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

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I INTRODUCTION

Company law rules operate within live social and economic conditions.[1] Traditionally, companies were viewed as private concerns whose primary purpose was to make it easier for entrepreneurs to do business. The separate legal personality of a company, with the capacity to hold rights and duties, meant that it could engage in business transactions and bear the potential risk of liability. The personal estates of the company's members were protected and their potential liability limited to their funds invested into the company's share capital.[2] Companies also created a platform for novel fund raising structures with a multitude of members being able to invest capital into the company in exchange for *shares*, which represent the proprietary interest in a company[3] and entitle them to share in its profits when dividends are declared. In order to ensure that a company's activities were conducted properly, a distinction was drawn between its shareholders (or members) as owners of the shares in the company and its board of directors that are entrusted with the company's management. The board of directors was placed under fiduciary duties to act in the company's best interests with the risk of personal liability if these duties were breached. The company's best interests roughly translated into the shareholders' interests, with profit

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[1] *South African Company Law for the 21st Century* GN 1183 in *GG* 46293 of 23 June 2004 ("*SA Company Law Policy Paper*") at 8 – 10.

[2] See section 19 of the Companies Act; *Salomon v Salomon & Co Ltd* [1897] AC 22 at 52; *Dadoo Ltd v Krugersdorp Municipal Council* 1920 AD 530 at 531; Elis Ferran *Company Law and Corporate Finance* (1999) at 10; RA Posner *Economic Analysis of Law* 4ed (1992) 396.

[3] See the definition of 'share' in section 1 of the Companies Act; *Randfontein Estates GM Co Ltd v the Master* 1909 TS 1978 at 971; *Standard Bank of SA Ltd v Ocean Commodoties Inc* 1983 (1) SA 276 (A) at 288H.

making viewed as a significant indication of what is best for them.[4] Although companies operated within society and their activities impacted on various stakeholders (such as its employees, customers and communities), their main purpose was to serve their member's interests.

It is now difficult to ignore the social influence that companies have. Some companies have grown to such an extent that they often wield power that is comparable to states. For instance, as far back as 1996, it was estimated that, of the 100 largest economies in the world, companies occupy 51 positions with states occupying the remaining 49.[5] Globalization has also contributed to the formation of large multinational companies whose activities span across the developed and developing world.[6] The growth of companies coincided with many instances of human rights violations by them in a fashion similar to state violations.[7] For example, in the early 1990s the Truth and Reconciliation Commission devoted three days of its hearings, and a chapter of its report, to consider the contribution of the business sector in human rights violations during apartheid.[8] Some have even argued that the role of business is deeper as 'apartheid was not (simply) a form of racial separation and oppression ''but a means of creating a dispossessed and radical closely controlled labour force for white-owned enterprises''.'[9] In *Khulumani v. Barclay National Bank Ltd*[10] the United States Court of Appeals for the Second Circuit held that South African plaintiffs (who sought claims of '$400 billion on behalf of all historical apartheid victims from more than 50 Western multinationals that did business with apartheid South Africa'[11]) were entitled to plead that such companies

[4] Section 76(3)(b) of the Companies Act. See also HS Cilliers, ML Benade, JJ Henning, JJ Du Plessis, PA Delport, L De Koker and JT Pretorius *Corporate Law* 3 ed (2000) at 139; JA Kunst (ed) *Henochsberg on the Companies Act* ed (1994) at 467; *Da Silva v CH Chemicals (Pty) Ltd* 2008 (6) 620 (SCA) at para 18; *Alexander v Automatic Telephone Co* [1900] 2 Ch 56 (CA) at 67; *Coronation Syndicate Ltd v Lilienfeld* 1903 TS 489 at 497; *Parke v Daily News Ltd* [1962] 2 All ER 929 at 948; *Hutton v West Cork Railway* 23 Ch D 654.

[5] RC Longworth "Large Companies Now Economically Bigger Than Some Countries" *Chicago Tribune* 15 Oct. 1996.

[6] Robert McCorquodale & Richard Fairbrother, "Globalization and Human Rights" (1999) 21 *Human Rights Quarterly* 735.

[7] See Jordan J Paust 'Human rights responsibilities of private corporations' (2002) 35 *Vanderbilt Journal of Transnational Law* 801 at 802. Accounts of some human rights violations by corporations are detailed in Human Rights Watch 'On the margins of profit rights at risk in the global economy' (2008) available at http://hrw.org/reports/2008/bhr0208/ at 7.

[8] *Truth and Reconciliation Commission, Final Report* (vol 4 1998) chapter 2 (http://www.polity.org.za/givdocs/commissions/1998/trc/4chap2.htm).

[9] Pierre de Vos 'A bridge too far? History as context in the interpretation of the South African Constitution' (2001) 17 *South African Journal of Human Rights* 1 at 14.

[10] 504 F.3d 254 (2d Cir. 2007).

