Finding Juridical Dispositions Germane to the Interpretative Context to be Attributed to 'Reasonably' under Section 4 of the Companies Act 71 of 2008

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Abstract

This article takes the view that the inclusion of the term 'reasonably' under s 4 of the Companies Act 71 of 2008 has profound foundational importance. It satisfies an important constitutional mandate embodied in s 1(*c*) of the Constitution, 1996: that the principle of legality be observed in all decision-making. Because of this requirement, the actions of a company director are required to be scrutinised in the light of the Constitution. This may mean that the courts must determine decisions made by directors having regard for the country's overall constitutional and economic objectives. Therefore, the inclusion of the term seems to be a validation, because the Constitutional Court has held in many cases that the principle of legality is fundamental to the South African constitutional legal order, as required by section 1(*c*) of the Constitution, 1996. Practically, as vanguards of the constitutional principles, the courts would be expected to infuse the principle of legality into their interpretative duties in order to instil in the company-law sphere an environment that will foster compliance with the Bill of Rights and ensure predictability and certainty. This article pertains specially to circumstances where a board of directors has erred in law by misdirecting itself or by falling short when considering and/or interpreting 'reasonable circumstances'. This is particularly necessary since the legal meaning the Act contemplates by including the term 'reasonably' in s 4 requires urgent examination before directors proceed to distribute company money or property.

Keywords: reasonableness; distribution; solvency; liquidity test

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Introduction

The 2004 paper that provided policy guidelines for corporate law reform in South Africa emphasised that one of the purposes of the Companies Act 71 of 2008 (2008 Act)[1] is to encourage accountability; its mission being to instil corporate efficiency in the manner in which the affairs of companies are carried out by those entrusted with their management.[2] The paper emphasised the strengthening of corporate governance standards, which must be premised on the principles of certainty and consistency[3] and informed by the Constitution of the Republic of South Africa, 1996.[4] Therefore, ultimately, these principles would be expected to inform the interpretation of the current regulatory framework, and in fact must do so.

The manner in which the wording of section 4(1) of the 2008 Act has been crafted appears to show that the intention was to incorporate the objective pronounced in the 2004 paper. The relevant introductory part of section 4(1) that informs the subject of the discussion here provides that

> for any purpose of the Act, a company satisfies the solvency and liquidity test at a particular time if, considering all reasonably foreseeable financial circumstances of the company at that time …

In this excerpt, the Act incorporates two concepts: 'reasonable' and 'foreseeable'. This article concentrates exclusively on 'reasonable', that is, the reasonableness of a particular decision. On a proper construction, the wording of this part of section 4(1) has the effect that whenever a board of directors of a company contemplates exercising its powers and/or performing its duties for any purpose permitted by the Act, the board must first establish the company's solvency and liquidity[5] status before a decision is

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1 The Act was assented to by the President on 9 April 2009. It came into operation on 1 May 2011, GG 32121, GN 421.

2 South African Company Law for the 21st Century: Guidelines for Corporate Law Reform, GN 1183 GG 26493, ('Guidelines for Corporate Law Reform 2004'). The goal is to balance the competing interests of the various economic actors. From an international community perspective, in addition to promoting good corporate governance and instilling predictability and confidence in the South African corporate sphere, it is to ensure that there is compatibility and harmonisation with best practice in other jurisdictions: Guidelines for Corporate Law Reform 2004 at 8–9. From a delictual perspective, a person is perceived to be accountable if that person has the necessary mental ability to distinguish between right and wrong and can also act in accordance with such appreciation: see Johann Neethling, Johannes M Potgieter and Petrus J Visser, *Law of Delict* (LexisNexis 2006) 110; *Weber v Santam Versekeringsmaatskappy Bpk* 1983 (1) SA 381 (A) 389, 403 and 410.

3 Guidelines for Corporate Law Reform 2004 (n 2) 6 and 11.

4 See the Bill of Rights ss 7–39 of the Constitution of the Republic of South Africa, 1996.

5 This test is contained in s 4(1)(*a*) and (*b*) of the 2008 Act. On balance, this obligation is economically significant as failure to observe it could have far-reaching consequences for the country: the liquidation and/or sequestration of companies due to ill-informed decisions made by company directors; the

made.[6] Pertinently, the implicit feature incorporated in the section is that the inclusion of the concept satisfies that all-important constitutional mandate embodied in section 1(*c*) of the Constitution, 1996: that the principle of legality be observed in all decision-making. This requirement should make company directors acutely aware of the importance of keeping their decisions within constitutional bounds.[7] The 2008 Act recognises the application of and/or the need for company-made decisions to comply with the Bill of Rights.[8] Many Constitutional Court decisions agree that the principle of legality is foundational to the South African constitutional order.[9] Accordingly, in *State Information*

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irreparable harm that would be caused would be economically and socially destructive as it would mean loss of jobs for the staff complements of companies. Therefore, the legal obligation brought about by the concept 'reasonably foreseeable' is that company boards would be unable to predict the satisfaction of the solvency and liquidity test if they fail or fall short in their responsibilities to consider the financial circumstances of companies adequately before and/or at the time of decision-making. That directors must exercise their powers and perform their duties diligently to ascertain a company's financial position for any purpose of the Act is therefore imperative. The obligation under the section serves to show that the Act seeks to traverse an important policy directive: to save the economy from collapsing due to ill-considered decisions made by company directors and those decisions made for their own selfish benefit without considering other stakeholders' interests.

6 The words 'reasonably foreseeable' are contained in s 4(1) and (2)(*b*)(i) of the 2008 Act.

7 Therefore, directors cannot consider themselves to be functioning outside the country's overall constitutional and economic objectives. For example, if a director operates outside the bounds of their duties or exercises power prejudicially to that company or another shareholder, and it is found by a court that indeed the conduct was oppressive, surely that director cannot be said to have conducted themselves constitutionally because the rights of that other shareholder would have been infringed unreasonably. The same can be said in instances where a director acts to the detriment of a company. If, as occurred in the case of *Lobelo v Kukama* [2013] ZAGPJHC 137 ('*Lobelo*'), that company's director distributes company property other than in the best interests of that company, then that director can be said to be acting against the objectives of the 2008 Act. They are therefore acting contrary to the interests of the country in general. In the present case, the Full Bench of the South Gauteng High Court, *per* Blieden J, Claassen J and Jordaan AJ, found that the appellant had abused his rights by conducting himself to the detriment of the company in question: *Lobelo* at paras 25, 31, 33, 35, 38, 41 and 44. Also see *Cohen NO v Segal* 1970 3 SA 702 (W) 706W; and *Msimang NO v Katuliiba* [2013] 1 All SA 580 (GSJ) para 29, where the court said that s 162 of the 2008 Act was directed at protecting companies and corporate stakeholders against company directors who had proven unable to manage the business of companies, or who had failed in or neglected their duties and obligations as directors of companies.

8 See s 7(*a*) of the 2008 Act.

9 *State Information Technology Agency SOC Ltd v Gijima Holdings (Pty) Ltd* [2017] ZACC 40 ('*Gijima*'); *Khumalo v MEC for Education, KwaZulu-Natal* 2014 (5) SA 579 (CC); *MEC for Health, Eastern Cape v Kirland Investments (Pty) Ltd t/a Eye & Lazer Institute* 2014 (3) SA 481 (CC) ('*Kirland Investments (Pty) Ltd*') *per* Cameron J; *Pepcor Retirement Fund v Financial Services Board* 2003 (6) SA 38 (SCA) ('*Pepcor Retirement Fund*'), to mention but a few. The principle of legality is often cited in dual form: as the doctrine of substantive justice (the crime control model) and the doctrine of strict legality (the due process model). The former refers to instances that prohibit and punish any conduct that is socially harmful, whether or not the conduct is criminalised by a legal system at the time it takes place. The latter refers to instances where a person may be held criminally liable and punished only if at the time the conduct of transgression was engaged in it was recognised as a crime under the legal system.

Technology Agency SOC Ltd v Gijima Holdings (Pty) Ltd[10] Madlanga J and Pretorius AJ held the principle to be:

> Central to the conception of our constitutional order that the Legislature and Executive in every sphere are constrained by the principle that they may exercise no power and perform no function beyond that conferred upon them by the law.[11]

The intention of this article is to examine the legal meaning that should be attached to the term 'reasonably' as used in section 4 of the 2008 Act.[12] The discussion begins with a brief sketch of the way in which the concept has been applied in South African law. After that, the meaning of the concept in the context of section 4(1) of the 2008 Act is discussed. Some observations and the conclusion follow.

