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Does the directors' fiduciary duty to act in the best interests of the company undermine other stakeholders' interests? A comparative assessment of corporate sustainability

By

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DECLARATION

I, Friedrich Hamadziripi, do hereby declare that except for the references indicated as such in the text, and any other help as I have acknowledged, this dissertation is wholly a product of my own research, opinion, analysis and industry and has not been submitted in fulfilment of the requirements for degree purposes or academic examination towards any qualification at any other University.

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DEDICATION

To my loving and hardworking mother Beauty Magaso whom God has allowed to see the fruit of all her labour for me day and night. May the God of Ezekiel bless you with many more years full of joy and health.

ACRONYMS AND ABBREVIATIONS

ABBREVIATION	*MEANING*
ADR	Alternative Dispute Resolution
AIG	American International Group Incorporated
ALI	American Law Institute
ASIC	Australian Securities and Investment Commission
BBBEE	Broad-Based Black Economic Empowerment
BCCA	British Columbia Companies Act
BCE	Bell Canada Enterprises
CBCA	Canada Business Corporations Act 1985
CC	Constitutional Court
CEO	Chief Executive Officer
CFO	Chief Finance Officer
CIPC	Companies and Intellectual Property Commission
CJ	Chief Justice
CLER	Corporate Law Economic Reform Bill
CLRSG	Company Law Review Steering Group
CSR	Corporate Social Responsibility
DTI	Department of Trade and Industry
ESV	Enlightened Shareholder Value
EU	European Union
FNB	First National Bank

HIH	Health International Holdings
IDZ	Industrial Development Zone
IFCOR	International Fishing Corporation (Pty) Ltd
JA	Judge of Appeal
JSE	Johannesburg Securities Exchange
LBO	Leveraged buyout
LLD	Doctor of Laws
LRA	Labour Relations Act 66 of 1995
MAF	MacAndrews & Forbes Group Incorporated
MNC	Multi-National Company
MTN	Mobile Telephone Network
NEMA	National Environmental Management Act
NGO	Non-governmental Organisation
PAIA	Promotion of Access to Information Act
Para	Paragraph
SA	South Africa
SARB	South African Reserve Bank
SARS	South African Revenue Services
SCA	Supreme Court of Appeal
SEC	Securities and Exchange Commission
UK	United Kingdom
UNISA	University of South Africa

USA	United States of America

ABSTRACT

This study sets out to answer the question whether compliance with the directors' fiduciary duty to act in the best interests of the company undermines other stakeholders' interests and corporate sustainability. It adopts a comparative approach whereby the South African legal system is compared to that of the United Kingdom, Canada, and the United States of America where corporate scandals in the last two decades resulted in the collapse of some large companies. Qualitative research methods namely the critical and evaluation, comparative and legal historical approaches are employed. The adoption of the comparative and historical approach to this study makes it significant for company law literature.

The study is hinged on two company law principles. The first one is that a company is a juristic and fictitious person. The second one is the separation of ownership and control of a company. To effectively understand how the directors' fiduciary duty to act in the best interests of the company has evolved over time, a historical overview of fiduciary obligations is presented. Four different views about the origins of fiduciary obligations are examined. It is submitted that the old English case of *Keech v Sandford*[1] and the South Sea Company Bubble are very significant to the development of fiduciary obligations and their assimilation into company law.

Thereafter, a discussion on the nature and scope of the directors' duty in question is presented. An analysis of the relationship between directors and the company and how rights and duties between the two legal subjects arise is also undertaken. It will be shown that the directors' fiduciary duty to act in the best interests of the company is broken down into a number of mandatory rules. After outlining some selected company stakeholders, an argument is presented on who the legitimate beneficiaries of directors' fiduciary obligations should be. Further, the study provides an explanation of the concept of 'the best interests of a company' before addressing the tension between the pursuit of sustainability and the best interests of the company.

An important question in the context of this study is how can directors' fiduciary obligations be enforced? Identifying that there is public and private enforcement of fiduciary obligations, this study focusses on private enforcement which mainly consists of judicial and administrative remedies. Judicial remedies especially the derivative action and oppression remedies will be

[1] 1726 25 ER 223 (Ch).

examined. A greater part of the discussion will dwell heavily on whether the available remedies are relevant and/or effective in protecting various stakeholders' interests.

Due to the nature of the office of director, it can be contended that directors should not be held liable for every decision they make. As such, American courts have come up with what has come to be known as the business judgment rule. This rule protects directors from civil liability if they act in good faith, with due care, without any personal interest and within the director's authority. It will be shown that the rule manifests or operates either as an abstention doctrine, as a standard of liability or as an immunity doctrine. As an abstention or standard of liability doctrine, the rule requires the plaintiff to rebut a presumption that directors acted in good faith in the best interests of the company. As an immunity doctrine, the rule requires the director to prove that s/he qualifies for the immunity.

Key terms

Company directors, history, corporate scandals, fiduciary duty; best interests of a company, company stakeholders, corporate sustainability, derivative action, oppression remedies, business judgment rule

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CHAPTER ONE

Introduction to the study

1 1 INTRODUCTORY BACKGROUND

A company is a juristic person.[2] This status as a legal person entitles a company to act as a legal entity separate from its members. Even if a company has only one member,[3] it has the ability to acquire rights and duties separate and distinct from those of its members. However, it has to be noted that a company is an artificial being.[4] This important characteristic makes it impossible for companies to function without the involvement of natural persons. A company needs natural persons to act on its behalf. For example, a company necessarily requires human beings to develop objectives to be achieved and formulate strategies required to achieve such goals.[5] This interaction between a company and natural persons gives birth to a special relationship between the two legal subjects. It is trite law that most relationships between legal persons result in the parties acquiring rights and duties. One of the functions of law is to regulate the relationship between different legal subjects.[6]

The most important group of natural persons through which a company acts is the board of directors or simply directors. In general, company directors have a duty to act in the best interests of their company.[7] It is common practice that company constitutions confer "broad discretionary

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2 *Salomon v Salomon* 1897 AC 22 (HL).

3 See section 66(2) of the Companies Act 71 of 2008 which provides that, "the board of a company must comprise (a) in the case of a private company, or a personal liability company, at least one director; or (b) in the case of a public company, or a non-profit company, at least three directors, section 155(1) of the United Kingdom Companies Act 2006 which state that, "Companies are required to have at least one director who is a natural person" and Davies and Worthington *Gower's Principles of Modern Company Law* 10 ed (2016) 29. It is therefore possible for a company to have only one director.

4 Davies and Worthington *Gower's Principles of Modern Company Law* 10 ed (2016) 29 and Nwafor "Corporate Criminal Responsibility: A Comparative Analysis" 2013 *Journal of African Law* 82.

5 See the cases of *Financial Mail (Pty) Ltd (1990) v Sage Holdings Ltd 1993* (AD) where it was held that a company has no feelings; *Dean v John Menzies (Holdings) Ltd E* 1981 where the court held that a company "has no sense of shame"; and in *Lennard's Carrying Co Ltd v Asiatic Petroleum Co Ltd* E 1915 it was held that "the directors are the directing mind and will of the corporation" and also Nwafor "Corporate Criminal Responsibility: A Comparative Analysis" 2013 *Journal of African Law* 83 note 7.

6 Meintjies *et al Introduction to South African Law: Fresh Perspectives* 2 ed (2011) 7.

7 Section 76(3)(b) of the Companies Act 71 of 2008; Farrar and Hannigan *Farrar's Company Law* 4 ed (1998) 380; and Davies and Worthington *Gower's Principles of Modern Company Law* 10 ed (2016) 485.

powers upon the boards of companies".[8] This is usually done for efficiency purposes.[9] The business environment is dynamic and consumer tastes vary over time.[10] To remain competitive and relevant, a company necessarily needs to respond to the ever-changing business environment. One of the main ways of keeping up with the dynamic business world is by being innovative.[11] Innovation carries with it a certain level of risk. There is no guarantee that an innovation will be successful. It is therefore necessary for company sustainability that directors are not unreasonably deterred from taking relevant risks when discharging their duties. However, it is not envisaged that directors should have unfettered discretion. The broader the power, the more it is likely to be abused. Accordingly, there has to be a balance between director autonomy and accountability even when acting in the best interests of the company.[12]

Another feature of company law which is relevant to this study is the separation of managerial and ownership functions.[13] Generally, shareholders have been taken to be the owners of a company whilst directors perform managerial duties.[14] However, in practice, this distinction is not so clear. There is considerable overlap. For example, one can be both a director and shareholder of the same company at the same time. This overlap has a significant bearing on corporate sustainability in the long run at least for two reasons. Firstly, it presents directors with a conflict of interests during decision making. Directors end up being players and referees in the same game.[15] Secondly, in cases where the directors own a significant number of shares which enable them to influence the outcome of shareholder meetings, other stakeholders' interests are most likely to be undermined.

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8 Davies and Worthington *Gower's Principles of Modern Company Law* 10 ed (2016) 462.

9 *Ibid.*

10 Du Toit *et al Introduction to Business Management* 8 ed (2010) 8-9. For example see News24 http://www.fin24.com/tech/gadgets/blackberry-lesson-adapt-or-die-in-the-internet-age (accessed 29-09-2016) in which the opening statement to that article read "Blackberry has joined Yahoo, Nokia and other technology industry stars felled by an internet age in which companies are forced to evolve quickly or perish". That article revealed how Yahoo, which was formed earlier than google was overtaken by the latter. Nokia, the Finland based company which was once a giant in the cell phone manufacturing industry also threw in the towel. Blackberry, the Canada based firm recently formally announced its decision to stop making cell phones. All these downfalls by such giants were due to failure to adapt to the changing economic environment.

11 With special mention of South Africa, the idea of promoting innovative companies is at the heart of the new Companies Act 71 of 2008 of which section 5(1) provides that "this Act must be interpreted and applied in a manner that gives effect to the purposes set out in section 7". Section 7(c) provides that one of the purposes of this Act are to "promote innovation and investment in the South African markets".

12 Bainbridge "The Business Judgment Rule as Abstention Doctrine" 2003 *Vand. L. Rev* 108-110.

13 Farrar and Hannigan *Farrar's Company Law* 4 ed (1998) 9 and Davies and Worthington *Gower's Principles of Modern Company Law* 10 ed (2016) 40.

14 Davies and Worthington *Gower's Principles of Modern Company Law* 10 ed (2016) 40.

15 McConvill and Bagaric "Why all Directors should be Shareholders in the Company" 2004 *Bond Law Rev*iew 50.

It is therefore proposed in this study to assess how the directors' fiduciary duty to act in the best interests of the company affects its sustainability in view of the apparently opposing interests of other stakeholders.

Corporate scandals in South Africa, the United Kingdom (UK), Canada and the United States of America (USA or America) provide an appropriate background for this study. In all these jurisdictions, directors' compliance with their fiduciary duty to act in the best interests of the company has been criticised or at least questioned.[16] In South Africa, major scandals which easily come to mind are LeisureNet, Regal Treasury Bank, Fidentia, Masterbond and most recently the Marikana Lonmin disaster. LeisureNet was a JSE listed public company[17] which "operated 85 Health and Racquet clubs with a membership of over 900 000 individuals and 5 400 employees".[18] In 1999, LeisureNet's total market capitalisation was R425 695 000.[19] Peter Gardener and Rod Mitchell were the co-CEOs of LeisureNet. The two had hidden interests in a German gymnasium operation that LeisureNet later bought in 1999.[20] Gardener and Mitchell had promised the company's investors that LeisureNet would only venture into the international market by franchising.[21] However, they acted against their word by purchasing a 57.8% stake in a Malta-based company called Healthland International.[22] In addition, LeisureNet failed to control its expansion which resulted in increased "interest-bearing debt".[23] Consequently, the company

16 For example in the USA, with specific reference to the Enron case Powers *et al Report of Investigation by the Special Investigative Committee of the Board of Directors of Enron Corporation* 2002 (hereinafter referred to as the Powers Report) 148; Levin and Collins "The Role of the Board of Directors in Enron's Collapse" *Report Prepared by the Permanent Subcommittee on Investigations of the Committee on Governmental Affairs:* United *States Senate* 107th Congress Second Session (hereinafter referred to as the Subcommittee Report) 3 and Gillan and Martin "Financial Engineering, Corporate Governance, and the Collapse of Enron" 2002 *Working Paper Series No 2002-001* 1 all agree that Enron directors did not comply with their fiduciary duty to act in the best interests of their company. In Canada, while referring to the Bre-X Minerals scandal, Ellis "The Bre-X Minerals Scandal: Year in Review 1997" http://global.britannica.com/EBchecked/topic/78395/The-Bre-X-Minerals-Scandal-Year-In-Review-1997 (accessed 23-04-2015) shows that the exploration director's role in the scandal remains questionable.

17 *Gardener v Walters* 2002 2 SA (CPD) 2.

18 IOL News "LeisureNet directors under scrutiny" http://www.iol.co.za/news/south-africa/leisurenet-directors-under-scrutiny-1.68310#.VW7Hkc-qqko (accessed 03-06-2015).

19 *Ibid.*

20 McLachlan "Ex-chief executives of LeisureNet found guilty of fraud to the tune of R12 million" http://www.sowetanlive.co.za/sowetan/archive/2007/02/14/ex-chief-executives-of-leisurenet-found-guilty-of-fraud-to-the-tune-of-r12-million (accessed 03-06-2015).

21 *Ibid.*

22 *Gardener v Walters* 2002 2 SA (CPD) 2.

23 IOL News "LeisureNet directors under scrutiny" http://www.iol.co.za/news/south-africa/leisurenet-directors-under-scrutiny-1.68310#.VW7Hkc-qqko (accessed 03-06-2015).

became unsustainable and collapsed with over R1 billion in debts.[24] Gavin Woodland who was counsel for the liquidators suggested that certain directors benefited from LeisureNet's suicidal expansion initiatives which also "bear upon the fiduciary duties of directors".[25]

Regal Treasury Private Bank (hereinafter, Regal Bank) commenced its business operations in December 1996 and collapsed after just five years.[26] Its CEO was Jeff Levenstein. Investigations revealed that the South African Reserve Bank (hereinafter, SARB) discovered that prior to its collapse, Regal Bank had corporate governance problems.[27] Furthermore, it was found that the bank failed because "Levenstein did not exercise the utmost good faith in his dealings with and on behalf of the bank, did not always act in the best interests of the bank, depositors and shareholders and he acted dishonestly and fraudulently and that the bank's board of directors contravened provisions of the Companies Act[28] and standards of corporate governance".[29]

In the Masterbond Group scandal, more than 22 000 investors lost total investments of more than R600-million after directors had pretended that the company was registered with the SARB.[30] A number of elderly people, who lost virtually everything, committed suicide.[31] In the Fidentia scandal, investors lost close to one billion rands which went missing.[32] This represented investments from more than 47 000 people. Most of the beneficiaries of these investments were mainly widows and orphans of deceased mine workers. Creditors also lost their money and workers lost their employment.

The recent Marikana massacre brought into question the role of directors who are expected to be stewards of their company. Carrying on the business of a mining company is one undertaking that has great potential to adversely affect the environment. During the Marikana incident, about 3 000

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24 *Ibid.*
25 *Ibid*.
26 Beamish "Failed bank CEO jailed for eight years" http://www.moneyweb.co.za/archive/failed-bank-ceo-jailed-for-eight-years/ (accessed 03-06-2015).
27 *Ibid.*
28 61 of 1973.
29 Report of Commissioner Advocate Myburgh SC in terms of section 69A(11) of the Banks Act 94 of 1990 Regal Treasury Private Bank Ltd (in curatorship) 2-3.
30 Pillai "Fraudsters exploit the fact that authorities across jurisdictions do not communicate" http://itinews.co.za/print.aspx?type=2&itemid=E6AC42E8-0C4D-40DE-9260-C6CB6F569B26 (accessed 24-04-2015).
31 *Ibid.*
32 Yeld "Fidentia scandal: more money is missing" http://www.iol.co.za/news/south-africa/fidentia-scandal-more-money-is-missing-1.320704#.VTjiiu_GPIU (accessed 23-04-2015).

miners went on strike demanding a salary increase from R4 000 to R12 500 per month.[33] The management of the company (Lonmin Platinum) did not agree with the workers' demand. The strike turned out to be fatal as a total of forty-four casualties were recorded.[34] Can it therefore be concluded that the conduct of Lonmin Platinum's directors resulted in the death of the striking workers whilst the directors feared that the company would go bankrupt? Although Lonmin Platinum did not collapse, the Marikana tragedy raises questions about the balancing of the interests of different stakeholders by its directors.

The USA has produced some of the world's most spectacular corporate governance scandals. These include Enron, WorldCom, Lehman Brothers, AIG and Tyco. Before being declared bankrupt and its subsequent total collapse, Enron had expanded enough to become the 7th largest company in the USA and had won the Fortune Magazine's most innovative corporation in America six times.[35] It had over one hundred billion dollars in gross revenues[36] but on 2 December 2001 its shares were worth less than a dollar each, down from $83.13 on 31 December 2000 which was just eleven months earlier.[37] Enron stakeholders were negatively affected as investors lost their money and employees were retrenched.[38] However, of relevance to this study is the question, "what role did the directors play in Enron's collapse?" The Report of the Special Investigation Committee and of the US Senate "both concluded that the board of directors failed in its oversight duties".[39] However, the Enron case is more interesting because it was also found that one of the contributing factors to its collapse was lack of directors' independence.[40] The United States Senate further emphasised that directors have fiduciary duties to act in good faith, in the best interests of the corporation and its shareholders and that Enron's board of directors contributed to its collapse by

33 Muswaka "Thematic Lessons from the Marikana Miners' Strike in South Africa: A Corporate Governance Perspective" 2014 *Mediterranean Journal of Social Sciences* 64.

34 Nicolson "South Africa: Two Years after Marikana Massacre, Families still wait for Justice" http://www.theguardian.com/world/2014/aug/15/south-africa-two-years-marikana-massacre-justice (accessed 05-06-2015).

35 Gillan and Martin "Financial Engineering, Corporate Governance, and the Collapse of Enron" 2002 *Working Paper Series 2002-001* 1.

36 *Ibid* 6.

37 Gillan and Martin "Financial Engineering, Corporate Governance, and the Collapse of Enron" 2002 *Working Paper Series 2002-001* 1and 8.

38 Rosen "Risk Management and Corporate Governance: The Case of Enron" 2003 *Connecticut Law Review* 1157-1158.

39 The Powers Report 148 and the Subcommittee Report 3 and Gillan and Martin "Financial Engineering, Corporate Governance, and the Collapse of Enron" 2002 *Working Paper Series 2002-001* 1.

40 Senate Report 3 and 51.

failing to protect Enron's shareholders' interests.[41] WorldCom and Tyco went through similar circumstances resulting in, *inter alia*, investors and workers losing their money and employment respectively. However, Tyco managed to recover. The collapse of Enron and WorldCom led to the United States Parliament enacting the Sarbanes-Oxley Act.[42]

The UK has not been spared from corporate scandals. Polly Peck International, Maxwell Communications Corporation, Equitable Life Insurance, MG River Group and Northern Rock are all examples of company debacles that have taken place in the UK. Polly Peck International's demise was one of the corporate scandals that prompted the Cadbury *Report of the Committee on the Financial Aspects of Corporate Governance*.[43] Moreover, the collapse of Polly Peck International and Maxwell Communications Corporation led to the UK's company law reform resulting in the initial editions of the Corporate Governance Code.[44] At the time of its collapse in 1990, Polly Peck International had debts amounting to £1,3 billion. In such circumstances, the fate of creditors, employees, suppliers and investors is predictable.

Canada has also experienced major corporate scandals. Examples include Nortel Networks Corporation and Bre-X Minerals Ltd (Bre-X). In 1993 Bre-X explored and reported significant "drilling results" in Busang, Indonesia.[45] Disclosure of the results of the "exploration" led to Bre-X shares rising significantly. However, it later came to light that there were no gold deposits in Busang as claimed by Bre-X. The company's Chairman and the Chief Executive Officer were cleared from liability after forensic investigations revealed that the company's chief geologist was responsible for the fraud.[46] However, the exploration director's contribution in the scandal remains questionable.[47] The effects of this scandal were immeasurable.[48] In this scenario, the critical

41 Subcommittee Report 5 and 9.
42 Of 2002.
43 1992 Gee and Co Ltd London. Hence forth, this report will be referred to as the "Cadbury Report". Boro "Importance of Governance" http://www.glasslewis.com/blog/nadirs-conviction-highlights-importance-of-governance/ (accessed 23-04-2015).
44 *Ibid.*
45 Ellis "The Bre-X Minerals Scandal: Year In Review 1997" http://global.britannica.com/EBchecked/topic/78395/The-Bre-X-Minerals-Scandal-Year-In-Review-1997 (accessed 23-04-2015).
46 *Ibid.*
47 Ellis "The Bre-X Minerals Scandal: Year In Review 1997" http://global.britannica.com/EBchecked/topic/78395/The-Bre-X-Minerals-Scandal-Year-In-Review-1997 (accessed 23-04-2015).
48 Ellis "The Bre-X Minerals Scandal: Year In Review 1997" http://global.britannica.com/EBchecked/topic/78395/The-Bre-X-Minerals-Scandal-Year-In-Review-1997

question is whether the exploration director acted within the scope of his fiduciary duty to act in the best interests of the company since he managed to significantly increase its (market) capitalisation?

1 2 RESEARCH PROBLEM

From all the corporate scandals discussed above, it can be seen that directors' compliance with their duty to act in the best interests of the company is very crucial to corporate sustainability. Most of the scandals eventually resulted in the collapse of the concerned companies. In some instances, directors' conduct may have taken place under the guise of acting in the best interests of the company. It has also been noted that when a company is not performing well or shuts down, a lot of stakeholders' interests are adversely affected. This study seeks to answer the question whether the current interpretation and application of directors' fiduciary duty to act in the best interests of the company undermines other stakeholders' interests and corporate sustainability.

It is also not settled law whether this fiduciary duty is owed to the company alone or to any of its other stakeholders as well. Different jurisdictions have arrived at dissimilar conclusions. More interestingly, different courts have arrived at different conclusions in one typical common law jurisdiction, the UK.[49] A comparative approach is therefore adopted in an attempt to isolate these differences. For that purpose, the South African position will be compared to the position in Canada and the UK.

(accessed 23-04-2015) indicates that "About $3 billion was lost by investors. As a result, investor confidence in small exploration companies was undermined, Indonesia's reputation as a country worth exploring was damaged and the effectiveness of the Canadian regulatory system was also questioned. Bre-X was later declared bankrupt and the company's workers lost their employment".

49 One of the reasons for this uncertainty as noted by Davies and Worthington *Gower's Principles of Modern Company Law* 10 ed (2016) 502 while making reference to *Brady v Brady* 1988 20 BCLC 40, is that "the interests of a company, as an artificial person cannot be distinguished from the interests of the persons who are interested in it". In *Bell v Lever Brothers* 1932 AC 161 (HL) and *Percival v Wright* 1902 2 (Ch) 421 it was held that directors' duties are not owed to shareholders. On the other hand, in *Gaiman v National Association for Mental Health* 1971 317 (Ch) 330 and *Heron International Ltd v Lord Grade* 1938 BCLC 265, it was held that directors owe fiduciary duties to shareholders.

1 3 RESEARCH OBJECTIVES

The objectives of this study are to:

- Trace the historical background of fiduciary law and assess its contribution to modern-day interpretation of the directors' fiduciary duty to act in the best interests of the company;
- Compare and contrast the main distinguishing aspects of the directors' duty to act in the best interests of the company in South Africa, Canada and the UK;
- Illustrate and interrogate the relationship between the directors' duty to act in the best interests of the company and the sustainability of the company's business and deliberate on the key debates in modern day company stakeholder interests studies;
- Discuss the effectiveness of various stakeholders' remedies; and
- Evaluate the appropriateness of the business judgment rule as a standard employed in balancing directorial autonomy and accountability.

1 4 RESEARCH QUESTIONS

It is argued that the directors' fiduciary duty to act in the best interests of the company is very critical for sustainability. It is therefore pertinent to clearly define the scope of this duty and to identify any inconsistencies in its interpretation and/or application. Accordingly, the following questions will be pursued in this study:

- What is the scope of directors' duty to act in the best interests of a company?
- Does the principle of corporate sustainability affect the protection of stakeholders' interests?
- Does acting in the best interests of the company automatically result in the directors undermining other stakeholders' interests?
- How can affected stakeholders invoke available remedies (if any), if their interests are undermined by directors' conduct especially when it happens under the guise of acting in the best interests of the company?
- Is the business judgment rule an appropriate standard in ensuring equilibrium between directorial autonomy and liability?

In responding to these questions, similarities and differences in the selected jurisdictions will be assessed and where possible the strengths or weaknesses of each system will be identified.

1 5 SIGNIFICANCE OF THE STUDY

A comparative study of this nature coupled with a historical perspective on whether directors, by acting in the best interests of the company undermine other stakeholders' interests *vis-à-vis* sustainability is valuable for at least three reasons. First, a look at the historical background of fiduciary law makes it possible to highlight the mischief that the rules were initially intended to address. Identifying the mischief is essential as it exposes the rationale behind the legal principle(s) in question and also affects the way in which the pertinent statutory provisions are interpreted. Once the mischief has been identified, any departures from the originally intended purpose(s) and developments in the interpretation of the directors' duty to act in the best interests of the company will then be easy to assess.

Second, as will be argued in chapter three of this dissertation, most directors are not aware of what exactly the duty to act in the best interests of the company entails.[50] This principle has its roots in the common law.[51] However, the underlying rule has evolved over time since its inception.[52] In South Africa and other common law jurisdictions, the duty of directors to act in the company's best interests has either been wholly or partially codified. This has led to some inconsistencies in interpreting the duty. Accordingly, this study will be helpful in exposing these inconsistencies and offering some related suggestions for law reform.

Third, substantive rules are of no effect if a legal system is devoid of the mechanisms and institutional platform for enforcement. Furthermore, some rules may only be available in theory because in practice their applicability may be limited. This study is important because it seeks to assess the extent to which the available stakeholder remedies are effective in practice. For that purpose, a comparison will be made between legislative provisions of selected jurisdictions and

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50 House of Commons Trade and Industry Committee *White Paper on Modernising Company Law Sixth Report of Session* 2002–03 stated that; "One of the areas where the accumulation of case law had become confusing was that of the duties of company directors. The Company Law Review Steering Group concluded that the law on this matter had become unclear both for the directors themselves and for those trying to hold them to account".

51 Mescher and Bondfield "Corporate Groups and the Duty of Directors to act in their Company's Best Interests" 2003 *Journal of Applied Research in Accounting and Finance* 3. See also *Industrial Equity Ltd v Blackburn* 1977 137 CLR 567.

52 Section 39(2) of the Constitution of the Republic of South Africa allows for the development of the common law taking into consideration the spirit, purport and objects of the Bill of Rights. With respect to the evolving nature of the duty DeMott "Beyond Metaphor: An Analysis of Fiduciary Obligation" 1988 *Duke Law Journal* 1 says, "Fiduciary law developed through analogy rather than principle. Recognition that the law of fiduciary obligation is situation specific should be the starting point for any further analysis". Furthermore, David *Major Systems in the World Today* 3 ed (1985) 342 concedes that the principle of fiduciary obligation is flexible.

how the courts thereof have interpreted the directors' duty to act in the best interests of the company.

1 6 DELIMITATION OF THE STUDY

Company directors have various responsibilities. These responsibilities derive from statutes, common law and even the memorandum of incorporation (which is also referred to as the company's constitution) as well as other agreements and contracts. However, not every responsibility of a director amounts to a fiduciary obligation. Furthermore, in some jurisdictions, company directors have more than one fiduciary duty. This study is limited to the directors' fiduciary duty to act in the best interests of their company. However, it has to be noted that, though retaining similar content, the way this duty/principle is expressed may vary depending on the jurisdiction.[53]

This study also adopts a comparative approach. South African company law on the directors' fiduciary duty to act in the best interests of the company will be compared to that of the UK and Canada. English company law provides the foundation of the company law of most if not all of the common law jurisdictions of which both South Africa and Canada are part. Therefore, exploration of the law in the UK is relevant as it has heavily influenced South African company law. Furthermore, not very long ago, the UK's company law underwent some major reforms.[54] It is submitted that the drafters of the current Companies Act[55] of South Africa drew some lessons from the reforms in the UK. Furthermore, Canada's company law system is similar to that of South Africa. However, reference will also be made to judicial decisions from other jurisdictions like the

53 Section 76(3)(b) of the South African Companies Act 71 of 2008 expresses it as a duty to act "in the best interests of the company"; section 122(1)(a) of the Canada Business Corporations Act 1985 requires directors to "act honestly and in good faith with a view to the best interests of the corporation"; whilst section 172 of the UK Companies Act 2006 places upon directors a "duty to promote the success of the company".

54 The House of Commons Trade and Industry Committee noted that a series of reviews were set up in response to financial scandals in the late 1980s and early 1990s. The reviews started with the *Cadbury Report* in 1992, followed by the *Rutteman Report* of 1994, the *Greenbury Report* of 1995, *the Hampel Report* of 1998 and the *Turnbull Report* of 1999. These reviews encouraged reforms in the law relating to *inter alia* directors' duties, environmental and social reporting, enhancing shareholder engagement and ensuring better regulation. These reforms were then proposed in the UK's *White Paper on Modernising Company Law Sixth Report of Session* 2002–03 and the Secretary of State for Trade and Industry's Company Law Reform Presentation to Parliament in 2005 and were finally incorporated in the current UK Companies Act, 2006.

55 71 of 2008.

USA and Australia where some of the major corporate scandals have taken place.[56] It is acknowledged that although decisions from the above-mentioned jurisdictions are not binding in South Africa,[57] they are interpretative tools with significant persuasive value.[58]

Due to the fact that the study requires a historical background to be provided, no time boundaries have been set. Relevant historical developments may be referred to throughout the study in addition to the discussion in chapter two which specifically deals with history. There is no one type of company that will be discussed. Directors' conduct in both public and private companies, holding companies and subsidiaries, profit-making and not-for-profit companies will be considered. This is a deliberate endeavour aimed at exposing any interpretation inconsistencies and defining the scope of the duty in question in a wider but explicit sense. Inevitably, the discussions will however essentially revolve around public companies and their issues since they are usually the ones of significantly greater public interest.

1 7 RESEARCH METHODOLOGY

Research methodology refers to "a set of rules of procedures about the way of conducting research which includes some explanation and justification for using certain research methods and of the methods themselves".[59] Research methodologies can be classified into various categories.[60] However, the general classification is between qualitative and quantitative research methodologies. Quantitative research refers to "a systematic scientific investigation of quantitative properties of a phenomenon and their inter-relation".[61] Generation and utilisation of mathematical theories and propositions regarding the problem under study is the main purpose of quantitative

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56 O'Regan J in *K v Minister of Safety and Security* 2005 6 SA (CC) 419 para 35, couched the importance of foreign law in the following words, "considerations of responses of other legal systems may enlighten us in analysing our own law and assist us in developing it further".

57 See *S v Makwanyane* 1995 3 SA 391 (CC) para 39 where Chaskalson CJ said, "We can derive assistance from public international law and foreign case law, but we are in no way bound to follow it".

58 Section 5(2) of the Companies Act 71 of 2008 also states that, "To the extent appropriate, a court interpreting or applying this Act may consider foreign company law".

59 Vibhute and Aynalem *Legal Research Methods- Teaching Material* (2009) 19.

60 Creswell *Research design: Qualitative, quantitative, and mixed methods approaches* 2 ed (2003) 5 divides them into Qualitative, Quantitative and Mixed Approaches while Vibhute and Aynalem *Legal Research Methods Teaching Material* (2009) 68 divide these into doctrinal and non-doctrinal or socio-legal. The two scholars also identify other categories such as evolutive and evaluative, identificatory and impact studies, projective and predictive and collative historical comparative. However, the same authors acknowledge the distinction between qualitative and quantitative methods. Du Plessis "A Self Help Guide: Research Methodology and Dissertation Writing" 2007 28, talks about legal comparative method, legal historical method and the empirical method.

61 Vibhute and Aynalem *Legal Research Methods- Teaching Material* (2009) 17.

research.[62] Quantitative research usually makes use of numbers or numerical means to interpret the outcome(s) of a study. The outcome is usually presented in the form of diagrams and it has a lot to do with size and amounts. Examples of quantitative research methods include experimental designs and non-experimental ones such as surveys.[63]

On the other hand, qualitative methods are concerned with or involve the quality of phenomena that is the subject matter of the study.[64] Qualitative research relies on the object behind different features of conduct.[65] This type of research is mostly based on description and observation.[66] Most qualitative research methods take the form of an in-depth analysis of relevant texts in the concerned discipline. In the case of the present study, this would mean working through legal texts such as legislation, case law, textbooks, articles and reports. Most legal studies are carried out through qualitative research methods. However, there have been some developments wherein researchers combine both qualitative and quantitative research methods.[67] A major contributing factor has been the emergence of inter- and transdisciplinary studies. Examples of qualitative methods include legal comparative method, legal historical method and the empirical method, interpretative and analytical, critical studies and evaluation.[68]

This study therefore chooses qualitative over quantitative research methodology. Furthermore, given the nature of this study which involves the relationship between juristic and natural persons, qualitative methods are preferable as they would allow the researcher to undertake an in-depth critical study of the conduct of directors. Through qualitative methods, it is proposed in this study to use the critical and evaluation, comparative and legal historical methods. A brief description and justification of these preferred methods follows hereunder.

Under the legal historical method, "one intends to trace historical antecedents of a legal fact".[69] Legal history goes beyond mere "study of the development of material legal norms".[70] It also

62 *Ibid*.
63 Creswell *Research design: Qualitative, Quantitative, and Mixed Methods Approaches* 2 ed (2003) 13**.**
64 Vibhute and Aynalem *Legal Research Methods- Teaching Material* (2009) 17.
65 *Ibid*.
66 Creswell *Research design: Qualitative, Quantitative, and Mixed Methods Approaches* 2 ed (2003) 18-20.
67 Creswell *Research design: Qualitative, Quantitative, and Mixed Methods Approaches* 2 ed (2003) 13 and Kroeze "Legal Research Methodology and the Dream of Interdisciplinarity" 2013 *PER* 35.
68 Du Plessis "A Self Help Guide: Research Methodology and Dissertation Writing" 2007 28.
69 Vibhute and Aynalem *Legal Research Methods- Teaching Material* (2009) 106.
70 Du Plessis "A Self Help Guide: Research Methodology and Dissertation Writing" 2007 30.

includes an investigation of such rules with respect to "external legal history".[71] Therefore, the legal historical method enables one to spot changes, amendments and the reasons thereof in respect of the scope of directors' duty to act in the best interests of the company taking into consideration relevant political and socio-economic factors. Vibhute and Aynalem point out that employing the legal historical method "discloses alternatives, different than the currently adopted ones, which were considered and rejected by the lawmakers and reasons thereof, it becomes useful, rather warranted, when the present statute or statutory provision has raised meaningful queries and it becomes necessary to explore the circumstances in which the present position came out and it supplies the researcher the reasons that justify the present position".[72] These reasons justify adoption of the legal historical method in this study.

The critical and evaluation approach seeks to appraise the significant legal rules on the issue in question. This method allows a researcher "to ascertain the nature, scope and source of law in order to explain what law is, and also to spell out several propositions used in law".[73] The method also enables one to look at both sides of the issue at hand and be able to make reasonable judgments. By employing this method, it will be possible to critique the nature and scope of the directors' duty to act in the best interests of the company *vis-à-vis* the imperative of sustainability and related concerns. The nature, scope and source of the law pertaining to the fiduciary duty in question will be ascertained in order to explain what is meant by acting in the best interests of the company. The different premises on which the directors' fiduciary duty to act in the best interests of the company is founded will also be spelt out.

There are different legal families. Some of these include religious systems such as the Hindu, Jewish and Islamic law, mixed systems such as South Africa and the UK and Roman-Germanic systems to which all European legal systems belong.[74] The legal comparative method compares different legal systems with each other.[75] The legal systems do not necessarily need to belong to the same family. The comparative method is crucial when studying legislative texts, jurisprudence and also legal doctrines of foreign laws.[76] "If a lawyer has knowledge of his or her own legal

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71 *Ibid*. By "external" is meant the economic, cultural, political, social, philosophical and religious environment.
72 Vibhute and Aynalem *Legal Research Methods- Teaching Material* (2009) 106-107.
73 *Ibid* 102.
74 Du Plessis "A Self Help Guide: Research Methodology and Dissertation Writing" 2007 3.
75 *Ibid*.
76 Razak "Understanding Legal Research" 2011 21.

system only, it is easy to sit down and praise the virtues of the existing legal system. That which is wrong is never seen".[77] The legal comparative method has been selected in this study since a comparison on similarities and peculiarities exposes inconsistencies and enables one to suggest solutions.[78] Furthermore, apart from being used to study law common to all, the legal comparative method also initiates acquaintance with foreign law.[79]

This research will basically adopt a literature study approach. Legislative instruments such as the Companies Act,[80] the Canada Business Corporations Act (CBCA)[81] and the UK Companies Act[82] will be critically analysed. In addition to the above primary sources of law, judicial decisions of the courts especially of South Africa, Canada and the UK will be analysed. Secondary sources of law will also be consulted. Books and journal articles will be referred to for expert legal commentary. These will prove helpful in providing diverse views and perspectives of the law in the selected jurisdictions. The Internet will also be used to find sources of both historical and most importantly current debates pertaining to the fiduciary duty of directors to act in the best interests of the company.

1 8 STRUCTURE OF THE STUDY

This study is divided into six chapters which are the introduction (the current chapter) followed by four discursive chapters and lastly, a conclusion.

The first chapter introduces the study and provides the general outline of the dissertation. It sets out the research objectives, questions, importance and delimitation of the study, the methodology and sources. The opening part of this chapter provides the context of the research by furnishing the background to the study. Additionally, chapter one also sets out two principles of company law which are essential to this study. The first is that a company is a juristic person which has legal personality.[83] The second principle is the separation of ownership and control of a company.

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77 Du Plessis "A Self Help Guide: Research Methodology and Dissertation Writing" 2007 28-29.
78 *Ibid* 30.
79 Vibhute and Aynalem *Legal Research Methods- Teaching Material* (2009) 107.
80 71 of 2008.
81 RSC 1985.
82 Of 2006.
83 *Salomon v Salomon* 1897 AC 22 (HL).

Chapter two provides a historical synopsis of the directors' fiduciary duty to act in the best interests of the company. It lays down the basic conceptual premises of the study by gleaning from the past those special/significant developments which have a bearing on the scope, meaning and relevant substantive and procedural essentials of the directors' duty to act in the best interests of the company. Additionally, this chapter provides a theoretical framework and examines how the resulting theories explain and justify the evolution and scope of the directors' fiduciary duty to act in the best interests of the company.

Chapter three deals with the "nitty gritties" of the nature of the duty to act in the best interests of the company. This chapter delves deep into the nature of the relationship between directors and the company as well as the rights and obligations that ensue from the interaction between the two. Furthermore, an analysis of various stakeholders' interests will be provided.

Chapter four looks at the enforcement of directors' fiduciary duty to act in the best interests of the company and stakeholders' remedies. The main issue which this section of the study seeks to clarify is whether there is currently adequate recourse in law to protect the interests of certain stakeholders. To this end, both administrative and judicial remedies will be critically evaluated. Judicial remedies are divided into criminal and civil and the latter has two further subdivisions namely derivative action and oppression remedies.

Chapter five discusses the business judgment rule and stakeholder protection. Of much relevance will be the balance between directorial autonomy and accountability. A brief historical background of the business judgment rule will be used as a preamble to the main discussion in the chapter. The three main theoretical approaches to or manifestations of the business judgment rule will be examined in discussing its appropriateness as a standard in the pursuit of a balance between directorial autonomy and liability.

Chapter six is the conclusion to the study. It presents a recapitulation of the discussions in the preceding chapters. The chapter also provides some brief recommendations on the scope and interpretation of the directors' duty to act in the best interests of the company.

1 9 REFERENCING

The style of referencing used in this study is that of *Speculum Juris*, an accredited, online and open-source law journal published by the Nelson R. Mandela School of Law, University of Fort Hare.

CHAPTER TWO

History of directors' fiduciary duty to act in the best interests of the company

2 1 INTRODUCTION

This chapter presents a historical and theoretical perspective of fiduciary law with specific reference to directors' duty to act in the best interests of the company. The first part traces the early origins of fiduciary law. The importance of context in legal history cannot be overstated.[84] Fiduciary law is no exception. Consequently, in tracing the history of fiduciary law, attention will not be given only to the legal aspects, but also to some relevant socio-economic and political features that either contributed to or influenced the development of fiduciary law.[85] One of the reasons for looking as far back as the ancient times in exploring the development of fiduciary duty is to assess the contribution of such history to modern-day interpretation of the scope of the directors' fiduciary duty to act in the best interests of the company. Furthermore, insights from the development of fiduciary duty will also provide answers as to why a legal system has certain characteristics.[86] It is also envisaged that looking at the comparative nature of this study, the differences in the selected legal systems will be explained better by tracing the historical origins of fiduciary law. Moreover, a historical background of fiduciary law will help in identifying the original purpose for which the rule was intended.

Two outstanding subjects of interest with respect to the history and development of fiduciary law will also be discussed. These are the case of *Keech v Sandford*[87] and the South Sea Bubble. It is however conceded that the history of fiduciary law is elusive and that the underlying concept is one of the least understood.[88] To counter this limitation, submissions made in this chapter are those that are supported by original sources such as case law and legislation. Although fiduciary concepts

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84 Frankel *Fiduciary Law* (2011) 79 points out that the economic structure and social practices of people can influence the way legal rules are constructed.
85 Du Plessis "A Self Help Guide: Research Methodology and Dissertation Writing" 2007 30.
86 *Ibid*.
87 1726 25 ER 223 (Ch) 223-224.
88 DeMott "Beyond Metaphor: An Analysis of Fiduciary Obligation" 1988 *Duke Law Journal* 879; Rotman "Fiduciary Law's 'Holy Grail': Reconciling Theory and Practice in Fiduciary Jurisprudence" 2011 *Boston University Law Review* 923; and Sealy "Fiduciary Relationships" 1962 *Cambridge Law Journal* 70.

can be gleaned from as early as the creation of the world, this chapter only focusses on the chronological developments in the common law world.[89]

The second part of this chapter provides a critical analysis of the theories that seek to explain the development and evolving nature of the directors' fiduciary duty to act in the best interests of the company. To this end, a couple of theories will be discussed. Some of these include the contractual, reliance and the *communitaire* theories. Each theory will be discussed and analysed to discover its value and contribution in explaining and justifying the directors' fiduciary duty to act in the best interests of the company. Strengths and weaknesses of each theory will be analysed as well. The chapter will end with a summary of all the issues discussed herein.

2 2 HISTORICAL DEVELOPMENT

The origin of fiduciary duties has been loosely identified as the common law.[90] However, a closer look at the history and development thereof as presented in this chapter will show that this assertion is insufficient if not inaccurate. In this section, four different views about the roots of fiduciary duties will be presented. All the proposed conceptions are based on the United Kingdom's (UK) legal system from at least the 15th century. To fully understand these views, a brief narrative of the socio-economic and political environment that prevailed during that time is necessary. The period concerned is one in which the feudal system was predominant. Under this system, all land belonged to the king who was the highest figure in the feudal hierarchy.[91] He always benefited from this system as he was never a tenant.[92] After the king followed lords, then knights and lastly peasants.[93]

89 Frankel *Fiduciary Law* (2011) 79-88 shows that the Jewish and Islamic legal systems and the laws of Hammurabi and Eshnunna have interacted with fiduciary principles very much earlier than in the common law world. For example the same scholar, while making reference to Szto "Limited Liability Company Morality: Fiduciary Duties in Historical Context" 2004 *Quinnipiac L. Rev.* 61 and 87 states that "Fiduciary duties in the biblical tradition begin in the Genesis creation account. The human mission on earth is to be a fiduciary, a steward of God's and other's property. Israel is a fiduciary. So is Jesus Christ . . . after creating the world, God appoints man and woman as agents. They steward the world, exercise dominion, and are fruitful".

90 McCamus "The Evolving Role of Fiduciary Obligation" in *The Continued Relevance of the Law of Obligations: Back to Basics* (2000) 173; Shepherd *Law of Fiduciaries* (1981) 5; and Seipp "Trust and Fiduciary Duty in the Early Common Law" 2011 *Boston University Law Review* 1034-1035.

91 The Feudal System and Castle and Manor Demesnes http://www.castlesandmanorhouses.com/demesnes.htm (accessed 29-06-2015).

92 Seipp "Trust and Fiduciary Duty in the Early Common Law" 2011 *Boston University Law Review* 1015.

93 The Feudal System and Castle and Manor Demesnes http://www.castlesandmanorhouses.com/demesnes.htm (accessed 29-06-2015).

Before the eighteenth century, land was primarily used for farming.[94] The somewhat sudden advance of mining activities which also boosted the UK's industrialisation in the eighteenth century led to a lot of pressures on land ownership.[95] Mining operations, especially on lands held in tenancy, presented the courts with a novel question of "whether the tenants had the right to deplete mineral resources and thus claim profits resulting from such commercial initiatives".[96] The relationship between lord and tenant was reinforced by the latter making an oath of fidelity to the former and the lord would in return guarantee to protect the tenant's interests in the land.[97] In view of this novel use of land, it was the Chancery Court that first applied fiduciary principles to the landlord-tenant relationships.[98]

Tara Helfman argues that English real property law is the genesis of fiduciary law.[99] John Langbein is Helfman's main authority for this view.[100] However, a closer look at Langbein's submissions shows that his concurrence with Helfman is qualified. Helfman went further and linked fiduciary law with the land holding feudal system of land trusts.[101] On face value, this may seem to be a contradiction. Indeed one can question whether Helfman gives credit to the law of trusts or real property law for the development of fiduciary obligations. However, further scrutiny of Helfman's article gives one the idea that, by recognising real property law as the origin of fiduciary duties, he wanted to be specific since, at the risk of oversimplification, real property law can be regarded as a sub-category of the law of trusts.[102]

However, there is one point that works against Helfman's assertion that fiduciary obligations originated in English real property law. In her introduction, Helfman mentions that fiduciary

94 Helfman "Land Ownership and the Origins of Fiduciary Duty" 2006 *Real Property, Probate and Trust Journal* 652.
95 *Ibid.*
96 Helfman "Land Ownership and the Origins of Fiduciary Duty" 2006 *Real Property, Probate and Trust Journal* 652.
97 *Ibid* 653.
98 Helfman "Land Ownership and the Origins of Fiduciary Duty" 2006 *Real Property, Probate and Trust Journal* 652-653 further explains that "initially courts did not reconcile themselves with this new economic activity".
99 Helfman "Land Ownership and the Origins of Fiduciary Duty" 2006 *Real Property, Probate and Trust Journal* 651 and Seipp "Trust and Fiduciary Duty in the Early Common Law" 2011 *Boston University Law Review* 1034.
100 Langbein "The Contractarian Basis of the Law of Trusts" 1995 *Yale Law Journal* 630-634.
101 Helfman "Land Ownership and the Origins of Fiduciary Duty" 2006 *Real Property, Probate and Trust Journal* 651.
102 *Ibid.*

obligations originated in English real property law.[103] After such an assertion, Helfman diplomatically moves away from her original premise and states that "this article does not argue that the modern concept of fiduciary duty sprang fully formed from land ownership. Rather, this article bridges a gap in the early history of fiduciary law. This analysis focuses on the earliest references to fiduciary duty in English case law".[104] Viewed from another angle, and taking into consideration the number of cases that Helfman relied on, her statement may be taken as an acknowledgment of the evolving nature of fiduciary law.[105]

According to Helfman, under English real property law, fiduciary duties originated in the following two discrete but associated waste[106] cases, which are "those involving the exploitation by the tenants of natural resources on lands held by tenants, and those involving contingent remainders".[107] Fiduciary law was developed by the Chancery Court as a way of trying to strike a balance between the rights of lord and tenant.[108] Helfman discussed a number of cases but the outstanding feature in the court's judgments was that, "the fiduciary [tenant] had a duty to manage the estate for the benefit of the beneficiary [lord]".[109]

The second idea about the origin of fiduciary law is very interesting indeed. Joshua Getzler, though at odds with the premise that fiduciary law emanated from trust law, concedes that the root

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103 Helfman "Land Ownership and the Origins of Fiduciary Duty" 2006 *Real Property, Probate and Trust Journal* 651.

104 *Ibid* 652.

105 On the evolving nature of fiduciary duties see McCamus "The Evolving Role of Fiduciary Obligation" in *The Continued Relevance of the Law of Obligations: Back to Basics* (2000) 191; Sealy "Fiduciary Relationships" 1962 *Cambridge Law Journal* 70; Rotman "Fiduciary Law's 'Holy Grail': Reconciling Theory and Practice in Fiduciary Jurisprudence" 2011 *Boston University Law Review* 921; DeMott "Beyond Metaphor: An Analysis of Fiduciary Obligation" 1988 *Duke Law Journal* 881; Frankel *Fiduciary Law* (2011) 795-796; and Shepherd *Law of Fiduciaries* (1981) 5.

106 **http://legal-dictionary.thefreedictionary.com/waste** (accessed 24-08-2015) defines waste as "harmful or destructive use of real property by one in rightful possession of the property". In this context, the harmful or destructive use is referring to mining activities carried on by tenants on landlords' property.

107 Helfman "Land Ownership and the Origins of Fiduciary Duty" 2006 *Real Property, Probate and Trust Journal* 652.

108 *Ibid*.

109 The first case in which fiduciary duties were recognised according to Helfman "Land Ownership and the Origins of Fiduciary Duty" 2006 *Real Property, Probate and Trust Journal* is *Bishop of Winchester v Knight* 1717 24 ER 447 (Ch) which was followed by *Garth v Cotton* 1750 21 ER 239 (Ch) and *Dench v Bampton* 1799 31 ER 362 (Ch). Furthermore, Sealy "Fiduciary Relationships" 1962 *Cambridge Law Journal* 72-73 also says that the word fiduciary was first considered in *Bishop of Winchester v Knight* 1717 24 ER 447 (Ch).

principle stemmed from feudal law.[110] It is difficult to clearly separate feudal law, which in itself is a form of landholding, from trust law without significant overlap since it was commonplace to hold land in trust.[111] Getzler insists that fiduciary law has its root in the principle of accountability.[112] He argues that the Chancery Court applied fiduciary law principles from as early as the 15th century.[113] Seipp, who is Getzler's main authority for this view, also acknowledged the role of the principle of accountability in fiduciary law development.[114] Getzler further argues that fiduciary duties initially emanated from the king's execution of "entrustment powers".[115] With the passage of time, this idea extended to estates which gave birth to the law of trusts and then to the law of contract, for instance agencies which then led to the power and definition of fiduciary doctrine.[116] By putting it this way, Getzler strengthens his view that "fiduciary law is not an offshoot of trusts law but that the trust is a particular instantiation of fiduciary law".[117] However, he acknowledges the contribution that the South Sea Bubble had on the development of fiduciary law and states that *Keech v Sandford*[118] was the first official judicial pronouncement of fiduciary duties.[119]

110 Getzler "An Interdisciplinary View of Fiduciary Law: 'As If.' Accountability and Counterfactual Trust" 2011 *Boston University Law Review* 976. This view is interesting taking into consideration the close links that existed between feudal and trust law.

111 Getzler "An Interdisciplinary View of Fiduciary Law: 'As If.' Accountability and Counterfactual Trust" 2011 *Boston University Law Review* 976.

112 In the words of Getzler "An Interdisciplinary View of Fiduciary Law: 'As If.' Accountability and Counterfactual Trust" 2011 *Boston University Law Review* 977, "to account to another is to narrate what happened to the assets or affairs entrusted to you: to give an account of what you did with your trust".

113 Getzler "An Interdisciplinary View of Fiduciary Law: 'As If.' Accountability and Counterfactual Trust" 2011 *Boston University Law Review* 980.

114 Seipp "Trust and Fiduciary Duty in the Early Common Law" 2011 *Boston University Law Review* 1034-1035.

115 Getzler "An Interdisciplinary View of Fiduciary Law: 'As If.' Accountability and Counterfactual Trust" 2011 *Boston University Law Review* 978-981.

116 *Ibid.*

117 Getzler "An Interdisciplinary View of Fiduciary Law: 'As If.' Accountability and Counterfactual Trust" 2011 *Boston University Law Review* 980.

118 1726 25 ER 223 (Ch).

119 Getzler "An Interdisciplinary View of Fiduciary Law: 'As If.' Accountability and Counterfactual Trust" 2011 *Boston University Law Review* 984.

The third view suggests that the idea of fiduciary duty originated from equity[120] during the late eighteenth and early nineteenth centuries.[121] During that time, there existed a parallel court system in the UK.[122] The Royal Courts adjudicated on common law matters and the Chancery Court[123] specialised in equity issues.[124] The law of equity developed due to the shortcomings of the common law.[125] According to McCamus the first text on fiduciary law appeared in 1727.[126] Considering the voluminous references he makes to the Chancery Court, one would expect that in substantiating his views, McCamus would have provided a judicial pronouncement which is a primary source of law as compared to scholarly works which are secondary sources of law. By the end of the nineteenth century, the doctrine of equity had crystallised into firm legal principles and rules.[127] Just as there cannot be two bulls in the same kraal, the two court systems could not survive together for too long. Shortcomings in the law of equity later resulted in the common law taking precedence.[128]

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120 See DeMott "Beyond Metaphor: An Analysis of Fiduciary Obligation" 1988 *Duke Law Journal* 880 and Vinter *A Treatise on the History and Law of Fiduciary Relationship and Resulting Trusts Together with a selection of selected Cases* 2 ed (1938) 2. As defined in Oxford Dictionaries www.oxforddictionaries/definition/english/equity (accessed 06-06-2015) equity is "a branch of law that developed alongside common law and is concerned with fairness and justice, formerly administered in special courts". If there was a conflict between principles of common law and equity, the latter prevailed.

121 McCamus "The Evolving Role of Fiduciary Obligation" in *The Continued Relevance of the Law of Obligations: Back to Basics* (2000) 173.

122 *Ibid*.

123 Abdullah *et al* "Court of Chancery" www.britannica.com/EBchecked/topic/105336/Court-of-Chancery (accessed 06-06-2015) explains further that "the Court of Chancery in England is the Court of equity under the Lord Chancellor that was formed in the fifteenth century to provide remedies not obtainable in the courts of common law. Today, the court comprises the Chancery Division of the High Court of Justice".

124 McCamus "The Evolving Role of Fiduciary Obligation" in *The Continued Relevance of the Law of Obligations: Back to Basics* (2000) 173.

125 See McCamus "The Evolving Role of Fiduciary Obligation" in *The Continued Relevance of the Law of Obligations: Back to Basics* (2000) 174 who says that the common law courts were harsh first in the sense that those who knew the law utilised it to the detriment of the ignorant. This may be a result of the adversarial nature of the common law courts. Second, common law proceedings were onerous. Moreover, common law only passed orders for payment of damages but under equity one could be awarded a different order, based on conscience. Those who were dissatisfied with the common law outcomes asked the king for relief. This practice grew until the Chancery Court was established. Therefore the law of equity "played a corrective role to the harshness of common law", DeMott "Beyond Metaphor: An Analysis of Fiduciary Obligation" 1988 *Duke Law Journal* 881 and Shepherd *Law of Fiduciaries* (1981) 13. Seipp "Trust and Fiduciary Duty in the Early Common Law" 2011 *Boston University Law Review* 1012-1014 narrates classic examples of common law shortcomings in the law of contract and further states that common law was in actual fact unfriendly to fiduciary relationships.

126 McCamus "The Evolving Role of Fiduciary Obligation" in *The Continued Relevance of the Law of Obligations: Back to Basics* (2000) 174 while making reference to Francis *Maxims of Equity* (1727).

127 McCamus "The Evolving Role of Fiduciary Obligation" in *The Continued Relevance of the Law of Obligations: Back to Basics* (2000) 173-174.

128 The law of equity became procedurally weak and proceedings in the Chancery Court turned out to be time-consuming. Consequently, the Judicature Acts of 1873 and 1875 were enacted in order to merge the two systems

The Chancery paved the way for legal institution of the trust.[129] The legal nature of the trust put its enforcement beyond the reach of common law. "A trust is an explicit arrangement under which a person, the settlor, transfers title to assets into the hands and under the control of the trustee for the purpose of benefitting a named beneficiary or beneficiaries for a specific purpose or cause".[130] According to the short-sighted common law perspective, "[if] ownership of such assets had been passed to the trustee…that was the end of the matter".[131] The common law did not provide relief for the third party beneficiaries in that they had no standing to sue.[132] However, in equity, the Chancellor was prepared to intervene and protect the interests of the trust and its predecessor.[133] Additionally, the Chancery Court provided relief in instances of abuse of confidence.[134]

The next important development in fiduciary duties' history was the definition of a "trust" in its strict sense. Before the nineteenth century, the term "trust" was loosely used to refer not only to trust relationships but simply as a standard of upholding faithfulness to one's obligation.[135] The term trustee was loosely employed to refer to all kinds of relationships including individuals such as agents, guardians and directors of charitable organisations.[136] However, in the nineteenth century, the meaning of the term was restricted to refer to "trusts" in its strict sense and the word "fiduciary" referred to all kinds of relationships that did not amount to trust.[137] The Chancery's

into one court. However, this might have worked at least in England because according to DeMott "Beyond Metaphor: An Analysis of Fiduciary Obligation" 1988 *Duke Law Journal* 881 the Delaware Court of Chancery still maintains a "separate court of equity operating with a self-consciously equitable style".

129 McCamus "The Evolving Role of Fiduciary Obligation" in *The Continued Relevance of the Law of Obligations: Back to Basics* (2000) 173.

130 McCamus "The Evolving Role of Fiduciary Obligation" in *The Continued Relevance of the Law of Obligations: Back to Basics* (2000) 175.

131 *Ibid*.

132 McCamus "The Evolving Role of Fiduciary Obligation" in *The Continued Relevance of the Law of Obligations: Back to Basics* (2000) 173.

133 *Ibid*.

134 Sealy "Fiduciary Relationships" 1962 *Cambridge Law Journal* 70 and DeMott "Beyond Metaphor: An Analysis of Fiduciary Obligation" 1988 *Duke Law Journal* 881.

135 McCamus "The Evolving Role of Fiduciary Obligation" in *The Continued Relevance of the Law of Obligations: Back to Basics* (2000) 176 and Rotman "Fiduciary Law's 'Holy Grail': Reconciling Theory and Practice in Fiduciary Jurisprudence" 2011 *Boston University Law Review* 925.

136 Sealy "Fiduciary Relationships" 1962 *Cambridge Law Journal* 69-72.

137 See McCamus "The Evolving Role of Fiduciary Obligation" in *The Continued Relevance of the Law of Obligations: Back to Basics* (2000) 176 and Rotman "Fiduciary Law's 'Holy Grail': Reconciling Theory and Practice in Fiduciary Jurisprudence" 2011 *Boston University Law Review* 925 who mention the criteria that was to be satisfied before a relationship would qualify as a trust. The criteria popularly known as the three certainties of trust law as held in *Knight v Knight* 1840 49 ER 63-64 are "[the] intention or desire of the settlor/testator to create the trust, subject (the existence of clearly identifiable property which constitutes the *res* of the trust), and object (the purpose or function of the trust, including who or what will benefit under it)". Sealy "Fiduciary Relationships" 1962 *Cambridge Law Journal* 72-73 also agrees with McCamus' view and goes further to imply

construction of fiduciary duties was narrow and was basically made up of two principles. First, the fiduciary was not allowed to be involved in commitments that would result in his personal interests conflicting with those of who he was supposed to be protecting.[138] Second, the fiduciary was not allowed to make personal secret profits from opportunities that were a result of him occupying the fiduciary position.[139] These two principles which are conventionally known as the conflict rule and the no-profit rule still exist in contemporary company law.[140]

"The modern law of fiduciaries is based on the somewhat sandy foundation of a number of historical anomalies".[141] Shepherd holds a liberal view that fiduciary law developed from both the common law and equity.[142] He further argues that fiduciary law did not develop as a separate area of law but that it has existed for years as an "unstated assumption behind the law of agency, trusts, corporations and wills".[143] However, his view faces direct objection from other scholars.[144] Also, the scholar does not explain further what he meant by fiduciary law being an underlying assumption. One may argue that it is not clear whether or not he referred to fiduciary principles being employed as interpretative tools or hypotheses upon which the court used as scapegoats when faced with uncertainty.

At one point, Shepherd acknowledged the corrective role of the law of equity.[145] Shepherd's view on the origins of fiduciary law are discussed here with reference to the law of agency. He highlights some of the challenges that the common law was faced with when dealing with the law of agency.[146] The fact that the law of agency was left to be the domain of equity principles whilst the

that the first judicial acknowledgment of fiduciary duties was in *Bishop of Winchester v Knight* 1717 24 ER 447 (Ch).

138 *Aberdeen Rwy Co v Blaikie Brothers* 1854 1 Macq. 461.

139 McCamus "The Evolving Role of Fiduciary Obligation" in *The Continued Relevance of the Law of Obligations: Back to Basics* (2000) 177.

140 *Ibid*.

141 Shepherd *Law of Fiduciaries* (1981) 5.

142 *Ibid*.

143 Shepherd *Law of Fiduciaries* (1981) 12.

144 Seipp "Trust and Fiduciary Duty in the Early Common Law" 2011 *Boston University Law Review* 1011; McCamus "The Evolving Role of Fiduciary Obligation" in *The Continued Relevance of the Law of Obligations: Back to Basics* (2000) 173; and Getzler "An Interdisciplinary View of Fiduciary Law: 'As If.' Accountability and Counterfactual Trust" 2011 *Boston University Law Review* 977-980.

145 Shepherd *Law of Fiduciaries* (1981) 13.

146 "Because of the way it dealt with the principal, the common law had considerable difficulty in delineating the status of the agent" Shepherd *Law of Fiduciaries* (1981) 13. Furthermore, under common law an agent was treated as *amanuensis* which means an object or tool which had no will or decision making capacity. If an agent had no volition then he or she would also not be expected to be loyal to his or her principal.

former existed long before the establishment of the Court of the Chancery is enough reason for Shepherd to hold the view that fiduciary law had its roots in both the common law and equity. It is clear that common law pre-existed equity. It therefore makes sense also to hold the view that at one time fiduciary duties developed through common law because if it only developed through equity the common law defects would not have been exposed. The common law responded by gently neglecting such problems as those that arose in the law of agency.[147] This led to the development of equity.

Between the seventeenth and eighteenth century, the law of equity improved the position of the agent which became more like that of a trustee.[148] The agent's obligations became fiduciary in nature.[149] But the battle between common law and equity continued. The law of equity failed to fully take care of the principal-agent relationship.[150] A compromise had to be reached as neither equity nor common law was willing to surrender and give way to the other.[151] The result was that equity governed "some areas of law like agency and trust[152] whilst the common law continued to govern those areas of law that were unencumbered by equity's incursions".[153] Between the two camps lay an "island" which neither equity nor the common law occupied. In this zone belonged all other relationships that later brought about fiduciary duties.[154] It is not clear however that during the embryonic stages of this "island" whose it was between common law and equity. Maybe this is the reason why Shepherd begins by stating that fiduciary law developed both through the common law and equity.[155]

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147 Shepherd *Law of Fiduciaries* (1981) 13.

148 Shepherd *Law of Fiduciaries* (1981) 13. Shepherd however does not specify in what respects the agent's obligations moved closer to those of a trustee. The context in which he makes his statement may imply that he was referring to an agent no longer being viewed as an object without decision making capacity but as one capable of disloyalty.