11 See Michael D. Goldhaber 'Not Dead . . . Yet: The Corporate Alien Tort Never Left Us, and It's Cued Up for Crucial Tests in the Supreme Court' *AM Law* March 2008 at 77; 'Beyond repair: Accomplice liability under international law and the Apartheid Reparations case' (2006) 21 *South African Public Law* 229 at 231.

aided and abetted in the human rights violations. More recently, one of the mandates of the Marikana Commission of Inquiry (which was established to investigate the deaths of 44 striking miners allegedly by policemen) was to consider the role of a mining company in this tragedy including its response to the threat of violence and labor unrest as well as the measures that in put in place to protect its employees.[12]

The need to hold companies responsible for human rights violations derives from the Constitution of the Republic of South Africa, 1996 ("the Constitution") which imposes human rights obligations on companies in certain cases.[13] Companies are, however, artificial persons and their activities are traceable to the decisions of their boards of directors. This raises the question whether the directors' fiduciary duty to act in the company's best interests can still be narrowly interpreted to mean its shareholders' interests or is there a need for the human rights interests of stakeholders to be considered?

This question has resurfaced in South Africa with the recent corporate law reform introduced by the new Companies Act 71 of 2008 ("Companies Act") which recognizes that one of its purposes is 'to promote compliance with the Bill of Rights as provided for in the Constitution, in the application of company law.'[14] Similarly, the Companies Act 'must be interpreted and applied in a manner that gives effect to' such purposes.[15] These provisions mean that company law principles cannot be seen in a vacuum, but must be read in conjunction with broader human rights principles envisaged in the Constitution.[16]

The directors' fiduciary duty to act in the company's best interests is partially codified[17] in Section 76(3)(b) of the Companies Act which states that 'a director of a company, when acting in that capacity, must exercise the powers and perform the functions of a director . . . . . in the best interests of the company'. A new innovation of the Companies Act is to qualify the duty by the introduction of a "business judgment rule" in section 76(4) which is as a

12 Establishment of a Commission of Inquiry into the Tragic Incident at or Near *the Area Commonly Known as the Marikana Mine in Rustenburg, North West Province, South Africa* GN 35680 in *GG* 50 of 12 September 2012 para 1.1.

13 Sections 8(2) and 39(2) of the Constitution; *Khumalo v Holomisa* 2002 (5) SA 401 (CC) para 31; *Du Plessis v De Klerk* 1996 (3) SA 850 (CC) paras 45 – 8.

14 Section 7(1)(a) of the Companies Act.

15 Section 5(1) of the Companies Act.

16 See Judith Katzew, Crossing the Divide between the Business of the Corporation and the Imperatives of Human Rights – The Impact of Section 7 of the Companies Act 71 of 2008 128 *South African Law Journal* (2011) 686.

17 Under section 77 of the Companies Act the fiduciary duty exists at both common law and statute.

defence or 'safe harbor'[18] for directors against an alleged breach of the fiduciary duty. This rule requires the courts to defer to the directors' judgment on what is in the 'best interests of the company' if their judgment was shown to be honest and reasonable.[19]

In addition to the business judgment rule, section 77(9) of the Companies Act provides that a court:

> 'may relieve the director, either wholly or partly, from any liability . . . on any terms the court considers just if it appears to the court that-
> (a) the director is or may be liable, but has acted honestly and reasonably; or
> (b) having regard to all the circumstances of the case, including those connected with the appointment of the director, it would be fair to excuse the director.'

In this article we argue that the directors' fiduciary duty to act in the company's best interests, together with the business judgment rule and the court's general discretion to relieve directors of liability, embody normative concepts that require directors to make value judgments on company's social responsibilities. Such value judgments are influenced by various policy considerations and societal norms that prevail at the relevant time. We begin, in Part 2, by showing that the common law duty was formulated in a pre-constitutional era where profit maximization was the primary concern for companies. Accordingly, the duty embraced limited social responsibility dimensions. In Part 3, we argue that the 'objective normative value system'[20] in the Bill of Rights must now guide the scope of the duty. This will make it necessary for both shareholder and stakeholder interests to be recognized and balanced against each other in determining the company's best interests. In Part IV, we show that a proper interpretation of the duty, in accordance with the Bill of Rights, will have at least three practical effects. First, the untested assumption that human rights are a burden to companies must be reconsidered. In fact, human rights are good for business and could even be an investment that may have financial returns for shareholders in the long run. Second, we argue that the business judgment rule should apply in such a manner so that the courts defer

[18] As it has been described by Australian authors. See Farrar *Corporate Governance in Australia and New Zealand* ed (2003) at 137; Redmond 'Safe harbour or sleepy hollows: Does Australia need a statutory business judgment rule?' in Ramsay (ed) *Corporate Governance and the duties of company directors* (1997) 185; Santow 'Codification of directors' duties' (1999) *Australian Law Journal* 336 at 348.
[19] Farouk HI Cassim, Maleka Cassim, Rehana Cassim, Richard Jooste, Joanne Shev and Jacqueline Yeats *Contemporary Company Law* 2 ed (2012) at 563.
[20] *Carmichele v Minister of Safety and Security* 2001 SA 938 (CC) para 56.

to the directors' judgment on whether socially responsible decisions are in the company's best interests. Third, we argue that, even if an application of the business judgment rule shows that directors' decisions are not in the company's best interests, the courts may relieve a director of liability if it was "fair" to do so. We conclude that these provisions will encourage directors to take bold and innovative steps to implement social matters as they would do for ordinary business ones. This is particularly so because those matters could also be in the interests of the company, taking into account the injunctions of the Bill of Rights through which South African company law must now be seen.

