THE EFFECTIVENESS OF SECTION 72(4) AND REGULATION 43(5) OF THE COMPANIES ACT 71 OF 2008

by

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SUMMARY

The objective of this study is to identify whether section 72(4) and Regulation 43 is viable as an effective provision to be relied upon by shareholders and stakeholders in enforcing their rights under the Companies Act 71 of 2008.

Corporate social responsibility is a relatively new concept within the context of company legislation and in turn raised the question as to whether stakeholder interests should be protected in the same manner as shareholder interests are. Due to being a relatively new concept, there is a lack of a proper legal framework. A comparative study is therefore made of the relevant legal rules and principles in the following countries: the United Kingdom; Germany; Canada; the United States of America and Australia.

It is submitted that under the context of CSR and in the absence of effective company legislation, there should be –

1) an introduction of an effective legal enforcement mechanism under the provisions of section 72;

2) a look into the viability of Regulation 43;

3) a provision that can effectively deal with stakeholder interests separate from shareholder interests, without prejudicing the success of the company.
1 Introduction

The objective of this study is to identify the viability of the social and ethics committee under the new Companies Act 71 of 2008 and whether Regulation 43 which provides for the functions and structure of the social and ethics committee can provide for any effective enforceability. The question that arises under this study is whether section 72(4) and Regulation 43 is mere window-dressing or has the ability to be enforced as a legally recognizable provision.

This first chapter provides a general introduction on the different constituents under company law and the social and ethics committee. Chapter 2 deals with the enlightened shareholder value approach and how its impact is still prevalent in modern company law. Chapter 3 deals with the pluralist approach and is briefly compared to the enlightened shareholder value approach. The fourth chapter provides a brief discussion on corporate social responsibility and its stance under South African company law. Chapter 5 deals with the rights and remedies that shareholders and stakeholders have in terms of company legislation and compares various international legal systems with South Africa’s company legislation. Chapter 6 deals with comparative legislation and how such legislations are either in favour of a shareholder primacy theory or a balancing of interests of both shareholders and stakeholders. Chapter 6 further deals with section 72(4)-(10) and Regulation 43 failure to provide an effective enforcement mechanism and questions as to whether such section is just windowing dressing or has actual footing under South African company law. Chapter 7 summarizes and concludes the objective of this study.

Section 1 of the 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’. However, because the objective of this study is partially based on corporate governance, it is necessary to subject this definition to s 57(1) of the Act, which contains a specific definition of a ‘shareholder’ that applies only to Part F of Chapter 2 of the Act, dealing with the governance of companies.
S 57(1) provides that a shareholder is 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.

Unfortunately, there is no definition provided by the Act as to the meaning of stakeholder in terms of company legislation. The concept of ‘stakeholder’ was coined as a result of a play on the word ‘stockholder’ and was used to more appropriately describe those groups or persons who have a stake, a claim, or some form of an interest in the company’s activities.1 Carroll states that: 2

“Sometimes the stake might represent a legal claim, such as that which might be held by an owner, employee, or a customer who has explicit or implicit contract. Other times it might be represented by a moral claim, such as when these groups assert a right to be treated fairly or with due process, or to have their opinions taken into consideration in an important business decision.”

Modern company law saw the introduction of corporate social responsibility becoming an even more relevant topic of debate than when it originated in the 1930s. Subsequently, with the introduction of this relatively new concept, company law saw stakeholders becoming more relevant. As such, there can be found many heated debates surrounding the importance of stakeholders and CSR. It is a long term view that the company’s objective has been and will always be for the directors to exercise their powers for the purpose of maximizing profits for the company.

With the debate as to what role a company plays in society heating up, it has given way to scholars choosing between an ‘enlightened shareholder value’ approach or a pluralist approach. The ‘enlightened shareholder value’ approach gives shareholders preference above stakeholders and believes that the interests of shareholders must prevail. It further argues that stakeholder interests should only be taken into account if it is in the best interests of the company. The pluralist approach focuses primarily on promoting the

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2 n 1 above.
interests of stakeholders and believes that such interests are essential for the success of the company.

Section 76(3)(b) of the Companies Act 71 of 2008 requires directors to perform their duties in the best interests of the company, ‘Company’ in common law terms refers to the collective body of the shareholders of the company. Unfortunately, there is no formal recognition of stakeholders under the Act and as such much of stakeholder interests have largely been left to the King III Report and the Code. Cassim FHI, Cassim MF, Cassim R, Jooste R, Shev J and Yeats J state that the South African approach to considering stakeholder interests appears to be that stakeholders must look to separate and specific legislation, rather, than to the Act, for the protection of their interests.

Thus the question arises as to what the legislators’ intentions were in implementing section 72(4) and the reasoning behind appointing a social and ethics committee to monitor company’s activities and their impact upon the community and environment. Regulation 43(5)(a) even provides that to monitor the company’s activities, regard must be had to any relevant legislation and other legal requirements or prevailing codes of best practice. Such provision further propounds this question as to whether stakeholders have any effective legal right to enforce their rights under the Act.

This study investigates shareholder rights in the context of CSR and more specifically what standing stakeholders have under the Act and whether stakeholders can be effectively recognized as an essential constituent of the company. A further investigation is made as to the effectiveness of section 72(4) and Regulation 43 and how such legislation fits in, in comparison to other more effective and recognized legislations and codes.

4 Cassim et al (n 3) 19.
2 The Enlightened Shareholder Value Approach

2.1 What is the ‘Enlightened Shareholder Value’ Approach?

The actual objective of companies has been a constant debate under corporate law for many years. This debate began in the 1930s between Professor A.A Berle and Professor E. Merrick Dodd. It is a well known debate that has been discussed extensively amongst academics, and it may seem pointless to dwell any further on it. However, it cannot be completely overlooked as this debate is what helped create the shareholder primacy principle and the stakeholder theory.

Berle argued that the powers and responsibilities given to a company which derived either from statute or charter must only be exercised for the benefit of the shareholders of that company. He further stated that such powers and responsibilities could only be limited or modified if it was to achieve such benefit or protect the interests of the relevant shareholders. Dodd contended that the objective or responsibility of a company was a social one in that shareholders benefited more through the company taking into consideration the interests of the shareholders, employees, consumers and the public in general. The ‘enlightened shareholder value’ approach can be viewed as an extension of Berle’s opinion. Dodd’s contention is one that will be discussed further in the following chapter.

The meaning of the word ‘company’ has been debated quite extensively due to reasons that courts have long deliberated as to whom the directors owe a duty to. Section 76(3)(b) of the Companies Act 71 of 2008 provides that directors have a duty to act in the best interests of the company. This section is a codification of the common-law principle. However, the word ‘company’ in section 76(3)(b) is not defined and as such the

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5 Berle “Corporate powers as powers in trust” (1931) 44 Harv LR 1049.
6 Dodd “For whom are corporate managers trustees?” (1931-32) 45 Harv LR 1145.
common-law definition must be accepted as there can be found vast authority as to the meaning of this word.\(^7\)

The word ‘company’ is defined in s 1 of the Act as a ‘juristic person incorporated in terms of the Act’. However, under the context of s 76(3)(b) it holds no value, hence, the reason for considering the common law view. The court in *Greenhalgh v Arderne Cinemas Ltd*\(^8\) stated that the phrase ‘company as a whole’ does not mean the commercial entity as distinct from the shareholders. It means the shareholders or incorporators as a general body. Thus, as Cassim *et al* state, the word ‘company’ in this context is merely a synonym for the shareholders of the company.\(^9\)

The court in *Bamford v Bamford*,\(^10\) held that directors are not agents of the shareholder to do what the shareholder wants, they are trustees who must exercise their fiduciary powers in the interest of all shareholders of the company as a whole.\(^11\) A view that can be seen to be in line with Berle’s argument of the shareholder value approach.

Milton Friedman could be regarded as a supporter in favour of Berle’s view. Friedman regarded shareholders as the owners of the company and emphasized that the ultimate objective of the directors of a company is to maximize the profits for that of the shareholders.\(^12\)

John McConvill argues that the shareholder primacy concept is based upon the view that the best interests of the company should be considered as ‘the best interests of the shareholder’ since the purpose is to maximize profits for the benefit of the shareholder.\(^13\) McConvill provides us with two statements that exemplify this shareholder primacy

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\(^7\) Cassim *et al* (n 3) 467.
\(^8\) 1951 Ch 286 p 291.
\(^9\) Cassim *et al* (n 3) 468.
\(^10\) (1970) Ch 212 (CA); [1968] 2 All ER 655.
\(^11\) *Bamford v Bamford* (n 10) 234.
\(^12\) Friedman “The Social Responsibility of Business is to Increase its Profits” 1970 *New York Times Magazine* September 13 p 32.
\(^13\) McConvill *Shareholders Participation and the corporation, A fresher Inter-disciplinary approach in Happiness* (2006) 17.
concept. The first by *Dodge v Ford Motor Company 204 Michigan 495; 170 NW 668 (1919)*: 14

‘A business corporation is organised and carried on primarily for the profit of stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end...’

The second statement is by Milton Friedman: 15

‘In a free-enterprise, private property system a corporate executive is an employee of the owners of the business. He has direct responsibility to his employers. That responsibility is to conduct the business in accordance with their desires, which generally will be to make as much money as possible while conforming to the basic rules of the society, both those embodied in law and those embodied in ethical custom.’

The principal of the separation of ownership and control influenced a strong focus on strict shareholder primacy due to the fact that maximizing profits for shareholders was considered to be essential in order for shareholders to be prepared to give control over a company to the directors. Similarly, if directors were failing to maximize profits for the company, shareholders were more likely to intervene in the running of the company. Likewise, if directors were generating profit, then shareholders were more likely to assume a passive role. 16

Andrew Keay states that the shareholder value principle or otherwise known as the shareholder primacy principle in short requires a company to be run in such a way as to maximize the interests of the shareholders ahead of any other interested parties who might have claims against the company. 17 The shareholder value principle formed the basis of the ‘enlightened shareholder value’ approach. Where the shareholder value approach objective was more focused on the wealth maximization of shareholders, the

14 n 13 above.
15 n 13 above.
16 McConvill (n 13) 79.
‘enlightened shareholder value’ approach takes a step further by striking a balance between the competing interests of different stakeholders in order to benefit the shareholders in the long run.\(^\text{18}\) It requires directors to maximize profits for the benefit of shareholders, but allows the interests of stakeholders to be considered only if such consideration is subordinate to that of the shareholder’s interests.

2.2 The Underlying Rationales of the Enlightened Shareholder Value Approach

Corporate governance has seemingly changed its objective in that companies are now required to take a wider stance from their purely economic perspectives to a more socially responsive stand. The reasoning behind this is that it seems to make better business sense, ultimately benefiting the shareholders in the end. As Cassim \textit{et al} state:\(^\text{19}\)

“The company benefits from the improved retention of employees, customers and suppliers and it enhances the goodwill and the image of the company in the local community in which it operates.”

Despite modern company law embracing more social responsibilities, it has not detracted entirely from companies’ objective of maximizing shareholder profit. The US and the UK both seem to permit non-shareholder interests to be taken into account but with the exception that in doing so, the interests of the company is thereby served. In other words, where there is a conflict of interest between the shareholders and stakeholders, the shareholders interest prevail and in turn retaining the principle of shareholder primacy.\(^\text{20}\)

The UK Government objective was to retain the idea of shareholders being the ultimate focus of directors, but with a greater emphasis on the company’s long term future. Thus section 172(1) of the UK Companies Act 2006 was implemented to achieve this goal. This section ensures that directors will still promote the success of the company but with reference to a number of factors. Keay states that the overall effect of s 172(1) is that the

\(^{18}\) Keay (n 17) 590.

\(^{19}\) Cassim \textit{et al} (n 3) 471.

\(^{20}\) n 19 above.
‘enlightened shareholder value’ approach can be described as a ‘shareholder’s first interpretation’.21

The US promotes a shareholder primacy concept in that the sole purpose of US companies is to maximize profits of the shareholder. However, there can be found to some extent in most states an ‘enlightened shareholder value’ approach. The American Law Institute’s Principles of Corporate Governance states that:22

“a corporation should have as its objective the conduct of business activities with a view to enhancing corporate profit and shareholder gain.”

However, this objective is qualified by an obligation to act within the boundaries set by law. The US unlike the UK and South Africa has enacted in certain states such as Pennsylvania, ‘constituency statutes’. These ‘constituency statutes’ permit directors to take into account the interests of other stakeholders or ‘constituencies’ of a corporation. The purpose of these statutes was to ensure that directors acted in the best interest of the corporation or as Keay puts it; to ensure that the harshest application of shareholder value principle does not prevail, certainly to the point of promoting short-termism. Unfortunately these statutes have been criticized as to be mostly focused in the area of take-over bids.23

The Australian Parliamentary Joint Committee on Corporations and Financial Services in its report, ‘Corporate Responsibility: Managing Risk and Creating Value’24, seems to disagree with Keay’s ‘shareholder’s first interpretation’ and rather supports the ‘enlightened self-interest’ interpretation on director’s duties. The Committee believes that corporations and their directors should act in a socially and environmentally responsible manner because such conduct is likely to lead to the long term growth of their

21 Keay (n 17) 592.
22 Keay (n 17) 595.
23 Keay (n 17) 595-596.
A viewpoint that does not seem to be in agreement with the ‘enlightened shareholder value’ approach but more in line with a pluralist approach.

With the codification of s 76(3)(b) the duty for directors to act in the best interest of the company has become mandatory but at the same time still keeping to its common-law foundation. With this section it can be viewed that South African company law prefers a shareholder primacy norm. The result of this is that where shareholders have received recognition, the interests of stakeholders have received no formal, legal recognition, an exception that can be debated to be found in the social and ethics committee. The question that follows is whether this recognition, found in the social and ethics committee, has the same legal force or effect as that of s 76(3)(b)?

Shareholders can enforce their rights not only based on remedies provided by the Companies Act 71 of 2008 but also through proving on the basis of section 77(2)(a) that the director can be held liable for any breach of duty established in section 76(3)(b). As such, should shareholders feel that the directors have prejudiced their interests under the context of CSR and such interest can be proved to be a breach in terms of section 76(3)(b) then they will have an enforceable right under section 77(2)(a). This in turn, further emphasizes the lack of enforceability of Regulation 43, as there can be found no mandatory obligation imposed upon the director to ensure that the interests of the various non-shareholder groups are not infringed.

