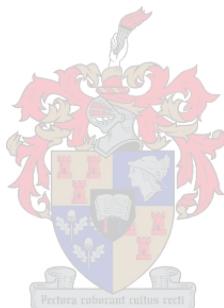


The models of attribution in the establishment of corporate liability revisited

by

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Summary

The separate legal personality of a company is one of the cornerstones of modern corporate law. Nevertheless, due to the artificial nature of a company it has no inherent moral blameworthiness necessary to impose corporate liability. With a rise in corporate wrongdoing, there is a need to hold companies liable. Therefore, certain models of attribution have developed whereby the conduct and will of a corporate actor can be imputed to the company to establish corporate liability. Especially in the realm of corporate criminal liability, these models of attribution have played a pivotal role to establish corporate wrongdoing. The two broad theories underlying the models of attribution are the fiction and realist theories respectively. The directing minds doctrine or identification doctrine and the vicarious liability model are traditionally associated with the fiction theory, which is rooted in the abstract nature of a company.

Whether the traditional models of attribution are suited for complex modern organisational structures, is explored in this thesis, whilst a more functional and realistic approach to corporate liability is proposed. Often the question of “what is a corporation” has overshadowed the determination of corporate liability, thus a more contextual analysis based on law and economics is proposed to ensure corporate liability.

The development of the rules of attribution through case law illustrate the importance of a purposive approach to establishing corporate liability. Furthermore, the underlying relationship between the rules of attribution and the rules of agency indicate that the interests of risk-bearers and managers are not always aligned and should be redressed.

Moreover, a realist approach as opposed to the fictional approach to attribution has been developed in English and Australian law. This approach focuses on the overarching corporate culture and identity when determining corporate fault, instead of individual corporate actors. These regulatory frameworks provide an alternative approach to the current South African model, which is based on the fiction theory.

Lastly, the economic considerations, such as the separation of ownership and control and the agency problem, are evaluated to determine whether the current models of attribution create an economically efficient outcome or an unsustainable a risk-taking environment.

Opsomming

Die afsonderlike regspersoonlikheid van 'n maatskappy is een van die hoekstene van korporatiewe reg. Nogtans belemmer die abstrakte aard van maatskappye die oplegging van aanspreeklikheid, aangesien 'n maatskappy nie oor die nodige afkeurenswaardigheid beskik nie. Ten einde die probleem te oorbrug, is sekere aanspreeklikheidsmodelle ontwikkel waarvolgens die handeling en wil van sekere individue aan die maatskappy toegerekend word. Ten opsigte van die strafregtelike aanspreeklikheid van regspersone, speel die aanspreeklikheidsmodelle 'n kern rol om aanspreeklikheid te vestig. Die fiksie-teorie en orgaan-teorie word as die twee noemenswaardige teorieë rakende die aanspreeklikheidsmodelle beskou. Die identifikasie-leerstuk en die middellike aanspreeklikheidsmodel word tradisioneel met die fiksie-teorie geassosieer, wat op die abstrakte aard van 'n maatskappy gegrond is.

Die vraag ontstaan of die tradisionele aanspreeklikheidsmodelle gesik is vir komplekse moderne organisatoriese strukture. Die oorsprong van die aard van 'n regspersoon word dikwels as 'n struikelblok tot aanspreeklikheid beskou, aangesien daar op die abstrakte aard van die regspersoon gefokus word. Gevolglik word 'n doelmatige benadering voorgestel, wat op 'n realistiese opvatting van regspersone geskoei is. Hierdie kontekstuele benadering spruit uit 'n reg en ekonomiese analise tot die aard van die regspersoon.

Die onderliggende doel van korporatiewe aanspreeklikheid word deurgaans in die ontwikkeling van die aanspreeklikheidsreëls beklemtoon. Weens die onderlinge verhouding tussen die aanspreeklikheidsreëls en verteenwoordiging is die belang van aandeelhouers en bestuur binne 'n maatskappy nie noodwendig belyn nie.