The Concept of 'Reasonableness'

The incorporation of the concept of 'reasonableness' into South African company jurisprudence is by no means novel. It has also been applied extensively in South African law generally.[13] In delict, for example, it has often been applied alongside foreseeability in cases of negligence (*culpa*).[14] The doctrine of subjective rights in South Africa was approved in *Universiteit van Pretoria v Tommie Meyer Films (Edms)*

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10 *Gijima* (n 9).

11 *Gijima* (n 9) para 38; *Fedsure Life Assurance Ltd v Greater Johannesburg Transitional Metropolitan Council* 1999 (1) SA 374 (CC) para 58 ('*Fedsure*').

12 This exercise finds more reason especially where, if a board were to misdirect itself to the extent that it falls short of its responsibilities to undertake and/or make a decision based on the reasonable financial circumstances of the company as it ought to have, it would have erred in law for failing to comply with this requirement prudently. See the comment of the court based on ss 2(*j*) and 18(5) of the Marine Living Resources Act 18 of 1998 in *Bato Star Fishing (Pty) Ltd v Minister of Environmental Affairs* 2004 (4) SA 490 (CC) para 42 ('*Bato Star Fishing (Pty) Ltd*'). Therefore, a critical examination and analysis of the concept will feature prominently in the discussion.

13 An example of these would be the spheres of administrative law and the law of delict in order to determine wrongfulness and/or negligence. See, for example, the cases of *Kruger v Coetzee* 1966 (2) SA 428 (A) 430E–F ('*Kruger*'); *Hendrik Johannes Pitzer v Eskom* [2012] ZASCA 44 ('*Hendrik Johannes Pitzer*'). The concept 'reasonably foreseeable' was not included in the previous company legislation but was introduced through the Companies Amendment Act 37 of 1999, when the solvency and liquidity test was first introduced.

14 The test there being whether the actor as a reasonable man (*diligens paterfamilias*) in the position of the defendant would foresee the reasonable possibility of his conduct injuring another in his/her person or property and causing him patrimonial loss; and would take reasonable steps to guard against such occurrence, and the defendant failed to take such steps. *Hendrik Johannes Pitzer* (n 13) para 18. The test can also be phrased as the defendant recognised the act as involving an unreasonable risk of causing an invasion of an interest of another, thereby taking reasonable steps to guard against such occurrence; but the defendant failed to take such steps. See Andries van der Merwe, 'Infringement of the Right to Goodwill; The Basic Legal Principles in Relation to South African Case Law' (2013) De Jure 1039–1055. The test involved determining the objective reasonableness of the conduct of the person who acted in the light of the prejudice he caused to another person: see Neethling (n 2) 50.

Bpk.[15] The enquiry in this case was premised on whether the defendant had a legal duty to prevent a loss.[16] The established principle is that, where a norm is based on a statute, the breach of a statutory duty based on damage by means of conduct is prima facie wrongful.[17] Failure to comply with the statutory duty would suggest that a violation of the plaintiff's interests has taken place wrongfully.[18] Obviously, considerations of public policy and boni mores would ultimately play a significant role in determining liability.[19] Therefore, to found liability there must be a causal connection between the conduct and the end-result.[20] In *Country Cloud Trading CC,* the Constitutional

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15 *Universiteit van Pretoria v Tommie Meyer Films (Edms) Bpk* 1977 (4) SA 376 (T) 387. See also Van der Merwe (n 14) 1039.

16 The reason is that the impairment of the legal object is not prima facie wrongful, the boni mores criterion does not place a general duty on another person to prevent loss to others by positive conduct, nor does it impose a general duty to prevent pure economic loss otherwise that would place too much burden on individuals within a community: Neethling (n 2) 50. With delict the action was based on the lex Aquilia, and all its elements (eg conduct, fault) had to be proven to found liability. See *Du Plessis v Phelps* 1995 (4) SA 165 (C) 170C; *Ex parte Lebowa Development Corporation Ltd* 1989 (3) SA 71 (T) 106; *Benson v De Beers Consolidated Mines Ltd* 1988 (1) 834 (NC) 836. See also FDJ Brand, 'Aspects of Wrongfulness: A Series of Lectures' (2014) Stellenbosch LR 451 at 455, commenting on the use of such words as 'legal duty'.

17 Wrongfulness had to be positively established because South African law has generally been reluctant to recognise claims for pure economic loss. Because wrongfulness (or duty of care, as it is referred to in English legal parlance (or wrongfulness in the South African context)) was determined based on the infringement of one's subjective rights or breach of a legal duty, until a court was satisfied that a plaintiff's rights had been wronged, its claim would not 'get off the ground': *Itzikowitz v Absa Bank Ltd* [2016] ZASCA 43 para 8 ('*Itzikowitz*'); *Country Cloud Trading CC v MEC, Department of Infrastructure Development, Gauteng* 2015 (1) SA 1 (CC) paras 23 and 43 ('*Country Cloud Trading CC*') and *Minister for Safety and Security v Scott & Another* 2014 (6) SA 1 (SCA); and Neethling (n 2) 69.

18 Neethling (n 2) 69; *MTO Forestry v Swart* [2017] ZASCA 57 paras 15–16 ('*MTO Forestry*').

19 *Phumelela Gaming and Leisure Ltd v Gründlingh* [2006] ZACC 6 paras 23–30. Public policy considerations were viewed from the perspectives of two concepts: 'wrongfulness and remoteness'. The application of these concepts was such that conduct resulting in loss for policy considerations may be wrongful, but for other policy reasons the loss may be too remote to found liability and therefore not be recoverable. These concepts are interconnected as both are used as measures of control, such that overlapping between them has always been inevitable: *International Shipping Co (Pty) Ltd v Bentley*; *Fourway Haulage SA (Pty) Ltd v SA National Roads Agency Ltd* 2009 (2) SA 150 (SCA) paras 31–32.

20 However, the violation of a norm by itself would not constitute wrongfulness. It would be the infringement of the interests of the plaintiff in a legally reprehensible manner that would constitute wrongfulness. For the various requirements to be proven, see Neethling (n 2) 69–70. Obviously, they could defend themselves based on the various grounds of justification open to a party to eliminate wrongfulness, resulting in the conduct not being unreasonable or contra bonos mores: Neethling (n 2) 70; and *Judd v Nelson Mandela Bay Municipality* [2011] ZAECPEHC 4 paras 6–13; *Minister of Law and Order v Kadir* 1995 (1) SA 303 (A) 317C–318A; and *Van Eeden v Minister of Safety and Security* 2003 (1) SA 389 (SCA).

Court endorsed recent developments regarding wrongfulness. It held that a wrongfulness enquiry focuses on:

> the [harm-causing] conduct and goes to whether the policy and legal convictions of the community, constitutionally understood, regard it as acceptable. It is based on the duty not to cause harm – indeed to respect rights – and questions the reasonableness of imposing liability.[21]

Therefore, if conduct is wrongful, public or legal policy considerations, constitutionally viewed, require that the conduct, if paired with fault, be actionable.[22] If the conduct is not wrongful, then public policy considerations demand that there be no liability, notwithstanding the fact that the defendant would have acted with fault.[23] Conduct was, and still is, prima facie wrongful in cases of harm caused to the person or property of another. However, this was and is still not so in cases of patrimonial loss sustained by a plaintiff with no physical harm to the person or their property.[24] The Constitution, 1996 entrenches the constitutional right to property. Therefore, wrongfulness under the current constitutional regime must be interpreted as a check on liability because it functions as a mechanism with which to curb liability indeterminably,[25] and in this way it keeps the rights of parties in balance.[26]

When we explain the meaning ascribed to the concept of 'reasonableness' in the context of the way in which directors are expected to conduct themselves in relation to company affairs, the starting point is that the concept has been discussed alongside 'rationality'. This is necessary in order to distinguish properly conduct that was rational from that which was reasonable. That is the approach adopted in this article because it seems to be the one contemplated by the 2008 Act in interpreting its provisions.