2.3 The Benefits of the Enlightened Shareholder Value Approach.

Enlightened shareholder value recognizes an alternative to a narrow view of strict shareholder primacy due to the fact that it takes into account that corporations should focus more on maximizing long-term returns to shareholders instead of short-term returns. Many companies throughout the UK, US, Australia and South Africa all prefer to

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25 n 24 above.
26 Companies Act 71 of 2008.
use the shareholder value approach as a basic guide in how their corporations should be run, but the question is how effective is this approach?

Short-termism has become an approach that has been highly criticized amongst many academics as it seems to offer very little opportunity for the success of the company. Keay argues that short-termism focuses more on instant gratification and more so for that of the director since the director benefits from pushing up the share price. This approach provides for every profit earned to be paid out to shareholders without taking into account investing funds and expanding the company’s market for future success. Therefore, the enlightened shareholder value approach offers an alternative in promoting not only the success of the company but ensuring that shareholders are benefited in the long-run. As Keay states:

“In maximizing for long-term value, directors should aim to balance seeking opportunities to make profits now with opportunities to make profits in the future.”

It is argued that focusing on shareholder wealth maximization limits the possibility of cost expenditure due to reasons that by focusing on only one objective, directors can perform more efficiently and their work can be monitored more effectively. Whereas, if directors owed duties to different groups of constituencies it would be more likely that it would be difficult for them to balance the diverse interests. Thus, the ‘enlightened shareholder value’ approach offers that exception in that directors can still focus on shareholder wealth maximization but with keeping in mind the interests of other stakeholders to the extent that such interests might effect the interests of shareholders.

Traditionally it was viewed that in focusing on shareholder wealth maximization, company value would increase and in turn so would social value. This has changed due to the fact that ‘enlightened shareholder value’ proposes that by increasing the value of the company in turn benefits the shareholders. Virginia Harper Ho states that ‘enlightened

27 Keay “Getting to Grips with the Shareholder Value Theory in Corporate Law” 2010 Common Law World Review 373.
28 Keay (n 27) 375.
29 Keay (n 27) 366-367.
shareholder value’ seems to emphasize the need to take into consideration interests beyond the shareholders alone and that such an approach is more likely to encourage companies to recognize and internalize risks to stakeholders than the pure shareholder wealth maximization approach. Harper Ho adds that companies that do good for society will do well in the market.\(^\text{30}\)

2.4 Corporate Social Responsibility and the Enlightened Shareholder Value Approach

Traditionally the view of whether business should be socially responsible took on a narrow perception in that the only social responsibilities to be adopted by businesses were the provision of employment and payment of taxes. Lance Moir stated that this view was taken to its extreme of maximizing shareholder value by Milton Friedman’s quote:\(^\text{31}\)

“Few trends would so thoroughly undermine the very foundations of our free society as the acceptance by corporate officials of a social responsibility other than to make as much money for their shareholders as they possibly can.”

Thus the question to be asked is when do shareholders gain if a company pursues CSR initiatives? In other words is there any economic value for shareholders in pursuing CSR activity?

Due to the enlightened shareholder value leaning more in favour of long-term returns for shareholders it becomes an obvious assumption that on this basis companies are more prone to engage in CSR activities, so long as such activities promote the interests or are beneficial to that of the shareholders. In other words any investment made in social demands that would in turn increase the value of shareholder wealth will be welcomed but if the social demands impose some cost to the company then it will be rejected.\(^\text{32}\)

\(^{30}\) Harper Ho “Enlightened Shareholder Value: Corporate Governance beyond the Shareholder-Stakeholder Divide” 2010 36 The Journal of Corporation Law 103.

\(^{31}\) Moir “What Do We Mean by Corporate Social Responsibility?” 2001 Corporate Governance Vol.1 p 17.

According to Paul Godfrey et al, theorists argue that engaging in CSR activities generates economic value due to the fact that the moral capital derived from such activities provide mitigating factors, in other words, the goodwill generated helps reduce the severity of sanctions by encouraging stakeholders to give the company the ‘benefit of the doubt’.  

Although there can be found economic value to pursuing CSR activities, it is difficult to measure such value in terms of a shareholder wealth maximization as the interests of stakeholders will also be relevant in this regard due to the basic underlying nature of CSR.

As a result, it seems that the notion of CSR relates better from a stakeholder perspective as CSR from a shareholder value approach, will always find itself on a subordinate level to that of activities that will promote shareholder wealth maximization. Even the Companies Act 71 of 2008 gives some formal recognition to CSR from a stakeholder perspective through the social and ethics committee. However, much of the Act is geared towards ways in which the shareholder can be benefited and protected, whereas, there is little to which the stakeholder can depend on.

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3 The Pluralist Approach

3.1 What is the pluralist approach and how did it come about?

The pluralist approach developed as a result from the famous debate between Professor A.A Berle and Professor E.Merrick Dodd. Berle was of the opinion that the objective of directors was to maximize profits of shareholders, whereas, Dodd was more of the opinion that this was not the only function or purpose but instead that a company is an economic institution which objectives was both to provide a social service as well as a profit-making function. In short, the pluralist approach emphasizes that a socially responsible company would consider the impact of its activities on its stakeholders.

Dodd argued that economic events back in the 1930s suggested that in the future, public opinion would demand a much greater degree of protection of the worker. One can say that Dodd’s argument was ahead of its time since the stakeholder theory debate has become increasingly relevant over the years, even to the extent that public opinion is now recognized, although not binding, within our judicial system. However, Dodd’s view seems to contradict the basic legal view of a company as a separate legal entity. His argument has further questioned whether a company is just a business entity or whether it forms an integral part of society?

It is necessary to note that Dodd’s argument was not that directors should be completely ignorant of shareholders or that there necessarily needs to be some legal enforcement of social responsibility, instead some form of recognition is in order as he states in his article that:

“…public opinion which may in some cases compel such recognition may in other cases encourage and approve it without compelling it. A sense of social responsibility toward employees, consumers, and the general public may thus come to be regarded as the appropriate attitude to be adopted by those who are

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34 Dodd (n 6) 1148.
35 Cassim et al (n 3) 470.
36 Dodd (n 6) 1160-1161.
engaged in business...Business ethics may thus tend to become in some degree those of a profession rather than of a trade.”

The pluralist approach recognizes stakeholders as an important constituency of a company and that shareholders are merely one of its several constituencies. This approach proposes that directors should only ignore shareholder interests in favour of stakeholder interests where it would be in the interests of the company in the extended sense. Another prominent issue that arises in respect of the viability of this approach is the wide diversity of stakeholder and other economic interests found in large public companies. Cassim et al argue that it is clearly difficult to expect directors of a company to weigh up competing and conflicting stakeholder interests.37

3.2 Developments since the 1930s

The 1980s saw the introduction of duties on directors to consider the interests of employees and creditors. Section 309 of the UK Companies Act 1985; first enacted in 1980, required directors to have regard to the interests of the company’s employees in general as well as the interests of its members. Unfortunately, the Company Law Review Steering Group believed that s 309 was misleading in that it had the possibility of being interpreted as enabling directors to prefer employee’s interests to those of shareholders. This in turn would threaten the principle of shareholder primacy. It was thought that directors should only consider employee’s interest if it was beneficial to shareholders.38

Thus the result of this was a repeal of s 309 and the enactment of s 172(1)(b)39 of the UK Companies Act 2006. Despite recognition still being given to employees, s 172(1) expressly provides that its direction is one of promoting the company in the interests of the shareholders thus favouring an ‘enlightened shareholder value’ approach.

37 n 19 above.
39 The interests of the company’s employees.
Section 172(3)\(^{40}\) provides that the duty to promote the success of the company has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company. Legislators’ intentions here were to make reference to the common law principle as well as reference to the Insolvency Act of 1986, that directors of an insolvent company must have regard to the interests of its creditors.\(^{41}\) However, the attempt made here to recognize another constituent’s interests is still limited in that such interests are only recognized under certain circumstances and not in general. This recognition is irrelevant as it does not deal specifically with promoting the interests of stakeholders in general.

Many state legislatures in the USA enacted provisions allowing corporate directors to consider the interests of employees, customers, creditors, suppliers and the public in general. These provisions were found in statutes known as ‘constituency statutes’. These statutes acknowledged the interests of constituencies apart from those of just shareholders.\(^{42}\) However, these statutes did not provide for any of these provisions to be mandatory, they were merely permissive in their approach. A further criticism of such statutes, is that it is argued that their objective is focused primarily on take-over bids and fails to encompass the objective of academic’s such as Dodd to incorporate a formal recognition of stakeholder interests for the benefit of the company.

It was not until the 1990s that stakeholders’ interests gained any real influence in Australian public policy debates. Such interests only gained consideration as a result of being viewed as an aspect of the CSR movement.

However, the underlying principle that seems to express itself beyond this recognition is the shareholder primacy approach. Section 180 and 181 of the Australian Corporations Act 2001 expressly provides that directors must exercise their powers in the best interest of the corporation, thus furthering this ideal of an ‘enlightened shareholder value’ approach. Unfortunately, the only attempt at some recognition in favour of stakeholders

\(^{40}\) UK Companies Act 2006.

\(^{41}\) n 39 above.

\(^{42}\) French, Mayson & Ryan (n 39) 480.
can be found in section 183 to 185, but such recognition is only effective in so far as shareholder’s interests are affected.

Under South African company law, there still to this day is no formal legal recognition of stakeholder interests as a constituency of a company. It was not until the 1990s that the interests of stakeholders and other economic interests were taken into account. This recognition came about due to the establishment of the King Committee in 1992. The objective of this Committee was to make recommendations on the effectiveness of corporate governance being implemented within the country through a Report known as the King I Report. However, over the years the Report has been revised and as a result of the corporate law reform in South Africa the King III Report was introduced. This Report went further than the previous two King Reports and applies broadly to all entities.43

The King III Report emphasizes the notion that directors are responsible for not only the company’s financial success but also the company’s performance within the triple context in which it operates. This triple context refers to the economic, social and environmental responsibility that companies should adhere to.44 The approach adopted by the King III Report is a stakeholder-inclusive approach. This approach recognizes that there are many stakeholders in a company that impact the success and long-term growth of a company and as a result it is necessary to consider the interests and expectations of these stakeholders when making decisions in the best interests of the company.45

Cassim et al note that the interests of the stakeholders under this approach are not considered as an instrument to benefit the shareholders that would be found in terms of the ‘enlightened shareholder value’ approach, but instead the interests of the stakeholders are afforded precedence based on what is believed to serve the best interests of the company at that point. Thus, the King III Report aims to promote a balance between the various stakeholder groupings.46

43 Cassim et al (n 3) 563-564.
44 Cassim et al (n 3) 449.
45 Cassim et al (n 3) 450.
46 n 45 above.
The downfall of the King III Report is that it holds no legal enforcement of duties over directors or offer any form of remedy that stakeholders can rely on to pursue any prejudice directed at them. The King III Report follows an ‘apply or explain’ philosophy, in other words, should the directors believe that to follow a recommendation would not be in the best interests of the company and thus apply a different approach or deviate slightly from the recommendation, then by explaining how the recommendations were applied or the reasons for applying a different approach would result in compliance. There is no formal legal provision that expresses any form of penalization that can be used against the directors should they fail to comply. The King III Report is merely a voluntary option for companies to choose whether they want to follow the recommendations or not.

It could be argued that s 72(4)-(10) of the Companies Act 71 of 2008 provides for the possibility of some form of formal recognition of stakeholder interests, however, neither the provisions nor the Regulations provide for any sort of effective measure to ensure that companies comply with the requirements given. This said s 84(6) and (7) appears to be the only provisions that provide for some form of requirement to ensure that the provisions of s 72(4)-(10) are adhered to but it can be argued as to how effective section 84(6) and (7) are and the extent to which these provisions cover.

3.3 The One-Tier and Two-Tier Board Structure

One-tier and two-tier board models incorporate the different perspectives of the shareholder primacy theory and the stakeholder theory. The control of managing directors of companies either lies in the hands of a separate supervisory board such as found in Germany or is an additional task placed in the hands of the board itself, as found in the UK and South Africa.\footnote{Jungmann “The Effectiveness of Corporate Governance in One-Tier and Two-Tier Board Systems” 2006 ECFR 426.}
3.3.1 The two-tier board model in Germany

Germany employs a certain kind of system where there is a management board and a separate supervisory board. Such system can further be found in the Netherlands, Austria, Finland and Denmark. The German two-tier board system has been highly criticized and compared as inferior to the UK one-tier board system. Despite this criticism the two-tier board system has not been abolished under the new German Corporate Governance Code adopted in 2002 and as amended in 2006.48

Corfield states that it is assumed that the co-operation approach adopted by German companies will benefit the community as a whole, and this as a result, tends to require placing economic benefits behind social duties.49 It is quite apparent that German company law prefers a pluralist approach to that of the UK’s adoption of the ‘enlightened shareholder value’ approach.

The German Stock Corporations Act 1965 provides that it is mandatory for all large public corporations to have two boards: a management board and a supervisory board. The supervisory board members consist of shareholder representatives, labour representatives or non-executive directors.50

The supervisory boards play an important role in the German system of worker participation in management, known as ‘co-determination’. It is common in most public companies that one-third of the members of the supervisory board must be elected by the employees of the company while the other two-thirds are elected by the shareholders.51

According to Klaus Hopt and Patrick Leyens, co-determination has proved to be an early warning system for social conflicts as it helps in stabilizing the possible risk of strikes.

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48 Jungmann (n 47) 428-429.
50 Jungmann (n 47) 432.
51 French, Mayson & Ryan (n 39) 425.
However, they do add that the dividing lines found within the supervisory board are detrimental to an efficient co-operation with the management board. 52

The strict separation under the two-tier board system between control and managerial tasks has been regarded as this system’s key advantage. However, Jungmann believes that it is this separation that seems to dilute the independence of the supervisory board whilst remaining a strength to the management board. The reason for this is that members of the supervisory board are chosen by the management board and are only formally elected in a general meeting. As a consequence it is the management boards’ opinion as to who is adequate to become a member and as such their definition of ‘adequacy’ may not correspond with the shareholder’s definition of ‘adequacy’. 53

Co-determination has over the years lost its appeal due to the development of company law. It seems that there are more disadvantages than advantages to adopting a system of a two-tier board system. Information within the company is regarded with much sensitivity; as a result shareholder representatives on the supervisory board are reluctant to discuss highly confidential issues with labour representatives, thus resulting in information asymmetry. Another disadvantage found under the two-tier board system is the mandatory qualification standards that members of the supervisory board have to meet. 54

As Jungmann states: 55

“The introduction of even advanced mandatory qualification standards would certainly not bar shareholders from finding adequately qualified representatives. Such standards would instead be regarded as a hindrance to employees which prevent them from freely choosing their representatives…It is unlikely, however, that an organ consisting of members with little or no expertise…would be able to enhance the quality of decisions made by the highly paid, carefully selected and well-educated members of the management board. Thus, it is even more challenging to involve the supervisory board more deeply in the decision-making process.”