149 Shepherd *Law of Fiduciaries* (1981) 13.

150 Shepherd *Law of Fiduciaries* (1981) 13-14.

151 Shepherd *Law of Fiduciaries* (1981) 14.

152 *Ibid*.

153 *Ibid*.

154 *Ibid*.

155 Shepherd *Law of Fiduciaries* (1981) 5.

2 3 THE CONTRIBUTION OF KEECH V SANDFORD AND THE SOUTH SEA COMPANY BUBBLE

Legal history literature with respect to the origin of fiduciary duties hardly omits reference to either *Keech v Sandford*,[156] the South Sea Company Bubble or both.[157] As evident from the four different views discussed above, some authors may acknowledge other sources as authority for the origin of fiduciary duties, but in the course of their submissions, the influence of *Keech v Sandford*[158] or the South Sea Bubble is always noticed. The contribution of these two events to the origin and development of fiduciary duties, therefore, deserves further attention. The two events which are only separated by a space of six years, are like a thread that runs through fiduciary obligations history. *Keech v Sandford*[159] will be discussed first then attention will shift to the South Sea Company Bubble.

2 3 1 Keech v Sandford

The case of *Keech v Sandford*[160] concerned a trustee of a lease (Rumford Market) who had failed to renew the lease for his *cestui que* trust.[161] The trustee renewed the lease in his own name and claimed entitlement to the benefits of the lease.[162] The issue to be decided by the court was whether the trustee was legally entitled to the benefits of the lease considering that he had failed to obtain renewal from the lessor. The court held that "the lease must be held on trust in the same terms as the original"[163] and "the trustee shall be obliged to convey to the infant [beneficiary] and account for the profits".[164] The court's judgment was based on the principle that "[whenever] a lease is

156 1726 25 ER 223 (Ch).
157 Hicks "The Remedial Principle of *Keech v Sandford* Reconsidered" 2010 *Cambridge Law Journal* 288; Sealy "Fiduciary Relationships" 1962 *Cambridge Law Journal* 77; Getzler "An Interdisciplinary View of Fiduciary Law: 'As If.' Accountability and Counterfactual Trust" 2011 *Boston University Law Review* 984; Wolfe "The Fiduciary Duty of Directors and Officers under the Louisiana Business Corporations Act of 2014" 2014 *Loy. L. Rev* 531 footnote 23; Shepherd *Law of Fiduciaries* (1981) 52 and 303-305; Rotman "Fiduciary Law's 'Holy Grail': Reconciling Theory and Practice in Fiduciary Jurisprudence" 2011 *Boston University Law Review* 922; Langbein "Questioning the Trust Law Duty of Loyalty: Sole Interest or Best Interest?" 2005 *Yale LJ* 929 952; and Davies and Worthington *Gower's Principles of Modern Company Law* 10 ed (2016) 16-89.
158 1726 25 ER 223 (Ch).
159 *Ibid*.
160 *Ibid*.
161 *Keech v Sandford* 1726 25 ER 223 (Ch). A *cestui que trust* refers to the beneficiary of a trust.
162 *Keech v Sandford* 1726 25 ER 223 (Ch).
163 Sealy "Fiduciary Relationships" 1962 *Cambridge Law Journal* 77.
164 *Keech v Sandford* 1726 25 ER 223 (Ch).

renewed by a trustee or executor, it shall be for the benefit of *cestui que* use".[165] This case's contribution to the development of directors' fiduciary obligations is significant. First, many scholars believe that *Keech v Sandford*[166] is the original acknowledgement of fiduciary law by a court of law.[167] Second, this case is also authority for the rule that a fiduciary may not make personal secret profits arising from his/her being a fiduciary.[168] This principle has been carried into contemporary corporate law and is known as the "no profit rule".[169] Third, Getzler submits that Lord Chancellor King's judgment in this seminal case is also the foundation for the modern day "conflict rule" against company directors.[170]

This case has influenced the meaning and scope of directors' fiduciary duty to act in the best interests of the company which is also referred to as the duty of loyalty by some sources.[171] Since *Keech v Sandford*[172] was basically concerned with trusts, and is generally accepted as the first judicial recognition of fiduciary obligations, it is worthwhile to consider how the courts exported fiduciary principles from trust to company law. Furthermore, it is important for the purposes of this study to show also how and when the interests of a company became equivalent to the interests of the shareholders. In *Charitable Corporation v Sutton*[173] company directors who were at that time known as committee-men, appeared before the Chancery Court as defendants on charges of, *inter alia*, breach of trust which resulted in the company incurring significant losses. The court had to consider whether the directors' conduct led to the company's losses. Lord Hardwicke held that "because directors are agents of the people who grant them power to manage the corporation's affairs, they are liable for any negligent acts or omissions. A director of a company owes duties to

165 *Ibid*.
166 1726 25 ER 223 (Ch).
167 Getzler "An Interdisciplinary View of Fiduciary Law: 'As If.' Accountability and Counterfactual Trust" 2011 *Boston University Law Review* 984-985 and Wolfe "The Fiduciary Duty of Directors and Officers under the Louisiana Business Corporations Act of 2014" 2014 *Loy. L. Rev* 531.
168 Sealy "Fiduciary Relationships" 1962 *Cambridge Law Journal* 77.
169 Hicks "The Remedial Principle of *Keech v Sandford* Reconsidered" 2010 *Cambridge Law Journal* 290 footnote 17.
170 Getzler "An Interdisciplinary View of Fiduciary Law: 'As If.' Accountability and Counterfactual Trust" 2011 *Boston University Law Review* 983.
171 *Regal (Hastings) Limited v Gulliver* 1942 All ER 378 (HL); Hicks "The Remedial Principle of *Keech v Sandford* Reconsidered" 2010 *Cambridge Law Journal* 290-291; Wolfe "The Fiduciary Duty of Directors and Officers under the Louisiana Business Corporations Act of 2014" 2014 *Loy. L. Rev* 531; and Getzler "An Interdisciplinary View of Fiduciary Law: 'As If.' Accountability and Counterfactual Trust" 2011 *Boston University Law Review* 983.
172 1726 25 ER 223 (Ch).
173 1742 2 Atk.

the company in the same measure and quality as does a trustee to a trust".[174] This case shows us that the court ascribed fiduciary duties to directors through analogy. By putting a trustee and a director on the same footing, the court exported fiduciary principles from trust law to company law.

In *Percival v Wright*[175] the plaintiff owned shares in a company but the shares neither had a market value nor were they quoted on the stock exchange. Moreover, the shares could only be transferred with the directors' approval.[176] Mr. Percival, through his legal representatives independently went on to value his shares and enquired from the company if there was anyone willing to purchase his shares for £12,50 each. The company chairman Mr. Wright with two other directors offered to buy the plaintiff's shares at £12,10 each. However, little did Mr. Percival know that the company directors were planning to sell the whole company to a third party for more than £12,10 a share. Mr. Percival later claimed that the directors had breached their fiduciary obligations.

The court dismissed the plaintiff's case holding that there was no question of unfair dealing since it was not the directors that first proposed to the plaintiff to buy his shares but that it was the shareholder who approached the directors and the latter only offered what they were willing to pay for Mr. Percival's shares.[177] Furthermore, based on the facts, the court held that directors owed fiduciary duties to the company as a separate entity and not to the shareholders.[178] By the time this case went to court, company law had developed to the extent that the question was no longer whether directors owe fiduciary obligations or not. The court's judgment shows that it differentiated between the interests of the company and the interests of shareholders. It is submitted that the principle in *Percival v Wright*[179] endured for quite some time as the court in *Bell v Lever Brothers*[180] (thirty years after the former judgment was delivered) also held that directors do not owe fiduciary duties to shareholders.

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174 *Charitable Corporation v Sutton* 1742 2 Atk.
175 1902 2 421 (Ch).
176 *Percival v Wright* 1902 2 421 (Ch).
177 *Ibid*.
178 *Percival v Wright* 1902 2 421 (Ch). However, the decision in this case has been heavily criticised. Farrar and Hannigan *Farrar's Company Law* 4 ed (1998) 378 say the decision "is limited to its facts". This case was also considered by the New Zealand Supreme Court in *Coleman v Meyers* 1977 2 NZLR 225 NZCA where Mahon J explicitly disagreed with the decision in *Percival v Wright.* See also *Re Chez Nico (Restaurants) Ltd* 1992 BCLC 192 208.
179 1902 2 421 (Ch).
180 1932 AC 161 (HL).

Company law jurisprudence then began to evolve. In *Heron International Ltd v Lord Grade*,[181] the court held that directors owed fiduciary duties to shareholders.[182] Clearly, this was a departure from previous decisions. After this case followed *Regal (Hastings) Limited v Gulliver*.[183] In that case, the plaintiff company owned and operated a cinema in Hastings. The appeal was brought by the Regal Company against five of its former directors to recover some money from them. The plaintiffs alleged that the defendants had made profits simply because they were directors in Regal which enabled them to acquire and sell its shares to Hastings Amalgamated Cinemas Limited, a subsidiary company formed by Regal.[184] The action was based on the claim that since the directors had used their positions to make profits, they were accountable for them to Regal and that also in so doing they had placed themselves in a position where their interests would conflict with their duty to Regal. Lord Russell, making reference to *Keech v Sandford*[185] held that by using their positions to make profits, the directors had breached their fiduciary obligations.[186] This case also confirmed the position that directors owe fiduciary duties to shareholders.[187]

In *Greenhalgh v Arderne Cinemas Ltd*,[188] while endorsing the principle that directors owe fiduciary duties to their company, it was held that "the phrase 'the company as a whole' does not mean the company as a commercial entity as distinct from the corporators".[189] Attenborough submits that Evershed M.R's judgment in this case "is to blame" for taking the phrase "the company" to mean shareholders.[190] Additionally, Davies and Worthington concede that fiduciary duties are traditionally owed to those persons who create the company or buy shares thereof.[191] There is no doubt that the scholars were referring to shareholders. They further explain that the reason why the word 'company' is so defined is that shareholders are the last to benefit from the

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181 1938 BCLC 265.
182 *Heron International Ltd v Lord Grade* 1938 BCLC 244 265.
183 1942 1 All ER 378 (HL).
184 *Regal (Hastings) Limited v Gulliver* 1942 All ER 378 (HL).
185 1726 25 ER 223 (Ch).
186 *Regal (Hastings) Limited v Gulliver* 1942 All ER 378 (HL).
187 This case will be discussed in detail in chapter 3 under "the rule against self-dealing".
188 (No 2) 1946 1 All ER 512.
189 *Greenhalgh v Arderne Cinemas Ltd* (No 2) 1946 1 All ER 512.
190 Attenborough "How Directors Should Act When Owing Duties to the Companies' Shareholders: Why we need to stop applying Greenhalgh" 2009 *ICCLR* 340. This scholar further states that subsequent cases "simply adopted the formulation in Greenhalgh".
191 Davies and Worthington *Gower's Principles of Modern Company Law* 10 ed (2016) 470-472.

company when the company is wound.[192] *Gaiman v National Association for Mental Health*[193] also confirmed the same position. By the time this case was heard it was settled that directors owe fiduciary duties to shareholders. Farrar and Hannigan called it the "traditional view".[194] By moving from the initial premise that directors do not owe fiduciary duties to shareholders and deciding the contrary, the courts thus equated the interests of the company to those of the shareholders. Essentially, Farrar and Hannigan also note that, "While directors may not owe any fiduciary duties to shareholders as such, the position is redressed to some extent by defining the directors' duty to act bona fide in the interests of the company in terms of the interests of shareholders…".[195] Furthermore, in *Brady v Brady*[196] it was held that "the interests of a company as an artificial person cannot be distinguished from the interests of the persons who are interested in it".[197]

2 3 2 The South Sea Company Bubble

The next important event that immensely contributed to fiduciary law development is the South Sea Company Bubble. One may argue that the South Sea Company Bubble was nothing more than an instance of over-overpricing of company securities and therefore belongs to the domain of securities regulation rather than company law. Conversely, to begin with, although company directors do not fix securities prices themselves, they have an indirect but significant influence on securities pricing.[198] Second, there is also authority for the view that South Sea Company directors intentionally raised the company's stock value for their own benefit which has been the traditional view.[199]

The history of the South Sea Company Bubble dates back to 1711 when John Blunt, who was a lawyer and merchant banker and Robert Harley formed a company which they named "The

192 *Ibid*.
193 1971 (Ch) 317.
194 Farrar and Hannigan *Farrar's Company Law* 4 ed (1998) 381.
195 Farrar and Hannigan *Farrar's Company Law* 4 ed (1998) 381-382.
196 1988 BCLC 579.
197 *Brady v Brady* 1988 BCLC 20 40.
198 The directors' report can affect the value of a company's securities. Kleer "Riding a wave: The Company's role in the South Sea Bubble" 2015 *Economic History Review* 265 footnote 15 explains this further. Temin and Voth "Riding the South Sea Bubble" 2004 *American Economic Review* 1655 while referring to Eugene "The Behaviour of Stock-Market Prices" 1965 *Journal of Business*, object the view that the bubble was a result of over-pricing.
199 Kleer "Riding a wave: The Company's role in the South Sea Bubble" 2015 *Economic History Review* 264 footnote 7. However, this point is not relied on because its public opinion but that it has been referred to solely for the purpose of showing that directors' conduct in the South Sea Company Bubble invites scrutiny and thus qualifies to be part of the subject matter of this study.

Company of Merchants of Great Britain Trading to the South Seas".[200] The initial purpose of establishing this company, which is evident from the name itself, was to secure trade in the South Seas.[201] The company was popularly known as the South Sea Company. It was so successful that in 1719 it proposed to take over the national debt by buying out all the creditors for cash or in exchange for shares.[202] Some commentators however erroneously hold the view that it is this object for which the South Sea Company was formed.[203] With strong connection to the government, the South Sea Company had a lot of investors which included *inter alia*, merchants, doctors, professors and even clergymen.[204] The South Sea Company's success resulted in a variety of similar schemes with interesting different goals for instance "to fatten elephants and to fix quicksilver".[205]

In 1720, the bubble eventually burst. New investors lost between twenty-five to fifty percent of their investment as the company failed even to pay its liabilities.[206] South Sea Company directors' conduct came under the spotlight. Davies and Worthington note that there were demands that the South Sea Company directors be given a "Roman-style execution".[207] On the other hand, Kleer argues that South Sea Company directors did not act to benefit themselves but were merely supporting "the market price of South Sea stock whenever it came under downward pressure". In general, the South Sea Company Bubble is viewed as a watershed in the history of business companies.[208] It led to, *inter alia,* the enactment of the Bubble Act[209] which prohibited a company

200 Farrar and Hannigan *Farrar's Company Law* 4 ed (1998) 17 para 3. Colombo "South Sea Bubble" http://www.thebubblebubble.com/south-sea-bubble (accessed 27-06-2015).

201 Farrar and Hannigan *Farrar's Company Law* 4 ed (1998) 17. Temin and Voth "Riding the South Sea Bubble" 2004 *American Economic Review* 1655 substitute the phrase Spanish America for the South Seas.

202 Farrar and Hannigan *Farrar's Company Law* 4 ed (1998) 17. The same authors on page 18 note that the South Sea Company's shares rose from £100 to £1000 within a few days. This study does not intend to provide a full account of the history of English company law. To this end for more on the background of how a company got to be allowed to buy the whole nation's debt see Farrar and Hannigan *Farrar's Company Law* 4 ed (1998) 15-18 and Temin and Voth "Riding the South Sea Bubble" 2004 *American Economic Review* 1654-1657.

203 Temin and Voth "Riding the South Sea Bubble" 2004 *American Economic Review* say that the company was more involved in dealing with government debt as opposed to foreign trade. This might justify why others hold this view.

204 Farrar and Hannigan *Farrar's Company Law* 4 ed (1998) 18.

205 Farrar and Hannigan *Farrar's Company Law* 4 ed (1998) 18 state that "at one time the amounts invested in such companies were twice the value of all the land in England".

206 Kleer "Riding a wave: The Company's role in the South Sea Bubble" 2015 *Economic History Review* 264.

207 Farrar and Hannigan *Farrar's Company Law* 4 ed (1998) 18.

208 Harris "The Bubble Act: Its Passage and Its Effects on Business Organization" 1994 *Journal of Economic History* 611 while making reference to Hunt *The Development of the Business Corporation in England, 1800-1867* (1936) 6-9; Manchester *A Modern Legal History of England and Wales 1750-1950* (1980) 348-349; Scott *The Constitution and Finance of English, Scottish and Irish Joint-Stock Companies to 1720* (1910) 437-438 and Shannon "The Coming of General Limited Liability" *Economic History* (1931) 358-359.

209 1720.

from acting as a body corporate**.**[210] The "deed of settlement company" which was an amalgamation of trust and association was thus designed to comply with this Act.[211] The assets of this business structure were "held in trust by trustees but its business was managed by managers or directors".[212] The South Sea Company directors were arrested.[213] A Bill was passed to enable the confiscation of those who were found guilty of fraud.[214] One can therefore argue that the South Sea Bubble contributed in shaping English corporate law which greatly influenced most of the common law jurisdictions. However, it has to be noted that the limited liability doctrine was only introduced in 1855.[215] If Kleer's view that the South Sea Company directors acted for personal benefit is to be believed, one can therefore learn that fiduciaries are not to put their personal interests ahead of their beneficiaries'.[216] This can be translated into the modern day "no conflict rule" which will be discussed in chapter 3 below.

2 4 CLASSIFICATION OF FIDUCIARIES

The development of fiduciary law gave birth to different classifications of fiduciaries. Most scholars agree on at least three traditional categories of fiduciaries.[217] Sealy, at one point, concedes that there may be more than four classifications of fiduciaries. However, in two of his major works on fiduciary law history, he discusses four classes of fiduciaries. On the other hand, Shepherd's first three classes of fiduciaries are also discussed by Sealy, but the former introduced another category of fiduciaries.[218] It has to be noted that since these categories are not a result of any rational judgment, considerable overlap is inevitable.[219] "What we are listing here is a series of relationships that, in the appropriate circumstances, can have a fiduciary component. It is a list in which the exception not only proves the rule, [but] is the rule".[220] However, this does not eclipse the importance of these classifications. First, these categories will help one have a clearer

210 Farrar and Hannigan *Farrar's Company Law* 4 ed (1998) 18.
211 *Ibid*.
212 Farrar and Hannigan *Farrar's Company Law* 4 ed (1998) 18.
213 Castelow "South Sea Bubble" http://www.historic-uk.com/HistoryUK/HistoryofEngland/south-sea-bubble/ (accessed 25-08-2015).
214 Farrar and Hannigan *Farrar's Company Law* 4 ed (1998) 20.
215 It was introduced in the Limited Liability Act of 1855.
216 See Kleer "Riding a wave: The Company's role in the South Sea Bubble" 2015 *Economic History Review* 264.
217 Shepherd *Law of Fiduciaries* (1981) 21; Sealy "Fiduciary Relationships" 1962 *Cambridge Law Journal* 74-78 and Sealy "Some Principles of Fiduciary Obligation" 1963 *Cambridge Law Journal* 74.
218 Shepherd *Law of Fiduciaries* (1981) 32.
219 *Ibid.*
220 Shepherd *Law of Fiduciaries* (1981) 22.

understanding of the directors' fiduciary duty to act in the best interests of the company by placing it in context. Second, the classifications will help explain the similar treatment between fiduciary and trust law. Lastly, for the purposes of this study, a discussion of these categories strategically acts as a forerunner to a discussion of the basis of fiduciary law.

2 4 1 Fiduciaries as property holders

The first classification views fiduciaries as property-holders.[221] This category has been largely influenced by the law of trusts.[222] It deals with people who hold property on behalf of others. Virtually all trustees fall into this category.[223] However, this is not all. There are other relationships which fall short of trust elements that also qualify as fiduciaries in this category. These include *inter alia* company directors, agents and attorneys. The fiduciary need not have physical possession of the property, control thereof is enough.[224] The "fiduciary must not hold property as a debtor,"[225] must separate between his property and the beneficiary's property and must not conduct any transactions with the beneficiary's property for personal gain.[226] In Sealy's submissions, it is not clear whether "property" refers to real property only. It can however be implied that the inclusion of attorneys in this category explains away the question of limiting the meaning of property to real property. On the other hand, this inference can be found wanting when one considers that the time during which these rules were formulated, real property such as land was the most valuable commodity.[227] A look at case law clears the mist around this area.

The majority judgment delivered by Cardozo J in the landmark American case of *Meinhard v Salmon*[228] though it arose from partnership law provides some insight into the development of

221 Shepherd *Law of Fiduciaries* (1981) 22; Sealy "Fiduciary Relationships" 1962 *Cambridge Law Journal* 74 and; Sealy "Some Principles of Fiduciary Obligation" 1963 *Cambridge Law Journal* 119.
222 Shepherd *Law of Fiduciaries* (1981) 21.
223 Shepherd *Law of Fiduciaries* (1981) 23 and Sealy "Fiduciary Relationships" 1962 *Cambridge Law Journal* 74-75.
224 Sealy "Fiduciary Relationships" 1962 *Cambridge Law Journal* 74.
225 *Ibid*.
226 Sealy "Fiduciary Relationships" 1962 *Cambridge Law Journal* 75 explains this further on footnote 28.
227 Helfman "Land Ownership and the Origins of Fiduciary Duty" 2006 *Real Property, Probate and Trust Journal* 651-652 implies that mining activities increased the value of land.
228 1928 164 NE 545 (NYCA) 546. This case was however tightly decided as it had four judges for the majority decision with three judges dissenting. Frankel "Fiduciary Law" 1983 *California Law Review* 795 reveals that directors' fiduciary duties can be traced back from the formation of partnerships. See also Havenga *Fiduciary Duties of Company Directors with Specific Regard to Corporate Opportunities* (Unpublished LLD thesis, University of South Africa, 1995) 12.

fiduciary duties of company directors. In that case, the defendant bought a twenty-year lease of Hotel Bristol from Louisa Gerry.[229] Salmon wanted to turn the hotel premises into shops and offices but did not have enough money for the alterations. He then negotiated with the plaintiff to provide the necessary funds. The plaintiff agreed. This resulted in a joint venture between the two. The plaintiff substantially provided the investment capital while the defendant was to solely "manage, lease, underlet and operate [the business]".[230] However, with less than four months into the lease, the defendant concluded another lease with Elbridge Gerry without notifying the plaintiff in his capacity as owner of another company, Midpoint Realty.[231] The question was whether Salmon owed any fiduciary duty to inform Meinhard of the opportunity since their lease was still running. The court found in favour of the plaintiff (investor) and stressed that the defendant (manager) owed the highest fiduciary duty of loyalty to the former as he had reposed confidence in him to manage the business. It is contended that this case shows the *nexus* between company law, partnership law, law of agency and contract law. The principle that managers owe fiduciary duties to investors established in *Meinhard v Salmon*[232] is extended to company law since partnership law forms the basis of the former.[233] Viewed from this angle, the defendant would represent directors while the plaintiff would represent shareholders.

2 4 2 Fiduciaries as representatives

Fiduciaries act as representatives of other people.[234] This category had its roots in the law of agency which was subject to principles of equity.[235] In the words of Asquith L.J, this category of fiduciary relationship arises "whenever the plaintiff entrusts to the defendant a job to be performed".[236] One may argue that Asquith LJ's explanation sounds shallow. Bare use of the words "plaintiff" and "defendant" leaves his explanation open to abuse because in practice anyone can be a party to a civil proceeding. The judge did not specify who is covered and who is not covered by this category two net. On the other hand, since fiduciary law itself developed through analogy rather than as a

229 *Meinhard v Salmon* 1928 164 NE 545 (NYCA) 461.
230 *Meinhard v Salmon* 1928 164 NE 545 (NYCA) 462.
231 *Ibid*.
232 1928 164 NE 545 (NYCA) 462.
233 Frankel "Fiduciary Law" 1983 *California Law Review* 795 footnote 3 says that company directors' fiduciary duties have their roots in partnership law.
234 Shepherd *Law of Fiduciaries* (1981) 25; Sealy "Fiduciary Relationships" 1962 *Cambridge Law Journal* 76; and; Sealy "Some Principles of Fiduciary Obligation" 1963 *Cambridge Law Journal* 122.
235 Shepherd *Law of Fiduciaries* (1981) 21.
236 *Reading v R* 1949 KB 232 236.

system of cogent principles,[237] Asquith L.J may just have fallen into the same trap and unconsciously extended the inherent defect. Shepherd concedes that the wide continuum of agency relationships makes it difficult to "determine the nature of agency relationships *vis-à-vis* the fiduciary principle".[238] Sealy however adds flesh to Asquith's rather skeletal explanation and says: "Any person will find himself in such a situation if he undertakes an obligation (not necessarily contract) to act on another's behalf or for another's benefit, or is deemed in equity to have done so".[239] Among others, this explanation gives birth to the "no profit rule" which has enjoyed much discussion in contemporary company law.[240]

In this second category falls company directors and officers, managers, advisers, public officials, partners and promoters.[241] It has to be noted that Shepherd differentiated between company directors and managers. However, he did not justify such differentiation which may confuse contemporary company lawyers who sometimes use these two words interchangeably. In this category, control of property is irrelevant and the key principle is that the fiduciary acted consistently in executing his undertaking. Although a company director falls under the category of property-holder fiduciaries, he/she also owes fiduciary duties to the company he/she directs under category two.[242] With respect to company directors owing fiduciary duties to shareholders, Shepherd mentioned in passing that there was some form of fiduciary duties that existed between the two but conceded that the matter was not yet settled. This shows that the question of directors' fiduciary duties has long been debated but still remains unclear. This is one of the objectives of this study, to trace and isolate the inconsistencies with respect to the scope and interpretation of the directors' fiduciary duty to act in the best interests of their company.

237 Shepherd *Law of Fiduciaries* (1981) 5; McCamus "The Evolving Role of Fiduciary Obligation" in *The Continued Relevance of the Law of Obligations: Back to Basics* (2000) 176; and DeMott "Beyond Metaphor: An Analysis of Fiduciary Obligation" 1988 *Duke Law Journal* 879.

238 Shepherd *Law of Fiduciaries* (1981) 25.

239 Sealy "Fiduciary Relationships" 1962 *Cambridge Law Journal* 76.

240 *Dorbyl v Verster* 2011 JOL 27671 (GS); *Phillips v Fieldstone Africa (Pty) Ltd* 2003 (SCA); *Canadian Aero Service Ltd v O'Malley et al* 1976 10 OR 239; Cassim *et al Contemporary Company Law* 2 ed (2012) 536-538; and Sealy "Fiduciary Relationships" 1962 *Cambridge Law Journal* 77.

241 Shepherd *Law of Fiduciaries* (1981) 25-26 and Sealy "Fiduciary Relationships" 1962 *Cambridge Law Journal* 76.

242 Shepherd *Law of Fiduciaries* (1981) 24-25; *Farrar v Farrars* Ltd 1889 40 Ch 395 (CA); *Hodson v Deans* 1903 2 647 (Ch) 652; and *In Re Worthington and Armand* 1915 21 DLR 402.

2 4 3 Life tenants and the doctrine of undue influence

The third classification of fiduciaries arises from the seminal case of *Keech v Sandford.*[243] For company law purposes, the most important principle in this case is the "no profit rule".[244] The last category stems from the law of undue influence.[245] Ernest Vinter states that "undue influence may exist in the form of bad companionship and yet not be sufficient to invalidate a will made under its operation. To be within the meaning of the rule of law, it must be an influence exercised by coercion or fraud. But actual violence is not necessary to constitute coercion".[246] For some reason(s), Shepherd calls this group of fiduciaries "advisors". Sealy admits that authorities are not in agreement as to who a fiduciary is with respect to this category.[247] There is case law which also suggests that this category includes some classes that are not fiduciary in nature.[248] Some identifiable fiduciaries in this category include attorneys, doctors, guardians, investment counsellors, appraisers and valuers.[249] The classification of fiduciaries has revealed that company directors were mentioned in at least two categories. Having traced the development of fiduciary law up to this period, one question still requires attention. The next section attempts to answer the question what is the basis of fiduciary obligations on company directors?

2 5 THE APPLICATION OF FIDUCIARY LAW TO COMPANIES

It is trite law that directors owe fiduciary obligations to the companies they manage or serve.[250] Of interest to this study is the directors' fiduciary duty to act in the best interests of their company. This question needs to be addressed as one may be confused by the discussion in the previous

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243 1726 25 ER 223 (Ch).

244 Sealy "Fiduciary Relationships" 1962 *Cambridge Law Journal* 78.

245 Sealy "Fiduciary Relationships" 1962 *Cambridge Law Journal* 78; Shepherd *Law of Fiduciaries* (1981) 21 and 28 and Vinter *A Treatise on the History and Law of Fiduciary Relationship and Resulting Trusts Together with a selection of selected Cases* 2 ed (1938) 3.

246 Vinter *A Treatise on the History and Law of Fiduciary Relationship and Resulting Trusts Together with a selection of selected Cases* 2 ed (1938) 19.

247 Sealy "Fiduciary Relationships" 1962 *Cambridge Law Journal* 78-79 however gives an example of the priest-devotee relationship.

248 See Lord Cranworth and Chelmsford's judgments in *Smith v Kay* 1859 7 (HL) Cas. 750 751 and *Tate v Williamson* 1866 LR 2 (Ch) App 55 60-61 respectively.

249 See Shepherd *Law of Fiduciaries* (1981) 28-31; Finn *Fiduciary Obligations* 2 ed (1977) 176 and *Hatch v Hatch* 1803 All ER 105.

250 Section 76(3) of the South African Companies Act 71 of 2008; section 122(1)(a) of the CBCA RSC 1985; section 172 of the UK Companies Act 2006; *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 168 (AD); Shepherd *Law of Fiduciaries* (1981) 355; Nwafor "Fraudulent Trading and the Protection of Company Creditors: the Current Trend in Company Legislation and Judicial Attitude" 2013 *Comm. L. World Rev* 297; and Davies and Worthington *Gower's Principles of Modern Company Law* 10 ed (2016) 465.

sections which heavily linked fiduciary obligations to trusts and agency law. However, the question as to what is the basis of company directors' fiduciary duties is still open for debate. Are directors fiduciaries because of their office and the nature of work that they perform or their similarity with trustees and agents? Judicial decisions will provide significant insight on this issue. Not many scholars have attempted to answer this question. In responding to it, four bases are discussed hereunder.[251] Each of these suggested views will be critically examined to ascertain if any of them is suitable to justify ascribing company directors with fiduciary obligations in general and specifically the duty to act in the best interests of their company.

2 5 1 Directors as trustees

The first view justifies ascribing fiduciary duties to company directors because they carry trustee-like obligations. English law has had a great influence on this view.[252] Dharmaratne draws from the Latin literal meaning of the word "fiduciary" to support the view that directors are trustees.[253] Surprisingly, company directors have also been described as trustees by courts of law.[254] The rationale behind such a rather misleading description, as will be discussed later, may help one understand this view better. First, the enactment of the Bubble Act[255] led to the development of the "deed of settlement company" which was in effect an enlarged partnership.[256] It is well known that the property of a partnership was held by trustees. During the embryonic stage of company law, directors oftentimes were trustees themselves. Therefore through analogy, the courts described company directors as trustees.[257] Second, it is possible that the description of directors

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251 Havenga *Fiduciary Duties of Company Directors with Specific Regard to Corporate Opportunities* (LLD thesis, University of South Africa, 1995) 11 suggests the first three. Cassim *et al Contemporary Company Law* 2 ed (2012) 411-414 in addition to these three, goes on to discuss another category to make it four.

252 Havenga *Fiduciary Duties of Company Directors with Specific Regard to Corporate Opportunities* (Unpublished LLD thesis, University of South Africa, 1995) 11.

253 Dharmaratne "A Consideration of Whether Company Directors Should Stand in a Fiduciary Relationship with the Company's Related and Inter-Related Companies" 2011 1 says the word fiduciary comes from the Latin words *fiduciaries* which means to hold in trust, *fides* which means faith and *fiducia* meaning trust. Vinter *A Treatise on the History and Law of Fiduciary Relationship and Resulting Trusts Together with a selection of selected Cases* 2 ed (1938) 2 also defines the term "fiduciary" from its Latin origin.

254 *Charitable Corporation v Sutton* 1742 2 Atk 400; *In re Lands Allotment Co* 1894 1 616 (Ch) 631; and Lord Selborne in *Great Eastern Railway Company v Turner* 1872 8 LR 149 (Ch) App 152.

255 1720.

256 Farrar and Hannigan *Farrar's Company Law* 4 ed (1998) 18 and Havenga *Fiduciary Duties of Company Directors with Specific Regard to Corporate Opportunities* (LLD thesis, University of South Africa, 1995) 12.

257 *In re Lands Allotment Co* 1894 1 616 (Ch) 631 it was held, "Although directors are not, properly speaking, trustees, yet they have always been considered and treated as trustees of money which comes to their hands, or which is actually under their control, and ever since joint stock companies were invented directors have been held liable to make good moneys which they have misapplied, upon the same footing as if they were trustees".

as trustees is a result of the Chancery Courts applying the term to anyone who seemingly occupied a fiduciary position. For example, in *Re German Mining Co, ex parte Chippendale*[258] the court treated directors as if they were trustees by affording them the latter's rights to be reimbursed by the members as their beneficiaries.[259] As evident from judicial decisions referred to in this section, it is suggested that to some extent, the courts had a role to play in the rather mistaken view that the basis of directors' fiduciary obligations lies in trust law.

It is conceded that there are some similarities between trustees and directors. However, these similarities do not in any way overshadow the sharp differences between the two to the extent that we treat them as if they are wholly identical. The first difference is, as pointed out by Havenga that, "A trust is not created when directors are appointed and a director does not occupy the office of trustee".[260] Second, trustees and directors duties are regulated by different legislative instruments.[261] Furthermore, as compared to directors of non-profit companies, a higher standard of conduct is expected from trustees of charitable trusts.[262] In other words, directors have more discretion than trustees in the execution of their duties. Lastly, the beneficiary of the directors exercising their fiduciary duties is a company as a separate legal entity whereas in the case of a trustee(s) it is a person(s) not a "collective legal entity".[263] Having examined the differences

In South Africa this view has also received judicial acceptance. See Goldstone J in *Sibex Construction (SA) (Pty) Ltd v Injectaseal CC* 1988 2 SA 54 (T) 65 who held that "there is high authority both in this country and other countries where similar legal principles obtain for the proposition that a director of a company is a trustee for his company and that a fiduciary relationship arises therefrom" and *French Hairdressing Saloons Ltd v National Employers Mutual General Insurance Association Ltd* 1931 60 (AD) 67-68.

258 1853 4 De GM and G 19.

259 *Re German Mining Co, ex parte Chippendale* 1853 4 De GM and G 19. See also *In re Forest of Dean Coal Mining Company* 1879 10 451 (ChD) 453 and *In re Wincham Shipbuilding, Boiler, and Salt Company* 1878 9 322 (ChD) 328.

260 Havenga *Fiduciary Duties of Company Directors with Specific Regard to Corporate Opportunities* (Unpublished LLD thesis, University of South Africa, 1995) 14.

261 In South Africa directors' duties have been incorporated into the Companies Act 71 of 2008 but the common law still applies whereas trustees' concerns are dealt with in the Trust Property Control Act 57 of 1988 and the Administration of Estates Act 66 of 1965. In Canada trusts are regulated primarily by the Trust and Loan Companies Act SC 1991 and also the Bankruptcy and Insolvency Act RSC 1985 whereas directors' rights and responsibilities are regulated by the CBCA RSC 1985. Finally, in the UK directors duties are incorporated into the UK Companies Act 2006 whereas the Trustee Act 2000 regulates trustees' duties.

262 Peregrine "what's in a name" http://www.mwe.com/info/pubs/What's%20in%20a%20Name%20%20Director%20vs.%20Trustee (accessed 26-06-2015).

263 Havenga *Fiduciary Duties of Company Directors with Specific Regard to Corporate Opportunities* (Unpublished LLD thesis, University of South Africa, 1995) 15.

between these two offices, it can be safely said that directors are not fiduciaries because they are trustees but that they are fiduciaries because of the nature of their obligations.[264]

2 5 2 Directors as agents

The second suggested basis for directors' fiduciary duties is that they are agents.[265] The critical question to be answered in this section is: Are company directors fiduciaries because they act or occupy the same position as that of agents? This view stems from the very core principle which forms the heart of corporate law that a company is a separate legal entity.[266] As an artificial being, a company necessarily requires natural persons, in this case directors, to act on its behalf.[267] Consequently, the law of principal and agent significantly regulates the relationship between a company and its directors.[268] In this resemblance, the company is taken to be the principal whilst the directors are viewed as the agents. As a result, directors have on numerous occasions been referred to as agents of their company.[269] This view has enjoyed a lot of support from proponents of the agency theory which will be discussed later.[270] In South Africa, this analogy enjoyed some support under the 1973 Act but the position has however changed with the introduction of the new Companies Act.[271] *Prima facie*, it can be argued that this argument is more convincing than the one discussed above which was merely based on analogy. Is it enough though to justify directors' fiduciary duties merely because they act like agents?

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264 Havenga *Fiduciary Duties of Company Directors with Specific Regard to Corporate Opportunities* (Unpublished LLD thesis, University of South Africa, 1995) 15. The same scholar while making reference to *Re International Vending Machines Pty Ltd* 1962 NSWR 1408 states that "To describe a mere fiduciary as a trustee is therefore at best a metaphor".

265 *Ferguson v Wilson* 1866 2 77 (Ch) App 89; *Aberdeen Rwy. Co v Blaikie Brothers* 1854 1 Macq. 461 and *Great Eastern Railway Company v Turner* 1872 8 LR 149 (Ch) App 152.

266 *Salomon v Salomon* 1897 AC 22 (HL).

267 Note 1 above. See also Cassim *et al Contemporary Company Law* 2 ed (2012) 31 footnote 12; Beuthin and Luiz *Beuthin's Basic Company Law* 3 ed (2000) 6 and Havenga *Fiduciary Duties of Company Directors with Specific Regard to Corporate Opportunities* (Unpublished LLD thesis, University of South Africa, 1995) 11.

268 Note 1 above and Havenga *Fiduciary Duties of Company Directors with Specific Regard to Corporate Opportunities* (Unpublished LLD thesis, University of South Africa, 1995) footnote 65.

269 Lord Selborne in *Great Eastern Railway Company v Turner* 1872 8 LR 149 (Ch) App 152 said that directors are agents of the company on whose behalf they enter into transactions. See also *Ferguson v Wilson* 1866 2 77 (Ch) 89-90; *Aberdeen Railway Co v Blaikie Bros* 1854 1 Macq 461 (HL); and *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 168 (AD) 216.

270 See chapter 2 (part 2 6 1) *infra*.

271 Cassim *et al Contemporary Company Law* 2 ed (2012) 412 notes that, "previously a director did not enjoy original powers to act and, like an agent, his or her power to act arose from, and was limited by the powers conferred on him or her. But section 66(1) of the new Companies Act now confers original powers and duties on directors".

On the other hand, the fact that not all agents are fiduciaries[272] must raise questions concerning the appropriateness of the suggestion that directors have fiduciary obligations because they are agents. Moreover, a look at the source of directors' authority sheds more light on this issue. Directors' authority, as opposed to mere agents, comes from the company's constitution.[273] Directors are not appointed to be agents but because of the incapability of the company are called up to fulfil its mandates. Again, unlike agents, directors have wider discretion in executing their powers and sometimes their failure to comply with legislative provisions may result in them being held either civilly or criminally liable for their conduct.[274] All these differences point to the fact that simply describing directors as agents is a major understatement of the fact. Therefore directors' fiduciary duties are not based on the fact that they are agents or that they occupy a position or act in a similar manner as mere agents.

2 5 3 Directors as managing partners

There is judicial authority in which directors have also been described as managing partners.[275] Cassim and Blackman agree that directors and managing partners have similar positions because they are both "empowered to run a business".[276] The dividing line between directors and managing partners becomes thinner when one considers the case of a personal liability company whereby both current and former directors are liable for the company's debts and liabilities.[277] This lack of limited liability on the part of those directors probably is what has led some to put the two in the same bracket. Furthermore, to strengthen this view, the courts have treated some companies as if they were partnerships.[278] However, these similarities of office and duty between directors and managing partners are not enough to treat them alike. First, unlike managing partners, a director's

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272 Shepherd *Law of Fiduciaries* (1981) 25.

273 Havenga *Fiduciary Duties of Company Directors with Specific Regard to Corporate Opportunities* (Unpublished LLD thesis, University of South Africa, 1995) 18.

274 Havenga *Fiduciary Duties of Company Directors with Specific Regard to Corporate Opportunities* (Unpublished LLD thesis, University of South Africa, 1995) 19.

275 As per Kay J in *Re Faure Electric Accumulator Co* 1889 LR 40 (ChD) 151 and Jessel MR in *Re Forest of Dean Coal Mining Co* 1878 450 (ChD) 453.

276 Cassim *et al Contemporary Company Law* 2 ed (2012) 413 while making reference to Blackman *et al Commentary on the Companies Act* Vol 2 (2002) 8-9.

277 Cassim *et al Contemporary Company Law* 2 ed (2012) 413.

278 Cassim *et al Contemporary Company Law* 2 ed (2012) 414 calls them "domestic-companies or quasi-partnerships". See also *In re Yenidje Tobacco Co Ltd* 1916 2 Ch 426 (CA). In South African law, the same view was shared in *Moosa NO v Mavjee Bhawan (Pty) Ltd* 1967 3 SA 131 (T) 137-138.

conduct neither binds other directors nor the company without prior authorisation.[279] Moreover, a director does not necessarily have a "financial interest" in a company.[280]

2 5 4 Directors as fiduciaries *sui generis*

It has thus been shown that the fiduciary duties of directors are not based on the fact that they are trustees, managing partners or agents. Neither do directors have fiduciary obligations because they perform similar tasks as trustees or agents. However, the existence of a trust or agency relationship may be an indicative sign of the existence of a fiduciary relationship.[281] The third suggested basis, which is held to be the correct one, is that directors are fiduciaries *sui generis.*[282] The literal meaning of the phrase *sui generis* is "in a class or group of its own, not like anything else".[283] Dharmaratne attempts to explain the phrase "*sui generis"* when he stated that directors are fiduciaries of their companies because of the nature of their relationship with the company.[284] In *Robinson v Randfontein Estates Gold Mining Co Ltd*,[285] the plaintiff had acquired property which he later sold to the company for a profit. The circumstances under which the property was acquired were such that the director should not have purchased it for himself but for the company which he worked. The company for which the director worked brought an action claiming the profit that was made by the latter. Innes CJ held that "the action with which we have to do falls under none

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279 Cassim *et al Contemporary Company Law* 2 ed (2012) 414 who also adds that the company constitution can restrict a director's powers.

280 Cassim *et al Contemporary Company Law* 2 ed (2012) 414.

281 *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 168 (AD) 180. This case was recently approved by the SCA in *Phillips v Fieldstone Africa (Pty) Ltd* 2003 (SCA). See also Havenga "Breach of Directors' Fiduciary duties: Liability on what Basis?" 1996 *SA Merc LJ* 366. In *Imperial Hydropathic Hotel Company, Blackpool v Hampson* 1883 1 23 (ChD) Bowen LJ held "When persons who are directors of a company are from time to time spoken of ... as agents, trustees or managing partners of a company, it is essential to recollect that such expressions are used not as exhaustive of the powers or responsibilities of those persons, but only as indicating useful points of view from which they may for the moment and for the particular purpose be considered... It is not meant that they belong to the category, but that it is useful for the purpose of the moment to observe that they fall *pro tanto* within the principles which govern that particular class". This case was referred to with approval in South Africa in *Cohen v Segal* 1970 3 702 (W) 706 D-F.

282 Cassim *et al Contemporary Company Law* 2 ed (2012) 414; Bainbridge "The Board of Directors as Nexus of Contracts" 2002 *Iowa L. Rev*. 550-551; Havenga "Breach of Directors' Fiduciary duties: Liability on what Basis?" 1996 *SA Merc LJ* 366; Cillers *et al Corporate Law* 2 ed (1997) 112; and Havenga *Fiduciary Duties of Company Directors with Specific Regard to Corporate Opportunities* (Unpublished LLD thesis, University of South Africa, 1995) 19.

283 http://www.merriam-webster.com/dictionary/sui%20generis (accessed 27-06-2015).

284 Dharmaratne "A Consideration of Whether Company Directors Should Stand in a Fiduciary Relationship with the Company's Related and Inter-Related Companies" 2011 3.

285 1921 (AD) 168 199.

of the specified classes suggested".[286] Some of the suggested classes included a claim for damages, an action on a contract and a *condictio indebiti*.[287] Solomon JA concurred with Innes CJ and said: "the action indeed is, as the Judges in the court below held, one *sui generis*".[288]

2 6 THEORETICAL FRAMEWORK

In this section one seeks to critically examine some theories that explain and justify the evolution and nature of directors' fiduciary duties. Most of these theories are of a contemporary nature though they seek to explain an ancient concept. However it has to be noted that these theories do not provide a clear answer to the question of whose interests directors should give preference to when they act.[289] This apparent shortcoming on the theories can be attributed to the fact that there is no agreement among scholars on what each theory entails. Different scholars explain them in different ways. Care has however been taken in the following presentation to make sure that it reflects the essence of each theory.

2 6 1 The contractual or agency theory

This theory was originally proposed by Austin Scott.[290] The origins of the theory lie in "quasi-contractual notions of restitutions which were at their strongest in the late nineteenth and early twentieth century".[291] The contractual theory has received judicial attention. In the case of *Boston Deep Sea v Ansell*[292] the defendant, a managing director of the plaintiff was dismissed from his employment for committing fraud. The plaintiff alleged that he had committed breach of duty. The court found in favour of the plaintiff. In that case, Bowen L.J described a fiduciary relationship as "an implied contract".[293] According to this theory, one of the necessary aspects of fiduciary obligations is that one binds him/herself to act loyally.[294] Finn and Sealy agree with Shepherd that

286 *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 168 (AD) 262.
287 *Ibid.*
288 *Ibid*.
289 Esser *Recognition of Various Stakeholder Interests in Company Management* (Unpublished LLD thesis, University of South Africa, 2008) 25.
290 Shepherd *Law of Fiduciaries* (1981) 64-65 as he makes reference to Scott "The Fiduciary Principle" 1949 *Calif. L. Rev*. 521 540 when he said, "Who is a fiduciary? A fiduciary is a person who undertakes to act in the interests of another person. It is immaterial whether the undertaking is in the form of a contract. It is immaterial that the undertaking is gratuitous".
291 Shepherd *Law of Fiduciaries* (1981) 65.
292 1888 39 (ChD) 339 367.
293 *Boston Deep Sea v Ansell* 1888 39 (ChD) 339.
294 Shepherd *Law of Fiduciaries* (1981) 65.

pledging to act in the best interests of the other is a prerequisite for one to be a fiduciary.[295] These principles imply that the fiduciary, company directors in this context, enters into a contract with the company which is a legal entity in which he or she undertakes to act on behalf of the latter. This theory therefore clearly links the fiduciary to his duties through the undertaking. This link may be the reason why some commentators have called it the nexus of contracts theory.[296]

The contractual theory is not critic free. First, one can argue that when this theory is viewed from company law lenses, it becomes apparent that it does not consider other stakeholders' interests. Directors are viewed as agents of the company. They should act solely in the best interests of their principal, the company. This theory does not therefore provide a solution in circumstances where the interests of the company differ from those of stakeholders. Second, Shepherd argues that the contractual theory is unrealistic.[297] Maitland and Brunyate share the same view with Shepherd and explain further that there are some situations where fiduciaries reject their obligations but those obligations are however attached to them by operation of law.[298] On the other hand, one may object to Maitland and Brunyate's views by arguing that fiduciary duties that arise by operation of law is only an exception to the general rule. The two scholars cited only a constructive trust as an example of a situation where fiduciary duties arise by operation of law.

2 6 2 The reliance theory

According to this theory, a fiduciary relationship is created when "one person reposes trust, confidence or reliance in another".[299] It has to be emphasised that regardless of the use of "or" in the definition above, it does not mean that the three can be used interchangeably or treated as

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295 Finn *Fiduciary Obligations* 2 ed (1977) 9 and Sealy "Fiduciary Relationships" 1962 *Cambridge Law Journal* 73.

296 Bainbridge "The Board of Directors as Nexus of Contracts" 2002 *Iowa L. Rev*. 550 and Hayden and Bodie "The Uncorporation and the Unraveling of 'Nexus of Contracts' Theory" 2011 *Michigan Law Review* 1129.

297 Shepherd *Law of Fiduciaries* (1981) 66.

298 Maitland and Brunyate *Equity* (1949) 44 as referred to by Shepherd *Law of Fiduciaries* (1981) 66. McCamus "The Evolving Role of Fiduciary Obligation" in *The Continued Relevance of the Law of Obligations: Back to Basics* (2000) 178 also agrees that a constructive trust is brought about by operation by law.

299 Shepherd *Law of Fiduciaries* (1981) 56.

synonyms.[300] The Reliance Theory is probably the most cited of all the theories.[301] In the Canadian case of *Morrison v Coast Finance Ltd*[302] the appellant, a 79 year old widow brought an action to have her mortgage set aside alleging that it was "procured by undue influence and as an unconscionable bargain made between persons in an unequal position".[303] The appellant had sought advice from two men Lowe and Kitley. Under the circumstances the two men were acting in a fiduciary capacity to the appellant. Sheppard JA held that fiduciary duties are a result of the presence of a relationship of trust and confidence.[304] Furthermore, Sachs J in *Lloyd's Bank v Bundy*[305] held that "a fiduciary duty exists where one person relies on another to the knowledge of that other, and there is in addition in the relationship a characteristic beyond reliance… 'confidentiality'".[306] In the context of company law, this theory posits that a director is in a position of trust, reliance and confidence. The company reposes confidence and trust in its directors.

However, regardless of the fact that this is probably the most cited theory, Shepherd argues that it is also probably the weakest.[307] First, the assertion that a person owes a fiduciary duty to anyone who relies on them is like a principle "taken out of the air which is not analytic but descriptive only and is untestable in law".[308] Weinrib as quoted by Shepherd also challenges the appropriateness of this theory when he states that in most cases trust may not exist in the fiduciary at all.[309] Waters concurs with Weinrib and Shepherd by implying that just as it is possible to have a fiduciary relationship without reliance, it is also possible to have reliance outside of fiduciary law.[310] However, one can argue that Waters probably misdirected his argument because what he

300 Shepherd *Law of Fiduciaries* (1981) 57 says that the word trust is used to convey at least two ideas. The first idea is when one believes in another person or fact. The second one is when one relies on another or a certain state of affairs. The second use is one that is usually preferred in law. Sealy "Fiduciary Relationships" 1962 *Cambridge Law Journal* 69-70 also emphasises the importance of differentiating between trust and confidence. Muir "Duties Outside of the Fiduciary Relationship" 1964 *Alta Law Rev.* 359 360 however argues that the common denominator in all fiduciary relationships is that there is some form of vulnerability present.

301 Shepherd *Law of Fiduciaries* (1981) 56 footnote 29 points out that this theory has been mentioned at least in passing by Lacobucci "The Exercise of Directors' Powers- The Battle of Afton Mines" 1973 *OHLJ* 353 354; *Re Coomber* 1911 1 (Ch) 723 (CA); *Kerrigan v O'Meara* 1924 71 Mont. 1 227 (P) 819 and *Ex parte James* 1803 32 ER 385.

302 1966 55 DLR.

303 *Morrison v Coast Finance Ltd* 1966 55 DLR.

304 *Ibid*.

305 1974 3 All ER 757 (CA).

306 *Lloyd's Bank v Bundy* 1974 3 All ER 757 (CA).

307 Shepherd *Law of Fiduciaries* (1981) 57.

308 *Ibid*.

309 Shepherd *Law of Fiduciaries* (1981) 58 quoting Weinrib "The Fiduciary Obligation" 1975 *UTLJ* 5.

310 Waters *Law of Trusts in Canada* (1974) 345.

in fact establishes is that fiduciary duty and reliance are mutually exclusive. In principle it is true. However, in practice it is difficult to have fiduciary duties without the existence of either trust or confidence.[311]

2 6 3 The *communitaire* theory

The *communitaire* theory emphasises that companies ought to identify their interests with those of the society in which they are situated.[312] As Irene puts it "the aims of the company reflect the aims of society. The company does not have a strong commercial character, but has become the tool used by the State to give effect to its goals".[313] This theory takes into account not only the interests of internal stakeholders, but also external stakeholders like societal values. Thus, the *communitaire* theory advocates for corporate social responsibility. Profit maximisation, therefore, cannot be the sole purpose of business entities.[314] In the company law context, directors therefore when making decisions ought to consider the interests of non-shareholder stakeholders.

Like the two previously discussed theories, this one also has its inherent defects. First, if there is no more commercial character among business entities what would drive businesspeople to remain in business? Dine says "once profit maximisation by stockholders has ceased to be the narrow focus of the company, businesspeople would not know what interests to serve".[315] Second, Berle and Dodd interestingly agree on the fact that taking out profit maximisation as the main goal of business enterprises necessarily strips directors of their powers.[316] Dine further elaborates on this and suggests that this may also make it difficult if not impossible to measure directors' performance.[317]

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311 Sealy "Fiduciary Relationships" 1962 *Cambridge Law Journal* 69 quoting Maitland and Brunyate *Equity* 2 ed (1932) 7.

312 Dine *The Governance of Corporate Groups* (2000) 17.

313 Esser *Recognition of Various Stakeholder Interests in Company Management* (Unpublished LLD thesis, University of South Africa, 2008) 30.

314 *Ibid*.

315 Dine *The Governance of Corporate Groups* (2000) 17 while also making reference to Friedman "The Social Responsibility of Business is to Increase its Profits" *The New York Times Magazine* September 13 1970. Mulligan "A Critique of Milton Friedman's Essay 'The Social Responsibility of Business Is to Increase Its Profits'" 1986 *Journal of Business Ethics* 265-269 suggests counter arguments to Friedman's submissions.

316 Dine *The Governance of Corporate Groups* (2000) 18. See also Dodd "For Whom Are Corporate Managers Trustees?" 1932 *Harvard Law Review* 1049 and Berle "For Whom Corporate Managers Are Trustees: A Note" 1932 *Harvard Law Review* 1365.

317 Dine *The Governance of Corporate Groups* (2000) 18.

2 7 SUMMARY AND PRELIMINARY CONCLUSIONS

This chapter has presented the historical development of the directors' fiduciary duty to act in the best interests of a company and the theoretical framework which sought to explain the evolution and scope of this duty. A brief narrative of the socio-economic and political structure that prevailed in the UK has also been presented. The narrative revealed that land was the most valuable asset during that time. Moreover, it was found that the value of land was increased by the proliferation of mining activities, especially by tenants.

Four different views on the origins of fiduciary law were critically examined.[318] First, Helfman stated that fiduciary law has its origins in English real property law.[319] She submitted that fiduciary law was developed in two different but related waste[320] cases by the Chancery Court as a way of trying to strike a balance between the interests of the landlord and tenant.[321] Second, Getzler suggested that fiduciary law originated from the principle of accountability.[322] The third view that fiduciary law has its roots in equity has more authority.[323] It was also found that the law of equity was developed through the Chancery Court to provide relief in instances of abuse of confidence and to correct the shortcomings of the common law.[324] Lastly, Shepherd though opposed by some scholars,[325] held the opinion that fiduciary obligations were developed through both the common law and equity.[326] The evolving nature of fiduciary law and the fact that it developed through analogy have contributed immensely to this rather confusing legal origin.[327]

318 *Supra* 2 2.

319 Helfman "Land Ownership and the Origins of Fiduciary Duty" 2006 *Real Property, Probate and Trust Journal* 651 and Seipp "Trust and Fiduciary Duty in the Early Common Law" 2011 *Boston University Law Review* 1034.

320 See note 104 on page 18 above for the technical meaning of the term "waste".

321 Helfman "Land Ownership and the Origins of Fiduciary Duty" 2006 *Real Property, Probate and Trust Journal* 652.

322 Getzler "An Interdisciplinary View of Fiduciary Law: 'As If.' Accountability and Counterfactual Trust" 2011 *Boston University Law Review* 977.

323 McCamus "The Evolving Role of Fiduciary Obligation" in *The Continued Relevance of the Law of Obligations: Back to Basics* (2000) 174; Francis *Maxims of Equity* (1727); Sealy "Fiduciary Relationships" 1962 *Cambridge Law Journal* 70 and DeMott "Beyond Metaphor: An Analysis of Fiduciary Obligation" 1988 *Duke Law Journal* 881; and Rotman "Fiduciary Law's 'Holy Grail': Reconciling Theory and Practice in Fiduciary Jurisprudence" 2011 *Boston University Law Review* 925.

324 See also Sealy "Fiduciary Relationships" 1962 *Cambridge Law Journal* 70.

325 Shepherd *Law of Fiduciaries* (1981) 5.

326 *Ibid*.

327 Sealy "Fiduciary Relationships" 1962 *Cambridge Law Journal* 72-73 and DeMott "Beyond Metaphor: An Analysis of Fiduciary Obligation" 1988 *Duke Law Journal* 879 further state that fiduciary duty is situation specific. Rotman "Fiduciary Law's 'Holy Grail': Reconciling Theory and Practice in Fiduciary Jurisprudence" 2011 *Boston University Law Review* 923 however refutes this and suggests that "the confusion associated with

The contribution of *Keech v Sandford*[328] and the South Sea Company Bubble to the development of fiduciary obligations was also discussed. It was found that *Keech v Sandford*[329] is widely regarded as the original judicial acknowledgement of fiduciary obligation[330] and is also authority for the no profit[331] and the no conflict rule.[332] The South Sea Company Bubble brought about the Bubble Act[333] which among others prohibited a company from acting as a body corporate. Moreover, the "deed of settlement company" whose assets were held by trustees and managed by directors was established to comply with the Bubble Act.[334]

Classifications of fiduciaries were also considered. It was found that fiduciaries can be classified as property-holders, representatives, life tenants and according to principles of the doctrine of undue influence.[335] It was also discovered that there is no agreement on the number of fiduciary classifications and that there is significant overlap between the classifications themselves. This overlap is enough to persuade one to agree with Shepherd's view that "there are no identifiable classes of relationships that consistently exhibit a fiduciary component".[336] It was found that directors fit into the first two categories namely property holders and representatives. Moreover, a number of suggestions on the basis of fiduciary obligations were discussed. It was concluded that the basis for directors' fiduciary obligations is *sui generis.*[337]

fiduciary law is not the result of substantive existing within a fiduciary concept, but rather because of a widespread and fundamental failure to recognise the foundational elements a 'holy grail' of fiduciary jurisprudence".

328 1726 25 ER 223 (Ch).

329 *Ibid*.

330 Wolfe "The Fiduciary Duty of Directors and Officers under the Louisiana Business Corporations Act of 2014" 2014 *Loy. L. Rev* 531; Getzler "An Interdisciplinary View of Fiduciary Law: 'As If.' Accountability and Counterfactual Trust" 2011 *Boston University Law Review* 984; and Hicks "The Remedial Principle of *Keech v Sandford* Reconsidered" 2010 *Cambridge Law Journal* 288.

331 Hicks "The Remedial Principle of *Keech v Sandford* Reconsidered" 2010 *Cambridge Law Journal* 290.

332 Getzler "An Interdisciplinary View of Fiduciary Law: 'As If.' Accountability and Counterfactual Trust" 2011 *Boston University Law Review* 983.

333 1720.

334 *Ibid*.

335 *Supra* this chapter part 2 4.

336 Shepherd *Law of Fiduciaries* (1981) 21. Sealy "Fiduciary Relationships" 1962 *Cambridge Law Journal* 72-73 further says "the word fiduciary is not definitive of a single class of relationships to which a fixed set of principles and rules apply".

337 See this chapter part 2 5 *supra*.

The last segment of the chapter was devoted to the theoretical framework which sought to explain the evolution and scope of directors' fiduciary duties.[338] The three theories that were considered are the contractual or agency, reliance and *communitaire* theories.

[338] *Ibid*.

CHAPTER 3

Nature of the directors' duty to act in the best interests of the company

3 1 INTRODUCTION

Due to the evolving nature of fiduciary law,[339] it is pertinent that a thorough exposition of the nature of the directors' fiduciary duty to act in the best interests of the company be provided. To that end, this chapter presents a comprehensive discussion on the nature and scope of the directors' fiduciary duty to act in the best interests of the company. It will also compare and contrast the main distinguishing aspects of the duty in question, between South Africa, Canada and the UK, if any.

The first part of the chapter presents a brief discussion of the different types of directors known to contemporary company law. The main purpose of that discussion is to ascertain whether the scope of directors' fiduciary duties varies according to the type of director that one is. The distinction between executive and non-executive directors will be presented. It is proposed also to examine whether such a distinction matters at all with respect to assigning fiduciary obligations to the said directors. Among others, the position of the nominal, shadow and holding company directors will be canvassed. In line with the spirit of this study, the discourse on the types of directors will adopt a comparative tone as South African law will be compared to that of Canada and the UK. It is also proposed to identify the point in time when fiduciary duties arise with respect to the different types of company directors. Moreover, with respect to termination of fiduciary obligations, it will also be examined whether a director who has resigned owes such duties to his/her former company.

This chapter will consider some tenets of the directors' fiduciary duty to act in the best interests of the company. As will be seen, the courts and company law commentators tend to express the content of the duty to act in the best interests of the company in rules that are usually classified into categories.[340] In this chapter, five of those rules will be briefly discussed. They are: the no conflict rule, the corporate opportunity rule, the no profit rule, the proper purpose rule and the rule

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339 A detailed discussion on the evolving nature of fiduciary law was presented above in Ch 2 under section 2 2.

340 *Canadian Aero Service Ltd v O'Malley* 1976 10 OR 239; *Aberdeen Rwy Co v Blaikie Brothers* 1854 1 Macq. 471; *Phillips v Fieldstone Africa (Pty) Ltd* 2003 (SCA) 23-24; Cassim *et al Contemporary Company Law* 2 ed (2012) 529; Havenga "The Company, the Constitution, and the Stakeholders" 1997 *Juta's Bus. L.* 134; and Havenga "Directors' Fiduciary Duties under our Future Company-Law Regime" 1997 *SA Merc LJ* 311.

that directors are to exercise an independent judgement in discharging their fiduciary obligations. Each of these rules will be examined separately though there is some degree of overlap[341] between them. The common law, as expressed in case law, will be extensively referred to in an effort to discuss the content of each rule. Since most of the common law jurisdictions have at least partially codified directors' duties, a discussion on how the legislature in South Africa, Canada and the UK have incorporated these common law principles into their legislation will be presented as well.

It is trite law that directors owe fiduciary duties to their companies.[342] One of the contentious areas of company law is the question "to whom are these obligations owed or who the legitimate beneficiaries of such duties are?" It will be seen that responses to these questions have led to what has been termed by company lawyers and commentators as the "traditional position".[343] This so-called traditional position will be critically analysed. Popular to company lawyers and commentators, the question of who should be the beneficiary of directors' duties triggered the Berle-Means debate.[344] However, this study does not purport to regurgitate the content of the Berle-Means debate but its contributions are scattered throughout this chapter. Certainty on the beneficiaries of the directors' fiduciary duty to act in the best interests of the company helps one to fully understand the scope of the obligation in question. A deeper understanding of the scope of the duty at issue in this study is a prerequisite in answering the overall question upon which the whole study is premised. Furthermore, directors' fiduciary duties, if any, to the various company stakeholders will also be discussed. The selected stakeholders are shareholders (both as individuals and collectively as a group), creditors, employees and the community. The issue of whether directors owe any duties to shareholders is largely clear and settled. However, there has been a lot

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341 Havenga "The Company, the Constitution, and the Stakeholders" 1997 *Juta's Bus. L.* 134 and Havenga "Directors' Fiduciary Duties under our Future Company-Law Regime" 1997 *SA Merc L.J.* 311.

