A CRITICAL AND COMPARATIVE ANALYSIS OF DELEGATION AND RELIANCE BY COMPANY DIRECTORS UNDER THE SOUTH AFRICAN COMPANIES ACT 71 OF 2008

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I. INTRODUCTION

The board of directors (the board) is responsible for managing the company's business and affairs[1] and serves as its focal point and custodian of corporate governance.[2] Yet, as modern companies are complex, it is not practically possible for the board to manage every aspect of the daily business of the company, particularly in large companies,[3] and so the board must delegate some management powers. Directors must also be able to rely on third parties' advice or information. Directors are, of course, restricted in what they may delegate and how far they may rely on third parties' information. The problem is that these restrictions are sometimes unclear. Balancing good corporate governance and entrepreneurship in delegation and reliance on third parties has proved difficult.[4]

This is a crucial practical issue. Directors unlawfully delegating their powers or relying on third parties may face serious consequences, such as liability for breaching their fiduciary duties, or even disqualification from acting as directors.[5]

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1 Section 66(1) of the Companies Act 71 of 2008.

2 King IV Report on Corporate Governance for South Africa 2016 (King Report), principle 6.

3 *Daniels and Others (formerly practising as Deloitte Haskins & Sells)* v. *Anderson and Others* (1995) 16 ACSR 607, at 666 (*Daniels* v. *Anderson*); *Kaimowitz* v. *Delahunt and Others* 2017 (3) SA 201 (WCC), at [21] (*Kaimowitz* v. *Delahunt and Others*).

4 See further G. Laing, S. Douglas, and G. Watt, 'Aspects of Corporate Delegation, Reliance and Financial Reporting: Lessons from Australian Securities and Investments Commission v. Healey (2011) 29 ACLC 11–67,' 13(1), *Canberra Law Review* (2015) 17–26, at 26.

5 Directors may be held liable for any loss, damages or costs sustained by the company because of a breach of their fiduciary duties (section 77(2)(a) of the Companies Act) or a breach of their duty of care, skill, and diligence (section 77(2)(b) of the Companies Act). They may also be declared delinquent and disqualified from acting as directors for at least seven years if they grossly abuse their position or act in a manner that constitutes gross negligence, wilful misconduct, or breach

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Uncertainty over when a director may appropriately delegate to or rely on others could foster an overcautious approach to managing the company's affairs and impede the company's decision-making processes, stifling the development of sound corporate governance practices.[6]

In South Africa, section 76(4)(b) and (5) of the Companies Act 71 of 2008 (the Companies Act) states the principles of directors' delegation and reliance. This article critically analyses these statutory principles and, where relevant, compares them to the equivalent provisions of the Revised Model Business Corporation Act 1984 (the MBCA) in the United States of America (USA) and the Corporations Act 2001 (Australian Corporations Act) to ascertain whether these foreign sources may yield useful guidelines for interpreting and applying these principles under the Companies Act.

Derivation and a new dispensation justify this comparison. The MBCA principles on delegation and reliance strongly influenced sections 76(4)(b) and 76(5) of the Companies Act, which follows them closely. Notably, the Australian Corporations Act enacted specific legislative authority for directors' delegation and reliance under the Corporate Law Economic Reform Program Act 1999 because doubts were expressed about how far directors might rely on others' advice and information.[7] To address this, the Australian Parliament enacted specific legislative authority for directors' delegation and reliance, echoed in section 76(4)(b) and (5) of the Companies Act. This comparative approach is further justified and reinforced by section 5(2) of the Companies Act, which provides that a court interpreting or applying the Companies Act may consider foreign law to the extent appropriate. South African company law has long taken its lead from the relevant English Companies Act and jurisprudence, but now section 5(2) encourages South African courts to look further afield and consider other corporate law jurisdictions, whether American, European, Asian, or African, in interpreting the Companies Act in appropriate circumstances.[8]

This article first discusses the power of directors to delegate their functions, as well as the limitations of this power, before moving on to the reliance principles set forth in sections 76(4)(b) and 76(5) of the Companies Act. The article also highlights ambiguities in the statutory provisions and suggests ways to clarify and improve them.

of trust in relation to the performance of their functions and duties (section 162 of the Companies Act). A discussion of directors' liability for unlawful delegation or reliance on third parties is beyond the scope of this article, but see further on the liability of directors F. H. I. Cassim, 'The Duties and Liability of Directors', in F. H. I. Cassim (ed.), *Contemporary Company Law*, 3rd edn (Juta, 2021) 681–802, at 783–89.

6 The Parliament of the Commonwealth of Australia, House of Representatives, *Corporate Law Economic Reform Program Bill, Explanatory Memorandum*, (1998), at [6.22].

7 *Ibid*.

8 *Nedbank Ltd* v. *Bestvest 153 (Pty) Ltd*; *Essa and Another* v. *Bestvest 153 (Pty) Ltd and Others* 2012 (5) SA 497 (WCC), at [26].

II. THE POWER OF DIRECTORS TO DELEGATE THEIR FUNCTIONS

A. Implied Power to Delegate

The Companies Act does not explicitly empower directors to delegate their functions to other parties: instead, this is implied. Section 66(1) of the Companies Act reads:

> The business and affairs of a company must be managed by or under the direction of its board, which has the authority to exercise all of the powers and perform any of the functions of the company, except to the extent that this Act or the company's Memorandum of Incorporation provides otherwise.

Section 66(1) gives directors the original power to manage the company's business and affairs; this power need not be delegated to the directors by the shareholders through the company's constitution.[9] So the ultimate power in a company lies with the board, not the shareholders, unless otherwise provided in the Companies Act or the Memorandum of Incorporation of the company (the company's constitution), which may limit the powers given to directors.[10] The words 'be managed by or under the direction of its board' in section 66(1) empower the board to delegate authority to appropriate officers, employees, or agents to exercise powers and perform functions not required by law to be exercised or performed by the board itself. The phrase acknowledges the reality that it is not practical for the directors to manage every aspect of the company's daily business, particularly in large companies, and that the board must delegate some management powers to other persons as business expediency may demand.[11]

Section 66(1) echoes section 198A(1) of the Australian Corporations Act, which states that the 'business of a company is to be managed by or under the direction of the directors.' Managing the company's business in Australia is also a matter for its directors, as shareholders lack the power to make management

9 *Kaimowitz* v. *Delahunt and Others*, *supra* note 3, at [12]; M. Havenga, 'Directors' Exploitation of Corporate Opportunities and the Companies Act 71 of 2008,' *Tydskrif vir die Suid-Afrikaanse Reg* (2013) 257–268, at 262; R. Cassim, 'The Right of a Director to Participate in the Management of a Company: *Kaimowitz v Delahunt* 2017 (3) SA 201 (WCC)' 30(1), *South African Mercantile Law Journal* (2018) 172–87, at 175; R. Cassim, 'Governance and the Board of Directors', in Cassim, *supra* note 5, 535–639, at 539.

10 *Pretorius and Another* v. *PB Meat (Pty) Ltd* (1057/2013) [2013] ZAWCHC 89 (14 June 2013), at [25]; *Navigator Property Investments (Pty) Ltd* v. *Silver Lakes Crossing Shopping Centre (Pty) Ltd and Others* [2014] JOL 32101 (WCC), at [31]; *Hacker* v. *Hartmann and Others* (1415/2017) [2019] ZAECPEHC 22 (10 April 2019), at [45].