52 Hopt & Leyens “Board Models in Europe-Recent Developments of Internal Corporate Governance Structures in Germany, the United Kingdom, France, and Italy” 2004 ECFR 145-146.
53 Jungmann (n 47) 450.
54 Jungmann (n 47) 456-457.
55 Jungmann (n 47) 457.
In light of the above, despite Germany’s adoption of the two-tier board system and seemingly favourable adoption of a pluralist approach, it seems that shareholders still tend to get preference and the final say as to how the company is run. Their attempt at providing some form of formal recognition of a stakeholder-inclusive approach is weak and in actual fact tends to hinder instead of promote the possibility for other constituencies such as employees to gain any form of benefits from the company at large. Despite recognition of other constituencies under this system, shareholders are still given some form of precedence, reason being that they are the residual claimants and have more grounds on which to take action should the company be prejudiced.

3.3.2 The one-tier board model

The one-tier board system can be found most commonly in the UK and South Africa. The one-tier board entrusts both management and control to the hands of the board of directors, who are ultimately vested with universal powers. All board members are elected by the shareholders, who can also remove the directors from power. Executive directors are employed as the managers of the company and have a more hands on approach in the running of the business whereas the non-executive directors are not employees of the company but rather members of the board.56

The Combine Code under UK legislation promotes a system of internal controls which includes a group wide supervision of financial, operational and compliance controls and risk management. Its effectiveness is reviewed annually of which the results of the review are reported to the shareholders.57 All members of the board are entrusted with the same tasks and obligated to perform the same duties and as such all have access to the same information, which in turn is seen as a vast improvement to that of the two-tier board model. Another advantage of following a one-tier board system is that the decision-making process is much more efficient. Where in a two-tier board system the

56 Hopt & Leyens (n 52) 150.
57 Hopt & Leyens (n 52) 154.
management boards needs the approval of the supervisory board, in a one-tier board system, board meetings take place more regularly thus allowing for swifter decisions.\textsuperscript{58}

The promotion of reviews under the one-tier board system is governed by the election of audit committees, a common feature found in such systems. The function of the audit committee is to monitor the integrity of the company’s financial statements, to review financial reporting judgments, to review the company’s internal financial controls and risk management systems and to make recommendations to the shareholders about auditor appointments and remuneration, to name a few. Auditors are elected by general meeting and primarily serve as a control device of the company’s members.\textsuperscript{59}

Section 84(4)(c) of the Companies Act 71 of 2008 requires a public company and a state-owned company to appoint an audit committee of which must be elected at the annual general meeting. This committee has to comprise of at least three members who must be directors of the company who satisfy the prescribed minimum qualifications. However, certain persons are excluded from being appointed such as persons who are involved in the day-to-day running of the company’s business, a prescribed officer, full-time employee, material suppliers or customers of the company; and persons related to such persons.\textsuperscript{60} The functions of the audit committee as provided for by s 94(7) expressly provides that the committee’s objectives must not be prejudicial or illegal in any respect relating to any operational, financial or internal procedure exercised by or within the company. Such functions are provided to ensure that a company’s activities are directed to promoting the success and wealth of a company, which in turn benefits shareholder interests. Furthermore, the exclusion of the various stakeholders from being appointed as members of the audit committee further proves that a company’s main concern is not the everyday employee but the ultimate success of the company and the maximization of profit for the company.

\textsuperscript{58} Jungmann (n 47) 459.
\textsuperscript{59} Davies Gowar and Davies Principles of Modern Company Law (2008) 785.
\textsuperscript{60} Section 94(4)(b).
The one-tier board system can clearly be seen as a mechanism geared to further the interests of shareholders as stakeholders are given very little or no recognition nor representation to ensure some form of protection or furtherance of their interests. Thus, in respect of the pluralist approach, the two-tier board system seems to be the most ideal system, despite the fact that there are still aspects that tend to favour the precedence of shareholder interests. The one-tier board system, however, can be viewed to be a total rejection of such theory.

In light of all this, such board systems seem to both either directly or indirectly, fail to support academics such as Dodd in their theories that there is a need for a stakeholder theory approach as such systems are undeniably geared to ensure the ultimate success of the company and in turn to ensure that the interests of shareholders are served.

### 3.4 Corporate Social Responsibility and the pluralist approach

The stakeholder theory, as mentioned, suggests that there are other groups of constituencies than just shareholders, who are affected by a company’s activities. Many academics believe it is necessary to incorporate a CSR notion to address such activities and to provide how companies can benefit from them. As such, academics believe that CSR should be based on a stakeholder view. Branco and Rodrigues quote that the stakeholder theory is considered a necessary process in the operationalisation of corporate social responsibility, as a complimentary rather than a conflicting body of literature.⁶¹

There are many characteristics attributed to CSR but the one that is more relevant to the pluralist approach is that CSR is sometimes viewed as the idea that business is accountable to various constituencies, who can be identified and capable of instituting a claim on the business activities that affect them.⁶² It seems that the legitimacy of

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stakeholder claims tends to lie on either a companies legal, economic, social, moral, ecological, political or power interests, thus further emphasizing the pluralist approach views that companies objectives lie far beyond mere profit maximization of that of the shareholders. In Carrol’s article on The Pyramid of Corporate Social Responsibility, he states that:  

“There is a natural fit between the idea of corporate social responsibility and an organisation’s stakeholders. The word ‘social’ in CSR has always been vague and lacking in specific direction as to whom the corporation is responsible. The concept of stakeholder personalizes social or societal responsibilities by delineating the specific groups or persons business should consider in its CSR orientation. Thus, the stakeholder nomenclature puts ‘names and faces’ on the societal members who are most urgent to business, and to whom it must be responsive.”

However, in light of the previous chapter’s discussion on the ‘enlightened shareholder value’ approach, the main focus of such academics in this context is wealth maximization and as a result the notion of CSR would fail to gain much precedence under this approach. In light of the pluralist approach, CSR promotes the objectives of such academics since they believe that the success or interests of the company goes far beyond the interests of just shareholders and takes into account other constituencies found within the company. These constituencies are not only your basic employees, creditors, customers and the general public but include companies’ environmental and material resources.

The functions of the social and ethics committee, found under section 72(4) of the Companies Act 71 of 2008, could be interpreted as a formal recognition of the various constituencies and a measure in emphasizing the link between CSR and the pluralist approach. Regulation 43(5)(a) provides that the social and ethics committee must monitor the company’s activities which include social and economic development, good corporate citizenship, the environment, health and public safety, consumer relationships as well as labour and employment. However, it must be noted that despite this recognition, it is

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63 Kakabadse, Rozuel & Lee-Davies (n 62) 290.
64 Carrol (n 1) 43.
questionable as to how effective the social and ethics committee is and whether its functions can be effectively enforced under South African company law?

3.5 The problem with the pluralist approach

Many academics find it difficult to accept the stakeholder theory, reason being that it stands against everything that a business aims to achieve. Where business objectives are to maximize the wealth for the long-term value of shareholders, the stakeholder theory precludes this possibility because it promotes an objective of balancing the interests of various constituencies.65

Stakeholder theory seems to offer very limited solutions for accountability and promoting the ultimate success of the company. One of the problems with the stakeholder theory is that it appears that it may result in the abuse of director’s discretion. Corfield argues that if there are no limits placed on stakeholder groups, then self-serving managers may always claim that they are acting in the interests of one of the various constituencies when they are in actual fact acting to further their own interests.66 Such claim by self-serving managers tends to arise in the use of the derivative action or any possible action a stakeholder may propose to have, whereas, a shareholder can hold a director accountable should they find that they have been acting to further their own interests.

Sternberg raises a very good argument in regards to the objective of the stakeholder theory of balancing conflicting interests of the various constituencies. She argues that it is almost impossible to balance such interests as each constituency regards their interests in different respects to one another. She states:67

“…even members of the same notional stakeholder constituency may have significantly different views as to what is beneficial. Some employees want higher wages, others want shorter hours; some regard more

66 Corfield (n 49) 15.
67 Sternberg (n 65) 19.
responsibility as a benefit, others consider it to be a burden. How are stakeholders’ divergent perceptions of benefit to be discerned and entered into the balance?”

Another question that Sternberg raises is the concept of ‘employee’. She questions as to what the concept entails, does it take into account temporary employees or just permanent employees? Does the concept include pensioners, former employees or even probationary employees?68 Thus, it seems that the concept ‘employee’ is in dire need of wider interpretation as to what it entails so that the stakeholder theory can carry any weight or be as effective as it proposes to be.

Many academics believe that making managers accountable to various groups of constituencies in turn makes them accountable to no-one as there is then no guideline to measure their performance by. Furthermore, Corfield adds that by placing the interests of shareholders below that of stakeholders may decrease the value of shares and ultimately affect the success of the company.69

In light of the above, the pluralist approach comes across as very relevant and deserving of recognition in theory. However, in practice it holds very little weight or force, as it is the shareholders that will always prevail in recognition, enforcement and precedence above that of other constituencies. Even the reformed provisions of modern company law such as s 172(1) of the UK Companies Act 2006 and our own s 76(3)(b) provide for the ultimate benefit of the shareholders. Stakeholders still have no locus standi to alter the business objectives as it is the shareholders that are the residual claimants and initial body that promotes the success of the company in business. Even if stakeholders can prove some form of locus standi to enforce an action, the court has discretion as to whether such action should be granted or not. Furthermore, the concept of ‘stakeholder’ is too broad and entails too much diversity, and as a result, instead of acting as an advantage, it acts as a disadvantage. This is because shareholders all have the same objective and interest; profit maximization. Stakeholder interests vary and it is difficult to pinpoint one interest that may be relevant and worthwhile for a company to consider completely.

68 Sternberg (n 65) 18.
69 n 66 above.
Stakeholders can only be viewed relevant as far as CSR is concerned or if it is in the best interests of the shareholders. As Corfield puts it:70

“The stakeholder concept serves to highlight the meaning of social responsibility for…they can decide whether or not to support the business with their labour, supplies and utilization of the goods provided by the company”.

70 n 49 above.
4 Corporate Social Responsibility

4.1. What is Corporate Social Responsibility?

CSR is a broad concept of which there can be found a variety of different definitions and vast amount of literature discussing the topic in depth. The practice of CSR has become multifaceted. This is due to the many instruments and activities that different company law systems implement as well as the many issues that fall under the notion of CSR. Another factor that is prevalent in this confusion on the understanding of CSR is the differences that can be found between the different national business systems. Regina Barth and Franziska Wolff state that these differences imply that what companies do as CSR in some countries corresponds to the fulfillment of legal requirements in others.71 In other words, what may be voluntary in one country may be mandatory in another.

An understanding of the concept of CSR is essential as it allows companies the possibility of accepting such a concept as part of their social objectives. In light of this it seems that the trend for the definition of CSR is different for each country. In Europe the European Commission defines 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. Being socially responsible means not only fulfilling legal expectations, but also going beyond compliance and investing ‘more’ into human capital, the environment and the relations with stakeholders.”

The Brundtland Commission of 1987 described the CSR concept in the context of sustainable development as development that meets the needs of the present generation without comprising the ability of future generations to meet their own needs.73

73 Barth R and Wolff F (n 71) 3.
The 2006 Corporations and Markets Advisory Committee (CAMAC) report noted that CSR essentially means:74

“In essence, the focus of the issue of corporate social responsibility is on the way in which the affairs of companies are conducted and the ends to which their activities are directed, with particular reference to the environment and social impact of their conduct. A responsible company, like a responsible individual, is one that acknowledges and takes responsibility for its actions.”

The concept of CSR is also put in relation to other concepts such as Corporate Social Responsiveness, Corporate Social Performance and Sustainable Development, to name a few.75 Such concepts give an indication as to the broad approach or interpretation attributed to the concept of CSR and extent to which it covers.

One of the founding definitions of CSR is the much cited four-part model of CSR by Carroll. According to this model, in order for CSR to be considered legitimate, the corporation has four types of responsibilities; the first being the economic responsibility. Carroll argues that the business institution is foremost the basic economic unit in society and as such it has a responsibility to provide goods and services and ultimately to be profitable. The second responsibility of businesses is that society expects businesses to operate its activities within the legal framework of the respective society in order to be productive.76 The third responsibility is the ethical obligation of businesses which obliges corporations to do what is right, just and fair even when business is not compelled to do so by the legal framework and lastly, the fourth type of responsibility is known as philanthropic and describes those activities “desired” by society.77

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75 Kakabadse, Rozuel & Lee-Davies (n 62) 280.
77 Chapple W, Crane A, Matten D “Behind the Mask: Revealing the True Face of Corporate Citizenship” 2003 Journal of Business Ethics 110
4.2. The Emergence of Corporate Social Responsibility

CSR first emerged in the 1950s but it was not until the late 1970s that the academic debate began to form. CSR came as a result of companies becoming aware of public responses to issues they had not previously thought were part of their business responsibilities.

Professor Berle argued that companies main focus was that of profit maximization and ensuring that any business activities or responsibilities entered into were for the benefit of the shareholder and eventual success of the company. However, with globalization and public policy becoming an ever present factor, companies have become increasingly aware of the economic benefit of CSR and as such it has become an expectation that socially responsible companies are expected to integrate economic, social and environmental concerns into their business practices and activities.

CSR academics argue that companies play an integral part in society as they are either the cause of economic and social exchange or take part in such activities. In order for a company to be profitable it needs to use society and its workforce as well as make use of the natural environment as a resource base. As a result companies create economic and social assets, contribute to the provision of public goods and offer opportunities for people’s social inclusion. An aspect that is very much in line with Carroll’s four-part model of his CSR perspective. This viewpoint further seems to promote companies adoption of the ‘enlightened shareholder value’ approach, as despite the underlying principal of CSR being a notion that regards the interests of various constituencies, it tends to be argued that its ultimate objective is to promote the eventual success of the company.