342 *Allen v Gold Reefs of West Africa Limited* 1900 1 656 (Ch) 671; *Re City Equitable Fire Insurance Co Ltd* 1925 (Ch) 407; *Charterbridge Corporation Ltd v Lloyds Bank* 1970 1 (Ch) 62; Nwafor "Fraudulent Trading and the Protection of Company Creditors: the Current Trend in Company Legislation and Judicial Attitude" 2013 *Comm. L. World Rev* 297; Havenga "Competing with the Company- When Does a Director Breach His or Her Fiduciary Obligation?" 1995 *SA Merc L.J.* 435; Havenga "Directors in Competition with their Companies" 2004 *SA Merc L.J.* 275; and Veasay and Guglielmo "How Many Masters Can a Director Serve? A Look at the Tensions Facing Constituency Directors" 2008 *Business Lawyer* 12.

343 See the Australian case of *Kinsela v Russell Kinsela (Pty) Ltd* 1986 4 NSWLR 722; Allair and Rousseau "To Govern in the Interest of the Corporation: What is the Board's Responsibility to Stakeholders other than Shareholders?" 2014 11; Ajibo "A Critique of Enlightened Shareholder Value: Revisiting the Shareholder Primacy Theory" 2004 *Birkbeck Law Review* 44; Rousseau "The Duties of Directors of Financially Distressed Corporations: A Quebec Perspective on the Peoples Case" 2004 *Canadian Business Law Journal* 380.

344 For more on this debate see Stigler and Friedland "The Literature of Economics: The Case of Berle and Means" 1983 *Journal of Law and Economics* 237-240.

of debate and difference of opinion with respect to directors' duties to creditors, employees and the community. Each of these stakeholders' interests will be outlined. Arguments for and against the "extension" of fiduciary duties to each of these stakeholders will also be put forth.

A discourse on the concept of "the best interests of the company" will then follow. In line with the spirit of the study, this discussion will also be targeted at identifying the legitimate beneficiaries of the directors' fiduciary duty to act in the best interests of the company. As will be established later, company law scholars and commentators have presented different views on the meaning of the phrase "the best interests of the company".[345] Additionally, it will also be argued that an analysis of jurisprudence on the meaning of this phrase reveals significant inconsistencies. One will also contend that the real meaning of the phrase can be described as a matter of speculation rather than legal norm. Some of the inconsistencies can be attributed to the legal personality status assigned to companies.[346]

A credible attempt to explain the meaning of the phrase "the best interests of the company" requires one to adopt a theoretical approach as well as undertake an assessment of how directors' decisions to take heed of the best interests of their company may affect its sustainability. The three approaches that will be discussed are the shareholder, the enlightened shareholder value and the stakeholder theories. As will be seen throughout the discussion of these theories, scholars' backgrounds influence who one thinks are the proper beneficiaries of the duty in question. The origins of each of these theories will be briefly set out. Assumptions underlying the theories and arguments supporting and criticising each of these approaches will be presented as well.

The discussion on sustainability will be aimed at identifying the tension that may be present or faced by directors in balancing the pursuit of the best interests of a company and the long term impacts of their decisions. Various conceptions of the principle of sustainability will be presented. In order to clearly bring out the issues surrounding the best interests of a company and the principle of sustainability, a hypothetical case will be utilised. Reference will also be made to some pertinent case law. It will also be noted that the main challenge faced by authorities in trying to enforce corporate social responsibility norms is the lack of explicit legal prescriptions in this area.

[345] See chapter 3 (part 3 5) *infra*.
[346] *Salomon v Salomon* 1897 AC 22 (HL).

Between the shareholder and the enlightened shareholder value approaches lies a discourse on company law reviews that have taken place in South Africa, Canada and the UK. The discussion on law reform will act as a bridge from the shareholder theory to the enlightened shareholder value approach. In South Africa, company law reform will be discussed in light of the recommendations of the King Committee Reports and Codes, the *South African Company Law for the 21st Century Guidelines for Corporate Law Reform,*[347] changes in the business environment, the impact of legislation such as the Promotion of Access to Information Act (PAIA),[348] the Broad-Based Black Economic Empowerment Act (BBBEE),[349] the Constitution[350] and finally the Companies Act.[351] In Canada, the influence of the Supreme Court's decisions in the *Peoples Department Stores Inc. v Wise*[352] and *BCE Inc. v 1976 Debentureholders*[353] cases on directors' duties will be examined. The UK has undertaken major corporate law reforms which significantly influenced directors' duties. To this end the Cadbury *Report of the Committee on the Financial Aspects of Corporate Governance,*[354] Greenbury *Directors' Remuneration Report of a Study Group Chaired by Sir Richard Greenbury*[355] and *Hampel Committee's Final Report*[356] will be discussed. Furthermore, the Company Law Reform *Presented to Parliament by the Secretary of State for Trade and Industry,*[357] the 2002 and 2005 White Papers, Companies Bill[358] together with the Guidance on the Key Clauses in the Companies Law Reform Bill and ultimately the Companies Act[359] together with the *Explanatory Notes on the UK Companies Act of 2006*[360] will be explored.

The chapter will then provide a reasoned analysis of the different types of model companies that result from the theories outlined above. Each of these theories will be assessed to identify their strengths and weaknesses. It will be argued that there is a very strong connection between the stakeholder theories and company models. Three company or corporate governance models will

347 2004 Department of Trade and Industry of South Africa (hereinafter referred to as the Policy Document).
348 2 of 2000.
349 53 of 2003.
350 Constitution of the Republic of South Africa, 1996.
351 71 of 2008.
352 2004 68 (SCC).
353 2008 69 (SCC).
354 1992 (hereinafter referred to as the 'Cadbury Report').
355 1995 (henceforth, this will be referred to as the 'Greenbury Report').
356 Hereinafter referred to as the 'Hampel Report'.
357 2005.
358 *Ibid*.
359 2006.
360 Department of Trade and Industry **(**hereinafter referred to as the 'Explanatory Notes').

be examined. These three are the contractarian, communitarian and the socialist models. The first two will be discussed in-depth. The socialist model will not be examined in detail since it no longer applies. Lastly, the chapter closes with preliminary conclusions which are a summary of the issues discussed hereunder.

3 2 TYPES OF COMPANY DIRECTORS

There are different types of directors.[361] The Companies Act[362] 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 a director or alternate director, by whatever name designated".[363] Section 66 of the Companies Act[364] provides that "a person becomes entitled to serve as a director of a company when that person [either] has been appointed or elected in accordance with this Part, or holds an office, title, designation or similar status entitling that person to be an *ex officio* director of the company, subject to subsection (5)(a); and has delivered to the company a written consent to serve as its director". These definitions of director contained in the Companies Act are an example of what one can refer to as "catch-all" phrases. It seems the legislature intended to not only to assign directorial obligations to persons who are officially called directors but also to those individuals who, though they do not essentially bear the name but are if they act like such they will be assigned directorial duties. So, according to the Companies Act,[365] one may not be officially called a director, but if s/he conducts her/himself in a manner that a director does then there is a possibility of fiduciary duties to be assigned to them. It is submitted that this stance enhances the standards of corporate governance in South Africa.

It is a paradox that in South Africa, it seems that the most common distinction is between executive and non-executive directors though the Companies Act[366] does not distinguish between the two. Furthermore, the CBCA[367] and the UK Companies Act[368] do not differentiate between the two.

361 Cassim *et al Contemporary Company Law* 2 ed (2012) 404-411 mentions *de jure*, temporary, nominee, puppet, *de facto*, shadow, executive and non-executive directors. Section 1 of the Companies Act 71 of 2008 makes reference to an alternate director and section 66 talks about *ex officio* and shareholder elected directors. See also Bailey and McCallum *Company Law* (1990) 129.
362 71 of 2008.
363 Section 1.
364 71 of 2008.
365 *Ibid*.
366 71 of 2008.
367 RSC 1985.
368 2006.

Based on this fact one can therefore contend that there is no "legal distinction" between executive and non-executive directors. However, the existence of these terms invites one to wonder and enquire about the roles of these "two" directors. An executive director is "involved in the day-to-day management of the company and in the full-time salaried employ of the company".[369] On the other hand, a non-executive director "is not an employee of the company who operates on a part time basis and is not involved in the daily management of the company".[370] In the South African case of *Howard v Herrigel,*[371] the court considered the distinction between executive and non-executive directors and held, per Goldstone JA, that "it is unhelpful, and even misleading, to use this classification to establish the duties of directors to the company or when any specific or positive action is required from them".[372] The scope of the directors' fiduciary obligations is not hinged on this distinction, and each case has to be decided on its merits.[373] According to the Cadbury Report "all directors are equally responsible in law for the board's actions and decisions".[374] It is therefore submitted that the difference between executive and non-executive directors does not define the scope of fiduciary obligations between the two.

One of the key aspects of globalisation has been the significant expansion of multinational or transnational companies' (MNCs or TNCs) activities. MNCs or TNCs are registered companies that have business interests in more than one country.[375] They normally operate through subsidiaries. However, subsidiary companies do not necessarily result from MNCs. The nature of a subsidiary company director's fiduciary duty to act in the best interests of the company requires some consideration. The critical question here is whether a person in such a position owes fiduciary obligations to the subsidiary or to the holding company. Some commentators remark that the common law is ambiguous in this area.[376] Havenga remarks that a director only owes fiduciary obligations to the company "on whose board he sits".[377] However, in the South African case of

369 Cassim *et al Contemporary Company Law* 2 ed (2012) 411.
370 *Ibid*.
371 1991 2 SA 660 (A).
372 *Howard v Herrigel* 1991 2 SA 660 (A).
373 Havenga *Fiduciary Duties of Company Directors with Specific Regard to Corporate Opportunities* (Unpublished LLD thesis, University of South Africa, 1995) 311.
374 See paras 1.8 and 4.3 of the Cadbury Report.
375 http://legal-dictionary.thefreedictionary.com/Transnational+Corporation (accessed 07-09-2015).
376 Mescher and Bondfield "Corporate Groups and the Duty of Directors to act in their Company's Best Interests" 2003 *Journal of Applied Research in Accounting and Finance* 2.
377 Havenga *Fiduciary Duties of Company Directors with Specific Regard to Corporate Opportunities* (Unpublished LLD thesis, UNISA, 1995) 313.

Robinson v Randfontein Estates Gold Mining Co Ltd[378] it was held that in certain circumstances, a director of a holding company may owe fiduciary duties to a subsidiary company.[379] There is also authority for the view that directors of a subsidiary company owe fiduciary obligations to the holding company as well as for the opposite assertion that they do not owe any obligations to their holding company.[380] However, when one applies the legal personality principle as explained in the seminal English case of *Salomon v Salomon*,[381] it can be further reasoned that directors in a subsidiary company do not owe fiduciary duties to the holding company since the subsidiary is recognised by law as a separate entity. However, there are instances whereby directors of a subsidiary are "mandated to manage the subsidiary with a view to promoting the interests of the parent".[382]

It is settled law that a director's fiduciary obligations commence upon appointment as such.[383] If one has not been formally appointed as a director then fiduciary duties will commence as soon as such an individual starts to conduct him/herself as one.[384] However, the issue whether one's fiduciary duties cease upon termination of office remains debatable. The subject becomes more contentious when one considers other "post-office" issues like, *inter alia*, restraints of trade. Havenga is of the opinion that a director should generally be relieved of his fiduciary duties upon termination of office.[385] "A former director may also be restrained from using confidential information acquired by him when he was a director to the prejudice of the company".[386] It is therefore concluded that, in general, a director who has resigned does not owe any fiduciary

378 1921 168 (AD) 197-198.
379 *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 168 (AD) 197-198.
380 See the leading English case of *Charterbridge Corp Ltd v Lloyds Bank Ltd* 1970 1 (Ch) 62 and compare it to the Australian High Court case of *Walker v Wimborne* 1976 3 ACLR 529. See also Mescher and Bondfield "Corporate Groups and the Duty of Directors to act in their Company's Best Interests" 2003 *Journal of Applied Research in Accounting and Finance* 5-7.
381 1897 AC 22 (HL).
382 Mescher and Bondfield "Corporate Groups and the Duty of Directors to act in their Company's Best Interests" 2003 *Journal of Applied Research in Accounting and Finance* 6.
383 Section 66(7) of the South African Companies Act 71 of 2008.
384 Havenga *Fiduciary Duties of Company Directors with Specific Regard to Corporate Opportunities* (Unpublished LLD thesis, University of South Africa, 1995) 312.
385 Havenga *Fiduciary Duties of Company Directors with Specific Regard to Corporate Opportunities* (Unpublished LLD thesis, University of South Africa, 1995) 312-313.
386 Havenga *Fiduciary Duties of Company Directors with Specific Regard to Corporate Opportunities* (Unpublished LLD thesis, University of South Africa, 1995) 313. See also *Canadian Aero Service Ltd v O'Malley* 1976 10 OR 239 and *Industrial Development Consultants Ltd v Cooley* 1972 2 All ER 162.

obligations to his/her former company but there are instances in which his/her conduct after resignation might lead to him/her being ascribed with such duties.[387]

In some cases, directors may delegate some of their duties to others. If a director delegates some of his/her duties to someone, then the person to whom those duties would have been delegated is known as an alternate director.[388] An alternate director "owes fiduciary duties to the company which he was appointed to act for and enjoys all the powers of the appointing director but only to the extent that he was asked to act".[389] Different opinions have been offered with respect to the fiduciary duties of *de facto* directors.[390] There is judicial authority that ascribes fiduciary obligations to *de facto* directors.[391] According to section 66(4) of the Companies Act,[392] a company's memorandum of incorporation may also make provision for the appointment of a director. However, other types of directors such as shadow, puppet, *ex officio,* and nominee directors also exist in South African law. The most important thing to note is that they are directors and for that reason it is proposed in this study on the basis that, in general, they owe fiduciary duties like any other director.

3 3 NATURE OF THE DUTY

The content of the directors' fiduciary duty to act in the best interests of the company has been traditionally explained categorically.[393] In the Canadian case of *Canadian Aero Service Ltd v*

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387 For example if the director resigns in order to appropriate a corporate opportunity which belonged to the former company as held in *Canadian Aero Service Ltd v O'Malley* 1976 10 OR 239. Furthermore section 170(2)(a) of the UK Companies Act of 2006 provides that "a person who ceases to be a director continues to be subject to the duty in section 175 (duty to avoid conflicts of interest) as regards the exploitation of any property, information or opportunity of which he became aware at a time when he was a director". For a more detailed judicial analysis of this issue, see the English case of *British Midland Tool Ltd v Midland International Tooling Ltd* 2003 2 BCLC 523 (ChD).

388 Section 1 of the South African Companies Act 71 of 2008 defines an alternate director as "a person elected or appointed to serve, as the occasion requires, as a member of the board of a company in substitution for a particular elected or appointed director of that company".

389 Cassim *et al Contemporary Company Law* 2 ed (2012) 405.

390 Havenga *Fiduciary Duties of Company Directors with Specific Regard to Corporate Opportunities* (Unpublished LLD thesis, University of South Africa, 1995) 306. Cassim *et al Contemporary Company Law* 2 ed (2012) 408 define a *de facto* director as "a person who claims to act and purports to act as a director without having been so appointed either validly or at all".

391 Cassim *et al Contemporary Company Law* 2 ed (2012) 409.

392 71 of 2008.

393 See *Canadian Aero Service Ltd v O'Malley* 1976 10 OR 239; *Aberdeen Rwy. Co v Blaikie Brothers* 1854 1 Macq. 471; *Phillips v Fieldstone Africa (Pty) Ltd* 2003 23-24 (SCA); Cassim *et al Contemporary Company Law* 2 ed (2012) 529; Havenga "The Company, the Constitution, and the Stakeholders" 1997 *Juta's Bus. L.* 134; and Havenga "Directors' Fiduciary Duties under our Future Company-Law Regime" 1997 *S.A Merc L.J.* 311.

O'Malley[394] it was held that a fiduciary relationship generally refers to "loyalty, good faith and avoidance of a conflict of duty and self-interest. The duty calls for a strict work ethic".[395] Discretion, power/influence and vulnerability are some of the factors that the courts consider when determining the existence of a fiduciary relationship.[396] The duty is broad and calls for a contextual approach when determining its ambit.[397] The nature and scope of this duty therefore depend on the circumstances of each case. There is no one-size-fits-all approach to delineate its scope. The duty is not limited to maximizing short term profits of a company, but by regarding it as a going concern, the long term interests of a company are also taken into consideration.[398] Agency is not a prerequisite for the presence of a fiduciary relationship but it can also be a sign of the existence of such a relationship.[399] One would have correctly expected agency to at least be a pointer to the existence of such a duty considering the close historical roots, as discussed in chapter 2 above, between the law of agency and fiduciary obligations.

However, Robert Flannigan disagrees with the decision of the Supreme Court of Canada[400] in the case of *BCE Inc. v 1976 Debenture holders.*[401] He refers to the court's view as "a conceptual stumble [and] an unfamiliar summary of the duty".[402] He further disputes that "fiduciary duty is not a 'broad' concept. It was designed to address the singular mischief of opportunism in limited access arrangements. While the duty has a broad practical application (because limited access arrangements are common), the concept itself is a narrow one. Further, [the duty] is not 'contextual' in the sense that the circumstances (the context) can excuse an unauthorized conflict

394 1976 10 OR 239.

395 *Canadian Aero Service Ltd v O'Malley* 1976 10 OR 239. See also *Aberdeen Rwy. Co v Blaikie Brothers* 1854 1 Macq. 471 and Cassim *et al Contemporary Company Law* 2 ed (2012) 534-535.

396 *Volvo (Southern Africa) Pty Ltd v Yssel* 2009 6 SA 531 (SCA) and *Phillips v Fieldstone Africa (Pty) Ltd* 2004 3 SA 465 (SCA).

397 *BCE Inc v 1976 Debenture holders* 2008 69 (SCC) 584.

398 *Ibid* para 38.

399 *Phillips v Fieldstone Africa (Pty) Ltd* 2004 3 SA 465 (SCA) and *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 168 (AD) 180.

400 Some of his works in which he argues such include Flannigan "Fiduciary Accountability Transformed" 2009 *Advocates' Quarterly* 336 and Flannigan "Reshaping the Duties of Directors: Case Comment" 2005 *Canadian Bar Review* 366. In the latter article, the Professor specifically criticises the Supreme Court of Canada's judgement in *Peoples Department Stores Inc v Wise* 2004 68 (SCC).

401 2008 69 (SCC) 584.

402 Flannigan "Fiduciary Accountability Transformed" 2009 *Advocates' Quarterly* 335.

or benefit. It is contextual only in the assessment of whether an arrangement involves a limited access, or whether a conflict or benefit is involved".[403]

However, Flannigan's views are not beyond criticism. First, a look at the development of fiduciary law as discussed in chapter 2 shows that the formulation of fiduciary obligations in *Keech v Sandford*[404] also gave birth to the modern day no-conflict rule. Therefore, it is not accurate to assert that fiduciary law was only designed to address the mischief of opportunism in limited access arrangements. Second, there is overwhelming judicial and commentators' authority on the view that fiduciary law has evolved over time.[405] This therefore makes it necessary to consider context. Moreover, Flannigan's articulation of fiduciary law becomes vague especially when one considers that the same author believes that "the duty to act in the best interest[s] of the corporation is not a fiduciary duty".[406]

Based on the sizeable and an almost unanimous stance by both the judiciary and company law commentators,[407] this study continues on the premise that the content of the directors' fiduciary duty to act in the best interests of the company can be divided into categories. These categories "are not exclusive and, to some extent, overlap. But they form part of one broad duty requiring the director to act in good faith in the best interests of the company".[408] In this study, the following categories will be discussed: the no conflict rule, the corporate opportunity rule, the no profit rule, the proper purpose rule and the rule that directors are to exercise an independent judgment.

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403 Flannigan "Fiduciary Accountability Transformed" 2009 *Advocates' Quarterly* 336.

404 1726 25 ER 223 (Ch).

405 *BCE Inc. v 1976 Debenture holders* 2008 69 (SCC) 584; *Peoples Department Stores Inc. v Wise* 2004 68 (SCC); *Ghersi v Tiber Developments (Pty) Ltd* 2007 4 SA 536 (SCA) para 9; *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 168 (AD) 268; *Bellairs v Hodnett* 1978 1 SA 1109 (A) 1128A - 1134D; *Volvo (Southern Africa) Pty Ltd v Yssel* 2009 6 SA 531 (SCA); McCamus "The Evolving Role of Fiduciary Obligation" in *The Continued Relevance of the Law of Obligations: Back to Basics* (2000) 191; Sealy "Fiduciary Relationships" 1962 *Cambridge Law Journal* 70; Rotman "Fiduciary Law's 'Holy Grail': Reconciling Theory and Practice in Fiduciary Jurisprudence" 2011 *Boston University Law Review* 921; DeMott "Beyond Metaphor: An Analysis of Fiduciary Obligation" 1988 *Duke Law Journal* 881; Frankel *Fiduciary Law* (2011) 795-796; and Shepherd *Law of Fiduciaries* (1981) 5.

406 Flannigan "Reshaping the Duties of Directors: Case Comment" 2005 *Canadian Bar Review* 366.

407 Havenga "The Company, the Constitution, and the Stakeholders" 1997 *Juta's Bus. L.* 134; Havenga "Directors' Fiduciary Duties under our Future Company-Law Regime" 1997 *S.A Merc L.J.* 311; and Cassim *et al Contemporary Company Law* 2 ed (2012) 529.

408 Havenga "The Company, the Constitution, and the Stakeholders" 1997 *Juta's Bus. L.* 134 and Havenga "Directors' Fiduciary Duties under our Future Company-Law Regime" 1997 *SA Merc L.J.* 311.

3 3 1 The no conflict rule

The no conflict rule originated from the pivotal English trust law case of *Keech v Sandford.*[409] The rationale for this rule was also borrowed from that case. Lord Herschell refined the rationale for the no conflict rule when he held that "there is a danger of the person holding a fiduciary position being swayed by interest rather than duty, and thus prejudicing those whom he was bound to protect".[410] Finn affirms that Lord Herschell's view has been carried down over time as the reason for the rule.[411] In substantially similar fashion, Cassim agrees with Lord Herschell when the former posits that the no-conflict rule exists to deter directors from misusing their positions for personal gain.[412] In contemporary company law, the no conflict rule is encapsulated both in legislation and the common law. The no conflict rule can further be divided into conflict of duty and interest and conflict of duty and duty.[413] Some prefer to explain it as the duty to avoid conflict of interest.[414] The no conflict rule will be discussed as contained in the common law first and then in legislation. Furthermore, the practical applications of the rule will also be examined.

The no conflict rule was considered by the Supreme Court of Appeal in *Phillips v Fieldstone Africa (Pty) Ltd.*[415] In that case, the plaintiff's cause of action related, *inter alia*, to the terms and scope of the employment of the appellant by the second respondent and the implied duties of loyalty. Heher JA held that the "existence of such a duty and its nature are questions of fact to be adduced from a thorough consideration of the substance of the relationship and any relevant circumstances which affect the operation of that relationship".[416] "The rule is a strict one which allows little room for exceptions".[417] The rule is not confined to actual conflicts of interests but also covers those situations that are "a real sensible possibility".[418] The introduction of the phrase "real sensible possibility" by Heher JA invites more questions than answers. One may question that whose sense

409 1726 25 ER 223 (Ch).
410 *Bray v Ford* 1896 AC 51-52.
411 Finn *Fiduciary Obligations* 2 ed (1977) 200.
412 Cassim *et al Contemporary Company Law* 2 ed (2012) 535.
413 Finn *Fiduciary Obligations* 2 ed (1977) 199 and 252.
414 Cassim *et al Contemporary Company Law* 2 ed (2012) 534.
415 2003 (SCA).
416 *Phillips v Fieldstone Africa (Pty) Ltd* 2003 (SCA) 15.
417 Heher JA in *Phillips v Fieldstone Africa (Pty) Ltd* 2003 (SCA) 17; *Regal (Hastings) Ltd v Gulliver* 1942 All ER 378 (HL); and *Canadian Aero Service v O'Malley* 1974 40 DLR 371 (SCC) 382.
418 *Phillips v Fieldstone Africa (Pty) Ltd* 2003 (SCA) 15; *Aberdeen Railway Co v Blaikie Bros* 1854 1 Macq. 461; *Boardman v Phipps* 1966 3 All ER 721 HL 737I, 743F-I, 748E-F, 756I and *Canadian Aero Service Ltd v O'Malley* 1976 10 OR 385.

of possibility will be applied in making such a determination? Is it the judge's or the director's sensibility? Furthermore, it is clear that the word sensible assumes a subjective approach. If a subjective approach is adopted, how will the acceptable sense of possibility be determined? One scape-goat answer to all these difficulties is the "legal anthem" that each case depends upon its circumstances. Moreover, it is irrelevant that the beneficiary did not suffer any loss or harm, that the beneficiary could not itself have made use of the information, opportunity or has rejected it or would do so or that the fiduciary acted honestly and reasonably.[419] However, English Law makes allowance for equity.[420]

The no conflict rule has been captured in the legislation of South Africa, Canada and the UK. In South African legislation, the duty is found in section 76(2) of the Companies Act[421] which provides for the standards of directors' conduct. In Canada, section 120 of the CBCA[422] requires directors to disclose any interest they might have in any transaction or contract. In the UK, section 175 of the Companies Act[423] places upon directors the duty to avoid conflict of interests.

In practice the rule applies in various circumstances which include the conclusion of a contract with the director's own company, holding directorships in competing companies, the acquisition of profit or gain in instances of insider trading,[424] self-employment for reward,[425] bribes, secret commissions,[426] loans by fiduciaries to their beneficiaries,[427] quasi loans, credit transactions and related transactions.[428]

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419 *Phillips v Fieldstone Africa (Pty) Ltd* 2003 (SCA) 19-20; *Regal (Hastings) Limited v Gulliver* 1942 All ER 378 HL 386A, 392D; *Boardman v Phipps* 1966 3 All ER 721 (HL) 744D, 745C-D; and Flannigan "Reshaping the Duties of Directors: Case Comment" 2005 *Canadian Bar Review* 371.

420 *Phillips v Fieldstone Africa (Pty) Ltd* 2003 (SCA) 20.

421 71 of 2008.

422 RSC 1985.

423 2006. Subsection (1) thereof provides that "a director of a company must avoid a situation in which he has, or can have a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company". In both South African and the UK's legislation, the way in which the duty is structured may give one an idea that the legislature purposed to express this rule as a stand-alone obligation apart from the duty to act in the best interests of the company. However, a closer look at the legislation itself, judicial decisions and scholarly work on this area suggests no departure from the traditional view that the no conflict rule is a category of the broad duty to act in the best interests of the company. See also Cassim *et al Contemporary Company Law* 2 ed (2012) 534.

424 Havenga *Fiduciary Duties of Company Directors with Specific Regard to Corporate Opportunities* (LLD thesis, University of South Africa, 1995) 68.

425 Finn *Fiduciary Obligations* 2 ed (1977) 206.

426 *Ibid* 214.

427 Finn *Fiduciary Obligations* 2 ed (1977) 230.

428 Farrar and Hannigan *Farrar's Company Law* 4 ed (1998) 404.

3 3 2 The corporate opportunity rule

Another aspect of the directors' fiduciary duty to act in the best interests of the company is the corporate opportunity rule. Due to the considerable degree of overlap, as highlighted earlier, some of the principles discussed above under the no conflict rule also apply to the corporate opportunity rule. One may argue that the overlap between these rules originates from the fact that, until recently,[429] especially in South Africa, the corporate opportunity rule used to be treated as part of either the no profit or the no conflict rule.

The corporate opportunity rule "prohibits a director from usurping any contract, information, or other opportunity that properly belongs to the company and came to him or her as a director of the company".[430] This articulation of the rule raises at least two fundamental questions which require consideration. The first one relates to what is taken into consideration in determining what constitutes a corporate opportunity. The second issue is how does one establish whether or not a corporate opportunity belonged to a company?

The phrase "corporate opportunity" is not defined in the statutes of the three main jurisdictions concerned in this study. The common law and scholarly views will therefore provide guidance. Farrar and Hannigan define a corporate opportunity as "a corporate asset which the directors cannot therefore appropriate for their own use".[431] When one takes a literal definition of the term "asset" Farrar and Hannigan's definition may be found wanting.[432] The only reasonable explanation could be that the term "asset" is technically not limited to the dictionary definition but also includes any form of gain. Davies and Worthington do not define what a corporate opportunity is but only indicate what cases may be covered by application of the rule.[433] The Supreme Court of Appeal, though initially hesitant, held that a corporate opportunity "is one that the company was

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429 *Da Silva v CH Chemicals (Pty) Ltd* 2008 6 SA (SCA) 627 para 18.

430 See Cassim *et al Contemporary Company Law* 2 ed (2012) 538 and Davies and Worthington *Gower's Principles of Modern Company Law* 10 ed (2016) 543-544.

431 Farrar and Hannigan *Farrar's Company Law* 4 ed (1998) 416.

432 The Oxford Dictionary of Accounting 4 ed (2010) 33 defines an asset as "any object, tangible or intangible, that is of value to its possessor. In most cases it either is cash or can be turned into cash".

433 The two scholars in Davies and Worthington *Gower's Principles of Modern Company Law* 10 ed (2016) 543 state that the corporate opportunity rule is limited to "opportunities of the company which he became aware of in the performance of his functions as director". This construction is potentially problematic. To begin with, how will one prove the director's awareness of the opportunity in the absence of objective factors pointing to this finding? Second, in the case of a director who has resigned, will he/she be found liable if they resigned in order to appropriate such an opportunity?

actively pursuing or one that can be said to fall within the company's existing or prospective business activities or that is related to the operations of the company within the scope of its business or that falls within its line of business".[434] Attempts to define a corporate opportunity and establishing circumstances in which one can readily say that an opportunity belonged to a company have resulted in the formulation of different tests by the judiciary. Some of these include the expectancy, line of business and fairness tests. Principles encompassed in these tests may overlap. In some instances, the tests can be combined. However, an in-depth analysis of these tests is outside the scope of this study.

The corporate opportunity rule was judicially considered in the English case of *Regal (Hastings) Limited v Gulliver.*[435] In that case, the plaintiff company brought an action to recover some money from the first five respondents who were its former directors. The sums of money in question were profits made by the directors when they sold shares of the subsidiary company, Hastings Amalgamated Cinemas Limited. The plaintiff, *inter alia,* alleged that the directors had used their positions to acquire shares in the subsidiary for themselves with the sole purpose of selling them at excessive profits and that they had obtained such profits by using their offices as directors. With respect to the first five defendants, the court held that "at all material times they were directors and in a fiduciary position, and they used and acted upon their exclusive knowledge acquired as such directors. They framed resolutions by which they made a profit for themselves. They sought no authority from the company to do so, and by reason of their position and actions, they made large profits for which, in my view, they are liable to account to the company".[436]

The corporate opportunity rule was also considered in the Canadian case of *Cook v Deeks.*[437] In that case, the Toronto Construction Company had four directors who were all equal shareholders. Their names were GM Deeks, GS Deeks, Hinds and Cook. The first three directors purposed to exclude Cook from an imminent deal with the intention of appropriating the contract for themselves. The Canadian Pacific Railway had offered a new lucrative contract to the Toronto Construction Company. Through a shareholder resolution, the first three directors were able to declare that Toronto Construction Company had no interest in the offer. The three directors then

434 *Da Silva v CH Chemicals (Pty) Ltd* 2008 6 SA (SCA) 627 para 18.
435 1942 All ER 378 (HL).
436 *Regal (Hastings) Limited v Gulliver* 1942 All ER 378 (HL) para 4.
437 1916 1 AC 554.

managed to appropriate the contract for themselves. Cook alleged that the opportunity belonged to the Company. The court found in favour of the plaintiff. It was held that "men who assume complete control of a company's business must remember that they are not at liberty to sacrifice the interest which they are bound to protect. This case proves that a 75% majority approval by directors is not sufficient to permit directors to usurp corporate opportunities for themselves".[438] The fiduciary would still be liable even if the company rejected the opportunity or was unable to pursue it.[439]

Section 75 of the South African Companies Act[440] requires directors to disclose their personal financial interests. Disclosure must be made to the board of directors.[441] The legislation is not prescriptive on the manner that disclosure should take place. Such disclosure must be made before the issue is considered by the board or before the company gets involved into the transaction.[442] The authors of Henochsberg submit rely on section 158(a) of the Companies Act[443] as authority for their position that the common law is still applicable unless there is a specific provision in the Act that excludes it or the former is in conflict with the latter.[444] A director cannot therefore have a direct or indirect interest in a contract with the company. It is submitted that the basis of this rule is a result of the fiduciary relationship between the director and the company.[445] The common law position was that it was not sufficient that the contract was approved by other directors.[446] However, section 75(7)(a) of the Companies Act has changed this by providing that "a decision by the board, or a transaction or agreement approved by the board, or by a company as contemplated in subsection (3), is valid despite any personal financial interest of a director or person related to the director, only if it was approved following disclosure of that interest in the manner contemplated in this section". With respect to the timing of the disclosure, it is submitted

438 *Cook v Deeks* 1916 1 AC 554.
439 Farrar and Hannigan *Farrar's Company Law* 4 ed (1998) and *Regal (Hastings) Limited v Gulliver* 1942 All ER 378 (HL).
440 71 of 2008.
441 See section 75(5)(a) to (c) of the South African Companies Act 71 of 2008; section 120 of the CBCA RSC 1985 and section 177(1) of the UK Companies Act of 2006.
442 Cassim *et al Contemporary Company Law* 2 ed (2012) 569.
443 71 of 2008. This section states that "when determining a matter brought before it in terms of this Act, or making an order contemplated in this Act a court must develop the common law as necessary to improve the realisation and enjoyment of rights established by this Act".
444 *Henochsberg on the Companies Act 71 of 2008* Vol 1 Service Issue 2 (2012) 281.
445 *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 168 (AD) 177-178.
446 *Imperial Mercantile Credit Association v Coleman* 1871 LR 6 (Ch App) 558.

that the declaration must be made before the board of directors considers it.[447] Disclosure must be made only in respect of "personal financial interest".[448] In *Hospital Products Ltd v United States Surgical Corporation*[449] it was held that "a material financial interest is likely to be one that would give rise to a real or sensible possibility of conflict of interest".[450]

3 3 3 The no profit rule

The no-profit rule also has its basis in *Keech v Sandford.*[451] According to this rule, "directors may not retain any profit made by them in their capacity as directors while performing their duties as directors".[452] The rule is strictly applied and allows little room for exception.[453] The fact that the company suffered no harm or loss or that no profit was made at the expense of the company or that the company could not have made use of the relevant opportunity is not sufficient to justify the director's conduct.[454] One may question whether the term 'profit' is only limited to money or whether it extends to other forms of gain including "an opportunity" Due to the potential confusion that may arise between the words "profit" and "opportunity", the difference between the corporate opportunity and no-profit rule is worth the consideration. The no-profit rule is much broader than the corporate opportunity rule for at least two reasons. First, the corporate opportunity rule is restricted in its application to commercial arrangements whereas the no-profit rule extends even to non-commercial relationships.[455] Second, the no-profit rule extends to all forms of collateral profits whereas the corporate opportunity rule is limited to the exploitation of business opportunities.[456]

The no profit rule was judicially considered in the South African case of *Robinson v Randfontein Estates Gold Mining Co Ltd.*[457] In that case, the plaintiff was a director and chairperson of the board of directors of the defendant company. The defendant company, Randfontein Estates, was

447 Section 75(5) of the Companies Act 71 of 2008.
448 *Ibid*.
449 1984 156 CLR 41.
450 *Hospital Products Ltd v United States Surgical Corporation* 1984 156 CLR 41.
451 1726 25 ER 223 (Ch).
452 Cassim *et al Contemporary Company Law* 2 ed (2012) 536.
453 *Phillips v Fieldstone Africa (Pty) Ltd* 2004 3 SA 465 (SCA) para 31.
454 *Phillips v Fieldstone Africa (Pty) Ltd* 2004 3 SA 465 (SCA) and *Regal (Hastings) Limited v Gulliver* 1942 All ER 378 (HL).
455 Havenga *Fiduciary Duties of Company Directors with Specific Regard to Corporate Opportunities* (Unpublished LLD thesis, University of South Africa, 1995) 92.
456 *Ibid*.
457 1921 168 (AD).

made up of associated companies that all belonged to the Robinson Group which had interests in Randfontein, Uitvalfontein and Waterval farms. The defendant's interest in Waterval farm took the form of a lease of mineral rights. In 1899, three subsidiaries which were; Ferguson, van Hulsteyn and Johnston Randfontein were floated to work the Waterval mijnpacht.[458] These subsidiaries never did any mining work at Waterval because of insufficient working capital. The defendant then pursued the "corporate opportunity". All the shares of the three subsidiaries were held either by the defendant or its nominees.

In 1906, the plaintiff bought an undivided half share of Waterval for £60 000 which he sold for £275 000 to the defendant. Randfontein Estates claimed that it was entitled to the profits made by the plaintiff on the basis that Robinson stood in a fiduciary relationship towards the defendant company when he acquired Waterval. The court found that the company was entitled to the profits made by Robinson because he "purchased the property under such circumstances that showed that it was his duty to have acquired it not for himself but for the company but thereafter resold the property at a profit".[459] Innes C.J held that "where one stands to another in a position of confidence involving a duty to protect the interests of another, he is not permitted to make a secret profit at the other's expense".[460] The principles in this case have been reconsidered with approval in the South African cases of *Volvo (Southern Africa) Pty Ltd v Yssel*[461] and *Phillips v Fieldstone Africa (Pty) Ltd*.[462] In the former case, five judges of the Supreme Court of Appeal held that "moneys earned secretly fall to be disgorged and there is little room to avoid that consequence".[463]

3 3 4 The proper purpose rule

In discharging their fiduciary duty to act in the best interests of a company, directors are also required to observe the proper purpose rule. Section 76(3)(a) incorporates this rule into the

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458 http://www.oxforddictionaries.com/definition/english/mijnpacht (accessed 01-11-2015) define a mijnpacht as "a mining lease granted (in terms of mining laws) to the owner or lessee of the mining rights on land proclaimed a public gold field, entitling this person to claim a certain percentage of the land prior to any other claims being registered; the area held under such a lease."

459 *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 168 (AD).

460 *Ibid*.

461 2009 6 SA 531 (SCA).

462 2004 3 SA 465 (SCA).

463 *Volvo (Southern Africa) Pty Ltd v Yssel* 2009 6 SA 531 (SCA) para 14.

Companies Act.[464] Therefore, the proper purpose rule is now both a common law and statutory requirement in South African company law.

The proper purpose rule was considered by the court in the English case of *Hogg v Cramphorn Ltd*.[465] In that case, the defendant company (Cramphorn Ltd), which was incorporated in 1896, carried on the business of corn and seed merchants. The plaintiff was holder of fifty ordinary shares of the defendant company. The defendants were, among others, the company and its chairman and managing director, Colonel Cramphorn. The company was prospering and proved profitable but the earnings yield on the amount of capital employed in the business was low. Baxter proposed to Colonel Cramphorn to buy the whole of the issued share capital of the company. However, Baxter had no experience of the particular kind of business carried on by the defendant company. To that end Baxter then assured Cramphorn that once he acquired control of the business he intended to expand it. Despite this assurance, Cramphorn was unconvinced. He still thought that there would be a change in the nature of the company's business. Cramphorn later presented the offer to the board of directors. The board determined, through legal advice, to suffocate the offer. The board then devised a scheme whereby shares were allotted to the trustees of a trust established for the benefit of the employees of the company. The rationale behind this scheme was that the trustees, who were related to the directors would vote in favour of the directors' view and thereby thwart the takeover bid.

The directors honestly believed that the takeover bid by an inexperienced bidder was contrary to the best interests of the company and its stakeholders including employees and customers. The plaintiff alleged that the attachment of the special voting rights to allotted preference shares and their allotment was *ultra vires*. The court held that the directors had improperly exercised their powers to issue shares.[466] The fact that they had acted honestly and in the best interests of the company was irrelevant. The court held that the primary purpose for the allotment of the shares was not to raise capital but to retain control of the firm.[467] Issuing of shares by directors is a fiduciary power which needs to be exercised for the proper purpose of raising capital. It was held

464 71 of 2008.
465 1966 3 All ER 420.
466 *Hogg v Cramphorn Ltd* 1966 3 All ER 420.
467 *Ibid*.

that it was against the company's constitution for the directors "to exercise their fiduciary power to issue shares of the company purely for the purpose of defeating a takeover bid".[468]

Similar circumstances prevailed in the leading UK case of *Howard Smith Ltd v Ampol Petroleum Ltd*.[469] The difference between this case and that of Hogg is that in the former there existed both a need to raise the share capital of the company and an intention to stop the defendant's takeover bid. In setting aside the share allotments, the court established first that the primary or substantial purpose was to defeat the defendant's takeover bid. Therefore, it can be deduced from this judgment that where there is a variety of purposes, a court has to decide first what the "primary, dominant or substantial" purpose is.[470] The court's decision would therefore be heavily influenced by that primary determination.

However, establishing the primary purpose from a set of facts is not as easy as reciting the alphabet. Practical scenarios are usually complex. Some of the cases may have taken a long time before they came before the courts. Between the period a case begins to build up and the time it is brought before a court of law, the law might have changed. The pertinent legislation might have been amended and/or even repealed. Some of the cases might involve a lot of parties, for instance, the directors might have held numerous directorships. In the presence of such potential complexities, there is need for some guidelines to determine the intended proper purpose in each case. In the English case of *Extrasure Travel Insurances Ltd v Scattergood*[471] the court came up with a four-step criteria. It was held that the court must "identify the particular power that is being challenged, the proper purpose for which the power was given to the directors, the substantial purpose for which the power was in fact exercised and decide whether the purpose is proper".[472] It is submitted that in determining whether a director acted for a proper purpose, an objective approach is adopted.[473]

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468 *Ibid*.
469 1974 AC 821 (PC).
470 *Hogg v Cramphorn Ltd* 1966 3 All ER 420 and Cassim *et al Contemporary Company Law* 2 ed (2012) 527.
471 2003 1 BCLC 598 (ChD) 619.
472 *Extrasure Travel Insurances Ltd v Scattergood* 2003 1 BCLC 598 (ChD) 619.
473 Cassim *et al Contemporary Company Law* 2 ed (2012) 525-526.

3 3 5 Obligation to exercise an independent judgment

It is not enough that directors adhere only to the no-profit, no-conflict, corporate opportunity and the proper purpose rule. In discharging their fiduciary duty to act in the best interests of the company, directors ought also to exercise an independent judgment and unfettered discretion.[474] As a general rule, "directors may not bind themselves in the present on how to vote in the future".[475] Cassim *et al* believe that the fact that this rule is taken to be part of the broad duty to act in the best interests of the company could be the reason why it is not explicitly referred to in section 76 of the Companies Act.[476] Davies and Worthington submit that in observing this rule, an objective approach is adopted.[477]

The essence of the duty to exercise an independent judgment comes to light when one considers the position of a nominee director. A nominee director is "a lawfully elected director appointed to the board of directors by a creditor, a financier or a substantial shareholder who controls significant voting power for this purpose".[478] An illustrative case on this issue is *Fisheries Development Corporation of SA Ltd v Jorgensen; Fisheries Development Corporation of SA Ltd v AWJ Investments*.[479] This case concerned two related issues which were consolidated for trial. It is the first issue that is relevant to this study and therefore regard will be given to it. In that case, the plaintiff company claimed from the defendant some moneys owing to it in terms of certain deeds of suretyship. The defendants pleaded a number of defences. In the alternative plea, the defendants alleged that the plaintiff appointed its servants or agents as its nominees to the board of directors. The defendants further alleged that a consequence of such appointment of nominee directors was that from that moment until International Fishing Corporation (Pty) Ltd (hereinafter referred to as IFCOR) was placed under a winding-up order, the plaintiff, through its nominees managed IFCOR

474 *Kregor v Hollins 1913* 109 LT 225 (CA) as referred to in Cassim *et al Contemporary Company Law* 2 ed (2012) 528.

475 Cassim *et al Contemporary Company Law* 2 ed (2012) 529.

476 71 of 2008. See Cassim *et al Contemporary Company Law* 2 ed (2012) 529. However, in the UK, the duty is clearly set out in section 173 of its Companies Act which provides that "a director of a company must exercise independent judgment. This duty is not infringed by his acting in accordance with an agreement duly entered into by the company that restricts the future exercise of discretion by its directors, or in a way authorised by the company's constitution".

477 Davies and Worthington *Gower's Principles of Modern Company Law* 10 ed (2010) 543-545.

478 Cassim *et al Contemporary Company Law* 2 ed (2012) 529.

479 1980 4 SA 156 (W).

in a manner which prejudiced the defendants as sureties and therefore the defendants were discharged from liability.

The issue was whether the nominee directors were supposed to serve the best interests of the company or to be subject to the control of their principal who had nominated them and not the company. The court held that a nominee director is "not the servant of the shareholder who procures his appointment to the board of directors. The director's duty is to observe the utmost good faith towards the company, and in discharging that duty he is required to make an independent judgment and to take decisions according to the best interests of the company as his principal. He cannot therefore fetter his vote as a director, save in so far as there may be a contract for the board to vote in that way in the best interests of the company".[480] Cassim *et al* comment that the decision in the Fisheries case in short, states that "a director may not serve two masters".[481] This is the position in South African law.

In the UK, the court rejected the view that "the board of directors may never make a contract by which they bind themselves to the future exercise of their powers in a particular way, even though the contract as a whole is manifestly for the benefit of the company".[482] It is submitted that the UK adopts a more flexible approach as compared to South African courts.

This section presented a discussion on five of the rules of the directors' fiduciary duty to act in the best interests of the company. The section served a dual purpose. First, the discussion provided an in-depth analysis of the various similarities and differences on the nature and scope of the duty in question in South Africa, Canada and the UK. Second, it also acted as a precursor to the next section which focusses on the beneficiaries of the duty in question. It is impossible to talk about the beneficiary of the duty without an in-depth analysis of the content of the duty.

3 4 TO WHOM IS THE DUTY OWED

This section seeks to provide an answer to the question "to whom is the directors' fiduciary duty to act in the best interests of the company owed?" For a well-reasoned response to be provided to

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480 *Fisheries Development Corporation of SA Ltd v Jorgensen; Fisheries Development Corporation of SA Ltd v AWJ Investments* 1980 4 SA 156 (W) 163.

481 Cassim *et al Contemporary Company Law* 2 ed (2012) 531.

482 *Fulham Football Club Ltd v Cabra Estates Plc* 1994 1 BCLC 363 (Ch) as referred to in Cassim *et al Contemporary Company Law* 2 ed (2012) 529.

this question, one will first identify the different company stakeholders that exist. These stakeholders' interests are central to this study. However, this study is restricted to shareholders', creditors', employees' and the community's interests. Each of these stakeholders' interests will be briefly discussed below.

It is trite law that directors owe fiduciary obligations to act in the best interests of the company.[483] Paramount to this duty is a definition of the phrase "the company".[484] Attenborough admits that it is difficult to define the expression "the company as a whole".[485] On his part, Andrew Keay acknowledges the correctness of the statement that directors must act in the best interests of the company but does not go further to explain what that means.[486] The meaning of the phrase is "an open-ended question … and ambiguous".[487] Esser and Du Plessis concede that an attempt to determine what the phrase means has led to confusion.[488] Havenga noted that the phrase has been defined in many ways but she does not attempt to do so herself.[489] The phrase is not defined in legislation and regard will therefore be given to the common law. Nevertheless, some commentators still feel that it is of no use to "regurgitate the numerous utterances of past courts on this topic".[490] However, regardless of the legislature's failure to define "the company", the judiciary, though not critic free, has attempted to at least arm scholars and lawyers with something

483 *Allen v Gold Reefs of West Africa Limited* 1900 1 656 (Ch) 671; *Re City Equitable Fire Insurance Co Ltd* 1925 (Ch) 407; *Charterbridge Corporation Ltd v Lloyds Bank* 1970 1 (Ch) 62; Havenga "Competing with the Company- When Does a Director Breach His or Her Fiduciary Obligation?" 1995 *SA Merc L.J.* 435; Havenga "Directors in Competition with their Companies" 2004 *SA Merc L.J.* 275; Macey and Miller "Corporate Stakeholders: A Contractual Perspective" 1993 *University of Toronto Law Journal* 401; Veasay and Guglielmo "How Many Masters Can a Director Serve? A Look at the Tensions Facing Constituency Directors" 2008 *Business Lawyer* 12; and Nwafor "Fraudulent Trading and the Protection of Company Creditors: the Current Trend in Company Legislation and Judicial Attitude" 2013 *Comm. L. World Rev* 297.

484 Sealy "Directors' 'Wider' Responsibilities – Problems Conceptual, Practical and Procedural" 1987 *Monash University Law Review* 166.

485 Attenborough "How Directors Should Act When Owing Duties to the Companies' Shareholders: Why we need to stop applying Greenhalgh" 2009 *ICCLR* 339; Ramnath and 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 *Speculum Juris* 98 and 102; and Havenga "Directors in Competition with their Companies" 2004 *SA Merc LJ* 275 who says that one of the challenges in this area of law is defining the boundaries of this duty.

486 Keay "The Director's Duty to Take into Account the Interests of Company Creditors: When is it Triggered?" 2001 *Melbourne University Law Review* 315.

487 Attenborough "How Directors Should Act When Owing Duties to the Companies' Shareholders: Why we need to stop applying Greenhalgh" 2009 *ICCLR* 339.

488 Esser and Du Plessis "The Stakeholder Debate and Directors' Fiduciary Duties" 2007 19 *SA Merc L.J.* 357.

489 Havenga "Regulating Directors' Duties and South African Company Law Reform" 2005 *Obiter* 617-618.

490 Esser and Du Plessis "The Stakeholder Debate and Directors' Fiduciary Duties" 2007 19 *SA Merc L.J.* 357 referring to *Ex parte Glossop* 1988 1 WLR 1068 1076; and Sealy "Bona Fides and Proper Purposes in Corporate Decisions" 1989 *Monash University LR* 265 269-271.

to work with. They have not left it to chance. The courts' approach on this question has crystallised into what has come to be known as the "traditional view".[491]

The traditional view equates or replaces "the company" with shareholders.[492] In the English case of *Percival v Wright,*[493] Eady J held that directors owe fiduciary duties to the company and not the individual shareholders.[494] Different views have been held with respect to Eady J's judgment. The decision was followed in another fairly recent English case of *Johnson v Gore Wood*.[495] However, some commonwealth courts have held that Eady J's judgment can be said to be the general rule, the exceptions being those cases where a director owes greater obligations to an individual shareholder for example when the director is dependent upon guidance from the shareholder or when the latter is vulnerable.[496] Such a view is problematic because the very nature of a fiduciary relationship itself entails that the beneficiary is vulnerable.[497] It is therefore absurd to hold it as an exception to the general rule. To do so will be like separating an eagle from the class of birds simply because it can fly in the midst of a storm.

3 4 1 Shareholders

A notable consequence of the traditional view of "the company" is to regard the company's interests as being equal to shareholders' interests.[498] Nwafor argues that profit maximisation is the only goal of shareholders.[499] The term shareholder has been defined differently but at least

491 *Percival v Wright* 1902 2 421 (Ch).

492 In the Australian case of *Kinsela v Russell Kinsela (Pty) Ltd* 1986 4 NSWLR 722, it was held that "the proprietary interests of the shareholders entitle them as a general body to be regarded as the company when questions of the duty of directors arise". See also Allair and Rousseau "To Govern in the Interest of the Corporation: What is the Board's Responsibility to Stakeholders other than Shareholders?" 2014 11; Ajibo "A Critique of Enlightened Shareholder Value: Revisiting the Shareholder Primacy Theory" 2004 *Birkbeck Law Review* 44; Macey and Miller "Corporate Stakeholders: A Contractual Perspective" 1993 *University of Toronto Law Journal* 402; and Rousseau "The Duties of Directors of Financially Distressed Corporations: A Quebec Perspective on the Peoples Case" 2004 *Canadian Business Law Journal* 380.

493 1902 2 421 (Ch).

494 *Percival v Wright* 1902 2 421 (Ch).

495 2000 UKHL 65.

496 See the New Zealand case of *Coleman v Myers* 1977 2 NZLR 225 and a fairly recent English case of *Peskin v Anderson* 2001 BCLC 372.

497 See *Volvo (Southern Africa) Pty Ltd v Yssel* 2009 6 SA 531 (SCA) and *Phillips v Fieldstone Africa (Pty) Ltd* 2004 3 SA 465 (SCA) where it was made clear that vulnerability is a prerequisite for the existence of fiduciary obligations on directors.

498 *Da Silva v CH Chemicals (Pty) Ltd* 2008 6 620 (SCA) para 18; *Parke v Daily News Ltd* 1962 2 All ER 948 and; *Hutton v West Cork Railway* 23 (ChD) 654.

499 Nwafor "The Shifting Responsibilities of Company Directors – How Desirable In Modern Times" 2012 *Macquarie J. Bus. L* 158.

retaining the fundamental concepts of voting rights and some form of ownership proportional to the value of shares owned.[500] Shareholders provide a company with capital and "receive rights to participate in the profits of the corporation in the form of dividends, as may be declared from time to time at the board's discretion, and to share in the firm's residual assets upon corporate dissolution".[501]

Directors owe fiduciary obligations to shareholders collectively but not as individuals.[502] In the English case of *Gaiman v National Association for Mental Health*[503] it was held that "the interests of some particular section or sections of the company cannot be equated with those of the company, and I would accept the interests of both present and future members of the company, as a whole, as being a helpful expression".[504] Commentators also submit that acting in the shareholders' interests means "balancing the short term interests of present members with the long term interests of future members".[505] Thus, directors are to take into account both the interests of current and future shareholders. This interpretation is questionable on at least one ground. How can one ascertain the interests of future shareholders? Since there is no time limit for the word "future", one can go further and claim that current competitors may become future shareholders. How is it then practical to act in an unknown person's interests? Explaining the term "future" in that way can be justified if one regards a company as a going concern and assume that every shareholder has one major objective, which is profit maximisation. In practice, however, it is not every time that shareholders only aim to maximise profits. At times it might be enough and important just to increase a firm's market share.[506] Based on these arguments one can contend that taking into

500 Section 1 of the South African Companies Act 71 of 2008 defines a shareholder as "the holder of a share issued by a company and who is entered as such in the certificated or uncertificated securities register, as the case may be". That definition is subject to section 57(1) of the same Act which provides that a shareholder "includes a person who is entitled to exercise any voting rights in relation to a company, irrespective of the form, title or nature of the securities to which those voting rights are attached".

501 Lin "Shift of Fiduciary Duty upon Corporate Insolvency: Proper Scope of Directors' Duty to Creditors" 1993 *Vanderbilt Law Review* 1488.

502 *Percival v Wright* 1902 2 421 (Ch).

503 1971 317 (Ch) 330.

504 *Gaiman v National Association for Mental Health* 1971 317 (Ch) 330.

505 Ajibo "A Critique of Enlightened Shareholder Value: Revisiting the Shareholder Primacy Theory" 2004 *Birkbeck Law Review* 44; and Havenga "Directors' Fiduciary Duties under our Future Company-law Regime" 1997 *SA Merc L.J.* 317.

506 Ajibo "A Critique of Enlightened Shareholder Value: Revisiting the Shareholder Primacy Theory" 2004 *Birkbeck Law Review* 44.

account the long term interests of current shareholders is more practical than considering future, unknown shareholders' interests.

The view that directors are to consider only shareholders' interests has been justified chiefly by the so-called "too many masters argument".[507] According to this argument if directors owe fiduciary obligations to several stakeholders, they will have too many masters to be accountable to and in the end will become servants of none.[508] The construction of the 'too many masters argument' requires some consideration. First, when directors act in the shareholders' interests it does not necessarily mean that they are the latter's servants. Second, directors, as seen above, are to exercise their powers with unfettered discretion.[509]

However, a company is made up of more than shareholders.[510] The mere fact that there are other stakeholders who also contribute to the sustainability of a company invites one to question the validity of the traditional view. First, some scholars claim that the traditional view was conceived during a period when companies' human rights obligations were still developing.[511] Second, shareholders cannot be regarded as a unified group who have common interests throughout all the

507 Esser and Du Plessis "The Stakeholder Debate and Directors' Fiduciary Duties" 2007 *SA Merc L.J.* 346. For more on the "too many masters" argument see Ho '"Enlightened Shareholder Value': Corporate Governance beyond the Shareholder-Stakeholder Divide" 2010 *Journal of Corporation Law* 69; Macey and Miller "Corporate Stakeholders: A Contractual Perspective" 1993 *University of Toronto Law Journal* 403; Sheehy "Scrooge-The Reluctant Stakeholder: Theoretical Problems in the Shareholder-Stakeholder Debate" 2005 *University of Miami Business Law Review* 208; and Roach "The Paradox of the Traditional Justifications for Exclusive Shareholder Governance Protection: Expanding the Pluralist Approach" 2001 9.

508 Roach "The Paradox of the Traditional Justifications for Exclusive Shareholder Governance Protection: Expanding the Pluralist Approach" 2001 9; Esser and Du Plessis "The Stakeholder Debate and Directors' Fiduciary Duties" 2007 *SA Merc L.J.* 346; and Sheehy "Scrooge-The Reluctant Stakeholder: Theoretical Problems in the Shareholder-Stakeholder Debate" 2005 *University of Miami Business Law Review* 208.

509 See part 3 3 5 (this chapter) above. See also Neumueller "A Canadian Solution: Recent Developments in the Law of Directors' Duties in the Context of Financially Distressed Corporations" 2005 *Dalhousie J. Legal Stud.* 93. Macey and Miller "Corporate Stakeholders: A Contractual Perspective" 1993 *University of Toronto Law Journal* 403 note that "this argument ignores the fact that corporations have long been able to issue multiple classes of shares with different economic and political rights, and corporate management has owed fiduciary duties to each of these classes. Thus it simply cannot be said that corporate law is incapable of reconciling the claims of a variety of competing interests".

510 Macey and Miller "Corporate Stakeholders: A Contractual Perspective" 1993 *University of Toronto Law Journal* 401; Esser and Du Plessis "The Stakeholder Debate and Directors' Fiduciary Duties" 2007 19 *SA Merc L.J.* 346 also insist that "there is, however, a shift in public opinion with regards to consideration of a wider variety of interests than only those of the shareholders". Esser and Du Plessis "The Stakeholder Debate and Directors' Fiduciary Duties" 2007 19 *SA Merc LJ* 360 point out that "a company is represented by many interests". See also Dodd "For Whom Are Corporate Managers Trustees?" 1932 *Harvard Law Review* 1153-1154. As held in *S v Makwanyane* 1995 3 SA 391 (CC) public opinion does not form the law but the law may take into account public interests.

511 Ramnath and 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 *Speculum Juris* 105.

time the company is in existence. That is why it is generally difficult to have unanimous decisions during shareholder voting.[512] Some scholars have noted that the question about the beneficiaries of the directors' fiduciary obligations is resurfacing.[513] Different circumstances may require different stakeholders' interests to be afforded primacy.[514] Allaire and Rousseau note that "a strict interpretation of the directors' fiduciary duties has remained marginal. [T]he obligation to act in the shareholders' interests must be assessed from a broad perspective that does not prevent the directors from taking the interests of the corporation's other stakeholders into account".[515] From a South African standpoint, all law, including company law, cannot be properly appreciated if it is not interpreted in line with the Bill of Rights.[516] Furthermore, taking into consideration the influence that MNCs and other companies in general have on society, it is important that one considers whether the traditional view still stands unchallenged in contemporary company law.[517] Some stakeholders will be discussed hereunder to find out if modern-day company law requires directors to depart from the traditional view to consider the former's interests as well.

3 4 2 Creditors

A creditor is any individual or company to whom money is owing.[518] Creditors also provide capital to a company. Nwafor, a notable company law scholar, explains that the meaning of the word "creditors" should "not [be] restricted to those who have present claims against the company, but extends to prospective creditors having future claims against it".[519] There are secured and

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512 For example, section 65(7) and (9) state that "for an ordinary resolution to be approved by shareholders, it must be supported by more than 50 percent of the voting rights exercised on the resolution. For a special resolution to be approved by shareholders, it must be supported by at least 75 percent of the voting rights exercised on the resolution".

513 Veasay and Guglielmo "How Many Masters Can a Director Serve? A Look at the Tensions Facing Constituency Directors" 2008 *Business Lawyer* 765.

514 *Ibid* 768.

515 Allair and Rousseau "To Govern in the Interest of the Corporation: What is the Board's Responsibility to Stakeholders other than Shareholders?" 2014 12.

516 Ramnath and 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 *Speculum Juris* 99-100. See also section 2 of the Constitution of the Republic of South Africa, 1996.

517 Ramnath and 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 *Speculum Juris* 99-100. Refer to chapter 1 for a discussion on the Marikana massacre.

518 Kavanagh *et al South African Concise Oxford Dictionary* (2002) 271.

519 Nwafor "Fraudulent Trading and the Protection of Company Creditors: the Current Trend in Company Legislation and Judicial Attitude" 2013 *Comm. L. World Rev* 312.

unsecured creditors.[520] Unsecured creditors are interested in the company's business as they see it as a credit risk.[521] Lin says "creditors have fixed claims against the corporation that entitle them to receive a pre-determined rate of interest and repayment of their principal at a specified maturity date".[522]

Generally, directors do not owe any fiduciary duties to creditors.[523] The question whether directors owe any fiduciary obligations to creditors only arises in the context of insolvency issues. This has been the most controversial and most debated of all the duties to other stakeholders. Before insolvency, directors do not owe any obligation to act in the best interests of creditors.[524] However upon insolvency, many courts have held that "once the corporation becomes insolvent, directors owe a fiduciary duty to creditors".[525] It is believed that this duty was formulated by the High Court of Australia in the case of *Walker v Wimborne.*[526] In that case, the directors guaranteed the loans of another company in the group during a time when the company was financially unstable. It was alleged that these directors breached their fiduciary duties to the company and its creditors. Mason J held that "it should be emphasised that the directors of a company must take account of its shareholders and its creditors. Any failure by the directors to take into account the interests of creditors will have adverse consequences for the company as well as for them".[527] This case has greatly influenced the construction of such a duty in that it has been referred to with approval in other common law jurisdictions.[528] Some scholars even conclude that directors' duty to act in the

520 http://www.investopedia.com/terms/u/unsecuredcreditor.asp (accessed 10-09-2015) defines an unsecured creditor as "an individual or institution that lends money without obtaining specified assets as collateral. A debenture holder is an unsecured creditor".

521 Esser and Du Plessis "The Stakeholder Debate and Directors' Fiduciary Duties" 2007 19 *SA Merc LJ* 346.

522 Lin "Shift of Fiduciary Duty upon Corporate Insolvency: Proper Scope of Directors' Duty to Creditors" 1993 *Vanderbilt Law Review* 1488.

523 *Winkworth v Edward Baron Development Co* 1986 1 WLR 1512 and *Kuwait Asia Bank EC v National Mutual Life Nominees Ltd* 1990 3 All ER 404.

524 Lin "Shift of Fiduciary Duty upon Corporate Insolvency: Proper Scope of Directors' Duty to Creditors" 1993 *Vanderbilt Law Review* 1510.

525 *Nicholson v Permakraft* 1985 1 NZLR 242; *Kinsela v Russell Kinsela (Pty) Ltd* 1986 4 NSWLR 722; and *Brady v Brady* 1988 20 BCLC.

526 1976 3 ACLR 529.

527 *Walker v Wimborne* 1976 3 ACLR 529.

