*,<sup>363</sup>

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<sup>358</sup> See KE van der Linde, 'The Steinhoff Corporate Scandal and the Protection of Investors Who Purchased Shares on the Secondary Market' (2022) 25 PELJ 1, 7.

<sup>359</sup> Section 76(4)(a)(iii) of the Companies Act.

<sup>360</sup> Lumsden, 'The Business Judgement Defence' 15.

<sup>361</sup> Lumsden, 'The Business Judgement Defence' 15.

<sup>362</sup> Lumsden, 'The Business Judgement Defence' 15.

<sup>363</sup> *Shuttleworth v Cox Brothers & Co (Maidenland) Ltd* [1927] 2 KB 9 (CA) 23.

determined that lack of rationality in a director's decision was an indication of bad faith.

### **4.3 Operation of the statutory BJR in South Africa and Australia**

#### *4.3.1 BJR and directors' duties*

The South African BJR in section 76(4)(a) is based on the fiduciary obligation to act in the best interests of the company in section 76(3)(b) and the duty of care in section 76(3)(c) of the Companies Act.<sup>364</sup>

Section 76(4) does not specify whether the BJR can be broadly or narrowly applied to specific instances,<sup>365</sup> such as in USA corporate takeover defences where the Delaware formulation has been predominantly used.<sup>366</sup> This uncertainty affects the interpretation of South Africa's BJR, making it impossible to ascertain its entire scope of application.<sup>367</sup>

Overall, it is argued that partial codification of directors' common law duties compound the application of the BJR in both jurisdictions. Partial codification of common law can result in legal uncertainty and inflexibility<sup>368</sup> as the courts consider corresponding statutory provisions.<sup>369</sup> However, a counterargument may also be made that statutory provisions have the benefit of certainty in defining and clarifying the content of the duty under consideration.<sup>370</sup>

As previously stated, the South African BJR pertains to the fiduciary duty to act in the company's best interests in conjunction with the duty of care.<sup>371</sup> This conflation of the two different duty classes burdens the BJR with legal complications and doctrinal tensions because breach of these duty classes result in different grounds

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<sup>364</sup> Cassim and others, *Contemporary Company Law* 761.

<sup>365</sup> Davis and Geach (eds), *Companies and Other Business Structures* [6.4.2].

<sup>366</sup> Farrar, 'Corporate Governance' 23.

<sup>367</sup> Davis and Geach (eds), *Companies and Other Business Structures* [6.4.1].

<sup>368</sup> Cassim and others, *Contemporary Company Law* 685.

<sup>369</sup> Cassim and others, *Contemporary Company Law* 685.

<sup>370</sup> Cassim and others, *Contemporary Company Law* 684.

<sup>371</sup> Chapter 4 para 4.3.1 above; Oost, 'A "Safe Harbour" for Directors in South Africa' 286.

for action.<sup>372</sup> Claims for restitution<sup>373</sup> arise from breaches of fiduciary obligations, whereas claims for delictual damages arise from a violation of the duty of care.<sup>374</sup> The two duty classes also have different legal historical foundations and principles with the fiduciary duty to act in the best interests of the company emanating from Roman- Dutch law,<sup>375</sup> while the duty of care is derived from English law.<sup>376</sup>

Section 180(2) of the Corporations Act indicates that the Australian BJR specifically pertains to the common law duty of care and statutory duty of care which is outlined in section 180(1). The limitation of the Australian statutory BJR<sup>377</sup> to the duty of care is regarded as an appropriate approach, as it is consistent with the usage of the rule in the United States. Section 180(2)(a) of the Corporations Act requires that a business decision be taken in good faith and for a proper purpose.

It may be argued that Australia's narrow BJR prevents overlaps between directorial fiduciary duties and the duty of care. This argument is however compromised by section 180(2) which extends the scope to equivalent common law and equity duties. The effect of the Australian BJR's inclusion of equivalent common law and equity differentiates it from the South African counterpart, which is presumed to require directors to only comply with statutory duties in sections 76(3)(b) and (c) of the Companies Act, as it is silent on common law or equity duties. This makes the Australian BJR more onerous for company directors as they have to comply with statutory duties on one hand, as well as equity and common law duties on the other.

#### 4.3.2 *Application of common law*

Although fiduciary duties and the duty of care are partially codified in South African and Australian company law, the South African BJR is ambiguous about the application of common law. However, section 76(4)(a) only states that the BJR applies to the duties outlined in sections 76(3)(b) and (c) of the Companies Act and

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<sup>372</sup> E Jones, 'Directors' Duties: Negligence and the Business Judgment Rule' (2007) 19 SA Merc LJ 326, 327.

<sup>373</sup> See s 77(2)(a) of the Companies Act; Jones, 'Directors' Duties' 334.

<sup>374</sup> Section 77(2)(b) of the Companies Act; *Fisheries Development Corporation of SA Ltd v Jorgensen* 1980 (4) SA 156 (W).

<sup>375</sup> Jones, 'Directors' Duties' 327.

<sup>376</sup> Jones, 'Directors' Duties' 327.

<sup>377</sup> See ss 180(1) and 180(2) of the Corporations Act.

does not mention common law. On the contrary, as discussed in paragraph 4.3.1 above, the Australian statutory BJR also applies to corresponding common law duties and equity,<sup>378</sup> which results in the Australian BJR defence being more burdensome because the intricacies of common law and statutory duties are different. For example, a claim for a breach of the common law duty of care requires the plaintiff to provide evidence of the breach and the resulting harm, whereas a similar action under the statutory duty can be established solely by showing evidence of the violation.<sup>379</sup>

#### 4.3.3 *Party which bears the onus of proof*

The South African BJR statutory clause does not specify which party bears the burden of proof in action involving BJR defence,<sup>380</sup> resulting in matters such as who must lead evidence between the defendant director and plaintiff being obscure. This also applies to other evidence related questions such: Which party begins? Can the BJR be explicitly raised as a defence in pleadings? Or can the court use its discretion to decide whether the BJR is applicable in given circumstances? It is argued that the lack of clarity on this matter undermines the South African BJR, resulting in legal uncertainty.

However, on the other hand, the wording of South Africa's statutory BJR in section 76(4) is compatible with the ALI definition of BJR, in that it states preconditions which directors must comply with in order to be eligible for the BJR's protection.<sup>381</sup> Given that the ALI formulation places the burden of proof on the directors to demonstrate that they complied with the BJR's preconditions,<sup>382</sup> it is argued that under South Africa's BJR, the directors bear the onus of proof.

The Australian court in *ASIC v Rich* held that section 180(2) of the Corporations Act did not unequivocally name the party which bears onus of proof.<sup>383</sup> It further held

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<sup>378</sup> See s 180(2) of the Corporations Act, see also Kenneth Hayne, 'Directors Duties and Company Creditors' (2014) 38 Melbourne University Law Review 795, 804.

<sup>379</sup> *Vrisakis v ASC* [1993] 9 WAR 395 252.

<sup>380</sup> Cassim and others, *Law of Business Structures* 375.

