

STAKEHOLDERS AND THE DUTY TO ACT IN THE BEST INTERESTS OF THE COMPANY: WHAT IS REQUIRED OF DIRECTORS?

by

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I INTRODUCTION

1.1 Introduction

A company is more than an economic unit generating wealth. It fulfils human and societal aspirations as part of the broader social system. Performance must be measured not only on the return to shareholders, but also on how it achieves its environmental, social and good governance objectives.

This is one of the fundamental recognitions of the ‘Davos Manifesto 2020: The Universal Purpose of a Company in the Fourth Industrial Revolution’, signed by numerous big corporations in early 2020.¹ The Manifesto represents the recognition that society demands more from companies.

Corporations are seemingly ubiquitous and omnipotent. In 2017, a study was conducted which determined that 69 out of the top 100 economic entities in the world, measured by company and country revenues, were companies. The divide deepened when considering the top 200 economic entities, of which 157 were corporations.² When this undeniable power is abused, someone must be held accountable. Blame is often attributed to the highest decision-makers of the company namely, directors. It is these officials who are the subject of this dissertation.

It has for decades been debated whether companies owe a duty of corporate social responsibility (‘CSR’) to the communities and environment in which they function and if so, to what extent. This question remains relevant in the year of 2020, a year which has left many parts of the world far more vulnerable than before. Corporations have been at the helm of human rights and environmental abuses for decades whether in the form of oil spills, sweat shops, obscene corruption or any similar inhumanity that might come to mind. In some cases, there is a gross inequality between management and other constituents of the company.³ This tension and even antagonism in society is perhaps an indication that Adam Smith’s ‘invisible hand’ needs assistance in minimising society’s dabbles in entropy. On a continent fuelled by

¹ World Economic Forum ‘Davos Manifesto 2020: The Universal Purpose of a Company in the Fourth Industrial Revolution’ available at <https://www.weforum.org/agenda/2019/12/davos-manifesto-2020-the-universal-purpose-of-a-company-in-the-fourth-industrial-revolution/>, accessed on 16 December 2020.

² Global Justice Now ‘69 of the richest 100 entities on the planet are corporations, not governments, figures show’ 17 October 2018, available at <https://www.globaljustice.org.uk/news/2018/oct/17/69-richest-100-entities-planet-are-corporations-not-governments-figures-show>, accessed on 12 June 2020. Seventeen years prior to the 2017 statistics only 51 of the top 100 entities were companies with 49 being countries. (Sarah Anderson & John Cavanagh ‘Top 200: The rise of global corporate power’ *Global Policy Forum*, available at <https://www.globalpolicy.org/component/content/article/221/47211.html>, accessed on 6 June 2020).

³ Kent Greenfield ‘Using behavioral economics to show the power and efficiency of corporate law as a regulatory tool’ (2002) 35(3) *University of California Davis Law Review* 581at 603.

foreign direct investment, often in the form of large multinational corporations, the scrutiny of corporate behaviour is a necessity.

Whether corporations should concern themselves with social, economic and environmental issues is foremost a moral and political question. The Davos Manifesto represents an increasing global realisation that corporate responsibility is no longer a ‘nice-to-have’ but a non-negotiable from companies by virtue of their interdependence with society. Imposing restrictions on corporations tugs at our convictions on private ownership, private property and liberty. The law provides numerous avenues for demanding greater responsibility from companies but this dissertation shall focus on the fiduciary duty of directors to act in the ‘best interests of the company’ as contained in both South African common law and section 76(3)(b) of the Companies Act of 2008.⁴

The purpose of this dissertation is to explore the historical, theoretical, policy and contemporary legal underpinnings of the fiduciary duty to act in the best interests of the company. This discussion examines the scope of the fiduciary duty and whether it aligns with law and legal policy. This contextual analysis provides further insight and thus legitimacy to interpretations of the fiduciary duty. It is necessary because ‘public opinion . . . ultimately makes law....’⁵

Contained herein is an outline of three theories of corporate governance: shareholder primacy, enlightened shareholder value and stakeholder pluralism. There has been a greater affinity for the enlightened shareholder value approach in recent decades.⁶ While theory and policy are useful, they are, in this case, indeterminate. The 2008 Companies Act of South Africa does not indicate a decisive choice of the corporate governance theories listed above. Consequently, this dissertation examines the common law to find content for the duty to act in the best interests of the company. It engages in an interpretive exercise with focus on the influence of the Constitution,⁷ its values, the King Reports⁸ and company law policy to give revised meaning to the duty. With much still to be decided by the courts, a discussion of the business judgment

⁴ Companies Act 71 of 2008.

⁵ E. Merrick Dodd ‘For whom are corporate managers trustees?’ (1932) 45(7) *Harvard Law Review* 1145 at 1148.

⁶ Companies Act 2006 s 172(1); The Company Law Review Steering Group (UK) *Modern Company Law for a Competitive Economy: The Strategic Framework* (February 1999) available at <https://webarchive.nationalarchives.gov.uk/20121101191957/http://www.bis.gov.uk/files/file23279.pdf>, accessed on 27 October 2020.

⁷ Constitution of the Republic of South Africa, 1996 herein referred to as the ‘Constitution.’

⁸ The latest being King IV: Report on Corporate Governance in South Africa 2016 available at https://cdn.ymaws.com/www.iodsa.co.za/resource/collection/684B68A7-B768-465C-8214-E3A007F15A5A/IoDSA_King_IV_Report_-_WebVersion.pdf accessed on 7 August 2020.

rule ('BJR') concludes this dissertation. The BJR provides clarity on how directors should act if they wish to avoid liability. The BJR thus adds clarity in light of a fiduciary duty that is ever changing, according to the convictions of the community.

This dissertation therefore serves two purposes. First, it examines the extent to which the fiduciary duty to act in the best interests of the company incorporates the interests of stakeholders other than shareholders. Given the finding that the fiduciary duty is ambiguous in content, this dissertation proceeds, secondly, to provide clarity to directors who may be unsure of what the law demands of them in exercising their decision-making powers.

1.2 Corporate Social Responsibility

1.2.1 The Origins

The social function or role of companies is not novel. Under Roman law, the state recognised numerous groups as distinct legal entities with their own separate legal identity.⁹ Such organisations included the *collegium* and *universitas*.¹⁰ These entities had a strong social element to them since they served to educate and upskill the public.¹¹ Distinct legal personality was also granted to hospitals, orphanages, burial societies, asylums, political clubs and homes established for the poor and elderly.¹² In this way, groups were licensed to serve public purposes.¹³

During the Middle Ages, the English Crown and later parliament reserved the powers to create corporations and grant corporate charters.¹⁴ These concessions were granted for religious, charitable and social purposes, such as for universities, rather than for commercial purposes.¹⁵ The English conception of the corporation spread to the English colonies in the Americas. There, for the first time, in the 1790s and 1800s, a distinction was drawn between profit and non-profit corporations through the enactment of the general incorporate statutes in states including North Carolina in 1795, New York in 1811 and Connecticut in 1837.¹⁶

⁹ Eric C. Chaffe 'The origins of corporate social responsibility' (2017) 85(2) *University of Cincinnati Law Review* 353 at 357.

¹⁰ *Ibid.*

¹¹ *Ibid.*

¹² *Ibid.*

¹³ *Ibid* at footnote 16.

¹⁴ *Ibid* at 358-9.

¹⁵ *Ibid* at 358-9.

¹⁶ *Ibid* at 360.

Nonetheless, corporate philanthropy persisted. Companies donated to charities but even the ‘robber barons’ of the American Industrial Revolution viewed this meagre form of corporate philanthropy as insufficient. One such baron, Andrew Carnegie, produced his noteworthy essay entitled ‘*The Gospel of Wealth*’ in 1889.¹⁷ Carnegie argued that the best antidote to the unequal distribution of wealth resulting from the Industrial Revolution was for the wealthy to administer their wealth for the public good and throughout their lifetimes.¹⁸ For Carnegie, vice manifested not in the accumulation of wealth, but in its hoarding. He proffered that wealth should be invested in the public good by creating libraries, universities and similar resources accessible to the public.

The laws of the early 1900s did not immediately follow suit. In the United States, the Michigan Supreme Court produced their seminal decision on corporate philanthropy in *Dodge v Ford Motor Co.*¹⁹ In the 1919 judgment, the court was tasked with determining the legality of a director’s decision to reinvest surplus company profits into the company for the end of increasing employee wages and decreasing the price of Ford motors to the benefit of consumers.²⁰ The court found in favour of the minority shareholders who brought the suit, the Dodge brothers. The court remarked²¹

A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of the directors is to be exercised in the choice of means to attain that end, and does not extend to . . . other purposes.

The judgment is oft quoted as authority for the position that the interests of shareholders supersede all other interests in the corporation.²² Stout provides valid criticism of this practice.²³

Little more than a decade after the judgment, the famous Dodd-Berle debate of the 1930s ensued. To whom directors owe their duties in exercising their powers was the central question in the debate and remains relevant. Charitable giving in the US is now largely regulated by

¹⁷ Andrew Carnegie ‘The Gospel of Wealth’ available at https://production-carnegie.s3.amazonaws.com/filer_public/ab/c9/abc9fb4b-dc86-4ce8-ae31-a983b9a326ed/ccny_essay_1889_thegospelofwealth.pdf, accessed on 29 August 2020.

¹⁸ *Ibid.*

¹⁹ *Dodge v. Ford Motor Co.* 204 Mich. 459, 170 N.W. 668 (1919).

²⁰ *Ibid.*

²¹ *Ibid.* at 684.

²² Lynn A. Stout ‘Why we should stop teaching *Dodge v. Ford*’ (2008) 3(1) *Cornell Law Faculty Publications* 163 at 166.

²³ *Ibid.* Stout purports that the decision is an incorrect interpretation of the doctrine of corporate purpose. She points out that the legislature and courts have treated it as irrelevant with the judgment only being cited once by the Delaware courts in thirty years and for a distinguishable issue.

‘philanthropy statutes.’²⁴ There is however, no consensus from the courts as to the extent to which these statutes permit charity with some courts still clinging to the requirement that such giving necessarily benefits the company.²⁵

The traditional common law approach in England was to apply the *ultra vires* doctrine. In *Hutton v West Cork Railway Company*, the English Court of Appeal was confronted with an insolvent company which resolved to compensate paid officials of the company for their loss of employment and directors for their previous service to the company. The court held that²⁶

. . . charity has no business to sit at boards of directors qua charity. There is, however, a kind of charitable dealing which is for the interest of those who practise it, and to that extent and in that garb (I admit not a very philanthropic garb) charity may sit at the board, but for no other purpose.

The court added that the inquiry is not simply whether a director’s decision was *bona fide*, but in addition, whether directors’ dealings are done within the ordinary scope of the company’s business and, whether it is reasonably incidental to the carrying on of the company’s business or for its benefit.²⁷ As the oft-quoted line goes, ‘the law does not say that there are to be no cakes and ale, but there are to be no cakes and ale except such as are required for the benefit of the company.’²⁸

Essentially, the Court of Appeal confirmed that charitable giving is *ultra vires*.²⁹ The 2006 UK Companies Act has since codified the consideration of stakeholder interests in its section on directors’ fiduciary duties.³⁰ Fiduciary duties are now the point of contention rather than the *ultra vires* doctrine.

Evidently the link between corporations and social needs was recognised as long ago as Roman times. While industrialisation may have contributed to amnesia regarding the social origins of corporations, the social responsibility of corporations is a contention which continues to reveal itself.

²⁴ R. Franklin Balotti and James J. Hanks ‘Giving at the office: A reappraisal of charitable contributions by corporations’ (1999) 54 *The Business Lawyer* 965.

²⁵ Lilia Franca ‘A legal analysis of corporate social responsibility: A comparative approach’ (2006) 12 *South African Private Law* 286 at 290.

²⁶ *Hutton v West Cork Railway Co* (1883) 23 ChD 654 at 673.

²⁷ *Ibid* at 672-673.

²⁸ *Ibid*.

²⁹ This decision followed from the earlier judgment of *Hampson v Price’s Patent Candle Company* (1876) 45 L.J Ch 437, where directors, after a highly profitable year, gifted employees. The court held the action was not *ultra vires* as it incentivised employees and therefore contributed to the company.

³⁰ Companies Act 2006 Chapter 46.

1.2.2. *Corporate Social Responsibility in South Africa*

The emergence of CSR in South Africa has been traced to the banking, mining and oil industries of the early 1970s.³¹ The law of the time posed little obligation on directors to consider running their corporations for the benefit of non-shareholder stakeholders as the common law duties on directors followed those developed by the English courts.³² In the case of *Amalgamated Society of Woodworkers of SA v Die 1963 Ambagsaalvereniging*, the court upheld the English position in *Hutton* when it stated that³³

the power of a corporate body to donate a major asset cannot be lightly inferred . . . donations should . . . be limited to such donations as are reasonably incidental to the carrying on of the activities of the donor or which are for the benefit of the donor.

The social responsibility of corporations was therefore denied and the law viewed corporations as responsible only for their profit-making function. The position as expressed in *Amalgamated Society of Woodworkers of SA* was formulated in 1967. It is significant because this contradistinction between profit and social functions of corporations informed the corporate law which applied during Apartheid

The injustices of Apartheid were however recognised by overseas corporates. In 1977, an African American Baptist minister and a member of the board of directors of General Motors in the United States, Revered Sullivan, created a code of conduct encapsulating six core principles to guide the conduct of US subsidiaries in South Africa. The Sullivan Principles demanded workplace desegregation, fair employment practices, equal pay for equal work, training, increased quality of life and the advancement of black Africans including by increasing representation in management.³⁴

The Code was revised in 1984 and additionally called for the unrestricted rights of black-owned businesses in urban areas, the adherence of other companies to the Sullivan Principles and the abolition of all Apartheid laws.³⁵ Of course, Apartheid persisted until 1994. While the Codes encouraged reform, one view is that they were fundamentally flawed for prolonging the stay

³¹ Neil Fourie *Corporate Social Responsibility – Evaluating Three South African Companies’ Initiatives* (unpublished MBA thesis, Nelson Mandela Metropolitan University Business School, 2005) at 13.