78 n 77 above.
81 Barth R and Wolff F (n 71) 5-6.
Social and environmental awareness quickly moved into the corporate boardroom and in the US during 2005, 360 different CSR-related shareholder resolutions were filed on issues ranging from labour conditions to global warming. As a result, governments began to mandate social reporting and enact legislation requiring companies to meet certain conditions or face penalties. In turn, companies became more socially and environmentally proactive. But despite this, there has been little research on what exactly the general public expects and as a result, Porter and Kramer stated that the most common response of corporations has been neither strategic nor operational but cosmetic.82

This seems to be the underlying issue and core problem when the question is put forward as to how CSR should be implemented. Due to CSR being such a broad concept and multifaceted, it is difficult to pinpoint a method that is best suited to enforce CSR under company law. The only viewpoint that seems to be in agreement amongst CSR academics is that under modern company law, CSR has become a notion that cannot be completely ignored due to the ever-increasing power that the general public can hold over the company. The issue that seems to be a difficult hurdle to overcome is how to incorporate such a notion into legislation without ultimately prejudicing a company’s underlying objective of profit maximization and ensuring the success of the company.

4.3 Elements of CSR

CSR seems to advocate the perspectives of various academics regarding both the ‘enlightened shareholder value’ approach and pluralist approach. CSR cannot be implemented or perceived as a short-term objective but rather a long-term economic perspective. It may be viewed as a concept that is difficult to be measured financially and debatable as to how beneficial it is as a profitable economic measure to the company but it seems to be undeniable as to offering some form of valuable asset for a company’s future success, especially in a society that is increasingly pushing for more social awareness and business future depending on support of the public’s perceptions. Kakabadse, Rozuel, and Lee-Davies are advocates of this view in that they argue that.83

82 n 79 above.
83 Kakabadse, Rozuel & Lee-Davies (n 62) 283.
“business does not pursue only short-term profits, but rather a multitude of goals which all combine to guarantee business’s survival and prosperity in a changing environment.”

Another issue that tends to come to the fore regarding CSR is that majority of academics agree that by just abiding by the law does not necessarily lead to a company being socially aware. It is agreed that CSR is viewed as a voluntary measure by which companies comply as opposed to purely economic and legal imperatives. Wealth maximization and legal transparency tend to take the back seat in respect of CSR as the main focus is that of balancing conflicting interests and promoting social awareness. This leads to my previous argument that the stakeholder theory is better adapted to be in line with the notion of CSR as CSR is viewed in relation to how business activities affect those of the company’s stakeholder who can be identified and have a claim.

4.4 South Africa’s perspective on CSR

Under South African company law, directors are invoked with fiduciary duties to perform in the best interests of the company. Such duties entail acting with an unfettered discretion, for a proper purpose, within the limits of powers conferred upon the particular director and without a conflict of interest. These duties are the foundation for the overriding duty of the director to act in good faith for the company as a whole and in turn promoting the interests of the shareholders. However, as mentioned public policy in present times demands that recognition of a wider variety of rights and interests should be considered in addition to just shareholders. These interests include stakeholders such as consumers, employees, the general public and the environment. This is where CSR comes into play as such concept requires directors to also include the interests of other non-shareholder groups than just only shareholders when managing the company.

84 n 83 above.
85 Kakabadse, Rozuel & Lee-Davies (n 62) 284.
87 n 86 above.
With South Africa’s diverse and rich history and fairly young democracy, it is difficult to compare CSR initiatives with other legal systems, however, South Africa can learn and be influenced by similar CSR initiatives. Due to the drastic change of South Africa’s economic and socio-economic landscape since 1994, such transformation cannot be achieved by the government alone and hence the reason for private role players, such as companies. 88 As Miles and Jones state: 89

“At face value, adopting an approach which combines the interests of shareholders and stakeholders is ideal in a country which is trying to redress the extreme inequalities caused by exploitative and discriminative policies under the apartheid regime.”

With the extreme oppressive history of South Africa and in order to integrate South Africa into the rapidly changing global environment, government embarked on many legislative and social infrastructures so as to transform South Africa’s socio-economic stance. 90 The first major transformation policy was the introduction of the King I Report, published in 1994. This report focused on the re-direction of corporate governance from apartheid days. It focused on shareholder protection and directors duties but also recommended stronger stakeholder engagement and consideration of the company’s activities on the various other constituencies. It was not until the King II that the ‘triple bottom-line’ approach was introduced and the first time the concept of CSR was to an extent formally recognized under a Code. King II advocated the need for companies to embrace how their activities may impact upon the social, environmental and economic aspects of society. 91

King III is an extension of King II and further enhances the duties on directors provided for in King II. King III further endorses the ‘stakeholder-inclusive’ approach, thus providing a better CSR initiative. Despite the King III’s attempt at enhancing a ‘triple bottom-line’ approach, it unfortunately fails the idea of CSR in that it cannot be legally

88 Dekker & Esser (n 86) 166.
90 Miles & Jones (n 89) 55.
91 Miles & Jones (n 89) 57.
enforced under company legislation as it follows a philosophy of ‘apply or explain’ and is regarded only so far as it is voluntary for the company. The exception lies of course with listed companies, as the King III is mandatory in that respect.92

A more successful approach to providing for the various constituencies is the Broad Based Black Economic Empowerment Act 53 of 2003. This Act is praised as it can be formally recognized in the courts and is a step in providing for further interests beyond that of the mere shareholder and an attempt in addressing the issue of a need for more social awareness. South African company law has further enhanced its view on CSR under the new Companies Act 71 of 2008, thus emphasizing the increasing effect such notion has on the activities and success of a company. As Miles and Jones state, the Act endorsed the approach taken in King I and II that a company is a social and economic entity and as such its pursuit for profit maximization should be limited to a reasonable extent by social and environmental imperatives.93

In light of this, it can be argued that CSR has to some extent been successfully dealt with in the Companies Act 71 of 2008 with the implementation of section 76(3)(b) and Regulation 43 as it is the first time such legislation has acknowledged that there are interests that exist beyond that of the shareholders. However, it is debatable, as is discussed within this research, as to how effective or enforceable such sections and provisions are under the context of CSR, due to the reasoning that such provisions either focus more for the sake of shareholder protection or lack effective protection and enforcement for the various non-shareholder interests.

92 Miles & Jones (n 89) 59-60.
93 Miles & Jones (n 89) 63-64.
5 Rights and Remedies

5.1 Introduction

Separate legal personality is a concept of company law, it states that a company is entirely distinct from its members and does not have a physical existence. Despite being a legal concept, a company is capable of acquiring rights and incurring obligations that are distinct from those of the directors and shareholders of the company. In Salomon v Salomon & Co Ltd,94 the court found that once a company is legally incorporated it must be treated like any other independent person with its rights and liabilities appropriated to it. This case established the principle that incorporation provides for limited liability of directors and shareholders and not for that of the company itself.

Section 19(2) of the Companies Act 71 of 2008 incorporates this principle of limited liability and states that a person is not, solely by reason of being an incorporator, shareholder or director of a company, liable for any liabilities or obligations of the company, except to the extent that the Act or the company’s Memorandum of Incorporation provides otherwise. As a result, a shareholder is capable of instituting a claim to enforce their interests against the company due to the concept of separate legal personality.

The English courts were of the view that a company was governed by democratic vote and that majority rule prevailed.95 Thus, it was a common law principle that shareholders were in ultimate control of the company and as such the board of directors was merely ‘agents’ of the company subject to the control of the shareholders. This was the case, despite any provision stating differently in the articles of association.96 As such it is a common factor established under company legislation that directors owe a fiduciary duty to the company and in turn to the shareholders, as shareholders are the residual claimants

94 1897 AC 22 (HL).
95 Cohen “The Distribution of powers in a company as a matter of law” 1973 SALJ 262.
96 n 95 above.
and are invoked with residual powers to sue for personal and corporate wrongdoings committed by management or a board of directors.97

Separation of ownership and control plays a significant role on shareholder rights, it raises the question as to who is responsible for the company’s activities. Cassim et al state that separation of ownership and control has the potential to cause a divergence between the interests of the shareholders and the directors without there being any effective check on the power of the directors.98 In this context, such check is limited unless the articles of association expressly deny directors the right to perform certain actions in favour of the shareholders or stakeholders for that matter. Thus, the question that arises is, although the boards of directors are endowed with powers that are unique to their respective positions, how can shareholders or stakeholders, if unhappy with the actions of the directors, enforce their rights against directors who have abused their powers?

5.2 The Derivative Action

A derivative action is an action brought about by a person in the name or on behalf of the company. This action belongs not to the person bringing the action, but is ‘derived’ from that of the company. The action is brought in order to protect the legal interests of the company and not that of the individual shareholder.99 Generally it is the director that brings an action on the company’s behalf due to the fact that the responsibility of managing the company lies in their hands, however, in some instances, it is necessary for shareholders to be given the right to bring about an action, especially when the wrongdoing has been committed by the board itself.100

98 Cassim et al (n 3) 452.
99 Cassim et al (n 3) 698.
Any relief found through the successful use of the derivative action will consequently go to the corporation and be subject to claims of the company’s creditors and to any deductible taxes. Shareholders will generally only receive a pro rata share, should anything be left. If the action is found to be individual in nature, then any recovery will fall to the shareholder only and not be subject to any other claims. For an individual action to be successful, the plaintiff must prove that he was a shareholder at the time the wrongdoing was committed against the company or that his share devolved by operation of law thereafter. Furthermore, any plaintiff bringing a derivative action must remain a shareholder at the time the action is brought.

Shareholders wishing to institute a derivative action must first exhaust internal corporate remedies. Section 165(2) of the Companies Act 71 of 2008 provides that an applicant with locus standi may serve a demand on the company to commence or to continue legal proceedings, or take related steps to protect the legal interests of the company. This demand gives a person the option to bring a derivative action on behalf of the company in the event that the company fails to initiate or continue such proceedings. Such demand allows the company to re-evaluate the conduct complained of and to take suitable remedial action itself to protect its own interests. If such demand is futile, only then can such requirement be waived and as in terms of section 165(3), the company may apply to a court to set aside the demand on the grounds that it is frivolous or vexatious or without merit. However, if the demand does not meet these grounds, then there is an obligation on the company to initiate or continue legal proceedings, or take related steps to protect its legal interests or either serve a notice on the person who made the demand, refusing to comply with it.

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102 n 101 above.
103 Cassim et al (n 3) 704.
104 Cassim et al (n 3) 705.
105 Welch (n 101) 151.
106 Section 165(4)(b).
5.2.1 The Derivative Action in terms of UK company law

Prior to the UK Companies Act 2006, a shareholder could rely on the common law derivative action if it felt the company’s interests were being prejudiced. The principles underlined in *Foss v Harbottle*\(^{107}\) provided the foundation for the shareholders’ reliance on the derivative action. The first principle was the presumption that the proper plaintiff was the company and the second principle was that if the majority of shareholders disapproved of the action, the company could not institute the action.\(^ {108}\)

Despite the fact that *Foss v Harbottle* produced strict limitations as to the availability of the derivative action to the shareholder, these limitations have since begun to ease. With the implementation of the UK Companies Act 2006, legislature for the first time provided statutorily based procedural rules for shareholders’ derivative action. This was to make the derivative action more accessible to the shareholder.\(^ {109}\)

Goehre states that the derivative action may be instituted in response to an actual or proposed act or omission involving negligence, default, breach of duty or breach of trust by a director of a company, notwithstanding whether the cause of action arose before or after the person seeking to bring the action or continue proceedings became a member of the company. He further adds that this makes the derivative action available for director’s breach of duty of reasonable care, skill and diligence.\(^ {110}\)

In respect of stakeholder interests that directors are required to consider, it is argued that negligence could include a breach of listing rules as well as environmental or health and safety obligations.\(^ {111}\) Rice contends that it will be up to the Courts to decide whether such a claimant is acting in good faith and whether the director acted to promote the success

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\(^{107}\) (1843) 2 Hare 461; 67 ER 189.


\(^{109}\) Goehre (n 108) 157.

\(^{110}\) n 109 above.

and long-term interests of the company.\textsuperscript{112} This tends to raise the questions of whether such action is in fact beneficial to the stakeholders or in the best interests or success of the company, since there is no authority to determine what success or the best interests of the company actually entails.

Rice adds that they will instead need to prove to the court that they have taken into account all the relevant stakeholders’ interests in their decisions, including employees’ interests, suppliers, customers and anything that may have an impact on the general public and environment.\textsuperscript{113}

Despite the new derivative procedure found under the UK Companies Act 2006 still holding on to some of its substantive principles established in \textit{Foss v Harbottle}, it extends this action to allow shareholders ‘easier access to justice’, by giving the courts greater control. As a result, it can be said that the legislators’ intentions have been to enhance the position of shareholders and the protection of their interest in the company.\textsuperscript{114} In contrast, there is little attempt to give stakeholders more accessibility to justice.

Section 260 of the UK Companies Act 2006 gives three elements which a member needs to fulfill in order to pursue an action under this remedy. The first element is that the action must be brought by a member of the company; the second element is that the cause of action is vested in the company; and the third is that the relief sought is on the company’s behalf. Section 260(5)(c) expressly provides that references to a member of a company include a person who is not a member but to whom shares in a company have been transferred or transmitted by operation by law.

This said; it should not be forgotten that although the new derivative action provides for wider protection and relief to the various shareholders and arguably to some extent, stakeholders, success of such action is still instituted on behalf of the company and not for the benefit of the individual shareholder or stakeholder.

\textsuperscript{112} n 111 above.
\textsuperscript{113} n 111 above.
\textsuperscript{114} Goehre (n 108) 160-161.
5.2.2 The Derivative Action under Canadian company law

Canadian law’s approach to the rights and remedies of the various constituencies is much wider than UK company law and in actual fact; its fiduciary and oppression doctrines diverge quite drastically from counterpart legislation in the US, the UK and Australian company law. Statutory oppression remedies and fiduciary doctrines operate much more generally in Canada.\(^{115}\) DeMott argues that the oppression remedy in s 241 of the Canadian Business Corporations Act (R.S.C., 1985, c. C-44) ‘expressly recognizes the interests of non-shareholders as interests appropriately vindicated through oppression legislation’.\(^ {116}\) Oppression legislation in UK and Australia, in contrast, limits its scope to shareholder interests.\(^ {117}\)

Under Canadian law a majority shareholder is not considered to be a fiduciary toward the minority shareholder, unlike its counterpart legislations. Kuras argues that it was due to this lack of a clearly developed fiduciary obligation from majority to minority shareholders in Canada that prompted the adoption of the ‘oppression remedy’ in s 241 of the CBCA.\(^{118}\) The oppression remedy in terms of section 238 and 239 of the CBCA allows ‘complainants’ to bring an action against a corporation on the basis that that action taken in respect of the corporation or its affiliates oppresses, unfairly disregards or is unfairly prejudicial towards a security holder, creditor, director or officer.\(^{119}\) Ben-Ishai and Puri state that the wording of section 238 of the CBCA suggests that the oppression remedy is not just a shareholder remedy, but instead can be extended to include a broader class of applicants such as directors and officers and on a more discretionary level, employees and other such stakeholders.\(^ {120}\) A similarity which can be drawn to our section 165(2)(d) of the Companies Act 71 of 2008.