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21 *Country Cloud Trading CC* (n 17) para 21; and *Loureiro v Imvula Quality Protection (Pty) Ltd* 2014 (3) SA 394 (CC) para 53.

22 *MTO Forestry* (n 18) para 16; and *Minister of Safety and Security v Van Duivenboden* 2002 (6) SA 431 (SCA) para 12. See also Johann Neethling and Johannes M Potgieter, 'Foreseeability: Wrongfulness and Negligence of Omissions in Delict – The Debate Goes On – *MTO Forestry (Pty) Ltd v Swart NO* 2017 (5) SA 76 (SCA)' (2018) Journal of Juridical Science 145–161; and David Lagnado and Shelley Channon, 'Judgments of Cause and Blame: The Effects of Intentionality and Foreseeability' (2008) Cognition 754–770.

23 *Country Cloud Trading CC* (n 17) para 21.

24 *Country Cloud Trading CC* (n 17) para 22.

25 *Country Cloud Trading CC* (n 17) para 25; *Ultramares Corporation v Touche* 174 NE 441 (1931) 444.

26 The court in *MTO Forestry v Swart* (n 18) confirmed the limiting mechanism on which wrongfulness is premised to ensure that liability would not be imposed even in cases where it would be undesirable or unreasonable to do so. Establishing wrongfulness must be differentiated from establishing negligence: *MTO Forestry* (n 18) para 16; *Van Vuuren v eThekwini Municipality* [2017] ZASCA 124 para 18; *Hawekwa Youth Camp & Another v Byrne* 2010 (6) SA 83 (SCA) para 22; and *Le Roux & Others v Dey (Freedom of Expression Institute and Restorative Justice Centre as amici curiae)* 2011 (3) SA 274 (CC) para 122.

The Principle of Rationality

Sections 4 and 46 provide for the way in which distribution must be carried out. But they do not require a director's decision to be rational—at least not expressly so. Under the Act, the operation of the rationality principle is invoked by reference to section 76(4)(*a*)(iii).[27] This section requires a director, when taking or supporting a board or a committee decision about any matter regarding the exercise of their powers or the performance of their functions, to do so based on reasoning that is rational. Moreover, when exercising rationality in decision-making or performing their functions, the director must believe that their decision was in the best interests of the company.[28]

As a point of comparison, under the Canada Business Corporations Act 1985 (CBCA), the United Kingdom (UK) Companies Act 2006 and the United States company law,[29] a director is also not expressly required to act 'rationally', as is the case under the 2008 Act and the Corporations Act 2001.[30] However, similarly to South Africa, in Australia, section 180(2)(*d*) of the Corporations Act 2001 contemplates that rationality will be at the centre of a board's business decision. Consequently, in both South African company law and Australian corporate law the principle of rationality influences the expectation of the way in which a director should perform their duties in relation to the affairs of that company. Both legislative frameworks firmly expect a board's conduct to be considered rational if the board, in carrying out its duties, conducts itself with the degree of care, skill and diligence that may reasonably be expected of a board or a director carrying out the same functions in relation to the company as those carried out by the board or the director.[31] In addition, under the 2008 Act, quite apart from the Corporations Act 2001 but similarly to the UK Companies Act 2006, a director is expressly expected to carry

27 Section 76(4)(*a*)(iii) contains one of the requirements which must be complied with for directors to have satisfied the business judgement rule under s 76(4) of the 2008 Act.

28 See also s 76(3)(*b*) of the 2008 Act.

29 For a discussion of the doctrine in the context of Delaware corporate law, see Eric J Pan, 'Rethinking the Board's Duty to Monitor: A Critical Assessment of the Delaware Doctrine' (2011) Florida State University LR 209–250; Justin Dharamdial (ed), 'Directors' Responsibilities in Canada' (2014) Institute of Corporate Directors 1–106 at 11. See also *Aronson v Lewis* 473 A2d 805 [Del 1984].

30 Under s 180(2)(*d*). The jurisdictions were referred to on the basis that they more or less have a similar regulatory framework as the 2008 Act, and that they have also enacted the solvency and liquidity test in their provisions, except for the United Kingdom. The intention is to ascertain to what extent the provisions are similar and to what extent they are interpreted similarly, if at all.

31 See s 76(3) of the 2008 Act and s 180(1) of the Corporations Act 2001 respectively. In the Corporations Act the wording of s 180(1) is not similar to that under the 2008 Act.

out their duties based on the general knowledge, skill and experience of any director performing the same functions.[32]

The Principle of Rationality and its Philosophical Approach

In the case of *Democratic Alliance v President of South Africa,*[33] the Constitutional Court stated that the principles of 'rationality' and 'reasonableness' are conceptually distinct even though they may overlap on their evaluation;[34] this leads to considerable disagreement about what they mean in relation to conduct.[35] The principle of rationality has on most occasions been determined based on matters related to administrative law: it has been used as a measure to constrain the conduct of administrators based on the principle of legality. Therefore, in recognition of the rule of law, the principle of legality is termed a fundamental constitutional principle recognised worldwide; it legitimises the exercise of public power only if the power is lawful;[36] it is meant to control the exercise of power.[37] Therefore, the Constitutional Court has held that the exercise of power must not be at variance with the principle of legality, otherwise such conduct would be unconstitutional.[38]

In the administrative-law context, the operation of the principle of rationality was evident in the case of *Democratic Alliance v President of South Africa*.[39] In applying the principle in circumstances where a government official was entrusted with exercising some power, Yacoob ADCJ stated that rationality postulates that the government may exercise no power and perform no function beyond that conferred

32 See s 76(3)(*c*)(i) and (ii) of the 2008 Act and s 174(2)(*a*) and (*b*) of the UK Companies Act 2006, which is to the same effect. The jurisdictions were referred to on the basis that they more or less have a similar regulatory framework as the 2008 Act and that they have also enacted the solvency and liquidity test in their provisions, except for the United Kingdom. The intention is to ascertain to what extent the provisions are similar and to what extent they are interpreted similarly, if at all. These sections will not be examined here in detail; reference will be made to them as and when the need arises. However, see the thorough discussion in Simphiwe S Bidie, 'Director's Duty to Act for a Proper Purpose in the Context of Distribution Under the Companies Act 71 of 2008' (2019) Potchefstroom Electronic LJ 39.

33 *Democratic Alliance v President of South Africa* 2013 (1) SA 248 (CC) paras 29–30.

34 The distinction between the two concepts is a comparison made in political philosophy. Political philosophy is defined as philosophical reflection on how best to arrange people's collective lives. Reference here is made to political institutions and people's social practices—for example, the economic system and the patterns of family life. David Miller, 'Political Philosophy' (1998) *Routledge Encyclopedia of Philosophy* (Taylor and Francis).

35 WM Sibley, 'The Rational Versus the Reasonable' (1953) The Philosophical Review 554–560.

36 *Gijima* (n 9) para 38.

37 *Gijima* (n 9) para 39; *Affordable Medicines Trust v Minister of Health* 2006 (3) SA 247 (CC) para 49.

38 *Gijima* (n 9) para 40. See also s 2 of the Constitution, 1996.

39 *Democratic Alliance v President of South Africa* (n 33) para 27.

by law.[40] The power must not be misconstrued. As a result, any decision taken as a consequence of the conferred power must be rationally related to the purpose for which the power was conferred.[41]

In the case of *Democratic Alliance v SABC Limited,*[42] the Western Cape High Court emphasised the fundamental nature of the principle of rationality. It stated that, in order for a decision to be considered rational, providing cogent reasons that justify the decision in question will be one of the criteria used against those who exercise the power conferred.[43] Linking the principle of legality to that of rationality, the court further held that:

> Rationality is a minimum threshold requirement applicable to the exercise of all public power by members of the executive and other functionaries. It is a requirement of the principle of legality that decisions must be rationally related to the purpose for which the power was given, otherwise they are in effect arbitrary.[44]

Rationality involves both substantive and procedural issues. This suggests that both the process by which a decision is made (the means) and the decision itself must be rationally related.[45] A court's review of rationality is concerned with evaluating the relationship between means and ends. Courts have to evaluate the relationship, connection or link between the means employed to achieve a particular purpose, on the one hand, and the purpose or the end itself, on the other.[46] Therefore rationality is fact-driven.[47]

It has, however, been accepted that when ascertaining what meaning to ascribe to the concept of rationality, those who have the power to do so have a wide discretion in selecting the means to achieve the permissible objectives.[48] In this respect, the courts are not expected to interfere with the means selected simply because they do

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40 The court explained the principle of rationality in the context of administrative law where an 'executive arm of government' exercised its powers. See also *Fedsure Life Assurance Ltd & Others v Greater Johannesburg Transitional Metropolitan Council* 1999 (1) SA 374 (CC) para 58.