528 For example see the New Zealand case of *Nicholson v Permakraft* 1985 1 NZLR 242; the Australian case of *Kinsela v Russell Kinsela (Pty) Ltd* 1986 4 NSWLR 722. English cases include *Brady v Brady* 1988 20 BCLC; *Horsley v Weight Ltd* 1982 3 All ER 1045; *Winkworth v Edward Baron Development Co* 1986 1 WLR 1512; and *Kuwait Asia Bank EC v National Mutual Life Nominees Ltd* 1990 3 All ER 404.

best interests of the creditors is well established.[529] The duty has also been recognised in Canada.[530] However, it is submitted that there is no South African case law on this question yet.

However, there are a lot of challenges in constructing directors' fiduciary obligations to creditors. The first issue is whether such a duty is a direct or an indirect obligation.[531] A look at the UK's case law reveals that courts have been more inclined to an indirect duty.[532] In *Yukong Lines of Korea v Rendsberg Investment Corp of Liberia (No2)*[533] the court rejected a direct duty and held that "a director does not owe a direct fiduciary duty to an individual creditor, nor is an individual creditor entitled to sue for breach of the fiduciary duty owed by the director to the company".[534] However, that statement alone is not enough to conclude that directors owe an indirect duty because the judge simply rejected a direct duty. The second difficulty relates to who the creditors are.[535] As highlighted above, directors' fiduciary duties to the company require them to consider both present and future shareholders. The question here is does a duty to creditors analogically cover present and future creditors' interests? Skene compounds the issue by adding that "creditors are not a homogeneous group, current and future creditors' interests may conflict, and does the duty apply to unsecured creditors only or 'general creditors'?"[536] Furthermore, current case law reveals some inconsistencies on whether "creditors are entitled to exclusive consideration".[537] It is also not clear whether a subjective or objective test applies and when the duty arises.[538]

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529 Skene **"**The Directors' Duty to the Creditors of a Financially Distressed Company: A Perspective from across the Pond" 2007 *Journal of Business and Technology Law* 3 and Keay "Directors' Duties to Creditors: Contractarian Concerns Relating to Efficiency and Over-Protection of Creditors" 2003 *Modern Law Review* 664.

530 See *Bank of Toronto v Lambe* 1887 12 AC 575 (PC); *Re Trizec Corp* 1994 10 WWR 127 and *Peoples Department Stores Inc. v Wise* 2004 68 (SCC).

531 Skene **"**The Directors' Duty to the Creditors of a Financially Distressed Company: A Perspective from across the Pond" 2007 *Journal of Business and Technology Law* 3. The same scholar explains that an independent duty is one whereby directors report directly to the creditors. The effect of this is that creditors can therefore enforce it on directors. An indirect duty is one owed to the company and only the latter can enforce it against the directors.

532 Skene "The Directors' Duty to the Creditors of a Financially Distressed Company: A Perspective from across the Pond" 2007 *Journal of Business and Technology Law* 3.

533 1998 1 WLR 294.

534 *Yukong Lines of Korea v Rendsberg Investment Corp of Liberia (No2)* 1998 1 WLR 294.

535 Skene "The Directors' Duty to the Creditors of a Financially Distressed Company: A Perspective from across the Pond" 2007 *Journal of Business and Technology Law* 4 and Sealy "Directors' 'Wider' Responsibilities – Problems Conceptual, Practical and Procedural" 1987 *Monash University LR* 178.

536 Skene "The Directors' Duty to the Creditors of a Financially Distressed Company: A Perspective from across the Pond" 2007 *Journal of Business and Technology Law* 5.

537 See *Kinsela v Russell Kinsela* 1986 4 NSWLR 722; *Brady v Brady* 1988 20 BCLC and *Walker v Wimborne* 1976 137 CLR.

538 Skene "The Directors' Duty to the Creditors of a Financially Distressed Company: A Perspective from across the Pond" 2007 *Journal of Business and Technology Law* 5; Keay "The Director's Duty to Take into Account the

On the other hand, there are also compelling arguments for the formulation of directors' duties to creditors. Keay says that if a company cannot sustain itself and depends on creditor funds then "the interests of the company are in reality the interests of existing creditors alone".[539] Although creditors are usually protected contractually, there is need for some fiduciary protection when a company is insolvent.[540] Current legislative protection is also not adequate.[541] In the Australian case of *Kinsela v Russell Kinsela*[542] it was held that "in a solvent company the proprietary interests of the shareholders entitle them as a general body to be regarded as the company when questions of the duty of directors arise. But where a company is insolvent the interests of the creditors intrude. They become prospectively entitled, through the mechanism of liquidation, to displace the power of the shareholders and directors to deal with the company's assets".[543]

Interests of Company Creditors: When is it Triggered?" 2001 *Melbourne University Law Review* 322-329 claims that the concept of insolvency is ambiguous and also lists some factors that are considered when deciding what triggers the duty at 331-334. The same author also points out that it is not clear whether the duty should be recognised at near insolvency, or in the vicinity of insolvency, at doubtful solvency, at risk of insolvency or at financial instability. However, Sealy "Directors' 'Wider' Responsibilities – Problems Conceptual, Practical and Procedural" 1987 *Monash University Law Review* 179 questions the relevance of insolvency in deciding whether directors owe any duties to creditors. For more on arguments against the enlargement of directors fiduciary obligations, see Rousseau "The Duties of Directors of Financially Distressed Corporations: A Quebec Perspective on the Peoples Case" 2004 *Canadian Business Law Journal* 382 and 390. With respect to characteristics of decisions in which directors were held to a fiduciary duty to creditors, see Lin "Shift of Fiduciary Duty upon Corporate Insolvency: Proper Scope of Directors' Duty to Creditors" 1993 *Vanderbilt Law Review* 1513 and Sealy "Directors' 'Wider' Responsibilities – Problems Conceptual, Practical and Procedural" 1987 *Monash University Law Review* 171-172.

539 Keay "The Director's Duty to Take into Account the Interests of Company Creditors: When is it Triggered?" 2001 *Melbourne University Law Review* 317. Keay "Directors' Duties to Creditors: Contractarian Concerns Relating to Efficiency and Over-Protection of Creditors" 2003 *Modern Law Review* 666 notes that this view is a favourite of the contractarians.

540 Keay "The Director's Duty to Take into Account the Interests of Company Creditors: When is it Triggered?" 2001 *Melbourne University Law Review* 317.

541 Keay "The Director's Duty to Take into Account the Interests of Company Creditors: When is it Triggered?" 2001 *Melbourne University Law Review* 318.

542 1986 4 NSWLR 722.

543 *Kinsela v Russell Kinsela (Pty) Ltd* 1986 4 NSWLR 722. For more on justifications of this duty see Keay "Directors' Duties to Creditors: Contractarian Concerns Relating to Efficiency and Over-Protection of Creditors" 2003 *Modern Law Review* 664; Flannigan "Reshaping the Duties of Directors: Case Comment" 2005 *Canadian Bar Review* 373; Rousseau "The Duties of Directors of Financially Distressed Corporations: A Quebec Perspective on the Peoples Case" 2004 *Canadian Business Law Journal* 383, 384, 389 and 390; Keay "The Director's Duty to Take into Account the Interests of Company Creditors: When is it Triggered?" 2001 *Melbourne University Law Review* 318; Havenga "Directors' Fiduciary Duties under our Future Company-law Regime" 1997 *S.A Merc L.J.* 318; Rousseau "The Duties of Directors of Financially Distressed Corporations: A Quebec Perspective on the Peoples Case" 2004 *Canadian Business Law Journal* 381; and Neumueller "A Canadian Solution: Recent Developments in the Law of Directors' Duties in the Context of Financially Distressed Corporations" 2005 *Dalhousie J. Legal Stud* 95-96. See also section 241 of the CBCA 1985.

3 4 3 Employees

In South Africa, section 200A(1) of the Labour Relations Act[544] provides a rebuttable presumption on who an employee is. Employees' interests in a company are basically founded on job security.[545] At common law, directors did not owe any fiduciary obligations to a company's employees.[546] The leading authority on this issue is the English case of *Parke v Daily News Ltd.*[547] In that case, the plaintiff was a shareholder in the defendant company. The board of directors of the company had sold it and had purposed to pay £1 million to its former workers and the widows of such former workers. The plaintiff then brought action before the Chancery Division of the High Court alleging that such payment to former employees did not coincide with the carrying on of business. The court held that "the making of an *ex gratia* payment as the company intended to do, and in the circumstances where that company no longer operated, was not reasonably incidental to the conduct of its business and was therefore *ultra vires* the company's memorandum and articles".[548] One may query whether if that is enough to hold that directors do not therefore owe any fiduciary duties to a company's employees because it is clear that one of the reasons why the court took that view was that the company in question no longer operated. What if the company is still carrying on business? The principle or lesson to be learnt from this case is that directors can only consider employees' interests if they coincide with the interests of the company. Cerioni's stance is that under the common law, employees' interests can be considered if they result in financial benefits to the company as a whole.[549]

Section 172(1) of the UK Companies Act[550] provides that employees' interests be considered when directors act to ensure the success of the company. However, Esser is of the view that the purpose of section 172(1) of the UK Companies Act[551] is "to create an awareness of the other interests that

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544 66 of 1995.
545 Esser "The Enlightened Shareholder Value Approach versus Plurism in the Management of Companies" 2005 *Obiter* 720.
546 Farrar and Hannigan *Farrar's Company Law* 4 ed (1998) 385.
547 1962 927 (Ch).
548 *Parke v Daily News Ltd* 1962 3 WLR. 666.
549 Cerioni "The Success of the Company in Section 172(1) of the UK Companies Act 2006: Towards an 'Enlightened Directors' Primacy'?" 2008 *OLR* 5-6. See also the English case of *Hutton v West Cork Railway Co* 1883 23 654 (ChD).
550 2006.
551 *Ibid*.

need to be considered as opposed to creating a direct duty".[552] Some are of the opinion that since employees' interests are protected by different statutes and contracts, it is not necessary to create direct directors' duties towards them. Therefore, under the common law, directors did not owe any fiduciary obligations to employees and although section 172 of the UK Companies Act[553] requires directors to consider employees' interests it is not certain if that section was intended to create a direct fiduciary duty towards employees.

3 4 4 Community

The community is concerned with the effects of the companies' activities. Several decades ago, Berle noted that company directors' responsibilities to the community had not yet been recognised.[554] Dodd however countered that there had been a change of opinion in respect of corporate obligations to the community.[555] There was and still is a growing feeling that companies should be held accountable for the impact of their activities on the community than to wait for legal compulsion.[556] The previous statement impliedly means that at present directors do not have any legal duty to act in the best interests of the community. There has not been much attempts made in respect of transforming the public opinion that directors ought to have fiduciary duties to the community into law.[557] It has also been contended that if company directors regard the interests of the community, in the end shareholders' wealth will be maximised.[558] It is argued that one of the factors that weighed against prescribing directors' fiduciary obligations to the community has been the fact that courts allow the former a lot of discretion.[559]

Current law does not assign fiduciary duties to directors in respect of community interests. In the English case of *Hutton v West Cork Railway Co*[560] Lord Bowen held that "charity has no business to sit at boards of directors *qua* charity. There is, however, a kind of charitable dealing which is

552 Esser *Recognition of Various Stakeholder Interests in Company Management* (Unpublished LLD-thesis, University of South Africa, 2008) 63.
553 2006.
554 Berle "For Whom Corporate Managers Are Trustees: A Note" 1932 *Harvard Law Review* 1370.
555 Dodd "For Whom Are Corporate Managers Trustees?" 1932 *Harvard Law Review* 1153. See also Nwafor "The Shifting Responsibilities of Company Directors – How Desirable in Modern Times" 2012 *Macquarie J. Bus. L* 159.
556 Dodd "For Whom Are Corporate Managers Trustees?" 1932 *Harvard Law Review* 1153.
557 Dodd "For Whom Are Corporate Managers Trustees?" 1932 *Harvard Law Review* 1156.
558 *Ibid.* See also Nwafor "The Shifting Responsibilities of Company Directors – How Desirable in Modern Times" 2012 *Macquarie J. Bus. L* 159.
559 Dodd "For Whom Are Corporate Managers Trustees?" 1932 *Harvard Law Review* 1157.
560 1883 23 654 (ChD).

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".[561] It was further held that "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".[562] "A firm that enjoys favourable community relationships can be a regular participant in local community planning and problem solving, and can have a chance to present its own side of the story when problems or opportunities arise".[563] Furthermore, if companies neglect their community obligations, they will damage their reputation and eventually might be outclassed by competitors.[564]

Therefore, as has been highlighted above, company directors, besides looking at shareholders as a whole, generally do not consider other stakeholders' interests. However there are circumstances in which such a consideration is relevant, for examples in instances of insolvency and when protecting the reputation of the company. In South Africa, the provision of section 72(4) of the Companies Act[565] strengthen the view that a broad interpretation of section 76 includes other non-shareholder stakeholders. Section 72(4) of the Companies Act provides that the minister, by regulation, may prescribe a category of companies that must each have a social and ethics committee, if it is desirable in the public interest. According to Regulation 43(1)(a), these companies include all the state owned companies and listed public companies.[566] According to regulation 43(5)(a) of the Companies Regulations, the functions of the Social and Ethics Committee include "good corporate citizenship, labour and employment [issues], social and economic development, the environment, health and public safety, including the impact of the company's activities and of its products or services".[567]

3 5 THE CONCEPT OF "THE BEST INTERESTS OF THE COMPANY"

Having looked at the meaning of "the company", attention now shifts to a discussion on the concept of "the best interests of the company". Since stakeholders' interests are central to this

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561 *Hutton v West Cork Railway Co* 1883 23 654 (ChD).
562 *Ibid*.
563 Cerioni "The Success of the Company in Section 172(1) of the UK Companies Act 2006: Towards an 'Enlightened Directors' Primacy'?" 2008 *OLR* 7.
564 *Ibid*.
565 71 of 2008.
566 Companies Regulations 2011 51.
567 Companies Regulations 2011 51-52.

study, the phrase will be defined with regard to them. This may sound like a repetition of the previous section. However, as will be seen, this part is in fact a continuation of the previous. The two complement each other. On one hand the two sections are similar in that they are both founded on the underlying concept of stakeholders' interests. On the other hand, the two sections also contain notable differences. Whilst the previous section focussed on the traditional view of the meaning of "the company" and whether the traditional view has been challenged, this section presents a theoretical approach of what the best interests of a company are. This section will also discuss recent law review processes that have taken place in South Africa, Canada and the UK.

3 5 1 Theoretical approach

Three different approaches will be discussed hereunder: the shareholder, enlightened shareholder value and the pluralist approaches. These three names are only used for easy reference as there are a lot of variances and nuances involved with respect to the stakeholder debate.[568] Esser and Du Plessis note that the stakeholder debate was fuelled by the change in perceptions of "the company".[569] Allaire and Rousseau reiterate that the interests of the company are broad and contextual.[570]

3 5 1 1 The shareholder approach

The shareholder approach is founded on the traditional view that "the company" means shareholders and therefore the company's interests must necessarily translate to shareholders' interests.[571] Under this theory, a shareholder is simply anyone whose main objective is to increase the value of his/her shares or dividends when declared.[572] Shareholder theorists state that "directors should hold company property for the sole benefit of shareholders and that the exclusive obligation

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568 Esser and Du Plessis "The Stakeholder Debate and Directors' Fiduciary Duties" 2007 *SA Merc L.J.* 353. Ajibo "A Critique of Enlightened Shareholder Value: Revisiting the Shareholder Primacy Theory" 2004 *Birkbeck Law Review* 42 says "shareholder versus stakeholder debates can further be analysed from the standpoint of the contractarian versus communitarian debate, the predominant versus progressive position, or the monist versus pluralist debate, amongst others, reflecting the diversity of perspectives".

569 Esser and Du Plessis "The Stakeholder Debate and Directors' Fiduciary Duties" 2007 *SA Merc L.J.* 349-50.

570 Allair and Rousseau "To Govern in the Interest of the Corporation: What is the Board's Responsibility to Stakeholders other than Shareholders?" 2014 2 and 12-15.

571 *Greenhalgh v Ardene Cinemas Ltd* 1951 291 (Ch); Attenborough "How Directors Should Act When Owing Duties to the Companies' Shareholders: Why we need to stop applying Greenhalgh" 2009 *ICCLR* 342; and Nwafor "The Shifting Responsibilities of Company Directors – How Desirable in Modern Times" 2012 *Macquarie J. Bus. L* 160.

572 Sheehy "Scrooge-The Reluctant Stakeholder: Theoretical Problems in the Shareholder-Stakeholder Debate" 2005 *University of Miami Business Law Review* 209.

of directors [is] the maximisation of shareholders' property".[573] According to Sheehy, John Locke's ideologies on private ownership are the foundation upon which the shareholder approach is founded.[574] He justifies private management of property on the right of ownership.[575] Applying Locke's formulation to contemporary company law would lead to the view that shareholders, as owners of a company, should have their interests respected by directors.[576]

The theory is based on a number of assumptions and principles. According to Ho, a company's main objective is the maximisation of shareholder wealth, shareholders are in ultimate control of a firm and are the primary beneficiaries of directors' fiduciary duties.[577] It is upon the first principle of shareholder wealth maximisation that the theory is premised.[578] According to one shareholder theorist, a company "is a free association of individuals for the purposes of wealth generation".[579] Friedman explicitly theorises that "the social responsibility of business is to increase its profits".[580] However, one can argue that this assumption is short sighted and based on a 'blinkered approach' to company law since not every stakeholder is interested in maximising wealth; for example the community.

Several arguments have been advanced to support the shareholder theory. The first argument is that since shareholders own the company, directors are to give their interests primacy in decision

573 Esser and Du Plessis "The Stakeholder Debate and Directors' Fiduciary Duties" 2007 *SA Merc L.J.* 347-348; Macey and Miller "Corporate Stakeholders: A Contractual Perspective" 1993 *University of Toronto Law Journal* 401; Berle "For Whom Corporate Managers Are Trustees: A Note" 1932 *Harvard Law Review* 1365 -1372; and Nwafor "The Shifting Responsibilities of Company Directors – How Desirable in Modern Times" 2012 *Macquarie J. Bus. L* 160.

574 Sheehy "Scrooge-The Reluctant Stakeholder: Theoretical Problems in the Shareholder-Stakeholder Debate" 2005 *University of Miami Business Law Review* 209.

575 *Ibid*.

576 This theory has also received judicial recognition. In *Hutton v West Cork Railway* 1883 23 654 (ChD), it was held that "the law does not say that there are to be no cakes and ale, but that there are to be no cakes and ale except such as are required for the benefit of the company". This can be interpreted to mean that other stakeholders' interests can only receive consideration if and when they benefit the company.

577 Ho '"Enlightened Shareholder Value': Corporate Governance Beyond the Shareholder-Stakeholder Divide" 2010 *Journal of Corporation Law* 72.

578 Ho '"Enlightened Shareholder Value': Corporate Governance Beyond the Shareholder-Stakeholder Divide" 2010 *Journal of Corporation Law* 72 and Friedman "The Social Responsibility of Business is to Increase its Profits" *The New York Times Magazine* September 13 1970 6.

579 Sheehy "Scrooge-The Reluctant Stakeholder: Theoretical Problems in the Shareholder-Stakeholder Debate" 2005 *University of Miami Business Law Review* 213.

580 Friedman "The Social Responsibility of Business is to Increase its Profits" *The New York Times Magazine* September 13 1970 1.

making.[581] It is also contended that by reason of shareholders being residual claimants, they should be the primary beneficiaries of the directors' fiduciary duty to act in the best interests of the company.[582] Proponents of this theory further justify their view by holding that "shareholders have the greatest risk, the greatest incentive to maximise firm value and the least protection".[583] Employees and creditors can protect themselves through contract and other relevant legislative provisions but shareholders do not have such remedial avenues.[584] Reliance on the company's constitution is not enough because it is drafted by management.[585]

However, the above arguments have been heavily criticised. Each argument presented above has had its own counter-argument. First, the argument that shareholders ought to be the primary beneficiaries of directors' fiduciary obligations because they own the company has been challenged on the ground that they cannot "own" the company.[586] In *Salomon v Salomon*[587] it was

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581 Esser "The Enlightened Shareholder Value Approach versus Plurism in the Management of Companies" 2005 *Obiter* 721; Roach "The Paradox of the Traditional Justifications for Exclusive Shareholder Governance Protection: Expanding the Pluralist Approach" 2001 2; Esser and Du Plessis "The Stakeholder Debate and Directors' Fiduciary Duties" 2007 *SA Merc L.J.* 358; Attenborough "How Directors Should Act When Owing Duties to the Companies' Shareholders: Why we need to stop applying Greenhalgh" 2009 *I.C.C.L.R* 340; and Dodd "For Whom Are Corporate Managers Trustees?" 1932 *Harvard Law Review* 1145-1146. This argument is centred on the separation of ownership and control as pointed out by McConvill and Bagaric "Why all Directors should be Shareholders in the Company" *Bond Law Review* 2004 48-50; and Veasay and Guglielmo "How Many Masters Can a Director Serve? A Look at the Tensions Facing Constituency Directors" 2008 *Business Lawyer* 766.

582 Sheehy "Scrooge-The Reluctant Stakeholder: Theoretical Problems in the Shareholder-Stakeholder Debate" 2005 *University of Miami Business Law Review* 215; Macey and Miller "Corporate Stakeholders: A Contractual Perspective" 1993 *University of Toronto Law Journal* 402; Esser and Du Plessis "The Stakeholder Debate and Directors' Fiduciary Duties" 2007 19 *SA Merc LJ* 358 and Rousseau "The Duties of Directors of Financially Distressed Corporations: A Quebec Perspective on the Peoples Case" 2004 *Canadian Business Law Journal* 381.

583 Macey and Miller "Corporate Stakeholders: A Contractual Perspective" 1993 *University of Toronto Law Journal* 402; Sheehy "Scrooge-The Reluctant Stakeholder: Theoretical Problems in the Shareholder-Stakeholder Debate" 2005 *University of Miami Business Law Review* 215. The same scholar at page 216 notes that this argument is based on a distinction between debt and equity. On page 217, the scholar however submits that "the traditional distinction between debt and equity fails to accord with economic reality and looks artificial, arbitrary and increasingly passe". See also Roach "The Paradox of the Traditional Justifications for Exclusive Shareholder Governance Protection: Expanding the Pluralist Approach" 2001 3-5; and Attenborough "How Directors Should Act When Owing Duties to the Companies' Shareholders: Why we need to stop applying Greenhalgh" 2009 *ICCLR* 340.

584 Esser "The Enlightened Shareholder Value Approach versus Plurism in the Management of Companies" 2005 *Obiter* 721; Roach "The Paradox of the Traditional Justifications for Exclusive Shareholder Governance Protection: Expanding the Pluralist Approach" 2001 5-8; Macey and Miller "Corporate Stakeholders: A Contractual Perspective" 1993 *University of Toronto Law Journal* 402-403; and Esser and Du Plessis "The Stakeholder Debate and Directors' Fiduciary Duties" 2007 *SA Merc L.J.* 358.

585 Esser "The Enlightened Shareholder Value Approach versus Plurism in the Management of Companies" 2005 *Obiter* 721 and Esser and Du Plessis "The Stakeholder Debate and Directors' Fiduciary Duties" 2007 *SA Merc L.J.* 358.

586 See this chapter part 3 4 above.

587 1897 AC 22 (HL).

held that a company is a legal entity which is separate from its members.[588] It is therefore flawed to hold that shareholders "own" the company since it is impossible to own another legal person.[589] Even if one was to justify the ownership argument by limiting it to a company's assets, the argument can still be countered with the view that the word "assets" ought not to be restrictively defined but must include other stakeholders like employees who can be called labour capital.[590] Second, Sheehy contends that "the only time that shareholders are real residual claimants is when a company is being wound-up or insolvent".[591] According to that scholar, shareholders are not justified to claim primacy of interests. However, it may not be practical for a company to declare dividends at the expense of paying debts that have become due. Therefore it is not accurate to say that shareholders are only residual claimants during insolvency and winding up of the company.

It is also submitted that it is not fully justified that directors discharge their fiduciary obligations to favour shareholders because the latter bear the greatest risk. First, other stakeholders such as employees also bear considerable risk.[592] Second, the position of other corporate financiers is similar to that of shareholders.[593] In the opinion of Roach, the environment bears more risk than shareholders.[594] Furthermore, the fact that shareholders cannot protect themselves through contract is not enough to justify their primary consideration by directors because the environment also

588 *Salomon v Salomon* 1897 AC 22 (HL).
589 Esser "The Enlightened Shareholder Value Approach versus Plurism in the Management of Companies" 2005 *Obiter* 721 and Macey and Miller "Corporate Stakeholders: A Contractual Perspective" 1993 *University of Toronto Law Journal* 402-403.
590 Roach "The Paradox of the Traditional Justifications for Exclusive Shareholder Governance Protection: Expanding the Pluralist Approach" 2001 10 further opines that "economics has identified four crucial assets known as the 'factors of production' and consist of land, labour, capital and rent. If a party to the company can claim to contribute one of these assets, then it may have a right to expect the company to be run with its interests in mind. For example, shareholders and creditors contribute capital and employees contribute labour".
591 Sheehy "Scrooge-The Reluctant Stakeholder: Theoretical Problems in the Shareholder-Stakeholder Debate" 2005 *University of Miami Business Law Review* 216.
592 Sheehy "Scrooge-The Reluctant Stakeholder: Theoretical Problems in the Shareholder-Stakeholder Debate" 2005 *University of Miami Business Law Review* 206. The scholar also insists that compared to employees who risk unemployment and cannot withdraw their investment as they wish, shareholders do not have greater risk than employees. Furthermore, shareholders can divest their investment and exit. They can also protect themselves through portfolio diversification.
593 Sheehy "Scrooge-The Reluctant Stakeholder: Theoretical Problems in the Shareholder-Stakeholder Debate" 2005 *University of Miami Business Law Review* 216.
594 Roach "The Paradox of the Traditional Justifications for Exclusive Shareholder Governance Protection: Expanding the Pluralist Approach" 2001 11. The same author goes on to say that "many companies create waste or by-products that harm the environment. In the case of pollution it is only the environment that is able to bear the damage, and consequently the risk. Corporations will try, in the absence of legal restraints, to pass on their costs to third parties".

cannot protect itself contractually.[595] Moreover, some scholars also reject the shareholder theory and posit that "the existence of the corporation is a by-product of team production involving the input of various interests not limited to shareholders simpliciter".[596]

3 5 1 2 The enlightened shareholder value approach

The enlightened shareholder value (ESV) approach is a result of company law reforms that have taken place in most of the common law jurisdictions around the world. The said transformations are the bridge between the shareholder and the ESV theories. The first part of this section is devoted to a presentation of company law reforms that have taken place in the UK, South Africa and Canada respectively. The UK's company law reforms will be discussed with reference to outcomes of inquiry commissions as represented in the Cadbury, Rutteman, Greenbury, Hampel and Turnbull Reports, the White Paper, the Companies Bill and ultimately section 172 of the Companies Act.[597] The South African discussion will be based on recommendations of the King Committee Reports and Codes, the impact of the Constitution,[598] and other relevant pieces of legislation, recommendations of the Department of Trade and Industry and finally the current Companies Act.[599] In Canada, the discussion will be centred on two outstanding judgements from its Supreme Court and certain provisions of the CBCA.[600]

This study does not disregard the effect of other committees' reports in the UK like the Higgs Report. The ones that have been selected are those which the author believes have more bearing on the subject matter under discussion. The Cadbury Report is named after Sir Adrian Cadbury who chaired the committee that carried out a review of the financial aspects of corporate governance. Paragraph 2.5 of that report indicates that directors owe shareholders duties. The Rutteman Report followed in 1994. In 1995, the report of a study group on directors' remuneration which was chaired by Sir Richard Greenbury was released. Then, in 1998 the Hampel Report was

595 Roach "The Paradox of the Traditional Justifications for Exclusive Shareholder Governance Protection: Expanding the Pluralist Approach" 2001 11 who also argues that the position of the environment is complicated because "the environment is not an aggregate of persons".

596 Ajibo "A Critique of Enlightened Shareholder Value: Revisiting the Shareholder Primacy Theory" 2004 *Birkbeck Law Review* 42.

597 2006.

598 Constitution of the Republic of South Africa, 1996.

599 71 of 2008.

600 1985. The two cases are *Peoples Department Stores Inc. v* Wise 2004 68 (SCC) and *BCE Inc v 1976 Debenture holders* 2008 69 (SCC).

released. This report reviewed "the operation of the Cadbury Committee's Code of Best Practice and pursue[d] any matters that arose from the Greenbury Committee's Report".[601] This was followed by the Turnbull Report in 1999. All these law reviews were responses to UK corporate scandals that were discussed above in chapter 1.

After these reports, the Department of Trade and Industry set up the Corporate Law Review Committee which was tasked to modernise the UK's company law. The House of Commons acknowledged that case law on company directors' duties had become confusing.[602] The Company Law Review Steering Group (CLRSG) proposed two ways of approaching directors' duties: the ESV and the pluralist approach.[603] According to the CLRSG, the ESV retains shareholder primacy but takes into consideration other stakeholders' interests.[604] On the other hand, the pluralist approach was rejected because it would force directors to consider other stakeholders' interests.[605] The CLRSG also proposed a statement of provision for directors' duties to creditors but this was later rejected in the White Paper.[606] The first White Paper was issued in July 2002 and the other one which resulted in the Companies Law Reform Bill was issued in March 2005. It is submitted

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601 Hampel Report 2.

602 *White Paper on Modernising Company Law Sixth Report of Session 2002–03* 2003 House of Commons Trade and Industry Committee London 7.

603 *White Paper on Modernising Company Law Sixth Report of Session 2002–03* 2003 House of Commons Trade and Industry Committee London 7; Goddard "'Modernising Company Law': The Government's White Paper" 2003 *Modern Law Review* 405; Ajibo "A Critique of Enlightened Shareholder Value: Revisiting the Shareholder Primacy Theory" 2004 *Birkbeck Law Review* 44-47; and Esser and Du Plessis "The Stakeholder Debate and Directors' Fiduciary Duties" 2007 *SA Merc L.J.* 351.

604 *White Paper on Modernising Company Law Sixth Report of Session 2002–03* 2003 House of Commons Trade and Industry Committee London 7; Goddard "'Modernising Company Law': The Government's White Paper" 2003 *Modern Law Review* 405; Ajibo "A Critique of Enlightened Shareholder Value: Revisiting the Shareholder Primacy Theory" 2004 *Birkbeck Law Review* 44-47; and Esser and Du Plessis "The Stakeholder Debate and Directors' Fiduciary Duties" 2007 *SA Merc L.J.* 351.

605 *White Paper on Modernising Company Law Sixth Report of Session 2002–03* 2003 House of Commons Trade and Industry Committee London 7; Goddard "'Modernising Company Law': The Government's White Paper" 2003 *Modern Law Review* 405; and Ajibo "A Critique of Enlightened Shareholder Value: Revisiting the Shareholder Primacy Theory" 2004 *Birkbeck Law Review* 44-47.

606 White paper, *White Paper on Modernising Company Law Sixth Report of Session 2002–03* 2003 House of Commons Trade and Industry Committee London 10; Goddard "'Modernising Company Law': The Government's White Paper" 2003 *Modern Law Review* 405; Ajibo "A Critique of Enlightened Shareholder Value: Revisiting the Shareholder Primacy Theory" 2004 *Birkbeck Law Review* 44-47; and Esser and Du Plessis "The Stakeholder Debate and Directors' Fiduciary Duties" 2007 *SA Merc L.J.* 351-352.

that the ESV approach was followed in the Companies Law Reform Bill.[607] Currently, in the UK, directors' duties are contained in section 172 of the Companies Act.[608]

It is further submitted that in the UK Companies Act[609] the phrase "success of the company" replaces the common law's "interests of the company".[610] The Companies Act[611] does not however define what "success of the company" means.[612] So either the intention of the legislature was to leave it to the directors to decide on their own what "the success of the company" means or they left it for the court. However, taking into account the fact that directors are to exercise unfettered discretion, the former view may be more consistent with the legislature's intention. A look at the Explanatory Notes to the UK Companies Act[613] may however lead to a different conclusion. The Explanatory Notes provide that "it has been suggested that the duty to promote the success of the company may also be modified by an obligation to have regard to the interests of creditors as the company nears insolvency. Subsection (3) [of section 172 of the UK Companies Act of 2006] will leave the law to develop in this area".[614] One may claim that the last part of the previous statement may be interpreted to refer to judicial development of the law by reference to the common law.[615]

607 Guidance on the Key Clauses in the Companies Law Reform Bill.

608 2006. This section provides that "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". See also Cerioni "The Success of the Company in Section 172(1) of the UK Companies Act 2006: Towards an 'Enlightened Directors' Primacy'?" 2008 *OLR* 1 and the Explanatory Notes 50 also confirm that the ESV approach was adopted in the Companies Act 71 of 2008.

609 2006.

610 Ajibo "A Critique of Enlightened Shareholder Value: Revisiting the Shareholder Primacy Theory" 2004 *Birkbeck Law Review* 44. The same scholar also contends that traditionally, in the UK, directors had a duty to act bona fide in the interests of the company.

611 2006. However, the Guidance on the Key Clauses in the Companies Law Reform Bill may give some hint.

612 Ajibo "A Critique of Enlightened Shareholder Value: Revisiting the Shareholder Primacy Theory" 2004 *Birkbeck Law Review* 37-38 says "section 172 is a graduation from the shareholder theory to the enlightened shareholder value". See also Cerioni "The Success of the Company in Section 172(1) of the UK Companies Act 2006: Towards an 'Enlightened Directors' Primacy'?" 2008 *OLR* 2-3

613 2006.

614 Explanatory Notes 50.

615 This interpretation is further strengthened by section 170(4) which states that "the general duties shall be interpreted and applied in the same way as common law rules or equitable principles, and regard shall be had to the corresponding common law rules and equitable principles in interpreting and applying the general duties".

In South Africa, recommendations of the King Committee Reports on corporate governance and the Codes thereof, though lacking legal force, have greatly influenced law reform.[616] The King Committee Reports and Codes were named after the chair of the committee, Mervyn King. The first report, known as the King I Report was issued in 1994, the second one which is popularly known as the King II Report was issued in 2002 and the latest, King III Report was issued in 2009. The UK's Adrian Cadbury under whose auspices the Cadbury Report was compiled, had an input into the King III Report.[617] "The third report on corporate governance in South Africa became necessary because of the new Companies Act 71 of 2008 and changes in international governance trends".[618] One of the key themes of the King III report, which is also core to this study is the sustainability of companies.[619] Furthermore, the King III Report recommended the inclusive stakeholder approach and integrated reporting.[620]

Besides the King Reports, the South African law review process has also been influenced by the changing business environment,[621] certain legislation[622] and the Constitution.[623] In 2004, the

616 King III para 2 provides that the King Report and Code are recognised internationally. See also para 3.

617 King III para 2.

618 King III para 1.

619 The report further states that "strategy, risk, performance and sustainability have become inseparable; hence the phrase 'integrated reporting' which is used throughout this Report. Sustainability is more than just reporting on sustainability. It is vital that companies focus on integrated performance. Sustainability also means that management pay schemes must not create incentives to maximise relatively short-term results at the expense of longer-term performance".

620 Para 15.2 of chapter 1 further provides that "inclusivity of stakeholders is essential to achieving sustainability and the legitimate interests and expectations of stakeholders must be taken into account in decision-making and strategy". Integrated reporting is also called triple bottom line reporting which does not only focus on the financial aspects of a company by goes further to require companies to look at social and environmental concerns. Principle 2.1 requires companies to be good corporate citizens; para 21 of chapter 1 encompasses the Ubuntu philosophy, principle 2.14 affirms that directors should act in the best interests of the company; para 17.2 under principle 2.14 provides that directors have "a fiduciary duty to act in good faith and in a manner that the director reasonably believes to be in the best interests of the company".

621 Policy Document 14 says "The domestic and global environment for enterprises has changed markedly since the 1970s. Corporate structures and financial instruments have undergone significant developments. Many old concepts have been abandoned or modified and new concepts have been developed. [Furthermore], a number of corporate failures in South Africa and other jurisdictions have revealed serious defects in the prevailing standard of corporate governance and the administration of the law and have resulted in investors suffering extensive losses. Socio-political and economic change in South Africa has underscored the need for social responsiveness, transparency and accountability of enterprises".

622 Legislation such as the Broad-Based Black Economic Empowerment Act 53 of 2003 (BBBEE) and the Promotion of Access to Information Act 2 of 2000 (PAIA) have also contributed to the South African law reform process.

623 Constitution of the Republic of South Africa, 1996, for example section 2. Esser "The Enlightened Shareholder Value Approach versus Plurism in the Management of Companies" 2005 *Obiter* 722-723; Havenga "The Company, the Constitution, and the Stakeholders" 1997 *Juta's Bus. L* 134-135 and the Policy Document 15 reiterate the supremacy of the Constitution.

Corporate Regulation Division of the Department of Trade and Industry issued the Policy Document which provided guidelines on corporate law review.[624] The review process was comprehensive in that besides taking into consideration the Companies Act,[625] it also included the Close Corporations Act 69 of 1984 and the common law relating to these entities.[626] However, partnerships were not included in the review process.[627] After considering both the ESV and pluralist approaches,[628] it is argued that the Policy Document favoured the ESV.[629] The Companies Draft Bill was then issued for public comment in February 2007.[630] When sections 5 and 76 of the current South African Companies Act[631] are read together, one can also agree with other scholars that the Policy Document position was carried through into the piece of legislation.[632]

In Canadian company law, the recent developments can be attributed to the judiciary's interpretation and application of the CBCA.[633] The first instructive case is *Peoples Department Stores Inc v Wise.*[634] In that case, the defendant company was founded as a small clothing shop in 1930. It significantly expanded through internal growth and acquisitions. It was listed on the Montreal Stock Exchange in 1986. By 1992 it was generating sales of over $100 million per year. By that same year, the plaintiff had been in business for about seventy-eight years. Although it was generating sales of $160 million annually, the plaintiff was struggling financially. Both parties were into the retail business and competed with other retailers such as Canadian Tire, Greenberg,

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624 Esser "The Enlightened Shareholder Value Approach versus Plurism in the Management of Companies" 2005 *Obiter* 723 and Esser and Du Plessis "The Stakeholder Debate and Directors' Fiduciary Duties" 2007 *SA Merc L.J.* 356

625 No 61 of 1973.

626 Policy Document 10 and Esser "The Enlightened Shareholder Value Approach versus Plurism in the Management of Companies" 2005 *Obiter* 723.

627 Policy Document 10.

628 Policy Document 24.

629 Policy Document 23 says "a company's existence and success are seen as inextricably intertwined with the consideration of the interests of its employees and others potentially qualifying as 'stakeholders' in the business, such as suppliers, customers, lenders and perhaps the society at large". See also Esser "The Enlightened Shareholder Value Approach versus Plurism in the Management of Companies" 2005 *Obiter* 722-723 and Havenga "Regulating Directors' Duties and South African Company Law Reform" 2005 *Obiter* 618 who attest that "the 'triple bottom line' approach, acknowledging social, economic and environmental considerations is recommended by the DTI".

630 Esser and Du Plessis "The Stakeholder Debate and Directors' Fiduciary Duties" 2007 *SA Merc L.J.* 356 and Muswaka "Shielding Directors against Liability Imputations: The Business Judgment Rule and Good Corporate Governance" 2013 *Speculum Juris* 3.

631 71 of 2008.

632 Esser "The Enlightened Shareholder Value Approach versus Plurism in the Management of Companies" 2005 *Obiter* 722-723.

633 1985.

634 2004 68 (SCC).

Hart, K-Mart, M-Stores, Metropolitan Stores, Rossy, Woolco and Zellers. The entry of Wal-Mart into the Canadian market in 1994 significantly increased the stiff competition that was already prevailing. The defendant company then acquired the plaintiff company to the effect that People's Department Stores became Wise's wholly owned subsidiary. Lionel, Ralph and Harold Wise (the Wise brothers) were majority shareholders and directors of Wise and the only directors of Peoples. However, before the end of 1994 both companies were declared bankrupt.

Peoples' trustee then filed a petition against the defendant. The trustee alleged that the Wise brothers had favoured the interests of Wise over Peoples and in so doing undermined Peoples' creditors, thereby breaching their duties as directors under section 122(1) of the CBCA.[635] The question before the court was whether company directors owe a fiduciary duty to the company's creditors *vis-a-vis* the statutory duty which is owed to the corporation.[636] The duty contained in section 122(1)(a) of the CBCA is also known as the duty of loyalty or the fiduciary duty.[637] The court held that directors do owe duties to creditors but such obligations do not amount to fiduciary duties.[638] The court noted that the appeal was only concerned with directors' statutory duties.[639] The court went further and held that the phrase "the best interests of the company" does not mean "the best interests of shareholders".[640] It was also held that courts may take other factors into consideration when determining the best interests of the company.[641]

The Canadian Supreme Court took a similar view in *BCE Inc. v 1976 Debenture holders.*[642] This case will be further discussed in detail in chapter 5. In that case it was held that "the duty requires directors to act in the best interests of the company. Often the interests of shareholders and other

[635] 1985. The relevant section provides that "every director and officer of a corporation in exercising their powers and discharging their duties shall (a) act honestly and in good faith with a view to the best interests of the corporation".
[636] *Peoples Department Stores Inc. v Wise* 2004 68 (SCC) 1.
[637] *Peoples Department Stores Inc. v Wise* 2004 68 (SCC) para 32.
[638] *Peoples Department Stores Inc. v Wise* 2004 68 (SCC).
[639] 481 para 42.
[640] *Ibid*.
[641] 481-482 para 42. Reference was made to *Teck Corp. v Millar* 1972 33 DLR (3d) 288 BCSC 314 in which Berger J held that "a classical theory that once was unchallengeable must yield to the facts of modern life. If today the directors of a company were to consider the interests of its employees no one would argue that in doing so they were not acting bona fide in the interests of the company itself. Similarly, if the directors were to consider the consequences to the community of any policy that the company intended to pursue, and were deflected in their commitment to that policy as a result, it could not be said that they had not considered bona fide the interests of the shareholders".
[642] 2008 69 (SCC).

stakeholders coincide with the interests of the corporation. But if they conflict, the duty is clear, it is to the corporation.[643] With respect to this case, Flannigan's view is that the Supreme Court of Canada broadened the scope of the directors' fiduciary duty to act in the best interests of the company.[644]

The above discussion has shown that company law reforms in the UK, South Africa and Canada have favoured the ESV approach. The next section now focusses on that approach in detail.

Esser says that in the ESV approach "the primary role of the directors should be to promote the success of the company for the benefit of the shareholders".[645] This definition seems to retain the shareholder approach on the one hand and includes the UK's "success of the company" principle. According to Nwafor, the ESV approach entails balancing short term and long term interests of all the stakeholders which however remain subordinate to shareholders' interests.[646] Havenga posits that the ESV approach "reflects traditional company law in giving primacy, but not exclusivity, to shareholders' interests".[647] One can quickly deduce from Havenga's argument that both the shareholder and the ESV approaches give primacy to shareholder but the major difference is that the latter does not do so exclusively. In South Africa, the purpose of the ESV approach is to balance shareholders' and other stakeholders' interests taking into consideration the objects of the Constitution,[648] other legislative provisions and most importantly when it is appropriate.[649] Havenga does not however clearly explain when it is appropriate to balance the stakeholders' interests. Furthermore, considering the Department of Trade and Industry's warning against a multiplicity of unnecessary obligations toward numerous stakeholders, Havenga observes that "it seems unlikely that this duty will be interpreted as a general obligation to consider other stakeholder interests".[650]

643 584 para 37.
644 Flannigan "Fiduciary Accountability Transformed" 2009 *Advocates' Quarterly* 335.
645 Esser "The Enlightened Shareholder Value Approach versus Plurism in the Management of Companies" 2005 *Obiter* 720.
646 Nwafor "The Shifting Responsibilities of Company Directors – How Desirable in Modern Times" 2012 *Macquarie J. Bus. L* 168.
647 Havenga "Regulating Directors' Duties and South African Company Law Reform" 2005 *Obiter* 618.
648 Constitution of the Republic of South Africa, 1996.
649 Havenga "Regulating Directors' Duties and South African Company Law Reform" 2005 *Obiter* 618.
650 *Ibid*.

In the UK, Ajibo notes that section 172(1) of the Companies Act,[651] which encapsulates the enlightened shareholder approach, is a graduation from the shareholder approach.[652] In promoting the success of the company, which is the UK equivalent of acting in the best interests of the company, directors are now expected to consider other stakeholders' interests and also to have regard to principles of social responsibility.[653] It is submitted that factors highlighted in section 172(1) of the Companies Act[654] are those which must be considered in line with running a company according to current best practice.[655] Ajibo contends that if section 172 was intended to create direct duties to the various stakeholders, then it might result in confusion.[656] Esser holds the view that there is no general duty on directors to regard other stakeholders' interests but that they can do so when circumstances so require.[657] This has been interpreted to mean that other stakeholders' interests remain subordinate to those of shareholders.'[658]

Ho differentiates between investor-driven and market driven ESV.[659] The ESV approach has also been described as weak in that it creates a situation whereby directors are only accountable to shareholders but responsible to other stakeholders. The differentiation between directors' "accountability" and "responsibility" stems from the King III report.[660]

651 2006.

652 Ajibo "A Critique of Enlightened Shareholder Value: Revisiting the Shareholder Primacy Theory" 2004 *Birkbeck Law Review* 37-38 and 49. However, the same author on page 39 feels that there are other scholars who are still content to submit that the said section retains the traditional view which gives primacy to shareholders.

653 Ajibo "A Critique of Enlightened Shareholder Value: Revisiting the Shareholder Primacy Theory" 2004 *Birkbeck Law Review* 37-38.

654 2006.

655 Cerioni "The Success of the Company in Section 172(1) of the UK Companies Act 2006: Towards an 'Enlightened Directors' Primacy'?" 2008 *OLR* 4.

656 Ajibo "A Critique of Enlightened Shareholder Value: Revisiting the Shareholder Primacy Theory" 2004 *Birkbeck Law Review* 51.

657 Esser "The Enlightened Shareholder Value Approach versus Plurism in the Management of Companies" 2005 *Obiter* 723.

658 Esser "The Enlightened Shareholder Value Approach versus Plurism in the Management of Companies" 2005 *Obiter* 724 and Esser and Du Plessis "The Stakeholder Debate and Directors' Fiduciary Duties" 2007 *SA Merc L.J.* 353.

659 Ho "'Enlightened Shareholder Value:' Corporate Governance Beyond the Shareholder-Stakeholder Divide" 2010 *Journal of Corporation Law* 79-80.

660 See para 5.1

3 5 1 3 The pluralist approach

According to the stakeholder theory, shareholders are just but one group among the many constituencies whose interests need to be considered in decision making.[661] Havenga notes that "the pluralist theory dictates that companies should be run in such a way that wealth and welfare are maximised for a number of different constituencies, each with a legitimate stake in the company's development and activities".[662] The stakeholder approach was rejected during the law reviews discussed above both in South Africa and the UK.[663] The pluralist approach is also known as the stakeholder theory. There are two perspectives to the origins of the stakeholder theory. On one hand, as a legal concern, the stakeholder theory can be traced to Professor Dodd during the days of the Great Depression.[664] On the other hand, as a management concern, it can be traced back to 1963 when it was applied by the Stanford Research Institute.[665]

According to this theory, directors are not allowed to favour shareholder interests when exercising their discretion on what they regard to be the best interests of the company.[666] Directors are therefore not supposed to solely focus on profit-making but they must balance shareholders' interests with those of other stakeholders' and take into account social and environmental factors.[667] The stakeholder theory is based on the following assumptions: that the company has a lot of effect upon the society, that those who are affected by a company's activities should be considered in decision making or at least have some degree of influence, that everyone must be able to own the consequences of their actions and that there must be a balance of costs and benefits in a society.[668]

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661 Nwafor "The Shifting Responsibilities of Company Directors – How Desirable in Modern Times" 2012 *Macquarie J. Bus. L* 174 and Esser "The Enlightened Shareholder Value Approach versus Plurism in the Management of Companies" 2005 *Obiter* 720-721.

662 Havenga "Regulating Directors' Duties and South African Company Law Reform" 2005 *Obiter* 618.

663 See chapter 3 (part 3 5) above.

664 Sheehy "Scrooge-The Reluctant Stakeholder: Theoretical Problems in the Shareholder-Stakeholder Debate" 2005 *University of Miami Business Law Review* 200.

665 *Ibid*.

666 Ramnath and 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 *Speculum Juris* 106-107.

667 Ramnath and 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 *Speculum Juris* 106-107.

668 Sheehy "Scrooge-The Reluctant Stakeholder: Theoretical Problems in the Shareholder-Stakeholder Debate" 2005 *University of Miami Business Law Review* 200-201.

Sheehy notes that stakeholder theorists provide four points in support of this approach.[669] These are: that a company is an independent entity and an agreement from the government, that a company should be controlled by those who bear the consequences of the actions of a company, that the most effective way of controlling a firm is by allowing those who are affected by its actions to have some degree of control or influence over it and that a company has to be managed in a way that benefits everyone whom its decisions and actions affect.[670] This theory seems to favour the "team production" approach according to which "the fact that the law makes possible the creation of a separate legal entity controlled by a board of directors—is best understood as a mechanism for fostering trust among the participants in the business enterprise, including employees, managers, and shareholders".[671] Team work will further boost cooperation among the various stakeholders.[672]

However, just like the shareholder and the enlightened shareholder theories, the stakeholder theory is no exception to criticism. First, it is argued that the stakeholder approach is not in line with corporate governance principles.[673] Some scholars point out that one of the most important facets that corporate governance hinges upon is the accountability of directors to shareholders.[674] Furthermore, it can be contended that the "accountability" argument is based on an untested assumption that balancing of stakeholders' interests necessarily means equality of interests.[675] The stakeholder theory has also been criticised in that it overlooks the practical side of directors'

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669 *Ibid*.

670 Sheehy "Scrooge-The Reluctant Stakeholder: Theoretical Problems in the Shareholder-Stakeholder Debate" 2005 *University of Miami Business Law Review* 201.

671 Blair "Post-Enron Reflections on Comparative Corporate Governance" 2002 *Working Paper Series in Business, Economics, and Regulatory Law Working Paper No 316663 5*. The sane author defines team production as "productive activity that requires the combined investment and coordinated effort of two or more individuals or groups, where the required investments are complex and difficult to specify in advance and for which the product is not simply the sum of separable outputs produced by each individual or group".

672 Blair "Post-Enron Reflections on Comparative Corporate Governance" 2002 *Working Paper Series in Business, Economics, and Regulatory Law Working Paper No 316663* 5 further notes, while citing the example of Enron, that competition instead of corporation among the workers led to some of them cheating and committing fraud so that they attract more incentives. Furthermore, the scholar impliedly drew a nexus between too much emphasis on financial incentives and the collapse of Enron.

673 Sheehy "Scrooge-The Reluctant Stakeholder: Theoretical Problems in the Shareholder-Stakeholder Debate" 2005 *University of Miami Business Law Review* 202.

674 Sternberg as quoted by Sheehy "Scrooge-The Reluctant Stakeholder: Theoretical Problems in the Shareholder-Stakeholder Debate" 2005 *University of Miami Business Law Review* 203.

675 Sheehy "Scrooge-The Reluctant Stakeholder: Theoretical Problems in the Shareholder-Stakeholder Debate" 2005 *University of Miami Business Law Review* 207.

duties.[676] Sheehy notes that it is very difficult to identify all the stakeholders of a company and then go ahead to delineate each of those stakeholders' interests as obligations upon directors.[677] Much emphasis on stakeholders' interests may have a deterring effect on prospective investors who may be afraid that much of their investments may be arbitrarily channelled towards "social responsibility" programmes.[678] Furthermore, the theory has been criticised that "it undermines private property rights by denying owners of private property the right to deal with it as they choose".[679] However, it is clear that this argument is based on the "ownership argument" discussed above where the view that shareholders are the owners of a company was refuted. The multiplicity of a company's interests invites one to look closely at the issue of corporate sustainability. Some stakeholders have long term interests while others have short term interests. The relevant question is how should company directors balance sustainability issues with the interests of shareholder and non-shareholder constituencies during their decision making process?

3 5 2 Corporate sustainability

This section will address the relationship or tension, if any, between the directors' fiduciary duty to act in the best interests of the company and principles of corporate sustainability. In this study, the concept of sustainability will also be coined as corporate social responsibility (also known as CSR) or corporate citizenship. The term corporate sustainability comes from principles of sustainable development.[680] The idea of CSR was introduced in 1987.[681] Sustainability refers to "the ability of a system of any kind to endure and be healthy over the long term".[682] This definition contains some important aspects which require attention. First, it refers to a "system". This word implies that the principle of sustainability comprises of different components and processes which

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676 Sheehy "Scrooge-The Reluctant Stakeholder: Theoretical Problems in the Shareholder-Stakeholder Debate" 2005 *University of Miami Business Law Review* 202.

677 *Ibid*.

678 Esser "The Enlightened Shareholder Value Approach versus Plurism in the Management of Companies" 2005 *Obiter* 724.

679 Sheehy "Scrooge-The Reluctant Stakeholder: Theoretical Problems in the Shareholder-Stakeholder Debate" 2005 *University of Miami Business Law Review* 202.

680 Jebe "Sustainability Reporting and New Governance: South Africa Marks the Path to Improved Corporate Disclosure" 2014 *Cardozo J of Int'l & Comp Law* 270.

681 McConvil and Joy "The Interaction of Directors' Duties and Sustainable Development in Australia: Setting off on the Uncharted Road" 2003 *Melbourne University Law Review* 118.

682 Measuring Up: A Study on Corporate Sustainability Reporting in Canada by the Certified General Accountants Association of Canada 17. Also, it has to be noted that most companies define sustainability in their own terms. See Spector "The Sustainability Imperative and Governance: Understanding a New Frontier in Corporate Board Oversight" 2012 *Notre Dame Journal of Law Ethics & Public Policy* 40-41.

are mutually connected in a way that a fault in one section or area affects the other components.[683] In the context of this study, it will be argued that all corporate stakeholders are relevant. If some of the stakeholders are unhappy with a company's decision and/or projects, the whole "system" will be affected. Second, sustainability is long-term concerned. But are there any stakeholders that are short-term orientated? If so, will this not clash with principles of sustainability? CSR relates to sustainable development at corporate level.[684]

Sjafjell and Sorensen define CSR as "a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis".[685] This definition as recent as it may seem, sounds outdated. The discussion nowadays has shifted from the voluntary basis referred to in the above explanation to the question whether companies have an actual legal obligation to the environment in which they operate. On the other hand, Joy and McConvil posit that CSR refers to companies' "obligation to incorporate social and environmental values into their operations".[686] Initially, CSR initiatives were aimed at how companies would incorporate reporting environmental and social concerns into their financial statements which only reflected the economic side of companies.[687] But the lack of a universally applicable definition of CSR has led to some scholars admitting that the concept is problematic.[688]

Recent developments show that corporate sustainability has become a mainstream topical issue.[689] Sarre points out that there has been a paradigm shift with respect to issues surrounding the concept of CSR.[690] As has been alluded to above, companies do not operate in a vacuum. A company's

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683 The South African Concise Oxford Dictionary 2002 1189 defines a system as "a complex whole; a set of things working together as a mechanism or interconnecting network".

684 Measuring Up: A Study on Corporate Sustainability Reporting in Canada by the Certified General Accountants Association of Canada 20.

685 Sjafjell and Sorensen "Directors' Duties and Corporate Social Responsibility" 2013 *LSN Research Paper Series* 16.

686 McConvil and Joy "The Interaction of Directors' Duties and Sustainable Development in Australia: Setting off on the Uncharted Road" 2003 *Melbourne University Law Review* 116.

687 Measuring Up: A Study on Corporate Sustainability Reporting in Canada by the Certified General Accountants Association of Canada 22 shows that reporting is referred to by various expressions such as triple bottom line, corporate responsibility reporting, extra-financial reporting or environmental or social reporting.

688 Sjafjell and Sorensen "Directors' Duties and Corporate Social Responsibility" 2013 *LSN Research Paper Series* 4; Horrigan "Fault Lines in the Intersection between Corporate Governance and Social Responsibility" 2002 *UNSW Law Journal* 522.

689 Sarre "Responding to Corporate Collapses: Is there a Role for Social Responsibility?" 2002 *Deakin Law Review* 5; Spector "The Sustainability Imperative and Governance: Understanding a New Frontier in Corporate Board Oversight" 2012 *Notre Dame Journal of Law Ethics & Public Policy* 41.

690 Sarre "Responding to Corporate Collapses: Is there a Role for Social Responsibility?" 2002 *Deakin Law Review* 6 footnotes 29 and 30.

activities and operations affect all its stakeholders. Of special mention in this part, but not to the exclusion of others will be the community and environment in which a company is located.

3 5 2 1 Sustainability and the best interests of a company

It has to be reiterated that there are two competing interests in this part. First, should companies continue to focus on profit maximisation only, as they have traditionally done? Or should they take into consideration a moral duty to the community in which case some of their profits will be sacrificed? Profit maximisation alone is not enough as it has been identified as one of the major causes of some of the corporate debacles mentioned in chapter 1 above. Horrigan notes that there is a tension between directors' duties, profit maximization and shareholders' returns on the one hand and CSR and triple bottom line on the other.[691] The same scholar raises a very relevant issue when he questions "do the best interests of corporations simply equate to profit maximisation?"[692]

On the one side is the directors' obligation to act in the best interests of a company. It was determined above that this duty has been elevated from a mere common law doctrine to a statutory provision since receiving the legislature's recognition. This duty requires the directors to maximise shareholders' profits. On the other hand, is the obligation placed upon companies to consider the environments in which they operate? It can be argued that there is at least an apparent conflict of interests between profitability and corporate citizenship.[693] This makes the directors' decisions of utmost importance.[694] Sustainability issues have an impact on the duties of the board.[695] There is no question that company activities can be detrimental to the environment. Horrigan submits that the collapse of some large companies like Enron and HIH Insurance was due to the strong link between corporate governance and sustainability issues.[696] In the opinion of advocates of CSR, the concept makes companies more sustainable and less likely to suffer financial collapse.[697] Financial

691 Horrigan "Fault Lines in the Intersection between Corporate Governance and Social Responsibility" 2002 *UNSW Law Journal* 519.
692 *Ibid* 520.
693 Horrigan "Fault Lines in the Intersection between Corporate Governance and Social Responsibility" 2002 *UNSW Law Journal* 529; Spector "The Sustainability Imperative and Governance: Understanding a New Frontier in Corporate Board Oversight" 2012 *Notre Dame Journal of Law Ethics & Public Policy* 39 and 42.
694 Sjafjell and Sorensen "Directors' Duties and Corporate Social Responsibility" 2013 *LSN Research Paper Series* 15.
695 Horrigan "Fault Lines in the Intersection between Corporate Governance and Social Responsibility" 2002 *UNSW Law Journal* 516.
696 *Ibid*.
697 Sarre "Responding to Corporate Collapses: Is there a Role for Social Responsibility?" 2002 *Deakin Law Review* 11.

success also depends on social and environmental sustainability.[698] It has been submitted that multi-national companies are the most problematic when it comes to corporate citizenship issues.[699]

An example of the tension between the two competing interests in this section is the classic case between Greenpeace and Shell. This case is also popularly known as Brent Spar. The Brent Spar was "a North Sea oil storage and tanker loading buoy in the Brent oilfield, operated by Shell UK".[700] After the completion of a pipeline to Shetland, Shell regarded this facility to be of no use. The gigantic oil producing company then purposed to "dump" the facility in the North Sea. Greenpeace organized a worldwide campaign aimed at preventing Shell from continuing with their plan. As a result, Shell was shunned in Germany and other parts of Europe. Its sales and share prices took a nose dive.[701] Consequently, Shell withdrew its plans to sink the Brent Spar in the North Sea. It is interesting to note that the UK government had consented to Shell's proposal. Usually, it is the government that ensures that companies are responsible to the environment in which they operate. Why would it bother? Its taxes would continue to come with or without the sinking of the Brent Spar. In this case, it took the intervention of Greenpeace, a non-governmental organisation (NGO). It can be contended that Shell did not withdraw its plans because it had a legal duty towards the environment but it gave in due to the drop in its sales and share prices. The directors of Shell, whilst "acting in the best interests of the company" decided to sink the oil rig. Impliedly, according to them, saving the cost of decommissioning the Brent Spar was more important than the harm it was going to cause to the North Sea's marine life. The sudden reversal of the company's plans due to financial constraints shows that the profit maximisation motive played a big role in the directors' arriving at the decision to abort Shell's original plans.

Taking into consideration the community and environment requires sacrificing some monies which under normal circumstances would have been declared as shareholders' dividends. McConvil and Joy in reference to Hinkley[702] endorse that since companies are creatures of statute, and are regulated by statute, they are not obliged to sacrifice shareholder profits to fulfil something that is

698 *Ibid* 12.
699 MNCs operate everywhere yet accountable nowhere. Bratspies "Sustainability: Can Law Meet the Challenge?" 2011 *Suffolk Transnat'l L Rev* 297.
700 https://www.iaea.org/nuccomtoolbox/documents/Brent_Spar_Case_Study.pdf (accessed 18-04-2016).
701 *Ibid*.
702 Hinkley "The Profit Motive Can Work with a Moral Motive" 2000 *Australian Financial Review* 32.

not recognised by the "legislature's pen".[703] Thus, their reasoning is that until the principle of CSR is captured in legislation, it cannot form part of the legal obligations upon directors. In Australia, there has been various attempts to include the concept of sustainability in statutes.[704] Some scholars go as far as labelling the concept of sustainable development as "a moral duty".[705] Had Shell continued with its plans, obviously, it would have resulted in more losses. Furthermore, the reputation of the oil giant would have been tarnished. Would governments have continued offering Shell oil related rights? Probably the UK would have continued doing so. In the long run, Shell's disregard of the environment would have compromised the company's sustainability.

McConvil and Joy state that the key question is how to reconcile the profit motive with the moral duties.[706] It also has to be noted that "recognition of directors' duties to other stakeholders does not override the primary duty to act in the best interests of the company".[707]

In South Africa, a good starting point as far as CSR is concerned is the King I Report.[708] The report advocated for "balanced annual reporting" which would include both financial and non-financial aspects.[709] In 2002, King II Report was issued. Compliance with the report was based on a voluntary basis coined "comply or explain".[710] King II Report emphasized more on the principle of sustainability than its predecessor.[711] Furthermore, the King II Report recognised a departure from a single bottom line which was basically focused on the interests of shareholders and profit

703 McConvil and Joy "The Interaction of Directors' Duties and Sustainable Development in Australia: Setting off on the Uncharted Road" 2003 *Melbourne University Law Review* 117.

704 *Ibid* footnote 3.

705 McConvil and Joy "The Interaction of Directors' Duties and Sustainable Development in Australia: Setting off on the Uncharted Road" 2003 *Melbourne University Law Review* 116-117.

706 McConvil and Joy "The Interaction of Directors' Duties and Sustainable Development in Australia: Setting off on the Uncharted Road" 2003 *Melbourne University Law Review* 117. In the long run the negative impact of companies on the environment will result in economic inefficiency or "profitmaking will become expensive" Sjafjell and Sorensen "Directors' Duties and Corporate Social Responsibility" 2013 *LSN Research Paper Series* 1.

707 McConvil and Joy "The Interaction of Directors' Duties and Sustainable Development in Australia: Setting off on the Uncharted Road" 2003 *Melbourne University Law Review* 126.

708 1994.