<sup>381</sup> Section 76(4)(a) of the Companies Act; s 4.01(c) of ALI, *Principles of Corporate Governance*.

<sup>382</sup> Section 4.01 (c) of ALI *Principles of Corporate Governance*.

<sup>383</sup> Geoffrey Nettle, 'The Changing Positions and Duties of Company Directors' (2018) 41 Melbourne University Law Review 1402, 1415.

that the burden must be on the defendant director because putting it on the plaintiff would create new components that the plaintiff would be required to demonstrate.<sup>384</sup> The court further stated that in order for the Australian BJR to be recognised as a safe harbour, it was necessary for directors to demonstrate compliance with the preconditions outlined in section 180(2) of the Corporations Act.<sup>385</sup> A similar conclusion was reached in the case of *ASIC v Fortescue Metals Group Ltd*.<sup>386</sup>

Consequently, the onus of proof under both South African and Australian statutory BJR is therefore presumed to rest with the directors as discoursed above.

#### 4.3.4 *Presumption or safe harbour for directors?*

A safe harbour is defined as a legal provision that discharges or restricts the liability of an offending party which meets certain criteria.<sup>387</sup> This criterion can include aspects such as age or mental capacity. For instance, a director who is a minor or has diminished capacity would be exempted from liability because they would be unable to make decisions and demonstrate the necessary level of care and skill. Both South Africa and Australia provide a safe harbour in their statutory BJR.<sup>388</sup> The South African High Court in *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd*<sup>389</sup> ruled that the courts will not interfere with directorial decisions that were considered to be rational. The effect of this judgment is that directors are protected from liability arising from their business judgment provided that they meet the requirements of the BJR as the BJR provide a safe harbour.

The Corporations Act does not create any presumption for the benefit of directors in its BJR provision.<sup>390</sup> The judgment in *ASIC v Rich*,<sup>391</sup> established that the onus

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<sup>384</sup> *ASIC v Rich* [2009] 75 ACSR 236 FLR 1 [7266].

<sup>385</sup> *ASIC v Rich* [2009] 75 ACSR 236 FLR 1 [7269].

<sup>386</sup> *Australian Securities and Investments Commission v Fortescue Metals Group Ltd* [2011] 190 FCR 364, 427 [197]–[198].

<sup>387</sup> Nickera Rodriguez, 'The Plight of Cyntoia Brown: Can Safe Harbor Laws Prevent the Prosecution of Child Sex Trafficking Victims' (2021) 31 University of Florida Journal of Law & Public Policy 459, 470.

<sup>388</sup> Cassim and others, *Law of Business Structures* 373.

<sup>389</sup> *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd* 2014 (5) SA 179 (WCC) [87].

<sup>390</sup> Andrew W Winden, 'Caremark's Climate Failure' (2023) 74 Hastings Law Journal 1167, 1196.

<sup>391</sup> *ASIC v Rich* [2009] 75 ACSR 236 FLR 1 [7269].

of proof rests upon the defendant directors and not the claimants.<sup>392</sup> This judgment therefore reinforces the view that the Australian BJR is a safe harbour.

A comparison between the safe harbour and presumption approaches indicates that the presumption approach is less burdensome to comply with. This follows that directors will not shoulder the onus of proof as in the case of the safe harbour approach.<sup>393</sup> Therefore the presumption approach may have the potential of encouraging directors to take risks in their business judgment as they will not be required to bear the burden of proof.<sup>394</sup>

On this basis, it is suggested that it would be advantageous for both South Africa and Australia to adopt the presumption approach. This is due to the fact that the presumption approach is likely to attract eligible persons to serve as directors because the office will be less onerous as the onus of proof will lie with the plaintiffs. The presumption approach may also make South Africa and Australia more attractive as investment destinations of multi-national companies. This follows that the directors and executives of these companies may be reassured of their legal protection due to the location of the onus of proof to plaintiffs under the presumption approach.

The presumption approach need not be viewed as disadvantaging the plaintiffs. This is because they will only need to demonstrate the existence of at least one unmet precondition to prompt a court review to determine if the expected duties from directors were upheld. This was the finding in *Smith v Van Gorkom* where the court found against company directors whose decision was found to be uninformed.<sup>395</sup>

#### 4.3.5 *Applicable BJR doctrine- immunity, abstention or standard of liability?*

Both South African and Australian BJR provisions suggest that directors must meet certain requirements in order to be eligible for the BJR protection. Section

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<sup>392</sup> *ASIC v Rich* [2009] 75 ACSR 236 FLR 1 [7269]; Winden, 'Caremark's Climate Failure' 1196.

<sup>393</sup> *Smith v Van Gorkom* 488 A 2d 858, 873 (Del 1985).

<sup>394</sup> See Lori McMillan 'The Business Judgment Rule as an Immunity Doctrine' (2013) 4 William & Mary Business Law Review 521, 564-565, where the author submits that immunised directors have the flexibility to take more risks in their business ventures.

<sup>395</sup> *Smith v Van Gorkom* 488 A 2d 858, 873 (Del 1985).

76(4)(a)(i)–(iii) of the Companies Act establishes preconditions of business decision, informed decision, lack of material personal financial interest and rationality that directors must meet.<sup>396</sup> This implies that the BJR defence is conditional on directors meeting the prerequisites stipulated in the respective BJR provision.<sup>397</sup> Similarly, the Australian BJR provision has related wording in its BJR provision which require directors to meet prescribed conditions in the form of business judgment, informed decision, rationality and lack of material interest.<sup>398</sup>

Accordingly, it is clear that both South African and Australian BJR provisions prescribe that directors can only be immunised from liability if they comply with certain preconditions.<sup>399</sup> The immunity doctrine provides protection to directors who have complied with the BJR conditions and are deemed to have complied with their directorial duties.<sup>400</sup> The immunity doctrine therefore applies to South African and Australian BJR provisions, as directors are only protected by the BJR after fulfilling certain preconditions.<sup>401</sup>

#### 4.3.6 *Parties who are eligible for the BJR protection*

South African directors and prescribed officers of the company are eligible for the BJR protection.<sup>402</sup> On compliance with the preconditions of the BJR, the directors and prescribed officers qualify for the BJR's protection.<sup>403</sup> Australia also has a broader application emanating from section 180(2) of the Corporations Act which provides that the Australian BJR pertains to both company directors and other officers of the company.<sup>404</sup>

It is therefore submitted that both countries permit broad application of the statutory BJR to various players within the corporate environment beyond persons with the titular designation of director. However, it appears that Australia's BJR is even

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<sup>396</sup> Section 76(4)(a) of the Companies Act.

<sup>397</sup> Davis and Geach (eds), *Companies and Other Business Structures* [6.4.2].

<sup>398</sup> Section 180(2) of the Corporations Act.

<sup>399</sup> See s 76(4) of the Companies Act; s 180(2) of the Corporations Act.

<sup>400</sup> McMillan 'The Business Judgment Rule as an Immunity Doctrine' 569; see also chap 3 para 3.5.1 for a detailed discussion on the immunity doctrine.

<sup>401</sup> Section 76(4)(a) of the Companies Act.