11 *Kaimowitz* v. *Delahunt and Others*, *supra* note 3, at [21]; *Daniels* v. *Anderson*, *supra* note 3, at 666; *Australian Securities and Investments Commission* v. *Healey* [2011] FCA 717 (27 June 2011), at [20] (*ASIC* v. *Healey*).

decisions.[12] Section 198A is a replaceable rule that the company's constitution may override or modify.[13]

Section 66(1) of the Companies Act also resembles section 8.01(b) of the MBCA which provides that corporate powers are exercised by or under the authority of the board of directors, and the corporation's business and affairs must be 'managed by or under the direction, and subject to the oversight, of the board of directors.' This approach retains flexibility as the company's constitution may alter the default rules.[14] Section 8.01(b) of the MBCA was amended in 1974 to include the words 'under the direction of' the board of directors because of increasing concerns that the traditional words 'managed by the board of directors' could be interpreted to mean that directors had to become involved in the detailed daily administration of the company's affairs.[15] It was acknowledged that, at least for public companies, this language misdescribed the directors' role.[16] As emphasised by the Western Cape High Court in *Kaimowitz* v. *Delahunt and Others*[17] and the Supreme Court of New South Wales in *Daniels* v. *Anderson*,[18] the board monitors or oversees the company's business rather than dealing with its daily affairs. The Federal Court of Australia agreed in *ASIC* v. *Healey*,[19] stating that '[d]irectors are required to take reasonable steps to place themselves in a position to guide and monitor the management of the company.'

It is submitted that this approach accords with section 7(j) of the Companies Act, which states that one of the purposes of the Companies Act is to encourage efficient and responsible corporate management. As it is impractical for the entire board to manage the company's daily affairs directly, it is more efficient and responsible for the board to monitor management and delegate the company's daily operations.

As the board's power to manage the business and affairs of the company is an original one, the maxim *delegatus delegare non potest*,[20] preventing agents from subdelegating their authority, does not apply to directors.[21] But the maxim would

12 *Massey and Another* v. *Wales and Others* (2003) 177 FLR 1, at 12.

13 The Australian Corporations Act or the company's constitution may limit the directors' powers (section 198A(2) of the Australian Corporations Act). Section 135(2) of the Australian Corporations Act addresses replaceable rules.

14 See sections 2.02(b) and 7.32 of the MBCA on amending the default rules.

15 American Bar Association, *Model Business Corporation Act Annotated: Model Business Corporation Act with Official Comments and Reporter's Annotations*, adopted by the Corporate Laws Committee of the Business Law Section, American Bar Association (2021) (MBCA Official Commentary) 8.01.

16 See J. F. Olson and A. K. Briggs, 'The Model Business Corporation Act and Corporate Governance: An Enabling Statutes Moves Towards Normative Standards,' 74(1), *Law and Contemporary Problems* (2010) 31–43, at 32.

17 *Supra* note 3, at 19.

18 *Supra* note 3, at 667.

19 *Supra* note 11, at 166.

20 This maxim is interpreted to mean 'one to whom power is delegated cannot himself further delegate that power.'

21 Notes, 'Delegation of Duties by Corporate Directors,' 47(2), *Virginia Law Review* (1961) 278–98, at 278; R. K. Goel, 'Delegation of Directors' Powers and Duties – A Comparative Analysis,' 18(1), *International and Comparative Law Quarterly* (1969) 152–77, at 154.

apply to board committees and other individuals to whom the board has delegated its power as they are delegates and so the power to delegate must be expressly granted to them and may not be presumed.[22]

Directors' implied power to delegate their powers, as embodied in section 66(1) of the Companies Act, is reinforced by section 71(2)(b) of the Companies Act, which states that, except to the extent that the Memorandum of Incorporation of a company provides otherwise, the board may delegate any of its authority to any committee. Section 76(4)(b)(i)(bb) of the Companies Act (discussed in III.C below) also acknowledges that directors may delegate their functions by providing that directors may rely on the performance of any of the persons 'to whom the board may reasonably have delegated' the authority or duty to perform one or more of the board's functions that are delegable under applicable law.

The King Report[23] expressly articulates the idea that the board may delegate its authority or duty to perform its functions. It provides that the board should ensure that its delegation arrangements within its own structures promote independent judgment and assist in the balance of power and the effective discharge of its duties.[24] It recommends that the delegation to a director should be recorded in writing and approved by the board,[25] and the record should specify the nature and extent of the responsibilities delegated, the decision-making authority, the duration of the delegation, and the delegates' reporting responsibilities.[26]

Unlike the Companies Act, the Australian Corporations Act gives the board express legislative authority to delegate powers, subject to any restrictions in the company's constitution. Section 198D states that, unless the company's constitution provides otherwise, directors may delegate any of their powers to a committee of directors, a director, an employee of the company, or any other person.[27] The delegate must exercise the delegated powers in accordance with any directions issued by the directors.[28] A delegate's exercise of delegated power will be as effective as if the directors had exercised it.[29] Directors may delegate any of their powers to a managing director under section 198C (a replaceable rule). The express statutory authority that the Australian Corporations Act grants the board to delegate their powers emphasises the importance of directors' delegation to and reliance on third parties.[30]

22 Goel, *supra* note 21, at 154.

23 Some corporate governance principles of the King Report are mandatory for listed companies, while the remainder must be adopted on an 'apply or explain' basis (see paragraph 7.F.5 of the Listings Requirements of the Johannesburg Stock Exchange).

24 King Report, principle 8.

25 *Ibid*., principle 8, recommended practice 41.

26 *Ibid*.

27 The delegation must be recorded in the company's minute book (section 251A of the Australian Corporations Act).

28 Australian Corporations Act, section 198D(2).

29 *Ibid*., section 198D(3).

30 G. Golding, 'Tightening the Screws on Directors: Care, Delegation and Reliance,' 35(1), *University of New South Wales Law Journal* (2012) 266–90, at 276.

B. The Limits of the Power to Delegate

One common-law limitation on the directors' power to delegate their functions is that they may not abdicate or relinquish their responsibilities. In *Barlows Manufacturing Co Ltd and Others* v. *RN Barrie (Pty) Ltd and Others*[31] the court expressed this principle as follows:

> A director owes a fiduciary duty to his company. He cannot, while he is a director, divest himself of that duty. It is something which is inextricably tied to the office. In the exercise of this duty the director may delegate some or even all of his powers of controlling the company but he cannot, without violating what I regard as a fundamental principle of company law, delegate his duty and hence his power to control the controller. He may delegate but he may not abdicate. The board must retain ultimate control.

Delegation by the board may shift the exercise of a power or function to a delegate. However, the delegation is still subject to the board's overriding authority and control as well as its ultimate supervision and responsibility, or it risks being declared null and void.[32] Abrogation of duty by a fiduciary is inappropriate: Some independent judgment and consideration are always mandated.[33] If the board's and a delegate's opinions differ, the board's opinion must prevail.[34]

This fundamental principle is reinforced by section 72(3) of the Companies Act, which states that the delegation of any power to a board committee does not alone satisfy or constitute compliance by directors with their duties as directors. The board may delegate its powers to a committee but may not abdicate its legal responsibility for the committee's conduct, and the board remains liable for the proper performance of the delegated power.[35] This principle is echoed by the King Report: Any delegation of the board's responsibilities to a board committee or a director will not 'by or of itself constitute a discharge' of the board's accountability.[36]

The idea that the board may delegate but not abdicate appears in both the MBCA and the Australian Corporations Act. In section 8.01(b) of the MBCA, the phrase 'managed by or under the direction, and subject to the oversight of, the board of directors' is interpreted to mean that directors may not abdicate their responsibilities and avoid accountability simply by delegating authority to

31 1990 (4) SA 608 (C), at 610–11.