41 *Democratic Alliance v President of South Africa* (n 33) para 27; *Resilient Properties (Pty) Ltd v Eskom Holdings (SOC) Ltd* 2019 (2) SA 577 (GJ) para 75, *per* Van der Linde J ('*Resilient Properties (Pty) Ltd*'); *Albutt v Centre for the Study of Violence and Reconciliation* 2010 (3) SA 293 (CC) para 49.

42 *Democratic Alliance v SABC Limited* 2015 (1) SA 551 (WCC) *per* Schippers J.

43 *Democratic Alliance v SABC Limited* (n 42) para 83. Cora Hoexter and Rosemary Lyster, *The New Constitutional & Administrative Law Vol 2* (Juta 2002) 181.

44 *Democratic Alliance v SABC Limited* (n 42) para 71; *Pharmaceutical Manufacturers Association of SA: In re Ex parte President of the Republic of South Africa* 2000 (2) SA 674 (CC) paras 85 and 90.

45 *Democratic Alliance v Acting National Director of Public Prosecutions* 2016 (2) SACR 1 (GP) para 47.

46 *Democratic Alliance v Acting National Director of Public Prosecutions* (n 45) para 46.

47 *Resilient Properties (Pty) Ltd* (n 41) para 76.

48 *Democratic Alliance v President of South Africa* (n 33) para 30, cited with approval in *Albutt* (n 41) para 51.

not like them; nor because there are other, more appropriate means that could have been employed.[49] Primarily, the court's duty lies in examining the means selected in order to determine whether they are rationally connected to the objectives sought to be achieved.[50] Making reference to this approach in *Democratic Alliance v Acting National Director of Public Prosecutions,*[51] the North Gauteng High Court stated that, in reviewing whether a decision was rational,

> courts are obliged to examine the means selected to determine whether they are rationally related to the objective sought to be achieved. What must be stressed is that the purpose of the enquiry is to determine not whether there are other means that could have been used, but whether the means selected are rationally related to the objective sought to be achieved. And if, objectively speaking, they are not, they fall short of the standard demanded by the Constitution.[52]

This approach has been recognised in the company-law context. Ruling in the context of section 163 of the 2008 Act, Rogers J, in *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd*,[53] held that:

> where matters are left by the constitution to the judgment of the general meeting or the directors, and the shareholders or directors as the case may be have exercised the power within the parameters of any express or implied limitations, a court should be wary of substituting its own business judgment for that of the persons entrusted with that decision by the corporate constitution.

Therefore, an examination of whether or not a decision or an exercise of power was rational is basically a threshold enquiry, roughly to ensure that the means chosen to arrive at a particular decision are rationally connected to the ends.[54] The court in *In re Dollar Thrifty* stated that the principle of rationality refers to the ability of a person to use their powers of judgement and deliberation in seeking ends and interests peculiar to their own.[55] Therefore, rationality is broad in its outlook, and would also look at

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49 *Democratic Alliance v President of South Africa* (n 33) para 30.

50 *Democratic Alliance v President of South Africa* (n 33) para 30.

51 *Democratic Alliance v Acting National Director of Public Prosecutions* (n 45).

52 *Democratic Alliance v Acting National Director of Public Prosecutions* (n 45) para 46; *Pharmaceutical Manufacturers Association of SA* (n 44) para 90.

53 *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd* 2014 (5) SA 179 (WCC) para 64 ('*Visser Sitrus (Pty) Ltd*'); *Re Smith & Fawcett Ltd* [1942] Ch 304, *per* Lord Greene MR.

54 *Ronald Bobroff & Partners Inc v De La Guerre; South African Association of Personal Injury Lawyers v Minister of Justice and Constitutional Development* [2014] ZACC 2 para 7 ('*Ronald Bobroff & Partners Inc*').

55 *In re Dollar Thrifty Shareholder Litigation Cons CA* No 5458-VCS (Del Ch Sept 8, 2010) 46–47 fn 181 ('*In re Dollar Thrifty*'); and J Rawls, *Political Liberalism* (Columbia University Press 1993) 50. Rational conduct simply has to reflect a logical approach to advancing one's own narrow self-interests, furthering the good or advantage of oneself, or of each person cooperating.

whether the decision taken was rational in the sense of being logical in advancing that company's objectives.[56] The test is objective, and if the means selected are not rationally connected, they then fail that standard.[57] The above narration mainly postulates that, for rationality to pass legal muster, there must be a causal connection between the means adopted and the legitimate end sought to be achieved.[58] Many options may be available to achieve this. It is not for the court to decide which one the board should have selected: as long as the one selected is rationally connected, the option will pass muster.[59]

But not only must the process by which the decision is taken be rational: both the process and the decision itself must be.[60] However, where one step in the process is irrational, that step will lead to the irrationality of the whole decision-making process only if that step colours the whole process such that the ultimate decision is seen to be irrational.[61] Compared to reasonableness, rationality is less stringent in its application,[62] suggesting that it is accommodative. In *Australian Securities and Investment Commission v Rich,*[63] the court was of the view that rationality calls for directors to show that there was some reasoning behind every decision taken by them, as instructed by section 180(2)(*d*) of the Corporations Act 2001.[64]

See Shaun Young, 'The (Un)Reasonableness of Rawlsian Rationality' (2004) 3 <https://www.cpsa-acsp.ca/papers-2005/Young,%20Shaun.pdf> accessed 10 December 2018; Steve Lydenberg, 'Reason, Rationality and Fiduciary Duty' (2012) 1–43 at 2 and 4 <http://www.irrcinstitute.org/pdf/FINAL-Lydenberg-Reason- Rationality-2012-Winner.pdf> accessed 10 December 2018.

56 It is a common-law concept and its ambit has been considered in cases such as *Theron en Andere v Ring Van Wellington van die NG Sending Kerk in Suid-Afrika en Andere* 1976 (2) SA 1 (A) 10B–F, 14C–H and 20D–21C. In *Theron* it was also confirmed that the reasonableness test based on rationality was a competent basis under common law for reviewing decisions of voluntary associations. See also *Khyber Rock Estate East Home Owners Associations v 09 of Erf 823 Woodmead Ext 13* CTC, [2007] ZAGPHC 137 paras 33 and 35 ('*Khyber Rock Estate*').

57 *Democratic Alliance v President of South Africa* (n 33) para 30.

58 See *Merafong Demarcation Forum & Others v President of the Republic of South Africa* 2008 (5) SA 171 (CC) para 114. For example, if a board contemplates selling the company to another, the means employed to assess the viability of the sale must be rationally connected to that purpose.

59 *Democratic Alliance v President of South Africa* (n 33) paras 31, 32 and 36; *Ronald Bobroff & Partners Inc* (n 54) para 6. Courts have also recognised their non-interference in cases related to homeowner's associations. See *Khyber Rock Estate* (n 56) paras 30–32; *Turner v Jockey Club of South Africa* 1974 (3) SA 633 (A) 645B–647A; *SA Medical & Dental Council v McLoughlin* 1948 (2) SA 355 (AD) 393, 406 and 410 and *Marlin v Durban Turf Club & Others* 1942 AD 112 at 125–126.

60 *Democratic Alliance v President of South Africa* (n 33) para 34.

61 *Democratic Alliance v President of South Africa* (n 33) para 37.

62 *Ronald Bobroff & Partners Inc* (n 54) para 7.

63 *Australian Securities and Investment Commission v Rich* (2009) 236 FLR 1, 16 [8] 206 [7515].

64 The section states that '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 rationally believe that the judgment is in the best interests of the corporation.'