³² Farouk HI Cassim ‘The duties and the liability of directors’ in Farouk HI Cassim et al *Contemporary Company Law* 2 ed (2012) 507.

³³ *Amalgamated Society of Woodworkers of SA and Another v Die 1963 Ambagsaalvereniging* 1967 (1) SA 586 (T) at 594f.

³⁴ Mzamo P Mangaliso ‘South Africa: Corporate social responsibility and the Sullivan Principles’ (1997) 28(2) *Journal of Black Studies* 219 at 228.

³⁵ *Ibid.*

of businesses in Apartheid South Africa.³⁶ Larson notes the usefulness in this contradiction in illuminating the tension between corporate globalisation and human rights.³⁷

Ultimately, the South Africa legal position remained reflective of the *Hutton* position. The pre-1994 CSR efforts have therefore been described as mere ‘philanthropic-type contributions’ which furthered company interests.³⁸ The law did not recognise any responsibility on the part of directors for the furtherance of Apartheid by companies.

1.2.3. Defining Corporate Social Responsibility in South Africa

1.2.3.1 Corporate Social Responsibility, Corporate Citizenship and Corporate Governance

This dissertation has thus far referenced the notion of corporate social responsibility without defining it. Commentators have not settled on a definition of corporate social responsibility. McBarnet offers that CSR exists when corporations voluntarily exceed their legal obligations in addressing broader issues.³⁹ These broader issues might include those posed by the economy, society and environment in which companies operate. For a corporation to be socially responsible, it might address human rights abuses, environmental degradation, fair trading, corruption or a range of other issues. Corporate social responsibility therefore means addressing societal ills or needs even when the law does not require it.

Corporate social responsibility in South Africa is encompassed primarily in the King Reports.⁴⁰ King Report III defines CSR as ‘the responsibility of the company for the impacts of its decisions and activities on society and the environment.’⁴¹ This, it explains, is achieved through transparent and ethical behaviour which contributes to sustainable development, taking into account the legitimate interests and expectations of stakeholders. The latest King Report, King IV, departs from this notion somewhat, mentioning CSR only once and in defining what

³⁶ Zeb Larson ‘The Sullivan Principles: South Africa, Apartheid, and globalisation’ (1996) 20(1) *Oxford University Press* 479.

³⁷ *Ibid.*

³⁸ Sharlene Ramlall ‘Corporate social responsibility in post-Apartheid South Africa’ (2012) 8(2) *Social Responsibility Journal* 270 at 273.

³⁹ Doreen McBarnet ‘Corporate social responsibility beyond law, through law, for law’ Working Paper Series 2009/03, University of Edinburgh School of Law at 3.

⁴⁰ The latest being King IV: Report on Corporate Governance in South Africa 2016 op cit note 8.

⁴¹ King III: Report on Governance in South Africa available at https://cdn.ymaws.com/www.iodsa.co.za/resource/resmgr/king_iii/King_Report_on_Governance_fo.pdf, accessed on 9 October 2020 at 118.

sustainable development is not.⁴² Instead, King IV forwards the concept of corporate governance, which can be explained with reference to corporate citizenship.

Corporate citizenship is the overriding philosophy from which CSR extends. It is, according to King IV, the recognition that companies, as juristic persons, attract both rights and obligations resulting from the fact that ‘society is [its] licensor.’⁴³ Porter and Kramer, the seminal writers on the Shared Value business management philosophy, would describe this as the ‘license to operate’ rationale of CSR.⁴⁴ The idea of attracting rights and obligations is reflected in section 8 of the Constitution of South Africa which states that juristic persons are both bound by the Bill of Rights and entitled to its rights to the extent that they may be applicable.⁴⁵

Corporate governance concerns the way in which directors discharge their duties.⁴⁶ The King IV report defines corporate governance as leadership which is both ethical and effective.⁴⁷ Ethical leadership entails integrity, competence, responsibility, accountability, fairness and transparency.⁴⁸ Notably, King IV includes that ethical leadership extends to the repercussions of an organisation’s activities on the economy, society and environment⁴⁹ and therefore alludes to director decision-making which is more inclusive of external interests. Effective leadership is defined in King IV as results-driven leadership which ‘goes beyond an internal focus,’⁵⁰ thus indicating support for considering the environment, economy and society.

1.2.3.2 The Four Proponents of Corporate Social Responsibility

Porter and Kramer identify four proponents of CSR namely, moral obligation, sustainability, license to operate, and reputation.⁵¹ While Porter and Kramer wrote in service of business strategists, their work does prove useful in clarifying the underlying rationales of CSR. King III alludes to Porter and Kramer’s first proponent: moral obligation. In defining corporate citizenship, King III states that companies’ responsibility is borne from their ‘legal and moral

⁴² King IV at 18.

⁴³ King IV at 11.

⁴⁴ Michael E Porter & Mark R Kramer ‘Strategy & society: The link between competitive advantage and corporate social responsibility’ (December 2006) *Harvard Business Review* 1.

⁴⁵ Constitution supra note 7 section 8(2) and (5).

⁴⁶ Rehana Cassim ‘Corporate governance’ in Farouk HI Cassim et al *Contemporary Company Law* 2 ed (2012) 472 at 473.

⁴⁷ King IV op cit note 8 at 20.

⁴⁸ Ibid.

⁴⁹ Ibid at 4.

⁵⁰ Ibid at 20.

⁵¹ Michael E Porter & Mark R Kramer ‘Strategy & society: The link between competitive advantage and corporate social responsibility’ op cit note 44 at 3.

obligations’ to their economic, social and natural environments.⁵² The introduction of morality plays to moral appeal – that CSR is the ‘right thing’ to do.⁵³ This approach is abandoned in King IV and perhaps well so considering the elusiveness of morality as evidenced by the long-standing debate between cultural relativism and moral universalism.

The sustainability proponent reflects in King IV’s expression of sustainable development as ‘development that meets the needs of the present without compromising the ability of future generations to meet their needs.’⁵⁴ Sustainable development demands an integrated approach to the challenges and opportunities presented by the triple context (meaning the environment, economy and society) in which companies function.⁵⁵ The Constitutional Court has supported similar definitions in interpreting the constitutional environmental right.⁵⁶ South Africa’s jurisprudence on sustainable development thus reflects the concept as defined in the King Reports and for corporations.

Kramer and Porter’s ‘license to operate’ element purports that companies exist on the permission of governments, communities and stakeholders, whether explicit or implied.⁵⁷ The Corporate Citizenship concept is the manifestation of this CSR proponent. It expressly acknowledges that the corporation is not an individual, but a citizenship intertwined with society. Some of the earliest companies were born from this thinking and it manifests in South African mining permissions which are heavily influenced by the communities in which mining is to occur.⁵⁸

Finally, Porter and Kramer’s proponent on reputation is perhaps most interesting. As the CSR movement has developed, numerous corporations have jumped at the opportunity to advertise their CSR achievements and attract customers. Business leaders have flurried to sign the 2020 Davos Manifesto. The irony being that corporate social responsibility becomes a means for

⁵² King III op cit note 41 at 117.

⁵³ Michael E Porter & Mark R Kramer ‘Strategy & society: The link between competitive advantage and corporate social responsibility’ op cit note 44 at 3.

⁵⁴ King IV op cit note 8 at 18.

⁵⁵ King IV op cit note 8 at 26.

⁵⁶ In *Fuel Retailers Association of Southern Africa v Director-General: Environmental Management, Department of Agriculture, Conservation and Environment, Mpumalanga Province, and Others* 2007 (6) SA 4 (CC) para 50-53, the court reflected triple context thinking in defining sustainable development as essentially the ‘integration of environmental protection and socio-economic development’ and founded on three pillars namely, economic development, social development and environmental protection. It added that the principle includes the need to preserve natural resources for the benefit of present and future generations.

⁵⁷ Michael E. Porter & Mark R Kramer ‘Strategy & society: The link between competitive advantage and corporate social responsibility’ op cit note 44 at 4.

⁵⁸ See *Maledu and Others v Itereleng Bakgatla Mineral Resources (Pty) Limited and Another* 2019 (1) BCLR 53 (CC); and *Baleni and Others v Minister of Mineral Resources and Others* 2019 (2) SA 453 (GP).

achieving profit rather than an end in itself.⁵⁹ Whether it is for moral, sustainability, legitimacy or reputational reasons, the incorporation of the triple context (meaning the economy, environment and society) into business strategies is gaining traction.

Porter and Kramer's writings on moral obligations, sustainability, license to operate and reputation provide insight into the purpose of CSR efforts. CSR is still treated as a 'nice to have' rather than a necessity. It stems from the thinking that corporations are a sort of individual in the abstract and juristic sense and therefore attract responsibilities. In turn, this requires that directors and managers govern their corporations in responsible ways to minimise detrimental repercussions to society and the environment. This is the logic of corporate social responsibility.

⁵⁹ Doreen McBarnet 'Corporate social responsibility beyond law, through law, for law' op cit note 39 at 15.

II THEORIES OF CORPORATE SOCIAL RESPONSIBILITY

Since chapter one has canvassed the thinking and definitions related to corporate social responsibility and its origins, it is appropriate to proceed to the legal debates surrounding the concept. While corporate social responsibility can be motivated by moral obligation, sustainability, the license to operate and reputational considerations, this does not mean that the law shares these views. Ultimately, it must be determined whether the law requires companies to act socially responsible. This chapter engages with the legal theories of corporate personality and corporate governance. This provides the legal foundations for arguments regarding whether corporations should be administered in socially responsible ways. When the legal theories underpinning debates on corporate social responsibility are understood, greater legitimacy can be granted to discussions on corporate social responsibility.

2.1 *The Dodd-Berle Debate*

CSR debates centre on two questions: who controls a company and in whose interest must that control be exercised.⁶⁰ Professor of Law at the Columbia Law School, Adolf Berle, argued that directors were a sort of trustee for shareholders and were obliged to put their interests above all else.⁶¹ Professor Merrick Dodd of Harvard Law School responded to this proposition in 1932 when he argued that companies have both a ‘social service’ and ‘profit-making function.’⁶² He agreed that the duty of managers⁶³ or directors was to use funds for the sole purpose of the company but he distinguished shareholders from the corporate entity itself. Dodd explained that a company was separate from ‘those who compose it’ and that as such, it could be conceived of as a person.⁶⁴

Dodd realised that the public opinion and ethics of the time were tending toward social responsibility. Consequently, companies, as a sort of person, could be held to certain ethical standards. This entailed that a director could make use of company funds in a way which might detriment shareholders if for the benefit of the corporate entity, without breaching their duties.⁶⁵

⁶⁰ S.M. Bainbridge ‘Director primacy: The means of corporate governance’ (2003) 97(2) *Northwestern University Law Review* 547 at 605.

⁶¹ A.A Berle ‘Corporate powers as powers in trust’ (1931) 44(7) *Harvard Law Review* 1049.

⁶² E. Merrick Dodd ‘For whom are corporate managers trustees?’ op cit note 5 at 147-148.

⁶³ It is important to note that while Berle and Dodd referred to managers as well as directors, the two should not be conflated. In *R v Mall* 1959 SA 607 (N) the material differences between the two positions were recognised. See Chapter III heading 3.2 for further explanation.

⁶⁴ E. Merrick Dodd ‘For whom are corporate managers trustees?’ op cit note 5 at 147-148.

⁶⁵ *Ibid* at 1161.

For Dodd, directors worked for the company, not shareholders, meaning that whatever was in the interests of the company was paramount.⁶⁶

Today it is generally accepted that directors owe their fiduciary duties to the company and not shareholders individually.⁶⁷ What remains unanswered is the extent to which that interpretation includes stakeholders. Stakeholders range from employees, creditors and suppliers to more indirect stakeholders including the communities and environment in which corporations function. The obligation of corporations to each of these stakeholders is an issue which falls outside the scope of this dissertation.

2.2 Theories of Corporate Personality

Corporate personality theories are distinct from those on corporate governance. The former explain the rights and responsibilities of companies in relation to society while the latter examine how power and control ought to be divided within a company.⁶⁸ The distinction is somewhat artificial considering the internal decision-making processes of a company have the capacity for external ramifications.⁶⁹ Nonetheless, the contract, concession and *communautaire* theories of corporate personality are useful in providing theoretical context for corporate governance theories.

2.2.1. Contract Theory

The premise of the contractarian theory is that a company is a ‘nexus of contracts.’⁷⁰ It is nothing more than a web of contractual rights and obligations between individuals and is essentially a ‘legal form created through a multitude of private contractual relationships’ rather than a juridical legal person.⁷¹ The relationships between the parties are defined by the voluntary contractual relations between them. The state is merely one such contracting party.⁷² A flaw in this view is that it does not account for the privilege of separate legal personality

⁶⁶ David Millon ‘Theories of the corporation’ (1990) *Duke Law Journal* 201 at 208.

⁶⁷ *Percival v Wright* [1902] 2 Ch 421 (ChD).

⁶⁸ Stefan J. Padfield ‘Corporate social responsibility & concession theory’ (2015) 6(1) *William and Mary Business Law Review* 1 at 19.

⁶⁹ *Ibid* at 19-20.

⁷⁰ Michael C. Jensen & William H. Meckling ‘Theory of the firm: Managerial behavior, agency costs and ownership structure’ (1976) 3 *Journal of Financial Economics* 305 at 310-311.

⁷¹ Kent Greenfield ‘Using behavioral economics to show the power and efficiency of corporate law as a regulatory tool’ *op cit* note 3 at 592.