<sup>402</sup> Section 76(1) of the Companies Act stating that the director includes prescribed officers.

<sup>403</sup> Section 76(4)(a) of the Companies Act.

<sup>404</sup> Oost, 'A "Safe Harbour" for Directors in South Africa' 342.

broader in its application because its inclusion of 'other officers' extend beyond prescribed officers, a limitation which South Africa's BJR has. It must however be noted that the inclusion of 'other officers' may bring some uncertainty because the term is loose whereas section 1 of the Companies Act, provides a more descriptive definition of a prescribed officer, whom it says is a person within a company who undertakes duties as mandated by the Minister pursuant to section 66(10) of the Companies Act.

*4.3.7 Enforcement model for breach of director duties*

Civil claims for directorial duty breaches are enforced privately in South Africa. Private parties primarily litigate disputes over alleged infringement of director duties without the involvement of the state.<sup>405</sup> In Australia, claims for breach of directorial duties are dealt with through a public enforcement framework. The Australian state organ, the Australian Securities and Investment Commission (hereafter ASIC) serves as plaintiff in this civil-penalty system.<sup>406</sup>

On this premise, it is submitted that the South African BJR has a private aspect, but the Australian BJR has both a private and a public aspect because the breach of duty of care is initiated by ASIC.<sup>407</sup>

**4.4 Comparative Table: Preconditions and Operation of the South African and Australian statutory BJRs**

A comparative analysis between the South African and Australian statutory BJR is summarised in the table below.

	South Africa	Australia
<b>Conditions:</b>		
Business judgment	It is a prerequisite with a broader meaning emanating from section 76(4)(a) of the Companies Act	It is a prerequisite which section 180(3) defines as a decision to take or not take action. Section 180(2) makes it a requirement.

<sup>405</sup> Sections 77(2)(a)–(b) and 77(3) of the Companies Act.  
<sup>406</sup> See s 1317E of the Corporations Act 2001; Winden, 'Caremark's Climate Failure' 1196.  
<sup>407</sup> Jason Harris, Anil Hargovan and Janet Austin, 'Shareholder primacy revisited: Does the public interest have any role in statutory duties?' (2008) 26 Company and Securities Law Journal 355, 370.

	which involve any business-related decision of the directors. <sup>408</sup>	
Informed decision	The director must diligently seek to be informed about the matter under consideration. <sup>409</sup> This provision directs focus on the process undertaken to arrive at a decision.	The directors must be informed about a matter they decide on. <sup>410</sup> This provision puts emphasis on the result, which is the decision and not on the process.
Personal interest	A director is prohibited from having a material personal financial interest on the matter to be decided on; or else the financial interest must be declared pursuant to section 75 of the Companies Act. <sup>411</sup> The personal interest applies to financial interests of the director and the parties related to the director. <sup>412</sup>	Directors are forbidden from having material personal interest <sup>413</sup> The interests precluded go beyond financial interest. There is no provision for interests of related parties. There is also no provision for disclosure arrangements of existing personal interests.
Rationality	The director should be driven by a rational belief that the decision is in the best interests of the company. <sup>414</sup>	The director must reasonably believe that his business decision will be in the best interests of the company. <sup>415</sup>
<b>Operation of the BJR:</b>		
Director duties	The BJR relates to the duty to act in the best interests of the company on one side and the duty of care, on the other. <sup>416</sup>	The BJR pertains to the duty of care. <sup>417</sup>
Application of common law	It is not clear whether the BJR applies to common law. However, it is provided that it applies to the codified duties of acting in the best interests of the company <sup>418</sup> and of care. <sup>419</sup>	It pertains to the common law duty of care and skill. <sup>420</sup>
Good Faith and Proper Purpose	Not provided for in section 76(4). <sup>421</sup>	Applicable. The judgement must be exercised in good faith and for a proper purpose. <sup>422</sup>

<sup>408</sup> See also Cassim and others, *Contemporary Company Law* 762.

<sup>409</sup> Section 76(4)(a)(i) of the Companies Act.

<sup>410</sup> According to s 180(2)(c) of the Corporations Act.

<sup>411</sup> Section 75(4) of the Companies Act.

<sup>412</sup> Section 76(4)(a)(ii) of the Companies Act.

<sup>413</sup> Section 180(2)(b) of the Corporations Act.

<sup>414</sup> Section 76(4)(iii) of the Companies Act.

<sup>415</sup> Section 180(2)(d) of the Corporations Act.

<sup>416</sup> Section 76(4)(a) of the Companies Act.

<sup>417</sup> Section 180(2) of the Corporations Act.

<sup>418</sup> Section 76(4) of the Companies Act.

<sup>419</sup> Section 76(4) of the Companies Act.

<sup>420</sup> Sections 180(2) and 185 of the Corporations Act.

<sup>421</sup> Cassim and others, *Contemporary Company Law* 761.

<sup>422</sup> Section 180(2)(a).

Party which bears the onus of Proof	There is no clarity from statutory or case law. <sup>423</sup> However, the framing of the BJR provision which resembles the ALI formulation suggests that the onus of proof rests with the directors. <sup>424</sup>	The onus of proof rests with the directors. <sup>425</sup>
Applicable Doctrine	Immunity doctrine. <sup>426</sup>	Immunity doctrine. <sup>427</sup>
Parties eligible for BJR protection	The BJR provision applies to company directors and prescribed officers. <sup>428</sup>	The BJR provision is applicable to both company directors and other officers. <sup>429</sup>
Is the BJR assumed to be a safe harbour or presumption	Safe harbour. <sup>430</sup>	Safe harbour. <sup>431</sup>
Enforcement model for breach of directors' duty of care and skill	Court action is based on private enforcement involving private parties with one claiming breach by directors. <sup>432</sup>	Court action is based on public enforcement system or civil-penalty model with the Australian Securities and Investments Commission (ASIC) as plaintiff. <sup>433</sup>

Figure 1: Comparative Table- Preconditions and operation of South African and Australian statutory BJR

#### 4.5 Functional Challenges and Relevance of Statutory BJR in South Africa

The BJR's doctrinal basis is to serve as a tool for protecting directorial business judgment.<sup>434</sup> Despite this objective as well as its rationale which was discussed previously in this study,<sup>435</sup> it is important to examine challenges that may limit the BJR's operation and relevance in the South African corporate framework.

<sup>423</sup> Cassim and others, *Law of Business Structures* 375.

<sup>424</sup> Chapter 4 para 4.3.3 above.

<sup>425</sup> *ASIC v Rich* [2009] 75 ACSR 236 FLR 1 [7269]–[7270].

<sup>426</sup> See discussion in paragraph 4.3.5 above.

<sup>427</sup> See discussion in paragraph 4.3.5 above.

<sup>428</sup> Section 76(1)(a) of the Companies Act.

<sup>429</sup> Section 180(2) of the Corporations Act.

<sup>430</sup> Section 76(4)(a)(i)–(iii) of the Companies Act; Davis and Geach (eds), *Companies and Other Business Structures* [6.4.2].