Considering that the 2008 Act does not elaborate on the manner in which rationality in the company-law context should be construed, it is submitted that the constitutional principle of legality plays that role. Therefore, obviously, the decisions that company directors make must be legal, otherwise they would fail this constitutionally imposed standard. One can therefore reason that the above rationality principles are capable of being applied analogously in the context of the distribution of company money and/or property; more especially because the 2008 Act envisages that the principle of rationality must play a central role in determining whether directors have carried out their duties properly in a given set of circumstances, such as those which arose in *Lobelo*.[65]

However, in terms of section 76(4)(*a*)(iii) of the 2008 Act, it would not be sufficient that a director takes a rational decision. Unlike in Australia where the director must only rationally believe without more being expected of them, the section also requires a director to believe rationally that indeed the decision is a rational one. In both section 76(4)(*a*)(iii) of the 2008 Act and section 180(2)(*d*) of the Corporations Act 2001 the requirement that a director must make a rational decision by implication confers a discretion on that director. However, unlike the Corporations Act 2001, the 2008 Act also partially curtails the extent to which a director may exercise their discretion by requiring the director in question to '*believe that the decision was indeed rational*'. Consequently, section 76(4)(*a*)(iii) does not confer an unfettered discretion on directors. One may argue, therefore, that the 2008 Act incorporates checks and balances in section 76 to help directors to clarify the belief reasonably expected. This clarity is seminal, especially when viewed against comments which often criticise the Act for being ambiguous regarding directors' duties. The section is more forceful than its Australian counterpart, suggesting that in South Africa, in line with the overall objectives of the Act in section 7, directors are called upon to ensure that the interests of a company are given greater protection than those of other stakeholders. To that extent, directors, as both the court *a quo* and the Full Bench found in *Lobelo*, are more likely than not to be held liable if they fail the rationality test.

It can be argued that the principles discussed above under rationality based on administrative law, and as alluded to by Rogers J in *Visser*, may similarly apply in instances where it is a director or an officer of a company who has been endowed with statutory powers or charged with obligations to manage the operations of a company. The powers conferred on a director by the 2008 Act and a company's Memorandum of Incorporation (MOI) are comparable to the powers conferred on an administrator through an empowering provision. Both of these officials are enjoined to exercise the powers conferred on them. By implication, they are expected to act within those powers;

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65 In *Visser Sitrus (Pty) Ltd* (n 53) para 75, Rogers J said: 'section 76 requires the bona fide assessment of the directors to have a rational underpinning.' The statement has been referred to less frequently, but is not an innovation.

if they were to act in contravention of those powers, they would break the law and, as a consequence, invite sanctions. Company directors would also have erred in law if they had failed to 'rationally/reasonably' and adequately consider the financial circumstances of their company before a distribution were made. This obligation is imposed through an enabling provision with which directors are expected and compelled to comply. This does not mean that officials may not err, however.[66] But when they do err, their exercise of that power must be challenged procedurally in court.[67]

Where directors act fraudulently or with the intent to defraud their company, as was proved in *Lobelo*, they are inevitably in breach of the trust placed in them in the same manner that administrators would have exceeded the limits of the powers conferred on them. In *Visser*'s case, Rogers J saw no reason why rationality principles based on administrative law and *enveloped in the principle of legality* would not be transposed to apply in the context of company law, save for modifications where it would be reasonable to do so.[68]

The Concept of Reasonableness

Unlike in the case of delict, in the context of company law the liability of a director is not necessarily based on any form of fault where the director had breached their fiduciary duties.[69] The basis of a director's liability is *sui generis* (of its own kind).[70] To understand whether a person has acted reasonably, a hypothetical person is used as a legal standard or test. This is done to determine whether someone acted with negligence. Specifically, the idea is to ascertain whether that person has exercised the degree of attention, knowledge, intelligence and judgement that society requires of its

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66 *Kirland Investments (Pty) Ltd* (n 9) para 88; *Logbro Properties CC v Bedderson NO* 2003 (2) SA 460 (SCA) para 17.

67 *Kirland Investments (Pty) Ltd* (n 9) para 90. Another context from which the principle of rationality is embodied under s 76(4)(*a*)(iii) is discussed in Simphiwe S Bidie, '"Knowledge" as a Mechanism to Hold Directors Personally Liable for Adverse Distributive Decisions Under the Companies Act 71 of 2008' (2018) J Corporate and Commercial L&P 1.

68 However, Rogers J did not elaborate on the modifications he referred to. But it is clear that such modifications would relate to the modification of administrative-law principles and be interpreted to fit the company-law context: *Visser Sitrus (Pty) Ltd* (n 53) para 78.

69 Strict liability was and still is the norm. See *Philip Towers v Premier Waste Management Ltd* [2011] EWCA Civ 923 para 8; and *Aberdeen Railway Co v Blaikie* 1 Macq 461 at 471.

70 Directors could be in breach of their fiduciary duties even if they conducted themselves honestly and in the best interests of the company. However, this was not to mean that because they were in breach, they would automatically be held liable; a court had to engage in a proper enquiry to determine such liability as requested before a court. The duty of care at common law is distinguished from a statutory duty of care. The distinction between the two lies in the bases for liability: at common law the duty is applied strictly (sui generis), whereas statutorily an interested person may institute an action based on delict, which is based on fault: Irene-Marie Esser and Petrus A Delport, 'The Duty of Care, Skill and Diligence: The *King Report* and the 2008 Companies Act' (2011) THRHR 449–455.

members in order to protect their own and others' interests. Therefore, in contrast to rationality, reasonableness is premised on an approach that is more focused on eliminating any unwarranted considerations. It seeks to examine the process by which a board arrived at its decision, taking into account any motivations compelling the board to opt for a particular decision.[71] In this respect, reasonableness requires a stricter test than rationality.[72]

Generally, reasonableness is concerned with the decision itself.[73] In other words, how a person has exercised his or her judgement as it relates to society.[74] Like rationality, however, the concept of reasonableness is meant to accord discretionary powers to company directors to act in whatever manner they see fit as long as their actions are reasonable and conform to a proper standard required in the exercise of their duties. It is submitted that, according to section 4 of the 2008 Act, the determining factor will be the reasonableness of the decision at the time it was made. In other words, whether the particular directors reasonably foresaw the financial predicament in which the company was and, as a consequence, conducted themselves with the reasonable care, skill and diligence expected of them, taking into account the general knowledge, skill and experience of the director.

The meaning that is to be ascribed to the term 'reasonable' is, however, not clear in the Act.[75] What is clear, though, is that, in order to determine whether or not a decision was reasonable, such a decision must be assessed, taking into account the business judgement of the decision-makers. The term 'reasonable' as inserted in section 4 of the 2008 Act has various connotations. One is that the Act seems to create a flexible approach by affording the directors a discretion in the manner in which the financial circumstances of their company are to be assessed ahead of a decision on whether or not to make a distribution. The other is that, by expressly introducing reasonableness in the section, the 2008 Act seems to take the view that the law and/or the courts should be slow to punish the board or individual directors whenever a decision to distribute is perceived to be wrongful. For a court to determine whether a breach has occurred, it must be justified in the circumstances, having engaged in a proper enquiry to establish

71 *In re Dollar Thrifty* (n 55) 45–46.
72 *In re Dollar Thrifty* (n 55) 46.
73 *Democratic Alliance v President of South Africa* (n 33) para 29.
74 Lydenberg (n 55) 5.
75 Reasonableness is also included in s 122(1)(*b*) of the CBCA, which refers to a 'reasonably prudent' person. The term is also provided for in ss 34(2) and 42 of the CBCA, which refers to 'reasonable grounds for believing'.

such liability.[76] The philosophical approach to the principle of reasonableness is discussed next.