32 Goel, *supra* note 21, at 171; Golding, *supra* note 30, at 277.

33 Laing et al., *supra* note 4, at 26.

34 Goel, *supra* note 21, at 176.

35 Cassim, 'Governance and the Board of Directors,' *supra* note 9, at 623. Section 94(10) of the Companies Act also confirms the legal principle that the board may delegate but not abdicate by stating that the appointment and duties of an audit committee do not reduce the function and duties of the board, except with respect to the auditor's appointment, fees and terms of engagement.

36 King Report, principle 8, recommended practice 49.

others.[37] Section 190(1) of the Australian Corporations Act states that if directors delegate a power under section 198D, they are responsible for the delegate's exercise of the power as if they themselves had exercised it.

The Companies Act gives directors no further guidance on the limitations of their power to delegate. By contrast, the Australian Corporations Act usefully guides directors on the limitation of their responsibility when they delegate their powers to a third party, and in some cases even relieve them of responsibility for the acts of their delegates. Under section 190(2) of the Australian Corporations Act, a director is not responsible for the delegate's exercise of power if:

- the director believed on reasonable grounds that the delegate would exercise the power in conformity with the duty imposed on directors by the Australian Corporations Act and the company's constitution;
- the director believed on reasonable grounds and in good faith, and after proper inquiry if the circumstances indicated the need for an inquiry, that the delegate was reliable and competent in relation to the power delegated.

Section 190(2) gives a useful statutory delegation defence to directors who can meet its requirements. The subsection also clarifies what is expected of directors when their functions are delegated to a third party, as well as where the line is to be drawn in holding directors responsible for the delegate's exercise of their functions. It is submitted that the Companies Act in South Africa should be amended to include similar guidelines.

III. RELIANCE PRINCIPLES UNDER THE COMPANIES ACT

Section 76(4)(b) of the Companies Act states that, in respect of any particular matter arising in the exercise of the powers or the performance of the functions of a director, a particular director[38] of a company is entitled to rely on:

- the persons 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;[39]
- the persons referred to in section 76(5) of the Companies Act,[40] being employees of the company, legal counsel, accountants or

37 MBCA Official Commentary 8.01.

38 Section 76 of the Companies Act applies not only to directors but also to alternate directors, prescribed officers (such as the chief executive officer or financial officer) and a person who is a member of a board committee or of the audit committee of a company, regardless of whether that person is also a member of the company's board (section 76(1) of the Companies Act). It follows that the reliance principles in sections 76(4)(b) and 76(5) of the Companies Act apply to these persons as well.

39 Companies Act, section 76(4)(b)(i)(bb).

40 *Ibid*., section 76(4)(b)(i)(aa).

other professional persons retained by the company, and board committees of which the director is not a member;

- any information, opinions, recommendations, reports, or statements, including financial statements and other financial data, prepared or presented by any of the persons referred to in section 76(5).[41]

These principles are canvassed below.

A. The Limits of the Reliance Principles

The basic justification for the reliance principles is that they correspond to prudent decision-making principles.[42] The reason for this is that directors are not expected to have all the knowledge and expertise needed to govern a company without seeking advice from third parties.[43] They are at times incapable of solely assessing and reading all written reports from the various company divisions.[44] In practice, directors must rely on advice and information from both internal and external sources.[45]

However, directors are not permitted to follow this advice blindly.[46] The court explained in *Fisheries Development Corporation of SA Ltd* v. *Jorgensen and Another; Fisheries Development Corporation of SA Ltd* v. *AWJ Investments (Pty) Ltd and Others*:[47]

> Obviously, a director exercising reasonable care would not accept information and advice blindly. He would accept it, and he would be entitled to rely on it, but he would give it due consideration and exercise his own judgment in the light thereof... a director may not be indifferent or a mere dummy. Nor may he shelter behind culpable ignorance or failure to understand the company's affairs.

This dictum was later endorsed, the Appellate Division[48] adding that directors have an affirmative duty to safeguard and protect the company's affairs,[49] and the Western Cape High Court emphasising that a director may properly act on advice in discharging directors' duties but may not follow it blindly.[50] In *Federal Deposit*

41 *Ibid.*, section 76(4)(b)(ii).

42 A. N. Rokas, 'Reliance on Experts from a Corporate Law Perspective,' 2(2), *American University Business Law Review* (2013) 323–352, at 328.

43 *Ibid.*, at 329.

44 *Ibid.*

45 M. Byrne, 'Do Directors Need Better Statutory Protection when Acting on the Advice of Others?' 21(3), *Australian Journal of Corporate Law* (2008) 238–57, at 238.

46 *Fisheries Development Corporation of SA Ltd* v. *Jorgensen and Another*; *Fisheries Development Corporation of SA Ltd* v. *AWJ Investments (Pty) Ltd and Others* 1980 (4) SA 156 (W), at 166; *Howard* v. *Herrigel and Another NNO* 1991 (2) SA 660 (A), at 674; *Cooper and Another NNO* v. *Myburgh and Others* [2021] 2 All SA 114 (WCC), at [15].

47 *Supra* note 46, at 166.

48 The Appellate Division was renamed the Supreme Court of Appeal in 1997.

49 *Howard* v. *Herrigel and Another NNO*, *supra* note 46, at 674.

50 *Cooper and Another NNO* v. *Myburgh and Others*, *supra* note 46, at [15].

Insurance Corp v. *Bierman*,[51] the US Court of Appeals for the Seventh Circuit also emphasised that directors may not rely blindly on the judgment of others and that there is a heightened responsibility among directors who have an 'inkling of trouble brewing.'[52]

As a result, the reliance principles necessitate limitations to prevent directors from blindly relying on third-party advice or hiding behind it without actively ensuring that it is worthy of trust. These limits should also help directors in determining how far they may rely on that advice and ensure that they are adequately protected when reasonably relying on third parties.

B. Interlinking of the Statutory Reliance Principles with the Business Judgment Rule

It is unclear whether the section 76(4)(b) reliance principles are connected to the business judgment rule in section 76(4)(a) of the Companies Act, or whether they are independent. This uncertainty arises because the legislature added the word 'and' between section 76(4)(a) (stating the business judgment rule) and section 76(4)(b) (stating the reliance principles). Because the reliance principles link with the business judgment rule, it may be argued that a director must first satisfy the business judgment rule requirements in section 76(4)(a) before being allowed to depend on the reliance principles in section 76(4)(b).

The business judgment rule prevents a court from interfering with the honest and reasonable business decisions of directors.[53] As to any particular matter arising in the exercise of the powers or the performance of the functions of a director, the rule deems a director to have satisfied the obligations of section 76(3)(b) (acting in the best interests of the company)[54] and section 76(3)(c) (acting with reasonable care, skill, and diligence).[55] The rule does not deem directors to have acted in accordance with their other duties, such as the duty to act in good faith and for a proper purpose (embodied in section 76(3)(a)). The rule requires that the director:

- has taken reasonably diligent steps to become informed about the matter;
- had no material personal or financial interest in the subject matter of the decision and no reasonable basis to know that any related person had such an interest, or the director disclosed his or her interest (under section 75 of the Companies Act); and
- made a decision, or supported the decision of a committee or the board, with regard to that matter, and had a rational basis for

51 (1993) 2 F 3d 1424, at 1433.

52 See further *Rankin* v. *Cooper* (1907) 149 F 1010, at 1013, where the court said that directors cannot shut their eyes to what is going on around them.