709 Jebe "Sustainability Reporting and New Governance: South Africa Marks the Path to Improved Corporate Disclosure" 2014 *Cardozo J of Int'l & Comp Law* 267.

710 King II Report Background. Jebe "Sustainability Reporting and New Governance: South Africa Marks the Path to Improved Corporate Disclosure" 2014 *Cardozo J of Int'l & Comp Law* 267 states that this principle was borrowed from the UK's Cadbury Report.

711 For example refer to section 4 of the King II Report.

maximisation only to triple bottom line which takes into account other stakeholders' interests.[712] However, as comprehensive as King II was on sustainability, it could not be enforced by any legislation.[713] But, to make up for this defect, the JSE included it as part of its listing rules that companies must comply with the report.[714] Later on, the King III Report was issued in 2009. It is a "landmark in the field of corporate reporting".[715] The main differences between the King III Report and its predecessors is that the former departs from the "comply or explain" to the "apply or explain" principle and makes sustainability issues mainstream.[716]

Like any other contemporary company law issues, CSR is not without its critics. Sarre, while making reference to David Henderson,[717] posits that corporate citizenship limits competition and retards the performance of the economy.[718] Competition is good for the economy and the public at large because it improves the quality of products and service delivery, gets rid of complacency and also leads to innovation.[719] However, not all competition is healthy. Sometimes rivals need to pool resources and work together. This is usually relevant in capital intensive business ventures and in instances where a rival is facing financial challenges but where its collapse would affect the whole industry. For example, if Vodacom, one of the biggest mobile network providers in South Africa was to collapse today, its major competitor, MTN would experience a rise in its sales and profits. But the important question will be does the latter have the capacity to immediately provide services to all those customers who were served by the former? Such cases may lead to a situation where customers are exploited. On the other hand, stiff competition may hinder new players from entering the market.

712 Jebe "Sustainability Reporting and New Governance: South Africa Marks the Path to Improved Corporate Disclosure" 2014 *Cardozo J of Int'l & Comp Law* 269.
713 Jebe "Sustainability Reporting and New Governance: South Africa Marks the Path to Improved Corporate Disclosure" 2014 *Cardozo J of Int'l & Comp Law* 270.
714 *Ibid*.
715 Jebe "Sustainability Reporting and New Governance: South Africa Marks the Path to Improved Corporate Disclosure" 2014 *Cardozo J of Int'l & Comp Law* 271; King III Report 5.
716 Jebe "Sustainability Reporting and New Governance: South Africa Marks the Path to Improved Corporate Disclosure" 2014 *Cardozo J of Int'l & Comp Law* 272; King III Report 5.
717 Henderson "Misguided virtue: false notions of corporate social responsibility" 2001.
718 Sarre "Responding to Corporate Collapses: Is there a Role for Social Responsibility?" 2002 *Deakin Law Review* 13.
719 Du Toit *et al Introduction to Business Management* 8 ed (2010) 8-9.

Spector explains some of the hindrances to the success of CSR.[720] The author revealed that although corporate sustainability is increasingly becoming popular, most directors do not possess the required knowledge about it.[721] The other hindrance is the belief that "allocation of shareholder resources to sustainability projects is an unsound decision".[722] This argument is usually presented by those who are short sighted. Sustainability projects can be costly but they are very beneficial in the long run. To explain this argument in detail, consider the following hypothetical scenario. Assuming that companies X and Y are competitors. They both manufacture bathing soap on a large scale. Both companies are based in the Eastern Cape Province. Company X has its headquarters in Port Elizabeth while company Y's are in East London. Company X is situated close to one of the sewerage dump sites in Port Elizabeth. It was strategically located in that place so as to dump its waste into the sewer. Company Y is situated close to East London's Industrial Development Zone (IDZ) which is close to the residential suburbs of West Bank and Sunny Ridge. Company Y makes use of septic tanks to discharge its waste.

However, one of the pipes that carries Company Y's waste has been leaking since 2012. This resulted in a swampy area forming. The area became a breeding place for insects like mosquitoes and it also was a den of thieves. Residents of West Bank and Sunny Ridge have on numerous occasions approached the company to fix the leaking pipe but to no avail. It was alleged that the leak was artificial in that it helped cut Company Y's costs since one of its pumps was ill-functioning. It was also alleged that Company Y's septic tanks were filling up and the leak was engineered in the hope that some of the waste could be dumped into the Indian Ocean. It was estimated that it would cost R20 000 000 to fix the filling septic tanks and the leaking pipe. Two years down the line, there was a cholera outbreak. West Bank and Sunny Ridge recorded the highest number of fatalities. The Department of Health carried out an investigation and the results showed that Company Y's leaking pipe aggravated the situation. The following day, the findings of the Department of Health were published in one of the Eastern Cape's weekly newspapers "EC Today". A week after the results were published, Company X's share prices and sales tripled whilst its competitor's share prices and sales hit rock bottom.

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720 Spector "The Sustainability Imperative and Governance: Understanding a New Frontier in Corporate Board Oversight" 2012 *Notre Dame Journal of Law Ethics & Public Policy* 43.

721 *Ibid*.

722 *Ibid*.

In the years 2013 and 2014 Company Y declared dividends to all categories of shareholders. On the other hand Company X only managed to declare dividends in 2014. It was alleged that the directors of Company Y concluded that the money that was supposed to be used to repair the leaking pipe and the filling septic tanks was better awarded to its shareholders as they had a duty to act in the best interests of the company by maximizing shareholder value. Last year Company X also managed to declare some dividends to its shareholders and opened two more sites in Gauteng and Western Cape Provinces. Company Y has a pending case in the Bhisho High Court. Residents of West Bank and Sunny Ridge sued the latter. The Eastern Cape Department of Health is also among the applicants and an NGO called Keep it Green also joined the case as *amicus curiae*.

This scenario shows that although the concept of corporate sustainability seems to eat away from a company's profits, it is the company and its stakeholders that will benefit in the long run. Chances are that Company Y may fall into insolvency. It has a pending case, the share prices have fallen sharply and they may continue to fall if the case in the Bhisho High Court takes long and/or if they lose it. All this has been a result of short terminism. The directors in the interests of the company only referred to profit maximisation. It is possible that in the normal course of events Company Y may become extinct. On the other hand, Company X took into account sustainability principles. During its first years, it sacrificed some of its profits and invested in long term goals which have just begun to pay off. What happened to Company Y is similar to what real firms like Exxon, Shell, Nike and Monsanto[723] went through.

The way forward is to merge the regulation framework into corporate sustainability principles.[724] Whether this will result in the desired balance between profit maximisation and CSR remains to be proven. In practice, can profitability and CSR really work side by side? According to Sarre, triple bottom line reporting is one of the ways of fostering CSR principles.[725] Triple bottom line reporting refers to reporting that is not merely focused on the financial aspects of a business only,

[723] Horrigan "Fault Lines in the Intersection between Corporate Governance and Social Responsibility" 2002 *UNSW Law Journal* 539; Sarre "Responding to Corporate Collapses: Is there a Role for Social Responsibility?" 2002 *Deakin Law Review* footnote 30.

[724] Sarre "Responding to Corporate Collapses: Is there a Role for Social Responsibility?" 2002 *Deakin Law Review* 7.

[725] Sarre "Responding to Corporate Collapses: Is there a Role for Social Responsibility?" 2002 *Deakin Law Review* 8; Horrigan "Fault Lines in the Intersection between Corporate Governance and Social Responsibility" 2002 *UNSW Law Journal* 544-545.

but is extended to the environmental and social aspects of a firm.[726] The phrase was coined by John Elkington of SustainAbility.[727] However, mere reporting might not be enough. Horrigan questions the degree to which directors' duties can be extended for the legal framework to properly accommodate sustainability issues.[728] McConvil and Joy claim that "there is no conceptual barrier to the introduction of a positive duty of sustainable development on the directors".[729] Maybe the same reasoning that has been applied in constructing duties to other stakeholders such as creditors in some circumstances should be applied to construct a duty to the environment.[730]

3 6 COMPANY MODELS

It has been shown above that the shareholder theory is favoured mostly by contractarians whilst the communitarians favour the stakeholder theory and to some extent the ESV approach as well.[731] Both the contractarian and the communitarian theories were discussed in detail in chapter 2 above. Sheehy notes that there is an intimate relationship between company models and the stakeholder debate.[732] The same author also mentions the three types of company models as the communitarian, the contractarian and the socialist.[733] The contractarian or agency theory therefore advocates for the shareholder approach and ultimately produces a contractual or aggregational model.[734] Contractarians believe that "people should be free to decide how to live, including how they should dispose of their property".[735] This theory focusses on the autonomy of the individual.[736] Even though scholars of the contractarian theory do not believe that shareholders

726 Horrigan "Fault Lines in the Intersection between Corporate Governance and Social Responsibility" 2002 *UNSW Law Journal* 544-545.
727 http://www.sustainability.com/history (accessed 23-04-2016).
728 Horrigan "Fault Lines in the Intersection between Corporate Governance and Social Responsibility" 2002 *UNSW Law Journal* 528.
729 McConvil and Joy "The Interaction of Directors' Duties and Sustainable Development in Australia: Setting off on the Uncharted Road" 2003 *Melbourne University Law Review* 127.
730 *Ibid* 126.
731 See also Havenga *Fiduciary Duties of Company Directors with Specific Regard to Corporate Opportunities* (Unpublished LLD thesis, University of South Africa, 1995) 32. Sheehy "Scrooge-The Reluctant Stakeholder: Theoretical Problems in the Shareholder-Stakeholder Debate" 2005 *University of Miami Business Law Review* 202 and 225.
732 Sheehy "Scrooge-The Reluctant Stakeholder: Theoretical Problems in the Shareholder-Stakeholder Debate" 2005 *University of Miami Business Law Review* 225.
733 *Ibid*.
734 Havenga *Fiduciary Duties of Company Directors with Specific Regard to Corporate Opportunities* (Unpublished LLD thesis, University of South Africa, 1995) 32.
735 Sheehy "Scrooge-The Reluctant Stakeholder: Theoretical Problems in the Shareholder-Stakeholder Debate" 2005 *University of Miami Business Law Review* 232.
736 *Ibid*.

own the company, they still view them as the primary beneficiaries of the directors' fiduciary duties.[737] A company based on a contractarian model will therefore exclude other stakeholders' interests and focus on shareholders' interests only.[738] Contractarians however point out that companies founded on a contractarian model automatically benefit the society through maximising shareholders' wealth.[739] Contractarians believe that the company "is a nexus of contracts between private individuals in which the government has no business and by which the greatest efficiency can be achieved, and that those without contractual bargaining power have no right to be considered in the corporate contract".[740]

There are two types of contractarians, legal and economic.[741] Advocates of contractualism believe that "the contract creates a legal entity in which directors and members are bound together in the corporation's articles of incorporation, that the contract defines the boundaries and membership of the corporation and that contractualism favours the interests of members, rather than the interests of the individual".[742] However, companies that are modelled under the legal contractual model are criticised in that such a model equates shareholders' interests with the company's.[743] Dine also notes that there are some challenges in applying this model to running a company.[744] The economic contractarian model was established by Ronald Coase.[745] This model draws a very strong connection between those who provide the capital, in this case the shareholders, and the directors.[746] Economic contractarians reject the view that a company is a body corporate separate from its shareholders.[747] Sheehy points out that this model is weak in that it fails to explain the

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737 Havenga *Fiduciary Duties of Company Directors with Specific Regard to Corporate Opportunities* (Unpublished LLD thesis, University of South Africa, 1995) 232.

738 *Ibid*.

739 *Ibid*.

740 Sheehy "Scrooge-The Reluctant Stakeholder: Theoretical Problems in the Shareholder-Stakeholder Debate" 2005 *University of Miami Business Law Review* 233.

741 Sheehy "Scrooge-The Reluctant Stakeholder: Theoretical Problems in the Shareholder-Stakeholder Debate" 2005 *University of Miami Business Law Review* 226-227.

742 Sheehy "Scrooge-The Reluctant Stakeholder: Theoretical Problems in the Shareholder-Stakeholder Debate" 2005 *University of Miami Business Law Review* 226.

743 Sheehy "Scrooge-The Reluctant Stakeholder: Theoretical Problems in the Shareholder-Stakeholder Debate" 2005 *University of Miami Business Law Review* 226 and Dine *The Governance of Corporate Groups* (2000) 4.

744 Dine *The Governance of Corporate Groups* (2000) 7.

745 Sheehy "Scrooge-The Reluctant Stakeholder: Theoretical Problems in the Shareholder-Stakeholder Debate" 2005 *University of Miami Business Law Review* 228.

746 *Ibid*.

747 *Ibid*.

doctrine of limited liability, fails to address the company's ability to acquire rights outside its shareholders and that it does not justify its emphasis on efficiency.[748]

The communitarian theory which advocates for a pluralist approach to corporate governance ultimately gives birth to the concession/stakeholder/managerialist model.[749] Stakeholder theorists view an individual within the social context and they view liberty as having positive duties.[750] However, it has to be noted that none of these theories lead to the correct or appropriate model of a company.[751] Havenga notes that the concession or stakeholder model has two forms wherein the first one favours the ESV approach and the second one favours the stakeholder theory.[752] Communitarians emphasise the power and effect of companies on the society and that companies are part of society.[753]

3 7 SUMMARY AND PRELIMINARY CONCLUSIONS

This chapter has presented a discussion on the nature and scope of the directors' fiduciary duty to act in the best interests of the company. The first part was dedicated to a brief discussion on types of directors, which was followed by a look at the tenets of the duty at issue, then the beneficiaries of the duty, a discussion on the concept of "the best interests of the company", and lastly company models.

With respect to types of directors, firstly, it was found that there are several of them. The main question in that section was whether the scope of directors' duties varies according to the type of director that one is. It was found that although the distinction between executive and non-executive directors is so popular, it is not contained in legislation. It was concluded that the distinction has no legal basis in that it does not determine the scope of a director's obligations.

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748 Sheehy "Scrooge-The Reluctant Stakeholder: Theoretical Problems in the Shareholder-Stakeholder Debate" 2005 *University of Miami Business Law Review* 229. See also Dine *The Governance of Corporate Groups* (2000) 7.

749 Havenga *Fiduciary Duties of Company Directors with Specific Regard to Corporate Opportunities* (Unpublished LLD thesis, University of South Africa, 1995) 232.

750 Sheehy "Scrooge-The Reluctant Stakeholder: Theoretical Problems in the Shareholder-Stakeholder Debate" 2005 *University of Miami Business Law Review* 232.

751 *Ibid*.

752 Havenga *Fiduciary Duties of Company Directors with Specific Regard to Corporate Opportunities* (Unpublished LLD thesis, University of South Africa, 1995) 233.

753 Sheehy "Scrooge-The Reluctant Stakeholder: Theoretical Problems in the Shareholder-Stakeholder Debate" 2005 *University of Miami Business Law Review* 233.

The section that followed focussed on the nature of the directors' duty to act in the best interests of the company. It was noted that the content of the duty in question depends on the surrounding circumstances and context and that each case has to be determined on its facts. It was further submitted that the duty in question is traditionally divided into different facets which are usually couched as rules. The first rule to be considered was the no conflict rule. Its foundations were traced back to the seminal case of *Keech v Sandford.*[754] It was found that this rule is contained both in statute and the common law. A South African perspective to the rule was provided through a discussion of the Supreme Court of Appeal decision in *Phillips v Fieldstone Africa (Pty) Ltd*.[755] It was also found that the South African courts' approach to this duty is stricter than that of the English courts. The corporate opportunity rule was next to be discussed. A discussion of this rule was presented as per the English case of *Regal (Hastings) Limited v Gulliver*[756] and the Canadian case of *Cook v Deeks.*[757] The no profit rule was also discussed. This duty was discussed with reference to the South African cases of *Robinson v Randfontein Estates Gold Mining Co Ltd*[758] and *Volvo (Southern Africa) Pty Ltd v Yssel*.[759] The proper purpose rule was also discussed. It was found that the rule is also contained in statute. The rule was discussed with reference to the English cases of *Hogg v Cramphorn Ltd*[760] and *Howard Smith Ltd v Ampol Petroleum Ltd.*[761] The last rule to be discussed was that directors are to exercise independent judgment in discharging their fiduciary obligations. It was noted that this rule is especially important in the case of a nominee director. The rule was discussed with reference to the South African case of *Fisheries Development Corporation of SA Ltd v Jorgensen; Fisheries Development Corporation of SA Ltd v AWJ Investments.*[762] It was also found that the UK has a more flexible approach as compared to South Africa's.

The section that followed dealt with the question "to whom is the duty owed?" This part attempted to answer the question: To whom do directors owe their fiduciary duty to act in the best interest of the company? Shareholders, creditors, employees and the community were identified as the

754 1726 25 ER 223 (Ch).
755 2004 3 SA 465 (SCA).
756 1942 All ER 378 (HL).
757 1916 1 AC 554.
758 1921 168 (AD).
759 2009 82 (ZASCA).
760 1966 3 All ER. 420.
761 1974 AC 821 PC.
762 1980 4 SA 156 (W).

relevant stakeholders in this study. The next part in that section was dedicated to defining the phrase "the company". It was noted that various scholars concede that a concise definition of the phrase was problematic if not unavailable. However, regard was given to the traditional view which equated the company with shareholders.

The selected stakeholders were considered one after the other in an attempt to establish whether current law prescribes fiduciary duties to them. It was argued that directors owe fiduciary duties to shareholders collectively but not as individuals. It was also found that a company is not made up of shareholders only and hence the need to look at other stakeholders' interests. This shift was justified by the impact of companies' actions upon the community, the argument that corporate sustainability requires more than shareholder primacy and with specific reference to South Africa, the impact of the Bill of Rights. It was found that, in general, directors do not owe fiduciary obligations to creditors. However, such obligations might arise in the case of insolvency. A lot of arguments were presented to support the creation of such a duty. However, it was also noted that there are a lot of challenges in formulating such a duty. The history of directors' duties to creditors beginning with the English case of *Walker v Wimborne*[763] was also considered. It was found that South African courts have not yet decided on this issue. It was noted that directors' duties to creditors have been judicially considered in cases where the company was closely held. Employees were the next stakeholders to be considered. It was found that at common law directors do not owe fiduciary obligations to employees. The leading authority on this issue is the English case of *Parke v Daily News Ltd.*[764] It was however found that employees' interests are now recognised in the UK.[765] However, it was found that such recognition cannot be elevated to fiduciary status. The community's interests were discussed last.

The next part dealt with the meaning of the concept "the best interests of the company". It was reiterated that the purpose of that section was to complement the immediately preceding one. The section also focussed on the beneficiary of the directors' fiduciary duty to act in the best interests of the company and it took a theoretical approach. Three approaches namely the shareholder, the ESV and the stakeholder theories were discussed. Between the shareholder approach and the ESV

[763] 1976 137 CLR.
[764] 1962 927 (Ch).
[765] Section 172 of the UK Companies Act 2006.

approach was a brief discussion on company law developments that have taken place in South Africa and the UK.

The shareholder approach was considered first. It was found that this approach is based on the traditional view. It was contended that shareholders should be the sole beneficiaries of the directors' fiduciary duty to act in the best interests of the company because they own the company, they are residual claimants in the company, bear the greatest risk, have the greatest incentive to maximise firm value and that they are the least protected of all the stakeholders. It was disputed on the contrary that shareholders cannot own the company since it is a legal person on its own, that the shareholder approach's definition of assets is only limited to the financial aspects, that the only time that shareholders are residual claimants in a company is during insolvency and winding up, that other stakeholders like employees bear greater risks than shareholders and that the community as well is not protected contractually, therefore shareholders have no superior to claim to being the primary beneficiaries of the directors' fiduciary duties.

The ESV approach was discussed next. That section was began with a presentation on company law reviews that have taken place in South Africa and the UK. In South Africa, the law review was traced from the King Reports' recommendations, the Codes thereof and the DTI Policy Document. It was also found that the South African law reform process was influenced by various factors including a changing business environment, various pieces of legislation and the Constitution.[766] It was found that current law as contained in the Companies Act[767] favours the ESV approach. In the UK, outcomes of company law reviews were presented in various reports. These reports were a response to the corporate law scandals that had taken place in the UK. The outcome of these reports was put into two White Papers which resulted in the Companies Bill and ultimately the Companies Act.[768] It was further found that, currently, section 172 of the Companies Act[769] adopts and supports the ESV approach. In Canada, it was found that company law reform took the form of judicial development in two of the Supreme Court of Canada's judgments. It is submitted that both cases favoured the ESV approach.

766 Constitution of the Republic of South Africa, 1996.
767 71 of 2008.
768 2006.
769 *Ibid*.

The discussion on the ESV approach proper then followed. It was noted that the difference between the shareholder approach and the ESV approach is that the latter takes into account broader stakeholder interests. It was also noted that there are two forms of ESV; which are investor driven and market driven ESV approach. Arguments in support of the theory and against it were presented.

Attention then shifted to the stakeholder approach. It was submitted that this theory vindicates a balance of the various stakeholder interests. It was also submitted that the balancing of interests does not necessarily mean equating such interests. It was found that this approach was rejected by the CLRSG's report in the UK and also by the South African Policy Document. The historical origins of this theory were traced to two perspectives. It was noted that stakeholder theorists understand that a company is an independent entity and is a product of an agreement from the government, that a company should be controlled by those who bear the consequences of the actions of a company, that the most effective way of controlling a firm is by allowing those who are affected by its actions to have some degree of control or influence over it and that a company has to be managed in a way that benefits everyone whom its decisions and actions affect. This theory has however been criticised on the grounds that it is not in line with corporate governance principles and undermines principles of private ownership of property.

Attention was then devoted to a discussion on the principle of sustainability. It was explained that in some instances there is tension between what may be considered as the best interests of a company and the dictates of the principle of sustainability. Furthermore, it was realised that in the long run it is actually profitable for company directors to take into consideration the sustainability of the corporate entities they lead. However, in the short term, such engagements can prove to be costly. It was also established that currently, companies do not have legal duties to the environment. What they owe to the environment can at most be described as a moral duty.

Models of companies were then discussed. It was shown that there is an intimate relationship between the stakeholder debate theories and the resulting company models. The contractarian, communitarian and socialist model of companies were identified. The first two were discussed in detail. The strengths and weaknesses of the two models were also discussed. It was also shown that there are two types of contractarian models of corporate governance, legal and economic.

CHAPTER 4

Enforcement of directors' fiduciary duties and stakeholder remedies

4 1 INTRODUCTION

This chapter presents a discussion of the enforcement of directors' duties and stakeholders' remedies. The mere provision of rights and duties, whether under statute or common law, is worthless unless there are effective mechanisms for the enforcement of such obligations.[770] It is not enough that remedies are available in black and white. The whole legal system, including institutional and procedural requirements, must allow for the enforcement of rights and duties outlined on paper. One notable English company law scholar, Andrew Keay, stated that "provision of directors' duties in statute is only half the job done".[771] The same author went on and said "unless breaches of the duties are subject to an efficient and effective enforcement scheme they are of not much use".[772] While it is true that market forces and other social factors may, to a certain extent, influence how directors act, the need to make available some form of external discipline through litigation remains relevant.[773] Some company law commentators have even stated that the major problem in corporate governance is not the law itself but that the main issue lies with the enforcement of duties when breached.[774]

A distinction is drawn between public and private enforcement of directors' duties. Public enforcement of directors' duties has to do with the institution of proceedings at the behest of the state or a state representative. There is usually some overlap between public enforcement of duties of directors and administrative remedies. In this study, a distinction will be made between judicial and administrative remedies. On the other hand, private enforcement of breach of duties entails the enforcement of such obligations by private actors. Normally, in the context of corporate law, such private actors are the various company stakeholders. A greater proportion of this chapter will be devoted to a discussion of the private enforcement of directors' duties.

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770 Keay "Public Enforcement of Directors' Duties: A normative enquiry" 2014 *Common Law World Review* 89.
771 *Ibid* 89.
772 *Ibid* 89.
773 *Ibid* 89.
774 Keay "Public Enforcement of Directors' Duties: A normative enquiry" 2014 *Common Law World Review* 91 while making reference to Millstein *et al Enforcement and Corporate Governance: Three Views, Global Corporate Governance Forum* 2005 28.

The first section of this chapter will be devoted to a discussion of judicial remedies. These remedies are generally categorised into criminal and civil proceedings. However, much of the discussion will be centred on civil proceedings since, as will be seen later, there has been a move aimed at decriminalising company law.[775] The most common forms of civil remedies are the derivative action and oppression claims. As will be shown later, these two have strong historical ties.

Under civil remedies, derivative actions will first be examined. The first part of that section will present a brief background to this remedy. It is impossible to effectively present a discussion of the history of the derivative action without discussing the case of *Foss v Harbottle*.[776] The judgment in that case resulted in what is now known as the rule in *Foss v Harbottle*[777]. It will also be determined whether the rule in the said case still applies in modern day company law. This chapter will also analyse the source, nature, reasons, advantages, and disadvantages of that rule and the exceptions thereof. A discussion of the historical background of the rule in *Foss v Harbottle*[778] is aimed at discovering the extent to which history has influenced the scope and interpretation of the derivative action in contemporary company law and how the remedy has evolved.

Judicial precedents on the derivative action from South Africa and other jurisdictions including the USA's Delaware Chancery Court will also be examined. The section which follows after that will then be devoted to the requirements that a complainant must comply with in order to bring derivative claims before the court. The South African position with respect to the requirements that one needs to comply with to successfully invoke derivative claims will be compared to those of the UK and Canada. As will be shown, the USA's approach to derivative claims is unique when compared to the common law jurisdictions. For example, the USA has developed what is known as the contemporaneous ownership requirement for one to be afforded standing before the court.[779]

The discussion of the requirements that a complainant needs to comply with before making use of the derivative action will also capture a very significant procedural necessity namely, the court's

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775 Davies *et al Companies and other Business Structures in South Africa* 3 ed (2013) 19 while making reference to section 171 of the South African Companies Act 71 of 2008.
776 1843 67 ER 189.
777 *Ibid*.
778 *Ibid*.
779 Aronson *et al* "Shareholder Derivative Actions: From Cradle to Grave" 2009 11.

leave or permission. After that, the South African case of *Mouritzen v Greystones Enterprises (Pty) Ltd*[780] will be examined. This case is very important as it was the first one to come before the courts after South Africa adopted the new Companies Act.[781] This case will also show how foreign precedents are vital to the elaboration of South African company law.[782] The rationale and justification for the leave requirement will be critically analysed. It will also be assessed whether the leave of court requirement is necessary. If so, it will further be assessed whether the leave requirement does not pose an inherent impediment to the utilisation of the derivative claims.

There are a lot of stakeholders who are concerned with the way things are run in a company.[783] As highlighted in chapter 1, this study only focusses on shareholders, employees, creditors and the community. In this chapter, the difference between majority and minority shareholders will be of much significance. It is submitted that minority shareholders are the ones who are at greater risk than majority shareholders. To that end, more regard will be had to the interests of minority shareholders. One of South Africa's notable scholars on company law, Tshepo Mongalo, has explicitly explained the need for and importance of protecting the interests of the minority.[784]

Thereafter, the discussion will delve deep into the crux of the matter and examine the types of stakeholders that can make use of the derivative action. This section is very significant as it will provide an assessment of the availability and effectiveness of the derivative action as a remedy. It will be assessed further whether the derivative action is a remedy on paper only or whether it can be applied by various stakeholders if their interests are undermined by the directors' conduct. It will also be shown that although South Africa, Canada and the UK are all common law states, the range of applicants or complainants that can make use of the derivative claims may vary from

780 2012 5 SA 74 (KZD).

781 71 of 2008.

782 As will be shown, the court made reference to several foreign judgments which include those from Australia, New Zealand, Canada and the UK. Note that in adopting a comparative approach, this study seeks both to identify the developments and inconsistencies in the adjudication of modern day derivative claims.

783 For a discussion of company stakeholders relevant to this study see section 3 4 above and the references thereunder.

784 Mongalo *Corporate Law and Corporate Governance: A Global Picture of Business Undertakings in South Africa* (2003) 260-262 and Mongalo *et al Forms of Business Enterprise: Theory, Structure and Operation* (2004) 268-269 state that "protection of minorities is made necessary by a fundamental rule of company law referred to as 'corporate democracy'. According to this rule the will of the majority carries the day. [However, this rule has a] potential for abuse by those in control of the company, especially in private companies. [Some of the] complaints by minority shareholders in a company include disregard of rights granted by statute or by the articles, alteration of the articles, self-interested contracts by controllers of the company, little or no participation in the profits". See also Davies *et al Companies and other Business Structures in South Africa* 3 ed (2013) 299 note 39.

jurisdiction to jurisdiction. The last part of this section will be devoted to a discussion of the shortcomings of the derivative action and by adopting a comparative approach, suggest ways in which the shortcomings or the effects thereof may be minimised.

The second civil remedy that will be discussed is the oppression claim. A brief historical background to the remedy will be presented from the onset. The effects of the Dickerson Proposals for a New Business Corporations Law for Canada[785] and the Jenkins Committee Report on Company Law[786] as well as the Interim Report of the Select Committee on Company Law[787] in the UK will also be explored. Furthermore, by referring to case law and various statutory provisions, the chapter will also examine the rationale, nature and scope of oppression remedies. It will be submitted that Canada has the widest and most influential oppression remedies. The advantages and disadvantages of the remedy will also be discussed.

Thereafter, the chapter will then examine the court's approach to oppression remedies in South Africa, Canada and the UK. The tests that courts apply in determining whether directors' conduct is oppressive will be outlined. With respect to Canada, the scope of oppression remedies as discussed in the Supreme Court of Canada case of *BCE Inc v 1976 Debenture holders*[788] will be elaborated. The way this remedy is contained in various common law jurisdictions' legislation makes it seem to be made up of three different components. These three components are "oppressive conduct, unfair prejudice and unfair disregard of stakeholders' interests".[789] It will be determined in this chapter whether the legislature intended these three elements to be regarded as different concepts, or whether the legislature meant them to complement each other.

Thereafter, the chapter will explore the requirements that must be complied with for an applicant to bring its application for an oppression remedy before a court of law. The chapter will then present a discussion of who can be a complainant in an application for oppression remedy. In other words, which class(es) of stakeholders can make use of oppression remedies? Again, this section will determine the availability and to some extent the effectiveness of this remedy.

785 1971 Vol I (hereinafter, referred to as the Dickerson Report).
786 1962 (hereinafter, referred to as the Jenkins Committee Report).
787 1967 (hereinafter, referred to as the Lawrence Committee Report).
788 2008 69 (SCC).
789 *Ibid*.

The chapter will also examine the similarities and differences between oppression remedies and the derivative action claims. Moreover, due to the strong historical ties between the derivative action and oppression remedies, it will be sought to answer the question whether there is any overlap between the two. Since it is possible that the same conduct can bring about both derivative and oppression remedies,[790] the next issue will be to try and delineate under what circumstances should one make use of the derivative action or oppression remedies. The factors that must be taken into consideration before one makes a choice to decide whether to make use of the derivative action or to invoke oppression remedies will also be examined.

The derivative action and oppression remedies are the most commonly invoked remedies but not the only ones available. There are also what are known as administrative remedies. The chapter will define what these are and under what circumstances they can be invoked as well as who qualifies to be a complainant under administrative remedies. In South African law, it will be seen that stakeholders can also apply for a director to be declared delinquent or to be put under probation.[791] Furthermore one can make use of forms of alternative dispute resolution (hereinafter, referred to as ADR).[792]

However, this study will not explore the exit option and shareholders' appraisal rights. The reason is that, in both situations one is terminating their relationship with the company. This study concentrates on those remedies that are invoked for the sustenance of the relationship between the company and the various stakeholders. The study is focussed on both the sustainability of the company and also of the relationship between it and its stakeholders.

4 2 JUDICIAL REMEDIES

Judicial remedies can be categorised into criminal sanctions and civil remedies. Criminal sanctions are usually instituted by the state and, if one is convicted, he can be imprisoned or fined a certain amount of money. However, regardless of the fact that sometimes, in criminal proceedings, the state can take some initiatives pertaining to enforcement of directors' duties, it is still believed that company law remains a branch of private law.[793] On the other hand, civil remedies here refer to

790 Cohen *et al* "Shareholders' Remedies: Distinguishing Oppression Claims and Derivative Actions" 2011 5.
791 See section 162 of the South African Companies Act 71 of 2008.
792 In South African company law, Alternative Dispute Resolution is provided for in section 166 of the Companies Act 71 of 2008.
793 Van der Walt *et al Introduction to Law: Fresh Perspectives* 2 ed (2013) 2.

those forms of relief that private citizens invoke against each other without state intervention.[794] The two most common forms of civil remedies are the derivative action and oppression claims. In this study, the terms "oppression remedies", "oppression claims" and "oppression applications" will be used interchangeably.

4 2 1 Criminal proceedings

Criminal sanctions are largely based on the deterrence theory.[795] The deterrence model assumes that "fear of legal sanctions keeps persons law abiding".[796] According to Comino, the need to have criminal law in the corporate world "is motivated by the desire for appropriate punishment and to serve as an effective general deterrent".[797] In fact, the same author goes on to compare criminal law and civil law in the context of curbing corporate misconduct and concludes that the former is more effective than the latter.[798]

However, Comino's submissions seem to be in contradiction with the South African corporate law regime as per the new Companies Act.[799] One of the aims of this Act is to decriminalise company law.[800] Furthermore, it has been noted that the application of criminal sanctions to corporate law did not yield the expected results in Australia.[801] Failure of the Australian Securities and Investment Commission (ASIC) to deal with some notable cases through criminal proceedings exposed some major loopholes in the application of criminal law.[802] Perhaps the South African

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794 *Ibid* 333-334.

795 Snyman *Criminal Law* 5 ed (2008); Comino "Civil or Criminal Penalties for Corporate Misconduct– Which Way Ahead?" 2009 *TC Beirne School of Law Legal Studies Research Paper No 09-01* 16**.**

796 Comino "Civil or Criminal Penalties for Corporate Misconduct– Which Way Ahead?" 2009 *TC Beirne School of Law Legal Studies Research Paper No 09-01* 16.

797 *Ibid*.

798 Comino "Civil or Criminal Penalties for Corporate Misconduct– Which Way Ahead?" 2009 *TC Beirne School of Law Legal Studies Research Paper No 09-01* 16. In arriving at such a conclusion, some of the reasons that Comino advances are that a criminal conviction results in bad publicity for the defendant's image and reputation. According to the same author, these effects which result from a criminal conviction, are more effective than any orders from civil proceedings.

799 71 of 2008. See Davies *et al Companies and other Business Structures in South Africa* 3 ed (2013) 19 on the decriminalisation of South African company law.

800 Davies *et al Companies and other Business Structures in South Africa* 3 ed (2013) 19.

801 Comino "Civil or Criminal Penalties for Corporate Misconduct– Which Way Ahead?" 2009 *TC Beirne School of Law Legal Studies Research Paper No 09-01* 6 footnotes 29-31.

802 Some of these include "additional time, cost and resources required to investigate and pursue the proceedings, the complexity of these cases, often involving many interrelated companies and contrived transactions, the difficulties of proving the criminal offence beyond a reasonable doubt and defendants who were powerful, well-resourced and able to take advantage of the criminal justice system". Comino "Civil or Criminal Penalties for Corporate Misconduct– Which Way Ahead?" 2009 *TC Beirne School of Law Legal Studies Research Paper No 09-01* 7.

legislature learnt some lessons from the Australian experience. However, regardless of the decriminalisation of company law in South Africa and the challenges faced in Australia, there is still a place for criminal sanctions in corporate law. In the USA, the Securities and Exchange Commission (SEC) successfully brought to book Dennis Kozlowski who was at one time the CEO of Tyco International.[803] Moreover, the same commission successfully prosecuted Enron former director, Jeffrey Skilling and other directors in 2006.[804]

In South Africa conduct that is still criminalised include "failure to provide access to any record that a person has a right to inspect or copy".[805] Furthermore, it is a criminal offence to prepare, publish or approve any false or misleading financial statement.[806] Any person who is a party to the aforementioned conduct is guilty of an offence.[807] In the UK, conduct that is criminalised is mainly associated with disclosure requirements.[808] There is also evidence from the CBCA that some conduct still remains under the scope of criminal sanctions in Canada.[809]

4 2 2 Civil remedies

There are a lot of remedies that shareholders and other stakeholders can invoke through civil proceedings.[810] However, due to the historical background and nature of some of these remedies, this section discusses only two of the most common of these remedies. The other forms of remedies will be discussed below under a different section. The two that will be discussed hereunder are the derivative action and oppression remedies. Farrar and Hannigan have noted that there is significant overlap between derivative actions and oppression remedies.[811] Additionally, company law

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803 See Comino "Civil or Criminal Penalties for Corporate Misconduct– Which Way Ahead?" 2009 *TC Beirne School of Law Legal Studies Research Paper No 09-01* 4 note 16 where he makes reference to Bayot "New York: Tyco chief jailed, fined $222m" *AFR* 21 September 2005 13.

804 See Comino "Civil or Criminal Penalties for Corporate Misconduct– Which Way Ahead?" 2009 *TC Beirne School of Law Legal Studies Research Paper No 09-01* 4 note 17, 5 note 19 and also note 84.

805 See section 26 of the Companies Act 71 of 2008 and Davies *et al Companies and other Business Structures in South Africa* 3 ed (2013) 292.

806 Section 214 Companies Act 71 of 2008.

807 *Ibid.*

808 See sections 84 and 1205 of the UK Companies Act 2006.

809 For example see sections 124, 179 and 188.

810 For more on categories of civil remedies Davies *et al Companies and other Business Structures in South Africa* 3 ed (2013) 292-293.

811 Farrar and Hannigan *Farrar's Company Law* 4 ed (1998) 430; MacIntosh "The Oppression Remedy: Personal or Derivative?" 1991 *Canadian Bar Review* 30; Cassim *et al Contemporary Company Law* 2 ed (2012) 822 say that according to the no reflective loss principle which applies when there is overlap between personal claims and derivative actions, the shareholder cannot recover double.

scholars in both the UK and South Africa agree that it is possible that the same conduct can bring about both derivative actions and oppression remedies.[812] If it is possible to have both options available from a single act or omission, then it would entail that a stakeholder faced with such a scenario will have to make a value judgment and decide whether to pursue relief through the derivative action or oppression remedies. What is it that one considers before making such a decision? MacIntosh warns that the decision whether to bring a derivative claim or oppression application is one that must be carefully taken as it has serious consequences in terms of "standing, procedures, costs rules, the substantive standard of liability, and the range of remedial options available to the court".[813] Cohen notes that the leave requirement[814] makes derivative claims much slower and more expensive than oppression remedies.[815]

Stakeholders may pursue both derivative and oppression claims arising from the same set of facts since the two are not mutually exclusive.[816] "For conduct [to] give rise to a derivative action [and also to] an oppression claim, the conduct must directly affect the shareholder in a manner that is different from the indirect effect on all of the shareholders' shares".[817] In one Canadian case, *Gopal v Burke*,[818] the applicants applied to amend an oppression remedy petition. These applicants were minority shareholders in Vladmir Computer Management Group Ltd, which was the second respondent. In March 2007 the second respondent communicated its intention to issue two million shares valued at $1 each. The proceeds from the share issue were to be used to pay for the company's operational losses. The applicants argued that these shares were significantly

812 See Farrar and Hannigan *Farrar's Company Law* 4 ed (1998) 430; Davies *et al Companies and other Business Structures in South Africa* 3 ed (2013) 295-303; Cohen *et al* "Shareholders' Remedies: Distinguishing Oppression Claims and Derivative Actions" 2011 6; and MacIntosh "The Oppression Remedy: Personal or Derivative?" 1991 *Canadian Bar Review* 30.

813 MacIntosh "The Oppression Remedy: Personal or Derivative?" 1991 *Canadian Bar Review* 52. The same author explains that with respect to standing (in the context of the CBCA 1985), the term complainant is clearly defined in the Act.

814 This will be fully discussed below under requirements of derivative claims.

815 Cohen *et al* "Shareholders' Remedies: Distinguishing Oppression Claims and Derivative Actions" 2011 5.

816 Cohen *et al* "Shareholders' Remedies: Distinguishing Oppression Claims and Derivative Actions" 2011 6. The same author refers to Newsbury J's statement in *Furry Creek Timber Corp v Laad Ventures Ltd* 1992 75 BCLR (2d) 246 where she stated that "obviously, the duty of a director to act in the best interests of the company is a duty owed to the company and the company may sue in respect of a breach. Can the same breach be the basis of a shareholder's oppression action? Although there appear to be authorities in Canada that suggest that derivative actions and oppression remedies are mutually exclusive, I think the better view is that it can, provided the complaining shareholder has been affected by the breach in a manner different from or in addition to the indirect effect on the value of all shareholders' shares generally".

817 Cohen *et al* "Shareholders' Remedies: Distinguishing Oppression Claims and Derivative Actions" 2011 6.

818 2007 BCSC 1930.

undervalued and therefore brought an application alleging that "the powers of the directors of the company were exercised in a manner that is oppressive" to them. Master Young whilst allowing the amendment of the claim, held that usurping a corporate opportunity[819] is sufficient ground for the derivative action.[820] However, if the corporate opportunity was appropriated in favour of the majority shareholders, this could justify oppression applications on the part of minority shareholders.[821] Cohen states that "where the decision is taken to advance both an oppression remedy and a derivative action, a party may apply to consolidate the two proceedings or to have them heard at the same time".[822] Undoubtedly, one of the reasons for this is the minimisation of monetary costs. However, the process of applying to have both proceedings consolidated might take time and may even end up costing more if there are a lot of appeals involved.[823]

4 2 2 1 Derivative action

A derivative action arises when the alleged wrongful conduct injures the company.[824] The company will be injured when "all shareholders are affected equally, with none experiencing any special harm".[825] Derivative remedy "is a representative action brought by one shareholder [on behalf] of all the shareholders in the company other than those who are made defendants".[826] The derivative action is so-called because "the shareholder 'derives' his or her right of action from that of the company".[827] In South Africa, a derivative action is brought under section 165 of the Companies Act.[828] In Canada, complainants invoke the derivative action under section 239 of the

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819 Refer to the detailed discussion of the corporate opportunity rule in chapter 3 (part 3 2 2).

820 *Gopal v Burke* 2007 BCSC 1930.

821 *Gopal v Burke* 2007 BCSC 1930. This usually happens in closely held companies. See also *Cook v Deeks* 1916 1 AC 554.

822 Cohen *et al* "Shareholders' Remedies: Distinguishing Oppression Claims and Derivative Actions" 2011 7.

823 MacIntosh "The Oppression Remedy: Personal or Derivative?" 1991 *Canadian Bar Review* 31.

824 MacIntosh "The Oppression Remedy: Personal or Derivative?" 1991 *Canadian Bar Review* 30; Davies and Worthington *Gower's Principles of Modern Company Law* 10 ed (2016) 598-600; Cassim *et al Contemporary Company Law* 2 ed (2012) 775.

825 MacIntosh "The Oppression Remedy: Personal or Derivative?" 1991 *Canadian Bar Review* 30.

826 Farrar and Hannigan *Farrar's Company Law* 4 ed (1998) 430 and 435 and Nwafor "Shareholder Derivative Action- Nigerian Statutory Innovation -Not Yet a Victory for the Minority Shareholder" 2010 *Macquarie J. Bus. L* 215.

827 Cassim *et al Contemporary Company Law* 2 ed (2012) 775 while making reference to the case of *Estmanco (Kilner House) v Greater London Council* 1982 1 WLR. See also Nwafor "Shareholder Derivative Action- Nigerian Statutory Innovation -Not Yet a Victory for the Minority Shareholder" 2010 *Macquarie J. Bus. L* 215.

828 71 of 2008.

CBCA,[829] whereas in the UK, sections 260-264 of the Companies Act[830] provide for derivative actions.

In exploring the historical background of derivative actions in this study, the starting point will be the English case of *Foss v Harbottle*.[831] The plaintiffs in that case were Foss and Turton. They were both shareholders in the Victoria Park Company (the Company) which was incorporated for the sole objective of buying land to use as a pleasure park. The defendants were the directors and other shareholders of the company. The plaintiffs alleged that the defendants had caused damage to the company by selling land belonging to them to the company at a very high price. They further alleged that such conduct resulted in the company recording a loss. A meeting was then held wherein the majority of the shareholders decided not to take action against the company directors holding that the loss was not a result of the directors' conduct. The plaintiffs, who were minority shareholders in the company approached the court asking it to order the directors to "make good the company's losses".[832]

The court dismissed the application and held that "the proper plaintiff for wrongs done to the company is the company itself and not the minority shareholders".[833] The reason behind the court's judgment is that the company is a separate legal entity that is different from its shareholders and should any of its rights be violated, it should be the company itself that should seek redress.[834] It was further held that "it is an elementary principle of law relating to joint stock companies that the court will not interfere with the internal management of the company, acting within their powers and jurisdiction to do so".[835] Vice-Chancellor Wigram's judgment was also based on the need to prevent a multiplicity of actions and the fact that the court's order may be nullified by a shareholders' resolution in a general meeting.[836]

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829 1985.
830 2006.
831 1843 67 ER 189.
832 *Foss v Harbottle* 1843 67 ER 189.
833 *Ibid* 189.
834 *Ibid* 189.
835 *Ibid* 189.
836 The case of *Foss v Harbottle* was nicely summarised in *Prudential Assurance v Newman Industries* 1981 (Ch) 257; 1982 Ch 204 (CA). In the latter case, the court couched the proper plaintiff rule as "the elementary principle that A cannot, as a general rule, bring an action against B to recover damages or secure other relief on behalf of C for an injury done by B to C. C is the proper plaintiff because C is the party injured, and, therefore the person in whom the cause of action is vested". In this expression, A represents any company stakeholder that wishes to

The judgment from this case was so significant that it later came to be known as the rule in *Foss v Harbottle*.[837] However, some corporate law commentators[838] contend that the rule in *Foss v Harbottle*[839] was actually a combination of the court's judgments in that case and in the case of *Mozley v Alston*[840] which was decided almost four years later. They argue that these two cases gave birth to the two-pronged rule.[841] However, the general view is that both principles contained in the rule are founded on the former case.[842] The two doctrines outlined in the *Foss v Harbottle*[843] rule are the "proper plaintiff" and the "internal management" principles.

The proper plaintiff principle is based on the direct harm rule which states that "where a wrong is committed, the only person(s) entitled to seek redress is/are him/her/those who suffered direct harm as a result of it".[844] In the context of corporate law, if a company, as a separate legal entity,[845] is injured, it is the only person with standing to approach a court for relief.[846] The "direct harm" principle is heavily linked to the legal personality of companies.[847] The proper plaintiff rule was considered and accepted by other courts both in the UK and many other common law jurisdictions.[848] A direct consequence of the proper plaintiff rule is that "where a wrong is committed against a company, it is for the company, as the proper claimant, to decide whether to

bring an action on behalf of the company, B represents directors and C represents the company that would have suffered harm.

837 1843 67 ER 189. Hargovan "Under Judicial and Legislative Attack: The Rule in Foss v Harbottle" 1996 *SALJ* 631-632; Farrar and Hannigan *Farrar's Company Law* 4 ed (1998) 430. For a discussion on the sources of this rule see Wedderburn "Shareholders' Rights and the Rule in Foss v Harbottle" 1957 *Cambridge L.J.* 196 and Davies *et al Companies and other Business Structures in South Africa* 3 ed (2013) 295-297. For more on the purpose of this rule see Hargovan "Under Judicial and Legislative Attack: The Rule in Foss v Harbottle" 1996 *SALJ* 639-640 and 642; Farrar and Hannigan *Farrar's Company Law* 4 ed (1998) 432 and Cassim *et al Contemporary Company Law* 2 ed (2012) 776.

838 See Farrar and Hannigan *Farrar's Company Law* 4 ed (1998) 431; Du Plessis "Revisiting the Judge-Made Rule of Non-Interference in Internal Company Matters" 2010 *SALJ* 306.

839 1843 67 ER 189.

840 1847 1 Ph 790. For this proposition see also Farrar and Hannigan *Farrar's Company Law* 4 ed (1998) 431.

841 Farrar and Hannigan *Farrar's Company Law* 4 ed (1998) 431.

842 Hargovan "Under Judicial and Legislative Attack: The Rule in Foss v Harbottle" 1996 *SALJ* 631 and 632; Idensohn "The Fate of Foss under the Companies Act 71 of 2008" 2012 *SA Merc L.J* 356; Cassim *et al Contemporary Company Law* 2 ed (2012) 775-777; Mongalo *Corporate Law and Corporate Governance: A Global Picture of Business Undertakings in South Africa* (2003) 265-266; Mongalo *et al Forms of Business Enterprise: Theory, structure and operation* (2004) 275.

843 1843 67 ER 189.

844 Idensohn "The Fate of Foss under the Companies Act 71 of 2008" 2012 *SA Merc L.J* 356.

845 *Salomon v Salomon and Company Ltd* 1897 (AC) 22 HL.

846 Cassim *et al Contemporary Company Law* 2 ed (2012) 775-777; Mongalo *Corporate Law and Corporate Governance: A Global Picture of Business Undertakings in South Africa* (2003) 265-266; Mongalo *et al Forms of Business Enterprise: Theory, structure and operation* (2004) 275.

847 Idensohn "The Fate of Foss under the Companies Act 71 of 2008" 2012 *SA Merc L.J* 356.

848 MacIntosh "The Oppression Remedy: Personal or Derivative?" 1991 *Canadian Bar Review* 31.

institute legal proceedings for redress".[849] One of the issues that arises from this consequence is: who decides to institute the legal proceedings?

The second principle of the rule, the internal management principle, is based on the separation of ownership and control.[850] The judiciary referred to those decisions that the general shareholder meeting has the power to make by simple majority vote as "matters of internal management".[851] There are two shortcomings of the proper plaintiff and internal management principles. First, if the rule is applied without qualification to all cases of conduct that may harm the company when it is in the power of the general meeting to decide whether or not to institute proceeding for and or on behalf of the company, only those instances in which the meeting decides to institute proceedings will have the chance of redress.[852] If it is decided in the general shareholders' meeting not to institute proceedings against the alleged conduct, regardless of which stakeholders are affected, the wrong will not be remedied. Second, no stakeholder in their personal capacities will have the standing to approach the court for redress on behalf of the company for the simple reason that they are not the "proper plaintiff" since they did not directly suffer the harm.[853]

However, the rule has its own advantages. Hargovan asserts that the reasons for the rule are also its advantages.[854] Firstly, the rule recognises that a company is a separate legal entity that can acquire rights and obligations and therefore should also acquire causes of action.[855] However, one may wonder if that qualifies to be termed an advantage because the mere fact of acknowledging the legal personality of a company does not add anything to the enforcement of directors' duties.[856] One may also claim that that is no more than an inherent feature of the rule which really does not amount to an advantage. The second reason is that the rule is an expression of the majority's will

849 Idensohn "The Fate of Foss under the Companies Act 71 of 2008" 2012 *SA Merc L.J* 356 and Farrar and Hannigan *Farrar's Company Law* 4 ed (1998) 431.

850 Idensohn "The Fate of Foss under the Companies Act 71 of 2008" 2012 *SA Merc L.J* 357. For more on the principle of separation and ownership see the English case of *Burland v Earle* 1902 AC 83 (PC).

851 Idensohn "The Fate of Foss under the Companies Act 71 of 2008" 2012 *SA Merc L.J* 357.

852 Idensohn "The Fate of Foss under the Companies Act 71 of 2008" 2012 *SA Merc L.J* 357.

853 *Ibid.*

854 Hargovan "Under Judicial and Legislative Attack: The Rule in Foss v Harbottle" 1996 *SALJ* 633; Mongalo *Corporate Law and Corporate Governance: A Global Picture of Business Undertakings in South Africa* (2003) 266; Mongalo *et al Forms of Business Enterprise: Theory, Structure and Operation* (2004) 274-275.

855 Hargovan "Under Judicial and Legislative Attack: The Rule in Foss v Harbottle" 1996 *SALJ* 633.

856 The Concise Oxford English Dictionary 2006 11 ed 18 defines an advantage as "a condition or circumstance that puts one in a favourable position or a benefit".

which in turn reduces the risk of a multiplicity of actions.[857] Third, the rule also "eliminates vexatious litigation by mischievous minority shareholders".[858]

Like any general rule, exceptions are always uninvited accomplices. The *Foss v Harbottle*[859] rule is no exception. First, the rule does not apply where the alleged conduct is either illegal or *ultra vires* to the company.[860] Second, the rule does not apply in cases where the issues cannot be resolved by a simple majority but requires a special majority vote.[861] Also the rule does not apply in instances where shareholders' personal or individual rights have been violated.[862] Lastly, the rule does not apply in cases where the conduct of those in control of a company amounts to fraud which affects the minority.[863]

It is the last exception that has a bearing on the derivative action. There is major disadvantage in the rule in *Foss v Harbottle*.[864] Although the company is the proper plaintiff to institute legal action against the wrongdoers, it can only do so through the agency of human beings who are its directors.[865] In some instances the directors themselves who may own enough shares to control the outcome of shareholders' meetings might be the wrongdoers themselves.[866] In such instances, it is

857 Hargovan "Under Judicial and Legislative Attack: The Rule in Foss v Harbottle" 1996 *SALJ* 633.

858 Hargovan "Under Judicial and Legislative Attack: The Rule in Foss v Harbottle" 1996 *SALJ* 633; Farrar and Hannigan *Farrar's Company Law* 4 ed (1998) 431; Mongalo *Corporate Law and Corporate Governance: A Global Picture of Business Undertakings in South Africa* (2003) 265-266; Mongalo *et al Forms of Business Enterprise: Theory, structure and operation* (2004) 275.

859 1843 67 ER 189. See also MacIntosh "The Oppression Remedy: Personal or Derivative?" 1991 *Canadian Bar Review* 31. These exceptions were outlined by Jenkins L.J. in *Edwards v Halliwell* 1950 2 All ER.

860 Wedderburn "Shareholders' Rights and the Rule in Foss v Harbottle" 1957 *Cambridge L.J* 203; Mongalo *Corporate Law and Corporate Governance: A Global Picture of Business Undertakings in South Africa* (2003) 267; Mongalo *et al Forms of Business Enterprise: Theory, structure and operation* (2004) 275-276; Farrar and Hannigan *Farrar's Company Law* 4 ed (1998) 433.

861 *Ibid*.

862 Wedderburn "Shareholders' Rights and the Rule in Foss v Harbottle" 1957 *Cambridge L.J* 203; Mongalo *Corporate Law and Corporate Governance: A Global Picture of Business Undertakings in South Africa* (2003) 267; Mongalo *et al Forms of Business Enterprise: Theory, structure and operation* (2004) 275-276; Farrar and Hannigan *Farrar's Company Law* 4 ed (1998) 434.

863 Wedderburn "Shareholders' Rights and the Rule in Foss v Harbottle" 1957 *Cambridge L.J* 203; Mongalo *Corporate Law and Corporate Governance: A Global Picture of Business Undertakings in South Africa* (2003) 267 and Mongalo *et al Forms of Business Enterprise: Theory, structure and operation* (2004) 275-276; Farrar and Hannigan *Farrar's Company Law* 4 ed (1998) 436. It is general knowledge that directors are the ones who control companies. In this study it must be borne in mind, as mentioned in chapter one, that there is a risk of conflict of interests and a possible undermining of other stakeholders' interests if those who are in control also own a significant number of shares and are able to influence the outcome of a shareholders' meeting.

864 Farrar and Hannigan *Farrar's Company Law* 4 ed (1998) 431.

865 *Ibid*.

866 Mongalo *Corporate Law and Corporate Governance: A Global Picture of Business Undertakings in South Africa* (2003) 266; Mongalo *et al Forms of Business Enterprise: Theory, Structure and Operation* (2004) 275; Cassim

predictable that they will not institute any action against themselves.[867] Indeed it is most probable that they will frustrate any efforts to sue and this will be to the detriment of the company.[868] Corporate law commentators from various common law jurisdictions agree that the derivative action developed as an exception to the rule in *Foss v Harbottle*.[869] The derivative action has developed from being simply a common law principle and has caught the legislature's attention.[870] Cassim has stressed the need for a statutory derivative action.[871]

The historical background and evolution that the derivative action has undergone makes it pertinent to analyse its nature and scope. If the board of directors fails to take action it will then be left to shareholders or any legitimate stakeholder to commence derivative proceedings.[872] Derivative actions are claims brought before a court of law by a complainant seeking redress on behalf of the company.[873] In other words, the complainant is not the direct beneficiary of the order of the court. This means that before one can institute action he/she must ensure that the action is

et al Contemporary Company Law 2 ed (2012) 776; Farrar and Hannigan *Farrar's Company Law* 4 ed (1998) 431.

867 Farrar and Hannigan *Farrar's Company Law* 4 ed (1998) 431; Cassim *et al Contemporary Company Law* 2 ed (2012) 776.

868 Farrar and Hannigan *Farrar's Company Law* 4 ed (1998) 431; Mongalo *Corporate Law and Corporate Governance: A Global Picture of Business Undertakings in South Africa* (2003) 266; Mongalo *et al Forms of Business Enterprise: Theory, Structure and Operation* (2004) 275; Cassim *et al Contemporary Company Law* 2 ed (2012) 776.

869 1843 67 ER 189. See also Keay "Public Enforcement of Directors' Duties: A normative enquiry" 2014 *Common Law World Review* 90 note 11; Farrar and Hannigan *Farrar's Company Law* 4 ed (1998) 431, Davies ***et al*** *Companies and other Business Structures in South Africa* 3 ed (2013) 297 and MacIntosh "The Oppression Remedy: Personal or Derivative?" 1991 *Canadian Bar Review* 31.

870 MacIntosh "The Oppression Remedy: Personal or Derivative?" 1991 *Canadian Bar Review* 31 states that "a statutory derivative action was adopted in the Ontario legislation in 1971 following a recommendation by the Lawrence Committee [and that] a broadly similar provision was adopted in British Columbia in 1973".

871 Cassim "When Companies are Harmed by Their own Directors: The Defects in the Statutory Derivative Action and the Cures (Part 1)" 2013 *SA Merc L.J* 170; Cassim "The Statutory Derivative Action under the Companies Act of 2008: The Role of Good Faith" 2013 *SALJ* 497-501; Cassim "Costs Orders, Obstacles and Barriers to the Derivative Action under Section 165 of the Companies Act 71 of 2008 (Part 1)" 2014 *SA Merc LJ* 1; Cassim "The Statutory Derivative Action under the Companies Act of 2008: The Role of Good Faith" 2013 *SALJ* 496.

872 Keay "Public Enforcement of Directors' Duties: A normative enquiry" 2014 *Common Law World Review* 97.

873 Farrar and Hannigan *Farrar's Company Law* 4 ed (1998) 430; Mongalo *et al Forms of Business Enterprise: Theory, Structure and Operation* (2004) 273. It is called derivative because the shareholder steps into the shoes of the company and seeks redress on behalf of the company and not for himself. In the South African case of *TWK Agriculture Limited v NCT Forestry Co-operative Ltd* 2006 6 SA 20 (N) it was held that "as a general rule, where a wrong is alleged to have been committed against a company, it is the company that must seek redress".

not personal.[874] Aronson states that a derivative action is made up of two causes of action.[875] Derivative actions can also be viewed as a feature of the checks and balances invoked by shareholders to monitor directors' conduct.[876] However, caution has to be taken when pursuing redress via derivative actions as there are multiple reasons for the board not to take action. Some of these are: members of the board might be the wrongdoers; the costs of the legal proceedings might outweigh what will be recovered if the claim is successful; and the directors may not be convinced of the chances of success.[877]

For one to be able to invoke the derivative action for relief, he or she must comply with certain requirements. These requirements will be discussed with respect to the American, South African, English and Canadian laws. The first requirement is standing. In America, for one to have standing before a court of law, the plaintiff must have been a "shareholder at the time the derivative action [was] filed".[878] The second requirement is known as the contemporaneous ownership requirement.[879] "This requirement is designed to curtail strike suits[880] by prohibiting potential plaintiffs from buying into a lawsuit or commencing a derivative action by simply purchasing shares after the alleged wrong has occurred".[881] The contemporaneous ownership requirement therefore ensures that only those who suffered harm get relief. South African jurisprudence on the derivative action is silent this requirement.

The application of the contemporaneous ownership requirement may however be difficult in some instances as it may prove to be quite a challenge to delineate the actual time when the alleged

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874 Aronson *et al* "Shareholder Derivative Actions: From Cradle to Grave" 2009 4-8 concede that it is not easy to differentiate between personal and derivative actions whilst at the same time he states that courts have wide discretion in making that decision. For example, in American law, the courts used to apply the "special injury" test to determine whether the action is direct or derivative. This was changed by the Delaware Chancery Court in 2004. The decision is now based on who suffered the harm between the stakeholder and the company and who will benefit if the claim is successful. However, this was later disapproved and the distinction between the two remains blurred in the case of closely held companies.

875 Aronson *et al* "Shareholder Derivative Actions: From Cradle to Grave" 2009 1. The same authors say that the first action is to compel the company to sue and the second one is when the shareholder brings the action before the court on behalf of the company. See also the American case of *Brown v Tenney* 1988 532 NE 2d 230, 232 Ill.

876 Aronson *et al* "Shareholder Derivative Actions: From Cradle to Grave" 2009 1.

877 Keay "Public Enforcement of Directors' Duties: A normative enquiry" 2014 *Common Law World Review* 96.

878 Aronson *et al* "Shareholder Derivative Actions: From Cradle to Grave" 2009 10.

879 *Ibid*.

880 http://thelawdictionary.org/strike-suit/ (accessed 23-11-2015) define a strike suit as "suit that is brought by a minority of shareholders against a corporation".

881 Aronson *et al* "Shareholder Derivative Actions: From Cradle to Grave" 2009 10 who refers to *Brambles USA Inc v Blocker* 1990 731 F Supp 643 (D Del).

wrong occurred. For example, if the board of directors is involved in some corrupt activities over a period of five years. Within the period concerned, the firm was illegally awarded multi-million rand tenders. As a result of the deals the company sealed, a lot of investors were attracted to it and bought its shares. The value of the company's shares then increased exponentially within the period concerned. Company X's corrupt activities were then later exposed at the end of the five years. News about the company's dirty deals led to a sharp drop in the value of its shares. The question is: was the harm done when the directors first engaged in the illegal procurement of tenders or is it when news of its illegal dealings broke out? Moreover, are shareholders who bought company X's shares after the tenders were procured but before the exposure to be treated as plaintiffs?

The plaintiff must also comply with the demand requirement.[882] For the plaintiff to satisfy the demand requirement, he or she must "allege with particularity the efforts, if any, made by the plaintiff to obtain the action the plaintiff desires . . . and the reasons for the plaintiff's failure to obtain the action or for not making the effort".[883] In other words, the plaintiff must first engage the director(s) or the board of directors who are the rightful persons to initiate legal action on behalf of the company.[884] The directors need to justify their decision not to initiate action. It is not clear whether the directors need to respond to the aggrieved party in writing or mere inactivity suffices. One can argue that in the absence of a written or any formal communication from the directors, the plaintiff's decision to proceed with legal action must be based on a couple of factors which may include the length of time that the directors have taken to come to a decision, and the number of times the plaintiff has engaged the directors and got no response, among others.