⁷² Stefan J. Padfield ‘Rehabilitating concession theory’ (2014) 66(2) *Oklahoma Law Review* 327 at 332.

which cannot be conferred by contract.⁷³ The contractarian response is simply to deny the significance of the privilege as a statutory concession.⁷⁴

The shareholder is somewhat more vulnerable here as contractarians view shareholders as an investor in the corporation, bonded through contractual undertaking rather than ownership.⁷⁵ The interests of contracting parties are settled through recourse to contractual remedies,⁷⁶ thus the contractarian director is not obliged to favour a stakeholder-inclusive approach to decision-making.⁷⁷ After all, a director might be overwhelmed by the diversity of interests he or she might be required to satisfy.⁷⁸ A director might even resort to satisfying the stakeholder interest which best advances his or her own interests.⁷⁹

The denial of the corporation as a person leaves little room for corporate social responsibility.⁸⁰ The role of corporate law for contractarians is to enable the efficiency of relationships by providing default rules.⁸¹ If directors were to be required to balance the interests of contracting parties throughout their decision making, they might run the risk of seeming political.⁸² This risk is one contractarians dare not take since they are averse to corporations taking on public law functions.⁸³ Qualms about moral regress are to be settled through the democratic process, according to the contractarian. Per this view, any interference with corporate contracts indicates a failure of democratic processes in resolving moral issues and constitutes an impermissible encroachment upon voluntary and private contractual relationships.⁸⁴

As a consequence of the separation of ownership and control in contractarian theory, parties may maximise their own interests.⁸⁵ Shareholders are only pre-eminent in the sense that they

⁷³ Ibid at 333.

⁷⁴ Ibid at 342.

⁷⁵ Armen A. Alchian & Harold Demsetz 'Production, information costs, and economic organization' (1972) 62(5) *The American Economic Review* 777 at 789 footnote 14.

⁷⁶ Michael C. Jensen & William H. Meckling 'Theory of the firm: Managerial behavior, agency costs and ownership structure' at 311.

⁷⁷ Daniel R. Fischel 'The corporate governance movement' (1982) 35(6) *Vanderbilt Law Review* 1259 at 1269.

⁷⁸ Frank H. Easterbrook & Daniel R. Fischel *The Economic Structure of Corporate Law* (1991) at 38.

⁷⁹ Ibid at 38.

⁸⁰ Jensen, M.C. & Meckling, W.H. 'Theory of the firm: Managerial behavior, agency costs and ownership structure' at 311.

⁸¹ Frank H. Easterbrook & Daniel R. Fischel 'The corporate contract' (1989) 89 *Columbia Law Review* 1416 at 1444-1445.

⁸² Milton Friedman 'A Friedman doctrine – The social responsibility of business is to increase its profits' *The New York Times* 13 September 1970 available at <http://umich.edu/~thecore/doc/Friedman.pdf>, accessed on 7 July 2020.

⁸³ Daniel R. Fischel 'The corporate governance movement' op cit note 77 at 1285-1286.

⁸⁴ Ibid at 1271.

⁸⁵ Irene-Marié Esser *Recognition of Various Stakeholder Interests in Company Management* (unpublished PhD thesis, University of South Africa, 2008) at 28.

are the primary risk takers in and not the owners of the company.⁸⁶ The duty of directors is to minimise risk to the company in order to maximise overall wealth.⁸⁷ The sympathetic contractarian might add that the company indirectly appeases misgivings about morality through paying taxes, hiring employees and providing goods and services.⁸⁸ Nonetheless, it is evident that this theory leaves little room for furthering the interests of non-shareholder stakeholders.

2.2.2. *Concession Theory*

The concession theory views companies as the result of concessions made by the state. These concessions include separate legal personality, separate and centralised management which increases efficiency, transferability of shares and, most importantly, limited liability.⁸⁹ In turn, the state benefits indirectly from the private wealth generation which spills over into society.⁹⁰ Because the company is a creature of the state, the state is entitled to interfere by regulating the powers of companies.⁹¹ The extreme view claims corporations have *only* those rights conferred by the state.⁹² The explanation of separate legal personality as a conferred privilege overcomes the corresponding contractarian inability to explain separate legal personality.

The division of ownership and control of the corporation is recognised and hence the question turns to the scope of director control.⁹³ It is not entirely certain whose interests must be championed in the exercise of directors' fiduciary duties, but interests other than shareholders' may be considered under concession theory.⁹⁴ The inherent danger of increasing director control and decreasing power of shareholders is that directors might pursue their own personal ends.⁹⁵ Hence accountability is crucial under concession theory.⁹⁶ If stakeholder interests are

⁸⁶ Ibid.

⁸⁷ Frank H. Easterbrook & Daniel R. Fischel 'Voting in corporate law' (1983) 26(20) *The Journal of Law & Economics* 395 at 403-406.

⁸⁸ Henry Hansmann & Reinier Kraakman 'The end of history for corporate law' (2001) 89(2) *Georgetown Law Journal* 439 at 441.

⁸⁹ Paul G. Mahoney 'Contract or concession – An essay on the history of corporate law' (2000) 34(2) *Georgia Law Review* 873 at 875.

⁹⁰ Stefan J. Padfield 'Corporate social responsibility & concession theory' op cit note 68 at 23.

⁹¹ Michael E. DeBow & Dwight R. Lee 'Shareholders, nonshareholders and corporate law: Communitarianism and resource allocation' (1993) 18(2) *Delaware Journal of Corporate Law* 393 at 397.

⁹² Stefan J. Padfield 'Rehabilitating concession theory' op cit note 72 at 334.

⁹³ Julian Velasco 'The fundamental rights of the shareholder' (2006) 40 *University of California Davis Law Review* 407 at 461.

⁹⁴ Irene-Marié Esser *Recognition of Various Stakeholder Interests in Company Management* op cit note 85 at 29.

⁹⁵ Julian Velasco 'The fundamental rights of the shareholder' op cit note 93 at 461-462.

⁹⁶ Ibid.

to be considered, this must be done with care since a waning of profits might jeopardise the survival of the company.

2.2.3. *Communitaire Theory*

The *communitaire* theory views companies not merely as concessions of the state, but instruments thereof.⁹⁷ The central tenant is that companies exist to serve the interests and pursuits of the state.⁹⁸ This theory sees companies be the vehicles for political and social ends.⁹⁹ The rationale is that stakeholders are vulnerable to abuse and unfairness and their interests should be protected.¹⁰⁰ Consequently, shareholder wealth maximisation is not the primary objective of the *communitaire* theory. Instead, the law should intervene to solve the negative consequences of shareholder wealth maximisation.¹⁰¹ The difficulty, as Esser points out, is that companies run the risk of losing their ‘commercial goal.’¹⁰² This blurs the public-private divide as the corporation increasingly takes on public responsibility.

2.2.4. *The Indeterminacy of Theory*

The above legal theories are important in providing justification for the existence of particular legal rules. To rely on a theory to justify normative claims about what the law should be is problematic in so far as the underlying theory can be challenged for its validity.¹⁰³ If the theory is determinate, then the legal or normative rule which is extracted from that theory will be valid and justifiable.¹⁰⁴ However, legal theory is undeniably indeterminate even if in a limited sense as the society must interpret the theory.¹⁰⁵ Inevitably ‘[l]egal concepts determine nothing but that which we allow them to determine.’¹⁰⁶ Whether the contract, concession and *communitaire* theory should apply in South Africa is not self-evident as any one of these theories could viably hold within our society. Further, the extent to which each theory provides for stakeholder inclusion is unclear. In consequence, a policy decision must be made to determine whether stakeholders should be included in corporate decision-making.

⁹⁷ Irene-Marié Esser *Recognition of Various Stakeholder Interests in Company Management* op cit note 85 at 30.

⁹⁸ *Ibid.*

⁹⁹ *Ibid* at 31.

¹⁰⁰ *Ibid.*

¹⁰¹ Julian Velasco ‘The fundamental rights of the shareholder’ op cit note 93 at 455-459.

¹⁰² Irene-Marié Esser *Recognition of Various Stakeholder Interests in Company Management* op cit note 85 at 30.

¹⁰³ David Millon ‘Theories of the corporation’ op cit note 66 at 244-245.

¹⁰⁴ *Ibid* at 246.

¹⁰⁵ *Ibid* at 247.

¹⁰⁶ *Ibid.*

Any policy decisions on the approach to corporate law and the obligations of directors must now be informed by the Constitution. For former Chief Justice Pius Langa, politics is inseparable from the law.¹⁰⁷ The Constitution demands a shift in legal culture toward substantively forwarding the principles embodied in the Constitution.¹⁰⁸ The section below will discuss the dominant legal approaches stemming from the above theories. They are shareholder primacy, enlightened shareholder value and pluralism. The approach accepted by the courts and legislature with regards to these three theories must align with the Constitution since it is supreme. The courts must therefore favour an approach which balances the rights of stakeholders in accordance with the Constitution and the Bill of Rights. What follows below is an explanation of the theories of corporate governance and the extent to which each address the interests of different stakeholders. These theories illustrate the policy considerations informing corporate law.

2.3 Theories of Corporate Governance

2.3.1 Shareholder Wealth Maximisation

At one end of the spectrum lies the shareholder wealth maximisation approach. Milton Friedman summed the essence of this approach so aptly when he asserted ‘there is one and only one social responsibility of business . . . to increase its profits.’¹⁰⁹ There are several rationales for this approach of maximising profits. First, shareholders are the primary risk-takers of the corporation since they provide investment in the company.¹¹⁰ This entitles them to the company’s surplus income in the form of returns on their shares.¹¹¹ This arrangement duly incentivises shareholders to manage the efficiency of the company to ensure returns.¹¹² The response to the claim that companies should be run for the purpose of maximising profits (because shareholders are the primary risk takers in the company) is that directors should instead mitigate the risks of shareholders.¹¹³ One method to mitigate risks includes demanding

¹⁰⁷ Pius Langa ‘Transformative constitutionalism’ (2006) 17 *Stellenbosch Law Review* 351 at 353.

¹⁰⁸ *Ibid* at 357.

¹⁰⁹ Milton Friedman ‘A Friedman doctrine – The social responsibility of business is to increase its profits’ op cit note 82.

¹¹⁰ Irene-Marié Esser *Recognition of Various Stakeholder Interests in Company Management* op cit note 85 at 36.

¹¹¹ *Ibid*.

¹¹² ‘South African Company Law for the 21st Century: Guidelines for Corporate Law Reform’ GN 1183 in *GG* 26493 of 23 June 2004 at 22.

¹¹³ Irene-Marié Esser *Recognition of Various Stakeholder Interests in Company Management* op cit note 85 at 36.

that shareholders wishing to sell their shares first offer the shares to other shareholders in the company therefore minimising risk to the original shareholders.¹¹⁴

A second premise for shareholder primacy is that shareholders own the company and its assets and are therefore entitled to benefit from them.¹¹⁵ This is counterintuitive in light of the doctrine of separate legal personality.¹¹⁶ It also ignores the contributions of other stakeholders to the corporation. Employees contribute their labour, yet they are not entitled to residual profits nor supremacy. As Esser points out, there is a narrow interpretation of ‘assets’ of the company which seemingly excludes labour.¹¹⁷ This perpetuates shareholder primacy.

A more appealing rationale for the shareholder wealth maximisation approach is that companies meet the needs of society indirectly, through paying taxes.¹¹⁸ If the company cannot sustain itself financially, society will be disadvantaged by the loss of revenue from income tax and thus the corporation must pursue profits first and foremost.¹¹⁹ It is not the aim of shareholder primacy theorists actively to pursue benefits to society. Instead, this theory permits social responsibility not in itself, but as a means for achieving profit maximisation.¹²⁰ The gripe with corporate social responsibility, for proponents of this theory, is that the exercise of CSR raises issues of legitimacy since directors are not elected by the public.¹²¹ Nonetheless, the legitimacy of considering stakeholder interests (even if only as a means of increasing profits) was recognised even by Berle and Dodd.¹²² Thus it seems that under this theory, social responsibility is permissible to the extent that it increases company profits.¹²³

A further argument for the shareholder wealth maximisation approach is that shareholders are among the most vulnerable stakeholders and thus deserve protection.¹²⁴ They are not able to protect themselves through contract.¹²⁵ Further, they receive far less statutory protection in

¹¹⁴ Ibid.

¹¹⁵ Ibid at 35.

¹¹⁶ *Salomon v A Salomon & Co Ltd* [1896] UKHL 1, [1897] AC 22 at 51; Irene-Marié Esser *Recognition of Various Stakeholder Interests in Company Management* op cit note 85 at 35.

¹¹⁷ Irene-Marié Esser *Recognition of Various Stakeholder Interests in Company Management* op cit note 85 at 35.

¹¹⁸ A.A. Berle ‘Corporate powers as powers in trust’ op cit note 61.

¹¹⁹ ‘South African Company Law for the 21st Century: Guidelines for Corporate Law Reform’ op cit note 112 at 23.

¹²⁰ See for example, Milton Friedman ‘A Friedman doctrine – The social responsibility of business is to increase its profits’ op cit note 82 at 5.

¹²¹ Ibid at 3.

¹²² Jill E. Fisch ‘Measuring efficiency in corporate law: The role of shareholder primacy’ (2006) 31 *Journal of Corporate Law* 637 at 648.

¹²³ Virginia Harper Ho ‘Enlightened shareholder value: Corporate governance beyond the shareholder-stakeholder divide’ (2010) 36(1) *Journal of Corporation Law* 59 at 73.

¹²⁴ Irene-Marié Esser *Recognition of Various Stakeholder Interests in Company Management* op cit note 85 at 37.

¹²⁵ Ibid.

comparison to other stakeholders. Specific legislation, such as the Labour Relations Act,¹²⁶ the Employment Equity Act¹²⁷ and the Basic Conditions of Employment Act,¹²⁸ protects employees. The Broad-Based Black Economic Empowerment Act¹²⁹ facilitates racial equality. In the context of energy, the Minerals and Petroleum and Resources Development Act provides rights of consultation to landowners and lawful occupiers.¹³⁰ The National Environmental Management Act¹³¹ is the framework legislation for numerous other statutes which give effect to environmental rights. Consumers too find recourse in the Consumer Protection Act¹³² and creditors reap the benefits of the National Credit Act.¹³³ Evidently there is a plethora of legislation protecting other company stakeholders. Shareholders are left to rely on company law for their protection.