\(^{117}\) DeMott (n 115) 186.

\(^{118}\) Kuras (n 116) 313.

\(^{119}\) n 116 above.

Another interesting factor is that where other statutory derivative actions are in place for the benefit of the company, section 241(2)(c) of the CBCA expressly provides that if a court is satisfied 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, the court may make any order to rectify the matters complained of. Thus, such provision, unlike UK, Australian and even South African law, expressly provides for the interests of other stakeholders, making this legislation the most advanced legislation in respect of catering for the various stakeholder interests in terms of modern company law.

Canadian legislation can be more easily interpreted than UK company legislation, so as to include other constituencies apart from shareholders and to provide for their interests to be protected on par with that of shareholders. In this regard, Canadian company law can be viewed as the most effective legislation that provides for the interests of both shareholders and stakeholders and goes beyond the issue of mere profit maximization.

5.2.3 The Derivative Action in terms of Australian company law

The rule found in *Foss v Harbottle* established a right’s based system which in turn inhibited shareholders’ actions and did little to counter-balance the power of the majority.\(^{121}\) Farrar states that it was the shortcoming of the rule that led to its adoption as a statutory remedy under s 210 of the UK Companies Act 1948 and its eventual adoption under section 94 of the Victorian Companies Act 1958.\(^{122}\)

The case of *Ebrahimi v Westbourne Galleries Ltd*\(^{123}\) was influential in law reform, this case led to the eventual reforming of the statutory minority shareholder remedy to what is known today as the statutory derivative action. Prior to the statutory derivative action,

\(^{121}\) Farrar “Minority Shareholder Remedies-Shifting Dispute Resolution Paradigms” 2001 *Bond LR* vol 13 10.

\(^{122}\) n 121 above.

\(^{123}\) [1973] AC 360.
shareholders or members could only bring an action under the common law derivative action and only if it was under one of the exceptions found in *Foss v Harbottle*. As a result there were very few common law derivative actions prior to the statutory derivative action.\footnote{Hofmann (n 97) 14.}

Section 236 of the Australian Corporations Act 2001 provides for persons wishing to bring or intervene in proceedings on behalf of a company, in other words, instituting a derivative action. S 236(1) provides that a person may bring proceedings on behalf of a company, or intervene in any proceedings to which the company is a party for the purpose of taking responsibility on behalf of the company for those proceedings, if the person is a member, former member, or person entitled to be registered as a member, of the company or of a related company; or an officer or former officer of the company and the person is acting with leave granted under section 237.

Section 236 of the Australian Corporations Act like the UK Companies Act 2006 does not expressly provide for other stakeholders, nor does it provide that any person can institute a derivative claim if it has some form of shareholding. In this regard it may seem more restricted as to who may institute a claim, however, it could be interpreted that ‘a person entitled to be registered as a member’ as provided for in section 236(1)(a)(i), could include other constituencies such as employees or trade union representatives entitled to be registered as a member. However, it is generally regarded that much of Australian company law is directed at a shareholder primacy norm thus a reasoning behind Australian company legislation failing to incorporate the interests of stakeholders as found under Canadian company law.

Having said this, consideration should be taken of section 237(3) as it seems to explain further as to who can possibly institute a derivate action. S 237(3) provides that it is a rebuttable presumption that granting leave is not in the best interests of the company if it is established that the proceedings are by the company against a third party; or by a third party against the company. The Act places a burden of proof on the applicant to show to
the court that it will be in the best interests of the company to institute such actions. The Court has discretion and will consider the factors expressed in section 237(c)\textsuperscript{125} whether to bring the proceedings or not; or to defend, discontinue, settle or compromise the proceedings.\textsuperscript{126}

The concept ‘third party’ is clarified in section 237(4) of the Australian Corporations Act 2001 for the purposes of section 237(3). This section provides that a person is a third party if the company is a public company and the person is not a related party of the company, or where the company is not a public company and the person would not be a related party if it were a public company. A related party is defined under section 228.\textsuperscript{127}With this in mind, it is difficult to interpret section 237(3) and section 237(4) as

\textsuperscript{125} Section 237(c) all of the directors who participated in that decision:
(i) acted in good faith for a proper purpose; and
(ii) did not have a material personal interest in the decisions; and
(iii) informed themselves about the subject matter of the decision to the extent they reasonably believed to be appropriate; and
(iv) rationally believed that the decision was in the best interests of the company.

\textsuperscript{126} S 237(b) of the Australian Corporations Act 2001.

\textsuperscript{127} Section 228: Related Parties:

\textit{Controlling entities}

(1) An entity that controls a public company is a related party of the public company.

\textit{Directors and their spouses}

(2) The following persons are related parties of a public company:
(a) directors of the public company;
(b) directors (if any) of an entity that controls the public company;
(c) if the public company is controlled by an entity that is not a body corporate—each of the persons making up the controlling entity;
(d) spouses and de facto spouses of the persons referred to in paragraphs (a), (b) and (c).

\textit{Relatives of directors and spouses}

(3) The following relatives of persons referred to in subsection (2) are related parties of the public company:
(a) parents;
(b) children.

\textit{Entities controlled by other related parties}

(4) An entity controlled by a related party referred to in subsection (1), (2) or (3) is a related party of the public company unless the entity is also controlled by the public company.
providing beyond the interests of the company and more specifically stakeholder rights. The underlying purpose of section 237(3) is to provide and ensure that the interests of the company and in turn the shareholders are ultimately served.

Australian company law attempts to widen its right under the derivative action as done in the CBCA, unfortunately, it is not as successful. The bottom line under the Australian Corporations Act 2001 is that, the company’s objective is to promote the success of the company as well as ensuring wealth maximization of shareholders and catering for the interests of shareholders above those of stakeholders. Ultimately proving Australia’s position in favour of a shareholder primacy approach.

It seems that corporate governance under the Australian Corporations Act 2001 is best achieved through reference to the relevant codes such as the OECD Principles of Corporate Governance, as such Principles allow for a broader and more effective approach in providing for shareholder, as well as stakeholder rights in respect of CSR issues. This is because social awareness and provision for interests beyond that of the shareholder seems to lack clarity and effective enforcement under the Australian Corporations Act 2001 and as a result can only be looked to in terms of voluntary codes and traditional practices. Unfortunately, such Principles and Codes are only effective in as far as the company wishing to rely on such practices and much depends on the

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**Related party in previous 6 months**

(5) An entity is a related party of a public company at a particular time if the entity was a related party of the public company of a kind referred to in subsection (1), (2), (3) or (4) at any time within the previous 6 months.

**Entity has reasonable grounds to believe it will become related party in future**

(6) An entity is a related party of a public company at a particular time if the entity believes or has reasonable grounds to believe that it is likely to become a related party of the public company of a kind referred to in subsection (1), (2), (3) or (4) at any time in the future.

**Acting in concert with related party**

(7) An entity is a related party of a public company if the entity acts in concert with a related party of the public company on the understanding that the related party will receive a financial benefit if the public company gives the entity a financial benefit.
discretion of the court, as it does not have formal legal recognition in terms of Australian company law.

5.2.4 USA Constituency Statutes

In the 1980s, many US states began to pass corporate constituency statutes as a response to the heavy hostile takeover biddings. Such takeovers left directors in a state of conflict. Directors needed to find a solution to such corporate actions without breaching their fundamental fiduciary duties owed to shareholders, hence, the implementation of constituency statutes. These statutes gave directors the option of considering the interests of various corporate stakeholders in carrying out their fiduciary duties to the corporation. By allowing directors to consider various stakeholder interests, constituency statutes theoretically allowed a board to reject a takeover even if it was in the best financial interest of shareholders.

Despite these ‘anti-takeover’ statutes being implemented in the US, they were still not regarded as mandatory and were only viewed as permissive in nature and thus were unenforceable. In other words, while directors had authority to consider the interests of other constituencies, they also had the discretion not to consider such interests. As a result of constituency statutes’ permissive nature, they failed to provide any remedy for a failure to consider stakeholder interests. Constituency statutes have also been criticized for allowing too much discretion on behalf of the director. Kuras states:

“Directors may hide behind vague duties to conflicting groups to serve their own interests; too much discretion is conferred without assigning any corresponding responsibility. Almost any corporate action can be justified as in the interest of some constituency.”

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130 n 128 above.
131 Kuras (n 116) 310.
132 n 131 above.
It is a common fact that majority of the US constituency statutes are permissive in their approach, except for Connecticut’s statute, which requires directors to consider non-shareholder interests, however, it does not provide for an enforcement mechanism for non-shareholders to protect their interests.\textsuperscript{133} According to Bisconti, even in states that require non-shareholder interests to be considered, failure to do so can only be challenged by a shareholder through a traditional breach of duty claim and even in this instance, it is unlikely for the court to uphold such a claim.\textsuperscript{134}

Despite the fact that constituency statutes objectives was used as an anti-takeover device, many academics have argued that such statutes have rekindled the long time debate between Professor A.A Berle and Professor E. Merrick Dodd as to where the objectives of company law lie. These constituency statutes tend to embody Professor Dodd’s argument that corporations serve a public responsibility beyond that of mere shareholder wealth maximization.\textsuperscript{135} Despite constituency statutes being a step ahead in theory with respect to considering other interests beyond the interests of shareholders, such statutes will seemingly continue to fail in their objectives as well as be ineffective in protecting CSR initiatives, should they fail to continue to expressly indicate to directors’ the weight that needs to be assigned to potentially competing interests.\textsuperscript{136}

In light of the above, the problem with constituency statutes seems to be in striking the appropriate balance between shareholder interests and the interests of other constituencies.\textsuperscript{137} As a result, such statutes will continue to be ineffective for as long as legislators fails to provide for some form of enforcement mechanism. Despite formal recognition in the US of non-shareholder interests, constituency statutes can be compared to have the same footing as that of a code found in UK company law or even our own company law. Such statutes are merely an alternative aspect for socially responsive companies to rely on should they find difficulty in their initiatives. It seems that such statutes can only be regarded so far as an attempt to consider interests beyond that of the

\begin{footnotes}
\item[133] Bisconti (n 128) 783.
\item[134] n 133 above.
\item[135] Bisconti (n 128) 791-792.
\item[136] Bisconti (n 128) 798.
\item[137] Bisconti (n 128) 805.
\end{footnotes}
shareholders. Thus, despite US constituency statutes attempt to consider other interests, shareholders will still have the upper hand when it comes to enforcing their rights and other constituencies may have to rely on other alternatives such as rights enforced through contracts made between the company and the employee.

5.2.5 South African company law and the derivative action

Unlike the UK Companies Act 2006, the new Companies Act 71 of 2008 has abolished the common-law derivative action and in its place has implemented a new statutory regime to govern the derivative action under section 165(1). This abolishment is similar to the provision found under the CBCA which also abolished the common law derivative action. S 165(1) provides 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 entirely abolished and that the rights in terms of s 165 replace such abolished rights.

Where ratification was a restriction to shareholders under the common law derivative action, under the new Act such restriction is no longer a problem to any derivative claim under s 165. According to Cassim et al, there are, however some of the underlying policy issues of the rule in Foss v Harbottle that are taken into account in s 165.

Section 266 of the Companies Act 61 of 1973 also incorporated the statutory derivative action but unlike the new Act it still incorporated the common law derivative action. Where section 266 of the 1973 Act only made the derivative action available to members, s 165 provides for a substantially wider class of applicants. Section 165(2) provides that s 165 is available to the following applicants:

138 Cassim et al (n 3) 701.
140 Cassim et al (n 3) 702.
141 Coetzee (n 139) 299.
142 Companies Act 71 of 2008.
(a) Shareholders of the company or a related company, as well as persons entitled to be
registered as shareholders of the company or a related company,
(b) Directors or prescribed officers of the company or related company,
(c) Registered trade unions that represent employees of the company, or other
representatives of employees of the company, and
(d) A person who has been granted standing by the court only if the court is satisfied
that it is necessary or expedient to do so to protect a legal right or that other person.

The crux of my argument as to whether non-shareholder groups have legal interests that
can be enforced under the Companies Act lies in section 165(2)(d). This section as stated
provides that a person may serve a demand upon a company to commence or continue
legal proceedings, or to take related steps, to protect the legal interests of the company if
the person has been granted leave of the court to do so.143 However, such granting of
locus standi to other stakeholders is left to the discretion of the court. Ultimately, if a
stakeholder can prove to the court’s satisfaction that they have locus standi to bring a
demand to institute a derivative action and that it is in the best interests of the company to
do so, then such court has no other alternative but to grant such leave, but the court will
only grant such leave as far as one of the factors in section 165(5) has happened.

In light of this probable recognition of other stakeholder interests, it must not be forgotten
that the ultimate purpose of the derivative action is to protect legal interests of the
company and not the legal rights of other constituencies. As Cassim et al contend, the
intention of section 165 may be to allow courts to grant standing to other constituencies
whose legal rights are indirectly affected due to an infringement of the company’s legal
interests.144

As a result it can be interpreted that s 165 has far more reaching effects than its
predecessor as well as the common law derivative action. S 165(2)(d) allows for the
possibility of legal recognition for stakeholders’ rights, including effective enforcement

143 Section 165(2)(d).
144 Cassim et al (n 3) 703.
of such rights should they prove to have *locus standi*. If such standing is successfully proved and depending on the discretion of the court, then such stakeholders can be said to have an effective action against management if their rights have been prejudiced. Section 165 unfortunately does not specify the causes of action for which the derivative action is available and thus as Coetzee states it may criticized as being too wide in its application.\(^{145}\) However, as mentioned it must be kept in mind that the purpose of the statutory derivative action is to provide for the interests of the company and not the stakeholders rights. Therefore, the court’s ultimate objective is to provide for the company’s interests under the institution of the derivative claim and should this indirectly benefit the stakeholders, then so be it.