The Concept of Reasonableness and its Philosophical Approach

Compared to rationality, overall reasonableness has a less selfish connotation and requires a person to propose and honour fair terms in dealing with others in society. In the process, such a person is also bound by those terms once an assurance is given that others will do the same.[77] For conduct to be reasonable, it must be fair and judicious in reference to its effects and accommodating others' points of view. Reasonableness therefore refers to fair terms of cooperation.[78] Using a reasonable standard to judge a director's decision-making process, and underpinned by a rational standard to determine one's belief at the time, is to demonstrate that a director's decision is well motivated and is a reasonable way of advancing the interests of that company and its shareholders. Directors are, therefore, required to undertake the burden of showing that their decisions were fair in the sense of having been taken in good faith or in a loyal manner; and rational in that the directors were careful and logical in their contextual approach to the matter at hand. Therefore, in their character, rationality is seen as more permissive while reasonableness is more exacting, demanding more focused scrutiny.[79]

In determining the legal principles applicable under reasonableness, it is important to refer to the facts of *In re Dollar Thrifty*.[80] The issue in this case was whether the board of Dollar Thrifty Company had breached its duty to take a reasonable approach to immediate value maximisation.[81] Put differently, in selling Dollar Thrifty Automotive Group, Inc to Hertz Global Holdings, Inc, did the board make an appropriate selection

76 This stance is therefore an acknowledgement and acceptance by the Act that directors are entrusted with certain responsibilities, as they must be, if the company is to function properly. But they must carry these out and conduct themselves prudently. Directors are therefore expected to take precautionary measures where it seems reasonable to do so to prevent any damage which might reasonably be seen to harm the company before such harm can materialise.

77 *In re Dollar Thrifty* (n 55) 46–47n181; Rawls (n 55) 49, 51, 54; Lydenberg (n 55) 2 and 4.

78 *In re Dollar Thrifty* (n 55) 46–47. Young (n 55) 2. In English law the reasonableness standard is used because of concern that directors without a pure self-dealing motive might be influenced by considerations other than the best interests of the corporation and other stockholders. *In re Dollar Thrifty* (n 55) 46–47 fn 181.

79 *In re Dollar Thrifty* (n 55) 46–47 fn 181.

80 *In re Dollar Thrifty* (n 55).

81 *In re Dollar Thrifty* (n 55) 41; *Revlon, Inc v MacAndrews & Forbes Holdings, Inc*, 506 A2d 173 (Del 1986); Lawrence Cunningham and Charles Yablon, 'Delaware Fiduciary Duty Law After QVC and Technicolor: A Unified Standard (and the End of Revlon Duties?)' (1994) The Business Lawyer 1593–1628.

and/or opt for the best price so as to maximise value for the shareholders?[82] In their arguments, the plaintiffs, who were shareholders of Dollar Thrifty, raised three issues: that the Dollar Thrifty directors had breached their duties by failing to engage Avis prior to the signing of the deal with Hertz; that the board also failed to respond when Avis expressed an interest just prior to signing the deal; that the board allowed the merger agreement to contain unreasonable deal-protection devices that were unwarranted in the light of the relatively small one-day premium paid by Hertz.[83]

In response, the court described the reasonableness standard and compared the heightened process of judicial review required in the *Unocal* and *Revlon*[84] cases to that of rationality review which resembles characteristics of the business judgement rule. The court stated that the appropriate question for analysis was whether the actions taken by the board were reasonable. In the words of the court:

> in contrast to business judgement review where the Court must find that the business decision was rational, a Court applying the heightened scrutiny that *Revlon* requires must engage in a nuanced analysis of the board of directors' personal interests to determine that the board acted reasonably and with proper purpose.[85]

The court went on to state that, in determining whether the directors' decision was reasonable where a board is given a mandate by its shareholders, it is not required that the board follow a specific plan or roadmap in complying with its duties to take

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82 This was expressed to be a narrow approach rather than to express an informed judgement to obtain the best value reasonably available to the stockholders: *Paramount Communications, Inc v QVC Network, Inc* 637 A2d 34 (Del 1994), as discussed in Cunningham and Yablon (n 81) 1594. Dollar Thrifty underwent a turnaround during 2008 and 2009, recovering from the brink of bankruptcy following cost-cutting measures implemented by the management. The result was that its stock price increased significantly. Consequently, the company received overtures from the Hertz and Avis companies, after which takeover discussions ensued. No agreement came of these discussions, however. During the discussions, Dollar Thrifty emphasised the need for deal certainty in the light of the deal's likely antitrust issues and its implications for employee morale. In late 2009 again, Hertz indicated an interest in purchasing the Dollar Thrifty Company. The Dollar Thrifty board authorised discussions with Hertz. Avis was excluded from these discussions owing to questions about its financial capabilities, antitrust issues and concerns that a leak could negatively affect Dollar Thrifty's business performance. The negotiations led to the conclusion of a merger agreement affording certain rights to both Hertz and Dollar Thrifty.

83 See also a concise memorandum of opinion from Potter Anderson and Corroon LLP, 'Delaware Law Updates' (September 2010) <http://www.potteranderson.com/pp/experience-275.pdf> accessed 5 January 2017.

84 In explaining the duties of a board in a target company, the Delaware Supreme Court held in *Revlon, Inc v MacAndrews & Forbes Holdings, Inc* (n 81) 182 that when it became clear in a takeover battle that the target company would be broken up, the duty of the target's board changed from defenders of the corporate bastion to auctioneers charged with getting the best price for the stockholders at a sale of the company. See Rutherford Campbell Jr, 'A Positive Analysis of the Common Law of Corporate Fiduciary Duties' (1996) Kentucky LJ 455–505 fn 8.

85 Therefore, reasonableness in the case would suggest the absence of personal conflict that would cause directors to act for their own benefit rather than for that of the company.

reasonable steps to secure or attain the best immediate value.[86] The only requirement is that the directors must, in line with their fiduciary duties, act reasonably by following a sound process to secure the best deal available.[87] The test is whether the directors made a correct judgement call and not a perfect one.[88] It remains within the board's discretion to select the path by which to maximise the company's value as long as they do so in a reasonable manner.[89] Where a discretion has been conferred by a statute, the board is required to consider the affairs of the company objectively.[90] The sentiments expressed in *In re Dollar Thrifty* were echoed by Major and Deschamps JJ in *Peoples Department Stores Inc (Trustee of) v Wise*.[91]

The two cases discussed above demonstrate that in determining whether a board's decision is reasonable, the determination is premised on a board's business judgement. Therefore, analogously, *Peoples Department Stores* can be read to have expressed the view that, as was argued for by the shareholder plaintiffs *In re Dollar Thrifty*, that alternative transactions were rejected by directors is irrelevant unless it can be shown that a particular alternative was definitely available and that it was clearly more beneficial to the company than the one chosen.

Examination of the Concept of Reasonableness

In undertaking an examination to determine director liability, it is submitted that the two-stage test found to be applicable in *In re Dollar Thrifty* is equally suitable in the

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86 *In re Dollar Thrifty* (n 55) 40.

87 *In re Dollar Thrifty* (n 55) 40–41.

88 *In re Dollar Thrifty* (n 55) 41.

89 ibid.

90 This is so because it has also been stated that the application of the 'but for' test is not based on mathematics, pure science or philosophy. It is a matter of common sense based on the practical way in which the ordinary person's mind works against the background of everyday life experiences. The test is an objective one: how one should have exercised one's discretion (*where there is an option to use discretion*). See *Minister of Finance & Others v Gore NO* [2007] 1 All SA 309 (SCA) paras 33 and 34. The importance of the existence of a discretion was also emphasised in *Phillips v Fieldstone Africa (Pty) Ltd* [2003] ZASCA 137 para 33, Heher JA concurring. See also on the use of discretion *Frame v Smith* [1987] 2 SCR 99 (SCC) 136.

91 *Peoples Department Stores Inc (Trustee of) v Wise* [2004] 3 SCR 461, 2004 SCC 68 (CanLII) (*'Peoples Department Stores'*), referring to Weiler JA in *Maple Leaf Foods Inc v Schneider Corp* 1998 CanLII 5121 (ON CA) (1998), 42 OR (3d) 177 at 192; and *Kerr v Danier Leather Inc* [2007] 3 SCR 331, 2007 SCC 44. The law as it has evolved in Ontario and Delaware has the common requirements that the court must be satisfied that the directors have acted reasonably and fairly. The court looks to see that the directors made a *reasonable* decision, *not a perfect* decision. Provided that the decision taken is within a range of reasonableness, the court ought not to substitute its opinion for that of the board even though subsequent events may have cast doubt on the board's determination. As long as the directors have selected one of several reasonable alternatives, deference is accorded to the board's decision. The formulation of deference to the decision of the board is known as the 'business judgement rule': *Peoples Department Stores* (n 91) para 65 and *BCE Inc v 1976 Debentureholders* [2008] 3 SCR 560, 2008 SCC 69 paras 40 and 83 ('*BCE Inc*'); *Maple Leaf Foods* (n 91) 192.

context of sections 4 of the 2008 Act and that it can be adopted when applying reasonableness. It was stated in *In re Dollar Thrifty* that a court must undertake:

1. a judicial determination regarding the adequacy of the decision- making process employed by the directors, including the *quality and character* of the information on which the directors based their decision; and

2. a judicial examination of the reasonableness of the directors' action in light of the circumstances then existing. In this regard, directors have the burden of proving that they were adequately informed and acted reasonably.[92]

In analysing the two-leg test in the context of section 4 of the 2008 Act where the distribution of company money or property would be at issue, the first leg suggests that two determinations must be made. The first is that a judge must determine the adequacy of the decision-making process employed by a board or director(s). The judge must ask the following questions:

- Was the process sound in the sense that all precautionary measures were taken to guard against the insolvency of the company or other losses or damage it might incur?