<sup>431</sup> Section 180(2) of the Corporations Act.

<sup>432</sup> Companies Act, ss 20(6) and 77.

<sup>433</sup> See s 1317E of the Corporations Act; Winden, 'Caremark's Climate Failure' 1196.

<sup>434</sup> Mongalo and Scott, *Corporate Law and Corporate Governance* [7.8.1].

<sup>435</sup> Chapter 3 para 3.3.1-3.3.5 above.

#### 4.5.1 Functional Challenges

It is observable that there have not been many court actions engaging the statutory BJR in South Africa.<sup>436</sup> The cases of *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus*,<sup>437</sup> and *Organisation Undoing Tax Abuse v Myeni*<sup>438</sup> are examples of reported court actions involving the statutory BJR, but the rule was only briefly referenced.<sup>439</sup> In *Visser Sitrus Pty Ltd v Goede Hoop Sitrus*, the Western Cape High Court ruled that a court should be cautious of interfering in business decisions.<sup>440</sup> In *Organisation Undoing Tax Abuse v Myeni*, the court ruled that the BJR can only defend persons who act in good faith and diligently make efforts to be informed and not those who are reckless and deceitful.

The South African BJR's apparent judicial underutilisation indicates a flaw which arguably can be attributed to a lack of legal certainty surrounding the rule, which has only been in effect for fourteen years.<sup>441</sup> This uncertainty may be due to several factors including those outlined below.

##### 4.5.1.1 The BJR's broad scope

As previously mentioned in paragraph 3.7 of this study, the South African statutory BJR is classified with directors' duties in section 76 under the subheading 'standards of directors' conduct'.<sup>442</sup> This is despite the fact that BJR is not a directors' duty. This conundrum is exacerbated by the fact that the statutory BJR is not addressed by name, forcing one to infer its existence from the phrasing of section 76(4)(a). This imprecise nature of BJR provision in section 76(4)(a) is highlighted by the wording of its opening statement which says, 'In respect of any particular matter arising in the exercise of the powers or the performance of the functions of a director, a particular director of a company...'. The wide scope of

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<sup>436</sup> Mongalo and Scott, *Corporate Law and Corporate Governance* [7.8.1]; Allens Linklaters, *Advice Regarding the Business Judgment Rule* (Australian Institute of Company Directors, 2020) 1.

<sup>437</sup> *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd* [2014] ZAWCHC 95.

<sup>438</sup> *Organisation Undoing Tax Abuse v Myeni* [2020] 3 All SA 649 [26].

<sup>439</sup> Allens Linklaters, *Advice Regarding the Business Judgment Rule* 20.

<sup>440</sup> *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd* 2014 (5) SA 179 (WCC) [64].

<sup>441</sup> See Proc 32 GG 34239 of 19 April 2011 which provides for the commencement date of the Companies Act 71 of 2008 as 01 May 2011.

<sup>442</sup> Section 76(4) of the Companies Act. See also para 3.7 above.

matters covered by the statutory BJR makes it unclear as to what constitutes a business decision.<sup>443</sup> Given that section 66 of the Companies Act grants directors' wide powers to manage the company's affairs, the rule's broad reach may expose it to abuse.<sup>444</sup>

It is submitted that the South African statutory BJR must clearly state that it applies to a business decision as does the Australian BJR. The current situation suggests that it may provide a safe harbour for undeserving directors.<sup>445</sup> Therefore, it is argued that the location and wording of the BJR provision compromise an understanding of the BJR and diminish its intended role as a tool for director defence.

As previously observed in paragraph 3.7 above, section 76(4)(a) of the Companies Act does not specify whether the BJR can be invoked in specific cases or applied generally.<sup>446</sup> Neither does the provision provide whether the BJR applies exclusively to the procedural traits of the directors' business judgment, or whether it can also be applied to substantive matters of directorial business judgment.<sup>447</sup> This lack of clarity on the conditions in which the statutory BJR can be invoked impedes understanding of its intended role and scope as a mechanism for defending directorial business judgment.

#### 4.5.1.2 Application of common law

The BJR provision in section 76(4) of the Companies Act does not address its relationship with common law. Its silence on the application of common law, suggests that it is not applicable as opposed to the Australian BJR provision in section 180(2) which explicitly specifies that it applies to common law. Given South Africa's use of common law as a legal source, this silence on how the BJR relates to common law may have the effect of lowering the rule's perception by legal

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<sup>443</sup> Davis and Geach (eds), *Companies and Other Business Structures* [6.4.2]; Cassim and others, *Contemporary Company Law* 760.

<sup>444</sup> Section 66(1) of the Companies Act.

<sup>445</sup> Cassim others, *Contemporary Company Law* 762.

<sup>446</sup> See also Davis and Geach (eds), *Companies and Other Business Structures* [6.4.2], saying the rule is imprecise.

<sup>447</sup> Friedrich Hamadziripi and Patrick C Osode, 'The Nature and Evolution of the Business Judgment Rule and its Transplantation to South Africa under the Companies Act of 2008' (2019) 33 *Speculum Juris* 26, 36.

practitioners and directors who regard common law as integral to South African company law.

#### 4.5.1.3 Lack of clarity on who bears the burden of proof

It has been suggested that while the South African BJR's position on the onus of proof is unclear, the wording of section 76(4)(a) of the Companies Act strongly suggests that the burden is on the directors.<sup>448</sup> This follows that directors must demonstrate compliance with the standards outlined in the BJR provision.<sup>449</sup> However, it is suggested that relying on an implied interpretation of the BJR's location of the burden of proof indicates a paucity of statutory clarity on the subject, which limits the utility of the South African statutory BJR.<sup>450</sup> Furthermore, the potential of the burden of proof resting on directors could be equally detrimental to the application of the BJR. This is because, by failing to grant a presumption in favour of directors, the BJR puts directors at a disadvantage by forcing them to defend themselves against allegations of breach.<sup>451</sup> It is submitted that such an approach may lead to frivolous litigation against directors. Such litigation may result in directors' reputational damage and reluctance by qualifying persons to serve as company directors.<sup>452</sup>

#### 4.5.1.4 Fusion of fiduciary duty and the duty of care

One of the concerns raised prior to the implementation of the statutory BJR in South Africa was that the BJR was a legal transplant from the United States and that its incorporation into the South African corporate law could lead to legal uncertainty.<sup>453</sup> It was contended then that unlike South Africa, the United States did not observe the separation between common law fiduciary duties and the duty of care, resulting

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<sup>448</sup> See Mongalo and Scott, *Corporate Law and Corporate Governance* [7.8.1].

<sup>449</sup> Davis and Geach (eds), *Companies and Other Business Structures* [6.4.2].

<sup>450</sup> See generally, Davis and Geach (eds), *Companies and Other Business Structures* [6.4.2].

<sup>451</sup> Larry Rittenberg, Karla Johnstone and Audrey A Gramling, *Auditing: A Business Risk Approach* (7th ed, South Western College 2010) 2.

<sup>452</sup> Davis and Geach (eds), *Companies and Other Business Structures* [6.4.2].