2.3.2 *The Pluralist Approach*

Pluralism lies at the end of spectrum that is opposite to shareholder wealth maximisation. According to this theory, shareholders are in no way superior to non-shareholder stakeholders.¹³⁴ Stakeholders have independent value;¹³⁵ stakeholder interests are an end in themselves rather than a means to an end.¹³⁶ This permits directors to sacrifice profits in the name of stakeholders,¹³⁷ provided it is in the interests of the company to do so.¹³⁸ The pluralist theory asserts that productive relationships will only be optimised where directors balance shareholder and stakeholder interests.¹³⁹ Accordingly, the best interests of ‘the company’ equates to ‘shareholders plus other participants.’¹⁴⁰

¹²⁶ Labour Relations Act 66 of 1995.

¹²⁷ Employment Equity Act 55 of 1998.

¹²⁸ Basic Conditions of Employment Act 75 of 1997.

¹²⁹ Broad-Based Black Economic Empowerment Act 53 of 2003.

¹³⁰ Minerals and Petroleum Resources Management Act 28 of 2002.

¹³¹ National Environmental Management Act 107 of 1998.

¹³² Consumer Protection Act 68 of 2008.

¹³³ National Credit Act 34 of 2005.

¹³⁴ Rehana Cassim & Femida Cassim ‘The reform of corporate law in South Africa’ (2005) *International Company and Commercial Law Review* 1 at 1-2.

¹³⁵ ‘South African Company Law for the 21st Century: Guidelines for Corporate Law Reform’ op cit note 112 at 25.

¹³⁶ Farouk HI Cassim ‘The duties and the liability of directors’ op cite note 32 at 520.

¹³⁷ Ibid.

¹³⁸ Rehana Cassim & Femida Cassim ‘The reform of corporate law in South Africa’ op cit note 134 at 1-2.

¹³⁹ The Company Law Review Steering Group (UK) *Modern Company Law for a Competitive Economy: The Strategic Framework* op cit note 6 at vi.

¹⁴⁰ Ibid at 39.

‘Participants’ include, at the minimum, stakeholders who have a legitimate interest in the company.¹⁴¹ A broad definition of stakeholders extends to those with a direct interest in the company such as an employee or creditor.¹⁴² R. Edward Freeman, one of the first thought leaders on stakeholder theory, expanded the definition of stakeholders to ‘any group or individual who can affect or is affected by the achievement of the firm’s objectives.’¹⁴³ The term ‘stakeholder’ can thus have far reaching consequences, depending on how it is defined.

The pluralist approach stems from concession theory.¹⁴⁴ As discussed previously, the concession theory views companies as concessions of the state. It could be said that this reliance on the concessionary theory to motivate the pluralist approach is outdated as it latches onto the ancient practice of conceiving of companies as the product of a parliament’s discretion to award corporate privileges.¹⁴⁵ Perhaps it is more apt to concede that modern society requires greater responsibility from corporations for moral reasons.

Pluralism falters at practicality because it leaves directors unsure of how to balance relevant and possibly competing interests, thus exacerbating inefficiency.¹⁴⁶ The confusion could lead to poor decisions, ultimately exposing directors to liability. It is further unclear how the approach could best be implemented in company law. Even if directors are left a discretion to balance the interests of various stakeholders, without a clear vision of the purpose of their specific company it would prove difficult to make decisions. Practicality is the biggest challenge that supporters of pluralism face.

2.3.3. *Enlightened Shareholder Value*

Between shareholder primacy and the pluralist approaches lies the enlightened shareholder value approach. This midground approach retains the paramountcy of maximising profits for the benefit of shareholders yet permits directors’ consideration of stakeholders.¹⁴⁷ Shareholder interests are predominant yet not exclusive.¹⁴⁸ The director may balance the interests of

¹⁴¹ Michele Havenga ‘Regulating directors’ duties and South African company law reform’ (2005) 26(3) *Obiter* 609 at 618.

¹⁴² *Ibid.*

¹⁴³ R. Edward Freeman *Strategic Management: A Stakeholder Approach* (1984) at 46.

¹⁴⁴ Irene-Marié Esser *Recognition of Various Stakeholder Interests in Company Management* op cit note 85 at 33.

¹⁴⁵ Ian B. Lee ‘Corporate law and the role of corporations in society: Monism, pluralism, markets and politics’ (2006) 85(1) *The Canadian Bar Review* 1 at 7.

¹⁴⁶ Farouk HI Cassim ‘The duties and the liability of directors’ op cit note 32 at 519; The Company Law Review Steering Group (UK) *Modern Company Law for a Competitive Economy: The Strategic Framework* op cit note 6 at 7.

¹⁴⁷ Farouk HI Cassim ‘The duties and the liability of directors’ op cit note 32 at 519.

¹⁴⁸ Michele Havenga ‘Regulating directors’ duties and South African company law reform’ op cit note 141.

stakeholders for the purpose of benefitting shareholders in the long-term.¹⁴⁹ Therefore, stakeholder interests may be considered only to the extent that it forwards profit maximisation.¹⁵⁰

In rationale, the enlightened shareholder value approach is not far different from shareholder wealth maximisation. Ultimately, both approaches champion shareholder interests with the former approach permitting the satisfaction of stakeholder interests as a means of achieving long-term returns to shareholders.¹⁵¹ The difference is that when a decision increases shareholder profits but ignores stakeholders, the company should not take that decision or otherwise should absorb the costs of that decision to stakeholders.¹⁵² This means that the company might incur short-term costs in order to achieve long-term benefits.¹⁵³ Enlightened shareholder value is therefore not always strictly profit-maximising.¹⁵⁴ The enlightened shareholder value approach is thus ‘a revision of . . . the standard against which "success" of the corporate enterprise is measured.’¹⁵⁵ It retains the profit motive yet incorporates stakeholder interests in the management of the company.

Enlightened shareholder value finds its roots in a form of the concession theory.¹⁵⁶ The ‘bottom up’ concession theory, as described by Dine, views the corporation as a product of the contracting parties’ original agreement.¹⁵⁷ This theory proposes that stakeholders should be considered to the extent that this benefits *shareholders*.¹⁵⁸ The second variant of Dine’s corporate governance theories (which stem from the ‘bottom up’ concession theory) purports that stakeholders should be considered because this benefits the *company*.¹⁵⁹ This latter variant

¹⁴⁹ Farouk HI Cassim ‘The duties and the liability of directors’ op cit note 32 at 519.

¹⁵⁰ The Company Law Review Steering Group (UK) *Modern Company Law for a Competitive Economy: The Strategic Framework* op cit note 6 at 7.

¹⁵¹ Virginia Harper Ho ‘Enlightened shareholder value: Corporate governance beyond the shareholder-stakeholder divide’ op cit note 123 at 96-97.

¹⁵² Ibid at 98.

¹⁵³ Ibid. For example, a corporation might invest heavily in reforming its supply chains by upskilling their suppliers or incorporating green technology. While this is costly in the short term, it increases the sustainability of the supply chain in the long term thus mitigating risk. See the Shared Value Project Hong Kong case study on the Mountain Hazelnuts company in Bhutan available at <https://sharedvalueprojecthongkong.com/shared-value-bhutan-mountain-hazelnuts-case-study/>, accessed on 27 December 2020. See also the likes of Nestle and Walmart

¹⁵⁴ Virginia Harper Ho ‘Enlightened shareholder value: Corporate governance beyond the shareholder-stakeholder divide’ op cit note 123 at 98.

¹⁵⁵ Ibid at 96.

¹⁵⁶ Irene-Marié Esser *Recognition of Various Stakeholder Interests in Company Management* op cit note 85 at 33.

¹⁵⁷ Janet Dine ‘Company law developments in the European Union and the United Kingdom: Confronting diversity’ (1998) *Tydskrif vir die Suid-Afrikaanse Reg* 245 at 247.

¹⁵⁸ Irene-Marié Esser *Recognition of Various Stakeholder Interests in Company Management* op cit note 33 read with Janet Dine ‘Company law developments in the European Union and the United Kingdom: Confronting diversity’ op cit note 157 at 249.

¹⁵⁹ Janet Dine *ibid*.

aligns rather with the pluralist approach.¹⁶⁰ Hence, enlightened shareholder value is rooted in a form of concession theory which furthers shareholder interests. Ultimately, enlightened shareholder value theory retains the profit motive but incorporates stakeholder interests. Under this theory, it is acceptable to incur costs for incorporating stakeholder interests in so far as this increases the overall or long-term profitability of the company.

2.3.4 Policy Choice

South African company law is founded on the principles of English law, many of which still apply today.¹⁶¹ Before the UK Companies Act of 2006 came into effect, English company law was antiquated and a hinderance to business.¹⁶² Since South African company law was largely based on these English laws, South African company law was reformed shortly after the UK laws were reformed.¹⁶³ The result was the Companies Act of 2008. Traditionally, English and therefore South African common law forwarded the interests of the company which meant shareholders.¹⁶⁴ That interpretation must now yield to the new Companies Act and the policy it embodies. Fortunately, the Department of Trade and Industry considered the policy on corporate governance in its policy paper ‘South African Company Law for the 21st Century: Guidelines for Corporate Law Reform’ (‘Guidelines’).¹⁶⁵ This instrument provides crucial insight into the fiduciary duty to act in the best interests of the company. Before the Guidelines can be considered, it is necessary to analyse the common law position on the duty to act in the best interests of the company since it is still applicable. The following chapter dives further into the fiduciary duty and its development through the common law.

¹⁶⁰ Irene-Marié Esser *Recognition of Various Stakeholder Interests in Company Management* op cit note 85 at 33.

¹⁶¹ ‘South African Company Law for the 21st Century: Guidelines for Corporate Law Reform’ op cit note 112 at 14.

¹⁶² FHI Cassim ‘The Companies Act 2008: An overview of a few of its core provisions’ (2010) 22 *South African Mercantile Law Journal* 157 at 157.

¹⁶³ ‘South African Company Law for the 21st Century: Guidelines for Corporate Law Reform’ op cit note 112 at 15-16.

¹⁶⁴ *Hutton v West Cork Railway Co* (1883) 23 ChD op cit note 26.

¹⁶⁵ ‘South African Company Law for the 21st Century: Guidelines for Corporate Law Reform’ op cit note 112.

III THE COMMON LAW DUTY TO ACT IN THE ‘BEST INTERESTS OF THE COMPANY’

3.1 *Interpretation*

The three approaches to corporate governance, discussed in chapter two above, are inextricably linked to the duties of directors, specifically the common law and statutory fiduciary duty to act in the ‘best interests of the company.’ Because our theories of corporate governance are indeterminate, the ‘best interests’ duty must be interpreted in light of the legal dispensation. It must be determined whether directors owe allegiance to stakeholders and if so, to what extent. That interpretation is now grounded in the Constitution. The Constitution and its values provide the lens for scrutinising director conduct.

Our scrutiny must too be informed by the reformation of the company law as manifested in the Companies Act of 2008. The 2008 Act partially codifies directors’ duties in an attempt to provide clarity and certainty.¹⁶⁶ The statutory duties are mandatory and unalterable.¹⁶⁷ Directors are still required to comply with the common law duties not contained in the Act.¹⁶⁸ Where duties exist in the common law and statute, the common law is preserved thus the statutory duties cannot be interpreted without reference to the common law.¹⁶⁹

Before the 2008 Act was created, the Department of Trade and Industry recognised the need to modernise company law and align it with the times. In 2004 they produced the ‘South African Company Law for the 21st Century: Guidelines for Corporate Law Reform’ (‘Guidelines’).¹⁷⁰ The Guidelines discuss many of the policy considerations underlying the Companies Act. They are useful to interpretation as they allude to many of the policy considerations at play in determining the scope of directors’ duties. While they are not binding, the Guidelines do provide insight into the intention of the provisions of the Companies Act.

¹⁶⁶ Farouk HI Cassim ‘The duties and the liability of directors’ op cit note 32 at 507-508.

¹⁶⁷ Section 78(2) of the Companies Act provides that a Memorandum of Incorporation, rules or resolutions of a company are void to the extent that they purport to absolve a director from liability under section 77 or the duties under sections 75 or 76 which includes the fiduciary duties. There are exceptions to this provision in sections 78(4) and (6). The exceptions are not relevant for present purposes.

¹⁶⁸ Farouk HI Cassim ‘The duties and the liability of directors’ op cit note 32 at 508.

¹⁶⁹ Ibid at 507-508.

¹⁷⁰ ‘South African Company Law for the 21st Century: Guidelines for Corporate Law Reform’ op cit note 112.

Finally, the King IV Report on Corporate Governance is the latest set of voluntary principles and best practice guidelines pertaining to corporate governance.¹⁷¹ King IV is mandatory to the extent that certain regimes require it. For example, the Johannesburg Stock Exchange has incorporated a number of King IV's principles in its listing requirements.¹⁷² Otherwise, King IV applies on an 'apply and explain' basis meaning it is assumed that the principles will be applied and corporations and organisations should explain how they are achieving these principles.¹⁷³ King IV extends not only to corporations but also to 'organisations' which includes state-owned enterprises, municipalities and non-profit organisations.¹⁷⁴ The courts have slowly incorporated the King Reports into their interpretations of directors' conduct.¹⁷⁵ The Reports are thus important in giving content to the duty to act in the best interests of the company.

3.2 Who is Bound by Fiduciary Duties?

Before defining the scope of the 'best interests of the company' duty, it is necessary to clarify who is bound by the duty. As will be shown, the definition of a director in terms of director duties is wide. Whether intentional or not, this ensures the standards expected of corporate leaders are pervasive and not limited by the formal titles of corporate decision-makers.