2. FIDUCIARY DUTIES & SOCIETAL NORMS

A fiduciary relationship is a special relationship based on trust and confidence. It arises when a fiduciary has the power to control or represent another who is at the fiduciary's mercy.[21] The existence and nature of a fiduciary duty is not cast in stone but depends on the factual circumstances of each matter including the substance of the parties' relationship.[22] In *Ghersi v Tiber Developments (Pty) Ltd*[23] the court recognised that 'the ambit of the duty can change from time to time' and that '[t]he existence of . . . a [fiduciary] duty and its nature and extent 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'.[24] The substance of the parties' relationships cannot be seen in isolation but must rather be developed to to suit 'modern conditions'.[25] In what follows, we show that the common law rules on the fiduciary duty were formulated in a social context that vastly differs from our present society in which human rights is a dominant feature. This requires a reconsideration of the existing rules.

a) The Common Law Era

In the classic formulation of common law, a company's best interests were associated with those of its shareholders. This was known as the 'shareholder dominance' theory.[26] Directors owed fiduciary duties to 'the company as a whole' which means not 'the company as a

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[21] *Bristol and West Building Society v Mothew [*1998] Ch 1at 18. *Hospital Products Ltd v US Surgical Corporation* (1984) 156 CLR 41 (HC of A) at 96 – 7.
[22] *Volvo (SA) (Pty) Ltd v Yssel* [2008] 3 All SA 488 (W) at 504.
[23] 2007 (4) SA 536 (SCA) at para 9. See also *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168 at 268; *Bellairs v Hodnett and Another* 1978 (1) SA 1109 (A) at 1128A - 1134D.
[24] *Ghershi* op cit note 23 para 9 (quoting *Phillips v Fieldstone Africa (Pty) Ltd and Another* 2004 (3) SA 465 (SCA) at 477H).
[25] *Phillips* (supra n 24) para 30; *Transvaal Cold Storage Co Ltd v Palm*er 1904 TS 4 at 34–5;
[26] Cassim et al op cit note 19 at 515; *Miller v Bain Sub Nom Pantone 485 Ltd* [2002] BCLC 166 (ChD).

commercial entity, distinct from the corporators: it means the corporators as a general body.'[27] Special attention was given to shareholders' financial interests in the company being profitable. In *Kinsela v Russel Kinsela Pty Ltd*[28] 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.' Companies were seen as essentially private concerns with no social obligations beyond the payment of taxes.[29] Friedman, the Nobel prize winning economist, in describing the role of companies, said that 'there is one and only one social responsibility of business - to use its resources and engage in activities to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud.'[30]

In this regard, if the directors made decisions aimed at protecting other stakeholders, they ran the risk of being personally liable to the company for breach of their fiduciary duties to act in the best of interests of the company (being equated with those of its shareholders). For instance, in the classic American case of *Dodge v Ford Motor Co*[31] the directors resolved to reinvest funds into the company, for the benefit of its employees and the community, instead of paying special dividends to its shareholders. In invalidating this decision, the court said:

> 'A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed to that end. The discretion of the directors is to be exercised in the choice of means to attain that end, and does not extend to a change in the end itself, to the reduction of profits, or to the non-distribution of profits among stockholders in order to devote them to other purposes.'

Directors were not prohibited from making socially responsible decisions but such decisions were only allowed if the directors believed that the shareholders would benefit from them.[32] The courts took a very conservative approach in judging whether a decision was in the shareholders' best interests. In *Evans v Brunner Mond & Company Ltd*[33] and *Re Lee Behrens*

[27] *Greenhalgh v Arderne Cinemas* [1951] Ch 286 at 291.
[28] (1986) 10 ACLR 395 CA NSW at 401.
[29] Adolf A Berle 'Corporate powers as powers in trust' (1931) 44 *Harvard Law Review* 1049.
[30] Milton Friedman 'The social responsibility of business is to increase its profits' in *New York Times Magazine*, 13 September 1970 (available at http://www.colorado.edu/studentgroups/libertarians/issues/friedman-soc-resp-business.html).
[31] 1919 170 NW 668.
[32] *Coronation Syndicate Ltd v Lilienfeld* supra note 4 at 497; Cassim et al op cit note 19 at 515 – 6.
[33] [1921] ChD 359.