<sup>453</sup> Derek Botha and Richard Jooste, 'A Critique of the Recommendations in the King Report Regarding a Director's Duty of Care and Skill' (1997) 114 SALJ 65, 66.

in the separation<sup>454</sup> between the two duties being distorted.<sup>455</sup> The fact that the South African statutory BJR in section 76(4)(a) of the Companies Act requires the observance of the fiduciary duty to act in the best interests of the company as well as the duty of care<sup>456</sup> indicates a lack of separation and potential legal uncertainty as South African corporate law strictly enforces the separation of the two duty classes.<sup>457</sup> It is submitted that the limited use of the BJR could be due to the legal uncertainty emanating from the blending of the fiduciary duty to act in the best interests of the company and the duty of care. This is due to the fact that the cause of action pertaining to the two duty classes is different as the cause of action for breach of fiduciary duty is restitutory<sup>458</sup> and for breach of the duty of care is a claim for delictual damages.<sup>459</sup>

#### 4.5.2 *Relevance of the BJR*

The BJR doctrinal scope is consistent with the aims and objectives of the Companies Act which aim to promote entrepreneurship<sup>460</sup> and high standards of corporate governance.<sup>461</sup> The BJR provision in section 76(4)(a) of the Companies Act promotes good corporate governance by specifying preconditions that directors are expected to comply with. This was affirmed in *Organisation Undoing Tax Abuse v Myeni*<sup>462</sup> where the court reiterated the importance of informed decision making and the absence of the reckless and deceitful conduct for the BJR defence to be viable.

The BJR encourages entrepreneurship by protecting directors from liability when they undertake their obligations in the best interests of the company with the necessary care, skill and diligence.<sup>463</sup> This enables directors to make risky and innovative decisions that they would not have taken if there was no legal

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<sup>454</sup> Christopher M Bruner, 'Is the Corporate Director's Duty of Care a Fiduciary Duty? Does it Matter?' (2013) 48 Wake Forest Law Review 1027, 1028–1029.

<sup>455</sup> Jones, 'Directors' Duties' 327.

<sup>456</sup> Section 76(4)(a) of the Companies Act.

<sup>457</sup> See Hamadziripi and Osode, 'The Nature and Evolution' 33.

<sup>458</sup> See s 77(2)(a) of the Companies Act; Jones, 'Directors' Duties' 334.

<sup>459</sup> See s 77(2)(b) of Companies Act.

<sup>460</sup> Section 7(b)(i) of the Companies Act.

<sup>461</sup> Section 7(b)(iii) of the Companies Act.

<sup>462</sup> *Organisation Undoing Tax Abuse v Myeni* [2020] 3 All SA 649 [26].

<sup>463</sup> See s 7(b) of the Companies Act.

mechanism to protecting them from liability.<sup>464</sup> The BJR thus safeguards company directors who make honest and risky corporate decisions in an increasingly uncertain business environment characterised by corporate collapses and new innovations.<sup>465</sup>

By prescribing preconditions that directors must meet before their decisions and actions can be protected, the South African BJR balances the pull between directorial powers and their accountability and thus fulfilling the purpose of the Companies Act to 'balance the rights and obligations of shareholders and directors within companies'.<sup>466</sup> It also creates a framework within which directors can exercise their authority and make unrestricted decisions while taking responsibility for the same.<sup>467</sup>

The rule is also relevant to legal practitioners who advise on corporate governance or defend their clients for breach of corporate duties as the BJR provides a legal defence mechanism for doing so. Judicially, the statutory BJR in section 76(4)(a) of the Companies Act provides a standard of justice and fairness on which allegations for breach of directorial duties can be made, rebutted and adjudicated within the confines of the law.

#### **4.6 Conclusion**

This chapter contrasted the South African and Australian statutory BJR provisions, focusing on preconditions, operation and judicial application. It analysed the nuances of the BJR in both jurisdictions and provided perspectives on the significance of the intricacies of the BJR in both jurisdictions. It argued that the limited application of the BJR defence in South Africa might possibly be from a lack of legal certainty arising from the framing and wording of the rule's statutory provision as well as its failure to grant a presumption in favour of directors where the onus of proof would rest on the plaintiff. The chapter concludes by arguing that despite these challenges, overall, the BJR is relevant to South Africa as it

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<sup>464</sup> See Cassim and others, *Contemporary Company Law* 762.

<sup>465</sup> See Van der Linde, 'The Steinhoff Corporate Scandal' 2; Leviticus Mensah and Murad A Bein, 'Sound Corporate Governance and Financial Performance: Is There a Link? Evidence from Manufacturing Companies in South Africa, Nigeria, and Ghana' (2023) 15 *Sustainability* 1, 2.

<sup>466</sup> Section 7(i) of the Companies Act.

<sup>467</sup> Mongalo and Scott, *Corporate Law and Corporate Governance* [7.8.1].

complements the purposes and objectives of the Companies Act which include the promotion of entrepreneurship and good corporate governance.

Findings which have arisen in this study as well as the researcher's recommendations are provided in the next chapter.

## **CHAPTER 5: FINDINGS, RECOMMENDATIONS AND CONCLUSION**

### **5.1 Overview**

This study aimed to offer an academic perspective on the relevance of South Africa's statutory BJR to its corporate law framework. It also aimed to understand why the BJR was limitedly applied in South African court actions involving breach of directorial duties.

To achieve the aforementioned, the researcher commenced the study in chapter 1 by presenting a roadmap of the study that included introductory remarks on the study and then addressed the problem statement, the purpose of the study, and the research method. The purpose of this introductory chapter was to provide the necessary guidelines and clarification on how the study would be conducted.

In chapter 2, the study conducted a literature review examining key corporate governance concepts and principles. These included directorial powers, duties, liabilities and corporate governance theories. To get insight into the intricacies of the corporate ecosystem, relevant literature such as case law, legislation, codes of corporate governance, textbooks, and reports was analysed.

In chapter 3, the study explored the subject of BJR where it discussed the meaning and rationale of the BJR, as well as the ALI and Delaware formulations, which are the doctrine's main theoretical manifestations. The three main doctrinal manifestations of the BJR, namely the immunity doctrine, the abstention doctrine and the standard of liability doctrine, were then explored to identify their key provisions. The chapter then concluded with an overview discussion of the South African and Australian statutory BJRs with a focus on the historical development of the rule and the subsequent statutory provisions of the rule in both South Africa and Australia.

The fourth chapter focused on comparison of the South African and Australian BJR provisions. It analysed and contrasted the rule's preconditions and operations in both jurisdictions. Australia was chosen as a comparison point because it was the first country to codify the BJR resulting in it having a developed jurisprudence on the BJR subject. Second, South Africa benchmarked its statutory BJR provision

against the Australian BJR. Third, both jurisdictions are based on English company law foundation, which makes comparative analysis easier and relevant. These common features influenced the study's decision to use Australia for the comparative analysis element since they provided a viable foundation for comparison.