Section 1 of the Companies Act defines a director as 'a member of the board of a company, as contemplated in section 66, or an alternate director of a company and includes *any person* occupying the position of director or alternate director, *by whatever name designated* [own emphasis].'¹⁷⁶ The definition includes executive, non-executive, *de facto*, *de jure*, alternate, *ex officio* and shadow directors.¹⁷⁷ The wording of the section 1 definition clearly does not intend to limit itself to those formally appointed under the title of director.¹⁷⁸ It has been argued that the definition might even extend to those giving advice to the board in their professional

¹⁷¹ King IV op cit note 8.

¹⁷² Johannesburg Stock Exchange 'JSE Limited Listings Requirements' available at <https://www.jse.co.za/sites/default/files/media/documents/2019-04/JSE%20Listings%20Requirements.pdf>, accessed on 31 December 2020.

¹⁷³ King IV op cit note 8 at 7 and 37.

¹⁷⁴ Ibid at 15.

¹⁷⁵ *South African Broadcasting Corporation Ltd and Another v Mpofu* [2009] 4 All SA 169 (GSJ); *Minister of Water Affairs & Forestry v Stilfontein Gold Mining Co Ltd & Others* 2006 (5) SA 333 (W).

¹⁷⁶ Companies Act supra note 4 s 1.

¹⁷⁷ Farouk HI Cassim 'The duties and the liability of directors' op cit note 32 at 510.

¹⁷⁸ Ibid.

capacity if the board tends to act on that advice.¹⁷⁹ The significance is that all who fall under this broad definition attract the duties of directors. *Ex officio* directors attract all director liabilities in addition.¹⁸⁰ The *ex officio* director is one who is a director by virtue of another title, role or similar status as specified in the company's Memorandum of Incorporation.¹⁸¹

Senior employees and managers also incur the directors' duties.¹⁸² Section 76 of the Companies Act sets out the standards of directors' conduct and includes prescribed officers in the section's definition of director.¹⁸³ A prescribed officer is a person who either (a) exercises general executive control or (b) regularly participates to a material degree in the exercise of general executive control over and management of the whole or a significant portion of the business and activities of the company.¹⁸⁴ The Regulation applies irrespective of the title of the person.¹⁸⁵ The chief executive officer, chief operating officer and financial director of a company would all likely constitute prescribed officers, depending on their functions.¹⁸⁶ The members of board and audit committees must too comply with the directors' duties.¹⁸⁷ This ensures that those who play a significant role in the functioning of corporate boards do so responsibly.¹⁸⁸

It should be noted that directors and managers incur distinct obligations. In *R v Mall*,¹⁸⁹ the distinctions were delineated. The court explained that a director's functions and duties are prescribed by law. They are appointed by shareholders and must manage and control the company. The director represents the company and there is a level of permanence to his or her

¹⁷⁹ Farouk HI Cassim 'The duties and the liability of directors' op cit note 32 at 510. Cassim points out that the 2008 Act definition does not include section 1(2) of the 1973 Act. The latter explicitly excluded a person who gives professional advice to the board.

¹⁸⁰ Companies Act supra note 4 s 66(4)(a)(ii) read with s 66(5)(b)(i) and (ii).

¹⁸¹ Farouk HI Cassim 'The duties and the liability of directors' op cit note 32 at 510.

¹⁸² See *Phillips v Fieldstone Africa (Pty) Ltd* 2004 (3) SA 465 (SCA) where the court held that the existence, nature and extent of the fiduciary duty is a question of fact deduced from the nature of the employment relationship. See also *Volvo (Southern Africa) (Pty) Ltd v Yssel* 2009 (6) SA 531 (SA) where the court held there is no closed list of relationships which attract fiduciary duties.

¹⁸³ Companies Act supra note 4 s 76(1)(a).

¹⁸⁴ 'Companies Regulations' GN R351 in GG 34239 of 26 April 2011 regulation 38(1)(a) and (b); Section 1 of the Companies Act supra note 4 defines a prescribed officer as 'a person who, within a company, performs any function that has been designated by the Minister in terms of section 66(10).' Section 66(10) empowers the Minister to make regulations designating a function or functions for a prescribed office.

¹⁸⁵ Companies Regulations ibid regulation 38(2).

¹⁸⁶ Rehana Cassim 'Governance and the board of directors' in Farouk HI Cassim et al *Contemporary Company Law* 2 ed (2012) 400 at 415.

¹⁸⁷ Companies Act supra note 4 s 76(1)(b).

¹⁸⁸ Farouk HI Cassim 'The duties and the liability of directors' op cit note 32 at 512. Cassim notes that increasing the responsibility of prescribed officers and members of the audit and board committees comes without a corresponding increase in power.

¹⁸⁹ *R v Mall* supra note 63.

appointment.¹⁹⁰ In contrast, a manager's role is not defined by law. It is inferred from the contract between the manager and employer, may be inferred from conduct and is essentially a question of fact.¹⁹¹ Directors are further accountable to shareholders and may be removed by them.¹⁹² Managers engage more readily with directors than shareholders and directors hold the power to appoint and dismiss their managers.¹⁹³ For the purposes of this dissertation, the duties of directors and not managers shall be considered.

3.3 The Scope of the Fiduciary Duty

Directors attract numerous duties. They are under (1) general fiduciary duties, (2) duties against conflicts of interest, (3) the duty of care, skill and diligence, (4) the duty to disclose personal financial interests and (5) the duty not to act fraudulently or recklessly under insolvent circumstances. There are further, (6) a number of specific duties which include the duty to keep accounting records,¹⁹⁴ the duty to file an annual return¹⁹⁵ and the duty to comply with the Companies Act Chapter 3 provisions regulating company secretaries, auditors and audit committees where required.¹⁹⁶ There is a duty to call and convene general meetings,¹⁹⁷ manage the business affairs of the company¹⁹⁸ and appoint a social and ethics committee,¹⁹⁹ a company secretary,²⁰⁰ auditors²⁰¹ or audit committee²⁰² where applicable.

At common law, the overarching fiduciary duty is the duty to act in good faith and in the best interests of the company.²⁰³ The Companies Act now makes clear that directors must act *bona fide*, in the best interests of the company and for proper purpose.²⁰⁴ Fiduciary duties are grounded in duties of loyalty, good faith and the avoidance of conflicts of interest.²⁰⁵ It can be broken down into the duty to (1) prevent a conflict of interest, (2) not exceed the limits of one's

¹⁹⁰ Ibid at 622-623.

¹⁹¹ Ibid.

¹⁹² Rehana Cassim 'Governance and the board of directors' op cit note 186 at 416.

¹⁹³ Ibid.

¹⁹⁴ Companies Act supra note 4 s 28.

¹⁹⁵ Ibid s 33.

¹⁹⁶ Ibid s 34(1).

¹⁹⁷ Ibid s 61.

¹⁹⁸ Ibid s 66(1).

¹⁹⁹ Ibid s 72.

²⁰⁰ Ibid s 86.

²⁰¹ Ibid s 90.

²⁰² Ibid s 94.

²⁰³ Farouk HI Cassim 'The duties and the liability of directors' op cit note 32 at 523.

²⁰⁴ Companies Act supra note 4 s 76(3)(a) and (b). The 'proper purpose' caveat introduces reasonableness to the subjective inquiry into whether a director acted in good faith.

²⁰⁵ Farouk HI Cassim 'The duties and the liability of directors' op cit note 32 at 509.

powers, (3) maintain an unfettered discretion and (4) exercise one's powers for the purpose conferred.²⁰⁶ This dissertation will focus on the duty to act in the best interests of the company, as codified in section 76(3)(b) of the Companies Act of 2008.

Fiduciary relationships are characterised by three elements: (a) the fiduciary must have some discretion or power; (b) the fiduciary must be able to unilaterally exercise that power or discretion in a way which affects the practical or legal interests of the beneficiary; and (c) the beneficiary is characteristically prey to the fiduciary's decisions.²⁰⁷ It is essential that the fiduciary act in the best interests of the beneficiary and in good faith.²⁰⁸ This duty is fundamental and qualifies the exercise of any of a director's powers.²⁰⁹ In South African law, the fiduciary relationship between the director and the company is *sui generis*.²¹⁰

3.4 'The Best Interests of the Company' at Common Law

The preceding sections have detailed who is bound by directors' fiduciary duties and what the nature of that fiduciary relationship is. This section unpacks the content of the specific fiduciary duty to act in the 'best interests of the company.' 'The company' must be defined. The common law has grappled with this task for over 100 years. In 1883 and in the context of fiduciary duties, the English court in *Hutton v West Cork Railway* held that 'the test . . . is not whether [the action of a director] is *bona fide*, but whether, as well as being done *bona fide* . . . it is reasonably incidental to the carrying on of the *company's* benefit [own emphasis]'²¹¹ Then, in 1902, the *Percival v Wright* judgment made clear that the fiduciary duty of directors is owed to the company and not its individual shareholders.²¹²

In New Zealand, the court declined to apply the *Percival v Wright* ratio after distinguishing it from the case before it: *Coleman v Myers*.²¹³ The New Zealand court found that the family nature of the company meant that the director owed a fiduciary duty of disclosure to individual

²⁰⁶ Irene-Marié Esser *Recognition of Various Stakeholder Interests in Company Management* op cit note 85 at 209.

²⁰⁷ *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168; *Phillips v Fieldstone Africa (Pty) Ltd* supra note 182 at 482.

²⁰⁸ Farouk HI Cassim 'The duties and the liability of directors' op cit note 32 at 513.

²⁰⁹ *South African Fabrics Ltd v Millman NO* 1972 (4) SA 592 (A) at 596.

²¹⁰ *Robinson v Randfontein Estates Gold Mining Co Ltd* supra note 207; *Du Plessis NO v Phelps* 1995 (4) SA 165 (C).

²¹¹ *Hutton v West Cork Railway Co* op cit note 26 at 672.

²¹² *Percival v Wright* op cit note 67.

²¹³ *Coleman v Myers* CA 70/76 [1977] NZCA 6; [1977] 2 NZLR 225 (11 August 1977) at 5-6. See also *Brunninghausen v Galvanics* (1999) 46 NSWLR538 (NSW).

shareholders.²¹⁴ The English courts seemingly supported this thinking in *Stein v Blake* where it was held that a director's fiduciary duty was owed to a specific shareholder who had suffered loss directly from the director inducing that shareholder to part with his shares at an undervalue.²¹⁵ In *Peskin v Anderson*, the general rule that the fiduciary duty is owed by the director to the company was reaffirmed and the position of *Coleman v Myers* supported.²¹⁶ The exception to the general rule occurs when the factual circumstances generate a fiduciary relationship between the director and specific shareholder(s).²¹⁷ The example given in *Peskin v Anderson* was the case where a director comes to confidential yet valuable information which would benefit shareholders.²¹⁸

Despite the exceptions, the English Court of Appeal in *Greenhalgh v Arderne Cinemas Ltd* recognised that "the company as a whole", does not . . . mean the company as a commercial entity, distinct from the incorporators: it means the incorporators as a general body'²¹⁹ Consequently, 'the company' has been understood to mean the collective body of shareholders.²²⁰ This interpretation held muster in both the UK and USA.²²¹ It has generally been accepted that present as well as future shareholders and their long-term interests should be considered.²²²

The incorporation of shareholder interests into the interpretation of the duty to act in the best interests of the company was echoed in the judgments on corporate donations. In *Evans v Brunner Mond & Company Ltd*, the court held that charitable donations were valid only if reasonably incidental to the company and for its benefit.²²³ This was followed in *Re Lee Behrens & Co Ltd*.²²⁴ To add, the *Hutton* dicta on 'cakes and ale' followed. The *Hutton* dicta was decisive for cases where shareholder and stakeholder interests collide. Similarly, in the Transvaal case of *Amalgamated Society of Woodworkers of SA v Die 1963*

²¹⁴ *Ibid.*

²¹⁵ *Stein v Blake* [1998] 1 All ER 724 at 727d and 729g.

²¹⁶ *Peskin v Anderson* [2000] EWCA Civ 326 (14 December 2000) para 33.

²¹⁷ *Ibid.*

²¹⁸ *Ibid.*

²¹⁹ *Greenhalgh v Arderne Cinemas Ltd* [1951] Ch 286 at 291; [1950] 2 All ER 1120 at 1126E; *Kinsela v Russell Kinsela Pty. Ltd.* (1986) 4 N.S.W.L.R. 722; *Peskin v Anderson* op cit note 216.

²²⁰ *Brady v Brady* [1988] BCLC 20 (CA); [1989] A.C. 755; *Gaiman v National Association for Mental Health* [1970] 2 All ER 362.

²²¹ *Grove v Flavel* (1986) 43 SASR 410; *Peskin v Anderson* op cit note 216. For the USA, see *Dodge v Ford Motor Co* op cit note 19; *Revlon Inc. v. MacAndrews & Forbes Holdings Inc.*, 506 A.2d 173 (Del. 1986).

²²² See *Percival v Wright* op cit note 67. Farouk HI Cassim 'The duties and the liability of directors' op cit note 32 at 515-516.

²²³ *Evans v Brunner Mond & Company Ltd* [1921] ChD 359.

²²⁴ *Re Lee Behrens & Co Ltd* [1932] 2 Ch 46.