& Co Ltd[34] the courts held that decisions authorizing charitable donations were only valid if they were 'reasonably incidental to the company's business' and for its benefit. Similarly, in setting aside a board decision to distribute gratuities to employees of a company being wound up, Bowen LJ in *Hutton v West Cork Railway*[35] emphasized the classic and entrenched shareholder dominance theory by saying:

> '[C]harity has no business to sit at boards of directors qua charity. There is, however, a kind of charitable dealing which is for the interests of those who practice it, and to that extent and in that garb (I admit not a very philanthropic garb) charity may sit at the board, but for no other purpose . . . The 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.'

b) Critique of Shareholder Dominance

The shareholder dominance theory was based on two main policy considerations. First, as shareholders invest capital in the company and are entitled to its profits, the company should be run in their interests. Second, the shareholders have residual claims of whatever is left in the company after all other payments are made. This places them in the best position to police the efficiency of the company and its directors.[36] Although these policy considerations are valid reasons for requiring the directors to recognize shareholder interests, they do not necessarily preclude other stakeholders from also being recognized.

In response to the first policy consideration, Corfield[37] argues that, while it is true that shareholders "own" the company due to their financial investments, other stakeholders such as employees have also invested into the company in the form of human capital. They also bear a risk of loss if the company is unsuccessful. The same may be said of other stakeholders like consumers who have faith in the company's products and the community which is interested in the company's operations being safe and not harmful to its environment. Similarly, suppliers that do business with a company may place great emphasis on the reputational risk of having relations with companies that violate human rights. It is clear that,

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[34] [1932] 2 Ch 46.
[35] *Hutton v West Cork Railway* supra note 4 at 673.
[36] *SA Company Law Policy Paper* note 1 at 24 .
[37] Andrea Corfield 'The stakeholder theory and its future in Australian corporate governance: A premlimnary analysis' (1998) 10(2) *Bond Law Review* 213 at 216

despite not being "owners" of the company, various stakeholders still have significant interests in it.

On the second policy consideration, stakeholders may play an active role in policing the management of the company by its directors. In certain cases stakeholders may have a derivative action to force the company to engage in legal proceedings which may include proceedings against its own directors.[38] It is not unusual for key stakeholders (such as employees or suppliers) to appoint directors to a company's board. The significance of board representation in protecting human rights is evident from the recent call, in the wake of the Marikana tragedy, for employees to be more strongly represented at the board level.[39] Even in the absence of specific remedies, the influence of strike actions, pickets and consumer boycotts cannot be underestimated in enforcing stakeholder interests and keeping the board of directors in check.

The common law position was conceived and bred in a society in which the human rights responsibilities of corporations were in its infancy. Human rights, if recognised, were essentially a 'charter of negative liberties' binding the state and not companies.[40] The state was responsible for creating domestic laws that bind companies. If domestic laws failed to recognize human rights, as was the case in apartheid South Africa, the result was that it may be easier for companies to commit human rights violations.

Today the legal landscape has changed significantly. The adoption of the Constitution as supreme law, with a Bill of Rights that binds private persons, requires a reconsideration of the social dimensions of companies' responsibilities.[41] As stated in *Du Plessis v De Klerk* by Madala J 'Ours is a multi-racial, multi-cultural, multi-lingual society in which the ravages of apartheid, disadvantage and inequality are just immeasurable. The extent of the oppressive measures in South Africa was not confined to government/individual relations, but equally to individual/individual relations.'[42] A proper interpretation of the nature and scope of a director's fiduciary duty to act in a company's best interests cannot be determined unless the impact of the Bill of Rights is appreciated. This has the potential of being a game-changer in

[38] Section 165 of the Companies Act.
[39] Martin Creamer 'Leon proposes employee codetermination at board level' (http://m.miningweekly.com/article/leon-proposes-employee-codetermination-at-board-level-2012-11-14).
[40] Posner J in *Jackson v City of Joliet* 715 F 2d 1200, 1203 (7th Cir) at 1206.
[41] See sections 8(2) and 39(2) of the Constitution.
[42] 1996 (3) SA 850 (CC) at 732E – F.

the domain of corporate law relative to the place of companies as organs of society. Human rights can no longer be seen as a restraint on the exercise of state power only, since there are growing calls for companies to adopt human rights protections within their '[s]phere of influence [which] is not about what rights companies must respect but rather about when and where companies must take steps to ensure they respect human rights'.[43]

3. STAKEHOLDER RECOGNITION & HUMAN RIGHTS

In *AP Smith Manufacturing Co v Barlow*[44] the court said that 'modern conditions require that corporations acknowledge and discharge social as well as private responsibilities as members of the communities in which they operate'. This is especially true in the South African context where the Bill of Rights binds a 'juristic person if, and to the extent that, it is applicable, taking into account the nature of the right and the nature of any duty imposed by the right'.[45] The Bill of Rights 'enshrines the rights of all people in our country'[46] and it is not surprising that the interests of most stakeholders in a company may be traced back to particular fundamental rights. For example, employees' interests may lie in their labour relations rights, community interests may lie in socio-economic rights and the protection of the environment may be traced to the environmental right. General rights such as equality and human dignity may span across all stakeholders.[47] The Bill of Rights should be the standard against which a company's private responsibilities (to its shareholders) are balanced with its social responsibilities to stakeholders. In recent years two theories have emerged to balance these diverse interests: the "pluralist theory" and the "enlightened shareholder value" theory.[48]

