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Introduction

Business is about taking risk for reward. In doing so, directors, whether executive or non-executive, are required to exercise their judgement as to the best decisions or courses of action available to a company. However, sometimes even the best laid plans fail, and, in such instances, the assessment of the appropriateness of the decisions taken by the directors is not based solely on the manner in which the decision turned out but are also based on the process that the directors followed in arriving at their decision.

This is the essence of the ‘business judgement rule’ which entered the South African legal lexicon with the arrival of the Companies Act, 2008 (‘the Act’). It has been heralded by many as the key form of protection for directors, and allows them to make informed judgements without the threat of liability hanging over their heads. The rule contained within South African law is considered to be broader than the equivalent rule in other countries, as it is not limited to judgements made by the directors but instead applies to all decisions that a director may take as it relates to the performance of his or her powers and functions. Whilst there has been much debate about how it will be applied by the courts, this paper seeks to provide a high level overview of the rule and some practical considerations.

It is critical to note that the business judgement rule can only be utilised if all of the requirements discussed below, as set out in the Act, have been complied with. Additionally, the Director, Prescribed Officer or Committee Member must have been acting in furtherance of a lawful and legitimate corporate purpose.

Elements of the definition

Section 76 of the Act discusses directors’ duties, and includes the following provisions:

S76 (3) states that directors must perform their duties

(a) in good faith and for a proper purpose; and
(b) in the best interests of the company; and
(c) with the degree of care, skill and diligence that may reasonably be expected of a person carrying out the same functions in relation to the company as those carried out by that director; and having the general knowledge, skill and experience of that director.

The duties described above are subject to subsections (4) and (5), which set out the circumstances which indicate whether a director is considered to have carried out these responsibilities appropriately.

S76 (4) states that a director is considered to have satisfied the obligations of acting in the best interests of the company; and with the degree of care, skill and diligence that may reasonably be expected of a person carrying out the same functions in relation to the company as those carried out by that director; and having the general knowledge, skill and experience of that director if the director has:

1. taken reasonably diligent steps to become informed about the matter;
2. 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
3. the director made a decision, or supported a 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 key elements outlined above are discussed in more detail in the paragraphs below. (Section 76(5) is dealt with under the heading “Reliance on Information Prepared by Others”)

Taking reasonably diligent steps to be informed

The director and the board have a responsibility to be reasonably informed about the affairs of the company and the environment within which it operates. The company secretary plays an important role in this regard in keeping directors informed about the latest developments, be these from an industry, regulatory or business trends perspective.

The responsibility to be informed is one that rests with the individual director. There is therefore a responsibility on the director to actively seek out information rather than being passively ignorant. However, the board and the company as a whole facilitate this process of obtaining information through regular briefings to directors.
The Act defines “knowing”, “knowingly” or “knows”, when used with respect to a person, and in relation to a particular matter, to mean that the person either:

(a) had actual knowledge of the matter; or
(b) was in a position in which the person reasonably ought to have—
   1. had actual knowledge;
   2. investigated the matter to an extent that would have provided the person with actual knowledge; or
   3. taken other measures which, if taken, would reasonably be expected to have provided the person with actual knowledge of the matter. This concept of considering not only the information before the directors but rather also the broader concept of what ought to have been considered was also discussed by Scrutton LJ in Shuttleworth v Cox Brothers & Co (Maidenhead) Ltd 1927 2 KB 9 (CA) at 23-24.

This does not, however, imply that the director is expected to be a subject matter expert on all matters, but rather that he or she should be sufficiently informed to interrogate as indicated in the Centro case, discussed in more detail below.

Subject to the conditions explained in the section titled ‘Reliance on information prepared by others’ below, in assessing the requirement to be reasonably informed, the director is entitled to rely on information provided by others.

An important part of the assessment of being informed is not simply accepting information presented at face value but probing and forming one’s own point of view before meetings so that the board meeting serves as an arena for robust discussion around an issue rather than the being the first time that the director has considered the impact of the issue on the business of the company.

The board should also ensure that sufficient time is devoted to those matters that are the most significant and that warrant the attention of the board, rather than consuming copious amounts of time on administrative items. Similarly, individual directors should ensure that they are given an opportunity to debate matters fully.

**Not having a material personal financial interest**

The term ‘material personal financial interest’ is defined in the Act and is narrower in scope than the broader term “conflict of interest”. However, directors would be well advised to deal with both material personal financial interests as discussed below and other conflicts of interest, be they actual or perceived, in an appropriate manner. This subject is discussed further in the The Corporate Governance Network paper, titled ‘Conflicts of Interest’, that is available on the IoDSA website.

Section 75 of the Act deals with directors’ personal financial interests. The term director here includes alternate directors, prescribed officers and members of committees of the board. It also applies to persons both individual and juristic, related to the director.

**What is a personal financial interest?**

The Act defines personal financial interest, when used with respect to any person, to mean:

(a) a direct material interest of that person, of a financial, monetary or economic nature, or to which a monetary value may be attributed; but

(b) Does not include any interest held by a person in a unit trust or collective investment scheme in terms of the Collective Schemes Act, 2002 (Act No. 45 of 2002), unless that person has direct control over the investment decisions of that fund or investment
However, since the concept of materiality is an important part of the definition of personal financial interest, it is important that the director is aware not only of what the Act defines as material but is also aware of the broader definition of materiality. The Corporate Governance Network has released a paper, titled 'Conflicts of Interest', that is available on the IoDSA website which further discusses this broader definition of materiality.

Exemptions from section 75

Section 75 discussed above does not apply to a director of a company in respect of a decision that may generally affect all of the directors of the company in their capacity as directors; or a class of persons, despite the fact that the director is one member of that class of persons, unless the only members of the class are the director or persons related or inter-related to the director.