Ambagsaalvereniging, the court held that company donations were permissible only if ‘reasonably incidental to the carrying on of the activities of the donor’ or if ‘for the benefit of the donor.’²²⁵

Decades later, the position began changing. In *AP Smith Manufacturing Co v Barlow*, the Supreme Court of New Jersey stated *obiter* that the ‘modern conditions require that corporations acknowledge and discharge social as well as private responsibilities as members of the communities within which they operate.’²²⁶ Nonetheless, the English court in *Parke v Daily News Ltd*, held that the directors were prohibited from providing voluntary redundancy payments to employees of a company being wound up because this was neither in the long- nor short-term interests of the company.²²⁷ In *Teck Corp Ltd v Millar* the court commented that ‘[i]f today the directors of a company were to consider the interests of employees no one would argue that in so doing they were not acting *bona fide* in the interests of the company itself’²²⁸ Following these judgments, it could be assumed that when shareholder and stakeholder interests were in conflict, the former would prevail.²²⁹

The legal standard against which directors are adjudged was formulated in *Re Smith and Fawcett Ltd*, as: ‘[directors] must exercise their discretion *bona fide* in what they consider – not what a court may consider – is in the interests of the company, and not for any collateral purpose’²³⁰ The duty to act in good faith is based on honesty.²³¹ Honesty is assessed subjectively.²³² The court will not engage in the merits in determining whether a director acted honestly.²³³ The subjectively assessed duty to act in good faith is tempered by the requirement that the director act for proper purpose. If there is no reasonable grounds for believing that a director acted in the best interests of the company, there may be a finding for a lack of good faith.²³⁴ According to *Shuttleworth v Cox Brothers & Co*, the test is whether a reasonable

²²⁵ *Amalgamated Society of Woodworkers of SA and Another v Die 1963 Ambagsaalvereniging* supra note 33.

²²⁶ *AP Smith Manufacturing Co v Barlow* 98 A2d 581 (NJ 1953) at 586.

²²⁷ *Parke v Daily News Ltd* [1962] 2 All ER 929 (ChD).

²²⁸ *Teck Corp Ltd v Millar* (1972) 33 DLR (3d) 288 (BCSC) at 313-314.

²²⁹ Farouk HI Cassim ‘The duties and the liability of directors’ op cit note 32 at 519.

²³⁰ *Re Smith and Fawcett Ltd*. [1942] Ch 304 at 306.

²³¹ *Ibid*; *Hogg v Cramphorn Ltd* [1967] Ch 254 at 268.

²³² *Ibid*.

²³³ *Hogg v Cramphorn Ltd* *ibid* at 268.

²³⁴ *Shuttleworth v Cox Brothers & Co (Maidenhead) Ltd* [1927] 2 KB 9 at 23.

person would have regarded the director as acting in the best interests of the company.²³⁵ Thus objectivity is crucial to finding that a director complied with his or her fiduciary duty.²³⁶

Finally, in *Charterbridge Corporation Ltd v Lloyd's Bank*, the court established that the test is whether an intelligent and honest person in the position of the director could, considering the circumstances as a whole, reasonably believe that he or she was acting in the interests of the company.²³⁷ Put otherwise, 'the test to determine whether a director acted in good faith and in the best interests of the company is subjective as to means (what is to be done in order to promote the interests of the company) but objective as to ends (the interests of the company).'²³⁸

The common law duty to act in the best interests of the company has evidently been argued before the courts many times. In terms of the common law, the courts will assess director conduct with both subjective and objective inquiries. The common law provides that 'the company' means the general body of incorporators and this has been interpreted to mean shareholders collectively, with some exceptions where duties may be owed to individual shareholders. Below, the duty to act in the 'best interests of the company' in the constitutional era is examined.

²³⁵ Ibid.

²³⁶ *Shuttleworth v Cox Brothers & Co (Maidenhead) Ltd* ibid at 23; *Teck Corp Ltd v Millar* (1972) 33 DLR (3d) 288 (BSCS) op cit note 238; *Extrasure Travel Insurances Ltd v Scattergood* [2003] 1 BCLC 598 (ChD).

²³⁷ *Charterbridge Corporation Ltd v Lloyd's Bank* [1970] Ch 62 at 74.

²³⁸ Jan Louis van Tonder 'An analysis of the directors' duty to act in the best interests of the company, through the lens of the business judgment rule' (2015) 36(3) *Obiter* 702 at 720.

IV THE ‘BEST INTERESTS OF THE COMPANY’ IN THE CONSTITUTIONAL ERA

The fiduciary duty of directors can be an instrument for achieving corporate social responsibility if expanded to include stakeholder interests.²³⁹ In *Gheri v Tiber Developments (Pty) Ltd*, the court stated that ‘the ambit of the [fiduciary] duty can change from time to time.’²⁴⁰ The existence, nature and extent of the duty are ‘questions of fact to be adduced from a thorough consideration of the substance of the relationship and any relevant circumstances which affects the operation of that relationship.’²⁴¹ The duty upon parties must not be construed within a vacuum instead, it must develop to suit ‘modern conditions.’²⁴² Those ‘modern conditions’ now include the Constitution and its values, a new Companies Act and the King Reports. This chapter discusses how each of these instruments influence the interpretation of the fiduciary duty to act in the best interests of the company.

4.1 *The Statutory Duty to Act in the ‘Best Interests of the Company’*

With the advent of the 2008 Companies Act came the partial codification of directors’ duties primarily in section 75 and 76. The codification prescribes duties yet gives little explanation as to their content. The duty to act in good faith and the best interests of the company is codified in section 76(3) of the 2008 Companies Act as follows:

- (3) Subject to subsections (4) and (5), a director of a company, when acting in that capacity, must exercise the powers and perform the functions of director—
- (a) in good faith and for a proper purpose;
 - (b) in the best interests of the company; and
 - (c) with the degree of care, skill and diligence that may reasonably be expected of a person—
 - (i) carrying out the same functions in relation to the company as those carried out by that director; and

²³⁹ Other methods include the two-tier board structure in Germany, social and ethics committees in South Africa and mandatory CSR in India. Section 135 of India’s Companies Act, 2013 mandates CSR from companies with certain turnovers. These companies are required to establish a CSR Committee and spend two per cent of their average net profits on CSR.

²⁴⁰ *Gheri and Others v Tiber Developments (Pty) Ltd and Others* (84/06) [2007] ZASCA 43; [2007] 4 All SA 847 (SCA); 2007 (4) SA 536 (SCA) (29 March 2007) para 9.

²⁴¹ *Ibid* para 9 (citing *Phillips v Fieldstone Africa (Pty) Ltd and Another* supra note 182).

²⁴² *Phillips v Fieldstone Africa (Pty) Ltd and Another* *ibid* para 30.

(ii) having the general knowledge, skill and experience of that director

The Act does not serve to replace the common law duties of directors to the extent that they are not in conflict with the Act.²⁴³ While the common law developments on the fiduciary duties still apply, the Companies Act adds that when determining a matter or making an order in terms of the Act, the court ‘must’ develop the common law as necessary to improve the realisation and enjoyment of rights established by the Act.²⁴⁴ Further, the court must promote the spirit, purport and objects of the Act.²⁴⁵ In the event of multiple, reasonable interpretations of the Act arising, the court must favour the interpretation which best promotes the Act’s spirit, purport and objects.²⁴⁶ These provisions must now guide the interpretation of the duty to act in the best interests of the company.

Accordingly, the Act must be interpreted and applied in a manner which gives effect to its section 7 purposes.²⁴⁷ Section 7(d) provides for the purpose to ‘reaffirm the concept of the company as a means of achieving economic and social benefits.’²⁴⁸ According to *Henochsberg on the Companies Act*, section 7(d), read in light of the DTI Guidelines and traditional interpretation, requires that directors consider stakeholders but that stakeholders are not afforded direct rights.²⁴⁹ Section 7(b)(iii) encourages high standards of corporate governance and transparency. At the same time, the Act is cognisant of the need to balance these purposes with the commercial goals of company law. The Act therefore encourages efficiency²⁵⁰ and flexibility²⁵¹ as well as ‘optimum conditions for the aggregation of capital for productive purposes.’²⁵² It calls for a balancing of the rights and obligations of shareholders and directors and thus remains cognisant of shareholder interests.²⁵³ As pointed out in *Henochsberg*, there is no explicit incorporation of a duty toward stakeholders.²⁵⁴ If the legislator intended this it would have done so explicitly.²⁵⁵ The Act’s purposes therefore allude only to a balancing of

²⁴³ Jan Louis van Tonder ‘An analysis of the directors’ duty to act in the best interests of the company, through the lens of the business judgment rule’ op cit note 238 at 720.

²⁴⁴ Companies Act supra note 4 s 158(a).

²⁴⁵ Ibid s 158(b).

²⁴⁶ Ibid s 158(c).

²⁴⁷ Ibid s 5(1).

²⁴⁸ Ibid s 7(d).

²⁴⁹ Piet A Delpont et al *Henochsberg on the Companies Act 71 of 2008* (2011) at 54.

²⁵⁰ Companies Act supra note 4 s 7(b)(i) and 7(j).

²⁵¹ Ibid s 7(b)(ii).

²⁵² Ibid s 7(g).

²⁵³ Ibid s 7(i).

²⁵⁴ Piet A Delpont et al *Henochsberg on the Companies Act 71 of 2008* op cit note 249 at 54.

²⁵⁵ Ibid.

interests rather than taking a decisive stance on enlightened shareholder value, pluralism or shareholder primacy.

Nonetheless, section 76(3)(b) makes clear that the duty must be exercised for the best interests of the *company*. Similarly, section 77(2)(a) and (b), which details the liability of directors for breaching their fiduciary duties, states that ‘[a] director of a company may be held liable . . . for any loss, damages or costs sustained by the *company* as a consequence of any breach by the director [own emphasis] . . .’ These sections make clear that the duty is owed to the company.²⁵⁶ The discussion below elucidates how the courts, in recent cases, have interpreted the ambit of ‘the company.’

4.2 Contemporary Common Law Position on the Duty to Act in the ‘Best Interests of the Company’

In the recent case of *De Bruyn v Steinhoff International Holdings N.V. and Others*, the court upheld the general rule from *Percival v Wright* that the fiduciary duty of directors is owed to the company.²⁵⁷ It stated, ‘the duty that a director may owe to a shareholder is not based upon the relationship between a director and the company, nor is there any general duty that is owed by directors to shareholders.’²⁵⁸ In *Hlumisa Investment Holdings (RF) Ltd and Another v Kirkinis and Others*, the court confirmed the common law position that the ‘best interests of the company’ duty is owed to the company and not individual shareholders.²⁵⁹

According to the *Steinhoff* judgment, exception may follow for shareholders where there is a ‘special factual relationship’ between the directors and shareholders.²⁶⁰ The list of special factual relationships is not exhaustive.²⁶¹ Whether a special factual relationship with shareholders has arisen ‘will usually require a personal relationship with the shareholders or some specific dealing between the directors and shareholders.’²⁶² If this relationship and therefore duty cannot be proved, a plaintiff will not have recourse to the common law as the

²⁵⁶ Jan Louis van Tonder ‘An analysis of the directors’ duty to act in the best interests of the company, through the lens of the business judgment rule’ op cit note 238 at 712.

²⁵⁷ *De Bruyn v Steinhoff International Holdings N.V. and Others* (29290/2018) [2020] ZAGPJHC 145 (26 June 2020) para 138.

²⁵⁸ Ibid.

²⁵⁹ *Hlumisa Investment Holdings (RF) Ltd and Another v Kirkinis and Others* (1423/2018) [2020] ZASCA 83; [2020] 3 All SA 650 (SCA); 2020 (5) SA 419 (SCA) (3 July 2020) para 48.

²⁶⁰ *De Bruyn v Steinhoff International Holdings N.V. and Others* supra note 257 para 139.

²⁶¹ Ibid.

²⁶² *De Bruyn v Steinhoff International Holdings N.V. and Others* supra note 257 para 141. Examples given by the court include where the director sells or purchases shares as the agent of the shareholder.

statutory duty to act in the best interests of the company is not distinct from the common law duty;²⁶³ the claim would extinguish in law.²⁶⁴ The court in *Steinhoff* explained its rule on ‘special factual relationships’ only with reference to shareholders. It made no reference to other stakeholders and their entitlements to a fiduciary duty. Whether a ‘personal’ or ‘special factual relationship’ exists between a director and other stakeholders including suppliers, creditors and employees, will depend on whether policy allows this extension, as discussed in 4.3 below.

4.3 Modern Interpretation: The Constitution, King Reports and DTI Guidelines

The DTI, in their 2004 Guidelines proposed the following model for corporate governance:²⁶⁵

A company should have as its objective the conduct of business activities with a view to enhancing the economic success of the corporation, taking into account, as appropriate, the legitimate interests of other stakeholder constituencies.

The DTI proposed that directors should ‘take account’ of stakeholder interests to the extent mandated by the Constitution and law.²⁶⁶ The model reflects the common law view that allegiance is owed to the company and not necessarily shareholders. It also evidences, *at least*, an enlightened shareholder approach. Rehana Cassim and Femida Cassim interpret the model as forwarding an approach that is in between enlightened shareholder value and pluralism.²⁶⁷ Their interpretation is motivated by the enshrinement of socio-economic rights in the Bill of Rights as well as the horizontal application of the Bill of Rights to corporations.²⁶⁸ It is the position of this dissertation that this interpretation should be followed considering the new Constitutional dispensation.

The Bill of Rights is binding on companies.²⁶⁹ Further, a purpose of the Companies Act is to ‘promote compliance with the Bill of Rights as provided for in the Constitution, in the application of company law.’²⁷⁰ The Act must be interpreted and applied to give effect to this purpose.²⁷¹ Insisting that a company must comply with the Constitution begs the question as to what the Constitution requires. *Ubuntu* has been described as a ‘concept that permeates the Constitution generally and more particularly chapter three which embodies the entrenched

²⁶³ Ibid para 203.

²⁶⁴ Ibid.

²⁶⁵ ‘South African Company Law for the 21st Century: Guidelines for Corporate Law Reform’ op cit note 112.

²⁶⁶ Ibid at 27.

²⁶⁷ Rehana Cassim & Femida Cassim ‘The reform of corporate law in South Africa’ op cit note 134 at 2.

²⁶⁸ Ibid.

²⁶⁹ Constitution supra note 7 s 8.

²⁷⁰ Companies Act supra note 4 s 7(a).