'n Alternatiewe benadering tot aanspreeklikheid gebaseer op realisme is onlangs in die Engelse en Australiese reg ontwikkel. Hierdie modelle fokus op die oorkoepelende korporatiewe kultuur en identiteit ten einde korporatiewe skuld te vestig, in plaas van die wilsvorming van bepaalde individue. Hierdie breër raamwerk word as alternatief tot die huidige Suid-Afrikaanse model voorgestel, wat op die fiksie-teorie gebaseer is.

Laastens word ekonomiese oorwegings, soos die verdeling tussen eienaarskap en beheer en die agentskap probleem, geëvalueer ten einde te bepaal of die huidige aanspreeklikheidsmodelle 'n ekonomies doeltreffende uitkoms verseker of 'n nie-volhoubare riskante omgewing daarstel.

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Chapter 1: Introduction

1 Background to the research problem: the directing minds doctrine and corporate liability

One of the founding principles of company law is the separate legal personality of a company.¹ Although all human beings are legal persons, meaning they have the capacity to acquire legal rights and incur legal obligations, a legal person is merely a legal concept which has no physical existence.² As an artificial being, a company has no mind of its own and both the conduct and fault of certain people within the company need to be attributed to the company. Ultimately, a company has “no soul to damn and no body to kick”,³ yet section 19 of the Companies Act 71 of 2008 (the “Companies Act”) provides that a company has all the legal powers and capacity of an individual, except where such a right is inherently human.⁴ Furthermore, section 8(4) of the Constitution of the Republic of South Africa, 1996 (the “Constitution”) entrenches the fundamental rights of juristic persons under the constitutional democracy where applicable. In both these instances, the premise that a company is a creation of fiction is upheld, which embeds the notion of attributing the conduct and will of certain individuals (who are often not the residual risk-bearers).⁵

One of the primary models of attribution is the directing minds doctrine,⁶ whereby a company’s fault and conduct are imputed from the board of directors or those with the power to influence corporate policy. The economic considerations underlying company law, such as the separation between ownership and control and the agency problem have indicated that corporate rules should address these economic

¹ *Salomon v Salomon & Co Ltd* 1897 AC 22 (HL); R Cassim “The Legal Concept of a Company” in FHI Cassim (ed) *Contemporary Company Law* 2 ed (2012) 28-65 31.

² Cassim “Legal Concept” in *Contemporary* 31.

³ Although this statement cannot be found in any reported judgments or other primary source, it has often been cited in case law, for example in *Lennard’s Carrying Co Ltd v Asiatic Petroleum Co Ltd* 1915 AC 705 HL 713 (“Lennard’s”); *Commissioner for Inland Revenue v Richmond Estates (Pty) Ltd* 1956 1 SA 602 (A) 606; *Manong & Associates (Pty) Ltd v Minister of Public Works* 2010 2 SA 167 (SCA) para 4.

⁴ Cassim “Legal Concept” in *Contemporary* 31.

⁵ MZ Abbasi “Legal analysis of Agency Theory: an inquiry into the nature of corporation” (2009) 51 *IJLMA* 401 403.

⁶ *Lennard’s* 713; *HL Bolton (Engineering) Co Ltd v TJ Graham & Sons Ltd* 1957 1 QB 159 172 (“*HL Bolton*”).

considerations.⁷ Being an artificial entity, a company cannot act itself; nor can it have a state of mind.⁸ However, due to its corporate personality, it is necessary for the law to attribute the acts and states of mind of certain natural persons to the company. The problem, however, is that with an increase in misbehaving corporate actors, the description and application of the relevant rules have become uncertain.⁹ Given the concerns relating to corporate attribution and its application in complex modern organisations, there is a need to revisit the rules of attribution. For this reason, the directing minds doctrine¹⁰ should be reconsidered and a more consistent mode of ascribing corporate fault and conduct should be investigated. However, the rules for ascribing acts or knowledge to the company would depend upon the type of liability and thus contractual or criminal liability could be imputed differently. In the case of contractual liability, the purpose is to establish authority (be it actual or ostensible), whereas criminal liability relates to unlawful conduct. Especially in the realm of corporate criminal liability, where crimes involving *mens rea* are concerned, a basis for attribution to the company as its own conduct and will is required.¹¹