5.3 *The Business Judgment Rule*

S 165(5)(b)(iii) of the Companies Act 71 of 2008 provides that in order for the court to grant leave for an applicant to institute a derivative action, it must be satisfied that it is in the best interests of the company. This requirement acknowledges that there may be rational reasons for companies to decline to pursue legal proceedings.\(^{146}\) The best interest requirement, like the Australian Corporations Act 2001, is coupled with a rebuttable presumption that it would not be in the best interests of the company to grant leave if one of the factors in section 165(7) is established.\(^{147}\)

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\(^{145}\) Coetzee (n 139) 305.

\(^{146}\) Cassim et al (n 3) 710.

\(^{147}\) Section 165(7): A rebuttable presumption that granting leave is not in the best interests of the company arises if it is established that:

(a) the proposed or continuing proceedings are by-
   (i) the company against a third party; or
   (ii) a third party against the company;

(b) the company has decided-
   (i) not to bring the proceedings;
   (ii) not to defend the proceedings; or
   (iii) to discontinue, settle or compromise the proceedings; and

(c) all of the directors who participated in that decision-
   (i) acted in good faith for a proper purpose;
   (ii) did not have a personal financial interest in the decision, and were not related to a person who had a personal financial interest in the decision;
   (iii) informed themselves about the subject matter of the decision to the extent they reasonably believed to be appropriate; and
   (iv) reasonable believed that the decision was in the best interests of the company.
In essence the business judgment rules serves to protect the director from liability if such director makes an informed and reasonable business judgment or decision. As a result, such rule can be seen as an obstacle to that of shareholders or other constituents who can prove that they have *locus standi* when wishing to institute the derivative action.

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148 Cassim et al (n 3) 514.
6. Comparative Legislation

6.1. Introduction

Modern day company law places pressure on companies to consider CSR due to rising issues such as ethics, corporate culture, employee satisfaction, environmental behaviour and public policy becoming increasingly relevant to modern consumers, government, organizations, corporations, employees and investors. Grossman argues that as a consequence to increasing demands, it is necessary to consider whether CSR today has any legal and effective impact upon companies and questions whether legislators attempts in promoting CSR within its various company legislations is mere window dressing or has substantial footing compared to similar provisions that have legal recognition.

In response to increased pressure by the general public and stakeholder expectations becoming more apparent, companies have sought to change their internal performances and external activities so as to relate better with such expectations as it has become a popular reality that acts of social welfare outside the scope of business operations and interests are no longer regarded as ultra vires as such activities are more likely to benefit a company by enhancing goodwill, employee morale and reducing public scrutiny. Academics argue that shareholder theory is outdated and inflexible in light of changing stakeholder expectations. Furthermore, stakeholders are increasingly aware that

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150 n 149 above.
151 Grossman (n 149) 579.
charitable giving is good for business. Therefore, restricting social awareness and charitable activities may lead to the detriment of a company as in present times reputation is a huge factor in the ultimate future success of a company.¹⁵²

6.2. Australia’s legislation

Australian corporation law does not provide expressly for social welfare, instead it adopts Berle’s shareholder primacy norm. The Corporations Act 2001 tends to promote profit maximization as its only objective, as it actively discourages social activities when it acts as a cost to a company instead of promoting or furthering profit maximization. The directors’ duties are found in sections 180, 181, 182 and 183 of the Corporations Act 2001 and are given extensive authority to manage the company as long as such control is exercised in the best interests of the company. The common law further entrenches these fiduciary duties as it imposes a duty of care, skill and diligence and the duty to act bona fide in the best interests of the company.¹⁵³ Grossman argues that:¹⁵⁴

“Given that the fiduciary duty is owed to the company, any actions which foster profitability appear to be in the company’s best interests. As a result, the traditional legal position provides that the role of a corporation is to maximize profits. In undertaking the obligation to maximize profits a director has broad discretion.”

Shareholder primacy theorists believe that CSR is best used as a marketing tool to help increase profits for the company and should not be used in business dealings unless it can

¹⁵² Grossman (n 149) 590.
¹⁵³ Grossman (n 149) 576.
¹⁵⁴ n 153 above.
be in aid of a legitimate business decision. However, shareholder primacy theorists argue that CSR is an illegal notion due to the costs imposed on adopting a relevant framework to incorporate such activities and the lack of financial gain that can be benefited from such pursuit.155

Australian corporation law supports the shareholder primacy theory by compelling directors to maximize profits. Such compulsion can be interpreted by the relevant provisions found in the Corporations Act 2001. Australia’s legislation imposes certain obligations on the employee which in turn further entrenches Australia’s perspective of the shareholder primacy norm and the relevance of CSR.

Section 180 imposes the common law duty of care and diligence on directors to exercise their powers reasonably and provides for the business judgment rule so as to restrict any liability that can be placed upon a director should they be faulted for any possible bad business decision. Section 181 ultimately provides for the shareholder primacy norm as it expressly states that a director or other officer of a corporation must exercise their powers and discharge their duties in good faith and in the best interests of the corporation and for a proper purpose. Section 57A provides a definition for corporation and states that a corporation includes a company, any body corporate and unincorporated body. As mentioned there is no definition or authority as to what the concept ‘company’ entails and as such, it can be assumed to be defined in common law terms as a ‘body of shareholders’.

155 Grossman (n 149) 579.
Section 182 provides that a director, secretary, other officer or employee of a corporation must not improperly use their position to gain an advantage for themselves or someone else or cause detriment to the corporation. Section 183 provides for exactly the same as section 182 but under the context of obtaining information due to their position as a director, secretary, other officer or employee. These two provisions subsequently limit the scope of these stakeholder positions as well as any right they may have due to their respective positions. Both provisions are geared to ensure that any advantage or information gained by a stakeholder through their positions is not used to the detriment of the corporation and ultimately is indirectly protecting the best interests and future success of the corporation.

Section 180, 181, 182 and 183 all carry with them a civil penalty provision found in section 1317E. This further entrenches Australia’s favoured position of shareholder primacy and that the main objective of a corporation must be to provide for the best interests of the corporation which in all respects is the maximization of profits. Despite civil penalty, the Corporations Act 2001 further provides that infringing on such duties of good faith and misusing information that has been obtained as a result of ones position as a director, other officer or employee or misusing ones position, can result in a criminal offence as provided for in section 184 should such infringement be to the detriment of the corporation. Another extension is provided for by section 185 which states that section 180-184 have effect in addition to any rule of law relating to the duty or liability of a person because of their office or employment in relation to a corporation.
Despite this favourable position of a shareholder primacy approach, modern day company law; begs the question as to how various non-shareholder groups can enforce their rights and to what extent do they impact upon the ultimate objective of a company. Much of CSR in Australia has been regulated through ‘soft’ law initiatives. However, there can be found some attempt in regulating CSR in the Corporations Act 2001; however, there is debate as to the extent that directors can consider stakeholder interests beyond that of shareholder interests, considering the enforceable and legally recognized provisions of section 180-184.\(^{156}\)

Due to the obvious fact that the objective of a company is to maximize profits for the benefit of the company and in turn the shareholders, it is to be expected that Chapter 2M of the Australian Corporations Act 2001 provides that the activities and performances of the corporation must be reported so as to measure and analysis the extent of the company’s success over the year. Section 299 requires directors to write a report on general information about the operations and activities of the company. Section 299(1)(f) provides that a directors’ report for a financial year must, if the entity’s operations are subject to any particular and significant environmental regulation under a law of the Commonwealth or of a State or Territory-give details of the entity’s performance in relation to the environmental regulation. The downfall of this section is that although such constituencies are formally recognized, there is no provision to provide for its

enforcement should a director fail to report on such activities as found in section 180-184.\(^{157}\)

It is debatable as to how effective such legislation is with regards to promoting the interests of other stakeholders beyond that of shareholder interests is and the answer may be because of the fact that there can be found other legislation that imposes additional obligations on companies and their directors in relation to employees and the environment. As a result it seems that the Australian legislators found it pointless to further enforce recognition of the various constituencies where there can be found other sufficient and more effective laws covering these aspects.

The Workplace Relations Act 1996 main objective is to provide a framework for cooperative workplace relations to promote the economic prosperity and welfare of the people of Australia.\(^{158}\) In this Act, guarantees are provided such as, companies must pay

\(^{157}\) n 156 above.

\(^{158}\) Part 1, section 3 of the Workplace Relations Act 1996: Principal object:
(a) encouraging the pursuit of high employment, improved living standards, low inflation and international competitiveness through higher productivity and a flexible and fair labour market; and
(b) establishing and maintaining a simplified national system of workplace relations; and
(c) providing an economically sustainable safety net of minimum wages and conditions for those whose employment is regulated by this Act; and
(d) ensuring that, as far as possible, the primary responsibility for determining matters affecting the employment relationship rests with the employer and employees at the workplace or enterprise level; and
(e) enabling employers and employees to choose the most appropriate form of agreement for their particular circumstances; and
(f) ensuring compliance with minimum standards, industrial instruments and bargaining processes by providing effective means for the investigation and enforcement of:
their employees minimum rates of pay,\textsuperscript{159} or a company must have regard to the provisions of the law dealing with occupational health and safeties that applies to an employee and whether that work is appropriate for the employee to perform when directing that employee to perform other available work.\textsuperscript{160} Such sections cover those parts that cannot be found in the Corporations Act. Consequently, such provisions can be presumed to be unnecessary, due to the fact that such rights and remedies are extensively provided for and recognized within the Workplace Relations Act. One of the Workplace Relations Act primary objectives as mentioned is to promote the economic prosperity and

\begin{itemize}
\item[(i)] employee entitlements; and
\item[(ii)] the rights and obligations of employers and employees, and their organisations; and
\item[(g)] ensuring that awards provide minimum safety net entitlements for award-reliant employees which are consistent with Australian Fair Pay Commission decisions and which avoid creating disincentives to bargain at the workplace level; and
\item[(h)] supporting harmonious and productive workplace relations by providing flexible mechanisms for the voluntary settlement of disputes; and
\item[(i)] balancing the right to take industrial action for the purposes of collective bargaining at the workplace level with the need to protect the public interest and appropriately deal with illegitimate and unprotected industrial action; and
\item[(j)] ensuring freedom of association, including the rights of employees and employers to join an organisation or association of their choice, or not to join an organisation or association; and
\item[(k)] protecting the competitive position of young people in the labour market, promoting youth employment, youth skills and community standards and assisting in reducing youth unemployment; and
\item[(l)] assisting employees to balance their work and family responsibilities effectively through the development of mutually beneficial work practices with employers; and
\item[(m)] respecting and valuing the diversity of the work force by helping to prevent and eliminate discrimination on the basis of race, colour, sex, sexual preference, age, physical or mental disability, marital status, family responsibilities, pregnancy, religion, political opinion, national extraction or social origin; and
\item[(n)] assisting in giving effect to Australia’s international obligations in relation to labour standards.
\end{itemize}

\textsuperscript{159} Section 182 of The Workplace Relations Act 1996.
\textsuperscript{160} Section 697(2) of the Workplace Relations Act 1996.
welfare of the people, thus ‘people’ can be interpreted to have a wider meaning and clearly provides recognition of stakeholder interests beyond that of the shareholder.

Public policy and globalization has further played a major part in the implementation of codes and principles to further enhance the need for companies to become socially aware. In some respects there can be seen a development with the enactment of some legislation that covers for such socially responsible activities. Companies are now even more obligated, than in the past, to comply with a wide range of environmental requirements. Such requirements can be found in the Environment Protection Act 1970.

The Environment Protection Act can be seen as Australia’s most extensive and effective piece of legislation in respect of CSR. It covers everything from integration of environmental policies to penalization of offences found under the Act. Section 1B provides for the principle of integration of economic, social and environmental considerations. Many company law academics have actively tried to pursue principles by incorporating it into company legislation. However, this Act seems to cover that which is not covered in the Corporations Act in respect of the triple bottom line approach. Section 1B(3) provides that for integration of such principle, it requires that the measures adopted should be cost-effective and in proportion to the significance of the environmental problems being addressed. This can be interpreted to be in favour of a shareholder primacy norm and even more so with the ‘enlightened shareholder value’ approach. Section 1B(3), despite being directed at environmental protection, also requires companies, being a juristic person, to cater for such legislation. Furthermore, by
expressly providing for cost-effective measures to be taken, such provision would as a result, sit comfortably with a company’s main objective of pursuing profit maximization.

The Environment Protection Act provides for accountability, duties and enforcement in respect of all persons and trade businesses. It formally recognizes that there is a responsibility beyond the individual. Its application is extensive and binding as provided in section 2 and 3. Thus, it can be presumed that due to the extensiveness and effectiveness of such legislation, there is no need to elaborate further such provisions in respect of company legislation since this legislation is applicable to companies found within its jurisdictional application.

However, despite other legislation providing for the recognition of various constituencies and the welfare of people in general, such legislation lacks the most important underlying issue found in the Corporations Act 2001. This issue being that the objective of a company is to maximize profits in the best interest of the company. At the end of the day it is this that is the reason for so much debate, because where employees or other stakeholders and even the notion of CSR may not be recognized effectively in the Corporations Act, they are recognized and catered for elsewhere further presuming that such recognition would be unnecessary within the Corporations Act and that such notions are of a subordinate nature to that of ultimately making a profit for the company and its shareholders.
With the implementation of section 172 of the UK Companies Act 2006, it is apparent that UK has chosen to support an ‘enlightened shareholder value’ approach. The Company Law Reform Steering Group (CLRSG) believes that the ‘enlightened shareholder value’ approach is a better method of achieving wealth generation and competitiveness for the benefit of all. Villiers believes that the enlightened shareholder value approach in actual fact makes all constituents worse off due to the main problem that this approach fails to provide for any method of enforcement for non-shareholder constituents. As a result it is more difficult for them to prove that the directors in question have failed to consider their interests when conducting business decisions.

Section 172 of the UK Companies Act has been praised in that it has somewhat effectively provided for the interests of other constituencies beyond those of shareholders interests, whilst still keeping to the traditional approach of company law’s objective to profit maximization. However, it has also been criticized, as this section is only an acknowledgment that there are interests beyond that of shareholders, and ultimately still no effective enforcement for stakeholders to rely on when their interests are being prejudiced.

Section 172 provides that there is a duty to promote the success of the company in that:

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162 Villiers (n 161) 8.
163 UK Companies Act 2006.
(1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to-

(a) the likely consequences of any decision in the long term;
(b) the interests of the company’s employees;
(c) the need to foster the company’s business relationships with suppliers, customers and others;
(d) the impact of the company’s operations on the community and the environment;
(e) the desirability of the company maintaining a reputation for high standards of business conduct;

and

(f) the need to act fairly as between members of the company.