53 Cassim, *supra* note 5, at 759.

54 Companies Act, section 76(4)(a) read with section 76(3)(b).

55 *Ibid.*, section 76(4)(a) read with section 76(3)(c).

> believing, and did believe, that the decision was in the company's best interests.[56]

Interlinking the reliance principles with the business judgment rule may imply that the reliance principles do not provide full protection to directors for a breach of their duties but apply only when directors are examined to determine whether they acted in the best interests of the company and in accordance with the duty of care, skill, and diligence. The legislature needs to clarify whether:

(i) it intended the reliance principles to form part of the ambit of the business judgment rule;
(ii) it intended the reliance principles to provide only partial protection to directors; and
(iii) directors may depend on the reliance principles in section 76(4)(b) even when the business judgment rule does not protect them.

In sharp contrast, the Australian Corporations Act's statutory reliance principles are independent of the business judgment rule and govern all the duties of directors. If directors meet the section 189 requirements entitling them to rely on information or advice from others, their reliance will be presumed to be reasonable unless proven otherwise.[57] Section 189(c) states that for this presumption to operate, the reasonableness of the director's reliance on information or advice must arise in proceedings brought to determine whether a director has performed a duty under Part 2D.1 or an equivalent general law duty. Part 2D.1 states the duties and powers of directors.[58] The duties under Part 2D.1 include the duty to:

- act with care and diligence;
- act in good faith in the best interests of the corporation;
- act for a proper purpose; and
- not to improperly use the position of director or information obtained in their position to gain an advantage for themselves or someone else or cause detriment to the corporation.[59]

So the reliance principles under the Australian Corporations Act fully protect directors who breach their duties.

Similarly, the statutory reliance principles in the MBCA, contained in section 8.30(d), (e), and (f) (discussed in III.C and D below), are independent and not linked to the business judgment rule in section 8.31 of the MBCA, nor are they restricted to the duty of care and the duty to act in the best interests of the company, as they are in the Companies Act. Section 8.30, 'Standards of Conduct for Directors,' focuses on how directors make their decisions.[60] The main purpose of section 8.30, according to the MBCA Official Commentary,[61] is to provide

56 See further on the business judgment rule Cassim, *supra* note 5, at 759–63.
57 Australian Corporations Act, section 189(c).
58 *Ibid*., section 179(1).
59 *Ibid*., sections 180–183.
60 MBCA Official Commentary 8.30.
61 *Ibid*.

guidance on the manner in which directors discharge the duties assigned to them by section 8.01(b) (which states that the corporation's business and affairs must be managed or directed by and subject to the oversight of the board). It follows that if directors satisfy the reliance principles in section 8.30(d), (e), and (f) they will not breach the general standards of conduct in section 8.30.[62] These standards of conduct are the duty to act in good faith, in a manner the director reasonably believes to be in the best interests of the corporation, and with the care that a person in a similar position would reasonably believe appropriate in similar circumstances.[63]

It is submitted that the approach taken under both the Australian Corporations Act and the MBCA is preferable because the reliance principles are separate from and unrelated to the business judgment rule, and directors who satisfy these principles are deemed to have fulfilled a broader range of their duties. A similar approach should be adopted by the Companies Act. Directors should not be punished for failing to act in good faith or for a proper purpose if an otherwise qualified expert's advice is found to be flawed in hindsight.[64] This is especially true when the directors reasonably believed that the expert was reliable and competent, that the matter fell within the expert's professional or expert competence, or that the particular expert merited confidence.

C. Persons to Whom the Board has Delegated its Functions

Under section 76(4)(b)(i)(bb) of the Companies Act, directors are entitled to rely on the performance of any of the persons 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.' A formal delegation may take the form of a board resolution,[65] while an informal delegation by course of conduct may entail involving managers in managing a significant joint venture.[66]

1. The Reasonableness of the Delegation

The phrase 'reasonably have delegated' indicates that the protection granted to directors by this provision is not absolute: The board's delegation to a third party must be reasonable before a director may rely on it under section 76(4)(b)(i)(bb). The test is objective because reasonableness is assessed objectively.[67] So, if a director subjectively believes that the board's delegation was reasonable but objectively it was not, he or she will not be protected by section 76(4)(b)(i)(bb).

62 *Ibid*.
63 MBCA, section 8.30(a) and (b).
64 See T. A. Uebler, 'Reinterpreting Section 141(e) of Delaware's General Corporation Law: Why Interested Directors Should be Fully Protected in Relying on Expert Advice,' 65(4), *Business Lawyer* (2010) 1023–54, at 1025.
65 MBCA Official Commentary 8.30.
66 *Ibid*.
67 Uebler, *supra* note 64, at 1042; Rokas, *supra* note 42, at 332.

The provision does not specify when a director's reliance on delegation is reasonable.

For example, it is unclear whether a director is expected to make independent inquiries to determine whether the delegation by the board was reasonable. Still, as the reliance principles are linked to the business judgment rule, it is arguable that a director must satisfy the business judgment rule requirements in order to rely on section 76(4)(b)(i)(bb), the first of which is that the director must have taken reasonably diligent steps to become informed about the matter. This implies that, in order to rely on a person to whom the board has delegated its functions, the director must in every instance take reasonably diligent steps to become informed about the matter. Clarification is required about whether the legislature intended this outcome.

The reasonableness of the delegation or reliance must be determined on an ad hoc basis.[68] In *ASIC* v. *Adler & 4 Ors*,[69] the New South Wales Supreme Court provided useful judicial guidance on the factors that are important to determine the reasonableness of the delegation or reliance. These factors include:

- whether the function delegated is one that should properly be left to the delegate;
- the extent to which the director is put on inquiry or should have been put on inquiry, given the facts of the matter;
- whether the director honestly believed that the delegate was trustworthy and competent and someone on whom reliance may be placed;
- the risk involved in the transaction and the nature of the transaction; and
- the extent of steps taken by the director, such as inquiries made or the circumstances leading the director to trust the delegate.

These factors have persuasive authority in South Africa and may provide useful guidance to the courts in determining the reasonableness of the board's delegation under section 76(4)(b)(i)(bb) of the Companies Act.

2. Ambiguity on Nondelegable Matters

The phrase 'delegable under applicable law' in section 76(4)(b)(i)(bb) of the Companies Act suggests that delegation is not always permissible because some functions are not legally delegable. As previously discussed, although it is clear that the board may not abdicate its responsibilities, it is unclear which of its functions it may not delegate. Section 76(4)(b)(i)(bb) provides no guidance in this regard.

Directors may not, of course, delegate their responsibility to act as directors. A director's appointment is personal and may be discharged only by the office-

68 *ASIC* v. *Adler & 4 Ors* [2002] NSWSC 171 (14 March 2002), at [372].
69 *Ibid*.

holder.[70] As previously discussed, under section 66(1) of the Companies Act, the Memorandum of Incorporation of a company may limit the powers granted to directors, while under section 72(1)(b) it may limit the matters that the board may delegate to a board committee. As a result, the company's Memorandum of Incorporation must be consulted to see whether it has made any matters nondelegable by the board.

Section 76(4)(b)(i)(bb) is modelled on and worded similarly to section 8.30(d) of the MBCA, which reads:

> In discharging board or board committee duties, a director who does not have knowledge that makes reliance unwarranted is entitled to rely on the performance by any of the persons specified in subsection (f)(1) or subsection (f)(3) to whom the board may 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.