- What process and tools did the board employ to help it to come to its decision?

- Did the board or director(s) carefully conduct any consultations to further inform themselves about the matter that forms the subject of the decision before the decision was made?

- Did the board or director(s) adequately and diligently consider and weigh the financial statements of the company and the financial predicament which the company was in at the time?

- Did the board or director(s), after such deliberations, chose the best option reasonably expected to be chosen by a prudent director in the same circumstances, and considering the general knowledge, experience and skill of the board or director(s) in question?

The second determination in the first leg suggests the following question: Was the information relied on truthful and accurate?[93] This question is intended to enable a court to assess the character and adequacy of the financial information relied on by the board in making a distribution. Such information would ultimately play a vital role in

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92 *In re Dollar Thrifty* (n 55) 41.

93 See also s 28 of the 2008 Act, which requires that information relied upon be accurate.

helping the court to determine whether the board should reasonably have relied on such information in making the decision to distribute. An allegation or argument would have to be made, therefore, that the directors of the company in question failed to take reasonably diligent steps to inform themselves of the facts relevant to the decision. In other words, that the board did not have sufficient information to make the decision properly to distribute, or that the insufficient information caused loss or damage to the company.[94] Where the information was not reasonable, the decision based on it would not stand in law as having been taken prudently; therefore there would be no sine qua non linking the information and the decision.

The board is responsible for applying its mind to the information in question or to any advice given.[95] The board would, therefore, be entitled to rely on such information as long as it would be reasonable in the circumstances to do so.[96] In Australia, directors are expected to inform themselves about the subject-matter of their judgement to the extent that 'they reasonably believe to be appropriate'.[97] In this regard, it would be the reasonable belief of a director that would matter. It is submitted that under the 2008 Act such unfettered discretion is not available to directors. In section 4, for example, the requirement is that directors must consider the 'reasonably foreseeable' financial circumstances of the company. The term 'foreseeable' seems intended to curtail unfettered exercise of discretion by directors, as is the case under the Corporations Act 2001. In fact, the word 'foreseeable' seems to suggest that the financial position in which the company would be at a particular time must with reasonable certainty 'appear' in the board's or directors' minds to be informed by the information at hand. For this reason, s 4 cannot be read to give unfettered discretion. Moreover, the section cannot be read in isolation: it would have to be read in the context of section 76(4)(*a*)(iii) discussed above.

In *C Fourie v FirstRand Bank Ltd*,[98] the court took the position that the board's or the directors' reliance on the information must reflect an appreciation that the information or advice should fairly indicate the financial position of the company. The information must not, to the knowledge of the director, be fraudulent or reflect reckless disregard of the affairs and/or the financial position of the company. In order to achieve this, the financial information in question must be relevant, accurate and

94 *Visser Sitrus (Pty) Ltd* (n 53) para 86.

95 See s 76(5) in terms of the persons to whom reference must be made in terms of the 2008 Act.

96 This would be an 'expert reliance' defence available to directors. The 2008 Act expressly allows such reliance in terms of s 76(4)(*b*)(i)(*aa*) and (*bb*) and (ii). The persons to be consulted are set out in s 76(5) of the same Act. Section 189 of the Corporations Act 2001 allows a director to rely on such information. See also *Australian Securities and Investments Commission v Mariner Corporation Limited* [2015] FCA 589; 327 ALR 95, 106 ACSR 343 para 529 ('*Mariner Corporation Limited*').

97 See s 180(2)(*c*) of the Corporations Act 2001.

98 [2012] ZASCA 119 ('*C Fourie*').

complete so that it is most closely connected to the decision that is ultimately made.[99] The directors of a company do not necessarily have to have first-hand knowledge of the affairs of the company.[100] However, in order to meet the requirements of the business judgement rule, the board or the director has a responsibility to take diligent steps to become informed about the financial position of the company and not to rely solely on the information presented to them.[101]

The second leg of the test requires judicial examination of the extent to which the board's or the directors' actions were reasonable, based on the circumstances existing at the time the decision was made. In other words, the court's determination must not be based on circumstances prevailing at some other time and not relevant to the immediate decision the board of directors was faced with. The court must, therefore, confine itself to the relevant issues. Whether the actions of the board of directors are reasonable is for the court to decide; and the decision of the court must be based on the evidence presented by the directors and whether they acted reasonably in the sense that they were adequately informed.[102] In *In re Dollar Thrifty* the plaintiffs argued that the board had acted unreasonably by not engaging with Avis. The court made a finding to the contrary and held that the directors had acted reasonably by not engaging with Avis since the company was reluctant even to make a firm bid at a lower price.

The board of Dollar Thrifty reasonably deliberated and chose not to engage in a bidding contest because of a deal structure that allowed a later higher bid after securing a firm deal with Hertz. In fact, the board had legitimate concerns about Avis's not having the ability to obtain financing or to clear antitrust hurdles. Furthermore, the plaintiffs argued that the price was insufficient and as such unreasonable to justify having concluded the merger agreement with Hertz. The court disagreed with this view, stating that the board had made up its mind. It further noted that during the protracted negotiations the stock price of Dollar Thrifty and Hertz had increased consistently, fundamentally changing the future outlook of Dollar Thrifty to being positive. Therefore, the court was in agreement with the decision of the respondent because the court was convinced that a well-motivated board was not obliged to refuse an offer that it reasonably believed

99 See s 28(1) of the 2008 Act.
100 Dharamdial (ed) (n 29) 14.
101 See s 76(4)(*a*)(i) of the 2008 Act.
102 See also Michael Legg and Dean Jordan, 'The Australian Business Judgment Rule After *ASIC v Rich*: Balancing Director Authority and Accountability' (2014) Adelaide LR 403–426 at 411 and *Mariner Corporation Limited* (n 96) paras 529–551.

appropriately met or exceeded the fundamental value of the company merely because it included a relatively small market premium.[103]

Legg and Jordan list various factors that should be taken into account in assessing whether a director's decision was reasonable. These are:

- the importance of the business judgement to be made;
- the time available for obtaining information and deciding the extent to which the director should be informed;
- the costs related to obtaining information;
- the director's confidence in those who explored a matter and those making presentations;
- the state of the corporation's business at the time and the nature of competing demands for the board's attention;
- the different backgrounds and experience of individual directors, the distinct role each plays in the corporation and the general value of maintaining board cohesiveness; and
- the general views or specialised experience of other board member colleagues.[104]

In *Bato Star Fishing (Pty) Ltd*,[105] the court identified additional factors to be taken into account:

- the nature of the decision;
- the expertise of the decision-maker;
- the range of factors relevant to the decision;
- the reasons given for the decision;

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103 Potter Anderson and Corroon LLP (n 83) 2. Legg and Jordan (n 102) criticise the standard by which a board's decision would be judged as having been reduced in *In re Dollar Thrifty* in that the emphasis seemed to have been on the preparedness of a board in making that business decision as distinct from the quality of the decision itself.

104 Legg and Jordan (n 102) 412, citing the American Law Institute's Principles of Corporate Governance document ('ALI').

105 *Bato Star Fishing (Pty) Ltd* (n 12).