(2) Where or to the extent that the purposes of the company consist of or include purposes other than the benefit of its members, subsection (1) has effect as if the reference to promoting the success of the company for the benefit of its members were to achieving those purposes.

(3) The duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company.

Although section 172 appears to be more supportive of the stakeholder perspective, on closer inspection there seems to be some debate as to how effective and how recognizable this section is for other constituencies. Under the introduction of s 172, employees, although given some recognition are only given recognition to the same extent as the other four considerations set out in s 172(1). Furthermore, there is no obligation on directors to ensure that employees are considered, as the section only provides that the following five factors only need to be regarded in promoting the success of the company. Prior to section 172 they could rely on section 309 of the Companies Act 1985,\textsuperscript{164} which

\textsuperscript{164} 309. Directors to have regard to interests of employees:
(1) The matters to which the directors of a company are to have regard in the performance of their functions include the interests of the company’s employees in general, as well as the interests of its members.
singled them out for consideration by the directors when performing their business activities. However, there was much criticism of this section as it was believed that the employees were being preferred above that of the shareholders and as such there was a need for a revised look at the purpose of s 309, hence its repeal and the introduction of s 172.

Section 172 broadens the range of interests to be considered and those listed are to be considered ‘amongst other matters’. Villiers states that:

“The potential effect is to dilute the importance attributed to the interests of the employees. Indeed, none of the interests listed are to be given primacy since the directors need only ‘have regard to’ such interests. Nor does this preclude directors from taking decisions that are inconsistent with any such interests.”

Section 172 could have the effect of increasing the discretion enjoyed by directors without exposing them to challenge by the stakeholders where they feel their interests have not been given due or sufficient consideration. First, such stakeholders must rely on shareholders to make any such challenge and if their interests conflict with those of shareholders it will be unlikely that the shareholder will challenge on their behalf. Conversely, the shareholders might complain that such a provision makes their own challenges more difficult because the need to consider that the other stakeholders may

(2) Accordingly, the duty imposed by this section on the directors is owed by them to the company (and the company alone) and is enforceable in the same way as any other fiduciary duty owed to a company by its directors.

(3) This section applies to shadow directors as it does to directors

\(^{165}\) Villiers (n 161) 9.
increase the discretion of the directors and equip them with a defence against a shareholder challenge.166

Section 172 imposes a duty on the directors to promote the success of the company but how they are judged on their fulfillment of that duty depends upon the information they make available to the shareholders and to others about how the company’s business is performing. The new requirement for directors to produce and enhanced business review is an important provision for enabling such judgments to be made.167

Section 417 focuses on the contents of the Business Review of corporate annual reports. Section 417 states that all directors of quoted companies must produce a business review in their annual reports. The purpose of the business review is to inform members of the company and help them assess how directors have performed their duty under section 172.168 The most relevant subsection of section 417 in respect of the context of CSR and the various rights of constituencies is subsection (5)169 as it specifies the information that must be provided by quoted companies.

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166 Villiers (n 161) 10.
167 Villiers (n 161) 11.
168 Section 417(2) of the UK Companies Act 2006.
169 (5) In the case of a quoted company the business review must, to the extent necessary for an understanding of the development, performance or position of the company’s business, include—
   (a) the main trends and factors likely to affect the future development, performance and position of the company’s business; and
   (b) information about—
      (i) environmental matters (including the impact of the company’s business on the environment),
      (ii) the company’s employees, and
      (iii) social and community issues, including information about any policies of the company in relation to those matters and the effectiveness of those policies; and
   (c) subject to subsection (11), information about persons with whom the
The information identified is closely linked to the matters that directors must consider in the duty to promote the success of the company in section 172. None of the specified matters to be included are in fact compulsory but if they are not covered the business review must state that fact.\textsuperscript{170}

Despite section 172 and 417 attempt to provide for the various constituents the predominance of shareholders is still highlighted as the main interest group to be considered by directors and as the potential challengers of director’s actions and in turn the emphasis on profit maximization is still an apparent reality within company’s directions.\textsuperscript{171}

As discussed in the earlier chapters, UK legislation is based upon a one-tier board structure, with larger companies having non-executive directors acting as supervisors and monitors of the executive board. This structure contrasts with that of German companies where the supervisory board is composed of shareholder and employee representatives. In the UK there is almost no tradition of employee participation in corporate strategic decisions and worker involvement is limited to collective bargaining, whereas in Germany, workers have legally protected rights within company law to participate in

\textsuperscript{170} Villiers (n 161) 13. 
\textsuperscript{171} Villiers (n 161) 16.
corporate decision making through codetermination and they have information and consultation rights in labour law that allow them to be involved in strategic decisions through unions or through a representative works council.\textsuperscript{172}

The legal notion that directors must act in good faith and in the interest of the company, rather than the shareholders, given the assumption that the board may have more freedom in taking a long-term view of what is in the best interests of stakeholders as a whole. This is reinforced by legislation requiring boards to consider the interests of employees alongside those of shareholders when exercising fiduciary duties. Thus emphasizing UK’s adoption of the ‘enlightened shareholder value’ approach, that is, it is striking a balance between the competing interests of the different stakeholders in order to benefit the shareholders in the long run. For example, in all but most exceptional cases, it would be legally open to the directors to pursue a policy of minimum redundancies (to gain the cooperation of the workforce) or a preferred supplier policy (to enhance the quality of supplier relations), if the ultimate objective of these policies were to advance shareholder interests.\textsuperscript{173}

A combination of ownership structures, corporate governance rules, and regulation of securities markets means, however, that boards frequently have to give higher priority to shareholder value in both the short and long run than a purely legal perspective would imply.\textsuperscript{174}

\textsuperscript{172} Villiers (n 161) 19-20.
\textsuperscript{174} Deakin (n 173) 978.
The notion of employees is generally a topic of debate with respect to their standing as a stakeholder within UK corporate governance due to the fact that other stakeholders can effectively rely on other bodies of law such as creditors can rely on insolvency law to enforce their rights. Labour law tends to lack such effective corporate governance, especially under the auspices of commercial law, due to the reasoning that labour law legislation effectively protects them either in an individual capacity or collectively and as such, it is unnecessary to provide for them under company legislation.175

Where the UK Companies Act 2006 fails to provide for the worker, the Employment Rights Act 1996 provides extensively for the worker under different circumstances. Under the Employment Rights Act a worker can enforce rights from wage disputes to disclosure of certain information. Section 43FB(1) provides that a worker is protected from any information disclosed should such information qualify in terms of the requirements set out.176 The information that may be disclosed is extensively set out

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176 (1) In this Part a “qualifying disclosure” means any disclosure of information which, in the reasonable belief of the worker making the disclosure, tends to show one or more of the following—
(a) that a criminal offence has been committed, is being committed or is likely to be committed,
(b) that a person has failed, is failing or is likely to fail to comply with any legal obligation to which he is subject,
(c) that a miscarriage of justice has occurred, is occurring or is likely to occur,
(d) that the health or safety of any individual has been, is being or is likely to be endangered,
(e) that the environment has been, is being or is likely to be damaged, or
(f) that information tending to show any matter falling within any one of the preceding paragraphs has been, is being or is likely to be deliberately concealed.
under this section and caters as far as the environment and health and safety of any individual is concerned. It thus tends to be in line with that of CSR principles.

In respect of section 43FB(1) a link can be made between CSR principles and the stakeholder theory. This section expressly provides for the protection and the opportunity for an employee to enforce their rights as a stakeholder under the Employment Rights Act. Subsequently, catering for the rights of stakeholders under company legislation may be unnecessary and more of a burden to prove considering all the other factors that such legislation makes provision for.

Section 44 of the Employment Rights Act further provides for aspects of how a company should treat its employee and have regard for their respective interests.177 Section 44 is a

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177 (1) An employee has the right not to be subjected to any detriment by any act, or any deliberate failure to act, by his employer done on the ground that—
(a) having been designated by the employer to carry out activities in connection with preventing or reducing risks to health and safety at work, the employee carried out (or proposed to carry out) any such activities,
(b) being a representative of workers on matters of health and safety at work or member of a safety committee—
(i) in accordance with arrangements established under or by virtue of any enactment, or
(ii) by reason of being acknowledged as such by the employer,
the employee performed (or proposed to perform) any functions as such a representative or a member of such a committee,
(ba) the employee took part (or proposed to take part) in consultation with the employer pursuant to the Health and Safety (Consultation with Employees) Regulations 1996 or in an election of representatives of employee safety within the meaning of those Regulations (whether as a candidate or otherwise),
(c) being an employee at a place where—
(i) there was no such representative or safety committee, or
(ii) there was such a representative or safety committee but it was not reasonably practicable for the employee to raise the matter by those means, he brought to his employer’s attention, by reasonable means, circumstances connected with his work which he reasonably believed were harmful or potentially harmful to health or safety,
(d) in circumstances of danger which the employee reasonably believed to be serious and imminent and which he could not reasonably have been expected to avert, he left (or proposed to leave) or (while the danger persisted) refused
provision for health and safety cases and provides for the rights of the employee not to be subjected to any detriment by any act or any deliberate failure to act by an employer and companies are obligated to bear in mind that they as ‘employers’ are subjected to such legislation and its provisions.

It can be argued that with the implementation of section 172 that there is provision for employee rights, however, such interpretation must be careful to not deviate too far from the actual purpose of section 172. Unlike Australian company law that promotes more of a shareholder primacy value, the UK has adopted a more liberal approach in considering the interests of various constituencies beyond the shareholder. But that is where such enlightenment stops, UK company law only considers such interests and does not provide for any real effective enforcement of such interests, as stakeholders still have to depend on whether the shareholders feel that such interests are of importance in that such possible infringement may ultimately affect their interests and the ultimate success of the company.
6.4 Canada’s legislation

With the implementation of the Canada Business Corporation Act 1985, Canada has quickly become the pioneers in regulating a stakeholder regime. Canada’s company law has not only adopted a stakeholder inclusive approach but has further extended the statutory remedies to that of non-shareholder groups. The CBCA can be interpreted so far as to say that it has abolished the distinction between shareholders and other stakeholders and has in turn placed them on par. However, Vasudev argues that despite the CBCA recognizing the ‘interests’ of all constituencies and providing a remedy for all, the directors are under no explicit duty to foster the interests of all the groups.178

Unlike other jurisdictions where company legislation objective is to promote the success of the company and to further profit maximization, CBCA objective is to strengthen the engagement of non-shareholder groups with corporations. Section 239 provides for the derivative action and makes it possible for non-shareholder groups to rely on such action should they feel that the corporations’ interests are being prejudiced and to further recover on behalf of the corporation any losses they may have suffered.179

The CBCA is unique in that it empowers ‘security holders’ to maintain derivative actions and as such there are no apparent limitations on their power to bring such actions. However, the position in regards to creditors who are not ‘security holders’ is different in that they can bring an action under the term ‘proper person’ included in the definition of

179 Vasudev (n 178) 8.
‘complainant’ found in section 238(d) of the CBCA. But to do so, they must first prove to the court that they fall under this term as a ‘proper person’.180

The oppression remedy which is generally a shareholders only remedy was adopted by the CBCA from UK law. Despite UK influence, the CBCA has extended the remedy to non-shareholder groups. The remedy is provided for by section 241 and is invoked when a business corporation unfairly prejudices or disregards the interests of any of the persons mentioned under section 241.181

The reason for Canada’s proactive step in taking into account non-shareholder interest is due to the case of People’s Department Stores Inc. (Trustees of) v Wise.182 This case is what set in motion Canada’s development in company law and the reason for company legislation being extended to cater for the interests of non-shareholder groups.183 In this case, the Supreme Court had to decide whether directors of financially distressed corporations were accountable to creditors. The Supreme Court dealt with this issue by analyzing directors’ fiduciary duties and duty of care. With respect to fiduciary duties, the Supreme Court set aside the traditional interpretation of the ‘best interests of the corporation’, which gave primacy to shareholders’ interests. Instead the court held that the best interests of the corporation refer to the maximization of the corporation’s value.

180 Vasudev (n 178) 9.
181 Vasudev (n 178) 38.
In other words, by extending the duty of care to the corporation, a personal right of action is created for every shareholder and stakeholder in turn.\textsuperscript{184}

Although directors were allowed to consider the interests of shareholders and stakeholders in pursuing this objective, the Court held that it was not appropriate for directors to favour one group of stakeholders. Stakeholders still need to convince the court that they are a proper person in order to institute an oppression application.\textsuperscript{185}

Stakeholders under the CBCA are still more effectively recognized and catered for and as such there is little need to investigate as to whether stakeholders need to refer to other legislation in order to protect their interests since the CBCA covers quite extensively for stakeholder interests under the context of company law.

\textbf{6.5 South Africa’s legislation}

In light of the above, the traditional viewpoint on shareholder primacy is becoming increasingly questioned as to its relevancy in modern day company law. There is now so, more than ever, increased pressure on companies to become more socially responsible as it is now becoming more prevalent as to what impact such activities can have on a company. CSR is more so an issue in South Africa, than found in any other jurisdiction. A reason for such emphasis on reforming South African company law is due to South Africa’s peculiarities and dark history. Apartheid has been a major instigator for

\textsuperscript{184} Rousseau (n 183) 226.  
\textsuperscript{185} n 184 above.
changing South Africa’s policies on the future of company legislation and CSR initiatives.

Miles and Jones argue that at face value, adopting an approach which combines the interests of shareholders and stakeholders is ideal in a country which is trying to redress the extreme inequalities caused by exploitative and discriminative policies under the Apartheid regime.¹⁸⁶

With such emphasis on CSR and taking into account South Africa’s history, it would be assumed that South Africa would be at the forefront of social initiatives under the context of company legislation. Unfortunately, this is not the case. It seems, however, under the Companies Act 71 of 2008, there is an attempt to incorporate the interests of the various constituencies with the implementation of section 72(4). The question that arises in this regard is whether such section and the accompanying regulation is effective in its objective and whether it can be enforced or is it just mere window-dressing?

The social and ethics committee established under section 72(4) of the Companies Act 71 of 2008 has been implemented to monitor the company’s activities, having regard to any relevant legislation, such as the Broad-Based Black Economic Empowerment Act 53 of 2003, the Labour Relations Act 66 of 1995, the Employment Equity Act 55 of 1998 or prevailing codes of best practice, such as the United Nations Global Compact Principles.

The social and ethics committee must also monitor the company’s activities with regard to good corporate citizenship including:¹⁸⁷

¹⁸⁷ Regulation 43(5)(ii).
• The company’s promotion of equality and the prevention of unfair discrimination,
• Contribution to the development of the communities in which the company’s activities are predominantly conducted,
• Its record of sponsorship, donations and charitable giving,
• The environment, health and public safety,
• Consumer relationships, and
• Labour and employment.