The purpose of this thesis is to analyse the traditional model for attribution, including the application of the directing minds doctrine, in the South African context. Due to South African company law's origin in English law, the common-law position will be used a basis to determine the similarities and differences in the application of the attribution rules. Moreover, the realist model as a mode of attribution will be examined as possible alternative to the directing minds doctrine. Apart from the theoretical framework regarding attribution, the efficacy of the directing minds doctrine in establishing corporate criminal liability will be discussed. English law and Australian law have recently opted for a realist approach for certain statutory offences,¹² consequently the possibility of a similar approach in South African law will be examined. In addition, an economic analysis will be made, due to the underlying agency problem in company law and its influence on corporate criminal liability. It will

⁷ MC Jensen & WH Meckling "Theory of the firm: managerial behaviour, agency costs and ownership structure" (1976) 3 *JFE* 305 305; EF Fama & MC Jensen "Agency Problems and Residual Claims" (1983) 26 *JL&E* 327 328.

⁸ MS Blackman, RD Jooste & GK Everingham *Commentary on the Companies Act* (RS 4 2007) 4-123.

⁹ S Worthington "Corporate attribution and agency: back to basics" (2017) 133 *Law Q Rev* 118 118.

¹⁰ *Lennard's* 713; *HL Bolton* 172.

¹¹ E Ferran "Corporate Attribution and the Directing Mind and Will" (2011) 127 *Law Q Rev* 239 241.

¹² The Corporate Manslaughter and Corporate Homicide Act 2007; Bribery Act 2010; Criminal Finances Act 2017.

be examined whether or not the traditional model creates an incentive for risk taking behaviour.

2 Traditional approach: The directing minds doctrine

The traditional approach to corporate liability is based on individual rather than corporate fault. In South African company law both the individualistic and vicarious liability model have been followed when attributing human qualities to the artificial being. These theories are based on the fictional nature of the company and was formulated by Viscount Haldane in *Lennard's*:

“A corporation is an abstraction. It has no mind of its own any more than it has a body of its own; its active and directing will must consequently be sought in the person of somebody who for some purposes may be called an agent, but who is really the directing mind and will of the corporation, the very ego and centre of the personality of the corporation.”¹³

In this sense the action and will of the directing mind, be it the board of directors, the body of shareholders or an authorised person, will be regarded as the action and will of the company.¹⁴ Nevertheless, it is paramount that the person be regarded as an “alter ego”¹⁵ of the company.¹⁶ This method of attribution is regarded as the identification doctrine, because it is based on ascribing an individual’s (or a group of individuals’) will and actions to the company.¹⁷ Despite the fact that the *Lennard's* case was a civil matter, the rhetoric of Viscount Haldane has been applied in both civil and criminal litigation.¹⁸

Although the board of directors is traditionally associated with being the directing minds of a company, the inquiry with regards to attribution of will and actions remains a context-specific consideration.¹⁹ This contextual analysis has been confirmed in *Consolidated News Agencies (Pty) Ltd (in Liquidation) v Mobile Telephone Networks*

¹³ 713.

¹⁴ 713-714.

¹⁵ This method of attribution is a manifestation of the identification doctrine, which is the primary method followed in English and South African company law. V Borg-Jorgensen & K Van der Linde “Corporate criminal liability in South Africa: time for change? (part 2)” (2011) 4 TSAR 684 684.

¹⁶ In *H L Bolton* 173 it is reiterated that a company could be compared to a human body, but certain employees only fulfil an instrumental function, whereas others (such as the directors or managers) represent the directing mind and will of the company and ultimately controls its actions.

¹⁷ Ferran (2011) *Law Q Rev* 241.

¹⁸ 241.

¹⁹ Ferran (2011) *Law Q Rev* 242; *El Ajou v Dollar Holdings plc* 1994 2 All ER 684 (CA) 699 (“*El Ajou*”).

(Pty) Ltd,²⁰ which stated that the directing mind and will of the company are those persons who have the “management and control in relation to the act in point”.²¹ A corporation therefore remains an abstract or fictional being, which lacks a substantive individual identity and consequently independent corporate fault.²²

2 1 The realist approach as alternative mode of attribution

Juxtaposed to the individualistic approach, is the realist approach, which was originally developed by Von Gierke.²³ This theory regards the company to have an existence in its own right, therefore it has a mind of its own.²⁴ Especially in terms of criminal corporate liability, this approach has been benchmarked to be in accordance with intricate corporate structures.