The derivative action is also part of South African law.[885] This remedy used to be based on a common law rule only but it has now been incorporated into legislation.[886] Mongalo states that under common law, to succeed with a claim based on the derivative action, one simply had to prove that there had been fraud on the minority and that the wrongdoers were in control of the

882 Aronson *et al* "Shareholder Derivative Actions: From Cradle to Grave" 2009 20.
883 Aronson *et al* "Shareholder Derivative Actions: From Cradle to Grave" 2009 20.
884 It has been emphasised that the institution of legal action by a company is a commercial decision which remains a prerogative of the directors.
885 1973 and 2008 Act, Davies *et al Companies and other Business Structures in South Africa* 3 ed (2013) 296.
886 See section 165 of the Companies Act 71 of 2008.

company.[887] The same scholar opines that the shortcomings of the common law derivative action led to the Report of the Commission of Enquiry on South Africa's company law[888] recommending the introduction of a statutory derivative action.[889] Cassim *et al* observe that "the new Act abolishes the common-law derivative action and institutes a new statutory regime to govern derivative actions".[890] However, Du Plessis disagrees with the above assertion but states that "there is no indication in the new Companies Act 71 of 2008 that any of these judge-made rules have been abolished or codified to any extent that would make them irrelevant or inapplicable in the modern company law context in South Africa".[891] The Companies Act[892] does not explicitly stipulate that it abolishes the common law derivative action. However, section 165 of the South African Companies Act[893] can be taken as the authority for the abolition of the common law derivative action.[894] It is submitted in this study that section 165 of the Companies Act has indeed abolished the common law derivative action in South Africa.

In South Africa, for one to invoke the derivative action, they must first have standing.[895] According to section 165(2) of the Companies Act,[896] stakeholders who may have standing before the court of law include shareholders, registered trade unions that represent employees of the company or other representatives of employees of the company and persons to whom after considering that it

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887 Mongalo *Corporate Law and Corporate Governance: A Global Picture of Business Undertakings in South Africa* (2003) 268 and Mongalo *et al Forms of Business Enterprise: Theory, Structure and Operation* (2004) 277-278.

888 1963 (hereinafter referred to as the Van Wyk De Fries Commission).

889 Mongalo *Corporate Law and Corporate Governance: A Global Picture of Business Undertakings in South Africa* (2003) 272; Mongalo *et al Forms of Business Enterprise: Theory, Structure and Operation* (2004) 280-281. Mongalo states that under common law, a stakeholder purporting to bring a derivative action against the company would bear all the legal costs and also faced the problem of information asymmetry. See also Davies *et al Companies and other Business Structures in South Africa* 3 ed (2013) 294.

890 Cassim *et al Contemporary Company Law* 2 ed (2012) 778. The authors further submit that the common law derivative action has been abolished in other common law jurisdictions such as Australia and England. Cassim "The Statutory Derivative Action under the Companies Act of 2008: The Role of Good Faith" 2013 *SALJ* 508 also states that the common law derivative action has been abolished by the new Act.

891 Du Plessis "Revisiting the Judge-Made Rule of Non-Interference in Internal Company Matters" 2010 *SALJ* 304-305.

892 71 of 2008.

893 71 of 2008. Section 165(1) states that "any right at common law of a person other than a company to bring or prosecute any legal proceedings on behalf of that company is abolished, and the rights in this section are in substitution for any such abolished right".

894 See Cassim *et al Contemporary Company Law* 2 ed (2012) 778.

895 Section 165 of the Companies Act 71 of 2008. Cassim *et al Contemporary Company Law* 2 ed (2012) 827 state that section 157 of the Companies Act 71 of 2008 extend the *locus standi* for applications for remedies. According to that section standing has been extended to the effect that one can bring a class action before a court.

896 71 of 2008.

is appropriate, the court grants standing.[897] With respect to shareholders, it is submitted that this remedy will most likely be invoked by the minority since the majority have power to pass resolutions favourable to them during shareholders' meetings. However, derivative actions are and should not be limited to minority shareholders alone.[898]

Employees' interests are indirectly taken into account through representation by registered trade unions.[899] It is clear that employees' interests are not at par with shareholders' as they do not have direct standing. Furthermore, if employees are only to get relief through trade union representation, what about those that are not affiliated to trade unions? Maybe this provision was inserted to do away with a multiplicity of cases since employees may not be equally affected by the directors' decisions. However, this is not enough to justify indirect recognition of employees' interests because even shareholders although they are not affected in the same way they can still invoke the derivative action without the need for representation by any third party.

Additionally, section 165(2) does not specifically include creditors among the possible complainants. It can therefore be contended that, in South Africa, creditors do not have a direct right to invoke the derivative action. However, a person can be granted leave by the court "if the court is satisfied that it is necessary or expedient to do so to protect a legal right of that other person".[900] The Act does not define what is necessary or expedient and neither does it provide guidelines or factors to be considered in determining such. This phrase "if the court is satisfied" can be interpreted to infer that the courts can exercise their discretion to determine whether a person can invoke the derivative action.[901] Therefore, if according to the court, it is necessary and expedient to protect a creditor's legal right, leave can be granted to allow the latter to commence or proceed with the derivative suit. Interpreted this way, section 165(2)(d) of the Companies Act[902] can then be invoked to protect the interests of employees as well. It is debatable whether the

897 Section 165(2)(a) of the Companies Act 71 of 2008. See also *Henochsberg on the Companies Act 71 of 2008* Vol 1 Service Issue 2 2012 586**.**
898 Section 165.
899 *Ibid.*
900 Section 165(2)(d) of the Companies Act 71 of 2008.
901 In Canada, the courts also exercise wide discretion in determining whether a stakeholder qualifies as a complainant in a derivative suit. This will be discussed in great detail below. As will be seen, Canadian courts have been very strict and hesitant to award complainant status to non-shareholder stakeholders.
902 71 of 2008.

community's interests can be protected by invoking this section since it makes reference to the legal right of a "person". The section is quiet on the interests of the community.

Secondly, the stakeholder must comply with the demand requirement.[903] This obliges the concerned stakeholder to serve the company with a demand to commence or continue with the legal proceedings or take steps to protect the company's interests.[904] It is submitted that the term "interests" is wider than "rights".[905] If the company thinks that the demand is "frivolous, vexatious or without merit",[906] it may apply to a court for an order setting aside the demand.[907]

Moreover, the plaintiff must obtain leave of the court.[908] The court thus performs a screening function in filtering away cases of "unwarranted interference by disgruntled shareholders, or other applicants in the internal management of the company".[909] Cassim further justifies the need for the leave requirement when he states that the leave requirement "averts opening the floodgates to a multiplicity of actions; if the leave of the court were not required, multiple actions could be brought by a multitude of individual shareholders and other applicants concerning the same wrong inflicted on the company".[910] In assessing whether one can proceed with the action, the court must be satisfied that the applicant is acting in good faith, that the subject matter is of material consequence to the company and that it is in the best interests of the company for the applicant to proceed with the action.[911] Cassim admits that good faith is an elusive concept whose scope is not easy to delineate.[912] The authors of Henochsberg comment that the good faith requirement under the Australian counterpart has been defined as a two-pronged enquiry.[913] The first part is "whether the

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903 Section 165(2) of the South African Companies Act 71 of 2008; *Henochsberg on the Companies Act 71 of 2008* Vol 1 Service Issue 2 2012 586.

904 Section 165(2) of the South African Companies Act 71 of 2008.

905 Cassim *et al Contemporary Company Law* 2 ed (2012) 781.

906 Section 165(3); *Henochsberg on the Companies Act 71 of 2008* Vol 1 Service Issue 2 2012 586.

907 Section 165(3). For more on information about the demand requirement see *Henochsberg on the Companies Act 71 of 2008* Vol 1 Service Issue 2 2012 586; Cassim *et al Contemporary Company Law* 2 ed (2012) 784.

908 Section 165(5)(a). See also Cassim *et al Contemporary Company Law* 2 ed (2012) 784

909 Cassim "The Statutory Derivative Action under the Companies Act of 2008: The Role of Good Faith" 2013 *SALJ* 501.

910 Cassim "The Statutory Derivative Action under the Companies Act of 2008: The Role of Good Faith" 2013 *SALJ* 501.

911 Section 165(1)(b). For more on the requirements to grant leave see *Henochsberg on the Companies Act 71 of 2008* Vol 1 Service Issue 2 2012 586(1) and Cassim *et al Contemporary Company Law* 2 ed (2012) 784.

912 Cassim "The Statutory Derivative Action under the Companies Act of 2008: The Role of Good Faith" 2013 *SALJ* 508.

913 *Henochsberg on the Companies Act 71 of 2008* Vol 1 Service Issue 2 2012 586(1).

applicant honestly believes that a good cause of action exists".[914] And the second one is "whether the applicant seeks to bring a derivative action for a collateral purpose".[915] Cassim suggests that the concept of good faith can be interpreted by referring to established common law principles.[916]

The court must also be satisfied that the proposed action raises a serious question of material consequence to the company.[917] The authors of Henochsberg argue that the phrase "a serious question of material consequence" is open to interpretation by the courts.[918] Henochsberg, referring to Australian case law opine that the phrase requires the applicant "to identify the legal or equitable rights to be determined at trial in respect of which the final relief is sought".[919] It is not clear whether the inclusion of "equitable rights" in the above formulation expands the scope of the derivative action. Equitable rights are broader in scope than legal rights because they are based on the fairness standard. The repeated reference to foreign case law, though constitutionally permissible,[920] can be interpreted to mean that South African company law is still in its infancy. Lastly, it must also be in the best interests of the company that the applicant be granted leave to commence or proceed with the action.[921]

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914 *Ibid*.

915 *Swansson v RA Pratt Properties Pty Ltd* 2002 42 ACSR 313 as referred to in *Henochsberg on the Companies Act 71 of 2008* Vol 1 Service Issue 2 2012 586(1).

916 Cassim "The Statutory Derivative Action under the Companies Act of 2008: The Role of Good Faith" 2013 *SALJ* 508. The same scholar draws an analogy between a director and an applicant who wishes to invoke derivative action and states that "just as a director has a duty to act in good faith in conducting the affairs of the company, so an applicant who wishes to pursue litigation on behalf of the company in terms of s 165 ought to act according to a similar standard of good faith".

917 Section 165(5)(b).

918 *Henochsberg on the Companies Act 71 of 2008* Vol 1 Service Issue 2 2012 586(1).

919 *Henochsberg on the Companies Act 71 of 2008* Vol 1 Service Issue 2 2012 586(1) while referring to *Ragless v IPA Holdings Pty Ltd (in liq)* 2008 65 ACSR 700.

920 See section 39(1) of the Constitution of the Republic of South Africa, 1996.

921 Section 165 of the South African Companies Act 71 of 2008. *Henochsberg on the Companies Act 71 of 2008* Vol 1 Service Issue 2 2012 586(1). In the Australian case of *Charlton v Baber* 2003 NSWSC 859 44, it was held that the "interests of the company" refer to "the separate and independent welfare of the company". In *Swansson v RA Pratt Properties Pty Ltd* 2002 42 ACSR 313 and 324 it was further held that "elements and circumstances that will be considered by the court in determining whether granting leave would be in the best interests of the company include the character of the company; the business of the company in that the effects of the proposed litigation on the conduct of the business may be appreciated; whether there are any other means of obtaining the same redress so that the company does not have to be brought into litigation against its will; and the ability of the defendant to meet at least a substantial part of any judgement in favour of the company". See also Nwafor "Shareholder Derivative Action- Nigerian Statutory Innovation -Not Yet a Victory for the Minority Shareholder" 2010 *Macquarie J. Bus. L* 219-222.

The first reported derivative action case to come before the courts after the new Companies Act[922] came into force in South Africa is *Mouritzen v Greystones Enterprises (Pty) Ltd*.[923] The case was brought under section 165(5) of the Companies Act.[924] The applicant and second respondent were brothers and the only directors of the first respondent company. The applicant and second respondent were paid equal monthly salaries by the company. These two, who will in this study be referred to as co-directors, had their personal credit cards which were issued in their names linked to the company's First National Bank (FNB) account to the effect that any transaction that took place using those credits cards would be automatically debited to and paid by the company. The applicant alleged that the second respondent grossly abused the credit card to the detriment and prejudice of both the company and its shareholders. The applicant therefore sought an order granting him leave to institute action in the name of the company against the second respondent.[925]

The issues to be determined by the court were: whether the demand served on the company by the applicant complied with section 165(2) of the Companies Act; whether the applicant acted in good faith and whether it was in the best interests of the company that legal proceedings commence against the second respondent. The demand in question was in the form of a letter from the applicant's attorneys which was posted to the company's postal address. The court adopted a purposive approach to the interpretation of the relevant provision of the Act[926] and held that "there is no legal or logical basis to read into section 165(2) words to the effect that service of the demand must be made necessarily 'at its registered office or principal place of business' when the ordinary grammatical reading of the section does not support such suggestion".[927]

Before the court made determinations on the other two issues, it noted that South Africa's company law on derivative actions was heavily influenced by foreign law namely Australia, New Zealand, Canada[928] and ultimately the UK. With respect to the question whether the applicant acted in good

922 71 of 2008.
923 2012 5 SA 74 (KZD).
924 71 of 2008.
925 *Mouritzen v Greystones Enterprises (Pty) Ltd* 2012 5 SA 74 (KZD) 2-3.
926 71 of 2008. It was further held that "the purposive interpretation of section 165(2) does not require that a demand referred to in that section must necessarily be served on a company by delivering it at its registered office or its principal place of business".
927 *Mouritzen v Greystones Enterprises (Pty) Ltd* 2012 5 SA 74 (KZD) 14-15.
928 *Mouritzen v Greystones Enterprises (Pty) Ltd* 2012 5 SA 74 (KZD) 18. Some of the foreign case law that the court referred to include the Australian seminal cases of *Swansson v RA Pratt Properties Pty Ltd* 2002 42 ACSR 313; *Ragless v IPA Holdings Pty Ltd (in liq)* 2008 65 ACSR 700.

faith, it had to be determined whether the enmity which had grown between the two brothers prompted the applicant to institute legal action under the guise of the company.[929] The court held that "there must be a demonstration of good conscience and sincere belief on the existence of reasonable prospects of success in the proposed litigation and, therefore, absence of an ulterior motive, on the part of an applicant".[930] Hostility between the parties is not conclusive proof of *mala fides* but it is an important factor to be considered by the court.[931] In pronouncing *obiter* that parties do not need to be in talking terms to institute a derivative action, the court held that "what is of utmost fundamental importance, amongst others, is the fiduciary duty which they individually owe to the company of which they are the directors".[932] The court then held that the applicant had successfully demonstrated on a balance of probabilities that he was acting in good faith as he had nothing to hide in that he was also ready to show his credit card record.[933] The court noted that in some instances, the good faith requirement overlaps with the best interests standard.[934] The court held that it was indeed in the best interests of the company that legal action be instituted by the applicant because "as a representative of the majority shareholder, the applicant is entitled to call for a proper investigation of any suspected irregularities and abuse of the company's assets".[935]

In Canada, the requirements for an applicant to invoke statutory derivative action are similar to those that one must comply with in South Africa. The stakeholder needs to first have standing before the court.[936] If a stakeholder has standing, it then has to obtain leave of the court.[937] Similar to South Africa, Canadian law also requires that three requirements be complied with for one to obtain leave of the court.[938] The applicant must give a reasonable notice to the directors, the complainant must act in good faith and it must be in the interests of the company that the action be instituted.[939] The only notable difference is that while South African courts need to be satisfied

929 *Mouritzen v Greystones Enterprises (Pty) Ltd* 2012 5 SA 74 (KZD) 30-31.
930 *Ibid*.
931 *Ibid*.
932 *Mouritzen v Greystones Enterprises (Pty) Ltd* 2012 5 SA 74 (KZD) 32.
933 *Mouritzen v Greystones Enterprises (Pty) Ltd* 2012 5 SA 74 (KZD) 33.
934 *Mouritzen v Greystones Enterprises (Pty) Ltd* 2012 5 SA 74 (KZD) paras 62 and 33. The court illustrated this through an example and stated that an applicant who is motivated by "personal vendetta" will not be acting in the best interests of the company as well.
935 *Mouritzen v Greystones Enterprises (Pty) Ltd* 2012 5 SA 74 (KZD) 34.
936 MacIntosh "The Oppression Remedy: Personal or Derivative?" 1991 *Canadian Bar Review* 32.
937 Section 239(1) of the CBCA; MacIntosh "The Oppression Remedy: Personal or Derivative?" 1991 *Canadian Bar Review* 32.
938 *Ibid*.
939 MacIntosh "The Oppression Remedy: Personal or Derivative?" 1991 *Canadian Bar Review* 32.

that the subject matter is of a material consequence, Canadian Courts do not require that. It is probable that what Canadian jurisprudence refers to as notice to the court is the equivalent of South Africa's demand requirement. It can therefore be concluded that South African requirements for leave of the court are stricter than Canada's. The Dickerson Committee Report states that the reasons for the leave requirement are to avoid strike suits, to prevent meritless claims and to avoid a multiplicity of cases.[940]

In the UK, under common law, a shareholder only had to establish fraud on the minority and wrongdoer control for one to succeed with their derivative action proceedings.[941] The UK's statutory derivative scheme commenced on 1 October 2007.[942] Sections 260 to 263 of the Companies Act[943] deal with derivative claims in the UK. Unlike the American system, in the UK, "it is immaterial whether the cause of action arose before or after the person seeking to bring or continue the derivative claim became a member of the company".[944] Furthermore, for the purposes of derivative actions, "director" includes former directors.[945] For these reasons, the UK's derivative action provision is wider than its South African counterpart. It is probable that the UK's legislature adopted such a "catch all" stance as a safeguard against all forms of misconduct that directors may engage in. On the other hand, it can also be argued that this provision may not lead to vexatious and frivolous actions whereby those shareholders who were not in any way harmed by directors' conduct come aboard and straight away take directors to court.

940 Dickerson Committee Report; MacIntosh "The Oppression Remedy: Personal or Derivative?" 1991 *Canadian Bar Review* 32.

941 Farrar and Hannigan *Farrar's Company Law* 4 ed (1998) 435-436. However, Davies and Worthington *Gower's Principles of Modern Company Law* 10 ed (2016) 601-605 state that the two conditions for access to the derivative action are that: first, "the individual shareholder may not sue to enforce the company's rights if the wrong in question is one which is ratifiable by the company in general meeting by ordinary resolution. Second, wrongdoers should be in control of the company". Nwafor "Shareholder Derivative Action- Nigerian Statutory Innovation -Not Yet a Victory for the Minority Shareholder" 2010 *Macquarie J. Bus. L* 226-233 argues that proving fraud and wrongdoer control have greatly hindered the effective application of derivative actions in Nigeria.

942 Keay "Public Enforcement of Directors' Duties: A normative enquiry" 2014 *Common Law World Review* 90.

943 2006. Section 260(3) provides that "a derivative claim under this Chapter may be brought only in respect of a cause of action arising from an actual or proposed act or omission involving negligence, default, breach of duty or breach of trust by a director of the company. The cause of action may be against the director or another person (or both)".

944 Section 260(4) of the UK Companies Act 2006.

945 Section 260(5) of the UK Companies Act 2006.

Just as in South Africa and Canada, a shareholder who wishes to bring a derivative action in the UK must first be granted permission by the court.[946] Davies and Worthington state that it also has to be taken into consideration whether litigation is in the best interests of the company.[947] Section 263(3)(a) to (f) of the UK Companies Act[948] outlines the six factors that a court must take into consideration when determining whether or not to grant leave to an applicant. Among these factors the good faith requirement is the one that is common to South Africa's regime. The others are unique to UK company law.

However, one who wishes to obtain relief from a court of law via derivative action must do so with knowledge of its shortcomings. Farrar and Hannigan concede that every shareholder, regardless of whether s/he wishes to institute action for her/himself or on behalf of the company faces challenges.[949] As such, the derivative action is no exception, it has its own shortcomings. The first challenge is information asymmetry.[950] The second one is that the plaintiff has to directly bear the legal costs of an outcome that s/he will not directly benefit from.[951] It is further claimed that the derivative action is an onerous remedy in that besides providing security for costs a stakeholder also has to seek the leave of the court for him/her to commence or proceed with the legal

946 Section 263(1).

947 Davies and Worthington *Gower's Principles of Modern Company Law* 10 ed (2016) 496.

948 2006. According to section 263(2), leave is to be refused "if the court is satisfied: (a) that a person acting in accordance with section 172 (duty to promote the success of the company) would not seek to continue the claim, or (b) where the cause of action arises from an act or omission that is yet to occur, that the act or omission has been authorised by the company, or (c) where the cause of action arises from an act or omission that has already occurred, that the act or omission— (i) was authorised by the company before it occurred, or (ii) has been ratified by the company since it occurred". It can be argued that para (b) conflicts with section 260(1) which includes the phrase "…proposed act or omission…". It is common knowledge that a proposal is something that has not yet taken place.

949 Farrar and Hannigan *Farrar's Company Law* 4 ed (1998) 429.

950 Cassim *et al Contemporary Company Law* 2 ed (2012) 791; Cassim "Obstacles and Barriers to the Derivative Action: Costs Orders Under Section 165 of the Companies Act of 2008 (Part 2)" 2014 *SA Merc LJ* 241 states that shareholders who wish to institute legal action on behalf of the company against controlling directors lack inside information which is required to prove their case. See also Keay "Public Enforcement of Directors' Duties: A normative enquiry" 2014 *Common Law World Review* 94.

951 Keay "Public Enforcement of Directors' Duties: A normative enquiry" 2014 *Common Law World Review* 101-104 who further explains that the low record of minority shareholders' success in invoking derivative action might discourage any prospective stakeholder in pursuing this remedy. The challenge is that this remedy is usually invoked by minority shareholders most of which do not have the financial stamina to bear the large costs of litigation. To add salt to injury, with respect to the UK, Keay "Public Enforcement of Directors' Duties: A normative enquiry" 2014 *Common Law World Review* 101 says "shareholders not only have to concern themselves with their costs, they must accept that if the action fails the court might well order costs against them in line with the usual practice in the UK of costs following the result".

proceedings.[952] The fact that the result of a successful action indirectly benefits all the other stakeholders but the costs will be borne by the plaintiff alone makes it vulnerable to free riding.[953] Keay concludes that all these shortcomings that are associated with the derivative action may cause company stakeholders "to suffer from inertia".[954]

4 2 2 2 Oppression remedies

The oppression remedy "is an equitable remedy, which gives a court a broad, equitable jurisdiction to enforce not just legal rights, but what is fair amongst the parties".[955] It is hoped that this broad discretion bestowed on the courts is exercised accordingly and will not be abused.[956] The oppression remedy focusses on "harm to the legal and equitable interests of a wide range of stakeholders affected by oppressive acts of a corporation or its directors".[957] The inclusion of equitable interests makes oppression remedies much wider than derivative actions. However, like its counterpart derivative action, the oppression remedy has also developed from being simply a

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952 Although these two requirements are meant to act as safeguards against the abuse of derivative action by some shareholders, it is unfortunate that in practice, they have the effect of burdening the plaintiff. See also Keay "Public Enforcement of Directors' Duties: A normative enquiry" 2014 *Common Law World Review* 100; and Cassim "Costs Orders, Obstacles and Barriers to the Derivative Action under Section 165 of the Companies Act 71 of 2008 (Part 1)" 2014 *SA Merc LJ* 12.

953 It may lead to a situation whereby corporate misconduct goes unpunished since the stakeholders will be hesitant to incur further costs (litigation costs) on behalf of other stakeholders and at the same time thinking that someone will initiate action.

954 Keay "Public Enforcement of Directors' Duties: A normative enquiry" 2014 *Common Law World Review* 105; and Cassim "Costs Orders, Obstacles and Barriers to the Derivative Action under Section 165 of the Companies Act 71 of 2008 (Part 1)" 2014 *SA Merc LJ* 12.

955 Cohen *et al* "Shareholders' Remedies: Distinguishing Oppression Claims and Derivative Actions" 2011 2. The same author also states that "what is just and equitable will be determined based upon the reasonable expectations of the stakeholders in the given circumstances". This statement can be interpreted to mean that what is equitable depends on each case. See also *BCE Inc. v 1976 Debenture holders* 2008 69 (SCC) 564; court's discretion Davies *et al Companies and other Business Structures in South Africa* 3 ed (2013) 277.

956 Cheffins "The Oppression Remedy in Corporate Law: The Canadian Experience" 1988 *Journal of International Law* 314 notes that although this broad discretion may lead to the court meddling with intra-corporate affairs, there are limits to the oppression remedy so that it will not be abused by every discontented stakeholder.

957 *BCE Inc v 1976 Debenture holders* 2008 69 (SCC) 564.

common law rule into statutory action.[958] It is submitted that Canada has the widest oppression provisions.[959] Oppression remedies adopt an objective test based on the standard of fairness.[960]

The oppression remedy differs from derivative actions both substantively and procedurally. First, derivative actions are action proceedings whilst oppression remedies are sought through application proceedings.[961] Second, a derivative action has no standard of liability but is based on principles of fiduciary law whereas oppression remedies are based on conduct that is "oppressive or unfairly prejudicial to or that unfairly disregards the interests of the plaintiff".[962] Oppression remedies arise from personal harm whereas derivative actions are based on harm to the company.[963] Furthermore, there are a lot of orders available to a plaintiff under oppression remedies than under derivative actions.[964] Procedurally, under derivative actions, the complainant has to first comply with the demand requirement and obtain the leave of the court before continuing with the action.[965] Under oppression remedies, one does not have to comply with such procedural requirements.

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958 In South Africa, section 163(1)(a) of the Companies Act 71 of 2008 provides that "a shareholder or a director of a company may apply to a court for relief if any act or omission of the company, or a related person, has had a result that is oppressive or unfairly prejudicial to, or that unfairly disregards the interests of the applicant". In Canada, the oppression remedy is provided for in section 241 of the CBCA, 1985 which provides that "a complainant may apply to a court for an order under this section if, on an application under subsection (1) , the court is satisfied that in respect of a corporation or any of its affiliates the powers of the directors of the corporation or any of its affiliates are or have been exercised in a manner that is oppressive or unfairly prejudicial to or that unfairly disregards the interests of any security holder, creditor, director or officer...". In the UK, section 994 of the Companies Act of 2006 provides that "a member of a company may apply to the court by petition for an order under this Part on the ground (a) that the company's affairs are being or have been conducted in a manner that is unfairly prejudicial to the interests of members generally or of some part of its members (including at least himself), or (b) that an actual or proposed act or omission of the company (including an act or omission on its behalf) is or would be so prejudicial".

959 Cheffins "The Oppression Remedy in Corporate Law: The Canadian Experience" 1988 *Journal of International Law* 305 and 313; and Van Duzer "Who May Claim Relief from Oppression: The Complainant in Canadian Corporate Law" 1993 *Ottawa L Rev* 465.

960 Farrar and Hannigan *Farrar's Company Law* 4 ed (1998) 451. Cassim *et al Contemporary Company Law* 2 ed (2012) 769 state that the test is unfairness as opposed to unlawfulness. Cheffins "The Oppression Remedy in Corporate Law: The Canadian Experience" 1988 *Journal of International Law* 313 further submits that "the oppression remedy cuts across traditional corporate law doctrines and should be interpreted in accordance with broad standards of fairness and ethical business behaviour".

961 Cohen *et al* "Shareholders' Remedies: Distinguishing Oppression Claims and Derivative Actions" 2011 5.

962 MacIntosh "The Oppression Remedy: Personal or Derivative?" 1991 *Canadian Bar Review* 57; Cohen *et al* "Shareholders' Remedies: Distinguishing Oppression Claims and Derivative Actions" 2011 4.

963 Cohen *et al* "Shareholders' Remedies: Distinguishing Oppression Claims and Derivative Actions" 2011 3.

964 See MacIntosh "The Oppression Remedy: Personal or Derivative?" 1991 *Canadian Bar Review* 57-58; Cohen *et al* "Shareholders' Remedies: Distinguishing Oppression Claims and Derivative Actions" 2011 4; Davies *et al Companies and other Business Structures in South Africa* 3 ed (2013) 299.

965 Cohen *et al* "Shareholders' Remedies: Distinguishing Oppression Claims and Derivative Actions" 2011 5

Since Canada has the most influential historical background to the oppression remedy, it is the one that is going to be examined in this section.[966] As highlighted above, the oppression remedy is contained in section 241 of the CBCA.[967] This provision has its origins in English statute law which can further be traced to the case of *Foss v Harbottle*.[968] The English statutory oppression remedy came about as an option to the strict winding-up action.[969] Besides this, a winding-up action is basically a means of terminating a company. There was, therefore, need to preserve the life of a company while at the same time addressing stakeholders' concerns.[970] Section 210 of the 1948 UK Companies Act granted wide discretionary powers to the courts when addressing oppressive conduct.[971] In 1962, on the recommendations of the Jenkins Committee Report, section 210 of the 1948 Companies Act was amended.[972]

Cheffins and MacIntosh posit that the oppression remedy first appeared in Canadian law in 1960[973] in the BCCA.[974] Section 195 of that Act permitted shareholders to "apply for relief from oppressive conduct by those in control of the company".[975] In 1973, the BCCA[976] was revised in order to bring

966 Cheffins "The Oppression Remedy in Corporate Law: The Canadian Experience" 1988 *Journal of International Law* 308-310.

967 1985.

968 1843 67 ER 189. See also Ben-Ishai and Puri "The Canadian Oppression Remedy Judicially Considered: 1995-2001" 2004 *Queen's L.J* 85; Cheffins "An Economic Analysis of the Oppression Remedy: Working Towards a more Coherent Picture of Corporate Law" 1990 *University of Toronto Law Journal* 775-776.

969 Ben-Ishai and Puri "The Canadian Oppression Remedy Judicially Considered: 1995-2001" 2004 *Queen's L.J*. 86; Cheffins "The Oppression Remedy in Corporate Law: The Canadian Experience" 1988 *Journal of International Law* 311.

970 Cheffins "The Oppression Remedy in Corporate Law: The Canadian Experience" 1988 *Journal of International Law* 308 stresses the need for the oppression remedy in that the winding up option was common as it was practically the best way unsatisfied shareholders could "protect" themselves. Majority shareholders were able to protect their rights through voting. The statutory protection offered to minority shareholders was not enough if not ineffective.

971 Ben-Ishai and Puri "The Canadian Oppression Remedy Judicially Considered: 1995-2001" 2004 *Queen's L.J* 86.

972 *Ibid*.

973 Cheffins "An Economic Analysis of the Oppression Remedy: Working Towards a more Coherent Picture of Corporate Law" 1990 *University of Toronto Law Journal* 775-776; Cheffins "The Oppression Remedy in Corporate Law: The Canadian Experience" 1988 *Journal of International Law* 310; MacIntosh "The Oppression Remedy: Personal or Derivative?" 1991 *Canadian Bar Review* 41.

974 Cheffins "The Oppression Remedy in Corporate Law: The Canadian Experience" 1988 *Journal of International Law* 306 says "Canada, like the United States, is a federal system. Unlike in the United States, however, the Canadian federal government, as well as the ten provinces, has the power to incorporate. All eleven jurisdictions have taken advantage of their constitutional authority and have enacted general incorporation statutes". So in this case the British Columbia Province enacted the BCCA.

975 Cheffins "An Economic Analysis of the Oppression Remedy: Working Towards a more Coherent Picture of Corporate Law" 1990 *University of Toronto Law Journal* 776.

976 1973.

its provisions in line with the recommendations of England's Jenkins Committee Report.[977] The Jenkins Committee Report sought to "widen the type of 'unfair conduct' for which relief would be given".[978] The Canadian Dickerson Committee's recommendations led to the legislature's inclusion of the oppression remedy in the CBCA.[979] The 1975 Act was much broader than the BCCA[980] in that it introduced a third form of conduct namely, unfair disregard of the interests of the applicant, as a ground upon which relief can be sought and also included creditors among applicants who can invoke this remedy.[981] Canada's current statutory oppression remedy is based on the amended section 210 of the UK's Companies Act of 1948.[982]

The oppression remedy has been partly triggered by the need for shareholder protection especially in smaller private companies.[983] The reason behind such a trend is that in a private company, the "business and acts of a company are generally conducted by its board of directors and by its shareholders in general meeting by majority vote".[984] Mongalo states that, in corporate governance, the structure of a company determines the type of issues that are likely to flow from a company.[985] In a "concentrated ownership structure" the main issues will be centred on the

977 MacIntosh "The Oppression Remedy: Personal or Derivative?" 1991 *Canadian Bar Review* 41 who further stressed that "the new legislation added unfair prejudice as a second class of conduct that could give rise to a remedy and dropped the requirement that there had to be grounds for winding up in order for relief to be granted". See also Cheffins "The Oppression Remedy in Corporate Law: The Canadian Experience" 1988 *Journal of International Law* 311 and Cheffins "An Economic Analysis of the Oppression Remedy: Working Towards a more Coherent Picture of Corporate Law" 1990 *University of Toronto Law Journal* 776.

978 MacIntosh "The Oppression Remedy: Personal or Derivative?" 1991 *Canadian Bar Review* 37 and 41. Cheffins "An Economic Analysis of the Oppression Remedy: Working Towards a more Coherent Picture of Corporate Law" 1990 *University of Toronto Law Journal* 776. Cheffins "The Oppression Remedy in Corporate Law: The Canadian Experience" 1988 *Journal of International Law* 311. The scholar also noted that Ontario's Lawrence Committee had recommended that an oppression remedy not be adopted as it would lead to the judiciary applying a case by case approach when dealing with such issues. However, the views of the Lawrence Committee were not accepted.

979 1975. MacIntosh "The Oppression Remedy: Personal or Derivative?" 1991 *Canadian Bar Review* 42.

980 1973. See Cheffins "The Oppression Remedy in Corporate Law: The Canadian Experience" 1988 *Journal of International Law* 311.

981 Cheffins "An Economic Analysis of the Oppression Remedy: Working Towards a more Coherent Picture of Corporate Law" 1990 *University of Toronto Law Journal* 776; Cheffins "The Oppression Remedy in Corporate Law: The Canadian Experience" 1988 *Journal of International Law* 311 and 312.

982 Ben-Ishai and Puri "The Canadian Oppression Remedy Judicially Considered: 1995-2001" 2004 *Queen's L.J.* 87; Cheffins "An Economic Analysis of the Oppression Remedy: Working Towards a more Coherent Picture of Corporate Law" 1990 *University of Toronto Law Journal* 775-776; Cheffins "The Oppression Remedy in Corporate Law: The Canadian Experience" 1988 *Journal of International Law* 310; MacIntosh "The Oppression Remedy: Personal or Derivative?" 1991 *Canadian Bar Review* 41.

983 ` Cassim *et al Contemporary Company Law* 2 ed (2012) 757.

984 Cassim *et al Contemporary Company Law* 2 ed (2012) 758.

985 Mongalo *Corporate Law and Corporate Governance: A Global Picture of Business Undertakings in South Africa* (2003) 260; Mongalo *et al Forms of Business Enterprise: Theory, Structure and Operation* (2004) 268.

restriction of security holders who own large numbers of the issued securities whilst in "dispersed share ownership structures", the main issue will be the monitoring of how directors execute their duties.[986] This is the reason why managerial accountability is of great significance.

The oppression remedy has its own merits and demerits. Ben Ishai and Puri propose that the oppression remedy can be used to justify the weaknesses of the contractual theory.[987] In addressing some of these weaknesses, these authors establish that the inclusion of creditors as stakeholders who can make use of the oppression remedy solves the problem of information asymmetry and since oppression remedies are mandatory in nature, it makes bargaining moot.[988] Cheffins points out that the oppression remedy has been successfully applied in closely held companies.[989] It has been alluded to above that stakeholders in closely held companies are highly vulnerable. It is however not clear why the oppression remedy has been successful in cases involving those companies. Probably, it could be because the derivative action is inaccessible to most of the stakeholders. It can also be advocated for that the oppression remedy has been successful in cases involving closely held companies because of the influence of the Dickerson Committee Report. If so, does this mean that the oppression remedy is always interpreted to reflect the intention of the drafters of the Dickerson Committee Report?

Furthermore, under oppression remedies, one makes direct claims and therefore there is no free riding. Furthermore, under oppression remedies, there is no need to seek the leave of the court, unfair prejudice is easier to prove than the derivative action's infringement of legal rights and that oppression remedies offer a wider range of relief.[990] Van Duzer also states that the oppression

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986 *Ibid*.

987 Ben-Ishai and Puri "The Canadian Oppression Remedy Judicially Considered: 1995-2001" 2004 *Queen's LJ* 82. For a recap, some of the criticisms levelled against the contractual or nexus of contracts model are that "non-monetary interests are disregarded and therefore not protected, those who have an interest in the affairs of a corporation are not all privy to all information relevant to their contract with the corporation, it is difficult to foresee what protection is necessary at the time of contract, and there is often no chance of individual bargaining". These criticisms were also discussed in Chapter 3 under section 3 6 which dealt with company models.

988 Ben-Ishai and Puri "The Canadian Oppression Remedy Judicially Considered: 1995-2001" 2004 *Queen's LJ* 82-83.

989 Cheffins "An Economic Analysis of the Oppression Remedy: Working Towards a more Coherent Picture of Corporate Law" 1990 *University of Toronto Law Journal* 776-8 and Cheffins "The Oppression Remedy in Corporate Law: The Canadian Experience" 1988 *Journal of International Law* 319 note 51.

990 Cassim "Costs Orders, Obstacles and Barriers to the Derivative Action under Section 165 of the Companies Act 71 of 2008 (Part 1)" 2014 *SA Merc LJ* 10; Van Duzer "Who May Claim Relief from Oppression: The Complainant in Canadian Corporate Law" 1993 *Ottawa L Rev* 465.

remedy can be a useful alternative to an ordinary civil claim for a creditor.[991] Also the fact that oppression remedies are less onerous makes them cheaper. However, McIntosh argues that if the case has numerous appeals the legal costs can be high as well.[992]

In Canada, the oppression remedy was examined extensively in the case of *BCE Inc v 1976 Debenture holders.*[993] The appellants in that case were BCE Inc and Bell Canada. BCE was a well-established telecommunications company with a number of subsidiaries amongst which was Bell Canada. Bell Canada became a wholly owned subsidiary of BCE Inc in 1983 as a result of a plan of arrangement under which Bell Canada's shareholders exchanged their shares for BCE's. The issue in that case arose after a group which was led by the Ontario Teachers' Pension Plan Board offered to purchase all of BCE's shares by way of a leveraged buyout.[994] This plan of arrangement was approximately valued at $52 billion and was to be financed in part by Bell Canada assuming a debt of over $30 billion. This was opposed by the debenture holders of Bell Canada. The debenture holders alleged that the proposed plan of arrangement would reduce the trading value of their debentures by twenty percent whilst conferring a premium of approximately forty percent on the market price of BCE Inc shares.[995] Furthermore, and most importantly to this study, the debenture holders also claimed that the plan of arrangement was oppressive to them and they therefore made an application under section 241 of the CBCA.

The trial judge dismissed the claims for oppression on the grounds, *inter alia*, that "the debt guarantee to be assumed by Bell Canada was not oppressive, …, and that BCE [Inc] and its directors had not unfairly disregarded the interests of the debenture holders".[996] The trial judge

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991 Van Duzer "Who May Claim Relief from Oppression: The Complainant in Canadian Corporate Law" 1993 *Ottawa L Rev* 476.

992 MacIntosh "The Oppression Remedy: Personal or Derivative?" 1991 *Canadian Bar Review* 55.

993 2008 69 (SCC).

994 Investopedia http://www.investopedia.com/terms/l/leveragedbuyout.asp (accessed 17-11-2015) defines a leveraged buyout as "the acquisition of another company using a significant amount of borrowed money to meet the cost of acquisition. Often the assets of the company that is being acquired are used as collateral for the loans in addition to the assets of the acquiring company".

995 *BCE Inc v 1976 Debenture holders* 2008 69 (SCC) para 4.

996 *BCE Inc v 1976 Debenture holders* 2008 69 (SCC) para 24. Of much relevance to this study is the reasoning of the trial court in arriving at its decision. The trial judge held that, "the BCE directors had a fiduciary duty under section 122 of the CBCA to act in the best interests of the corporation. He held that corporate law recognizes fundamental differences between shareholders and debt security holders. He concluded that these differences affect the content of the directors' fiduciary duty. As a result, the directors' duty to act in the best interests of the corporation might require them to approve transactions that, while in the interests of the corporation, might also benefit some or all shareholders at the expense of other stakeholders". See *BCE Inc. v 1976 Debenture holders* 2008 69 (SCC) paras 23-25.

considered BCE Inc and Bell Canada's plan of arrangement and held that it was fair and should be approved.[997] The decision was appealed and the appeal court overturned the trial judge's approval of the plan of arrangement. *BCE Inc v Debenture holders*[998] was a cross-appeal against the Court of Appeal's judgment. The main issue was whether the Court of Appeal erred in dismissing the debenture holders' section 241 oppression claim.

The Supreme Court first laid down the requirements for one to have a right to a remedy under section 241 of the CBCA. It was held that there were two possible approaches to the interpretation of the oppression remedy under section 241.[999] The first approach views "oppression, unfair prejudice and unfair disregard" as different types of conduct which must be treated separately.[1000] The second approach unites these various aspects of the oppression remedy.[1001] However, the Supreme Court of Canada held that the best method is one that combines both of the above-mentioned approaches. The Supreme Court then went on to examine two elements that run through the jurisprudence of both approaches.[1002] The first element is that the oppression remedy is an equitable remedy. The Supreme Court of Canada referred to the English case of *Ebrahimi v Westbourne Galleries Ltd*[1003] where it was held by Lord Wilberforce that "the words [just and equitable] are a recognition of the fact that a limited company is more than a mere legal entity, that there is room in company law for recognition of the fact that behind it, or amongst it, there are individuals, with rights, expectations and obligations *inter se* which are not necessarily submerged in the company structure".[1004]

The second element is that "the conduct complained of must amount to 'oppression', 'unfair prejudice' or 'unfair disregard' of relevant interests".[1005] The court then suggested a two-tier

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997 *BCE Inc v 1976 Debenture holders* 2008 69 (SCC) para 26.
998 2008 69 (SCC).
999 *BCE Inc v 1976 Debenture holders* 2008 69 (SCC) para 54.
1000 *BCE Inc v 1976 Debenture holders* 2008 69 (SCC) para 54. Referring to *Scottish Co‑operative Wholesale Society Ltd v Meyer* 1959 AC 324 (HL); *Diligenti v RWMD Operations Kelowna Ltd* 1976 1 BCLR 36 (SC); *Stech v Davies* 1987 5 WWR 563 (Alta QB).
1001 *BCE Inc v 1976 Debenture holders* 2008 69 (SCC) para 54. For cases in which this approach was followed see *First Edmonton Place Ltd v 315888 Alberta Ltd* 1988 40 BLR 28 (Alta QB); *Westfair Foods Ltd v Watt* 1991 79 DLR (4th) 48 (Alta CA).
1002 *BCE Inc v 1976 Debenture holders* 2008 69 (SCC) para 57.
1003 1973 AC 360 (HL) 379.
1004 *Ebrahimi v Westbourne Galleries Ltd* 1973 AC 360 (HL) 379.
1005 In the absence of the definition of "oppression, unfair prejudice and unfair disregard" in Canada's legislation, its Supreme Court offered some guidelines and held that "'oppression' carries the sense of conduct that is coercive and abusive, and suggests bad faith. 'Unfair prejudice' may admit of a less culpable state of mind, that

enquiry to a claim for oppression remedy that is: "does the evidence support the reasonable expectation asserted by the claimant and does the evidence establish that the reasonable expectation was violated by conduct falling within the terms "oppression", "unfair prejudice" or "unfair disregard" of a relevant interest"?[1006]

Therefore, a stakeholder that wishes to invoke an oppression remedy must prove before the court of law that the conduct complained of is either oppressive, unfairly prejudices or unfairly disregards its interests.[1007] In South Africa, one must establish that "an act or omission of the company or a related person has had a result that is oppressive or unfairly prejudicial to, or that unfairly disregards the interests of the applicant".[1008] From the wording of the relevant sections in both South African and Canadian legislation, it seems that the conduct itself does not need to be oppressive but that the conduct complained of must produce such a result.[1009]

nevertheless has unfair consequences. Finally, 'unfair disregard' of interests extends the remedy to ignoring an interest as being of no importance, contrary to the stakeholders' reasonable expectations". Ben-Ishai and Puri "The Canadian Oppression Remedy Judicially Considered: 1995-2001" 2004 *Queen's LJ* 89 refused to comment on the meaning of oppression. *Henochsberg on the Companies Act 71 of 2008* Vol 1 Service Issue 2 2012 568-72 have suggested that conduct that is "burdensome, harsh, wrongful and [which] includes a lack of probity and/or good faith" qualifies as oppressive conduct. With respect to the phrase "unfairly prejudicial" Delport *et al* state that 'unfair' means unreasonable and further recommended that guidance may be sought from case law on the previous Companies Act 61 of 1973 which also contained the same word. For example *Garden Province Investment v Aleph (Pty) Ltd* 1979 2 SA 525 (D). Cheffins "An Economic Analysis of the Oppression Remedy: Working Towards a more Coherent Picture of Corporate Law" 1990 *University of Toronto Law Journal* 779 noted that the scope of unfair prejudicial conduct is much wider than that of oppressive conduct. For more on the explanation of these terms see *Brant Investments v Keeprite Inc* 1987 60 OR 2 nd 737 (Ont); Bieber "Directors' and Officers' Liability: The Oppression Remedy" 2013 5; Nwafor "The unfair prejudice remedy - a relief for the minority shareholders" 2011 *U. Botswana L.J* 40-46; Cheffins "The Oppression Remedy in Corporate Law: The Canadian Experience" 1988 *Journal of International Law* 320-321; *Arthur v Signum Communications Ltd* 1991 Carswell Ont 2523 Ontario Court of Justice for exemplar conduct; Cohen *et al* "Shareholders' Remedies: Distinguishing Oppression Claims and Derivative Actions" 2011 1; Cheffins "An Economic Analysis of the Oppression Remedy: Working Towards a more Coherent Picture of Corporate Law" 1990 *University of Toronto Law Journal* 780, whose academic analysis can be summed up in the following words- not much has been said but one believes that the remedy should be interpreted in light of shareholder expectations; Van Duzer "Who May Claim Relief from Oppression: The Complainant in Canadian Corporate Law" 1993 *Ottawa L Rev* footnote 8. For the standard required in Canada see *Henochsberg on the Companies Act 71 of 2008* Vol 1 Service Issue 2 2012 569.

1006 Para 68. In para 72, the court held that some of the factors that are considered in establishing whether there is a reasonable expectation include "general commercial practice; the nature of the corporation; the relationship between the parties; past practice; steps the claimant could have taken to protect itself; representations and agreements; and the fair resolution of conflicting interests between corporate stakeholders".

1007 Nwafor "The unfair prejudice remedy - a relief for the minority shareholders" 2011 *U. Botswana L.J* 40.

1008 Section 163 of the Companies Act 71 of 2008. See also Davies *et al Companies and other Business Structures in South Africa* 3 ed (2013) 300.

1009 See section 163 of the South African Companies Act and section 241 of the CBCA.

In South Africa, one of the first cases to come before the courts to deal with section 163 of the new Companies Act[1010] was *Peel v Hamon J & C Engineering (Pty) Ltd.*[1011] In that case, the first applicant was both a shareholder and director of the first respondent. The second applicant, who was also the father of the first applicant was a retired businessman and a former shareholder of Hamon J & C Engineering (Pty) Ltd which was also the first respondent. The third and fourth applicants were a director and shareholders, respectively, of the first respondent. The second respondent was Hamon South Africa (Pty) Ltd. The third respondent was Hamon and Cie (International SA) and the fourth, fifth and sixth respondents were directors of the first respondent. It was held that all the respondents were related persons in terms of section 2 of the Companies Act.[1012] To that end, the terms respondent and Hamon will be used interchangeably in this study. In 2009 the applicants commenced negotiations with the respondent. The negotiations were aimed at finding ways in which two of the respondent's subsidiaries could form a "joint venture company or at least work together for the mutual benefit of the company".[1013] After a series of negotiations, the parties finally drew up a Sale and Transfer Agreement and a Shareholders' Agreement.[1014]

In order to improve its "BEE" status based on the Broad-Based Black Economic Empowerment Act (BBBEE),[1015] the respondent sold some of its shares to some two ladies. These shares constituted 26% of the total shareholding in the respondent/joint venture company. The applicants contended that the transaction was not genuine and therefore a sham. It was also contended that the BBBEE issue was never communicated to the applicants and when they discovered it the respondent made light of it. The applicants approached the court basing their application on section 163 of the Companies Act.[1016] They contended that "an act or omission of the respondent has had a result that is oppressive and unfairly prejudicial to; or that unfairly disregards the interests of the applicants or is being carried out or conducted in a manner that is oppressive or unfairly prejudicial to or that unfairly disregards the interests of the applicants and that the powers of the directors or

[1010] 71 of 2008.
[1011] 2013 2 SA 331.
[1012] 71 of 2008.
[1013] *Peel v Hamon J & C Engineering (Pty) Ltd* 2013 2 SA 331 para 8.2.
[1014] *Peel v Hamon J & C Engineering (Pty) Ltd* 2013 2 SA 331 para 9.
[1015] 53 of 2003.
[1016] 71 of 2008.

prescribed office bearers of the respondent are being or have been exercised in a manner that is oppressive or unfairly prejudicial to or that unfairly disregards the interests of the applicants".[1017]

The Court noted that section 163 of the new Companies Act[1018] is successor to section 252 of the old Companies Act.[1019] It referred to *Henochsberg on the Companies Act 71 of 2008*[1020] and related foreign law principles such as those of Australia and Canada.[1021] It was held that Canada's approach to oppression remedies offers a much wider scope of judicial discretion.[1022] It was also noted that one of the purposes of the new Companies Act[1023] was "to provide legal redress for investors and third parties with respect to companies".[1024] By making reference to the Australian case of *Morgan v 45 Flers Avenue (Pty) Ltd,*[1025] Matshidi J held that "the words 'oppressive to', 'unfairly prejudicial to' and 'unfairly discriminatory to' should be seen as a 'composite whole and the individual elements mentioned in the section should be merely seen as different aspects of the essential criterion namely commercial unfairness'".[1026] After a thorough consideration of the law relating to oppression remedies and application of such to the facts, the court held that "the fact that the improper BBBEE transaction was not remedied by the respondent was oppressive to the applicants and that the non-disclosure of the improper BEE transaction was unfairly prejudicial to the applicants and to unfairly disregard their interests".[1027]

However, Beukes and Swart disagree with the court's judgment in that case.[1028] The two are of the view that the court erred because it based its judgment on the fact that the new Companies Act[1029] has a much wider scope for *locus standi* than its predecessor.[1030] Beukes and Swart propose that

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1017 *Peel v Hamon J & C Engineering (Pty) Ltd* 2013 2 SA para 7.
1018 71 of 2008.
1019 61 of 1973.
1020 Vol 1 Service Issue 2 2012.
1021 *Peel v Hamon J & C Engineering (Pty) Ltd* 2013 2 SA paras 48-50.
1022 *Ibid*.
1023 71 of 2008.
1024 Preamble to the Companies Act 71 of 2008 as referred to in *Peel v Hamon J & C Engineering (Pty) Ltd* 2013 2 SA para 34.
1025 1986 10 ACLR 692.
1026 *Peel v Hamon J & C Engineering (Pty) Ltd* 2013 2 SA 331 para 49.
1027 *Peel v Hamon J & C Engineering (Pty) Ltd* 2013 2 SA 331 paras 55 and 59.
1028 Beukes and Swart "*Peel v Hamon J&C Engineering (Pty) Ltd*: Ignoring the Result Requirement of Section 163(1)(A) of the Companies Act and Extending the Oppression Remedy Beyond its Statutorily Intended Reach" 2014 *PELJ* 1695.
1029 71 of 2008.
1030 Beukes and Swart "*Peel v Hamon J&C Engineering (Pty) Ltd*: Ignoring the Result Requirement of Section 163(1)(A) of the Companies Act and Extending the Oppression Remedy Beyond its Statutorily Intended Reach" 2014 *PELJ* 1695. Their argument is specifically based on an excerpt from para 52 of the judgment which reads

the court should have differentiated between the application of section 163 and the orders that a court can make to provide relief.[1031] It is submitted that the construction of section 163 of the new Companies Act[1032] differentiates between the application of the section in question and the orders that can be made to provide relief. However, a closer examination of the judgment in paragraph 41 shows that the court actually took into consideration the orders that can be made to provide relief. In fact, Matshidi J actually listed the orders.[1033] A logical response to Beukes and Swart's argument can be that what the two argued was not that the court failed to take into consideration the orders that can be made to provide relief but that they partly do not agree with the latter's *ratio decidendi.* On the other hand, it can also be submitted that such misunderstandings were likely to happen as this case was only the second reported case dealing with section 163 of the new Companies Act[1034] to come before the courts in South Africa after *Mouritzen v Greystones Enterprises (Pty) Ltd*.[1035] It is worth noting that the UK Companies Act[1036] only makes reference to conduct that unfairly prejudices the rights of shareholders.

It is submitted that the oppression remedy is not available to shareholders alone.[1037] Ben Ishai and Puri note that this remedy can be made use of by other stakeholders including employees and creditors.[1038] The two scholars reason that the wording of section 238 of the CBCA cannot be taken to imply that the legislature only intended a narrow scope of complainants for the oppression remedy.[1039] Van Duzer, while in tandem with the above authors' view divides oppression claimants

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"a careful consideration of the interpretation given by our courts to the provisions of sec 252 of the old Companies Act and the provisions in sec 163 of the new Companies Act … shows a continuing intention by the legislature to broaden relief in these provisions, rather than to limit them".

1031 Beukes and Swart "*Peel v Hamon J&C Engineering (Pty) Ltd*: Ignoring the Result Requirement of Section 163(1)(A) of the Companies Act and Extending the Oppression Remedy Beyond its Statutorily Intended Reach" 2014 *PELJ* 1696.

1032 71 of 2008.

1033 See *Peel v Hamon J & C Engineering (Pty) Ltd* 2013 2 SA para 41.

1034 71 of 2008.

1035 2012 5 SA 74 (KZD).

1036 2006.

1037 Ben-Ishai and Puri "The Canadian Oppression Remedy Judicially Considered: 1995-2001" 2004 *Queen's LJ* 97; Van Duzer "Who May Claim Relief from Oppression: The Complainant in Canadian Corporate Law" 1993 *Ottawa L Rev* 465-6; CCL 758-761; *Henochsberg on the Companies Act 71 of 2008* Vol 1 Service Issue 2 2012 573; Cheffins "An Economic Analysis of the Oppression Remedy: Working Towards a more Coherent Picture of Corporate Law" 1990 *University of Toronto Law Journal* 795**.**

1038 Ben-Ishai and Puri "The Canadian Oppression Remedy Judicially Considered: 1995-2001" 2004 *Queen's LJ* 97.

1039 Ben-Ishai and Puri "The Canadian Oppression Remedy Judicially Considered: 1995-2001" 2004 *Queen's LJ* 97. According to section 238 of the CBCA the word complainant means (a) a registered holder or beneficial owner, and a former registered holder or beneficial owner, of a security of a corporation or any of its affiliates, (b) a into statutory complainants and discretionary complainants.[1040] According to this scholar, shareholders qualify as statutory complainants whilst creditors qualify as discretionary complainants.[1041] However, it seems that Van Duzer's categorisation into statutory and discretionary complainants is confusing. If creditors are to bring an application before the court, it would obviously be under section 238 of the CBCA. In other words, the application remains a statutory application even though the court may play a bigger part in making such a determination. Moreover, the power of the court to make such a determination still emanates from section 238. The fact that the court has discretion under section 238(1)(d) does not nullify the idea that such powers are exercised within the confines of the statute and not common law. However, Van Duzer's view can find support in the sense that since parliament did not prescribe factors to be considered by the courts the omission makes them have full discretion in determining who qualifies to be a complainant.

Regardless of the fact that creditors' interests are explicitly mentioned in section 241 of the CBCA, Canadian courts have been hesitant to exercise their discretion to the effect that creditors are regarded as complainants under section 238(1)(d) of the CBCA. In the case of *Royal Trust Corp Canada v Hordo*[1042] it was held that "the court may use its discretion to grant or deny a creditor status as a complainant under section 238(1)(d). [T]he court's discretion should [not] be used to give 'complainant' status to a creditor where the creditor's interest in the affairs of a corporation is too remote or where the complaints of a creditor have nothing to do with the circumstances giving rise to the debt or if the creditor is not proceeding in good faith. Status as a complainant should also be refused where the creditor is not in a position analogous to that of the minority shareholder and has no particular legitimate interest in the manner in which the affairs of the company are managed".[1043] However, this formulation has been criticised as lacking practical applicability.[1044]

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director or an officer or a former director or officer of a corporation or any of its affiliates, (c) the Director, or (d) any other person who, in the discretion of a court, is a proper person to make an application under this part".

1040 Van Duzer "Who May Claim Relief from Oppression: The Complainant in Canadian Corporate Law" 1993 *Ottawa L Rev* 468-475.

1041 See Van Duzer "Who May Claim Relief from Oppression: The Complainant in Canadian Corporate Law" 1993 *Ottawa L Rev* 468.

1042 1993 10 BLR 2d 86 (Ont Gen Div).

1043 *Ibid*.

1044 Van Duzer "Who May Claim Relief from Oppression: The Complainant in Canadian Corporate Law" 1993 *Ottawa L Rev* 475-476.

In the case of *First Edmonton Place Ltd v 315888 Alberta Ltd,*[1045] the plaintiff was a landlord who owned and leased premises. It provided a rent free period to the defendant company which was controlled by three directors. The defendant company through its directors then made use of the free rent period but vacated the premises as soon as the rent-free period was over. No lease and therefore no contract was signed between the two parties. The defendant did not pay any further rent. The landlord claimed that the directors' conduct "were unfairly prejudicial to or unfairly disregarded the landlord's interests".[1046] The plaintiff, therefore, sought relief and brought an oppression claim against the directors of the company.

The issue was whether the applicant was the proper person to bring the action before the court. It was held that "the determination of the proper plaintiff should be left to the court".[1047] Additionally the court held that creditors can be granted complainant status in two distinct cases, namely where there is "fraud and breach of underlying expectations".[1048] With respect to the second ground, the court sought to clarify whether the applicant had some expectations to become a creditor of the defendant company. It was held that the "applicant must have interest as creditor at the time the acts complained of occurred. Here, 'creditor' didn't include the lessor because no rent was owing at the time of the wrongful acts and the lawyers hadn't signed the lease".[1049] Therefore the applicant did not obtain the expected relief from the court not because oppression remedies are not open to creditors but that it did not qualify to be called a 'creditor' in the technical sense of the word.

Van Duzer submits that in cases where creditors were awarded complainant status, they were not subjected to such careful scrutiny but that the inability to enforce one's claim was enough.[1050]

4 3 OTHER STAKEHOLDER REMEDIES

However, stakeholders do not obtain relief by invoking the derivative action and oppression claims only. The two above discussed remedies are simply the most common but not the only ones. This

[1045] 1988 (Alta QB).
[1046] *First Edmonton Place Ltd v 315888 Alberta Ltd* 1988 (Alta QB).
[1047] *Ibid*.
[1048] *Ibid*.
[1049] *Ibid*.
[1050] See *R v Sands Motor Hotel Ltd* 1985 1 WWR 59 (Sask QB); *Canadian Opera Co v 670800 Ontario Inc* 1989 69 OR 2d 532 and *Prime Computer of Canada v Jeffrey* 1991 6 OR 3d 733 (Gen Div) as referred to in Van Duzer "Who May Claim Relief from Oppression: The Complainant in Canadian Corporate Law" 1993 *Ottawa L Rev* 476.

section seeks to present a discussion of other remedies which, though not so common, are available to protect stakeholders' interests. In South Africa, an application can be brought to declare a director delinquent.[1051] For the purposes of such an application, the term "director" includes "a person who was a director of the company within two years prior to the application".[1052] For a director to be declared a delinquent, the applicant must prove that the former "grossly abused the position of director, [in that he/she] took personal advantage of information or an opportunity, contrary to section 76(2)(a), intentionally, or by gross negligence, inflicted harm upon the company or a subsidiary of the company, contrary to section 76(2)(a) and acted in a manner that amounted to gross negligence, wilful misconduct or breach of trust in relation to the performance of the director's functions within, and duties to, the company; or contemplated in section 77(3)(a), (b) or (c)".[1053] It has to be noted that section 76(2) is a fiduciary duty and the applicant does not have to prove fault for liability in terms of section 77. However, for an order in terms of section 162(5), the applicant has to prove fault in the form of either intention or gross negligence. The phrase 'gross negligence' is not defined in legislation and therefore common law will be instructive.

There are three categories of applicants who can bring an application before a court for an order of delinquency.[1054] The first category of applicants, as listed in section 162(2) of the Companies Act[1055] relates to, *inter alia*, shareholders and registered trade unions that represent employees of the company or another representative of the employees of the company. The second category relates to applications that can be brought by the Companies and Intellectual Property Commission (CIPC) or the Takeover Regulation Panel (Panel).[1056] Lastly, "any organ of state responsible for the administration of any legislation may [also] apply to a court for an order declaring a person delinquent".[1057] It is not clear whether creditors and the community can also bring applications to declare directors delinquent. These two stakeholders are not explicitly mentioned in section 162. However, it can be argued that creditors can bring their applications through the CIPC. It can also

1051 Section 162(2) of the Companies Act 71 2008.
1052 Davies *et al Companies and other Business Structures in South Africa* 3 ed (2013) 294.
1053 See section 162(5)(a)-(c) of the Companies Act 71 of 2008. See also *Kukama v Lobelo* 38587/2011 (GSJ) as referred to in *Henochsberg on the Companies Act 71 of 2008* Vol 1 Service Issue 2 2012 563.
1054 *Henochsberg on the Companies Act 71 of 2008* Vol 1 Service Issue 2 2012 563. Davies *et al Companies and other Business Structures in South Africa* 3 ed (2013) 294.
1055 71 of 2008.
1056 Section 162(3); Davies *et al Companies and other Business Structures in South Africa* 3 ed (2013) 294.
1057 *Ibid*.

be contended that the community's interest can be taken into account by applications brought under section 162(4). For example the organ of state that administers the National Environmental Management Act[1058] can bring an application to a court of law if the activities of a company harm the environment. On the other hand, the fact that the legislators knew that creditors and community's interests need to be taken into account but intentionally chose not to include them might be inferred to mean that this section was not intended to be available to such stakeholders.