Basically this can be understood as legislations adoption of the ‘enlightened shareholder value’ approach and of CSR. However, this regulation is subject to suspect as it is believed that it merely results in companies ensuring that they comply with the requirements and does not go beyond this, ultimately rejecting traditional practices of voluntary approaches to CSR.\textsuperscript{188}

Since 1995, the South African government undertook a ‘multi-faceted’ approach to address the inequalities which existed as a result of Apartheid. As a result government has been making efforts for black economic empowerment. The purpose of black economic empowerment is to bring about a significant increase in the numbers of black people that manage, own and control the country’s economy.\textsuperscript{189}

With the implementation of the Broad Based Black Economic Empowerment Act 53 of 2003, new pressure was put on companies to commit to black economic empowerment. The Act is structured in such a way as to ensure that BBBEE will touch to some extent

\textsuperscript{188} Cassim et al (n 3) 475.
\textsuperscript{189} Dekker & Esser (n 86) 161.
every aspect of the business supply chain. The Act defines BBBEE as the economic empowerment of all black people through socio-economic strategies.

The Act allows for certain documents and Codes that help define the BBBEE policy. One such code is the Codes of Good Practice. Where the Act provides for the framework for BBBEE, the Codes contain the detailed regulations. The Codes contain the detail on BBBEE measures and provide the tools and mechanisms for measuring the progress made on implementation and execution of BBBEE measures. The ultimate effect of the Act and Codes is that companies to which the Act applies will be given a Broad Based Black Economic status. This status will depend on the extent to which the company complies with the BBBEE Act and Codes. Companies with a good rating will obviously be able to benefit from public sector work and procurement policies.

CSR requires directors to consider the interests of other stakeholders and not only just shareholders when managing a company. Thus the BBBEE Act forces companies and directors of companies to consider all stakeholders through a score card rating. If a company falls within the scope of the Act and does not properly comply with the prescribed black economic empowerment score card the company will receive a poor BBBEE rating which will negatively affect its ability to do business in South Africa and will directly impact on the interests of shareholders.

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190 Dekker & Esser (n 86) 162.
191 Section 1 of the BBBEE Act.
192 Dekker & Esser (n 86) 165.
193 n 88 above.
The BBBEE Act forces companies, directly and indirectly, to consider the broader South African community within its political and socio-economic context. On a direct level, a BBBEE strategy of a company will ensure an increase in black participation in all levels of a company. On an indirect level, preferential procurement, involvement in enterprise development and socio-economic upliftment projects will ensure that the community at large reaps the benefits of corporate social responsibility. The effect of BBBEE will therefore filter through to the community at large and the country and ultimately a compliance with the ‘triple-bottom line’ approach.\(^\text{194}\)

The BBBEE Act illustrates how the State, through legislation can compel companies to have a social conscience. Unfortunately, despite being recognized as a formal piece of legislation within which the Codes operate, the Act does not state that these codes are binding or how much freedom can be given to companies and relevant enterprises.

As mentioned earlier the King III follows an ‘apply or explain’ approach to governance and instead reflects a new role that business plays in society today. The King III applies to all entities but is only mandatory for companies listed on the Johannesburg Stock Exchange (JSE) to comply with its principles set out. Chapter 6 is relevant in respect of promoting communication and accountability towards other stakeholders. This chapter provides for ‘integrated sustainability’ reporting or otherwise known as the ‘triple bottom line’ reporting. Chapter 8 of the King III further deals with the triple bottom line approach in that it aims at balancing the competing interests of shareholders and stakeholders so as to provide for better protection or at least consideration of stakeholder

\(^\text{194}\) n 193 above.
Once again, such Report has very little effective enforcement within the courts and may only extend as far as merely influencing the courts decision when dealing with a situation concerning conflicting rights of the various constituencies and shareholders ultimate interests.

Another relevant piece of legislation is the Labour Relations Act 66 of 1995. This Act acts as a countervailing force to the employer’s economic power. Thus, the LRA guarantees employees the right to join trade unions and participate in their activities, affords representative trade unions a set of organizational rights, establishes collective bargaining structures and upholds the right to strike.

Labour law is at the heart of political, social and economic debates on the nature and extent of labour market regulation. The definition of ‘employee’ is important as it is the starting point in determining the nature and scope of the protection afforded by the LRA and other relevant statutes such as the Employment Equity Act 55 of 1998. The LRA defines an ‘employee’ as:

(a) any person, excluding an independent contractor, who works for another person or for the State and who receives, or is entitled to receive, any remuneration; and

(b) any other person who in any manner assists in carrying on or conducting the business of an employer,

and ‘employed’ and ‘employment’ have meanings corresponding to that of employee.

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195 Miles & Jones (n 186) 60-61.
197 S 213 of the LRA.
Thus once the concept of ‘employee’ is defined then such rights can be enforced under the LRA or the EEA. For example, the LRA states that ‘every employee’ has the right not to be unfairly dismissed and not to be subjected to an unfair labour practice.198

Another aspect covered by the LRA is employee’s claims against employers. There is a common law duty on employers to establish safe working conditions for their employees. Thus, should an employer act in breach of this duty, the prejudiced employee have a claim for damages against the employer. Similarly, the Basic Conditions of Employment Act 75 of 1997 (BCEA) works in line with the LRA and gives further effect to statutory minimum terms and conditions of employment. The BCEA objective is to advance economic development and social justice by establishing and enforcing minimum conditions of employment, and by defining the circumstances in which these minimum standards may be varied. As Van Niekerk et al state:199

“The policy that underlines the Act is…a framework within which a balance between employer (company) and employee (stakeholder) interests in security can be achieved.”

Thus, both the LRA and the BCEA are effective and enforceable legislation, that extensively provides for the protection of an employee, as well as the conditions of employment. Therefore, it can be safely assumed that in respect of stakeholder rights and remedies, such constituents can rely on these two legislations to actively protect any prejudice they may feel from the company. The LRA and BCEA indirectly provide for

198 S 185 of the LRA.
199 Van Niekerk, Chistianson, McGregor, Smit & van Eck Law @ work (2008) 110.
the environment since, employers have a duty to ensure safe and healthy working conditions for the employee.

The Employment Equity Act 55 of 1998 works in line with the LRA and the BBBEE Act as it also provides for the well being of the employee and is one of the Acts mentioned in Regulation 43 under the Companies Act 71 of 2008 that must be given consideration. The purpose of the Employment Equity Act is to achieve equity in the workplace by promoting equal opportunity and fair treatment in employment through the elimination of unfair discrimination, implementing affirmative action measures to redress the disadvantages in employment experienced by designated groups and to ensure their equitable representation in all occupational categories and levels in the workforce. Chapter 4 of the Act provides for monitoring, enforcement and legal proceedings. Section 51 provides for the protection of employee rights, whereas section 60 provides for the liability of the employer. Thus, this Act is another measure that stakeholders can use to their benefit should they find that their rights are being prejudiced within the workplace.

In light of the above, it can be assumed that this may be the reason for the lack of effective stakeholder protection under the Companies Act 71 of 2008 and further the reason for section 72(4) providing that a social and ethics committee has the function to monitor a company’s activities, having regard to any relevant legislation, other legal requirements or prevailing codes of best practice, since it can be found under the above mentioned legislations a more effective and legally recognizable form of protection for the various constituencies than can be provided for under the Companies Act.

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200 Regulation 43(5)(a).
In respect of section 72(5) of the Companies Act it seems to further emphasise the lack of need for the social and ethics committee and the accompanying regulation of this section. Section 72(5) provides that a Tribunal can exempt a company that falls within the category of companies required to have a social and ethics committee, if such Tribunal is satisfied in terms of other legislation that requires some form of formal mechanism within its structures that substantially performs the functions required to be performed by the social and ethics committee. This section further entrenches the fact that such regulation is ineffective and lacking in enforcement.

Section 72(8) is another provision that proves the lack of enforcement of such section as it provides that a social and ethics committee of a company is entitled to require or request certain information, or to attend and be heard at any general meeting of shareholders. If this provision is interpreted strictly, it does not state that the committee must receive or require or be heard but that the committee is only entitled to such functions and cannot demand or enforce such functions under the provision of this Act. In other words, a director or prescribed officer of a company is not obligated to provide any information to the committee as there is no formal duty on them to do so.

Section 72(10) provides that section 84(6) and (7) applies in respect of a company that fails to appoint a social and ethics committee as required by section 72 and the regulations but does not provide for anything beyond the failure to appoint. Furthermore, there is no legal enforcement for any other infringements that may occur in light of the
performances by such a committee or infringements by any director, prescribed officer or relevant corporate body.

Section 84(6) and (7) is a further vague provision as it does not provide for any proper penalization should a company fail to appoint a social and ethics committee. The extent of these two provisions is limited and weak in its application. Section 84(6) only provides that a Commission may issue a notice to the company who failed to appoint a committee to show cause why the Commission, itself, should not appoint such committee. Should a company fail to respond to such notice or satisfy the Commission that the board will make the appointment, within an acceptable period, the Commission may give notice and convene a shareholders meeting to make an appointment or assess a pro rata share of the cost of convening the general meeting to each director who knowingly permitted the company to fail to make the appointment. Thus section 84(6)(b)(ii) can be seen to be the only form of legal enforcement to ensure that such a committee is appointed. However, it can be argued that such cost to the directors is ineffective, as another aspect that needs consideration is the extent of the directors ‘knowledge’ as such ‘knowledge’ can be interpreted either subjectively or objectively depending on the situation at hand. In contrast, section 84(7) is a provision that is seemingly more in favour of directors as it gives them the possibility of applying to the Companies Tribunal to set aside the notice, or the assessment, in whole or in part.

Another aspect that seems to come to the fore is that shareholders play a role in appointing a social and ethics committee as the appointment of such committee must be
done at a shareholders meeting, emphasizing that shareholders play a further role in how the committee is structured in who should be on it and indirectly further proving companies traditional perspective on the shareholder primacy norm. It seems as though the legislators in constructing this section, did not effectively think through as to how such a committee should be formed or catered for and ultimately the reason for having such a committee. Section 72(4) further proves that such a committee has no real *locus standi* as in light of regulation 43(5)(a) the committee has to have regard to other legislation and prevailing codes of best practice, further placing such committee on a subordinate level to other prevailing legislation or codes.
7 Conclusion

From the beginning, stakeholder interests have held very little relevance under company law, due to the fact that the ultimate objective of the company was to promote the success of the company, which in turn meant benefiting the shareholders. Stakeholder interests have only recently come to the fore as a result of modern company law reforms and companies in general becoming more socially responsive. Through much debate and research it has been found that the various constituencies have to some extent an effect on the operations and ultimate success of the company. Unfortunately, company law lags in this field as there is much debate as to the cost effects such concerns can have and whether it will still promote the underlying principle of the success of a company.

Despite many legal systems’ attempts to incorporate stakeholder interests, it seems that shareholder interests tend to always have the upper hand. Constituency statutes can hardly be considered as a form of effective legal measure for stakeholders looking to uphold their rights due to the failure of such statutes to provide an effective enforcement mechanism. Even the derivative action, despite its development from its common law origin, fails to provide effectively for stakeholders; as such action is ultimately for the company’s benefit. This said, section 165(2) of the Companies Act 71 of 2008, provides much more than that of the UK and Australia derivative action, as it expressly provides for other constituencies, whereas it can only be interpreted or implied that the UK and Australia are referring to other constituencies than that of only shareholders. Thus, in this regard our law seems to be more developed in acknowledging the interests of other stakeholders; despite that the ultimate end of the derivative action is for the benefit of the company and not the person instituting the action.

Even though modern company law has strived to ensure that other constituencies, apart from just shareholders, are protected and catered for, it seems that legislatives are far from effectively providing for such rights. As Cassim et al points out, the problem with section 72(4) of the Companies Act 71 of 2008, is that there is no legal duty that is directly owed to any of the stakeholders, a similar case found in s 172(1) of the UK
Companies Act 2006. Thus as a result the provisions of section 72(4)-(10) and the regulation are unenforceable by stakeholders, unless they are able to rely on some form of action, such as the derivative action as provided for in terms of the Act.\(^{201}\)

In comparison to the Companies Act 61 of 1973, our new Companies Act 71 of 2008 provides for enhanced accountability and transparency. It partly codifies the common law duties of directors thus invoking more responsibility upon directors to act in the best interests of the company. CSR is also a relatively new concept under our company law and there can be seen an attempt to cater for such a notion through section 72(4), however, it fails to be effective as discussed, due to the lack of enforcement. As has become apparent in this study, stakeholder protection is more relevant with the introduction of CSR and as such it is vital for company legislation to delve into possible solutions. Unfortunately, unlike Canadian legislation, our company law seems to fail in providing effectively for stakeholder protection, although there can be seen an attempt through the implementation of section 72(4) and especially with the new derivative action found under section 165. The problem with these two sections is that they require in depth interpretation and as mentioned fail to effectively provide for a formally recognizable enforcement mechanism in respect of non-shareholder groups.

Under the new Companies Act, it seems that stakeholders have more of a burden to prove that they have the relevant \textit{locus standi} to enforce their rights as on par with shareholders, despite the implication that more recognition has been provided. Another factor to be discussed is the issue of our history. It is all very well to discuss how far other jurisdictions have come in promoting the recognition of stakeholders and CSR. However, it is difficult to fully compare South African company law with other jurisdictions due to our dark history. Whilst Canadian company law has managed to proactively cater for non-shareholder groups, our company law is burdened with the issue of ensuring that not only non-shareholder groups are catered for but that previously disadvantaged groups are given priority.

\(^{201}\) Cassim et al (n 3) 475.
Section 72(4) and Regulation 43 does not effectively provide for stakeholders and can be seen as more of an attempt to align our company law with UK company law and specifically section 172 of the UK Companies Act 2006. The only option to change such section and regulation so that it does not resemble mere window-dressing is to refine the objective of Regulation 43 and to provide a better enforcement mechanism within section 72(4). Alternatively, it seems unnecessary to cater for stakeholders under company legislation due to the fact that other and more specific legislation such as the BBBEE Act and the Labour Relations Act deal with such groups quite extensively. Regulation 43 further promotes the use of these Acts as it specifically refers to them by stating that regard should be made to such legislation, thus propounding the question as to how effective section 72(4) and Regulation 43 is, especially when questioning the extent of its enforceability.
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