²⁷¹ Ibid s 5(1).

fundamental human rights.²⁷² *Ubuntu* and *botho*, expressed as ‘*uMuntu ngumuntu ngabantu*’, means ‘I am because you are; you are because we are.’²⁷³ *Ubuntu* ‘places emphasis on communality and on the interdependence of the members of a community.’²⁷⁴ In *South African Broadcasting Corporation Ltd and Another v Mpofu*, the court stated that directors must consider *ubuntu* in carrying out their fiduciary duties.²⁷⁵ *Ubuntu* must therefore be taken into consideration in determining whether there has been a departure from the traditional approach that fiduciary duties are owed to the company meaning shareholders.

With regards to the King Reports, the Act does not explicitly provide for the use of the Reports in interpreting the Act. Muswaka argues that the section 7 purposes should be interpreted broadly and thus section 7(b)(iii), which calls for high standards of corporate governance, permits reliance on the Reports by the courts.²⁷⁶ The King IV too provides for *ubuntu*. *Ubuntu* and *botho* are part of King IV’s foundational concepts. King IV’s premise is that the common purpose of all human and corporate endeavours is service to humanity.²⁷⁷ The argument goes that the interdependency of society extends to juristic persons. The corporation benefits from the provisions of society and in turn must take responsibility for its external effects on society.²⁷⁸ This aligns with section 8(2) of the Constitution which horizontally binds corporations to the Bill of Rights. Since the Companies Act promotes compliance with the Bill of Rights and the Bill of Rights is underpinned by the value of *ubuntu*, *ubuntu* must permeate corporate law. Further, the King Reports have increasingly been used by the courts to determine the liability of directors.²⁷⁹ Since King IV incorporates *ubuntu*, it informs the ethos of corporate social responsibility and, following *Mpofu*, the interpretation of fiduciary duties. What could this mean for the future of company law?

In one alternate reality, *ubuntu* could mandate pluralism. Ojwang argues that corporate social responsibility has taken on a monolithic definition, characterised by individualism.²⁸⁰ CSR has

²⁷² *S v Makwanyane and Another* 1995 (3) SA 391 para 237.

²⁷³ King IV op cit note 8 at 24. Ultimately, the concept centres on social values including communality, unconditional respect and dignity. See C Himonga, M Taylor & A Pope ‘Reflections on judicial views of ubuntu’ (2013) 16(5) *Potchefstroom Electronic Law Journal*. See also *S v Makwanyane* ibid.

²⁷⁴ *S v Makwanyane* ibid para 224, concurring judgment of Justice Langa.

²⁷⁵ *South African Broadcasting Corporation Ltd and Another v Mpofu* supra note 175 para 63.

²⁷⁶ Linda Muswaka ‘Shielding directors against liability imputations: The business judgment rule and good corporate governance’ (2013) 1 *Speculum Juris* 1 at 35.

²⁷⁷ Ibid.

²⁷⁸ Ibid.

²⁷⁹ *South African Broadcasting Corporation Ltd and Another v Mpofu* supra note 175; *Organisation Undoing Tax Abuse NPC and Another v Myeni and Another* (15996/2017) [2019] ZAGPPHC 957 (12 December 2019).

²⁸⁰ Duncan Ojwang ‘Converging ubuntu principles with corporate social responsibility to extend corporate benefits to communities’ (2015) *East African Law Journal* 49 at 52.

been majorly influenced by Western philosophy particularly Kantian Deontology.²⁸¹ This thinking champions individualism to the extent that corporations attract no duties to the communities which they affect except in so far as they may not positively harm society.²⁸² CSR under this thinking is not obligatory because while CSR might be the ‘good’ or ‘right’ thing to do, it is not a necessary condition of being human.²⁸³ In contrast, *ubuntu* recognises the essential interdependence of humans.²⁸⁴ The transplant of a static yet non-neutral (or Western) definition of CSR into South African law hinders the concept from taking on African values. A context-specific notion of CSR would incorporate *ubuntu*. According to Ojwang, *ubuntu* demands mandatory CSR as service to the community arises from the interconnectedness of people: being human in relational.²⁸⁵ Under these values a mandatory CSR would very likely incorporate stakeholder interests more than what is currently provided for in the law. This might even provide the legal foundation for pluralism.

Nonetheless, this is not what the law provides. Section 76(3)(b) makes no reference to consideration of stakeholders. In comparison, the UK Companies Act of 2006 makes explicit reference to stakeholders. Section 172(1) of the UK Companies Act provides:

- (1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to—
- (a) the likely consequences of any decision in the long term,
 - (b) the interests of the company’s employees,
 - (c) the need to foster the company’s business relationships with suppliers, customers and others,
 - (d) the impact of the company’s operations on the community and the environment,
 - (e) the desirability of the company maintaining a reputation for high standards of business conduct, and
 - (f) the need to act fairly as between members of the company.

The South African Act does not replicate this provision. Further, a ‘profit company’ is defined in section 1 of the South African Companies Act as ‘a company incorporated for the purpose

²⁸¹ Ibid.

²⁸² Ibid at 50 and 61.

²⁸³ Ibid at 61.

²⁸⁴ *S v Makwanyane* supra note 272 para 224.

²⁸⁵ Duncan Ojwang op cit note 280 at 50.

of financial gain of its *shareholders* [own emphasis].’ Thus, the law’s commitment to stakeholders, at least through the company law, is arguable.

Inevitably, the company law principles continue to govern the interpretation and limitation of the scope of fiduciary duties. The owing of fiduciary duties to the company is a result of the *Saloman* principle of separate legal personality.²⁸⁶ It is also an implication of the proper plaintiff principle from the rule in *Foss v Harbottle*.²⁸⁷ These corporate principles are firmly entrenched in corporate law.²⁸⁸ In the *Steinhoff* judgment, the court considered the policy considerations behind extending wrongfulness in delict for harm caused due to the breach of the duty to act with care, skill and diligence.²⁸⁹ While this duty is distinct from the duty to act in the best interests of the company, the points the court raised are useful in guiding the expansion (or not) of the duty to act in the best interests of the company. The court noted the danger of indeterminate liability and the difficulty in delineating which plaintiffs have claims against directors. There is also the question as to who should bear the risk of loss to stakeholders and what benefit that might have for society. Whether a director’s conduct infringes a right is another consideration. There may also be an obligation on plaintiffs to take reasonable steps to avoid their risk of harm.²⁹⁰

An extension of the fiduciary duty to act in the best interests of the company even to shareholders generally has been frowned upon. In *Steinhoff*, the court reasoned that shareholders enjoy the benefits of separate legal personality as they assume no risk, other than their equity stake, for the liabilities of the company.²⁹¹ To permit shareholders the right to claim for losses to their shares in addition to the company being entitled to claim for harm done to it would permit double counting against liable directors (and is a sure way of discouraging persons from assuming director roles).²⁹² Shareholders assume the risk of jeopardy of their shares in investing and the law provides for mitigation of that risk by entitling the company to claim for loss caused to it.²⁹³ It is these crucial considerations which will continue to ensure that fiduciary duties remain limited.

²⁸⁶ *Saloman v A Saloman & Co Ltd* supra note 116; *De Bruyn v Steinhoff International Holdings N.V. and Others* supra note 257 para 136.

²⁸⁷ *Foss v Harbottle* [1843] EngR 478; *De Bruyn v Steinhoff International Holdings N.V. and Others* ibid para 137.

²⁸⁸ *De Bruyn v Steinhoff International Holdings N.V. and Others* ibid para 136-137.

²⁸⁹ Companies Act supra note 4 s 77(2)(b).

²⁹⁰ Ibid para 152.

²⁹¹ Ibid para 156.

²⁹² Ibid.

²⁹³ Ibid.

The common law must be interpreted to promote the spirit, purport and objects of the Bill of Rights.²⁹⁴ The Constitution is further relevant when rights are in conflict. It is not likely that the fiduciary duty be interpreted so that it is inconsistent with the Constitution as interpreters should favour constitutionally compliant interpretations. Nonetheless, directors will have to balance competing interests in the exercise of their duties. If that infringes a right, section 77(3)(b) may be challenged in terms of section 36(1) of the Constitution. In terms of the latter section, a right in the Bill of Rights may be limited only in terms of the law of general application and to the extent that the limitation is reasonable and justifiable in an open and democratic society based on human dignity, equality and freedom and taking into account the listed factors.²⁹⁵ Stakeholder rights should be balanced against the corporation's right to freedom of association and freedom of contract. Stakeholder rights are already provided for in numerous specific statutes including employees, the environment, creditors and more. It would seem illogical for non-shareholder stakeholders to challenge section 76(3)(b) of the Companies Act since they have recourse to specific legislation.

Given the aversion of section 76(3)(b) to mentioning stakeholder interests, pluralism is evidently not incorporated into the Companies Act. Since interpretations which give effect to the purposes of the Companies Act must be preferred and that one purpose is to promote the Bill of Rights (including its value of *ubuntu*), it is submitted that the Act incorporates the enlightened shareholder value approach. The conclusion is that directors should consider the interests of stakeholders but only in so far as this promotes the long-term interest of profit-maximisation.²⁹⁶ The profit motive is still foundational to company law. For example, in the event that a company is deadlocked and cannot continue to run *for the benefit of shareholders*, it may be wound up.²⁹⁷ This, however, is balanced against the inclusion of employees as stakeholders in a number of sections including 20(9), 45(5), 128(1), 31(3), 9, 162(2), (7), (8) and 165(2).²⁹⁸ Evidently, the Act finds the midground.

The common law will still require a 'special factual relationship' between directors and stakeholders to be proved. It is submitted that this will be strictly interpreted as stakeholders

²⁹⁴ The Constitution supra note 7 s 39(2).

²⁹⁵ The factors listed in section 36(1) are the nature of the right, the importance of the purpose of the limitation, the nature and extent of the limitation, the relation between the limitation and its purpose, and less restrictive means to achieve the purpose.

²⁹⁶ Piet A Delpont et al *Henochsberg on the Companies Act 71 of 2008* op cit note 249 at 54 supports this interpretation.

²⁹⁷ Companies Act supra note 4 s 81(1)(d)(i)(bb).

²⁹⁸ Dennis Davis & Michelle Le Roux 'Changing the role of the corporation: A journey away from adversarialism' (2012) *Acta Juridica* 306.

have recourse to specific legislation. Further, corporate law remains dependent on its well-entrenched principles. It is the conclusion of this section and that of the DTI, that stakeholder interests should be left to specific legislation.²⁹⁹ The fiduciary duty to act in the best interests of the company therefore requires at least an enlightened shareholder value approach. Arguments motivated by *ubuntu* would demand greater consideration of stakeholder interests. However, the Companies Act clearly does not mandate pluralism and thus, at best, a constitutionally compliant interpretation of the Companies Act requires an approach greater than enlightened shareholder value but less than pluralism. Nonetheless, recent judgments indicate that the courts remain aligned to the longstanding corporate law principles. In sum, it would appear that modern South African law requires an enlightened shareholder value approach albeit in a tempered form.

Given this position, directors may still be unsure of what the Companies Act actually requires of them to the extent that they should consider stakeholders. Even if the law were clearer, a director may struggle to know which of its decisions will be permitted by the law considering the ambiguity in the duty to act in the best interests of the company. After all, each company is unique and directors tailor their decisions to the unique needs of the company. The law therefore should not be overly prescriptive in what it requires from directors. Given the uncertainty regarding what is required of directors, the following chapter discusses the business judgment rule ('BJR'). This rule prescribes the standard of director conduct which determines whether a director will be liable for a breach of their duties. It is therefore highly relevant to the scope of fiduciary duties and provides further insight into the kind of director conduct which is permissible.

²⁹⁹ 'South African Company Law for the 21st Century: Guidelines for Corporate Law Reform' op cit note 112 at 28.

V ADDITIONAL CHECKS TO DIRECTOR CONDUCT: THE BUSINESS JUDGMENT RULE AND COURT DISCRETION

5.1 *The Business Judgment Rule*

The advantage of the ambiguity in the section 76(3)(b) duty is the freedom and flexibility it affords to directors. The 1973 Companies Act was overly formalistic therefore onerous and costly.³⁰⁰ The 2008 Act was intended to provide simplicity and flexibility.³⁰¹ The approach was to provide maximum flexibility and minimum mandatory rules.³⁰² According to the DTI Guidelines ‘company law should provide for the means of co-operation among various stakeholders, it should not attempt to prescribe what the co-operation should be.’³⁰³ The ambiguity of the best interests duty provides flexibility to decision-makers. It is submitted that the person best suited to determining the application of the fiduciary duty is a director. Directors are familiar with the stakeholders that are unique to their company. They are also at grips with the financial needs of their company. They are informed and thus equipped to balance interests.

In balancing interests, it is possible that profit be maximised while giving effect to stakeholder interests. Shared Value is one business management strategy which finds the intersection between creating economic value and addressing societal needs.³⁰⁴ Discovery is one South African company which implements Shared Value thinking.³⁰⁵ Discovery incentivises healthy habits in its customers which addresses the societal need of improving health while mitigating the risk of the insurer.³⁰⁶ By finding the intersection between profits and social responsibility, companies achieve a competitive advantage. This realisation has come to Nestle and Walmart too.³⁰⁷ The success of these corporations evidences the effectiveness of leaving decision-making to company directors and that it is possible to forward stakeholder and profit interests simultaneously.

³⁰⁰ ‘South African Company Law for the 21st Century: Guidelines for Corporate Law Reform’ op cit note 112 at 17.

³⁰¹ Ibid at 29.

³⁰² Ibid at 30.

³⁰³ Ibid.

³⁰⁴ Michael E. Porter & Mark R. Kramer ‘Creating shared value’ (January–February 2011) *Harvard Business Review* 1 at 6.

³⁰⁵ ‘Discovery Integrated Annual Report 2020’ available at <https://www.discovery.co.za/assets/discoverycoza/corporate/investor-relations/2020/discovery-integrated-annual-report-2020.pdf> accessed on 16 December 2020.

³⁰⁶ Ibid at 15–41.

³⁰⁷ Shared Value available at <https://www.sharedvalue.org/community/partners/> accessed on 16 December 2020.