Section 162 of the Companies Act[1059] was judicially considered in the case of *Kukama v Lobelo*.[1060] The first to fourth respondents were Lobelo Lambert, Peolwane Properties (Pty) Ltd, Diphuka Construction (Pty) Ltd and the CIPC respectively. In that case, the first respondent and the applicant were each 50% shareholders of the issued shares in the second and third respondents. The first respondent and applicant were directors of the second respondent and the first respondent was the sole director of the third respondent. It was alleged that the first respondent "failed to detect the fraud to SARS of R39m when he should have done and utilised the two amounts paid by SARS into an incorrect account of the third respondent for the benefit and interest of the other companies to the detriment of the second respondent".[1061] The applicant brought the application under section 162(2) of the Companies Act[1062] seeking, among others, that the first respondent be declared delinquent.[1063] Tshabalala J held that the first respondent breached his fiduciary duty under section 76(2)(b) and on that basis, he was declared delinquent.[1064]

Stakeholders can also bring an application under section 162(2) for a director to be placed on probation. A director may be put under probation for the grounds mentioned in respect of delinquency[1065] and also for the grounds listed in section 162(7), among others "acted in a manner materially inconsistent with the duties of a director".[1066] This application may be brought by a shareholder, a registered trade union or other representative of the employees of a company,[1067]

1058 107 of 1998. The Department of Environmental Affairs and Tourism administers this Act.
1059 71 of 2008.
1060 38587/2011 (GSJ).
1061 *Kukama v Lobelo* 38587/2011 (GSJ) paras 9.2 and 9.3.
1062 71 of 2008.
1063 *Kukama v Lobelo* 38587/2011 (GSJ).
1064 *Kukama v Lobelo* 38587/2011 (GSJ) paras 10 and 27.
1065 *Henochsberg on the Companies Act 71 of 2008* Vol 1 Service Issue 2 2012 565; Davies *et al Companies and other Business Structures in South Africa* 2 ed (2013) 295.
1066 Section 162(2); Davies *et al Companies and other Business Structures in South Africa* 3 ed (2013) 295.
1067 *Ibid*.

the CIPC or the Panel.[1068] By linking corporate collapse to the conduct of directors, section 162(7)(b) provides a very striking *nexus* which is of great significance to this study.[1069]

Stakeholders can also get relief through an application to protect the rights of security holders[1070] and an application against any person who contravenes any provision of the Companies Act.[1071] In the UK, besides the exit option, which is outside the scope of this study, shareholders have other avenues to enforce their rights. First, according to section 168 of the Companies Act,[1072] "a company may by ordinary resolution at a meeting remove a director before the expiration of his period of office".[1073] Keay states that in the case of public companies, "substantial shareholders or a large coalition of disgruntled shareholders (in a public company) can seek to negotiate with the board for it to remove the relevant director(s)".[1074] In the event that such negotiations are futile, the shareholders may put pressure on the board or the director(s) whom they want to depart.[1075]

4 4 ADMINISTRATIVE REMEDIES AND ADR PROCEEDINGS

In addition to the above-mentioned forms of relief, a person who could have otherwise applied to a court or filed a complaint with the CIPC can also refer such a matter to the Companies Tribunal, to an accredited entity or to any other person for mediation, conciliation or arbitration.[1076] The wording of section 166(1) allows one to infer that stakeholders who are eligible to bring applications to the court or the CIPC regardless of whether the application is under the derivative action, oppression remedies or any other forms of relief also qualify to make use of administrative remedies. However, if this process fails, the Companies Tribunal, accredited person or any person to whom the matter has been referred must issue a certificate to that effect.[1077] It is submitted that

1068 Section 162(3); Davies *et al Companies and other Business Structures in South Africa* 3 ed (2013) 295. For a detailed discussion of applications for delinquency and probation see Davies *et al Companies and other Business Structures in South Africa* 3 ed (2013) 134-137.

1069 Section 162(7)(b) provides that "a court may make an order placing a person under probation, … if the person was a director of each such company or managing member of each such close corporation, two or more of those companies or close corporations each failed to fully pay all of its creditors or meet all of its obligations …". See also *Henochsberg on the Companies Act 71 of 2008* Vol 1 Service Issue 2 2012 565.

1070 Section 161 of the Companies Act 71 of 2008.

1071 Sections 20 and 218 of the Companies Act 71 of 2008. The difference between these two sections is that only shareholders have *locus standi* under section 20 whereas under section 218 'any person' can bring an application.

1072 2006.

1073 Keay "Public Enforcement of Directors' Duties: A normative enquiry" 2014 *Common Law World Review* 94.

1074 *Ibid*.

1075 *Ibid*.

1076 Section 166 of the South African Companies Act 71 of 2008.

1077 Section 166(2) of the Companies Act 71 of 2008.

these forms of dispute resolution are cheap and easily accessible to stakeholders. However, it has to be noted that these processes are voluntary and are therefore subject to the will of the parties involved. Furthermore, the enforceability of the outcomes of such processes is also questionable.[1078]

4 5 RATIFICATION AND CONDONATION

Not every breach of duty by directors is punishable. In some instances, a director may get relief from the court[1079] or his/her conduct may be ratified by shareholders.[1080] With respect to the court's relief, the director must first prove that he/she acted honestly and reasonably.[1081] Second, the court will then use its discretion to determine whether in all the circumstances of the case it is fair to excuse the director.[1082] Ratification of directors' conduct by shareholders refers to "a condonation by the company of a specific breach of fiduciary duty that takes place after the occurrence of that breach".[1083] Not all breach of fiduciary duty is ratifiable. Cassim *et al* observed that the courts have not been consistent in interpreting what constitutes ratifiable and non-ratifiable breaches.[1084] There must be full disclosure of the conduct for it to be properly ratified.

4 6 SUMMARY AND PRELIMINARY CONCLUSIONS

This chapter has presented a discussion of the enforcement of directors' duties and stakeholders' remedies. The discussions majored on judicial remedies. However, other non-judicial remedies such as administrative remedies and ADR were also examined. A distinction was drawn between the two major forms of judicial remedies, namely criminal and civil proceedings. It was noted that the South African Companies Act[1085] decriminalises company law. To that end, more attention was given to civil remedies that are available to the different company stakeholders. It was also

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1078 *Henochsberg on the Companies Act 71 of 2008* Vol 1 Service Issue 2 2012 587-588.

1079 Section 77(9) of the Companies Act 71 of 2008.

1080 Cassim *et al Contemporary Company Law* 2 ed (2012) 581 suggest that since there is no express provision in the new Companies Act which abolishes the common law principles relating to ratification by shareholders, such common law principles still apply.

1081 Section 77(9)(a) and Cassim *et al Contemporary Company Law* 2 ed (2012) 579.

1082 Section 77(9)(b) and Cassim *et al Contemporary Company Law* 2 ed (2012) 579

1083 Cassim *et al Contemporary Company Law* 2 ed (2012) 581.

1084 Cassim *et al Contemporary Company Law* 2 ed (2012) 581. In *Hogg v Cramphorn Ltd* 1966 3 All ER 420 it was held that "the issue of shares for an improper purpose of defeating a takeover bid was ratifiable". In *Pavlides v Jensen* 1956 (Ch) 565, it was held that negligence was ratifiable. It is however not clear if gross negligence or recklessness is also ratifiable. In *Regal (Hastings) Limited v Gulliver and Others* 1942 All ER 378 (HL) it was held that breach of the no-profit rule was ratifiable.

1085 71 of 2008.

noted that the most common but not the only forms of civil remedies are the derivative action and oppression remedies. It was submitted that these two remedies have significant historical ties which were traced back to the famous English case of *Foss v Harbottle*.[1086] It was also found out that that case brought about the proper plaintiff and internal management principles.

The first remedy to be discussed under civil remedies was derivative action. It was found that this remedy was a result of one of the exceptions to the rule created in *Foss v Harbottle*.[1087] The basis of a derivative action was considered and it was concluded that it arises when a stakeholder brings action on behalf of the company.[1088] It was also submitted that the derivative action is no longer a mere common law rule. The claim has received statutory recognition in all the jurisdictions under consideration in this study.[1089]

The nature of the derivative actions was also considered. It was pointed out that with respect to harm done to the company, it is the board of directors or simply director(s) that has/have the mandate to institute legal action on its behalf. It was reiterated that the institution of legal proceedings on behalf of the company is a commercial decision which remains the domain of directors. However, it was also found that this rule has inherent flaws in that it is not at all times that directors will be willing to institute action on behalf of the company. More so, if the directors themselves are the culprits, chances of legal recourse are almost nil. It was however also noted that there are some genuine reasons that might lead directors not to be willing to institute action on behalf of the company.

The requirements for one to be able to invoke the derivative action were also discussed at length. A comparison was drawn between what complainants need to comply with in South Africa, Canada, the UK and the United States of America (USA). It was found that in the USA, first one has to have standing, must have been a shareholder at the time the derivative action was filed, must comply with the contemporaneous ownership requirement and must also comply with the demand requirement.

[1086] 1843 67 ER 189.
[1087] *Ibid*.
[1088] See chapter 4 (part 4 2 2 1) above.
[1089] See section 165 of the South African Companies Act 71 of 2008; sections 260-263 of the UK Companies Act 2006 and section 239 of the CBCA RSC 1985.

The derivative action was noted to be part of South African company law.[1090] Common law derivative action was abolished by the Companies Act.[1091] It was found that, like the USA derivative action, one needs to have standing according to section 165(2) of the Companies Act,[1092] comply with the demand requirement and also obtain leave of the court before proceeding or commencing with the derivative action. In considering whether or not to grant leave to the applicant, the court has to be satisfied that the applicant is acting in good faith, that the subject matter is of a material consequence to the company and that it is in the best interests of the company for the applicant to proceed with the action.[1093] Since these three concepts are not defined in South African legislation, reference was made to foreign case law to give meaning to them. It was found that Canadian company law requirements with respect to derivative actions are similar to South African law. The major difference between the two jurisdictions is that the latter requires that the plaintiff prove that the matter is of a material consequence whilst the former does not. Under UK common law, an applicant had to first prove fraud on the minority and wrongdoer control to continue or commence derivative action proceedings. It was found that the UK's system is different from that of the USA in the sense that in the former it is not relevant whether the cause of action arose before or after the person seeking to bring or continue the derivative claim became a shareholder. The shortcomings of the derivative action were then discussed.

The next civil remedy to be discussed was oppression remedies. It was found that oppression remedies are much wider and procedurally simpler than the derivative action claims in that the former allows for more stakeholders to make use of it, has more options for relief and there is no need for compliance with the demand and leave requirements. However, the catch is that with the exception of shareholders, the court exercises wide discretion in determining who qualifies for such a remedy. Unlike derivative action claims, it was concluded that oppression remedies are invoked when one is claiming for direct harm or injury. The Canadian oppression remedy was analysed in-depth because of its nature and influence on other jurisdictions.

1090 See Davies *et al Companies and other Business Structures in South Africa* 3 ed (2013).
1091 71 of 2008.
1092 *Ibid*.
1093 See *Henochsberg on the Companies Act 71 of 2008* Vol 1 Service Issue 2 2012 586(1) and Cassim *et al Contemporary Company Law* 2 ed (2012) 784.

The historical origins of this remedy were also traced back to English company law.[1094] It was found that the Jenkins Committee Report greatly influenced the current provisions of the English version of oppression remedies. Canada's oppression remedy was incorporated into legislation as per the recommendations of the Dickerson Committee Report. Regardless of any historical and internal differences between the UK and Canada,[1095] it was submitted that Canada's oppression remedies are still based on section 210 of the UK's Companies Act of 1948.

It was submitted that the need for minority shareholder protection, especially in smaller private companies, precipitated the oppression remedy. It was argued that one of the merits of the oppression remedy was that it can be used to justify the weaknesses of the contractual theory. The Canadian case of *BCE Inc v Debenture holders*[1096] was critically examined. It was highlighted that that case introduced a two-pronged approach to the interpretation of the concepts "oppression, unfair prejudice and unfair disregard". This third approach basically combined the two traditionally used approaches. It was found that in South Africa and Canada, a stakeholder that wishes to invoke the oppression remedy must prove that the directors' conduct was either oppressive, unfairly prejudiced or unfairly disregarded their interests. However, unlike South African and Canadian legislation, it was found that the UK's Companies Act[1097] does not include the phrase "oppression, unfair prejudice and unfair disregard" in a single section. Section 994 of the UK Companies Act[1098] only makes reference to conduct that unfairly prejudices shareholders' rights.

It was found that the oppression remedy is not only available to shareholders but that creditors and employees can also make use of this remedy.[1099] However, in practice, it was found that courts are hesitant to award complainant status to creditors worse still employees. The courts exercise significant discretion in determining who qualifies to be a complainant apart from shareholders.

1094 Section 210 of the UK Companies Act 1948.
1095 One of them is that Canada is a federal state whereas the UK is not.
1096 2008 69 (SCC).
1097 2006.
1098 *Ibid*.
1099 Ben-Ishai and Puri "The Canadian Oppression Remedy Judicially Considered: 1995-2001" 2004 *Queen's LJ* 97; Van Duzer "Who May Claim Relief from Oppression: The Complainant in Canadian Corporate Law" 1993 *Ottawa L Rev* 465-466; Cassim *et al Contemporary Company Law* 2 ed (2012) 758-761; *Henochsberg on the Companies Act 71 of 2008* Vol 1 Service Issue 2 2012 573.

However, it was found that there have been Canadian cases in which creditors successfully invoked the oppression remedy.[1100]

It was further submitted that though stakeholders usually make use of the derivative actions and oppression remedies, these two should not be regarded as the only ones. It was found that in South African law stakeholders can apply for a director to be declared delinquent,[1101] or to be placed under probation[1102] or make an application for protection of their rights.[1103] Stakeholders can also make use of ADR procedures.[1104] It was highlighted that although ADR procedures are cheap and almost available to all stakeholders, they may not be effective in the sense that participation in them is voluntary and outcomes thereof are difficult to enforce. In the UK, shareholders may resolve to remove the director(s), or negotiate with the board to remove the relevant director(s) and if such negotiations fail, the shareholders may then pressurise the board or director(s) to remove the erring directors.[1105]

Lastly, since not every breach of duty by directors is punishable, a brief discussion of ratification and condonation of directors' breaches of their obligations was presented. It was submitted that for a director to get relief from the court, s/he must first prove that s/he acted honestly and reasonably and the court will then use its discretion to determine whether in all the circumstances of the case it is fair to excuse the director.[1106]

1100 See *First Edmonton Place Ltd v 315888 Alberta Ltd* 1988 (Alta QB); *R v Sands Motor Hotel Ltd* 1985 1 WWR 59 (Sask QB); *Canadian Opera Co v 670800 Ontario Inc* 1989 69 OR 2d 532 and *Prime Computer of Canada v Jeffrey* 1991 6 OR (3d) 733 (Gen Div).

1101 Section 162 of the Companies Act 71 of 2008.

1102 *Ibid*.

1103 Sections 20 and 218 of the Companies Act 71 of 2008.

1104 See section 166 of the Companies Act 71 of 2008.

1105 See Keay "Public Enforcement of Directors' Duties: A normative enquiry" 2014 *Common Law World Review* 94.

1106 Section 77(9)(b) of the Companies Act 71 of 2008.

CHAPTER FIVE

The business judgment rule and stakeholder protection

5 1 INTRODUCTION

The office of director is a complex and challenging one. Since a company is an artificial person, a director becomes its hands, brain, legs, mouth and eyes.[1107] It is also worth noting that to a large extent the economy of a country depends on how companies perform.[1108] The performance of companies is greatly (but not solely) influenced by the decisions that directors make. This places directors in very critical positions which also makes their accountability an issue of public interest.[1109] However, there are always two sides to a coin. The greater the authority, the higher the accountability levels. This chapter focusses on the balance and/or tension between director autonomy and accountability in general and on the business judgment rule specifically. There is no precise definition of the business judgment rule.[1110] As will be discussed in detail later, the business judgment rule was developed by American judges of the State of Delaware.[1111] Decision making involves taking risks. Some of the decisions that directors make may seem "stupid" *ex post facto*. If one, however, was to be placed in the position of the director or board of directors at the time the decision was made, s/he might reach a different conclusion. The question is when should directors be held liable for damage suffered by the company as a result of their decisions? Bainbridge argues that the business judgment rule is the solution to the tension between director authority and accountability.[1112] Despite the fact that the business judgment rule has been in

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1107 *Lennard's Carrying Co Ltd v Asiatic Petroleum Co Ltd* 1915 AC 705. For companies with one director see *CIR v Richmond Estates (Pty) Ltd* 1956 1 SA 602 A.

1108 Rider *The Realm of Company Law* (1998) 62.

1109 McMillan "The Business Judgment Rule as an Immunity Doctrine" 2012 *William & Mary Business Law Review* 524; Arsht "The Business Judgment Rule Revisited" 1979 *Hofstra Law Review* 115.

1110 Bogota "Factors affecting the Application of the Business Judgment Rule: An Empirical Study of the US, UK, Australia and the EU" 2006 118 defines the business judgment rule as "a doctrine that protects officers and directors from personal liability only if they have acted in good faith, with due care and within the officer or director's authority". According to Arsht "The Business Judgment Rule Revisited" 1979 *Hofstra Law Review* 111 if directors acted in good faith and with due care then "a corporate transaction that involves no self-dealing by, or other personal interest of the directors who authorized the transaction will not be enjoined or set aside for the directors' failure to satisfy the standards that govern a director's performance of his or her duties, and directors who authorized the transaction will not be held personally liable for resultant damages".

1111 Cassim *et al Contemporary Company Law* 2 ed (2012) 563; Muswaka "Directors' Duties and the Business Judgment Rule in South African Company Law: An Analysis" 2013 *International Journal of Humanities and Social Science* 89; Schoeman "How the Companies Act Impacts on Directors" 2013 *Without Prejudice* 11; and Bouwman "An Appraisal of the Modification of the Director's Duty of Care and Skill" 2009 *SA Merc LJ* 523.

1112 Bainbridge "The Business Judgment Rule as Abstention Doctrine" 2004 *Vand. L. Rev* 105.

existence for a long time and has been analysed by various commentators and courts, it remains misunderstood.[1113]

Scholars and commentators have come up with different rationales as to why the business judgment rule exists. According to Bainbridge, the purpose of the business judgment rule is to strike a compromise between two competing values namely authority and accountability.[1114] The same author adds that the rule exists to protect directors and to encourage them to fully exercise their powers.[1115] McMillan points out that the business judgment rule protects directors who act in good faith even though *ex post facto* their decisions might prove to be illogical.[1116] Mongalo says that the purpose of the business judgment rule is to prevent courts from second-guessing directors' decisions.[1117] With respect to the new South African Companies Act,[1118] Muswaka posits that the business judgment rule exists to further the objectives of the Act.[1119] Cassim *et al* say that the rule was created "to protect directors from hindsight bias".[1120] Similarly, but in more general terms, Havenga submits that the rule is there "to protect honest directors".[1121] These scholars may seem to be saying different things but the two most outstanding concepts emanating from the above submissions are director protection and balancing authority and accountability.

The next section will focus on the evolution and adoption of the business judgment rule. This study will show through case law and scholarly commentaries how the rule originated in American Courts and evolved in other jurisdictions like Canada, the United Kingdom and Australia before it was introduced to South Africa. With respect to South Africa, the rule will be traced from the recommendations of the King Reports, then the Companies Bill and finally the new Companies

1113 McMillan "The Business Judgment Rule as an Immunity Doctrine" 2012 *William & Mary Business Law Review* 524; Bainbridge "The Business Judgment Rule as Abstention Doctrine" 2003 *Vand. L. Rev* 85; Branson "The Rule That Isn't a Rule- The Business Judgment Rule" 2002 *Valparaiso University Law Review* 631; Arsht "The Business Judgment Rule Revisited" 1979 *Hofstra Law Review* 93.

1114 Bainbridge "The Business Judgment Rule as Abstention Doctrine" 2004 *Vand. L. Rev* 85.

1115 Bainbridge "The Business Judgment Rule as Abstention Doctrine" 2004 *Vand. L. Rev* 111.

1116 McMillan "The Business Judgment Rule as an Immunity Doctrine" 2012 *William & Mary Business Law Review* 527-528.

1117 Mongalo *Corporate Law and Corporate Governance: A Global Picture of Business Undertakings in South Africa* (2003) 159; Mongalo *et al Forms of Business Enterprise: Theory, Structure and Operation* (2004) 217.

1118 71 of 2008.

1119 Muswaka "Directors' Duties and the Business Judgment Rule in South African Company Law: An Analysis" 2013 *International Journal of Humanities and Social Science* 92.

1120 Cassim *et al Contemporary Company Law* 2 ed (2012) 565.

1121 Havenga "The Business Judgment Rule: Should We Follow the Australian Example?" 2000 *SA Merc LJ* 28.

Act.[1122] An exposition of the evolution and adoption of the rule enables one to ascertain how the rule has developed over the years and notice any adaptations it has undergone from jurisdiction to jurisdiction.

Thereafter, attention will be devoted to the principles of the business judgment rule. The first part of that section will be focused on some of the arguments that have been advanced as justifications for the rule. After that, an in-depth analysis of the nature of the rule will be provided. This part is very crucial as it shows the extent to which directors are protected from personal liability. The three approaches to the business judgment rule, which are abstention, immunity and standard of liability will then be examined one after the other.

Lastly, one will look at the business judgment rule and stakeholder protection. This part is aimed at presenting the relationship or tension between the rule at issue and stakeholder protection. The key question is does the business judgment rule, by functioning as a shield to directors undermine stakeholders' interests? This question will be answered in light of the three manifestations of the business judgment rule. It should be noted that it is difficult to discuss the business judgment rule without mentioning the directors' duty of care and skill.[1123] This is mainly because the Americans treat both the duty to act in the best interests of the company and the duty of care and skill as fiduciary duties.[1124] However, in South Africa and other common law jurisdictions, this is not the case. The duty of care and skill is not a fiduciary duty.[1125] Care has been taken to maintain this distinction. This study is aimed at discussing the directors' duty to act in the best interests of the company. Any mention of the duty of care and skill, especially in this chapter, will be kept as minimal as possible and that will only happen for the sole purpose of explaining the business judgment rule.

1122 71 of 2008.

1123 Leach *The Correct Understanding of the Business Judgment Rule in Section 76(4) of the Companies Act 71 of 2008: Avoiding the American Mistakes* (Published Masters' thesis, University of Cape Town, 2014) 6 points out that "[the] business judgment rule is inseparable from the duty of care and skill".

1124 McMillan "The Business Judgment Rule as an Immunity Doctrine" 2012 *William & Mary Business Law Review* 531.

1125 In the Companies Act 71 of 2008, the director's fiduciary duty to act in the best interest of the company is in section 76(3)(b) whilst the duty of care, skill and diligence is provided for in section 76(3)(c).

5 2 EVOLUTION AND ADOPTION OF THE RULE

The business judgment rule has been in existence for more than one hundred and fifty years.[1126] One would consider such time as long enough for the legislature, courts, scholars and commentators to have clarified all the nitty gritties surrounding the rule. On the other hand, a more studious person would still expect some misunderstanding about the rule taking into consideration that fiduciary law itself, under which the business judgment rule is categorised, at least for the purposes of this study, which is even centuries older than the latter remains a mystery.[1127] Longevity is therefore no guarantee for precision. It is submitted that regardless of its prolonged existence, the business judgment rule is still misunderstood.[1128] This section seeks to isolate some of the adaptations and inconsistencies that the business judgment rule has undergone in the USA, UK, Canada, Australia and South Africa. The USA and Australia have been specifically included in the comparative analysis because, as will be shown later, the genesis of the business judgment rule lies in the former whilst the latter is one of the first jurisdictions to codify the rule.

Corporate law scholars are unanimous that the business judgment rule is an American legal export.[1129] To this end, some understanding of the USA legal system is necessary. To begin with, it has to be noted that the USA is a federation.[1130] In a federation, there is "a central government and a number of separate states which retain control of [their] own internal affairs".[1131] The USA has fifty states. Some powers can only be exercised by the central government, others are exercised exclusively by the states while others are shared between the central government and the states.[1132] For example, the federal government has exclusive powers to declare war and print money whilst

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1126 Arsht "The Business Judgment Rule Revisited" 1979 *Hofstra Law Review* 93. Bouwman "An Appraisal of the Modification of the Director's Duty of Care and Skill" 2009 *SA Merc LJ* 523 says that the rule can be traced back to 1829.

1127 McMillan "The Business Judgment Rule as an Immunity Doctrine" 2012 *William & Mary Business Law Review* 524; Bainbridge "The Business Judgment Rule as Abstention Doctrine" 2004 *Vand. L. Rev* 85; Branson "The Rule That Isn't a Rule- The Business Judgment Rule" 2002 *Valparaiso University Law Review* 631.

1128 McMillan "The Business Judgment Rule as an Immunity Doctrine" 2012 *William & Mary Business Law Review* 524.

1129 Cassim *et al Contemporary Company Law* 2 ed (2012) 563; Muswaka "Directors' Duties and the Business Judgment Rule in South African Company Law: An Analysis" 2013 *International Journal of Humanities and Social Science* 89; Schoeman "How the Companies Act Impacts on Directors" 2013 *Without Prejudice* 11; Bouwman "An Appraisal of the Modification of the Director's Duty of Care and Skill" 2009 *SA Merc LJ* 523.

1130 https://www.usa.gov/ (accessed 22-03-2016).

1131 http://www.thefreedictionary.com/Federal+state (accessed 13-03-2016).

1132 "Explaining Federal, State and Local Government Responsibilities in Virginia" http://www.fairfaxcounty.gov/dmb/federal-state-local-government-responsibilities (accessed 13-03-2016).

only state governments issue driver's and marriage licences but both levels of governments have the power to establish courts and to make and enforce laws.[1133] The main focus of this section is the Court of Chancery of the State of Delaware which is reputed for its competence in business and commercial law disputes.[1134]

Cassim *et al* point out that the rule is a "cornerstone of corporate law in the [USA] that was adopted in Australia, Hong Kong but rejected in the UK and New Zealand".[1135] The rule developed together with the directors' duty of care and skill.[1136] In the USA, there are two main formulations of the business judgment rule.[1137] The first one is by the Delaware Chancery Court which is couched as follows: "the business judgment rule is a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company".[1138] The popularity of this definition by the Chancery Court makes the abstention doctrine take precedence in the USA. The second one is by the American Law Institute (ALI) according to which "a director who makes a business judgment in good faith fulfils the [duty of care] if [s/he] is not interested in the subject of his business judgment, is informed with respect to the subject of the business judgment to the extent the director or officer reasonably believes to be appropriate under the circumstances and rationally believes that the business judgment is in the best interests of the corporation".[1139] The ALI's formulation was originally a draft for the codification of the business judgment rule. It is therefore not tantamount to codification but is a very persuasive instrument as evidenced by the numerous references to it by various courts from different states in the USA.[1140] Principles of the business judgment rule have been included in sections 8.30b and 8.31 of the United States Model Business

1133 *Ibid*.

1134 http://courts.delaware.gov/chancery/ (accessed 13-03-2016); Leach *The Correct Understanding of the Business Judgment Rule in Section 76(4) of the Companies Act 71 of 2008: Avoiding the American Mistakes* (Published Masters' thesis, University of Cape Town, 2014) 5.

1135 Cassim *et al Contemporary Company Law* 2 ed (2012) 563.

1136 Bouwman "An Appraisal of the Modification of the Director's Duty of Care and Skill" 2009 *SA Merc LJ* 523.

1137 Branson "The Rule That Isn't a Rule- The Business Judgment Rule" 2002 *Valparaiso University Law Review* 634; Bogota "Factors affecting the Application of the Business Judgment Rule: An Empirical Study of the US, UK, Australia and the EU" 2006 121 and 129.

1138 *Aronson v Lewis* 473 A 2d 805 812 (Del 1984). Branson "The Rule That Isn't a Rule- The Business Judgment Rule" 2002 *Valparaiso University Law Review* 635 submits that this is the oft quoted statement by the Delaware Chancery Court.

1139 American Law Institute Principles of Corporate Governance: Analysis and Recommendations 1994.

1140 For example see *Rosenfield v Metals Selling Corp* 643 A 2d 1994 (Conn) 1261; *Omnibank v United States Bank* 607 So 2d 1992 (Miss) 85*; Cuker v Mikalauskas* 692 A 2d 1997 (Pa) 1045-1046.

Corporation Act.[1141] Leach, however, contends that the model Act does not codify the business judgment rule.[1142] The state of California was nearest to codifying the business judgment rule in section 309 of its Corporations Code.[1143]

Scholars[1144] agree that the earliest business judgment rule case to come before the courts of law was *Percy v Millaudon*.[1145] In that case, the shareholders of a bank sued its directors. They alleged that the bank's directors were liable for the losses suffered by the company as a result of misappropriation of funds by the bank's president and cashier. The Louisiana Supreme Court held that "when the person who was appointed attorney-in-fact, has the qualifications necessary for the discharge of the ordinary duties of the trust imposed, we are of the opinion that on the occurrence of difficulties, in the exercise of it, which offer only a choice of measures, the adoption of a course from which loss ensues cannot make the agent responsible, if the error was one into which a prudent man might have fallen. The test of responsibility should be, not the certainty of wisdom in others, but the possession of ordinary knowledge; and by showing that the error of the agent is of so gross a kind that a man of common sense, and ordinary attention, would not have fallen into it".[1146] It is this formulation that later came to be known as the business judgment rule.[1147] On the face of it, it seems like the court was clear in its judgment. However, it is its use of words and phrases like "ordinary knowledge", "gross…", and "ordinary attention" that are behind the confusion and misunderstanding around the business judgment rule.[1148] From the court's *ratio decidendi*, the fallibility of man and the need to encourage able persons to take up the office of director by allowing them reasonable room for error are at the core of the business judgment rule.

1141 2002.

1142 Leach *The Correct Understanding of the Business Judgment Rule in Section 76(4) of the Companies Act 71 of 2008: Avoiding the American Mistakes* (Published Masters' thesis, University of Cape Town, 2014) 23.

1143 As a matter of law, the court in *Gaillard v Natomas Co* 208 Cal App 3d 1989 1264 held that the section codifies the business judgment rule. It is however submitted that such a ruling was incorrect. See Eisenberg "Whether the Business Judgment Rule should be Codified" 1998 48.

1144 See Arsht "The Business Judgment Rule Revisited" 1979 *Hofstra Law Review* 93; Bouwman "An Appraisal of the Modification of the Director's Duty of Care and Skill" 2009 *SA Merc LJ* 523; Bogota "Factors affecting the Application of the Business Judgment Rule: An Empirical Study of the US, UK, Australia and the EU" 2006 120.

1145 8 Mart (ns) 68 (La 1829).

1146 *Percy v Millaudon* 8 Mart (ns) 68 (La 1829).

1147 Arsht "The Business Judgment Rule Revisited" 1979 *Hofstra Law Review* 97.

1148 In fact, Arsht "The Business Judgment Rule Revisited" 1979 *Hofstra Law Review* 93-94 asserts that "the misunderstanding stems from the tendency of courts to use loose language in expressing the rule".

The American courts were not consistent in their interpretation of the business judgment rule. In the case of *Shlensky v Wrigley*,[1149] the plaintiff shareholder brought a derivative action against the board of directors of Chicago Cubs. Chicago Cubs was a baseball team that used Wrigley Field as its home ground. The Chicago Cubs' President, Mr. Wrigley, refused to install lights at the field for night games citing that baseball was a daytime game and that "it would greatly deteriorate the neighbourhood if stadium lights were installed".[1150] It has to be noted that at that time the Chicago Cubs was the only major league team without lights on its field. The plaintiff alleged that other teams, for example, the Chicago White Sox made some significant revenues through night games. Consequently, so claimed the plaintiff, this resulted in lower profits for the shareholders.

The issue was whether the board of directors should install lights on Wrigley Field and award Shlensky damages.[1151] It was held that the club President was not liable for failing to maximise the team's profits. The court was "not satisfied that the motives [of the directors were] contrary to the best interests of the corporation and the stockholders… [because they] showed no fraud, illegality or conflict of interest in making that decision".[1152] It was further highlighted that there was not enough evidence to prove that there was a direct link between the financial position of other clubs and attendance of night games. Furthermore, it was stressed that "the decision makers are professionals at what they do and most judges would not have the proper knowledge to decide if it was right or not, and the fact that the issue would be looked at after a bad decision was made it easier to pick apart. The courts [are] involved when a crime or fraud has been committed by a fiduciary".[1153] From this statement, it can be deduced that the American courts will not interfere with the decision of a director or board of directors unless the latter's decision was influenced by fraud, illegality and personal interest.

In the case of *Gimbel v The Signal Companies Inc*,[1154] the plaintiff was a shareholder of the respondent company. The plaintiff brought an action before the Delaware Chancery Court seeking injunctive relief to prevent the consummation of the pending sale by the respondent of all of the outstanding shares of Signal Oil and Gas Company to Burmah Oil Incorporated. Signal Oil and

[1149] 95 Ill App 2d 173 237 NE 2d 776 (1968).
[1150] *Shlensky v Wrigley* 95 Ill App 2d 173 237 NE 2d 776 (1968).
[1151] *Shlensky v Wrigley* 95 Ill App 2d 173 237 NE 2d 776 (1968).
[1152] *Ibid* 237.
[1153] *Ibid* 237.
[1154] 316 A 2d 599 (1974).

Gas Company was a wholly owned subsidiary of the respondent. The effective sale price which exceeded 480 million dollars was approved at a special meeting of the respondent's board of directors towards the end of 1973. The plaintiff alleged that the special meeting was not properly convened and that the proposed sale required authorisation by the majority of the outstanding shares of the respondent.[1155] The plaintiff further alleged that the 480 million dollars sale price was insufficient and that certain directors had personal interests in the business decision.[1156]

In evaluating the merits of the allegation that the proposed sale price was inadequate, the court noted that directors are presumed to have acted in good faith in the best interests of the company.[1157] It held that this presumption is known as the business judgment rule according to which the court cannot "substitute its uninformed opinion for that of experienced board members".[1158] Application of the rule depends on proof that informed directors actually made a business judgment.[1159] The court conceded that utilisation of the rule has been broadened with special mention of cases involving the sale of corporate assets.[1160] However, the presumption does not constitute an absolute protection of directors' conduct. The courts will scrutinize the merits of the decision of directors if the plaintiff can prove that the directors acted fraudulently or that the sale price was clearly inadequate.[1161] In that case, the court was at it again when it used confusing terms such as "constructive fraud", "badge of fraud", "intentional fraud", "inferred fraud" and "actual fraud".[1162]

In *Smith v Van Gorkom,*[1163] popularly known as "The Trans Union Case", a company by the name Marmon attempted a leveraged buy-out[1164] of Trans Union. Trans Union's CEO, Van Gorkom

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1155 *Gimbel v The Signal Companies Inc* 316 A 2d 599 (1974).
1156 Para 89.
1157 Paras 65 to 68.
1158 Para 69.
1159 *Gimbel v The Signal Companies Inc* 316 A 2d 599 (1974); Davies *et al Companies and other Business Structures in South Africa* 3 ed (2013) 124; Cassim *et al Contemporary Company Law* 2 ed (2012) 564; Havenga "The Business Judgment Rule: Should We Follow the Australian Example?" 2000 *SA Merc LJ* 28; Bouwman "An Appraisal of the Modification of the Director's Duty of Care and Skill" 2009 *SA Merc LJ* 525.
1160 *Gimbel v The Signal Companies Inc* 316 A.2d 599 (1974).
1161 *Ibid*.
1162 Para 77.
1163 488 A 2d 858 (Del 1985).
1164 According to Investopedia http://www.investopedia.com/terms/l/leveragedbuyout.asp#ixzz4FszhJIIe (accessed 30-07-2016) "a leveraged buyout (LBO) is the acquisition of another company using a significant amount of borrowed money (bonds or loans) to meet the cost of acquisition. Often, the assets of the company being acquired are used as collateral for the loans in addition to the assets of the acquiring company. The purpose of leveraged buyouts is to allow companies to make large acquisitions without having to commit a lot of capital".

proposed a price of $55 a share. Van Gorkom and his CFO did not conduct any research about the company's actual worth nor was Trans Union's legal department informed about the transaction. Moreover, it turned out that the $55 a share represented only about sixty percent of what the company was later appraised at. A derivative action against Trans Union's directors was commenced. The trial court found in favour of Van Gorkom stating that the latter's actions "fell within the business judgment rule [according to which] the courts should not second-guess business decisions made by directors".[1165] On appeal, the *court a quo's* decision was reversed. The Appellate Court concluded that "the business judgment rule was not a [valid] defense because the directors and Van Gorkom did not use any 'business judgment' when they came to their decision. There is no protection for directors who have made an unintelligent or unadvised judgment. Thus, the party attacking a board decision as uninformed must rebut the presumption that its business judgment was an informed one".[1166]

The other factor that necessitated the business judgment rule is director sovereignty.[1167] However, there is some confusion as to whether the rule only applies as far as the procedural aspects of the decision are concerned or whether it extends to substantive issues also. For example, in the cases of *McMullin v Beran*[1168] and *Cede & Co v Technicolor Inc*,[1169] it was held that "the business judgment rule operates as both a procedural guide for litigants and a substantive rule of law".[1170] On the other hand, there is overwhelming authority to support the view that the business judgment rule only applies to the procedural aspects of the decision.[1171]

Australia, like any other common law jurisdiction, relied on the UK for most of its corporate law principles including directors' duties.[1172] The stage for the codification of the business judgment

1165 488 A 2d 858 (Del 1985).
1166 488 A 2d 858 (Del 1985).
1167 Bogota "Factors affecting the Application of the Business Judgment Rule: An Empirical Study of the US, UK, Australia and the EU" 2006 123.
1168 765 A 2d 910 (Del 2000) 916-917.
1169 634 A 2d 345 (1993).
1170 *McMullin v Beran* 765 A 2d 910 (Del 2000) 916-917; *Cede & Co v Technicolor Inc* 634 A 2d 345 (1993).
1171 *Smith v Van Gorkom* (The Trans Union Case) 488 A 2d 858 (Del 1985); Leach *The Correct Understanding of the Business Judgment Rule in Section 76(4) of the Companies Act 71 of 2008: Avoiding the American Mistakes* (Published Masters' thesis, University of Cape Town, 2014) 29, Bainbridge "The Business Judgment Rule as Abstention Doctrine" 2004 *Vand. L. Rev* 101; Schoeman "How the Companies Act Impacts on Directors" 2013 *Without Prejudice* 12.
1172 Keller "Australia's Proposed Statutory Business Judgment Rule: A Reversal of a Rising Standard in Corporate Governance?" 1998 *Deakin Law Review* 127.

rule in Australia was set by the introduction of the Corporate Law Economic Reform Bill[1173] (hereinafter referred to as CLER) by Mr. Peter Costello.[1174] The "game changer" provision is now contained in section 180(2) of the Corporations Act.[1175] Before codification of the rule, there were numerous calls and attempts to discourage the move.[1176] For example, according to Keller, the introduction of a statutory business judgment rule was "unusual, inappropriate, unfortunate and unnecessary".[1177] The scholar contended that the business judgment rule was unusual because other professions do not have it. Keller's argument assumes that directors are professionals. However, it is not completely accurate to assert that directors are professionals. Which professional body do directors report to? What does one need to do in order to qualify to be a director? The Australian business judgment rule is wider in scope than South Africa's in the sense that it applies to both common law and equity.[1178] It is similar to the formulation of the ALI's. Furthermore, it also includes proper purpose as a requirement.[1179]

In Canada, the business judgment rule is encapsulated in case law. In *Maple Leaf Foods Inc v Schneider Corporation,*[1180] the appellant, with the support of two small shareholders of the respondent company, was a bidder for Schneider's shares. The appellant declared its intention to make an unsolicited take-over bid for Schneider at $19 a share. After the establishment of a special committee by the respondent and some consultations between the former and the latter's board of directors, Schneider ended up accepting Smithfield Foods' offer of $25 a share. The appellants

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1173 1998.

1174 Keller "Australia's Proposed Statutory Business Judgment Rule: A Reversal of a Rising Standard in Corporate Governance?" 1998 *Deakin Law Review* 125. Mr. Peter Costello was the Australian Federal Treasurer who introduced the CLER into the House of Representatives on 7 July 1998.

1175 2001. The section provides that "a director or other officer of a corporation who makes a business judgment is taken to meet the requirements of subsection (1), and their equivalent duties at common law and in equity, in respect of the judgment if they make the judgment in good faith for a proper purpose and do not have a material personal interest in the subject matter of the judgment, inform themselves about the subject matter of the judgment to the extent they reasonably believe to be appropriate, and rationally believe that the judgment is in the best interests of the corporation".

1176 Keller "Australia's Proposed Statutory Business Judgment Rule: A Reversal of a Rising Standard in Corporate Governance?" 1998 *Deakin Law Review* 125.

1177 Keller "Australia's Proposed Statutory Business Judgment Rule: A Reversal of a Rising Standard in Corporate Governance?" 1998 *Deakin Law Review* 126.

1178 See section 180(2) of the Australian Corporations Act 2001.

1179 See section 180(2)(a) of the Australian Corporations Act 2001.

1180 42 OR (3d) 177 [1998] OJ No 4142. Schneider Corporation was controlled by members of the Schneider family through a holding company. The issued share capital of Schneider consisted of common voting shares and Class A non-voting shares. Although the family only owned seventeen per cent of the non-voting shares, it controlled the company because it owned approximately seventy five per cent of the common voting shares.

alleged that the agreement between the Schneider family and Smithfield Foods unfairly disregarded the interests of non-family shareholders and prejudiced them. It was held that "the court looks to see that the directors made a reasonable decision not a perfect decision. Provided the decision taken is within a range of reasonableness, the court ought not to substitute its opinion for that of the board even though subsequent events may have cast doubt on the board's determination. As long as the directors have selected one of the several reasonable alternatives, deference is accorded to the board's decision. This formulation of deference to the decision of the board is known as the 'business judgment rule'".[1181] The court introduced the requirement of reasonableness, a concept that is not so clear especially when applied to the business judgment rule.[1182] The concept of the reasonableness of the directors' decisions was repeated in another Canadian case of *Peoples Department Stores Inc v Wise.*[1183] The court noted the evolution of the law relating to the business judgment rule both in Delaware and Ontario.[1184] On the other hand, Branson claims that reasonableness is not required.[1185] As will be seen later, the numerous references to the test for reasonableness in Canadian law point to the business judgment manifesting as an immunity doctrine.

In another Canadian case of *BCE Inc v 1976 Debenture holders*,[1186] a group of debenture holders opposed the approval of a plan of arrangement arguing that "the short-term trading value of the debentures would decline by an average of 20 percent and could lose investment-grade status".[1187] It was held that "the fact that the shareholders stood to benefit from the transaction and that the debenture holders were prejudiced did not in itself give rise to a conclusion that the directors had breached their fiduciary duty to the corporation. Through the business judgment rule, deference should be accorded to business decisions of directors taken in good faith and in the performance of the functions they were elected to perform by the shareholders".[1188]

1181 *Maple Leaf Foods Inc v Schneider Corporation* 42 OR (3d) 177 (1998) OJ No 4142.
1182 *Peoples Department Stores Inc v Wise* 2004 (SCC) 68.
1183 *Ibid*.
1184 2004 (SCC) 68.
1185 Branson "The Rule That Isn't a Rule- The Business Judgment Rule" 2002 *Valparaiso University Law Review* 635.
1186 2008 (SCC) 69.
1187 *BCE Inc v 1976 Debenture holders* 2008 (SCC) 69.
1188 *Ibid.*

Cassim *et al* submit that the business judgment rule was rejected in the UK.[1189] However, Bogota disagrees and believes that the business judgment rule exists in the UK but only that it is not codified.[1190] Bogota further explains that the UK does not need a codified statutory business judgment rule due to a number of factors. First, shareholders rarely invoke the derivative action because of its complex nature and because the derivative action is much more costly in the UK than in the USA.[1191] It has to be noted that the business judgment rule is strongly linked to the derivative action and the duty to act in the best interests of the company. Second, apart from the derivative action, there are other efficient and direct judicial avenues for shareholder recourse such as actions against directors' and company officers' policy insurers.[1192] Does this imply that those jurisdictions which invoke the rule lack other judicial remedies? There is no direct answer to this question because multiple factors are involved. Lastly, since directors are usually sued for commissions rather than for omissions, the rule is not relevant because a study that was once conducted shows that in the UK, directors are mostly sued for omissions.[1193] Therefore these could be justifications as to why there is no strict reference to the business judgment rule in the UK.[1194] Mongalo[1195] is of the opinion that English courts only came close to adopting the business judgment rule in the case of *Devlin v Slough Estates Ltd.*[1196] In light of the above, it can thus be inferred that probably what Cassim *et al* meant by "the rule was rejected in the UK" is that it was not codified.

The business judgment rule was introduced into South African company law by the Companies Act 71 of 2008.[1197] The 1973 Companies Act did not contain any provision on the rule. It is

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1189 Cassim *et al Contemporary Company Law* 2 ed (2012) 563.

1190 Bogota "Factors affecting the Application of the Business Judgment Rule: An Empirical Study of the US, UK, Australia and the EU" 2006 132-133.

1191 *Ibid*.

1192 *Ibid*.

1193 Bogota "Factors affecting the Application of the Business Judgment Rule: An Empirical Study of the US, UK, Australia and the EU" 2006 132-133.

1194 Mongalo *Corporate Law and Corporate Governance: A Global Picture of Business Undertakings in South Africa* (2003) 160 making reference to *Shuttleworth v Cox Brothers* 1927 1 (Ch) 154 and *Burland v Earle* 1902 AC 83 (PC).

1195 Mongalo *Corporate Law and Corporate Governance: A Global Picture of Business Undertakings in South Africa* (2003) 160.

1196 1983 BCLC 497 504.

1197 Section 76(4)(a) provides as follows "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-

therefore imperative to look at how South African company law was before the new Companies Act[1198] and the process that led to its codification. A good starting point may be 1994, the year the King I Report was published. In that report, it was recommended that "a director should not be liable for a breach of the duty of care and skill if he or she exercised a business judgment in good faith, the decision was an informed one based on all the facts of the case, the decision was rational and there was no self-interest".[1199] So according to the King I Report, the principles of the business judgment rule were good faith, an informed decision, rationality and absence of self-interest. Bouwman comments that the purpose of this recommendation was "to encourage the competitiveness of South African companies, to encourage entrepreneurship and persons with skill and reputation to accept appointments as directors".[1200]

In the King II Report, it was highlighted that "what constitutes the business judgment rule is controversial".[1201] The recommendations in the King II Report contain the same principles of good faith, an informed decision, absence of self-interest and rationality just as is contained in its predecessor.[1202] The King III Report contains the business judgment rule in the "Introduction and Background" section.[1203] The report does not go so far as to provide any guidelines on the application of the rule.[1204] It has to be noted also that all three reports do not mention any grounds or instances such as fraud or illegality whereby a court can intervene in directors' decisions.

(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".

1198 71 of 2008.

1199 King Report on Corporate Governance for South Africa 1994 9.

1200 Bouwman "An Appraisal of the Modification of the Director's Duty of Care and Skill" 2009 *SA Merc LJ* 526-527. For a criticism of these reasons see the same article at 527-528.

1201 King Report on Corporate Governance for South Africa 2002 70.

1202 See chapter 9 note 1 of the King Report on Corporate Governance for South Africa 2002 70.

1203 "A new statutory defence has been introduced for the benefit of directors who have allegedly breached their duty of care. This defence will be availed of by a director who asserts that he had no financial conflict, was reasonably informed, and made a rational business decision in the circumstances". King Report on Governance for South Africa 2009. Unlike its two predecessors, King III does not contain anything about good faith as a requirement for a director to rely on the business judgment rule.

1204 Bouwman "An Appraisal of the Modification of the Director's Duty of Care and Skill" 2009 *SA Merc LJ* 527.

Clause 91 of the Companies Bill of 2007 was the first attempt to include the business judgment rule in South African legislation.[1205] The result was section 76(4) of the Companies Act.[1206] This is the section that eventually codified the rule in South Africa.[1207] It is submitted that the business judgment rule is incorporated into South African law as part of both the directors' fiduciary duty to act in the best interests of the company and the duty of care and skill.[1208] However, Muswaka recognises only the nexus between the rule and the fiduciary duty.[1209] Cassim *et al* insist that section 76(4) creates a presumption[1210] which necessarily means that the plaintiff bears the burden of proof. The statutory provision is similar to the King I and II Reports except that the King I Report does not contain the requirement of good faith. Although Schoeman concedes that the adjudication and application of the rule has not been tested by South African courts,[1211] the authors of Henochsberg opine that the test whether a director's decision is covered by the business judgment rule is partly subjective and objective.[1212]

The above discussion of the business judgment rule shows that the contents of the rule and how it is applied continue to evolve. With its latest codification in South Africa, one can expect more statutory recognition of the rule in the near future in those jurisdictions that recognise the rule but have not gone so far as to codify it.

5 3 PRINCIPLES OF THE RULE

Now that the foundation has been laid by discussing the evolution and adoption of the rule, this section seeks to provide a deeper understanding of what the rule entails. Initially, the justifications and/or the reasons for having the business judgment rule will be discussed. Thereafter, focus will

1205 Bouwman "An Appraisal of the Modification of the Director's Duty of Care and Skill" 2009 *SA Merc LJ* 528. Clause 91(2) of the 2007 Bill provided that "[a] director's judgement that an action or decision is in the best interest of, or for the benefit of, the company is reasonable if ... the director ... has taken reasonably diligent steps to become informed about the subject matter of the judgement … does not have a personal financial interest in the subject matter of the judgement; and ... it is a judgement that a reasonable individual in a similar position could hold in comparable circumstances".

1206 71 of 2008.

1207 Bouwman "An Appraisal of the Modification of the Director's Duty of Care and Skill" 2009 *SA Merc LJ* 528; Leach *The Correct Understanding of the Business Judgment Rule in Section 76(4) of the Companies Act 71 of 2008: Avoiding the American Mistakes* (Published Masters' thesis, University of Cape Town, 2014) 4.

1208 Bouwman "An Appraisal of the Modification of the Director's Duty of Care and Skill" 2009 *SA Merc LJ* 528.

1209 Muswaka "Directors' Duties and the Business Judgment Rule in South African Company Law: An Analysis" 2013 *International Journal of Humanities and Social Science* 90.

1210 Cassim *et al Contemporary Company Law* 2 ed (2012) 564.

1211 Schoeman "How the Companies Act Impacts on Directors" 2013 *Without Prejudice* 12.

1212 *Henochsberg on the Companies Act 71 of 2008* Vol 1 Service Issue 2 2012 297.

shift to the nature of the rule which will make way for a discussion of the theoretical bases which are the abstention doctrine, standard of liability and the doctrine of immunity. In this discussion, it is important to separate the policies upon which the rule is founded and the effects of the rule from the rule itself.[1213]

First, it is contended that the business judgment rule exists because of information asymmetry.[1214] The courts are simply "ill-equipped to make business decisions and should not second-guess directors or substitute its judgment for that of the directors".[1215] According to this reasoning, since directors are involved in the day to day running of the company they are more experienced and knowledgeable than the courts. Directors have more information and experience about the businesses they manage than the courts. It must, therefore, be presumed that their decision is better. The other angle of information asymmetry is that directors themselves lack full information about the future, so whatever decision they make has some inherent limitations. Directors are not fortune-tellers or prophets of future events so if their decision turns out to adversely affect the company, they must not be crucified for what a reasonable person placed in their position could not have foreseen.[1216] With respect to information, what is required of directors is for them to make an informed decision. However, if directors' decisions are to be respected merely because the courts do not have as much information as directors why do unmarried judicial officers adjudicate on marriage and divorce matters?

1213 Davies *et al Companies and other Business Structures in South Africa* 3 ed (2013) 125; Cassim *et al Contemporary Company Law* 2 ed (2012) 565.

1214 McMillan "The Business Judgment Rule as an Immunity Doctrine" 2012 *William & Mary Business Law Review* 529; Bogota "Factors affecting the Application of the Business Judgment Rule: An Empirical Study of the US, UK, Australia and the EU" 2006 121.

1215 Bogota "Factors affecting the Application of the Business Judgment Rule: An Empirical Study of the US, UK, Australia and the EU" 2006 121-122. The same scholar further reasons that "the law supposes that it is the board [of directors] in charge of running the company. Justices are lawyers and not business managers and thus are incompetent to manage human and physical resources, financial portfolios or specific commercial transactions". *Dodge v Ford Motor Co.* 1919 170 NW 668; Bainbridge "The Business Judgment Rule as Abstention Doctrine" 2004 *Vand. L. Rev* 120-124; Branson "The Rule That Isn't a Rule- The Business Judgment Rule" 2002 *Valparaiso University Law Review* 637; Havenga "The Business Judgment Rule: Should We Follow the Australian Example?" 2000 *SA Merc LJ* 29; McLennan "Duties of Care and Skill of Company Directors and Their Liability for Negligence" 1996 *South African Mercantile LJ* 94; Bouwman "An Appraisal of the Modification of the Director's Duty of Care and Skill" 2009 *SA Merc LJ* 524. In *Brehm v Eisner* 746 A 2d 244 2000 Del it was held that "if judges failed to respect the decisions of directors made in good faith, this would have the effect that the courts would become super directors measuring matters of degree in business decision making and executive compensation".

1216 McLennan "Duties of Care and Skill of Company Directors and Their Liability for Negligence" 1996 *South African Mercantile LJ* 95.

Furthermore, Bogota argues that it is important to protect directors from the risk of hindsight bias.[1217] Hindsight refers to "understanding that you have of a situation only after it has happened and that means you would have done things in a different way".[1218] In this case, it refers to judicial officers and other stakeholders who, with the knowledge of events that took place after the decision was made suggest that the directors were unreasonable, careless and negligent.

Furthermore, there is need to avoid "the risk of stifling innovation and venturesome business activity".[1219] Competition creates innovation which in turn gives birth to risk. By definition, innovation refers to a new way of doing things.[1220] There is no guarantee that every innovative idea will be successful. But, at the same time for businesses to stay alive, there is need for new products and services due to consumer tastes and choices which constantly change. McLennan reasons that "in the normal course of events no businessmen can avoid taking risks. One of the main differences between directors and trustees is that directors must, of necessity, take commercial risks. Even where the most careful investigations and research have been carried out in advance, there is still the element of risk".[1221] So if perfection is required in decision making, only "Pharisees"[1222] would be willing to take up the office of director.

It is also argued that the business judgment rule has something to do with "respecting shareholders' will".[1223] In other words, there is a need to prevent shareholders from becoming managers of their company.[1224] This view is supported by the fact that first, directors are appointed by shareholders

1217 Bogota "Factors affecting the Application of the Business Judgment Rule: An Empirical Study of the US, UK, Australia and the EU" 2006 122.

1218 Hornby *et al Oxford Advanced Learner's Dictionary* 7 ed (2006) 706.

1219 *Joy v North* 692 F 2d 880 (1982); Bogota "Factors affecting the Application of the Business Judgment Rule: An Empirical Study of the US, UK, Australia and the EU" 2006 122; Bainbridge "The Business Judgment Rule as Abstention Doctrine" 2004 *Vand. L. Rev* 112; Branson "The Rule That Isn't a Rule- The Business Judgment Rule" 2002 *Valparaiso University Law Review* 637; Havenga "The Business Judgment Rule Should We Follow the Australian Example?" 2000 *SA Merc LJ* 29; Muswaka "Directors' Duties and the Business Judgment Rule in South African Company Law: An Analysis" 2013 *International Journal of Humanities and Social Science* 91; Bouwman "An Appraisal of the Modification of the Director's Duty of Care and Skill" 2009 *SA Merc LJ* 524; Davies *et al Companies and other Business Structures in South Africa* 3 ed (2013) 125; and Cassim *et al Contemporary Company Law* 2 ed (2012) 565.

1220 Hornby *et al Oxford Advanced Learner's Dictionary* 7 ed (2006) 769-770.

1221 McLennan "Duties of Care and Skill of Company Directors and Their Liability for Negligence" 1996 *South African Mercantile LJ* 95. Bouwman "An Appraisal of the Modification of the Director's Duty of Care and Skill" 2009 *SA Merc LJ* 524 argues that there is need to persuade competent persons to accept the office of director.

1222 This idea is taken from the ancient belief that Pharisees, one of the religious groups during Jesus' days, were perfect and followed all the laws that Moses commanded them to.

1223 Bogota "Factors affecting the Application of the Business Judgment Rule: An Empirical Study of the US, UK, Australia and the EU" 2006 123.

1224 Bouwman "An Appraisal of the Modification of the Director's Duty of Care and Skill" 2009 *SA Merc LJ* 524.

and secondly, shareholders have a choice to invest or continue investing in the company that is being governed by those directors.[1225] This argument seems to suggest that directors are agents of shareholders which is correct under the shareholder primacy model[1226] according to which the directors' fiduciary duty to act in the best interests of the company is owed to shareholders.

Also, directors' decisions need to be respected due to the principle of bounded rationality.[1227] This concept is defined by Bainbridge to mean "the natural limits on the ability of decision makers to gather and process information".[1228] The same scholar further opines that "all humans have inherently limited memories, computational skills, and other mental tools …".[1229] All these factors point to the imperfection and fallibility of human beings. Human fallibility, therefore, forms one of the core values underlying the business judgment rule.

In this section, the "nature" of the business judgment rule refers to its inherent features and characteristics. The section covers the limits and boundaries of the rule and the circumstances in which it is applicable. Corporate lawyers and commentators agree that the business judgment rule applies to fiduciaries.[1230] The rule is usually utilised in cases of derivative actions and review of acceptance of takeovers.[1231] Some scholars contend that the business judgment rule is not a rule at all.[1232] The rule mostly applies in determining the procedural aspects of the directors' decision or

1225 Bogota "Factors affecting the Application of the Business Judgment Rule: An Empirical Study of the US, UK, Australia and the EU" 2006 123 referring to *Joy v North* 692 F 2d 880 (1982).

1226 For more on this refer to chapter 3 under 3 5 1 1.

1227 Bogota "Factors affecting the Application of the Business Judgment Rule: An Empirical Study of the US, UK, Australia and the EU" 2006 123.

1228 Bainbridge "The Business Judgment Rule as Abstention Doctrine" 2004 *Vand. L. Rev* 121.

1229 *Ibid*.

1230 Bainbridge "The Business Judgment Rule as Abstention Doctrine" 2004 *Vand. L. Rev* 89; Leach *The Correct Understanding of the Business Judgment Rule in Section 76(4) of the Companies Act 71 of 2008: Avoiding the American Mistakes* (Published Masters' thesis, University of Cape Town, 2014) 22; McMillan "The Business Judgment Rule as an Immunity Doctrine" 2012 *William & Mary Business Law Review* 531.

1231 Branson "The Rule That Isn't a Rule- The Business Judgment Rule" 2002 *Valparaiso University Law Review* 647. Derivative actions were extensively discussed in chapter four above.

1232 See Bogota "Factors affecting the Application of the Business Judgment Rule: An Empirical Study of the US, UK, Australia and the EU" 2006 121. Branson "The Rule That Isn't a Rule- The Business Judgment Rule" 2002 *Valparaiso University Law Review* 631-632 observes that since the rule does not have do's and don'ts it is either a standard of review or non-review. By this the scholar meant that the business judgment rule is a standard by which courts apply to see if the decision of the director or board of directors is reviewable or not. However, this study seeks to differ with the aforementioned scholar. First, not all rules come in plain do's and don'ts. The scholar is semantically correct but in practice all rules are meant to set or maintain standards of some sort. The rule has some do's and don'ts. For example, as will be discussed in greater detail later in this section, if a director acts fraudulently and was motivated by personal interest the business judgment rule will not apply. In practice, by precluding the application of the rule is instances of fraudulent conduct the rule is forbidding fraud and setting a certain standard. On the other hand, Davies *et al Companies and other Business Structures in South Africa* 3 the decision-making process[1233] and only in exceptional cases is the rule utilised to review the merits of the decision.[1234] Schoeman asserts that it is a "legal defence for directors challenged with exercising their duties of care and skill".[1235] The rule remains mostly uncodified with the exception of Australia and South Africa.[1236] The way the rule is fashioned in section 76(4) of Companies Act of 2008 has been criticised that it blurs the distinction between the directors' fiduciary duty to act in the best interests of the company and the common law duty of care and skill.[1237] This can be attributed to the fact that in the USA where the rule originates, there is no such distinction. The two are regarded as fiduciary duties.

It is convenient at this stage to examine how the business judgment rule operates in practice. The rule has been applied either as an abstention doctrine, as an immunity doctrine or as a standard of liability. These three can also be referred to as the different conceptions, theoretical bases or manifestations of the business judgment rule. They are important because they affect how the judiciary will interpret the rule[1238] and, in the words of Bainbridge, might have "outcome-determinative effects".[1239] As will be shown, there has been different ideas about the rule being an abstention doctrine and to that end, much of the discussion that follows immediately hereunder will focus on that concept. It has to be noted that these three conceptions of the rule are not clear cut as there is some sizeable degree of overlap between them.

ed (2013) 124 call the business judgment rule a test. The confusion that may arise by using the word "test" was highlighted by the Supreme Court of Canada in *BCE Inc v 1976 Debenture holders* 2008 69 (SCC) para 140.

1233 *Smith v Van Gorkom* (The Trans Union Case) 488 A 2d 858 (Del 1985); Leach *The Correct Understanding of the Business Judgment Rule in Section 76(4) of the Companies Act 71 of 2008: Avoiding the American Mistakes* (Published Masters' thesis, University of Cape Town, 2014) 29; Bainbridge "The Business Judgment Rule as Abstention Doctrine" 2004 *Vand. L. Rev* 101; Schoeman "How the Companies Act Impacts on Directors" 2013 *Without Prejudice* 12.

1234 Arsht "The Business Judgment Rule Revisited" 1979 *Hofstra Law Review* 126.

1235 Schoeman "How the Companies Act Impacts on Directors" 2013 *Without Prejudice* 11.

1236 Branson "The Rule That Isn't a Rule- The Business Judgment Rule" 2002 *Valparaiso University Law Review* 633. It is a paradox that the rule is not codified in Delaware which frequently deals with corporate law issues relating to it but has been codified in South Africa where the rule has barely been tested by the courts. For more on the advantages and disadvantages of codification and non-codification see Bouwman "An Appraisal of the Modification of the Director's Duty of Care and Skill" 2009 *SA Merc LJ* 521-523.

1237 See Cassim *et al Contemporary Company Law* 2 ed (2012) 564.

1238 Leach *The Correct Understanding of the Business Judgment Rule in Section 76(4) of the Companies Act 71 of 2008: Avoiding the American Mistakes* (Published Masters' thesis, University of Cape Town, 2014) 30.

1239 Bainbridge "The Business Judgment Rule as Abstention Doctrine" 2004 *Vand. L. Rev* 83.

5 3 1 The business judgment rule as an abstention doctrine

According to this view, the judiciary should refrain or be precluded from making business decisions.[1240] Cassim *et al* call it a rule of restraint.[1241] However, judges do not necessarily make business decisions. If the judiciary can interpret and apply the law with respect to corruption, fraud and theft what stops them from reviewing the merits of a decision made by directors? In South African law, it has to be noted that the abstention doctrine does not only apply to company directors' business decisions. The courts have also been urged to abstain from reviewing administrative matters.[1242] Bainbridge clarifies this when he pronounced that "abstention [does not mean] judicial abnegation of its role. Abstention contemplates judicial reticence but leaves open the possibility of intervention in appropriate circumstances. The problem is to identify those circumstances in which intervention is necessary. Put another way, when do accountability concerns trump preservation of the board's authority".[1243] As a response to Bainbridge's concern of identifying circumstances where judicial intervention becomes vital, it can be submitted that proof of fraud, personal interest and lack of good faith justify judicial interference.