In this chapter, the researcher aligns the findings with each of the research questions, thus ensuring that the purpose of the study is achieved. The themes that emerged were as follows: the South African statutory BJR's relevance is that it promotes entrepreneurship and corporate governance as well as reducing judicial interference. In line with the second question, the findings revealed that the South African BJR is formulated as a statutory defence mechanism with its intended role being to protect directors' honest decisions. Regarding the third question, the study identified the shortcomings of the rule to include the fact that the South African BJR is placed under the subheading 'standard of directors' conduct' despite being framed as a standard of review aimed at determining eligibility for statutory defence, and that the broad scope of the BJR limits its application. Following the discussion of the findings, the study concludes by tabling recommendations, which align with research question number four, whose goal was to understand policy and legal reforms that can be introduced to make the BJR a more effective defence mechanism for directors.

The next section features the findings of the study.

## **5.2 Findings**

This part presents the main findings of the dissertation. The findings are linked to the dissertation research questions. To facilitate easy reference to the findings, the findings will be presented under their own subheadings.

### *5.2.1 The relevance of the South African statutory BJR (Research Question1)*

#### 5.2.1.1 Protecting directors from personal liability

Despite having enjoyed limited judicial application to date, the study finds that the South African BJR plays a vital role in defending honest directors whose decisions

harm their companies.<sup>468</sup> A major justification of this defence is the fact that directors often have to make decisions in circumstances inherent with risks, limited time and market uncertainties.<sup>469</sup>

While admittedly, the BJR's defence is not automatic but rather conditional to compliance with certain preconditions, the rule serves its intended purpose of protecting directors.

#### 5.2.1.2 Promoting Entrepreneurship

The BJR supports the Companies Act objective of promoting entrepreneurship<sup>470</sup> by acting as defence mechanism of directors' decisions which may result in negative outcomes after being made in the best interests of the company and with due care. As noted, the BJR defence provides an incentive for directors to accept directorships on the grounds that negative outcomes of the decisions they make with care and in the best interests of the company do not attach personal liability to them.<sup>471</sup> It thus enables directors to direct their attention on substantive commercial issues instead of concentrating on devising strategies to protect themselves from personal liability claims.

#### 5.2.1.2 Promoting corporate governance

To the extent that the Companies Act stipulates that one of its goals is to promote good corporate governance,<sup>472</sup> it is submitted that the BJR supports this objective. It achieves this objective by balancing the directors' authority and accountability by defending directors' honest decisions and making them accountable for breach of their duties to act in the best interests of the company and with due care by defending them against personal liability claims.<sup>473</sup>

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<sup>468</sup> Chapter 4 para 4.5.1 above.

<sup>469</sup> Chapter 3 para 3.3.1 above.

<sup>470</sup> Section 7(b)(i) of the Companies Act; chap 3 para 3.3.4 above.

<sup>471</sup> Chapter 3 para 3.3.3 above.

<sup>472</sup> Section 7(b) of the Companies Act.

<sup>473</sup> Tshepo Mongalo and Tshepiso Scott, *Corporate Law and Corporate Governance: An Overview of Business Undertakings in South Africa* (E-book, 2nd edn, Van Schaik 2023) [7.8.1].

### 5.2.1.3 Reducing judicial interference and promoting directors' authority

The BJR promotes directors' control of their companies and reduces judicial overreach in business decisions by protecting directors' good faith decisions from second guessing by the courts.<sup>474</sup> By exempting directors from judicial scrutiny in circumstances where they have appropriately discharged their duties, the BJR empowers directors to exercise their powers in line with section 66(1) of the Companies Act which provides that companies are managed under the wide powers and authority of directors.

### 5.2.2 Formulation and intended use of the BJR (Research Question 2)

South Africa's statutory BJR in section 76(4) of the Companies Act exempts directors' honest decision-making from judicial review.<sup>475</sup> As has been noted in this study,<sup>476</sup> the South African BJR insulates company directors by preventing courts from second-guessing their decisions or making alternative business judgments with the advantage of hindsight.<sup>477</sup> Section 76(4) of the Companies Act lists certain criteria which directors must first fulfil before they are eligible for the BJR's protection. Directors must have made an informed decision<sup>478</sup> with no material personal financial interest.<sup>479</sup> The director making the decision must have a rational belief that the decision will serve the best interests of the company.<sup>480</sup> It has been learned that the South African statutory BJR does not explicitly specify that the director's decision must be a business decision.<sup>481</sup> This differs from Australia's statutory BJR provision in section 180(2) of the Corporations Act explicitly states that it only protects business decisions. By protecting directors, the BJR is intended to insulate directors from excessive liability exposure which may paralyse their

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<sup>474</sup> Chapter 3 para 3.3.2 above.

<sup>475</sup> Mongalo and Scott, *Corporate Law and Corporate Governance* [7.8.1].

<sup>476</sup> Dennis Davis and Walter Geach (eds), *Companies and Other Business Structures in South Africa* (E-book, 5th edn, Oxford University Press 2021) [6.4.2]; chap 3 para 3.3.1.

<sup>477</sup> Mongalo and Scott, *Corporate Law and Corporate Governance* [7.8.1]; chap 3 para 3.3.2 above.

<sup>478</sup> Section 76(4)(a)(i) of the Companies Act; chap 4 para 4.2.2 above.

<sup>479</sup> Section 76(4)(a)(ii) of the Companies Act; chap 4 para 4.2.3 above.

<sup>480</sup> Section 76(4)(a)(iii) of the Companies Act; chap 4 para 4.2.4 above.

<sup>481</sup> Section 76(4)(a) of the Companies Act; chap 4 para 4.2.1 above.

capacity to exercise their powers and make risky but necessary commercial decisions.<sup>482</sup>

### 5.2.3 Shortcomings of the South African statutory BJR (Research Question 3)

#### 5.2.3.1 Framing and location of the South African statutory BJR

As previously discussed, the South African BJR is framed as a standard of directors' conduct and is placed together with the statutory duties in section 76(3) of the Companies Act.<sup>483</sup> This creates some interpretative ambiguity because the text of the provision does not separate the BJR provision from the directorial duties in section 76(3) of the Companies Act. The text flows uninterrupted into section 76(4) despite the fact the BJR clause in section 76(4)(a) implies a standard of review that assesses performance of directorial duties mentioned in the BJR provision in order to secure directorial statutory defence. The BJR thus does not appear under a heading which states that it is the BJR nor does the text in the provision explicitly state the term business judgment rule. Conversely, it was put forward that the Australian BJR in section 180(2) of the Corporations Act appears with a subheading indicating that it is the business judgment rule,<sup>484</sup> thus setting it apart from the preceding text. South Africa's interpretation of the BJR as standard of directors' conduct is flawed because it confuses its role in determining whether the negative effects of a director's business decision qualify for judicial review exemption. This framing of the South African BJR may have the unintended consequence of weakening its legal position.<sup>485</sup>

#### 5.2.3.2 Broad scope of the BJR

The study noted that one of the motives of the BJR is to limit judicial interference where courts make business decisions because they are ill-equipped to do so.<sup>486</sup> As a result, the BJR provision must be explicit in order for the judicial review for

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<sup>482</sup> Mongalo and Scott, *Corporate Law and Corporate Governance* [7.8.1]; chap 3 para 3.3.5 above.