The pluralist theory is based on the premise that 'co-operative and productive relationships can only be optimized where directors are permitted (or required) to balance shareholders' interests with those of [other stakeholders] committed to the company'.[49] Shareholders are but one of many groups with interests in the company and do not warrant any special preference over other stakeholders when determining the company's best interests (in its

[43] John Ruggie 'Corporate responsibility to protect human rights' on a meeting convened by him in Geneva on 4–5 December 2007, available at http://www.reports-and-materials.org/Ruggie-Geneva–4-5-Dec–2007.pdf.
[44] 98 A2d 581 (NJ 1953) at 586.
[45] Section 8(2) of the Constitution.
[46] Section 7(1) of the Constitution.
[47] See sections 9, 10, 23, 24 and 26 of the Constitution.
[48] United Kindgom Department of Trade & Industry *Modern Law for Competitive Economy: The Strategic Framework* ed (Issued February 1999); URN 99/654) ("*UK Policy Paper*") para 5.1.
[49] Ibid para 5.1.13.

extended sense). Directors are free to decide what is in the best interests of the company even if it means ignoring shareholders' interests in favour of a stakeholder.[50] The facts of the *Hutton* case, which we discussed earlier, are an example of a situation where shareholder and stakeholder interests are in opposition. The directors' decision to pay gratuities to employees did not benefit the shareholders in any way since the company was being dissolved and there was no prospect for future gain for the shareholders.

Traces of the pluralist approach are found in the *King III Codes and Report*[51] which adopt a "triple bottom line" or "integrated stakeholder" approach that requires directors to consider economic, social and environmental factors when managing a company. Directors are not only responsible for profit making but must also recognise other stakeholder interests within society. Like the pluralist theory, directors are not obliged to favour shareholder interests when assessing what, in their opinion, is in the company's best interests.

In contrast to pluralism, the enlightened shareholder value theory acknowledges the importance for a company to have 'productive relationships with a range of interested parties – often termed "stakeholders" – and to have regard to the longer term, but with the shareholders' interests retaining primacy'.[52] Directors are entitled to take a social decision favouring a stakeholder only if they believed this would also, for the long or short term, be for the shareholders' best interests. If there is a conflict between the interests of shareholders and stakeholders, the shareholders' interests must prevail.[53]

The enlightened shareholder approach resembles the approaches adopted in the *Evans* and *Lee Behrenss* cases discussed earlier since both involved arguments that favouring stakeholders may, at times, also be for the shareholders' long term benefit. It is therefore argued that the enlightened shareholder approach fits easily into the common law without the need for substantial amendments.[54] There is, however, one significant difference between the two approaches. At common law, a decision favoring a stakeholder had to be 'reasonably incidental to the company's business' and for the shareholder's benefit. The courts adopted a

[50] Cassim et al op cit note 19 at 495 – 7.
[51] Institute of Directors *King Report on Corporate Governance for South Africa* 2009 ("*King III Report*") at principles 7.3 and 7.4; page 22 paras 16 – 18 and page 100 paras 4 - 6 paras Institute of Directors *King Code of Governance in South Africa* 2009 ("*King III Code*") at code 8.3.1.
[52] *UK Policy Paper* supra note 48 para 5.1.12.
[53] *SA Company Law Policy Paper* supra note 1 at 44.
[54] ibid at 47.

conservative interpretation by placing greater emphasis on short term profit maximization than longer term shareholder benefits. That is why the *Evans*, *Lee Behrens* and *Dodge* cases held that charitable donations, and decisions to favour employees and the community, were not in the shareholders' best interests. The enlightened shareholder value approach, if read in accordance with the Bill of Rights, may require a more liberal interpretation of the best interests of the company that recognizes long term interests. The courts appear to gradually move towards a liberal reading, as is evident from *Teck Corp Ltd v Millar*[55] in which Berger J observed that '[i]f today directors of a company were to consider the interests of employees no one would argue that in so doing they were not acting bona fide in the interests of the company itself.'

This shift from a conservative to liberal approach is also evident from our Companies Act which confers wide-ranging powers on employees, trade unions and certain other stakeholders in respect of the company's management.[56] Outside company law, various pieces of legislation formally recognise stakeholder interests (such as those of employees,[57] consumers,[58] the environment[59] and the community.[60]) This will trickle down to the board room as directors will have to consider these rules in their decisions.

The enlightened shareholder theory is criticised on the basis that directors are legally "accountable" to shareholders and merely "responsible" to other stakeholders.[61] This is because, unlike shareholders,[62] stakeholders did not have remedies to enforce their interests in the company. This criticism does not appreciate two recent legal developments.