- the nature of the competing interests involved; and
- the impact of the decision on affected parties.[106]

In *ASIC v Rich*[107] the concepts of rationality and reasonableness were interpreted and applied differently, as one would submit they should be applicable in the South African context.[108] The action was against two directors of the OneTel Company, Rich and Silbermann.[109] Referring to rationality and reasonableness, the court was of the view that the requirement of rationality in section 180(2) of the Corporations Act did not have to be reasonable. This meant that a director could invoke the business judgement rule if that director could show that they arrived at the business judgement after a reasoning process irrespective of 'whether or not the reasoning process was convincing to the judge and, therefore, reasonable in an objective sense.'[110] According to the court, the intended purpose of the rule, which is found in section 180(2) of the Corporations Act 2001, was not to introduce a reasonableness test but to show that there was some reasoning behind every decision taken by directors even if the decision was not reasonable per se. In other words, it would be enough if a court found that the process by which the decision was made was rational, even if the decision itself would not be considered reasonable in the eyes of the court.

106 *Bato Star Fishing (Pty) Ltd* (n 12) para 45.

107 *ASIC v Rich* (n 63).

108 Perhaps this is one of the nuances that tends to lead to differentiation in the interpretation of some provisions of the 2008 Act and the Corporations Act 2001. *ASIC* sought civil penalties for alleged breaches of the statutory duty of care and diligence arising out of the collapse of OneTel Company in May 2001. OneTel Ltd ('OneTel') was a large listed telecommunication company in Australia, which counted Publishing and Broadcasting Limited (PBL) and News Corporation (News Corp) as two of its major shareholders. In April 2001, there were ultimately futile discussions about the possibility of PBL and News Corp injecting cash into OneTel through a rights issue. In May 2001 PBL and News Corp united to remove the CEO and the Finance Director of OneTel from the board of OneTel. The board then appointed voluntary administrators to OneTel. *ASIC v Rich* (n 63); Legg and Jordan (n 102) 414–415.

109 Legg and Jordan (n 102) 415. The challenge centred on establishing that the financial position of the OneTel Group was much worse over the relevant period than the information provided to the board revealed, and that the forecast that had been provided to the board had no proper basis. *ASIC* also contended, amongst other things, that the defendants were aware of OneTel's poor financial position, or ought to have been aware of it, and failed to make proper disclosure to the board. The case was based on s 180(1) and (2) of the Corporations Act 2001, which provides for the business judgement rule. Justice Austin ruled against ASIC, saying that it had failed to prove its case against the directors that they had contravened s 180. In the South African context, see also in *Price Water House Coopers & Others v National Potato Co-Operative Limited* [2013] ZASCA 123.

110 ibid.

It is submitted that the interpretative approach adopted in the *ASIC v Rich* case does not seem to be in accordance with the wording of section 180(2)(*c*) of the Corporations Act 2001. This section provides that:

> a director or other officer of the corporation who makes a business judgment is taken to meet the requirements of subsection (1), and their equivalent at common law and in equity, in respect of the business judgment if they inform themselves about the subject matter of the judgment to the extent they reasonably believe to be appropriate.

The phrase 'to the extent they reasonably believe to be appropriate' accords a discretion to directors and so it introduces a reasonableness test. It refers to the fact that directors must themselves hold the belief that they have informed themselves enough about the subject-matter of the decision to be made. The Corporations Act 2001, therefore, gives a discretion to company directors to the extent that they themselves would believe it would be appropriate. The ruling of the court in *ASIC v Rich* to the effect that section 180(2) of the Corporations Act 2001 does not require a decision by directors to be reasonable per se is therefore confusing and in conflict with the wording of the section.

The use of 'reasonable' in section 180(2) of the Corporations Act 2001 is not similar to the way in which it is used under section 4 of the 2008 Act.[111] In addition, in terms of the business judgement rule as contained in section 76(4) of the 2008 Act, a director is expected to take reasonably diligent steps to become informed about a matter. After that, the director may take a decision on the matter only if they had a rational basis for believing, and in fact did believe,[112] that the decision was in the best interests of the company. The 2008 Act differs from the Corporations Act in that it accords a discretion by using the word 'reasonable' in sections 4 and 76(4). It does not give an unfettered discretion to the board to determine reasonableness or whether the diligent steps they took were according to themselves indeed reasonable. The 2008 Act also curtails the exercise of such discretion by incorporating the words 'did believe'. It would seem, therefore, that the approach to interpreting and applying the concept of 'reasonable' under the 2008 Act is at variance with the other jurisdictions consulted in this article.

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111 This is also the case under s 254T of the Corporations Amendment (Corporate Reporting Reform) Act 66 of 2010, which provides for the solvency test.

112 Meskin, referring to 'reasonable ground to believe and did … believe', opines that two legs must be satisfied. First, in order for a director to avoid liability, it would be necessary for them to prove that they had reasonable grounds for their belief. If they prove this, they are likely to have gone a long way towards proving that they actually held the required belief. Secondly, if the director fails to show that they had reasonable ground for their belief, their defence will fail, however honestly they held the belief. This was based on s 160 of the 1973 Companies Act: Edgar Henochsberg, Philip Meskin and MS Blackman, *Henochsberg on the Companies Act* (4 edn, Butterworths 1985) 238.

Nevertheless, the common departure point is that what constitutes a reasonable decision depends on the circumstances of each case.[113]

Observations and Conclusion

From the above discussion, the drafters of the 2008 Act clearly gave it careful thought when they replaced the capital maintenance mechanism in crafting the section 4 test. Their intention was clearly to introduce measures that would protect the country's economy. By ensuring that company directors make proper decisions when they contemplate distributing company money or property, the first step of compliance in line with the Constitution, 1996 has been achieved. What the intended purpose makes clear is that directors' compliance with the law when distributing company capital, informed by reasonable considerations, is as fundamentally important as the rights of shareholders to such distributions. When we consider the conduct of directors in cases such as *Lobelo*, it is commendable that the concept 'reasonable' in section 4 acts as a support mechanism. It does so to inculcate a culture of responsible decision-making in those who are entrusted with the duty to manage the affairs of another in an effort to strengthen accountability. The principle of legality in the form of rationality sets out clear guidelines for considering whether director-made distribution decisions are reasonable. Such decisions must be informed by rational underpinnings that, in the context of section 4, draw upon accurate financial information and other advice in order to indicate whether or not directors are or were justified in making a distribution. Decisions to distribute must be supported by evidence, that is, there must be a sine qua non between the decision and the information before decision-makers. Reasons must also be given for such decisions.[114] Such decisions must not be made for an ulterior purpose either: they must be in line with the purpose for which the power was conferred and for which a decision was and/or would purportedly be taken.[115] Therefore, reasonableness not only requires directors to give reasonable consideration to their decisions, without more: the concept also compels directors to ensure that the distribution decisions they make are lawful and informed by lawful considerations. Nor must directors rely on speculative dispositions to make their decisions. Making a connection between a decision and accurate and truthful information would enable them to provide reasons in support of their decisions. Therefore, the concept is not only concerned with how reasonable a decision is; it is also informed by the contextual approach that directors must adopt to arrive at a decision permitting the distribution of company money or property. A reasonable decision must be premised on a rational basis.[116]

The purpose buttressed by the incorporation of 'reasonably' in section 4 is therefore to encourage and invite company directors to take cognisance of their statutory duties, and

113 *Bato Star Fishing (Pty) Ltd* (n 12) para 45.
114 Hoexter and Lyster (n 43) 181.
115 ibid.
116 ibid.

also to be vigilant before they distribute company property. The 2008 Act aptly places a duty on courts to be as vigilant, but mostly requires directors to apply their experience, skill and knowledge in a cautious and reasonable manner when predicting the financial predicament a company could possibly be faced with after a distribution. Distributive decisions must therefore not be informed by one's own predispositions: the application of experience, skill and knowledge must be for the benefit of not only shareholders but also of the economy and society at large. There seems to be no other reason why its drafters would have considered it necessary to craft section 4 in the manner that they have done. Reasonableness, therefore, calls upon directors not to be complacent in the manner in which they carry out their responsibilities towards their companies and society at large.[117] Accordingly, it would seem that where the concept of reasonableness involves an enquiry into aspects that motivated a board's decision, such aspects introduce subjective elements as opposed to limiting the enquiry only to objective elements.

117 See s 76(3) of the 2008 Act. Common-law duties have not been done away with by the Act. See ss 76(3) and 77(2) of the 2008 Act.

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