Section 8.25(d) of the MBCA sets out the board's functions that a full board must perform and may not delegate to a board committee. These include:

- filling board vacancies;
- authorising or approving distributions (except according to a formula or method or within limits prescribed by the board);
- approving or proposing to shareholders action that the MBCA requires to be approved by shareholders; and
- adopting, amending, or repealing by-laws.[71]

The rationale behind these restrictions is that the listed nondelegable matters substantially affect shareholders' rights or are so critical to the company's governance that they should be decided by the full board only.[72] Although section 76(4)(b)(i)(bb) of the Companies Act is closely modelled on section 8.30(d) of the MBCA, the South African Parliament omitted a provision like section 8.25(d) of the MBCA clarifying matters that the board may not delegate. So, it must address this omission urgently, particularly because nondelegable functions are often contentious, as demonstrated by the landmark Australian cases *ASIC* v. *Healey*[73] and *Australian Securities and Investments Commission* v. *Macdonald (No 11)* (*ASIC* v. *Macdonald*).[74]

70 See *Barlows Manufacturing Co Ltd and Others* v. *RN Barrie (Pty) Ltd and Others*, *supra* note 31, at 610.

71 See section 8.25(d)(1) to (4) of the MBCA. Adopting a merger agreement, declaring dividends or distributing corporate assets, authorising the issue of shares, and altering resolutions of the full board are also nondelegable matters in US states (see section 141(c) of the Delaware General Corporation Law (Title 8, Chapter 1 of the Delaware Code) and section 712(a) of the New York Business Corporation Law).

72 MBCA Official Commentary 8.25.

73 *Supra* note 11.

74 [2009] NSWSC 287 (23 April 2009).

The Federal Court of Australia held the directors of the Centro Properties Group (Centro) liable in *ASIC* v. *Healey*[75] for breaching their duty of care and diligence under section 180(1) of the Australian Corporations Act.[76] Centro's directors allowed incorrect information to be released in its annual financial statements and failed to detect the misclassification of $1.5 billion (AUD) in debt as non-current liabilities in Centro's 2007 financial accounts when the debt was a current liability.[77] The directors argued that they were entitled to rely on the auditors and the expertise of the company's audit committee and had delegated these matters to management and their advisors.[78] However, the court ruled that since the Australian Corporations Act specifically required that the board approve the company's financial statements,[79] while the directors were entitled to delegate the preparation of books and accounts to others and rely on competent advice[80] they could not substitute management's and their advisors' advice for their own examination of an important matter that fell specifically within their responsibility.[81] In validating and approving the annual financial statements, the court said that each director must:

- purposefully apply their individual discerning judgment;
- take a diligent and intelligent interest in the information available;
- understand that information and apply an 'enquiring mind' to the responsibilities placed upon him or her; and
- make further inquiries if the matters revealed in the financial statements called for those inquiries.[82]

The court found that each director missed the obvious errors in the financial statements because they all took the same approach of relying completely and solely on management and their advisors.[83] Although *ASIC* v. *Healey* suggests that directors may not delegate matters if there is a specific statutory requirement for all directors to take part in the act or decision, the Supreme Court of New South Wales held in *ASIC* v. *Macdonald*[84] that a matter was nondelegable even when there was

75 *Supra* note 11.
76 This provision requires directors to exercise their powers and discharge their duties with the degree of care and diligence that a reasonable person would exercise if they were a director of a corporation in the corporation's circumstances, occupied the director's office, and had the same responsibilities within the corporation as the director.
77 *ASIC* v. *Healey*, *supra*, note 11, at [9] and [584].
78 *Ibid*., at [220].
79 Section 344(1) of the Australian Corporations Act requires directors to take all reasonable steps to comply with, or to secure compliance with, the obligation to prepare financial statements in Part 2M.2 (financial records) and Part 2M.3 (financial reporting). Section 295(4)(d) (in Part 2M.3) requires directors to sign a declaration about the annual financial statements stating that in their opinion the financial statements and notes have been prepared in accordance with the Australian Corporations Act.
80 *ASIC* v. *Healey*, *supra* note 11, at [20].
81 *Ibid*., at [175].
82 *Ibid*., at [20].
83 *Ibid*., at [569].
84 *Supra* note 74.

no statutory requirement for a director to assume individual responsibility for a corporate action.[85]

In *ASIC* v. *Macdonald*, management had entrusted the board with vetting a draft announcement to the Australian Stock Exchange (ASX).[86] The court ruled that the directors had breached their duty of care and diligence in section 180(1) of the Australian Corporations Act by voting to approve the release of the announcement when they ought to have known that it was misleading in a material respect.[87] The court accepted the general legal proposition laid down by the Supreme Court of New South Wales in *Daniels* v. *Anderson*,[88] where that court had drawn upon US authority[89] that directors are entitled to rely on others except where they know, or by the exercise of ordinary care should have known, any facts that would deny the reasonableness of their reliance on others.[90] However, in *ASIC* v. *Macdonald*, the court held that this was not a matter on which a director was entitled to rely on his or her co-directors or outside experts because it was a key statement about a critical restructuring of the company group and made unequivocal statements about matters that were intrinsically uncertain (being the future value of asbestos litigation liabilities).[91] It ruled that since management had brought the matter to the board's attention, no director was entitled to rely blindly on management or a co-director on strategic matters that required their attention and fell within the board's responsibilities.[92] The directors could thus not delegate their responsibility to others, as the approval of the ASX announcement was a nondelegable duty.[93] This conclusion does not imply that directors are required to review every media communication issued by the company: it will depend on the facts of the case and whether the document in question is considered a strategic issue.[94]

These two cases illustrate the challenges that directors face when determining whether a matter is delegable or nondelegable. *ASIC* v. *Macdonald*,[95] in particular, demonstrates the difficulty that directors face in assessing when a matter has become significant to a degree that it may not be delegated.[96] To address these issues, it is submitted that the Companies Act should carve out statutory

85 See further Golding, *supra* note 30, at 281.

86 *ASIC* v. *Macdonald*, *supra* note 74, at [260].

87 *Ibid*., at [270]–[71].

88 *Supra* note 3, at 666.

89 See *Federal Deposit Insurance Corp* v. *Bierman*, *supra* note 51, at 1432–3, citing *Rankin* v. *Cooper*, *supra* note 52, at 1013.

90 *ASIC* v. *Macdonald*, *supra* note 74, at [248]. This general principle was followed in a number of cases, including *ASIC* v. *Adler & 4 Ors*, *supra*, note 68, at [372] and *Australian Securities and Investments Commission* v. *Mariner Corporation Limited* [2015] FCA 589 (19 June 2015), at [528] (*ASIC* v. *Mariner*).

91 *ASIC* v. *Macdonald*, *supra* note 74, at [260].

92 *Ibid*.

93 *Ibid*. See further A. Hargovan, 'Australian Securities and Investments Commission v Macdonald [No 11]: Corporate Governance Lessons from James Hardie,' 33(3), *Melbourne University Law Review* (2009) 984–1021, at 1013.

94 *Ibid*.

95 *Supra* note 74.

96 Golding, *supra* note 30, at 282.

exceptions similar to those in section 8.25(d) of the MBCA, which specify the matters that the board may not delegate. These should include decisions that have a significant impact on shareholders' rights or are so fundamental to the company's governance that only a full board should make them, such as:

- authorising and approving distributions;
- issuing shares;
- providing financial assistance;
- approving mergers and amalgamations; and
- filling vacancies on the board.