First, section 165 of the Companies Act gives certain stakeholders legal standing to bring derivative actions forcing a company to engage in legal proceedings including against directors for breaches of fiduciary duty. This action may be brought by a shareholder,

[55] (1972) 33 DLR (3d) 288 (BCSC) at 313-4.
[56] See section 165 of the Companies Act.
[57] See the Labour Relations Act 66 of 1995; the Employment Equity Act 55 of 1998 and the Basic Conditions of Employment Act 75 of 1997.
[58] See the Consumer Protection Act 68 of 2008; the National Credit Act 34 of 2005; the Competition Act 89 of 1998.
[59] See for example Environmental Law Rationalisation Act 51 of 1997.
[60] See for example the Broad-Based Black Economic Empowerment Act 53 of 2003.
[61] *King III Report* para 5.1 at 7.
[62] Besides the derivative action in section 165 of the Companies Act, the collective body of shareholders usually exercise ultimate control by their powers to appoint and remove directors as well as to make decisions at general meetings of the company.

director, prescribed officer, trade union, employee representative or any other person who has leave of the court if it satisfied that this action 'is necessary and expedient . . . to protect a legal right of that person'. This section opens the possibility for stakeholders (whose rights have been infringed) to have legal standing to bring derivative actions.

Secondly, although a legally enforceable right or remedy is a strong way to protect stakeholder interests, it is not the only remedy. The *United Nations Guiding Principles*[63] recognise that 'judicial' and 'non-judicial' remedies (including, amongst others, grievance mechanisms and encouraging dialogue) may be effective remedies to protect human rights, depending on the circumstances. Accordingly, even if the enlightened shareholder approach does not recognize the need for stakeholders to have legally enforceable rights against the company (or its board), this does not necessarily mean that their interests will necessarily be ignored.[64] The inclusion of human rights issues in board deliberation is, at the minimum, a step in the right direction to protect stakeholders and is better than no remedy at all. Further, the Companies Act also requires large companies to form a social and ethics committee of the board that will be tasked with considering social issues.[65]

Save for a few European countries,[66] jurisdictions that follow the English board model have been reluctant to adopt a purely pluralist approach which places shareholders on an equal footing with other stakeholders. This may partially be due to the common law emphasis on shareholder interests and policy consideration that the survival and economic success of a company (which will in turn deliver social benefits to various stakeholders like creating jobs for employees) would not be possible if the company is a business failure.[67] Keeping shareholders happy is therefore an important cog to ensure that the company exists and will be able to serve society.[68] For these reasons the enlightened shareholder approach is likely to be the more popular theory in South Africa until the courts are bold enough to adopt a pluralist approach either holistically or, as we suggest below, in exceptional circumstances.[69]

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[63] *The Guiding Principles on Business and Human Rights: Implementing the United Nations 'Protect, Respect and Remedy' Framework* A/HRC/17/31 (21 March 2011).
[64] Ibid para 6 and Part III.
[65] Section 84 of the Companies Act.
[66] For example Germany and Hungary. See Boglárka Szánthó "One and Two Tier Corporate Governance Systems" 12 November 2012 (http://www.internationallawoffice.com/newsletters/detail.aspx); Cassim et al op cit note 19 at 520.
[67] *SA Company Law Policy Paper* supra note 1 at 215.
[68] Ibid at 215 and 219.
[69] See part IV(c) below.

Our view is nevertheless that the distinction between the pluralist and the enlightened shareholder approaches should not be overemphasized since they share the common thread of requiring the directors to balance competing interests of various stakeholders and shareholders. Their material difference lies in the importance that they place on shareholder interests and whether this should trump those of other stakeholders. In the next Part, we argue that if a liberal interpretation of the company's best interests, and the business judgment rule is adopted, it may make the distinction between the two theories less important. This is because it will be very difficult (but not impossible) to find a situation where a board decision based on human rights will not be in the long terms interests of the shareholders.

4. LIBERAL INTERPRETATION OF THE COMPANY'S BEST INTERESTS

Both the enlightened shareholder and pluralist theories require directors to balance the interests of various stakeholders and shareholders.[70] On a practical level three further issues must be considered: First, under the enlightened shareholder approach, can respecting human rights ever be in the best interests of the shareholders even from a purely financial perspective? Second, should the courts defer to the directors' judgment on what is in the company's best interests in situations where their decisions are made pursuant to human rights concerns? Third, even if a decision is clearly not in the company's best interests, may the decision still survive scrutiny based purely on its social significance? We consider these questions in turn.

a) Are Human Rights Good for Business?

Human rights responsibilities were often viewed as a burden, instead of an investment, for companies. In recent years, however, more arguments have emerged to support the view that human rights may actually be good for business.[71] In managing a company, directors are required to develop and implement a business strategy that is aimed at generating value for the company. Kerr[72] notes that there is a growing acceptance that, because various

[70] Cassim et al op cit note 19 at 519;

[71] Mary Robinson 'The business of case for human rights' in Malcolm McIntosh (ed) Visions of Ethical Business (1998), quoted in Andrew J Wilson 'Beyond Unocal: Conceptual problems in using international norms to hold transnational corporations liable under the Alien Tort Claims Act' in Olivier de Schutter (ed) Transnational Corporations and Human Rights (2006) 43 at 63. Scott Greathead 'The multinational and the ''new stakeholder'': Examining the business case for human rights' (2002) 35 *Vanderbilt Journal of Transnational Law* 719.