If directors are best equipped to determine what is in the best interests of the company, the question remains as to the extent of the leeway the law provides to them. The business judgment rule (BJR) provides guidance on this front.³⁰⁸ Section 76(4) of the Companies Act contains the business judgment rule. The section is expressed as follows:

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

Essentially, the business judgment rule provides that directors may avoid personal liability for the breach of their fiduciary duty to act in the best interests of the company if first, they were reasonably informed and secondly, had no financial interest in the matter. For the second requirement, a director must not be self-dealing, alternatively, he or she must meet the section 75 requirements for proper and due disclosure.³⁰⁹ Thirdly, the director must have had a rational basis for believing they were acting in the best interests of the company. The rule also applies to the duty to act with reasonable care, skill and diligence.³¹⁰

The relevance of the BJR to the fiduciary duties was described in *Visser Citrus (Pty) Ltd v Goede Hoop Citrus (Pty) Ltd and Others* as follows:³¹¹

Section 76(4) makes clear that the duty imposed by section 76(3)(b) to act in the best interests of the company is not an objective one, in the sense of entitling a court, if a

³⁰⁸ See Piet A Delpont et al *Henochsberg on the Companies Act 71 of 2008* op cit note 249 at 295–299.

³⁰⁹ Farouk HI Cassim ‘The duties and the liability of directors’ op cit note 32 at 564.

³¹⁰ Companies Act supra note 4 s 76(4)(a) read with section 76(3)(c).

³¹¹ *Visser Citrus (Pty) Ltd v Goede Hoop Citrus (Pty) Ltd and Others* (15854/2013) [2014] ZAWCHC 95; 2014 (5) SA 179 (WCC) (19 June 2014) para 74.

board decision is challenged, to determine what is objectively speaking in the best interests of the company. What is required is that the directors, having taken reasonably diligent steps to become informed, should subjectively have believed that their decision was in the best interests of the company and this belief must have had "a rational basis".

The business judgment rule therefore provides a threshold for avoiding liability for the breach of a fiduciary duty. Even if a director does not meet the reasonableness standard of the duty to act in the best interests of the company, he or she will escape liability if the conduct was rational. The High Court further explained that:³¹²

The rationality criterion as laid down in section 76 is an objective one but its threshold is quite different from, and more easily met than, a determination as to whether the decision was objectively in the best interests of the company.

The rationality standard is therefore less stringent than the threshold for assessing whether a director complied with his or her fiduciary duty. The BJR has both a procedural and substantive nature.³¹³ In the procedural sense and as described in the *Visser Sitrus* dicta above,³¹⁴ the business judgment rule allows directors who have contravened their section 76(3)(b) or (c) duties, an escape from liability provided they acted rationally. Once the rationality threshold is satisfied, a breach of a fiduciary duty is of little significance to liability; a director 'will have satisfied'³¹⁵ the section 76(3)(b) and (c) duties if the three elements of the business judgment rule are met. There a director may breach their duty to act in the best interests of the company yet avoid liability for meeting the standard set out in the BJR.

The BJR is too substantive because it is a standalone provision on director conduct which must be complied with regardless of other provisions. Although interrelated with, it is distinct from the duty to act in the best interests of the company and with care, skill and diligence. The rule is new to South African corporate law and is still being defined by the courts.³¹⁶ In *Visser Sitrus* the court provided the test for the BRJ. It held that the BJR requires rationality in the objective sense.³¹⁷ The court borrowed from rationality in terms of the administrative law principle of legality in formulating the test.³¹⁸ Rationality in terms of administrative law requires that the

³¹² Ibid para 76.

³¹³ Richard Stevens & Philip De Beer 'The duty of care and skill, and reckless trading: Remedies in flux' (2016) 28(2) *South African Mercantile Law Journal* 250 at 260. See also Jan Louis van Tonder 'An analysis of the directors' duty to act in the best interests of the company, through the lens of the business judgment rule' op cit note 238 at 723.

³¹⁴ *Visser Sitrus* supra note 311 para 74.

³¹⁵ Companies Act supra note 4 s 76(4)(a).

³¹⁶ See Farouk HI Cassim 'The duties and the liability of directors' op cit note 32 at 563–566. The rule originates from US law and has been adopted in Australia and Hong Kong while rejected in the UK and New Zealand.

³¹⁷ *Visser Sitrus* supra note 311 para 76.

³¹⁸ Ibid para 76–77.

means be rationally related to the ends sought.³¹⁹ According to this test, it is not for the courts to opine what was the best course of action that a director should have taken. Rather, they are relegated to assessing only the relationship between the means employed and ends sought.³²⁰

The rationality test laid out in *Visser Sitrus* affords a certain liberty to directors as the courts will inquire simply into whether the director's conduct in acting in the best interests of the company was rational that is, that that conduct constituted a means to the end of furthering the best interests of the company. This inquiry highlights the deference that the business judgment rule affords to directors. The BJR effectively protects directors against an adverse finding from the courts who judge with the wisdom of hindsight that directors do not have.³²¹ Part of the rationale for this deference is that directors' powers to manage the affairs of the business are statutorily conferred.³²² While it is not necessarily ideal to borrow from administrative law which serves purposes different from company law, the use of the administrative law rationality test is at least a start.³²³

A construction of rationality alternative to the *Visser Sitrus* standard is found in section 180(2)(d) of the Australian Corporations Act 2001 which provides that:

'[t]he director's or officer's belief that the judgment is in the best interests of the corporation is a rational one unless the belief is one that no reasonable person in their position would hold.'³²⁴

This test uses reasonableness to define rationality. This conflation makes the standards of the business judgment rule and the duty to act in the best interests of the company, *prima facie* identical. As Stevens and De Beer point out, this construction of rationality would logically lead to redundancy.³²⁵ It would imply that a director's failure to act reasonably in terms of section 76(3)(b) would *necessarily* constitute a failure to conform with the BJR as the BJR would adopt the same standard: reasonableness. Hence, the BJR cannot be construed as incorporating only a reasonableness standard. Further, the *Visser Sitrus* dicta explicitly

³¹⁹ Ibid.

³²⁰ Ibid.

³²¹ Farouk HI Cassim 'The duties and the liability of directors' op cit note 32 at 563.

³²² Jan Louis van Tonder 'An analysis of the directors' duty to act in the best interests of the company, through the lens of the business judgment rule' op cit note 238 at 721; Companies Act supra note 4 s 66(1).

³²³ Richard Stevens & Philip De Beer 'The duty of care and skill, and reckless trading: Remedies in flux' op cit note 313 at 258-259.

³²⁴ Corporations Act 2001.

³²⁵ Richard Stevens & Philip De Beer 'The duty of care and skill, and reckless trading: Remedies in flux' op cit note 313 at 261-262.

distinguished the standards, describing the rationality criterion as ‘quite different from, and more easily met than’ the standard in the ‘best interests’ duty.³²⁶

In consequence, there is a zone of director conduct between the section 76(3)(b) duty and the BJR which may be devoid of reasonableness yet still rational. Even if conduct is rationally related to the ends of forwarding the long-term interests of the company, stakeholder interests may unreasonably be disadvantaged. The point at which a court will defer to a director’s discretion and find that a director is not liable in terms of the business judgment rule even though he or she unreasonably disadvantaged stakeholder interests is not yet known. Since the BJR invites the courts to defer to the director’s judgment, it could be said that stakeholder interests may be disregarded if this decision forwards ‘the company’ as defined in the common law. Stevens and De Beer suggest that only gross negligence or recklessness would constitute irrationality.³²⁷ It will therefore be unlikely that a stakeholder will find recourse in the Companies Act against a director who favours other stakeholders or shareholders over their own interests.

A rationality standard devoid of and lesser than reasonableness aligns with the DTI’s aims of affording flexibility to directors and avoiding overregulation.³²⁸ The lower standard of rationality is not incompatible with enlightened shareholder value. Enlightened shareholder value permits the trumping of stakeholder interests in favour of shareholder interests if in the best interests of the company. Because the business judgment rule lends itself to deference to directors’ decisions, it may very well be that stakeholders are disadvantaged without directors being liable therefor simply because the decision is rational.

Nonetheless, stakeholders have recourse to the rights enshrined in the Constitution and its corresponding legislation. The Companies Act provides further recourse including the application to have a director declared delinquent or on probation³²⁹ and for relief against oppressive or unfairly prejudicial conduct or conduct which disregards the interests of the specific applicant.³³⁰ Additionally, the derivative action may be exercised.³³¹ Further, any person who contravenes any provision of the Companies Act is liable to any other person for

³²⁶ *Visser Citrus* supra note 311 para 76.

³²⁷ Richard Stevens & Philip De Beer ‘The duty of care and skill, and reckless trading: Remedies in flux’ op cit note 313 at 260-264; Piet A Delpoort et al *Henocheberg on the Companies Act 71 of 2008* op cit note 249 at 298(17).

³²⁸ ‘South African Company Law for the 21st Century: Guidelines for Corporate Law Reform’ op cit note 112 at 29-30.

³²⁹ Companies Act supra not 4 s 162.

³³⁰ *Ibid* s 163.

³³¹ *Ibid* s 165.

any loss or damage suffered by that person as a result of the contravention.³³² These remedies are not without limitation. The derivative action, for example, protects the interests of the *company* and not necessarily the party bringing the action.³³³ Remedies are not the focus of this dissertation. It is merely useful to note that there are remedies available to stakeholders, although with limitations. Recourse to specific legislation is an apt alternative.

In sum, the BJR provides clarity as to the kind of conduct the law expects of directors. So long as directors act rationally in fulfilling their duty to act in the best interests of the company, they will escape liability. Because the rule provides a low standard, directors may not always be accountable to stakeholders. In contrast, it provides directors with the liberty to forward stakeholder interests as a means of nourishing the overall success of the company.

5.2 Discretion of the Courts

Section 5.1 above has explored the BJR as an avenue through which directors may avoid liability despite having breached their fiduciary duties. This is not their only recourse. Section 77(9) of the Companies Act empowers the courts to relieve a director, wholly or partly, from liability in terms of section 77 if it appears to the court that the director acted honestly and reasonably or, having ‘regard to all circumstances,’ it would be ‘fair’ to excuse the director.³³⁴ The director bears the onus of proving that he or she acted honestly and reasonably.³³⁵ Thereafter, the onus shifts to the court to determine whether the director should be excused from liability.³³⁶ Ramnath and Nmehielle submit that in the rare circumstances in which the decisions of the board favour stakeholders but detriment shareholders, this section will have particular relevance.³³⁷

The elements of section 77(9) still need to be defined by the courts. Ramnath and Nmehielle submit that the section should be distinguished from the business judgment rule.³³⁸ Section 77(9) and the business judgment rule must have differing standards otherwise redundancy

³³² Ibid s 218.

³³³ Farouk HI Cassim ‘The duties and the liability of directors’ op cit note 32 at 775-796; Piet A Delport et al *Henocheberg on the Companies Act 71 of 2008* op cit note 249 at 584(2)–593.

³³⁴ Companies Act supra note 4 s 77(9).

³³⁵ Farouk HI Cassim ‘The duties and the liability of directors’ op cit note 32 at 579.

³³⁶ Ibid.

³³⁷ Minal Ramnath & Vincent O. Nmehielle ‘Interpreting directors’ fiduciary duty to act in the company’s best interests through the prism of the Bill of Rights: Taking other stakeholders into consideration’ (2013) 2 *Speculum Juris* 98 at 114.

³³⁸ Ibid.

would result.³³⁹ An interpretation which results in redundancy should of course be avoided. Because section 77(9) requires that courts have regard to ‘all circumstances,’ it is reminiscent of pluralism.³⁴⁰ If this is so, it may be easier for a director to avoid liability through the lower standard of rationality provided by the BJR than the section 77(9) standard which references reasonableness and arguably alludes to stakeholders in the phrase ‘all circumstances.’ Nonetheless, the section does not invalidate the decision of the director,³⁴¹ it only relieves a director of liability. Thus, section 77(9)’s ability to resolve stakeholder qualms is limited. Once the elements of the section are defined, greater clarity shall be afforded to the scope of director conduct.

³³⁹ Ibid.

³⁴⁰ Ibid.

³⁴¹ Ibid.

VI CONCLUSION

The law evolves slowly and clings to its founding principles. This dissertation has attempted to illuminate those founding principles and the theories from which they have extended. The aim has been to provide greater legitimacy to current interpretations of the fiduciary duty to act in the best interests of the company by couching those interpretations in theory. It has been shown that this approach can take us only so far as theory is indeterminate. Naturally, the solution would be to identify the policy decision made by the legislature in the promulgation of the Companies Act of 2008. This dissertation has shown further that this is too unclear since the duty to act in the best interests of the company is ambiguous and open to interpretation. This dissertation has shown that the duty embodies at least an enlightened shareholder value approach. This does not provide further clarity to directors in how they may practically balance the interests of shareholders and stakeholders in their companies.

In light of the ambiguity of the duty to act in the best interests of the company, this dissertation has delved into the standards prescribed by the duty to act in the best interests of the company, the business judgment rule and the discretion afforded to the courts in terms of section 77(9). These standards provide further clarity to directors who may be unsure of what the law requires of them in their decision-making exercise.

Ultimately the law requires that directors consider stakeholder interests to the extent that it benefits the company – meaning the shareholders as a whole – in the long term. The flexibility of the fiduciary duty to act in the best interests of the company affords directors the freedom to incorporate stakeholders to the extent that it benefits their unique company. Directors must act reasonably, assessed objectively and subjectively. If they fail to do so, they may still, in accordance with the business judgment rule, avoid liability if they acted rationally.

Stakeholders are evidently not championed by the common law. They have recourse to specific legislation which gives effect to their Constitutional rights. At present, company law remains founded on corporate law principles and the Companies Act remains in allegiance to these principles. The Constitution and the new Companies Act do not incorporate a pluralist approach despite the new constitutional era. It is expected that corporate law principles will continue to be furthered by the Companies Act while stakeholder interests will be championed through other, specific legislation.

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