Short notes on:

**THE BUSINESS JUDGEMENT RULE**

**Introduction**

By accepting their appointment to the position, directors imply that they will perform their duties to a certain standard, and it is a reasonable assumption that every director will apply his or her particular skills, experience and intelligence to the advantage of the company.

Section 76 of the Companies Act No. 71 of 2008 (“the Act”) sets out the partial codification of directors’ duties as ‘Standards of directors’ conduct’ and section 77 sets out directors’ liability. Directors’ fiduciary duties have now been codified together with the duty of care and skill. The common law remains applicable insofar as it is consistent with the provisions of the Act. The result is the standard set for directors is very high, with the intention of the legislature to encourage directors to act honestly and to be accountable for their decisions and actions.

Directors need to measure their decisions and actions against the business judgement rule or test. This test can serve directors well in that they may free themselves of liability where they meet the requirements of this test.

**Legislation**

Section 76(4)(a) of the Act provides that a director satisfies his/her obligations as outlined above if:

- he/she takes the reasonable and diligent steps to become sufficiently informed about the specific matter in question or topic under consideration by the board;
- he/she has no material personal financial interest in the subject matter of the decision taken, or he/she discloses such interest to the board or shareholders in accordance section 75 of the Act; and/or
- he/she rationally believes that the decision taken was in the best interests of the company.

In terms of Section 76(4)(b) of the Act, a director is entitled to rely on the advice of certain people or committees in the following situations:

- he/she reasonably believes one or more of the employees to be trustworthy and competent in regards to the duties they have performed or in their advice provided;
• he/she relies on the professional advice, reports or statements provided by legal counsel or other professional persons retained by the company; and/or

• he/she relies on the skills and/or expertise exercised by the board or a committee on a particular matter, which matter the director truly believes is within the particular person’s professional and/or expert competency.

**Interpretation of the business judgement rule**

The business judgement rule thus reflects the idea that a director should not be held liable for decisions which yield undesirable results, where that director has taken reasonably diligent steps to become informed about the matter; either had no conflict of interest in relation to the matter, or complied with the rules on conflict of interests; and had a rational basis for believing, and did believe, that his decision was in the best interest of the company. Basically to put it in simpler terms - acted with due care, skill and diligence.

The rule is available to directors as a defence for escaping liability for a suspected breach of the already mentioned statutory law of ‘Standards of directors’ conduct’.

However, in the case of Fisheries Development Corporation of SA Ltd v Jorgensen: Fisheries Development Corporation of SA Ltd v AWJ investments (Pty) Ltd, the court held that:

“The extent of a director’s duty of skill and care depends on the nature of the business the company is engaged in and that the law does not require the director to have special business acumen, and furthermore that directors may assume that officials will perform their duties honestly”.

Our courts have on numerous occasions made it quite clear that directors are not liable for mere errors of judgement. In Levin v Feld and Tweeds Ltd it was held that it is not the duty of the court to consider what was best for the companies from the business point of view. Further in Mafikeng Mail (Pty) Ltd v Centner (No 2) it was held that recklessness was not an error of judgement, provided the defendant had an explanation which showed that he was confronted by a choice, and that thought and reflection went into the decision taken.

The principle of holding directors liable for decisions which have an adverse effect on a company is unchanged. However, certain situations may arise where a director would be unfairly prejudiced by the statutory law provisions and the business judgement rule is vital in protecting directors’ from liability provided the decision of a director was made in good faith and in the interests of the company.
On the other hand, a blatant disregard of relevant information or advice given to a director combined with mala fide conduct would still render the rule unenforceable.

Hence, the business judgement rule is available to directors as a defence for escaping liability for a suspected breach of the ‘Standards of directors’ conduct’. The rationale being the promotion of innovation by providing the right balance between the competing interests of commercial risk taking by directors and, on the other hand, their accountability.

**Conclusion**

With the standards set so high for directors, the consequence may be that directors would not be prepared to take difficult decisions or expose the company to risk. To a large degree risk taken responsibly forms an integral part of any business. This based on misunderstanding.

However, the Act includes provisions to ensure that directors are allowed to act without constant fear of personal exposure to liability / claims. This is the reasoning behind the business judgement rule.

Thus, the solution is not to be passive, before accepting a position as director, it is of utmost importance to have knowledge of the imposed directors’ duties and liability. Speak to a specialist corporate law attorney at SchoemanLaw Inc. to make a sound decision and understand when you can be held liable and when not.