[72] Janet E Kerr 'Sustainability meets profitability: The convenient truth of how the business judgment rule protects a board's decision to engage in social entrepreneurship' (2007) 29 *Cardozo Law Review* 623 at 631 -8.

stakeholders have interests in the performance of a company, good strategic managers make decisions in consideration of all stakeholders. At times this may require that short term interests (such as profit making) should be sacrificed so that socially responsible decisions, which may be better for shareholders in the long run, may be adopted.

Williams and Connelly[73] point out that companies are beginning to realize the benefits of human rights on their business success and this is partly due to the a growing tendency for consumers and suppliers to prefer companies with good human rights records. Sullivan[74] similarly notes that affirmative action employment policies have been embraced, by many companies in the United States, as a way to gain an advantage over competitors by accessing a previously untouched pool of talent and diversity. Investing in human rights may also lead to empowering persons and communities that may, in turn, become new consumers for companies. It is also evident that state procurement systems (such as broad-based black economic empowerment in South Africa) creates an incentive for companies to have good human rights records since it may be material to their ability to bid for work from the state.

The Harvard Business School recently coined the phrase 'social innovation' which reflects a growing trend for businesses to reject "Band-Aid" solutions (such as financial donations and voluntary work) in favour of treating social issues as any other business problem. This will insure that a company's best skills and resources are involved in the social issue[75] and that the solution becomes more sustainable and empowering for the beneficiary as opposed to mere charity.[76]

A decision to favour a particular stakeholder's interests does not necessarily mean that other stakeholders or shareholders will suffer. A "zero sum" approach, in terms of which stakeholders compete so that success for one means defeat for the other, does not necessarily have to be followed. Instead, a "symbiotic" approach may be adopted, in terms of which initiatives may be explored to determine how the company can achieve both financial benefits and shared benefits for its stakeholders. This symbiotic approach (of balancing

[73] Cynthis A Williams & John M Conley 'Is there an emerging fiduciary duty to consider human rights?' 74 *University of Cincinatti Law Review* (2005) 75 at 78 – 81.
[74] Kathleen Sullivan "The Supreme Court, 1985 Term – Comment: Sins of Discrimination: Last Term's Affirmative Action Cases" 100 *Harvard Law Review* 78 (1986) at 84. See also Anonymous 'Rethinking *Weber*: The business response to affirmative action' 102 *Harvard Law Review* 658 (1988-9) at 672.
[75] RM Kanter 'From spare change to real change' *Harvard Business Review* May 1, 1999 at 122 – 32.
[76] Williams & Conley op cit note 73 at 78.

various stakeholder and shareholder interests) is also consistent with Bill of Rights which often requires the balancing competing rights with each other.[77]

The symbiotic approach is workable because stakeholders and shareholders may depend on each other for success.[78] For example, to reconsider the facts of the *Dodge* case, it may be argued that the court was short sighted in not appreciating that investing in employees and the community may actually be better for shareholders in the long term. This decision may, for instance, result in happier (and more productive) workers as well as increase the community's (and potential consumer's) perception of the company which may in turn result in increased sales. The difficulty, however, is that the same facts could have easily backfired, such as if disgruntled shareholders abandoned the company, which ultimately leads to its bankruptcy and workers losing their jobs.

There can never be certainty on whether the outcome of a decision will be successful or not. However, this uncertainty is actually a reason to defer to directors who (as experts with the mandate to make business decisions) are in the best positions to balance competing interests.

b) Business Judgment Rule

Directors must balance various interests in making a value judgment on what they feel will be in the company's best interests. They risk personal liability if their decisions are poorly made. This risk may either discourage directors from accepting board appointments or, if appointed, may lead to directors taking the cautious approach of not deviating from traditionally accepted decisions (such as profit maximization).

The business judgment rule responds to these concerns by limiting judicial scrutiny on business matters. Section 76(4) provides that a director may be excused from liability for a breach of fiduciary duty if the director was properly informed, had no financial interests in the matter and made a decision that he 'had a rational basis for believing, and did believe, that the decision was in the best interests of the company'. The rationality requirement is an objective test and merely requires a belief that no unreasonable person in the position of the director will hold.[79] This rationality requirement is similar to that adopted in *Minister of*

[77] See for example section 36 of the Constitution.
[78] Kerr op cit note 72 at 48.
[79] Cassim op cit note 19 at 564 -5.

Finance v Van Heerden[80] which, in the context of reviewing the constitutionality an affirmative action measure, Moseneke J said: 'It is sufficient if the measure carries a reasonable likelihood of meeting that end. To require a sponsor of a remedial measure to establish a precise prediction of a future outcome is to set a standard that is not required . . . [and] would render the remedial measure still born'.