This approach would avoid controversy and confusion, clarify and strengthen the law, and avoid litigation against the company and the board. It would also promote healthy corporate development if the board's authority on matters critical to the company's governance were determined by a full board and statutorily rendered nondelegable.[97]

D. The Persons Referred to in Section 76(5) of the Companies Act on whom Directors May Rely

Section 76(4)(b)(i)(aa) of the Companies Act entitles directors to rely on the three groups of persons set out in section 76(5), as discussed below.

1. Employees

Under section 76(5)(a) of the Companies Act, a director may rely on 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.' This provision is modelled on both section 8.30(f)(1) of the MBCA[98] and section 189(a)(i) of the Australian Corporations Act.[99]

The reliance will be acceptable if the director 'reasonably believes' that the employee is reliable and competent in the functions performed or the information, opinions, reports, or statements provided. In *Tshishonga* v. *Minister of Justice and Constitutional Development and Another*,[100] the court interpreted the phrase 'reasonably believed' in the context of the whistleblower provisions in section 159 of the Companies Act[101] as indicating that the test is objective because the belief must be reasonable. So a subjective belief about the matter will not qualify for

97 Goel, *supra* note 21, at 166.

98 A director may rely on one or more officers or employees of the corporation whom the director reasonably believes to be reliable and competent in the functions performed or the information, opinions, reports, or statements provided (section 8.30(f)(i) of the MBCA).

99 Directors may rely on information or professional or expert advice given or prepared by an employee of the corporation whom the director believes on reasonable grounds to be reliable and competent in relation to the matters concerned (section 189(a)(i) of the Australian Corporations Act).

100 2007 (4) SA 135 (LC), at [185].

101 To be eligible for protection under section 159(3)(b) of the Companies Act, the whistleblower must reasonably believe at the time of making the disclosure that the information showed or

protection. The court said that whether a belief is reasonable is a finding of fact based on what the relevant person believes.[102] In *SA Municipal Workers Union National Fund* v. *Arbuthnot*,[103] the court clarified that the inquiry into the phrase 'reasonably believes' (also in the context of section 159 of the Companies Act) concerns the reasonableness of the *belief* about the truthfulness of the information, not the reasonableness of the information itself. So a belief can still be reasonable even if the information turns out to be inaccurate.[104] If this interpretation of the phrase 'reasonably believes' were applied to interpreting the equivalent phrase in section 76(5) of the Companies Act, the test to determine whether a director reasonably believed an employee or other expert to be reliable and competent would be objective and would focus on the reasonableness of the belief rather than the information.

Some commentators argue that the test for the phrase 'reasonably believes' in the context of the equivalent reliance principles under section 141(e) of the Delaware General Corporation Law[105] is objective.[106] For directors to prove that they reasonably believed an expert to be reliable or competent, they should prove that they considered all the material information about the expert and the issue that was reasonably available and that in the context of considering this information, it was reasonable to retain and rely on that expert at the time of the matter.[107]

According to the MBCA Official Commentary on the meaning of these words in section 8.30(f)(1), on which section 76(5)(a) is modelled, the phrase 'reasonably believes' embodies both a subjective and an objective element.[108] The first level of analysis focuses on what the specific director actually believes, assuming that belief is honestly held in good faith – a subjective frame of reference.[109] The second level of analysis considers whether the director's belief is objectively reasonable: That is, could (not would) a reasonable person in a similar position and acting in similar circumstances have arrived at that belief, given that director's knowledge and experience.[110] In other words, the belief must not be irrational and must fall within the bounds of sound discretion.[111] In line with this approach, it is submitted that the preferable interpretation of the phrase

tended to show that the company or a director or prescribed officer acting in that capacity had committed one of the types of wrongdoing listed in section 159(3)(b).

102 *Tshishonga* v. *Minister of Justice and Constitutional Development and Another*, *supra* note 100, at [185].

103 (2014) 35 ILJ 2434 (LAC), at 15.

104 *Ibid.*; *Radebe and Another* v. *Premier, Free State and Others* 2012 (5) SA 100 (LAC), at [36].

105 Section 141(e) of the Delaware General Corporation Law protects directors who rely in good faith on the information, opinions, reports, or statements presented to the corporation by its officers, employees, board committees, or experts which the director reasonably believes are within such person's professional or expert competence, and who has been selected with reasonable care by or on behalf of the corporation.

106 See, for example, Uebler, *supra* note 64, at 1042 and Rokas, *supra* note 42, at 332.

107 *Ibid*.

108 MCBA Official Commentary 8.30.

109 *Ibid*. See further R. F. Balotti and J. Hinsey IV 'Director Care, Conduct and Liability: The Model Business Corporation Act Solution,' 56(1), *Business Lawyer* (2000) 35–61, at 51.

110 MCBA Official Commentary 8.30.

111 Balotti and Hinsey, *supra* note 109, at 51.

'reasonably believes' in the context of the reliance principles in section 76(5) of the Companies Act is that the test is both subjective and objective.

In determining whether an employee is 'reliable' under section 76(5)(a), a director should consider the employee's experience and scope of responsibility within the company to assess the employee's knowledge of the subject matter, as well as the employee's record and reputation for honesty and ability in discharging responsibilities.[112] A director should take into account the same considerations in assessing whether the employee is 'competent,' but if the employee's expertise is relevant, the director should also take into account the employee's technical skills.[113]

It is puzzling why section 76(5)(a) of the Companies Act does not cover reliance on the employees' recommendations when section 76(4)(b)(ii) mentions recommendations as one of the categories on which directors may rely.[114] It is unclear whether Parliament omitted the category of the employees' recommendations intentionally or as an oversight. Recommendations, it could be argued, do not fall within the category of opinions. An opinion is a view or judgment about something and is subjective because it is based on a person's thoughts and beliefs; a recommendation is a proposal or an idea for consideration. It is arguable that, as section 76(4)(b)(ii) allows reliance on the recommendations of the persons referred to in section 76(5), reliance on employees' recommendations would impliedly be included. However, the legislature must clarify this discrepancy and correct it if it was an oversight.

2. Legal Counsel, Accountants, and Other Professional Persons

The second group of persons on whom directors may rely, under section 76(5)(b) of the Companies Act, are legal counsel, accountants, or other professional persons retained by the company, the board or a committee in matters involving skills or expertise that the director reasonably believes are matters:

(i) within the particular person's professional or expert competence; or
(ii) as to which that person merits confidence.

Section 76(5)(b) is modelled on section 8.30(f)(2) of the MBCA[115] and section 189(a)(ii) of the Australian Corporations Act.[116]

112 MBCA Official Commentary 8.30.

113 *Ibid*.

114 Directors are entitled to rely on any information, opinions, recommendations, reports, or statements, including financial statements and other financial data, prepared or presented by any of the persons specified in section 76(5) of the Companies Act (section 76(4)(b)(ii) of the Companies Act).

115 A director may rely on legal counsel, public accountants, or other persons retained by the corporation as to matters involving skills or expertise that the director reasonably believes are matters: (i) within the particular person's professional or expert competence; or (ii) as to which the particular person merits confidence (section 8.30(f)(2) of the MBCA).

116 A director may rely on information or professional or expert advice given or prepared by a professional advisor or expert in relation to matters that the director believes on reasonable

The reference to 'other professional persons' in section 76(5)(b) implies that the list of persons in this category is open-ended as long as the relevant person is a professional, such as a lawyer, engineer, management consultant, or investment banker. Section 1 of the Companies Act defines a 'person' as including a juristic person. The reference to 'person' implies that the professional person may be an individual or a juristic person, such as an accounting firm or a law firm.