<sup>483</sup> Chapter 4 para 4.5.1 above.

<sup>484</sup> Chapter 2 para 3.7 above.

<sup>485</sup> Chapter 3 para 3.7 above.

<sup>486</sup> Mongalo and Scott, *Corporate Law and Corporate Governance* [7.8.1]; chap 3 para 3.3.2 above.

breach of the directorial duties to be objective. The South African statutory BJR provision does not expressly mention business decision by name but instead states: 'In respect of any particular matter arising in the exercise of the powers or the performance of the functions of a director...'.<sup>487</sup> This implies that the South African BJR also applies to the performance of any other functions that the director may decide to perform on behalf of the company. The scope of the BJR is therefore broad and vague because it does not explicitly provide for decisions that it encompasses,<sup>488</sup> for example whether it can be applied to anti-takeover strategies. The BJR's elastic scope thus destabilises its corporate purpose as a directors' shield because the extent of its application cannot be ascertained.<sup>489</sup> The inherent difficulty in assigning the scope of the South African BJR may undermine the objective of the Companies Act in section 77 of making directors liable for breach of duties. This is because judicial review may end up being done under uncertain legal conditions where the BJR scope cannot be defined resulting in undeserving directors being exempted from liability or *vice versa*.

Australia's BJR provision in section 180(2) of the Corporations Act explicitly states that the BJR applies to a business judgment.<sup>490</sup> Section 180(3) of the Corporations Act also describes business judgment as any decision to act or to refrain from action in relation to the company's operations. The above two provisions have the effect of explicitly defining the parameters of the Australian BJR in terms of it being conditional to a business decision as well as clarifying what a business decision is.

### 5.2.3.3 Location of the burden of proof

We observed in paragraph 4.2.1 that the South African statutory BJR does not explicitly state the party that bears the burden of proof.<sup>491</sup> It was argued that the wording of the BJR provision implies that the burden of proof rests with the

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<sup>487</sup> Section 76(4) of the Companies Act.

<sup>488</sup> Davis and Geach (eds), *Companies and Other Business Structures* [6.4.2]; chap 3 para 3.7; chap 4 para 4.3.2; chap 4 para 4.5.1 above.

<sup>489</sup> Chapter 4 para 4.5.1 above.

<sup>490</sup> Chapter 4 para 4.5.1 above.

<sup>491</sup> Chapter 4 para 4.3.3 above.

defendant director.<sup>492</sup> It was further contended that the BJR provision resembles the safe harbour doctrine in which directors bear the onus of proof.<sup>493</sup>

Australia's BJR provision does not specify who carries the burden of proof. However, evidence from case law like *ASIC v Rich*<sup>494</sup> and *ASIC v Fortescue Metals Group Ltd*,<sup>495</sup> suggests that Australia's BJR locates the onus of proof on the defendant directors. While Australia's statutory BJR is not explicit on this matter, case law on the subject has assisted Australia in making a judicial determination on who bears the onus of proof under the Australian BJR. However, South Africa has not received the same benefit. As previously stated, South Africa has had a few reported court actions on the BJR judicial application.<sup>496</sup> It only counts limited cases such as *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus*,<sup>497</sup> and *Organisation Undoing Tax Abuse v Myeni*<sup>498</sup> as being examples of reported cases where the BJR was briefly referenced.

By failing to provide clarity on whether directors have the benefit of automatic presumptive defence or conversely if they must actively prove their defence, the South African BJR leaves open the question of who bears the burden of proof. It follows that potential directors may become more risk-averse and forgo directorship opportunities due to their inability to conclusively assess their personal liability exposure.

#### 5.2.3.4 Blending of fiduciary duty and duty of care

The South African statutory BJR relates to the fiduciary duty imposed by section 76(3)(b) to act in the company's best interests and the duty of care established in section 76(3)(c).<sup>499</sup> It was argued in paragraph 4.5.1 that this approach is not ideal because it conflates and blurs the separation of these two duties which have

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<sup>492</sup> Chapter 4 para 4.3.3 above.

<sup>493</sup> Davis and Geach (eds), *Companies and Other Business Structures* [6.4.2]; chap 4 para 4.3.4 above.

<sup>494</sup> *ASIC v Rich* [2009] 75 ACSR 236 FLR 1 [7269].

<sup>495</sup> *Australian Securities and Investments Commission v Fortescue Metals Group Ltd* [2011] 190 FCR 364, 427 [197]–[198].

<sup>496</sup> Chapter 4 para 4.5.1 above.

<sup>497</sup> *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd* [2014] ZAWCHC 95.

<sup>498</sup> *Organisation Undoing Tax Abuse v Myeni* [2020] 3 All SA 649 [26].

<sup>499</sup> Section 76(4)(a); chap 4 para 4.3.1 above.

separate court actions and consequences.<sup>500</sup> Breach of fiduciary duty results in claims for restitution being mounted against the offending party with the claimant merely needing to establish proof of breach.<sup>501</sup> Whereas for violation of the duty of care, the appropriate claim is for delict which requires proof of both the breach and the prejudice inflicted.<sup>502</sup>

Court actions grounded on the BJR may conflate fiduciary duties with the duty of care. This may result in the requirement for the courts to adjudicate separate actions with one applying to the breach of trust related to section 76(3)(b) and another for delict pertaining to the breach of duty of care in section 76(3)(c) of the Companies Act.

#### 5.2.3.5 Lack of clarity regarding application of common law

In paragraph 4.3.2 it was argued that South Africa's statutory BJR does not specify whether it relates to the corresponding common law duties of acting in the best interests of the company and the duty of care.<sup>503</sup>

The Australian BJR provision in section 180(2) of the Corporations Act explicitly provides that it also applies to common law and equity.<sup>504</sup> By saying so, the Australian BJR clarifies that the parameters of the Australian company directors are not only statutory but also include common law duties as well as duties in equity. This clarity assists in asserting the legal certainty of the Australian BJR and informing the would-be claimants of the BJR defence about the extent of the duties they are expected to comply with in order to benefit from the BJR defence. Furthermore, such clarity would assist courts to determine whether defendants complied with parameters of the rule. This is significant because since the BJR is a statutory provision, judicial interpretation of the rule will not be as flexible as with common law provisions.

The lack of a comparable provision with the South Africa's BJR in section 76(4) of the Companies Act means that South African directors cannot positively determine

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<sup>500</sup> Section 77(2) of the Companies Act; chap 4 para 4.5.1 above.

<sup>501</sup> See s 77(2)(b) of Companies Act; chap 4 para 4.5.1 above.

<sup>502</sup> See s 77(2)(b) of Companies Act; chap 4 para 4.5.1 above.

<sup>503</sup> Chapter 4 para 4.3.2 above.

<sup>504</sup> Chapter 4 para 4.5.1 above.

the scope of their directorial obligations, which if met, can result in judicial exemption. Therefore, this leaves a legal vacuum where the extent of the South African BJR preconditions cannot be clearly determined.