We suggest that a similar test should be applied to the business judgment rule. This will create a low threshold against which directors' decisions (especially socially responsible ones) will be tested. In the United States and Australia the rule has been used to shield directors' socially responsible decisions from scrutiny by the courts. In *Shlensky v Wrigley*[81] the court said that 'the effect [of a decision] on the surrounding neighbourhood might well be considered by a director'. Similarly in *Unocal Corp v Mesa Petroleum Co*[82] the court held that directors may consider the impact of their decisions on non-shareholder constituencies such as employees, suppliers, customers, creditors and the community. This approach is consistent with the aim of the rule, which is to avoid judicial second-guessing, with the benefit of hindsight, on decisions honestly and reasonably made by the directors. It would also be consistent with the court's duty to 'respect, protect, promote and fulfil' the Bill of Rights[83] which, in this context, may require judicial deference instead of activism.

b) The Court's General Discretion

The company's best interests is a general term and, if interpreted liberally, may extend beyond shareholder profit maximisation to embrace socially responsible board decisions which, indirectly, will benefit the company and its shareholders. However, an unanswered question is whether such a socially responsible board decision may be justified even if it is clearly not in the company's best interests? We submit that this will be a rare eventuality since most decisions may, in some way, be argued to be in the company's best interests. This is especially so if the courts defer to the directors' business judgment on this issue. The facts of *Hutton*, where the anticipated dissolution of the company meant that shareholders received no benefit from an altruistic act to employees, is one of the very rare exceptions that we can imagine where a socially responsible decision was in clear opposition to the company's best interests.

[80] 2004 (6) SA 121 (CC) para 24.
[81] 95 III App 2d 173, 181 (1968).
[82] 493 A 2d 946, 955 (Del 1985).
[83] Section 7(2) of the Constitution.

Section 77(9) of the Companies Act states that in any proceedings against a director, save for willful misconduct or breach of trust, a court may relieve the director, either wholly or partly, from liability on any terms that the court considers '*just*' if it appears to the court that the director is or may be liable but 'acted *honestly* and *reasonably*' or 'having regard to *all the circumstances* of the case, including those connected with the appointment of the director, it would be *fair* to excuse the director.'[84]

This section embodies normative phrases such as 'just', fair' and 'reasonable' which will have to be interpreted in accordance with the Bill of Rights' objective normative values. For purposes of this article we shall not attempt an in depth interpretation of this section, save to make a few observations. First, it will be important to distinguish section 77(9) from the business judgment rule since it will be nonsensical if both provisions adopted the same standard. Second, a major difference between the two provisions is that section 77(9) requires *all the circumstances of the case* to be considered in making a normative judgment. This is significant because, as indicated earlier, the business judgment defense is only relevant in considering whether a decision is in the company's best interests.

It is our view that section 77(9), in this context, may be relied on once it has been shown that the business judgment defense is not applicable in that the decision is not in the company's best interests (even if interpreted by the enlightened shareholder approach). Section 77(9) contain traces of pluralism since it permits all circumstances (including stakeholder interests) that fall within the normative standard of this section, to prevail over those of the company (and its shareholders). However, this appears to apply only to the case when assessing whether a director may be excused from liability and does not extend to validating the actual board decision itself.

5. CONCLUSION

Human rights are not merely moral imperatives, or legal doctrines, but are rather living and practical concerns for directors who manage companies. It is important for directors to realise that protecting the human rights of a company's various stakeholders may be linked to the best interests of the company (and perhaps it shareholders too). This is because taking

[84] Our emphasis.

stakeholder interests into account in board decisions will assist in creating stability in the companies' activities. The likelihood of employee strikes, consumer boycotts and other disruptive activities may be reduced if stakeholders' most fundamental interests are protected. In other words, protecting human rights does make business sense, since it is a strategy to ensure business stability and sustainable growth. In business, innovation and risk are vital tools for success, irrespective of whether the factors on which innovation are based are technology, skills, price or other concerns. Human rights should be added to this list.

We have argued that the business judgment rule, in which the courts defer to reasonable decisions taken by directors, should be interpreted so that the courts will defer to the directors on decisions to protect human rights. In many cases, the financial or immediate benefits to the company, and its shareholders, of such a decision may not be apparent. However, in the long term, the measure may contribute to the company's business sustainability and future growth. The courts should therefore tread lightly on decisions taken by directors to promote human rights before finding that such decisions violate their fiduciary duty to act in the company's best interests. By reviewing directors' decisions under the low threshold of the business judgment rule, directors will be encouraged to find innovative ways to impute human rights (and stakeholders interests) into their business decisions without the fear of personal liability for breach of fiduciary duty if the desired outcome of their decisions do not materialise.

Lastly, we have argued that section 77(9) goes further and, in exceptional cases, excuses directors from liability for human rights decisions even if such decisions are not in the company's best interests.

The precise content of the directors' fiduciary duty to act in the company's best interests, the business judgment rule and section 77(9) are not clear as it will require a test case to settle what has thus far mainly been an academic exercise. However, in the interim, it is hoped that enough has been done to encourage greater corporate citizenship amongst directors.