Section 75 also does not apply to a company, or its director, if one person holds all of the beneficial interests of all of the issued securities of the company; and is the only director of that company.

Who are related persons as it relates to personal financial interest?

Furthermore, the requirements of s75 (5) also extend to persons, related to the director, who have a personal financial interest in the matter. This extends the circle of influence that the director must consider in making the assessment of whether he or she is conflicted.

Related persons means persons who are connected to one another in any manner contemplated in sections 2(1) (a) to (c) which states that:

(a) An individual is related to another individual if they:
   1. Are married, or live together in a relationship similar to marriage, or
   2. Are separated by no more than two degrees of natural consanguinity or affinity

(b) An individual is related to a juristic person if the individual directly or indirectly controls the juristic person as determined in subsection 2

Additionally, Section 75(5) (b) includes in the definition of a related person any company or close corporation of which the director (or a related person) is also a director or member respectively.

In practice the director may or may not be aware of the interests of related persons in matters that are before the board. The director should take every reasonable step to obtain this information. The assessment as to whether the director has taken reasonable steps in this regard must be performed on a case by case basis.

Actions required where a personal financial interest is present

Section 75(5) of the Act states that if a director of a company has a personal financial interest in respect of a matter to be considered at a meeting of the board, or knows that a related person has a personal financial interest in the matter, the director—

(a) must disclose the interest and its general nature before the matter is considered at the meeting;

(b) must disclose to the meeting any material information relating to the matter, and known to the director;

(c) may disclose any observations or pertinent insights relating to the matter if requested to do so by the other directors;

(d) if present at the meeting, must leave the meeting immediately after making any disclosure contemplated in paragraph (b) or (c);

(e) must not take part in the consideration of the matter, except to the extent contemplated in paragraphs (b) and (c).

It is important to note that the obligation of the director to disclose material information that he or she is aware of relating to the matter does not imply that the director should lobby the remainder of the board on a position that is of benefit to that director. The director in this situation should only provide the pertinent facts relevant to his or her fiduciary duty.

This section does not cover the wider discussion around conflicts of interest. For more information on conflicts of interest in the broader context, the Corporate Governance Network has released a paper, titled 'Conflicts of Interest', that is available on the IoDSA website.
Rational basis for believing the decision was in the best interest of the company

The Oxford dictionary defines rational as being based on or in accordance with reason or logic. In assessing whether a decision the director has made is considered to be logical, there must be a link between the action that the director took and the information and circumstances that were available at the time.

The Centro decision highlighted the fact that the director must have an enquiring mind and has a responsibility for ensuring that errors have been identified by asking appropriate questions of those that are experts in the field.

The board and committee pack and minutes of meetings play an important part in showing that the decision taken was in the best interest of the company and that there was a rational basis for the decision. It is therefore fundamental that the board pack contain all the relevant information that indicates the different options or choices that were available to the directors. Often references are made to email and round robin approvals including, other committee meetings. Where this or other additional information is requested, this should also form part of the formal documentation that is retained by the company in substantiation of the decision.

The Centro case highlighted that the board has the responsibility for controlling the flow of information to it and the manner in which the information is provided to it.

The Centro case also highlighted that ‘directors cannot substitute reliance upon the advice of management for their own attention and examination of an important matter that falls specifically within the Board’s responsibilities...’

576 allows directors to rely on information provided to them by the company, and by individuals within the company. Directors will generally rely on the information contained within the board pack. However, as discussed above, it is important for directors to understand what controls are in place to ensure that they receive information that is of the appropriate quality and relevance. It is also important for directors to consider what they ought to have known, as discussed in the section titled ‘Taking reasonably diligent steps to be informed discussed above.

In considering what information to rely on, directors should consider both the quality and relevance of the information. The quality of the information refers to the robustness of the process that the information goes through before it reaches the board and speaks to its credibility. The relevance of the information refers to what information was considered necessary to present to the board and what the process was of determining what information was relevant to the board’s decision and what was not.

Where directors discover inconsistencies in the information presented to them, the directors have a responsibility to probe these inconsistencies and obtain appropriate answers and explanations. These inconsistencies may also be indicative of a lack of an appropriate process to ensure that directors receive the relevant information which is of a high quality.

Section 76(5) of the Act allows directors to rely on

(a) one or more employees of the company whom the director reasonably believes to be reliable and competent in the functions performed or the information, opinions, reports or statements provided;

(b) legal counsel, accountants, or other professional persons retained by the company, the board or a committee as to matters involving skills or expertise that the director reasonably believes are matters—
1. within the particular person’s professional or expert competence; or
2. as to which the particular person merits confidence; or
(c) a committee of the board of which the director is not a member, unless the director has reason to believe that the actions of the committee do not merit confidence.

In considering the reliance on these persons, the Act indicates that this includes persons or committees to whom the board may reasonably have delegated formally or informally by course of conduct, the authority or duty to perform one or more of the board’s functions that are delegable under applicable law. Directors are entitled to rely on these persons or committees for any information, opinions, recommendations, reports or statements, including financial statements and other financial data, prepared or presented by any of the persons specified above.

To the extent that directors still have doubt about the information provided by management, they may request independent advice to get a second opinion.

Conclusion

The role of the director is a critical one for both the company and the economy to succeed. Business involves taking risk for reward. In making their decisions, directors must weigh-up this risk and reward. In this context the business judgement rule serves as an important defence to directors from liability for actions taken bona fide and in the best interests of the company.

However, it is imperative that directors, in order to avail themselves of this protection, ensure that they fall within the scope of the rule by being reasonably informed, not having a material personal financial interest in the matters subject to discussions and by having a rational basis for their decisions.