A director may rely on this group of professional persons if he or she reasonably believes[117] that the relevant skills or expertise are within the person's professional or expert 'competence' or reasonably believes are matters on which the particular person merits 'confidence.' This assessment should take into account all relevant factors.[118] In the US case of *Selectica, Inc.* v. *Versata Enterprises*,[119] for example, it was argued that the board was unreasonable in relying on an investment banker's expert advice in determining the company's net operating losses because he was not an expert in net operating losses.[120] In rejecting this argument, the Delaware Court of Chancery held that even though this banker was not an expert in net operating losses, he was nevertheless a suitable person to assess the value of the company's net operating losses, given his work experience as an investment banker, a tax attorney, a certified public accountant, and a partner at several accounting firms specialising in tax accounting in the context of mergers and acquisitions.[121]

The term 'confidence' is used in section 76(5)(b)(ii) of the Companies Act, implying that technical skills are not required for a director to rely on the relevant person.[122] In other words, directors may rely on outside professional advisors when technical skills or expertise are not required, as long as the director reasonably believes that the person merits confidence.[123] For example, if the board hires a private investigator to investigate a specific matter, a director may properly rely on this investigator's report if the director reasonably believes that the person merits confidence.[124]

In *Moyo* v. *Old Mutual Limited and Others*,[125] the court held that the threshold for rejecting the board's reliance on legal counsel's advice is high. The board had acted on legal advice in refusing to reinstate a former chief executive officer to his position in the company and locking him out of the building. In determining whether the directors were justified in relying on the legal advice provided by legal counsel, the court held that the inquiry is not whether the legal advice was correct, but whether the reliance on it was sufficient to negate an inference that

grounds to be within the person's professional or expert competence (section 189(a)(ii) of the Australian Corporations Act).

117 The meaning of the phrase 'reasonably believes' is discussed in III.D.1 above.

118 Rokas, *supra* note 42, at 332.

119 No 4241-VCN (Del Ch Feb 26, 2010), at 50.

120 *Selectica, Inc.* v. *Versata Enterprises*, *supra* note 119, at 48.

121 *Ibid*., at 50.

122 MBCA Official Commentary 8.30.

123 *Ibid*.

124 *Ibid*.; Balotti and Hinsey, *supra* note 109, at 51.

125 [2022] 3 All SA 795 (GJ), at [148].

the directors had acted in bad faith.[126] The court found that the legal advice could not be labelled fictitious, palpably uncreditworthy, or unreasonable,[127] that the directors' actions in relying on it were based on good faith legal advice and that the board was justified in relying on it.[128]

Directors must exercise caution when selecting professional persons. Relying on those who lack the necessary qualifications or experience risks breaching directors' fiduciary duties as well as their duty of care, skill, and diligence. In *ASIC* v. *Citrofresh International Ltd (No 2)*,[129] for example, the Federal Court of Australia held that the appointee as both managing director and chief executive officer of a publicly listed company relied unreasonably on two consultants. The company issued a misleading ASX announcement stating that it had discovered a way to curb the spread of the Human Immunodeficiency Virus (HIV) by using the company's chemical product.[130] The announcement was approved by the managing director, who had also participated in preparing and drafting it.[131] In his defence, he argued that when preparing the announcement he had placed reasonable reliance on two experts retained by the company.[132] The court rejected this defence because it found that the two individuals were not experts on the subject matter of the statements and lacked technical or scientific qualifications or experience to justify the managing director's reliance on them.[133] The court held him liable for a breach of his duty of care and diligence under section 180(1) of the Australian Corporations Act as he had caused the company to make misleading and deceptive statements to ASX.[134]

3. Board Committees

The third group of persons a director may rely on, under section 76(5)(c) of the Companies Act, are board committees of which the director is not a member, unless he or she has reason to believe that the committee's actions do not merit confidence. Section 76(5)(c) is modelled on section 8.30(f)(3) of the MBCA[135] and section 189(a)(iv) of the Australian Corporations Act.[136]

In general, the appointment of board committee members or the reconstitution of the members of a standing committee such as the audit committee following

126 *Moyo* v. *Old Mutual Limited and Others*, *supra* note 125, at [152].
127 *Ibid*., at [151].
128 *Ibid*., at [152].
129 [2010] FCA 27 (2 February 2010).
130 *Australian Securities and Investments Commission* v. *Citrofresh International Ltd (No 2)*, *supra* note 129, at [2].
131 *Ibid*.
132 *Ibid*., at [53].
133 *Ibid*., at [55].
134 *Ibid*., at [6].
135 A director may rely on a board committee of which he or she is not a member if the director reasonably believes that the committee merits confidence (section 8.30(f)(3) of the MBCA).
136 A director may rely on information or professional or expert advice given or prepared by a committee of directors on which the director did not serve in relation to matters within the committee's authority (section 189(a)(iv) of the Australian Corporations Act).

an annual general meeting would manifest the non-committee members' belief that the committee 'merits confidence.'[137] In the usual case after making an initial judgment that a board committee merits confidence, a director may continue to rely on that board committee, provided he or she has no reason to believe that the committee's actions no longer merit confidence.[138]

4. Information Prepared or Presented by the Persons Referred to in Section 76(5)

Section 76(4)(b)(ii) of the Companies Act entitles directors to rely on any information, opinions, recommendations, reports, or statements, including financial statements and other financial data, prepared or presented by any of the persons specified in section 76(5).

Section 76(4)(b)(ii) is modelled on section 8.30(e) of the MBCA,[139] but a difference between the two provisions is that section 8.30(e) considers directors to have discharged their duties if they do 'not have knowledge that makes reliance unwarranted.' In other words, reliance is prohibited when a director has knowledge that makes reliance unwarranted. This proviso has not been incorporated into section 76(4)(b)(ii) of the Companies Act. It is submitted that as directors have a fiduciary duty to act in good faith and in the best interests of the company under section 76(3)(a) and (b) of the Companies Act, they would breach their fiduciary duties if they were to rely on information in circumstances where they had knowledge that made the reliance unwarranted. It is therefore arguably implied that directors should not rely on information when reliance is unwarranted, even though section 76(4)(b)(ii) does not explicitly incorporate these words. Nevertheless, it would be useful to include this proviso in section 76(4)(b)(ii) for clarity and avoidance of doubt, and to guide directors on the limits of their reliance.

Under section 76(4)(b)(ii), directors may rely on the relevant category of information 'prepared or presented' by any of the persons specified in section 76(5). According to the MBCA Official Commentary, under section 8.30(e) of the MBCA, a director's reliance on the relevant information will be permitted only if he or she has read the relevant information, orally heard the presentation, or taken steps to become generally familiar with it.[140] As section 76(4)(b)(ii) is closely modelled on section 8.30(e) of the MBCA, it is submitted that this interpretation of the equivalent provision carries persuasive force in South Africa. Thus, directors are arguably not entitled to rely on the information in question under section 76(4)(b)(ii) of the Companies Act if they have not taken any steps to become familiar with it.

137 MBCA Official Commentary 8.30.

138 *Ibid*.

139 According to section 8.30(e) of the MBCA, in discharging board or board committee duties, a director who does not have knowledge that makes reliance unwarranted may rely on information, opinions, reports, or statements, including financial statements and other financial data, prepared or presented by any of the persons specified in subsection (f). Section 76(4)(b) of the Companies Act is wider than section 8.30 of the MBCA in that it entitles directors to rely on recommendations, whereas section 8.30 of the MBCA does not cover this category.