### **5.3 Recommendations**

This part presents the recommendations based on a thorough analysis made in the above study as well as the comparison with Australia and the dissertation findings concerning the South African BJR. The recommendations focus on the final research question which seeks to address the policy and legal reforms that may be introduced to the South African BJR.

The main recommendations are presented under their own subheadings for easy reference.

#### **5.3.1 Subheading of business judgment rule**

It is proposed that the BJR in section 76(4)(a) be clearly placed under a sub-heading titled 'Business judgment rule' so that the BJR provision is prominently displayed in the text as with Australia's BJR provision in section 180(2) of the Corporations Act which is clearly reflected by its name.<sup>505</sup>

By implementing the aforementioned amendment, the framing of the South African statutory BJR will enhance its legal certainty by separating the rule from standards of director conduct.

#### **5.3.2 Statutory definition of business decision**

It is proposed that instead of advancing a broad and yet vague definition of a business decision as 'any particular matter arising in the exercise of the powers or the performance of the functions of a director', an insertion must be made in section 76(4)(a) to enhance statutory clarity. The insertion must reflect that the BJR pertains to a business decision the same way that Australia's Corporations Act<sup>506</sup> specifies the conditional requirement of a business decision for it to be viable. The recommended insertion must additionally specify the types of decisions or

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<sup>505</sup> Section 180(2) of the Corporations Act; chap 3 para 3.7 above.

<sup>506</sup> Section 180(3) of the Corporations Act; chap 4 para 4.2.1 above.

circumstances to which the BJR applies. The proposal to determine the decisions that can be judicially reviewed under the BJR is crucial because it establishes the rule's parameters. It was noted from this study<sup>507</sup> that the court in *ASIC V Rich*<sup>508</sup> ruled that oversight decisions of directors such as reviewing company policies or financial statements were not protected by the Australian BJR, emphasising the importance of carefully defining the scope.

An insertion which defines business decision must be made either in section 1 of the Companies Act or in section 76(4) beneath the text of the BJR. The proposed insertion is intended to be similar to section 180(3) of Australia's Corporations Act defines a business judgment.

The changes recommended in this paragraph will help to specify the BJR's scope and parameters, making it easier to define the doctrine which scholars have said is ambiguous.<sup>509</sup> The proposed statutory definition will provide the South African BJR with legal and doctrinal certainty which it currently appears to lack. Alternatively, in the interim, it is proposed that South African courts consider the respective narrow and precise definitions of the BJR and business decision in sections 180(2) and 180(3) of the Corporations Act to the extent that section 5(2) of the Companies Act provides for consideration of foreign law in the application or interpretation of the Companies Act.

### 5.3.3 Limiting the business judgment rule to only apply to the duty of care

It is recommended that the wording '...subsection 76(3)(b) and...' be severed from section 76(4)(a) of the Companies Act. This eliminates the South African BJR's requirement of fiduciary duty to act in the best interests of the company and thus limiting it to the duty of care provided in clause 76(3)(c). This will effectively resolve the shortcoming that the South African BJR has legal ambiguities because it conflates the duty to act in the company's best interests with the duty of care.<sup>510</sup>

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<sup>507</sup> Chapter 4 para 4.2.1 above.

<sup>508</sup> *ASIC v Rich* [2009] 75 ACSR 236 FLR 1 [7272].

<sup>509</sup> See Farouk HI Cassim and others, *Contemporary Company Law* (3rd edn, Juta 2021) 761; Davis and Geach (eds), *Companies and Other Business Structures* [6.4.2].

<sup>510</sup> E Jones, 'Directors' Duties: Negligence and the Business Judgment Rule' (2007) 19 SA Merc LJ 326, 327; chap 4 para 4.3.1 above.

#### 5.3.4 Amendment to reflect that common law applies to the business judgment rule

It is proposed that an amendment be made to South Africa's BJR provision in section 76(4) of the Companies Act to read:

- (4) A particular director, a member of a board committee or a prescribed officer of a company, shall be presumed to have made a business decision in respect of a decision taken, or a decision not taken in respect of the company's affairs if –
  - (a) He has satisfied the duty of care, skill and diligence under subsection (3)(c) or any corresponding common law duty, if –

It is also recommended that section 77(2) be cross-referenced to the BJR provision in section 76(4) to establish a link between the BJR and the common law principles that the liability framework in the Companies Act establishes in section 77. By making the above changes, the South Africa BJR provision will explicitly reflect that it also applies to the common law duty of care.

#### 5.3.5 The onus of proof should be vested on the plaintiff

It is recommended that an insertion be made in section 76(4)(a) of the Companies Act by introducing a new provision, section 76(4A) which reads as follows:

Where a director is alleged to have contravened his duty of care, skill and diligence under subsection (3)(c), the director shall be presumed to have fulfilled that duty. This presumption shall stand unless proven to the contrary by the person who alleges the breach.

The rationale of the insertion is to explicitly place the onus of proof on the plaintiffs. This is because placing the burden on the defendant director may disadvantage and expose them to spurious litigation from claimants who may exploit the fact that they can make allegations without bearing the burden of proof.<sup>511</sup>

Further, as previously mentioned, locating the onus of proof on the director may deter potential directors from serving as directors,<sup>512</sup> a situation which may

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<sup>511</sup> Chapter 4 para 4.3.4 above.

<sup>512</sup> Davis and Geach (eds), *Companies and Other Business Structures* [6.4.2]; chap 4 para 4.5.1.3 above.

undermine the BJR's rationale of promoting entrepreneurship and good corporate governance.<sup>513</sup>

#### **5.4 Conclusion**

Despite being limitedly applied in South African courts,<sup>514</sup> the BJR serves as a bulwark which shields directors from personal liability claims arising from the negative effects of their honest decisions. This study has demonstrated that the rule is relevant to South Africa because its intended role of defending directorial decisions complements the Companies Act in, for example, promoting entrepreneurship<sup>515</sup> and good corporate governance.<sup>516</sup> It contended that the BJR's limited application emanates from the legal uncertainty and underdeveloped jurisprudence surrounding the rule. This uncertainty stems from, among others, the framing and wording of the rule as a standard of director conduct, lack of clarity on the location of the onus of proof, the fusion of the fiduciary duty to act in the best interests of the company and the duty of care, as well as the broad and imprecise scope of the rule.

The study has made several recommendations to address these findings. These recommendations include placing the BJR under its own heading, providing a definition of a business decision as well as clarifying the circumstances under which BJR defence can be invoked. Furthermore, the study recommended a legislative amendment to the South African BJR clause in section 76(4) of the Companies Act so that it only applies to the duty of care as opposed to the current situation in which it also applies to the fiduciary duty to act in the best interests of the company. Finally, the study proposed that an amendment be made in section 76(4) to reflect that the South African BJR also applies to common law.

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<sup>513</sup> Chapter 4 para 4.5.2 above.

<sup>514</sup> Chapter 4 para 4.5.1 above.

<sup>515</sup> Chapter 3 para 3.3.4 above.

<sup>516</sup> Section 7(b) of the Companies Act; chap 2 para 2.3 above.

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