According to McMillan,[1244] the abstention doctrine was first developed in the case of *Railroad Commission of Texas v Pullman Co.*[1245] The main issue in that case was the independence of state courts versus the exercise of authority by federal courts.[1246] Frankfurter J concluded that the complaint "tendered a substantial constitutional issue [which touched] a sensitive area of social policy upon which the federal courts ought not to enter unless no alternative to its adjudication is open".[1247] So the doctrine of abstention originated from the tension between state and federal courts in cases of concurrent jurisdiction in the USA. It was further held that according to the abstention doctrine "federal courts exercise a wise discretion [to] restrain their authority because of scrupulous regard for the rightful independence of the state governments and for the smooth

1240 Mongalo *Corporate Law and Corporate Governance: A Global Picture of Business Undertakings in South Africa* (2003) 159; Mongalo *et al Forms of Business Enterprise: Theory, Structure and Operation* (2004) 217.
1241 Cassim *et al Contemporary Company Law* 2 ed (2012) 563.
1242 Hoexter *Administrative Law in South Africa* 2 ed (2012) 147-155.
1243 Bainbridge "The Business Judgment Rule as Abstention Doctrine" 2004 *Vand. L. Rev* 127-129.
1244 McMillan "The Business Judgment Rule as an Immunity Doctrine" 2012 *William & Mary Business Law Review* 537.
1245 312 US 496 498 (1941).
1246 *Railroad Commission of Texas v Pullman Co* 312 US 496 498 (1941).
1247 *Ibid*.

working of the federal judiciary".[1248] From this statement by Frankfurter J, it can be deductively concluded that the abstention doctrine was based on respect and efficiency. The case of *Railroad Commission of Texas v Pullman Co*[1249] was followed by *Burford v Sun Oil Company.*[1250] The Sun Oil Company attacked the validity of an order of the Texas Railroad Commission granting Burford a permit to drill some wells in the East Texas oil field. Again, the issue arose in the context of the jurisdiction of state and federal courts. It was held that "[it] is in the public interest that federal courts of equity should exercise their discretionary power with proper regard for the rightful independence of state governments in carrying out their domestic policy".[1251]

After this followed the case of *Colorado River Water Conservation District v United States.*[1252] That case was also about the tension between state and federal courts. Most importantly, the three circumstances in which the abstention doctrine is appropriate were examined. It was held that the doctrine is applicable "in cases presenting a federal constitutional issue which might be mooted or presented in a different posture by a state court's determination of pertinent state law, where there have been presented difficult questions of state law bearing on policy problems of substantial public import whose importance transcends the result in the case then at bar, and absent bad faith, harassment, or a patently invalid state statute, federal jurisdiction has been invoked for the purpose of restraining [*inter alia*] state criminal proceedings".[1253] If one was to contextualise these circumstances and apply reasoning by analogy, the federal court will be "the court" exercising abstention and the state court will be the "board of directors". One would then expect the courts to apply the abstention doctrine at least in cases where the directors are more informed or experienced, in complex commercial issues and in the absence of bad faith. The above case law shows that the business judgment rule continues to develop. In *Railroad Commission of Texas v Pullman*,[1254] the doctrine was presented as a basis for postponement, in *Burford v Sun Oil Company*,[1255] the court expressed a hands-off policy, while in *Colorado River Water Conservation*

1248 *Railroad Commission of Texas v Pullman Co* 312 US 496 498 (1941).
1249 312 US 496 498 (1941).
1250 319 US 315 332 (1943).
1251 *Burford v Sun Oil Company* 319 US 315 332 (1943).
1252 424 US 80, 817 (1976).
1253 *Colorado River Water Conservation District v United States* 424 US 800 817 (1976); McMillan "The Business Judgment Rule as an Immunity Doctrine" 2012 *William & Mary Business Law Review* 539.
1254 312 US 496 498 (1941).
1255 319 US 315 332 (1943).

District v United States[1256] the court highlighted the exceptional circumstances wherein the doctrine ought to apply.[1257]

The courts and scholars agree that the doctrine of abstention functions as a rebuttable[1258] presumption.[1259] However, in one of the scholarly articles, Cabrielli backtracks by suggesting that directors should demonstrate disinterest, independence and that they were well informed.[1260] The difference between the two sentiments is that if the business judgment rule functions as a presumption, then the plaintiff has the burden of proof, but when the directors have to prove disinterest and independence it then means that they have the burden of proof.[1261] For the abstention doctrine to apply, certain conditions must be met. The director or board or directors have to make a conscious informed decision.[1262] This connotes positive action or a commission. Failure to act is not covered by the business judgment rule because it is regarded as an omission[1263] but a decision not to act falls within the ambit of the doctrine.[1264] Also, it is one thing to make a decision but it is another thing to make an informed decision.[1265] The latter suggests that one commits himself to diligently seek relevant information before making a decision. It is this type of conduct that the business judgment rule is concerned with. Moreover, the decision maker has to

1256 424 US 800 817 (1976).

1257 McMillan "The Business Judgment Rule as an Immunity Doctrine" 2012 *William & Mary Business Law Review* 538.

1258 Furlow "Good Faith, Fiduciary Duties, and the Business Judgment Rule in Delaware" 2009 *Utah Law Review* 1084-1087.

1259 *Gimbel v The Signal Companies Inc* 316 A 2d 599 (1974); Cabrelli "Presentation for Universita' Bocconi on the Reform of the Law of Directors' Duties in UK Company Law" 2008 *Edinburgh Research Explorer* 27-28; Branson "The Rule That Isn't a Rule- The Business Judgment Rule" 2002 *Valparaiso University Law Review* 645 footnote 51; Arsht "The Business Judgment Rule Revisited" 1979 *Hofstra Law Review* 109; Schoeman "How the Companies Act Impacts on Directors" 2013 *Without Prejudice* 11.

1260 Cabrelli "Presentation for Universita' Bocconi on the Reform of the Law of Directors' Duties in UK Company Law" 2008 *Edinburgh Research Explorer* 27-28.

1261 Furlow "Good Faith, Fiduciary Duties, and the Business Judgment Rule in Delaware" 2009 *Utah Law Review* 1093 emphasises that the burden of proof is on the plaintiff.

1262 Section 76 of the South African Companies Act 71 of 2008; section 180(2) of the Australian Corporations Act 2001; *Brehm v Eisner* 746 A 2d 244 2000 Del footnote 100; Bainbridge "The Business Judgment Rule as Abstention Doctrine" 2004 *Vand. L. Rev* 101; Branson "The Rule That Isn't a Rule- The Business Judgment Rule" 2002 *Valparaiso University Law Review* 639-640; Davies *et al Companies and other Business Structures in South Africa* 3 ed (2013) 124; Cassim *et al Contemporary Company Law* 2 ed (2012) 564; Havenga "The Business Judgment Rule: Should We Follow the Australian Example?" 2000 *SA Merc LJ* 28; Bouwman "An Appraisal of the Modification of the Director's Duty of Care and Skill" 2009 *SA Merc LJ* 525.

1263 Arsht "The Business Judgment Rule Revisited" 1979 *Hofstra Law Review* 112.

1264 Bouwman "An Appraisal of the Modification of the Director's Duty of Care and Skill" 2009 *SA Merc LJ* 525.

1265 Arsht "The Business Judgment Rule Revisited" 1979 *Hofstra Law Review* 120.

act in good faith.[1266] Furthermore, the directors should be disinterested and independent.[1267] The decision also needs to be rational.[1268] In South Africa, the proper purpose rule is not part of these conditions unless it is treated as a principle which falls within the broad fiduciary duty to act in the best interests of the company.[1269]

On the flip side of the coin, the presence of other factors precludes the utilisation of the business judgment rule in general and as a doctrine of abstention in particular. Proof of fraud, illegality of the decision made and conflict of interest on the part of the decision-maker displaces the doctrine of abstention.[1270] Arsht adds bad faith, gross abuse of discretion, self-dealing and negligence to this list.[1271]

The abstention doctrine precludes courts from deciding whether directors violated the duty of care or not.[1272] This doctrine has its own merits and demerits. Some of the benefits of the abstention doctrine include the conservation of judicial resources[1273] by not wasting time and money on issues that the courts will eventually refer back to the board of directors because the former does not have enough information and experience thereon. The doctrine also helps maintain the board of

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1266 Section 76 of the South African Companies Act 71 of 2008; section 180(2) of the Australian Corporations Act 2001; *Brehm v Eisner* 746 A 2d 244 2000 Del footnote 100; Bainbridge "The Business Judgment Rule as Abstention Doctrine" 2004 *Vand. L. Rev* 101; Branson "The Rule That Isn't a Rule- The Business Judgment Rule" 2002 *Valparaiso University Law Review* 644; Davies *et al Companies and other Business Structures in South Africa* 3 ed (2013) 124; Mongalo *Corporate Law and Corporate Governance: A Global Picture of Business Undertakings in South Africa* (2003) 159; Mongalo *et al Forms of Business Enterprise: Theory, Structure and Operation* (2004) 217; Havenga "The Business Judgment Rule Should We Follow the Australian Example?" 2000 *SA Merc LJ* 28; Bouwman "An Appraisal of the Modification of the Director's Duty of Care and Skill" 2009 *SA Merc LJ* 524. The requirement of good faith has been discussed in chapter three above.

1267 *Brehm v Eisner* 746 A 2d 244 2000 Del footnote 100; Bainbridge "The Business Judgment Rule as Abstention Doctrine" 2004 *Vand. L. Rev* 101; Branson "The Rule That Isn't a Rule- The Business Judgment Rule" 2002 *Valparaiso University Law Review* 641; Davies *et al Companies and other Business Structures in South Africa* 3 ed (2013) 124; Cassim *et al Contemporary Company Law* 2 ed (2012) 564; Havenga "The Business Judgment Rule: Should We Follow the Australian Example?" 2000 *SA Merc LJ* 28; Bouwman "An Appraisal of the Modification of the Director's Duty of Care and Skill" 2009 *SA Merc LJ* 525.

1268 Section 76 of the South African Companies Act 71 of 2008; section 180(2) of the Australian Companies Act 2001; *Brehm v Eisner* 746 A 2d 244 2000 Del footnote 100; Bainbridge "The Business Judgment Rule as Abstention Doctrine" 2004 *Vand. L. Rev* 101; Branson "The Rule That Isn't a Rule- The Business Judgment Rule" 2002 *Valparaiso University Law Review* 643; Cassim *et al Contemporary Company Law* 2 ed (2012) 564.

1269 Cassim *et al Contemporary Company Law* 2 ed (2012) 565.

1270 Bainbridge "The Business Judgment Rule as Abstention Doctrine" 2004 *Vand. L. Rev* 98; Arsht "The Business Judgment Rule Revisited" 1979 *Hofstra Law Review* 127.

1271 Arsht "The Business Judgment Rule Revisited" 1979 *Hofstra Law Review* 108-109. For some of the factors that are considered when proving bad faith see the same article on 127 and Furlow "Good Faith, Fiduciary Duties, and the Business Judgment Rule in Delaware" 2009 *Utah Law Review* 1088.

1272 Bainbridge "The Business Judgment Rule as Abstention Doctrine" 2004 *Vand. L. Rev* 102.

1273 Branson "The Rule That Isn't a Rule- The Business Judgment Rule" 2002 *Valparaiso University Law Review* 637.

directors' internal group dynamics.[1274] Bouwman adds that market mechanisms favour the abstention doctrine in the sense that "for directors to remain in the market and to continue to be sought after to take office as director, they will have to make sure that they manage the company successfully and abide by the rules".[1275] On the criticisms that have been levelled against the abstention doctrine, Schoeman wonders at how the court determines the reasonableness of a decision without examining the decision itself.[1276] Furthermore, there is a risk that if the abstention doctrine is followed, the business judgment rule may end up being a mere determinant of which party bears the burden of proof. This is nothing more than a repetition of the general rule that when the plaintiff fails to prove a prima *facie case* the defendant will be entitled to summary judgment.[1277]

5 3 2 The business judgment rule as an immunity doctrine

The business judgment rule has also been couched as an immunity doctrine. Literally, the word "immunity" refers to special privilege or to be exempted from any natural or usual liability.[1278] The effect of an immunity is to protect the beneficiary of such from liability for conduct undertaken by persons acting in certain capacities.[1279] In this context, the immunity will apply to directors as long as they are acting in their capacities as directors. There are public and private immunities. Examples of public immunities include judicial immunity, prosecutorial immunity and legislative immunity.[1280] An example of private immunity is the one that is afforded to parents.[1281] However, regardless of whether an immunity is public or private, the policy underpinnings are the same.[1282]

1274 Bainbridge "The Business Judgment Rule as Abstention Doctrine" 2004 *Vand. L. Rev* 127.
1275 Bouwman "An Appraisal of the Modification of the Director's Duty of Care and Skill" 2009 *SA Merc LJ* 524.
1276 Schoeman "How the Companies Act Impacts on Directors" 2013 *Without Prejudice* 12.
1277 See *Cede & Co v Technicolor Inc* 634 A 2d 345 (1993); Bainbridge "The Business Judgment Rule as Abstention Doctrine" 2004 *Vand. L. Rev* 103.
1278 http://www.dictionary.com/browse/immunity (accessed 21-03-2016).
1279 McMillan "The Business Judgment Rule as an Immunity Doctrine" 2012 *William & Mary Business Law Review* 542.
1280 *Ibid* 542-555.
1281 McMillan "The Business Judgment Rule as an Immunity Doctrine" 2012 *William & Mary Business Law Review* 560.
1282 McMillan "The Business Judgment Rule as an Immunity Doctrine" 2012 *William & Mary Business Law Review* 564-565 is of the opinion that the policy underpinnings of the immunity doctrine are to increase efficiency by encouraging the beneficiary's independent judgment on risky matters, to allow the recipient of the immunity room to make some mistakes and at the same time protect them from those who allege that their decisions were wrong in hindsight and finally to avail remedies to the beneficiaries of such immunities.

The effect of the business judgment rule is "to insulate directors from liability for their business-related decisions".[1283] McMillan concludes one of his articles on the rule by saying "when I see a bird that walks like a duck and swims like a duck and quacks like a duck, I call that bird a duck. The business judgment rule 'walks' like an immunity, 'swims' like an immunity and 'quacks' like an immunity. It has the same policy underpinnings as an immunity, the same procedure as an immunity and has the same effect as an immunity".[1284] With respect to the immunity doctrine, the defendant bears the onus of proof[1285] in that s/he must prove that s/he qualifies for the immunity. Cassim *et al* hold that by applying the immunity doctrine, the business judgment rule becomes a "safe harbour" from liability for directors.[1286] It should be noted however that what the directors are entitled to is qualified immunity and not absolute immunity.[1287]

5 3 3 The business judgment rule as a standard of liability

The business judgment rule has also been applied by the courts and described by corporate law scholars as a standard of liability.[1288] Such a standard of liability dictates how one should conduct himself or how one is expected to play an assigned role.[1289] In other words, there is a certain degree of freedom or scope for making mistakes that can be allowed to role players in different settings and capacities which when exceeded would result in liability being imputed onto the offender. In this context, the role players are company directors. Viewed this way, the business judgment rule can be said to be a test applied by the courts to determine whether a director's conduct gives rise to personal liability.[1290]

1283 McMillan "The Business Judgment Rule as an Immunity Doctrine" 2012 *William & Mary Business Law Review* 569.

1284 McMillan "The Business Judgment Rule as an Immunity Doctrine" 2012 *William & Mary Business Law Review* 574.

1285 McMillan "The Business Judgment Rule as an Immunity Doctrine" 2012 *William & Mary Business Law Review* 569; Bogota "Factors affecting the Application of the Business Judgment Rule: An Empirical Study of the US, UK, Australia and the EU" 2006 130.

1286 Cassim *et al Contemporary Company Law* 2 ed (2012) 563.

1287 Leach *The Correct Understanding of the Business Judgment Rule in Section 76(4) of the Companies Act 71 of 2008: Avoiding the American Mistakes* (Published Masters' thesis, University of Cape Town, 2014) 47.

1288 McMillan "The Business Judgment Rule as an Immunity Doctrine" 2012 *William & Mary Business Law Review* 529; Furlow "Good Faith, Fiduciary Duties, and the Business Judgment Rule in Delaware" 2009 *Utah Law Review* 1083.

1289 McMillan "The Business Judgment Rule as an Immunity Doctrine" 2012 *William & Mary Business Law Review* 529.

1290 *Ibid*.

Consistent with the above indication that there is some considerable degree of overlap between the ways in which the rule has been applied, the standard of liability test, like the abstention doctrine, states that the plaintiff has the burden of proof to establish the existence of conditions such as fraud, self-dealing and illegality among others.[1291] If the plaintiff fails to meet the appropriate burden of proof, the court will apply the business judgment rule to protect the director(s).[1292] However, it has to be noted that grossly negligent decisions fall outside of the "grace" of the business judgment rule.[1293] However, the challenge will be in defining what is gross negligence and how it differs from mere negligence. Is it in the amount of harm suffered by the company or is it about the unreasonableness of the decision? On the other hand, Branson contends that the degree of care required is due care not some care or slight care or gross negligence.[1294] In *Cede & Co v Technicolor Inc*,[1295] it was held, concerning the business judgment rule that, "as a rule of evidence, it creates a "presumption that in making a business decision, the directors of a corporation acted on an informed basis, [that is] with due care, in good faith and the honest belief that the action taken was in the best interest of the company".[1296]

The standard of liability as a theoretical basis of the business judgment rule is not without its critics. Bainbridge claims that the standard of liability approach is tantamount to putting the cart before the horse in the sense that the courts first seek evidence of misconduct and if they fail to find such they then proceed to adopt the "hands off policy".[1297] This approach would result in the courts becoming more and more involved in reviewing directors' decisions. However, review of directors' decisions should be the exception rather than being the norm.[1298] Such practice might result in a situation whereby the courts usurp the authority of directors. The important question

1291 McMillan "The Business Judgment Rule as an Immunity Doctrine" 2012 *William & Mary Business Law Review* 529.

1292 McMillan "The Business Judgment Rule as an Immunity Doctrine" 2012 *William & Mary Business Law Review* 529-530; Furlow "Good Faith, Fiduciary Duties, and the Business Judgment Rule in Delaware" 2009 *Utah Law Review* 1083.

1293 McMillan "The Business Judgment Rule as an Immunity Doctrine" 2012 *William & Mary Business Law Review* 530.

1294 Branson "The Rule That Isn't a Rule- The Business Judgment Rule" 2002 *Valparaiso University Law Review* 638.

1295 634 A 2d 345 (1993).

1296 *Cede & Co v Technicolor Inc* 634 A 2d 345 (1993).

1297 Bainbridge "The Business Judgment Rule as Abstention Doctrine" 2004 *Vand. L. Rev* 94; McMillan "The Business Judgment Rule as an Immunity Doctrine" 2012 *William & Mary Business Law Review* 534.

1298 McMillan "The Business Judgment Rule as an Immunity Doctrine" 2012 *William & Mary Business Law Review* 534.

then would be who is the final decision maker in the company? The board of directors or the court? In the words of Jackson J in *Brown v Allen*,[1299] "we are not final because we are infallible, but we are infallible only because we are final".[1300]

5 4 THE BUSINESS JUDGMENT RULE AND STAKEHOLDER PROTECTION

It has been found that the business judgment rule mostly functions as an abstention doctrine.[1301] Furthermore, whatever theoretical basis that is applied, the purpose of the rule remains the same, that is, protection of directors. The key question that arises in this context is whether the business judgment rule does not undermine other stakeholders' interests. It appears there could be some tension around the business judgment rule. On the one hand, it has been found that the rule applies to fiduciaries, directors in this case, and also that the rule is mostly utilised in cases of derivative actions which as discussed in chapter four above is one of the few available effective methods of enforcing directors' duties. On the other hand, there are stakeholders whose fate lies, to a greater extent, in the decision-making capacity of the directors. These stakeholders have at their disposal the derivative action as a tool to enforce directors' duties. However, before the stakeholders obtain protection from the court, they have one more hurdle to deal with, which is the business judgment rule. The rule places a burden of proof on the plaintiffs, who are mostly other stakeholders in the company besides directors themselves. This burden of proof is not easy to meet since in most instances it requires some inside information as evidence to fully support their claims. Such information is usually not readily accessible.

The rule also needs to be considered in light of the recent corporate scandals mentioned in chapter one above. Leach, while agreeing with Jones[1302] and Herzel and Katz[1303] is of the opinion that "recent Delaware Supreme Court's decisions depart dramatically from the tradition of management deference".[1304] The so-called departure from the abstention doctrine, however, needs to be treated with care as directors still require the protection of the courts for them to be effective

1299 344 US 443 540 (1953).
1300 *Brown v Allen* 344 US 443 540 (1953).
1301 See chapter 5 (part 5 3 1) above.
1302 Jones "Rethinking Corporate Federalism in the Era of Corporate Reform" 2004 29 *Journal of Corporation Law* 625.
1303 Herzel and Katz "*Smith v Van Gorkom:* The Business of Judging Business Judgment" 1986 *Business Lawyer* 1188.
1304 Leach *The Correct Understanding of the Business Judgment Rule in Section 76(4) of the Companies Act 71 of 2008: Avoiding the American Mistakes* (Published Masters' thesis, University of Cape Town, 2014) 5.

and efficient. Therefore there is a need to strike a compromise between corporate governance enhancement and directors' protection.

How can the compromise be reached in light of the current jurisprudence and the rather limited legislative framework? The courts basically rely on proof of factors such as fraud, illegality and bad faith for them to intervene and look into the merits of the directors' decision. Besides this, the only recourse for disgruntled stakeholders is a review of the procedural aspects of the decision. If in the absence of fraud, illegality and bad faith, a decision was arrived at through the proper procedure, the best that can be done by the courts is to refer the decision back to the board. Does this mean that all procedurally correct decisions are also substantively sound? No. Just as one can reach the wrong destination by using the correct means of transport, it is also possible to arrive at an unreasonable decision after following the proper procedures. The business judgment rule is perfect when applied as a guide to the courts' review of decisions but it must not be a bar to determining the merits of a decision. Mongalo asserts that the business judgment rule is not a general shield to directors.[1305] McMillan also confirms that the fact that the business judgment rule applies does not mean that the "subject matter before the court is permanently protected from a review".[1306] It is recommended that there should be a change in the current legal framework (i) to allow stakeholders reasonable access to inside information to be used as evidence to prove fraud, illegality and bad faith (ii) to permit the courts reasonable intervention into the merits of a decision and (iii) to construct flexible guidelines for the courts to follow when deciding when to interfere with the substantive aspects of a decision.

For a credible response to the question whether the business judgment rule undermines stakeholder protection,[1307] the three manifestations of the rule will now be analysed. First, the abstention doctrine will be examined, then the standard of liability doctrine and lastly the immunity doctrine will be analysed. The fairly recent case of *In re The Walt Disney Company Derivative Litigation*[1308] from the Supreme Court of the US State of Delaware is a good example of how the business judgment rule, when it manifests as an abstention doctrine, can grossly undermine stakeholders'

[1305] Mongalo *Corporate Law and Corporate Governance: A Global Picture of Business Undertakings in South Africa* (2003) 160; Mongalo *et al Forms of Business Enterprise: Theory, Structure and Operation* (2004) 218.
[1306] McMillan "The Business Judgment Rule as an Immunity Doctrine" 2012 *William & Mary Business Law Review* 40.
[1307] Especially non-shareholder ones.
[1308] 906 A 2d 27 (Del. 2006).

interests. The case was an appeal from the Court of Chancery. In this case, Mr. Michael Ovitz ("Ovitz") and The Walt Disney Company ("Disney") entered into an employment agreement according to which Ovitz would serve as President of Disney for five years. However, just fourteen months after commencing employment, Ovitz's contract was terminated for no apparent cause. This resulted in a severance pay-out to him valued at approximately $130 million.[1309]

Several Disney shareholders brought derivative actions in the Court of Chancery, on behalf of Disney, against Ovitz and the directors of Disney.[1310] The plaintiffs claimed that "the $130 million severance pay-out was, [*inter alia*], breach of fiduciary duty by the Disney defendants, and a waste of assets".[1311] The plaintiffs further contended that such breach of fiduciary duty deprived the Disney defendants of the protection of the business judgment rule.[1312] In the alternative, the plaintiffs argued that even if the business judgment were to apply, the Disney defendants were still liable because the pay-out constituted corporate waste and the Court of Chancery erred in concluding otherwise.[1313] It was reiterated that in making decisions, directors are rebuttably presumed to have acted on an informed basis, in good faith and in the best interests of the company.[1314] In that case, the only way to rebut the business judgment rule presumptions was to show that the Disney defendants had either breached their duty of care or had not acted in good faith. To establish a breach of duty of care, the plaintiffs were supposed to prove that the board acted with gross negligence in which case the burden would shift to the directors to show that the employment contract was entirely fair.

It was held that the plaintiffs failed to prove that Disney directors breached their duty of care or that they acted in bad faith. Justice Jacobs further held that "even if the trial court's analytical approach were improper, the appellants have failed to demonstrate any prejudice. Nowhere have the appellants shown that the result would have been any different had the Chancellor proceeded in the manner that they advocate[d]".[1315]

1309 *In re The Walt Disney Company Derivative Litigation* 906 A 2d 27 (Del. 2006) para 1.
1310 *In re The Walt Disney Company Derivative Litigation* 906 A 2d 27 (Del. 2006) para 1.
1311 *Ibid*.
1312 *In re The Walt Disney Company Derivative Litigation* 906 A 2d 27 (Del. 2006) 26.
1313 *Ibid* 26-27.
1314 *In re The Walt Disney Company Derivative Litigation* 906 A 2d 27 (Del. 2006) 39.
1315 *Ibid* 40 and 41.

The plaintiff bears the burden to prove that the directors acted in bad faith, were interested in the business transaction(s) at issue, or failed to act on an informed basis and in the best interests of the company.[1316] However, the presumption is not easy to rebut due to numerous factors which include information asymmetry. As highlighted above, a plaintiff can make a special application to access necessary information. This process, however, can take long and might be financially constraining. Taking into consideration that most of the stakeholders who might require such information are financially disadvantaged and cannot determine the outcome of general or shareholders' meetings, the abstention doctrine is most likely to undermine stakeholders' interests.[1317]

Bainbridge contends that at times the business judgment rule simply plays the role of assigning burdens of proof.[1318] For stakeholders, the most agonizing fact about the abstention doctrine is that even if the applicants are successful in rebutting the presumption, the courts will only review the procedural aspects of the decision.[1319] Accordingly, if the impugned decision was arrived at through the right procedure, then the courts will not interfere with it. Therefore, even if the plaintiffs in the Disney case, after all the struggle, were successful in their rebuttal, the Delaware Supreme Court was only going to focus on the manner in which the directors arrived at their decision to make such an outlandish pay-out to Ovitz. The plaintiffs, however, were not complaining about the way in which the decision was made. Their complaint was about the substantive fairness of the decision itself. It is therefore submitted that, by ignoring the real concerns of the plaintiffs, the abstention doctrine undermines stakeholders' interests. Furthermore, if shareholders themselves struggle to rebut the presumption, how much more difficult and strenuous will it be for other non-shareholder stakeholders to protect their interests?

It was mentioned above that the business judgment rule can also manifest as a standard of liability. The Delaware Supreme Court case of *Cede v Technicolor*[1320] will be used to illustrate the extent to which the standard of liability doctrine protects or undermines stakeholders' interests. Again, this case was an appeal from the Delaware Chancery Court which encompassed consolidated

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[1316] *Brehm v Eisner* 746 A 2d 244 n 66 (Del 2000) 264; *Cede & Co v Technicolor Inc* 634 A 2d 371; Bainbridge "The Business Judgment Rule as Abstention Doctrine" 2004 *Vand. L. Rev* 88.
[1317] Chapter 4.
[1318] Bainbridge "The Business Judgment Rule as Abstention Doctrine" 2004 *Vand. L. Rev* 103.
[1319] *Ibid* 48.
[1320] 634 A 2d 345 (1993).

suits.[1321] In this study, attention will be on “the shareholders’ individual suit for rescissory damages for fraud and unfair dealings (the personal liability action)”.[1322] The plaintiffs were Cinerama Inc. which was a New York Corporation and Cede & Co.[1323] In this study, the words plaintiffs and Cede will be used interchangeably with reference to this case only.

The actions arose from a cash-out merger in which Technicolor Inc. was acquired by MacAndrews & Forbes Group, Incorporated ("MAF"), through a merger with Macanfor Corporation ("Macanfor"), a wholly-owned subsidiary of MAF. According to the terms of the tender offer and later cash-out merger, each shareholder of Technicolor (excluding MAF and its subsidiaries) was offered $23 cash per share. The question before the Delaware Supreme Court was “whether the Technicolor board's decision to approve the planned merger with MAF was protected by the business judgment rule or should be subject to judicial review for its entire fairness”.[1324] The standard of liability and abstention doctrines are similar in the fact that they both require the plaintiff to rebut the presumption that the defendant directors acted on an informed basis, in good faith and in the best interests of the company. Therefore, it was the plaintiff's burden “to establish that any director's self-interest was individually, or collectively, so ‘material’ as to persuade a trier of fact that the independence of the board "as a whole" had been compromised”.[1325] The Chancellor found that Cinerama failed to rebut the business judgment rule’s presumption of director independence.[1326]

Before the Supreme Court, the appellants contended that the trial court had committed fundamental errors of law in its formulation and application of the business judgment rule's requirements of director duty of loyalty and duty of care by placing upon a shareholder plaintiff burdens of proof for breach of duty of loyalty and duty of care that are foreign to equity and to Delaware law.[1327] It was further argued that, even under the court's articulation of the duty of loyalty element of the rule, the court had clearly erred in finding that there was insufficient evidence to prove that a majority of the directors had breached their duty of loyalty for the purpose of rebuttal of the

1321 *Cede v Technicolor* 634 A 2d 345 (1993) para 1.
1322 *Ibid*.
1323 *Ibid.*
1324 *Cede v Technicolor* 634 A 2d 345 (1993) para 23.
1325 *Cede v Technicolor* 634 A 2d 345 (1993) para 25.
1326 *Ibid*.
1327 *Ibid* 26-27.

business judgment rule.[1328] On the other hand, the defendants, while agreeing with the Chancellor, asserted that "the trial court's reformulation of the duty of loyalty element of the rule to require a director's interest to be 'material' to be disabling is not new law, but simply different terminology".[1329]

The Supreme Court held that the business judgment rule operates both as a procedural guide for litigants and as a substantive rule of law.[1330] Although, the rule posits a powerful presumption in favour of directors' conduct,[1331] the major difference between the abstention and standard of liability doctrines is that, with respect to the latter, if the plaintiff is successful in rebutting the presumption, "the burden shifts to the defendant directors, the proponents of the challenged transaction, to prove to the trier of fact the 'entire fairness' of the transaction to the shareholder plaintiff".[1332] In other words, a successful rebuttal will lead to the court looking into the substantive aspects or the merits of the directors' decision. With respect to the entire fairness standard of judicial review, the defendant directors must establish to the court's satisfaction that the transaction was the product of both fair dealing and fair price.[1333] It was therefore ordered that the plan of merger be scrutinised for its entire fairness.[1334] However, some scholars like Prickett and Brown are adamant that the Supreme Court did not authorise a review of the directors' decision.[1335] In that case, the question would be how was the trial court going to decide on the fairness of the decision without looking at the merits thereof? Furthermore, the Supreme Court had hinted that, when couched as a standard of liability, the rule applies both procedurally and substantively.[1336] The decision should not therefore come as a surprise.

However, it has to be noted that although the plaintiff-appellants secured a favourable result, the journey to it was not easy. Along the way, the Supreme Court rejected the plaintiffs' contention that "'any' found director self-interest, standing alone and without evidence of disloyalty, is

1328 *Cede v Technicolor* 634 A 2d 345 (1993) para 28.
1329 *Ibid*.
1330 *Aronson v Lewis Del. Supr.* 473 A 2d 805 812 (1984).
1331 *Cede & Co v Technicolor Inc.* 634 A 2d 345 (1993).
1332 *Cede & Co v Technicolor Inc.* 634 A 2d 345 (1993) 17.
1333 *Ibid*; *Nixon v Blackwell* 626 A 2d 1376; *Mills Acquisition Co v MacMillan Inc* 559 A 2d 1279; and *Weinberger v UOP Inc* 457 A 2d 710.
1334 *Cede & Co v Technicolor Inc.* 634 A 2d 345 (1993) 25.
1335 Prickett and Brown "Cede v Technicolor: The Supreme Court Re-illuminates Existing Lines of Delaware's Level Playing Field" 1994 *Delaware Journal of Corporate Law.*
1336 See *Aronson v Lewis Del. Supr.* 473 A 2d 805 (1984) 812.

sufficient to rebut the presumption of loyalty of our business judgment rule".[1337] Furthermore, in an effort to rebut the presumption, the plaintiffs' use of the reasonable person standard for determining the materiality of a given director's self-interest in a challenged corporate transaction was also rejected.[1338] It is thus evident that even though the standard of liability doctrine offers some space for the courts to scrutinise the substantive aspects of a decision, rebutting the presumption remains a major challenge. Stakeholders will still need to go through the furnace of rebutting the presumption.[1339] This process, as alluded to before can be financially stressful and sometimes takes too long. But, unlike the abstention doctrine, since there is an "outside" chance of a review of the merits of the directors' decisions, the risk can be worth taking. McMillan also states that the standard of liability doctrine moves the liability bar from mere negligence to gross negligence or recklessness.[1340] In this scholar's view, gross negligence is a lower standard than mere negligence, but it seems the opposite is true.[1341]

Lastly, the business judgment rule also manifests as an immunity doctrine. It seems the immunity version of the rule offers a lot of incentives to stakeholders. To begin with, the immunity is decided through a motion to dismiss, at an early stage of the litigation process.[1342] This saves a lot of time and money. Unlike the other manifestations of the business judgment rule, if a director claims immunity, s/he bears the burden to prove that s/he is entitled to such immunity.[1343] The party that claims immunity, in this case, a director, "must establish her entitlement thereto, whether through a motion for summary judgment or a motion to dismiss".[1344] Furthermore, there is no complete presumption in the sense that no one is entitled to automatic absolute immunity.[1345] Instead, so argues McMillan, "an evaluation of the role the defendant [director] was acting in at the time of

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1337 *Cede & Co v Technicolor Inc.* 634 A 2d 345 (1993) 21.

1338 *Ibid*.

1339 Richards "Cede & Co. v Technicolor Inc. A Whole New Ball Game for Dissenting Shareholders" 1989 *Delaware Journal of Corporate Law* 1007 states that the presumption are difficult to prove and the burden often proves insurmountable for the plaintiff shareholder. The scholar cites an example of trying to rebut the presumption by proving fraud in the context of a merger transaction and concludes that "fraud is difficult to prove since mere inadequacy of price will not reveal fraud". "The inadequacy must be so gross as to lead the court to conclude that it was due not to an honest error of judgment but rather to bad faith, or to a reckless indifference to the rights of others interested".

1340 McMillan "The Business Judgment Rule As An Immunity Doctrine" 2013 *Wm. & Mary Bus. L. Rev.* 534.

1341 *Ibid.*

1342 McMillan "The Business Judgment Rule As An Immunity Doctrine" 2013 *Wm. & Mary Bus. L. Rev.* 567.

1343 McMillan "The Business Judgment Rule As An Immunity Doctrine" 2013 *Wm. & Mary Bus. L. Rev.* 568.

1344 McMillan "The Business Judgment Rule As An Immunity Doctrine" 2013 *Wm. & Mary Bus. L. Rev.* 569

1345 *Ibid*.

the injury must be done to establish absolute immunity, or a good faith or reasonableness evaluation must be done to establish the application of the qualified immunity".[1346]

The use of the term "reasonableness" in the description of the evaluation process points to an objective test. If that is the case then the courts at least have a bar against which to measure directors' conduct. The immunity doctrine, therefore, is an advanced theory when compared to its counterparts which basically use if not abuse the business judgment rule's presumption. Care has to be taken though in applying the reasonableness or reasonable person test.[1347] Clearly, a wholesale application of this test might lead the courts into exactly what the business judgment rule is intended to avoid- hindsight bias, the judiciary reviewing the merits of a decision after its negative effects have already been felt. Given such a scenario, will a judge's impartiality not be impaired by such knowledge? The next paragraph shows how the immunity doctrine functions.

When a disgruntled stakeholder attempts to hold a director who may qualify for the protection of a type of immunity, liable for his/her decisions, the court has to make a determination whether the alleged immunity applies to the defendant. Obviously, the conduct complained of should have taken place whilst the defendant was in his/her office of director. The director has to prove to the court that s/he qualifies for the immunity.[1348] During this process, the focus of the court should not be on the role that the director played but rather on "a procedural checklist of disqualifiers which cannot be said to be part of the director's role [such as] fraud, illegality, self-dealing, no decision made and failure to inform oneself appropriately".[1349] The preferred interpretation of these disqualifiers is that if any of them is/are found to exist then the director is afforded qualified immunity and his conduct is evaluated against the test of reasonableness or what was expected of her/him.[1350] Therefore the presence of any of these disqualifiers does not lead to an automatic conclusion that the director was wrong. It is submitted that such a "reluctance" by the courts to

1346 *Ibid*.

1347 Snyman *Criminal Law* 5 ed (2008) 214 states that "a reasonable person is an ordinary, normal, average person. He or she is the person of ordinary knowledge and intelligence. The reasonable person is not a perfect being or fully programmed automation which never errs". The same also explains that "a person's conduct was unreasonable if the reasonable person in the same circumstances would have foreseen the possibility that the particular circumstance might exist, or that his conduct might bring about the particular result, the reasonable person would have taken steps to guard against such a possibility and the conduct of the person whose [unreasonableness] has to be determined differed from the conduct expected of the reasonable person".

1348 McMillan "The Business Judgment Rule As An Immunity Doctrine" 2013 *Wm. & Mary Bus. L. Rev.* 570.

1349 *Ibid*.

1350 *Ibid* 571.

make a decision that is adverse to a director is necessary and justifiable because it balances director authority and accountability.

5 5 SUMMARY AND PRELIMINARY CONCLUSIONS

The chapter has presented a discussion on the business judgment rule. The first part dealt with the evolution and adoption of the rule from the USA to South Africa. The following part then focused on the three approaches to the business judgment rule. That part looked at the historical backgrounds, rational and merits and demerits of these principles. The last part, which is the crux of this chapter, devoted focus to the nexus between the business judgment rule and stakeholder protection.

The purposes of the business judgment rule are to strike a balance between two competing interests namely authority and accountability[1351] and to protect disinterested directors who act in good faith, on an informed basis and in the best interests of the company from hindsight bias.[1352] The rule originated in the USA but has expanded to many other jurisdictions such as Australia, Canada and South Africa. The business judgment rule is thus an American legal export. The rule continues to evolve and its contents and interpretation vary from jurisdiction to jurisdiction. There is authority to support the view that the rule only applies to procedural aspects of the decision whilst there is also authority that validates the idea that it also applies substantively. There is, therefore, some confusion with respect to this issues. Maybe codification is the panacea. The business judgment was first codified in Australia's section 180(2) of the Corporations Act.[1353]

In Canada, the rule still remains a common law aspect but has been recognised by its Supreme Court.[1354] The rule manifests either as an abstention doctrine, standard of liability or as an immunity doctrine. As an abstention doctrine, the rule is couched as a rule of restraint or as a rebuttable presumption which places the burden of proof on the plaintiff. As an immunity doctrine, the rule protects directors but they must first prove that their conduct was covered by the immunity. As a standard of liability, the doctrine functions as a test to determine whether the director's conduct gives rise to personal liability. When the rule manifests as an abstention doctrine or

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1351 Bainbridge "The Business Judgment Rule as Abstention Doctrine" 2004 *Vand. L. Rev* 85.
1352 Cassim *et al Contemporary Company Law* 2 ed (2012) 565.
1353 2001.
1354 See *Peoples Department Stores Inc v Wise* 2004 68 (SCC); *BCE Inc v 1976 Debenture holders* 2008 69 (SCC).

standard of liability, the plaintiff stakeholder bears the burden of proving that the defendant director(s) has or have conducted themselves without properly informing themselves, in bad faith or were interested in the business transaction. On the other hand, when the rule is applied as an immunity, the beneficiary of the immunity bears the onus of proving that s/he is entitled to the alleged immunity.

CHAPTER SIX

Conclusions and recommendations

6 1 INTRODUCTION

The question whether compliance with directors' duty to act in the best interests of the company undermines other stakeholders' interests has evolved from being a mere academic issue to a practical one. Indeed, it has become part of our lives. A company director occupies a very influential position which invites public interest and scrutiny.[1355] It was argued earlier in this study that, while on the one hand, the conduct of directors needs to be regulated to avoid abuse of authority,[1356] directors, on the other hand, need to be allowed flexibility in their decision-making processes as rigidity will stifle innovation and risk-taking two ingredients which are very vital in today's dynamic corporate world.[1357] Achieving a balance between director authority and accountability is therefore critical to corporate sustainability since every decision made will in one way or the other affect all the stakeholders of a company. This study, by taking a comparative approach to corporate sustainability attempted to answer the question whether the directors' compliance with their duty to act in the best interests of a company undermines other stakeholders' interests. This chapter presents a recapitulation of the main arguments presented above, conclusions drawn from the entire study and recommendations for possible reform of the current law and solutions to the problems identified.

6 2 RECAPITULATION

The first chapter introduced the study and provided a general overview of the dissertation. It set out the research questions, objectives, importance and delimitation of the study, the methodology and sources. The opening part of the chapter provided the context of the research by furnishing the background to the study in the form of corporate scandals that occurred in jurisdictions carefully selected for comparative purposes.[1358] Additionally, chapter one also set out two company law

[1355] McMillan "The Business Judgment Rule as an Immunity Doctrine" 2012 *William & Mary Business Law Review* 524; Arsht "The Business Judgment Rule Revisited" 1979 *Hofstra Law Review* 115.
[1356] Bainbridge "The Business Judgment Rule as Abstention Doctrine" 2004 *Vand. L. Rev* 85.
[1357] See chapter 1 (part 1 1) above.
[1358] The jurisdictions, which were most frequently referred to throughout the study are the United Kingdom, Canada and South Africa. In some isolated instances, reference was also made to the United States of America, New Zealand and Australia.

principles which can be likened to a thread running through the entire study. The first is that a company is a juristic person which as such has legal personality.[1359] It was argued that the fictitious nature of a company makes it impossible for it to function without the involvement of natural persons who are in this case, directors.[1360] The second principle is the separation of ownership and control of a company.[1361] It was argued that in general, directors control the company whilst shareholders own it. However, concern was raised in respect of instances where some influential shareholders are also directors in the same company.

Chapter two presented a detailed historical background and theoretical discussion of the directors' fiduciary duty to act in the best interests of the company. The chapter traced the historical circumstances from which the duty emerged and how the duty has evolved since its inception. Additionally, a theoretical framework which examined how the resulting theories explain and justify the evolution and scope of the directors' fiduciary duty to act in the best interests of the company was presented.

The "nitty gritties" of the nature of the directors' duty to act in the best interests of the company were dealt with in chapter three. That chapter explored the nature of the relationship between directors and the company as well as the rights and obligations that ensue from the interaction between the two. Furthermore, an analysis of various stakeholders' interests was undertaken.

Chapter four was devoted to the enforcement aspects of the directors' fiduciary duty under discussion and related stakeholder remedies. One of the issues which that chapter sought to clarify was whether there is currently enough recourse in law to protect the interests of stakeholders especially non-shareholders. To that end, both administrative and judicial remedies were critically evaluated. Judicial remedies were divided into criminal and civil of which the latter has two further subdivisions in the form of the derivative action and oppression remedies.

The final discursive chapter examined the balance between directorial autonomy and accountability. Of much relevance in that chapter was the interpretation and application of the business judgment rule in achieving the much desired balance. A brief historical background of

[1359] *Salomon v Salomon* 1897 AC 22 (HL).
[1360] This principle gives birth to rights and duties between the company and directors.
[1361] This principle is the foundation upon which the question whether directors owe any fiduciary obligations or duties to shareholders is founded.

this rule was provided. The three main approaches to, or manifestations of, the business judgment rule were examined in discussing its appropriateness as a mechanism for striking a balance between directorial autonomy and liability.

6 3 CONCLUSIONS

It was submitted in this study that directors are fiduciaries *sui generis*.[1362] It was also found that the assertion that fiduciary obligations have their roots in the common law is debatable. It was shown that fiduciary principles developed during the era of the feudal system after a sudden change in the main uses of land from farming to mining.[1363] The lord-tenant relationship was very crucial to the development of fiduciary duties. The critical question was, with respect to the rented land, whether tenants were allowed to exploit the mineral deposits and subsequently claim profits from such commercial activities? After analysis of various views on the origins of fiduciary law from different scholars such as Helfman,[1364] Getzler[1365] and Shepherd,[1366] it can be concluded that the existence of fiduciary obligations in feudal law was observed as early as the fifteenth century but was chronologically traced from the beginnings of the law of equity. It is further submitted that the case of *Keech v Sandford*[1367] has contributed much to directors' duties by being the genesis of concepts such as the conflict rule and the no-profit rule.

It is further submitted that there is a gap in the historical development record of fiduciary law. Shepherd's view that current Anglo-American law of fiduciaries is based on "a number of anomalies"[1368] makes sense considering that most of the studies that have been done so far have all taken parallel routes. For example, some have linked fiduciary law only to the law of equity,[1369] others have postulated a nexus between fiduciary law and the law of trusts[1370] whilst some have

1362 See chapter 2 (part 2 5 4) above.

1364 Helfman "Land Ownership and the Origins of Fiduciary Duty" 2006 *Real Property, Probate and Trust Journal* 651 and Seipp "Trust and Fiduciary Duty in the Early Common Law" 2011 *Boston University Law Review* 1034.

1365 Getzler "An Interdisciplinary View of Fiduciary Law: 'As If.' Accountability and Counterfactual Trust" 2011 *Boston University Law Review* 977.

1366 Shepherd *Law of Fiduciaries* (1981) 13.

1367 1726 25 ER 223 (Ch).

1368 Shepherd *Law of Fiduciaries* (1981) 5.

1369 See DeMott "Beyond Metaphor: An Analysis of Fiduciary Obligation" 1988 *Duke Law Journal* 880; and Vinter *A Treatise on the History and Law of Fiduciary Relationship and Resulting Trusts Together with a Selection of Selected Cases* 2 ed (1938) 2.

1370 Shepherd *Law of Fiduciaries* (1981) 21.

linked it only to the English feudal system.[1371] Accordingly, there is a need for comprehensive research into the historical origins of fiduciary law. Such integrated studies will help fill in the gaps between the various views presented by the scholars referred to in this dissertation. If such studies are undertaken, some of the inconsistencies in the interpretation of contemporary fiduciary law will be resolved.

However, for reasons mentioned hereunder, perfection should not be the standard expected from the results of such research initiatives. To begin with, fiduciary law started centuries ago when preservation of information was difficult. In most instances, the passing of information from generation to generation depended on tradition, human memory and the ability to accurately and objectively recite important facts to others. Regardless of this fact, it is still possible to produce an integrated study that reasonably represents the history of fiduciary law.

In seeking to justify and explain the evolution and nature of fiduciary duties, a couple of theories were examined. The contractual/agency/nexus of contracts theory, according to which one promises to act in another's interests to become a fiduciary, was criticised for failing to consider other stakeholders' interests apart from those of the company's shareholders.[1372] According to the reliance theory, which is the most cited one, fiduciary obligations arise when the company reposes trust and confidence in its directors.[1373] The *communitaire* theory advocates for company directors to make their decisions bearing societal needs in mind.[1374] It is submitted that although the *communitaire* theory may be the ideal one it may not be the most efficient theory. This theory embraces the existence of non-shareholder stakeholders and aims for a balancing of such diverse interests but makes it difficult to measure the quality of directors' performance. The reliance theory notes the relationship between the company and its directors but makes no prescription as to whose interests should take precedence. This shows that substantial confidence has been placed in directors, a factor which can act as an inherent restraint to would-be misbehaving directors. If this is true then the much-needed balance between director authority and accountability would be

[1371] Helfman "Land Ownership and the Origins of Fiduciary Duty" 2006 *Real Property, Probate and Trust Journal* 651.
[1372] *Supra* chapter 2 (part 2 6 1).
[1373] Shepherd *Law of Fiduciaries* (1981) 56.
[1374] Dine *The Governance of Corporate Groups* (2000) 17.

achieved. It is therefore submitted that the reliance theory best justifies and explains fiduciary duties.

As part of the introduction to the second discursive chapter of the study, a brief presentation on types of company directors was provided. The main question there was whether fiduciary obligations depend on or vary with one's type of directorship.[1375] It is submitted that once a person becomes a director, s/he is expected to act as a fiduciary regardless of the type of director that one is. As soon as one becomes a director, s/he has the power of decision making or at least the power to influence the outcome thereof and every decision has consequences. No consequence flowing from a decision will be differentiated based on the type of director that one is. Therefore fiduciary duties attach to directors indiscriminately.

The nature and scope of directors' duty to act in the best interests of a company is generally couched in rules or doctrines such as the no-profit rule, the conflict rule, the proper purpose rule and the corporate opportunity rule. The next important question pursued in chapter three was to establish - to whom do company directors owe their fiduciary duty to act in the best interests of the company? Is the duty owed to the company alone, to shareholders alone or to any other stakeholders? Efforts to answer this question led to the need to define "the company".[1376] Initially, it was conceded that the phrase "the company" is confusing. However, it was found that according to the traditional view, the company refers to shareholders.

However, the traditional view did not offer convincing reasons as to why directors owed obligations to shareholders exclusively. Considering how other stakeholder interests have been taken into account in other jurisdictions, for example, under the United Kingdom Companies Act,[1377] it remains doubtful whether the traditional view is valid in all circumstances. Furthermore, when one takes into account the position of creditors of a company that is insolvent, it can be contended that directors do not owe their fiduciary duties to shareholders alone. Additionally, contemporary company law, especially in South Africa, has moved away from the single bottom-line approach to the triple bottom-line approach which requires incorporation of non-financial

1375 See chapter 3 (part 3 2) above.
1376 See chapter 3 (part 3 4) above.
1377 2006.

aspects of a company's operations into its reporting.[1378] It is contended that these reasons are sufficient to cast reasonable doubt on the validity of the traditional view. However, it is submitted that it is correct to state that directors generally owe fiduciary obligations to shareholders collectively and not individually except in specific circumstances.[1379] Current law does not explicitly state whether directors owe fiduciary obligations to other stakeholders. Even the triple bottom-line approach itself is not yet hard law. This study adopts the stance that directors owe their fiduciary duty to act in the best interests of the company to shareholders but they should in some instances[1380] take other stakeholders' interests into consideration. Recommendations for the development and reform of the law on this aspect are outlined below.[1381]

In trying to define what "the interests of the company" are, a theoretical approach was adopted. The shareholder, enlightened shareholder value and pluralist approaches were discussed. The question at hand was which approach best serves the interests of the numerous stakeholders of a company. It is submitted that the shareholder approach is still very much influential as most companies measure director performance through profit maximisation. However, looking at the contemporary legal terrain in which human rights and sustainability issues are making headlines, it can be contended that the days of the shareholder approach are numbered. On the other hand, although the tenets of the pluralist approach are as attractive as the 'Promised Land' was to the biblical Israelites, it is argued that it is too early to accept and apply the theory mainly due to its lack of legal backing.[1382] It is therefore submitted that the enlightened shareholder value approach is the most suitable one because of its inclination towards the primacy of shareholder interests while also requiring the consideration of other stakeholders' interests.

The study also sought to address the relationship or tension between the directors' fiduciary duty to act in the best interests of the company and its sustainability.[1383] This part was very crucial to this study as evident from the title of the dissertation itself. It is submitted that a decision by the directors of a company affects all the stakeholders either in a positive or negative way. At the risk

[1378] Jebe "Sustainability Reporting and New Governance: South Africa Marks the Path to Improved Corporate Disclosure" 2014 *Cardozo J of Int'l & Comp Law* 269.
[1379] *Percival v Wright* 1902 2 421 (Ch).
[1380] One of them is insolvency. See *Nicholson v Permakraft* 1985 1 NZLR 242; *Kinsela v Russell Kinsela (Pty) Ltd* 1986 4 NSWLR 722 and *Brady v Brady* 1988 20 BCLC.
[1381] See this chapter part 6 4 2 *infra*.
[1382] Dodd "For Whom Are Corporate Managers Trustees?" 1932 *Harvard Law Review* 1153.
[1383] Refer to chapter 3 (part 3 5 2).

of over-generalisation, it can be asserted that every corporate decision has its winners and losers. Second, it has to be borne in mind that all stakeholders are relevant for the sustainability of a company.[1384] Also, the priorities of a company vary from time to time. For example, a company that is just starting out may focus on gaining a larger portion of the market share by implementing various penetration strategies. An established company, on the other hand, may be focusing on profit maximisation. During the aftermath of an economic recession or after a product failure a company may focus on paying its creditors and other survival strategies. Additionally, the principle of sustainability is long-term focused whilst some stakeholders might have short-term goals.[1385] By assuming that a company functions as a system, it can be readily accepted that if one set of stakeholders catches a cold, the company will sneeze.

The above submissions put directors in a dilemma when making decisions. It is inevitable that some stakeholder interests may be trampled upon while pursuing the sustainability of a company. By accepting the fact that a company is a going concern[1386] it can be argued that it is in the best interests of a company to always consider the sustainability consequences of directors' decisions. However, the question pursued in chapter three was, should directors undermine other stakeholders' interests when acting in the best interests of a company? It is submitted that the response to this question may be both affirmative and negative. It may be affirmative in the sense that there are some instances where the board of directors needs to temporarily sacrifice other stakeholders' interests and focus on sustainability aspects if it is in the best interests of the company to do so. For example, directors may not need to declare dividends in a certain trading year if the reason is to expand and open other branches of the company around the globe. Whereas the answer may be negative in the sense that directors do not have the liberty to arbitrarily abuse the confidence and trust placed upon them for personal or *ultra vires* purposes[1387] and expect to be protected. It is therefore submitted that directors need to consider all stakeholders' interests before making a decision as this will promote the company's sustainability.

1384 See chapter 3 (part 3 5 2) above.

1385 Ajibo "A Critique of Enlightened Shareholder Value: Revisiting the Shareholder Primacy Theory" 2004 *Birkbeck Law Review* 44 and Havenga "Directors' Fiduciary Duties under our Future Company-law Regime" 1997 *SA Merc L.J.* 317.

1386 *BCE Inc v 1976 Debenture holders* 2008 69 (SCC) 584 para 38.

1387 McMillan "The Business Judgment Rule as an Immunity Doctrine" 2012 *William & Mary Business Law Review* 530.

The study then sought to ascertain in chapter four whether there are currently enough legal remedies for stakeholders in cases where their interests have been arbitrarily undermined by directors. It was noted that judicial remedies can be categorised into criminal sanctions and civil remedies.[1388] Due to the current move to decriminalise company law,[1389] the study focused on discussing civil remedies which usually manifest in the form of either the derivative action or oppression claims. It was found that for one to invoke the derivative action in the USA they must have standing,[1390] and comply with the contemporaneous ownership[1391] and demand requirements.[1392] In South Africa, it was found that for one to successfully pursue the derivative action, s/he must have standing, satisfy the demand requirement and obtain leave of the court.[1393] To obtain leave of the court, the stakeholder must satisfy the court that the applicant is acting in good faith, that the subject matter is of material consequence to the company, that it is in the best interests of the company for the applicant to proceed with the action and that the proposed action raises a serious question of material consequence to the company.[1394] The requirements for Canada are similar to those applicable in South Africa.[1395] It was also noted that the scope of the derivative action in the UK is wider than in South Africa with respect to the time at which the cause of action arose. There is no doubt that the derivative action is available to minority shareholders. However, even minority shareholders have to meet all the onerous requirements of the derivative action.[1396]

Since the derivative action remedy is based on harm to the company, it is suggested that the fact that it is not accessible to other stakeholders besides shareholders may be regarded as a justifiable evil.[1397] It is further proposed that non-shareholder stakeholders make use of the oppression remedy which is based on personal harm. The availability of the oppression remedy under the law must be applauded especially because of its suitability to not just determine legal rights but also

1388 See chapter 4 (part 4 2) above.
1389 Davies *et al Companies and other Business Structures in South Africa* 3 ed (2013) 19 while making reference to section 171 of the South African Companies Act 71 of 2008.
1390 Aronson *et al* "Shareholder Derivative Actions: From Cradle to Grave" 2009 11.
1391 *Ibid*.
1392 Aronson *et al* "Shareholder Derivative Actions: From Cradle to Grave" 2009 20.
1393 Section 165(5)(a). See also Cassim *et al Contemporary Company Law* 2 ed (2012) 784.
1394 MacIntosh "The Oppression Remedy: Personal or Derivative?" 1991 *Canadian Bar Review* 32.
1395 See chapter 4 (part *4 2 2 1*).
1396 Keay "Public Enforcement of Directors' Duties" 2013 11; and Cassim "Costs Orders, Obstacles and Barriers to the Derivative Action under Section 165 of the Companies Act 71 of 2008 (Part 1)" 2014 *SA Merc LJ* 12.
1397 This flows from the shareholder primacy approach discussed above in chapter 3 (part *3 5 5 1*) that equates the interests of the shareholders with those of the company.

that which is just and equitable among parties.[1398] Whilst the derivative action is mostly suitable for use against large corporations, the oppression remedy is ideal for small private companies.[1399] The oppression remedy can also be easily invoked by creditors and employees.[1400] For an applicant to successfully invoke this remedy, there must be proof of conduct that is "oppressive or unfairly prejudicial to or that unfairly disregards the interests of the plaintiff'.[1401] To a greater extent, it is submitted that there is not enough judicial recourse available to stakeholders whose interests are undermined by directors even if such conduct is done under the guise of acting in the best interests of the company.

The last discursive chapter of this study (chapter five) sought to examine the balance of director authority and accountability and whether the business judgment rule is an appropriate standard for determining such an equilibrium. It was noted that the business judgment rule is an American legal export.[1402] The rule was invented by American courts but has evolved over time and been adopted in various common law jurisdictions like Canada, Australia and South Africa. It was noted that in the USA the rule manifests as an abstention doctrine whilst in Canada it operates as a standard of liability whereas in Australia it manifests as an immunity doctrine. Thus far, there has been no South African judicial pronouncement on the rule.

As an abstention doctrine and standard of liability, the applicant (complainant) bears the burden of proving that the directors acted in bad faith, were interested in the business transaction(s) at issue, failed to act on an informed basis and in the best interests of the company.[1403] The presumption implicit in the business judgment rule is not easy to rebut due to, among other things, information asymmetry. It is difficult if not impossible to prove that a director acted in bad faith

1398 *Henochsberg on the Companies Act 71 of 2008* Vol 1 Service Issue 2 2012 586(1) while referring to *Ragless v IPA Holdings Pty Ltd (in liq)* 2008 65 ACSR 700.

1399 Cassim *et al Contemporary Company Law* 2 ed (2012) 757.

1400 Section 163(1) of the Companies Act 71 of 2008.

1401 *BCE Inc v 1976 Debenture holders* 2008 69 (SCC); MacIntosh "The Oppression Remedy: Personal or Derivative?" 1991 *Canadian Bar Review* 57; Cohen *et al "*Shareholders' Remedies: Distinguishing Oppression Claims and Derivative Actions" 2011 4.

1402 Cassim *et al Contemporary Company Law* 2 ed (2012) 563; Muswaka "Directors' Duties and the Business Judgment Rule in South African Company Law: An Analysis" 2013 *International Journal of Humanities and Social Science* 89; Schoeman "How the Companies Act Impacts on Directors" 2013 *Without Prejudice* 11; Bouwman "An Appraisal of the Modification of the Director's Duty of Care and Skill" 2009 *SA Merc LJ* 523.

1403 *Aronson v Lewis* 473 A 2d 805 812 (Del 1984). Branson "The Rule That Isn't a Rule- The Business Judgment Rule" 2002 *Valparaiso University Law Review* 635 submits that this is the oft quoted statement by the Delaware Chancery Court.

without gaining access to some inside information. Furthermore, with respect to the abstention doctrine, even if the applicants are successful in rebutting the presumption, the courts will only adjudicate process related challenges.[1404] It is therefore concluded that the business judgment rule is not an appropriate standard for ensuring or promoting a balance between director authority and accountability.

6 4 RECOMMENDATIONS

6 4 1 To whom is the duty owed

Current law does not explicitly state when directors owe fiduciary obligations to non-shareholder stakeholders. It is suggested that there is room for improvement of the law on this aspect. Accordingly, it is recommended that existing company law legislation needs to be modified to include an explicit direct duty of directors to creditors of insolvent companies. This recommendation raises a lot of issues. A direct duty has the advantage that creditors will be afforded the opportunity to enforce the duty on their own as opposed to an indirect one whereby the company is required to sue on behalf of creditors. With respect to the question whether the duty will cover current or future creditors, it is suggested that the same approach that has been applied in respect of shareholders be applied to creditors as well.[1405] It is further suggested that in cases where the duty is invoked, an objective approach should be adopted because it promotes certainty and predictability and in cases where credible evidence is presented the information can be applied to a number of cases, thereby saving time. Additionally, for the duty to be effectively constructed, company law legislation needs to re-define the following terms: insolvency, near insolvency, when insolvency begins and "the company".

Directors do not necessarily need to owe fiduciary obligations to employees and the other remaining stakeholders. However, it is recommended that the triple bottom-line approach contained in the King III Code be made part of our law. This will effectively accommodate the interests of workers, the community and sustainability issues. In this connection what is required for now is a legal non-fiduciary obligation on company directors. The reasoning behind not making the duty fiduciary in nature is that if there are too many beneficiaries of such obligations, directors

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[1404] Bainbridge "The Business Judgment Rule as Abstention Doctrine" 2004 *Vand. L. Rev* 130.

[1405] In chapter 3 (part 3 4 1) it was explained that the directors' fiduciary duty to act in the best interests of the company is not only limited to current shareholders but also includes future ones.

will be confused and may in response shun risk taking because of the many masters to which they have to report. As things presently stand, companies can, through decisions of their directors, choose not to comply with recommendations of the King Code because it is not (hard) law.

6 4 2 Stakeholder remedies

It is submitted that the challenges faced by stakeholders in invoking the derivative action are huge and may in the absence of law reform render it a remedy that exists only in theory but inaccessible in practice. It is argued that if the following recommendations are considered, this remedy may be more effective. The shareholders who invoke the derivative action do so on behalf of the company but bear all the costs. However, if the action is successful it benefits all the stakeholders and the company at large. It is suggested that the pertinent rules of contemporary company law be re-formulated in a way that provides some incentives to those who take it upon themselves to invoke the derivative action. To curb the danger of multiplicity of unreasonable actions, it is suggested that companies reimburse the costs of all successful actions. The reasoning behind covering the costs of successful actions is to encourage only those with genuine and reasonable concerns to approach the courts of law.

The second law reform adjustment that needs to be made pertains to information asymmetry. Shareholders who may be wary or reasonably suspect some kind of wrongdoing by company directors are sometimes discouraged by the fact that they do not have sufficient inside information to prove their case. It is recommended that the law be constructed in a way that reasonable access to such information be allowed to such shareholders. The other option is to provide that if a shareholder approaches a court of law seeking an order for reasonable access to pertinent inside information, the burden should shift to the directors to prove why such information should not be made available to the applicant. Currently, if aggrieved stakeholders intend to make a special application they have to prove why they need the information.[1406]

Minor changes also need to be made with respect to the application of the oppression remedy. Section 238 of the CBCA[1407] confers broad discretion on Canadian courts in determining who qualifies as a complainant under the oppression remedy. It was noted above that courts are even

[1406] Section 26 of the South African Companies Act 71 of 2008.
[1407] 1985.

hesitant to award complainant status to creditors.[1408] It is therefore suggested that the courts be granted limited discretion by firstly, amending section 238(d) of the CBCA to state that "… any other stakeholder who is an affected party in respect of oppressive or unfairly prejudicial conduct or conduct that unfairly disregards their interests". Furthermore, there will inevitably be a need to define who an affected party is. It is suggested that an affected party be defined as "any stakeholder whose interests have been unfairly disregarded or who reasonably believes that the powers of directors have been exercised in a manner that is oppressive or unfairly prejudicial to them.

6 4 3 The business judgment rule

It has been submitted that the major challenge to stakeholders arises when the business judgment rule operates either as an abstention or standard of liability doctrine where the applicant stakeholder has to first rebut some presumptions. Since it is not predetermined which version or manifestation of the rule will be applied by the courts it is suggested that the legislature enacts guidelines to help the courts determine which version of the rule to apply. These should be guidelines which also give some discretion to the courts since every case is unique. The second recommendation in this respect is that since the rule requires the applicant to first prove that the defendant directors acted in bad faith, there is also a need to allow the former reasonable access to some inside information. The law should enable such aggrieved stakeholders to become equipped with necessary information before they approach the courts. The rationale is not to punish misbehaving directors but to promote the integrity of the corporate governance system while at the same time reward excelling directors.

[1408] *Royal Trust Corp Canada v Hordo* 1993 10 BLR 2d 86 (Ont Gen Div).

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