140 MBCA Official Commentary 8.30.

Notably, section 76(4)(b)(ii) entitles directors to rely on financial statements and other financial data prepared or presented by any of the persons specified in section 76(5) (such as accountants or the audit committee). This provision must be read together with section 30(3)(c) of the Companies Act, which states that a company's annual financial statements must be approved by the board and signed by an authorised director. As the Companies Act specifically requires the board to approve the company's financial statements, according to *ASIC* v. *Healey*[141] discussed earlier, which has persuasive authority in South African law, even though section 76(4)(b)(i)(ii) of the Companies Act entitles directors to rely on financial statements and other financial data prepared or presented by the persons specified in section 76(5), each director would be charged with the responsibility of attending to and focusing on these accounts, and would not be allowed to delegate or abdicate his or her responsibility to approve the financial statements to others.

Is it necessary for directors to conduct an independent assessment of the information, opinions, recommendations, reports, or statements received from third parties? Sections 76(4)(b) and 76(5) of the Companies Act do not address this matter. However, if, as previously discussed, the reliance principles in section 76(4)(b) are linked to the business judgment rule, then directors must in every instance of reliance on information or advice from third parties satisfy the first requirement of the business judgment rule of taking reasonably diligent steps to become informed about the matter.

In sharp contrast, section 189 of the Australian Corporations Act expressly addresses the need for directors to make inquiries. Under section 189 a director's reliance is presumed reasonable if certain conditions were met, unless the contrary is proved. The conditions are that the reliance by the director was made:

(i) in good faith;[142] and
(ii) after making an independent assessment of the information or advice, having regard to the director's knowledge of the corporation and the complexity of its structure and operation.[143]

The Federal Court of Australia said in *ASIC* v. *Mariner*[144] that the independent assessment under section 189(b)(ii) of the Australian Corporations Act does not require directors to obtain an assessment by an independent expert (although this step may be necessary if the circumstances are serious enough), nor does it require the assessment to be comprehensive or conducted from a position of scepticism, but it does suggest that the directors should analyse the information or advice without bias.[145] The fact that the independent assessment must take into

141 *Supra* note 11, at [17].
142 Australian Corporations Act, section 189(b)(i).
143 *Ibid*., section 189(b)(ii).
144 *Supra* note 90, at [533].
145 See further on the nature of independent assessments in this context *In the matter of Idylic Solutions Pty Ltd – Australian Securities and Investments Commission* v. *Hobbs* [2012] NSWSC 1276 (24 October 2012), at [1525].

account the director's knowledge of the corporation, as well as the complexity of its structure and operations, implies that the type of assessment may vary depending on these facts and that some information or advice will be scrutinised more closely by a director.[146] For example, if a director is a finance director, it will be reasonable to expect that financial information or advice provided by a third party will be subjected to more detailed scrutiny or assessment by that director than information or advice falling outside that director's area of expertise.[147]

Some contend that section 189(b)(ii) of the Australian Corporations Act places too high a burden on directors by requiring them to make an independent assessment of information or advice received in every instance in order to benefit from the presumption and have their reliance presumed to be reasonable.[148] It is submitted that requiring directors in every instance to make an independent assessment of the information or advice they receive would impede efficient decision-making and would be impractical. The more directors are required to verify the information and advice sought, the more inefficient the decision-making process becomes.[149]

For this reason, it is submitted that under section 76(4)(b)(ii) of the Companies Act, directors should have to make further inquiries about the information, opinions, recommendations, reports, or statements relied on only if the circumstances indicate the need for it or if the information alerts the director to a potential irregularity – but not in every instance of reliance, as this requirement may be overly burdensome. Although directors must not turn a blind eye or bury their heads in the sand, when there is no cause for suspicion, a director's belief that the relevant third party was reliable, competent, or merited confidence, or that the relevant skills or expertise fell within his or her competence should be considered reasonable. For certainty and clarity, it is submitted that the legislature should guide directors on whether they must continue to make independent inquiries to verify the accuracy of the information they receive and clarify whether they are required to take reasonably diligent steps to become informed about the matter in every instance of reliance, as stipulated in the business judgment rule.

IV. CONCLUSION

This article attempted to distil the principles of directors' delegation and reliance under sections 76(4)(b) and 76(5) of the Companies Act. These principles, it

146 R. P. Austin and I. M Ramsay, *Ford, Austin and Ramsay's Principles of Corporations Law*, 17th edn (LexisNexis 2018), at 314.

147 *Ibid*.

148 See, for example, Byrne, *supra* note 45, at 249, who argues that the very purpose of introducing sections 189 and 190 of the Australian Corporations Act was to make it easier for directors to delegate and leave matters to those who appear to be trustworthy, but that section 189 may now be making matters more difficult for directors. Austin and Ramsay also argue that section 189(b)(ii) imposes a 'heightened burden' on directors in order for them to obtain the benefits of section 189 (Austin et al., *supra* note 146, at 314).

149 Byrne, *supra* note 45, at 254.

has been argued, lack clarity and are ambiguous in some ways. The following submissions are suggested to clarify and improve on these principles.

The South African legislature must clarify whether it intended the reliance principles in section 76(4)(b) of the Companies Act to be included in the scope of the business judgment rule and whether directors may depend on the statutory reliance principles even when they are not protected by the business judgment rule. The legislature must also clarify whether it intended the reliance principles to provide only partial protection to directors and to be limited to cases in which directors are scrutinised over whether they have acted in the best interests of the company and in accordance with the duty of care, skill, and diligence. The delegation and reliance principles in section 76(4)(b) of the Companies Act should be independent principles fully protecting directors, as they are under both the Australian Corporations Act and the MBCA.

Guidelines similar to those in section 190(2) of the Australian Corporations Act should be incorporated into the Companies Act to guide directors on where to draw the lines of delegation to a third party and when they may be relieved of liability for the exercise of their power by a delegate. Further, statutory exceptions like those in section 8.25(d) of the MBCA should be carved out in section 76(4)(b)(i)(bb) of the Companies Act to specify the functions that the board may not delegate.

The legislature must clarify whether the omission of the category of recommendations in section 76(5)(a) was intentional or unintentional. Section 76(4)(b)(ii) of the Companies Act should incorporate a proviso similar to section 8.30(e) of the MBCA stating that reliance on the relevant information is prohibited when a director's knowledge renders reliance unwarranted. The legislature must also clarify whether directors are required to make further inquiries or conduct an independent assessment of the information, opinions, recommendations, reports, or statements received from third parties and whether they must take reasonably diligent steps to become informed about the matter in every instance of reliance, as stipulated in the business judgment rule.

Until these ambiguities are resolved, directors should exercise caution when deciding whether to delegate their functions and when relying on third parties. As the court stressed in *ASIC* v. *Healey*,[150] more than just 'going through the paces' is needed from a director, who is not 'an ornament, but an essential component of corporate governance.' Nonetheless, given the current lack of clarity and the ambiguity in the delegation and reliance principles under the Companies Act, courts should apply these legal principles to directors in a realistic and practical manner.

150 *Supra* note 11, at [19]; the latter quotation is Pollock J's ruling in *Francis* v. *United Jersey Bank* (1981) 432 A 2d 814 (Supreme Court of New Jersey) at [34].

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To aid discovery of authors, articles, research, multimedia and reviews published in Journals, and as a consequence contribute to increasing traffic, usage and citations of journal content.

2. Audience

Blog posts are written for an educated, popular and academic audience within EUP Journals' publishing fields.

3. Content criteria - your ideas for posts

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- No heavy restrictions to the style or format of the post, but it should best reflect the content and topic discussed.

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