The following characteristics of the realist theory are accordingly discussed. Firstly, in terms of realist theory a company is regarded as a separate corporate entity and not an artificial embodiment of various individuals.²⁵ A company is therefore awarded a unique legal (and possibly moral) existence.²⁶ Affirmation of the unique attributes of a juristic person is found in the promotion of corporate entities of themselves as distinct with individualistic features,²⁷ distinguishing them in society from the humans associated with them.²⁸ Secondly, fault should be founded on the corporate culture within the company and not pinned on a single individual's thoughts. Bearing in mind the intricate organisational structures within companies, it might be more rational to follow a holistic approach to corporate criminal liability.²⁹

²⁰ 2010 3 SA 382 (SCA) paras 29, 31.

²¹ Para 10 citing *El Ajou* 696.

²² V Borg-Jorgensen & K Van der Linde “Corporate criminal liability in South Africa: time for change? (Part 1)” (2011) 3 TSAR 452 453.

²³ SJ Naudé *Die reg sposisie van die maatskappydirekteur, met besondere verwysing na die interne maatskappyverband* (1970) 14.

²⁴ Naudé *Reg sposisie van die maatskappydirekteur* 15.

²⁵ Borg-Jorgensen & Van der Linde (2011) TSAR 454.

²⁶ PG du Toit & GJ Pienaar “Korporatiewe identiteit as grondslag van die strafregtelike aanspreeklikheid van regspersone (1): teoretiese grondbeginsels” (2011) 14 PELJ 33 33; G Kemp, S Walker, R Palmer, D Baqwa, C Gevers, B Leslie & A Steynberg *Criminal Law in South Africa* 2 ed (2015) 215. Although a juristic person cannot perform inherently human acts, it still possesses its own legal personality, which can acquire rights and incur obligations separate from its directors or shareholders. This separate legal personality is enshrined in section 19(1)(b) of the Companies Act, as well as section 8(4) of the Constitution of the Republic of South Africa, 1996.

²⁷ B Fisse & J Braithwaite “The allocation of responsibility for corporate crime: Individualism, collectivism and accountability” (1988) 11 Syd LR 468 476.

²⁸ Borg-Jorgensen & Van der Linde (2011) TSAR 454.

²⁹ PG du Toit & GJ Pienaar “Korporatiewe identiteit as die basis van strafregtelike aanspreeklikheid van regspersone (2): die praktyk” (2011) 14 PELJ 98 98.

Corporate conduct is not merely the summation of different decisions by various individuals, but rather an intricate mosaic of differing decisions, institutional procedures and structures.³⁰ Therefore, both the conduct and fault of the company should be evaluated from the perspective of the corporate culture in its entirety, rather than focusing on the individual pieces of the puzzle. Lederman argues that the self-identity model of corporation is based on the assumption that it has a set of values and morals, which could simultaneously influence and constrain the thinking and behaviour of the people within its framework.³¹ Thus the corporate identity of a company is distinguishable from the individual's embodying it; ascertaining the fault of juristic persons should be based on this identity rather than illogical modes as vicarious liability.

2 1 1 The scope of corporate identity

The corporate identity model is firstly founded on the principle that the unique identity of a juristic person would influence its adherence to legal rules.³² The King Code of Governance for South Africa 2016 ("King IV") promotes responsible corporate citizenship and an ethical framework to promote this goal,³³ whereby the unique corporate culture is confirmed.³⁴ In determining the company's identity, reference should be made to the control and monitoring mechanisms set in place, along with the general ethos and working environment within the company. These factors could encourage the compliance with legal rules and regulations, but on the other hand negligent or capricious conduct might be promoted.³⁵ Whether adherence to the principles of King IV is sufficient to establish a law-abiding corporate environment remains uncertain; partly because the board of directors remains the focal point (and not the company *per se*) and partly due to the fact that it is regarded as soft law.

At the core of corporate identity lies the fact that a company is governed by its traditions and corporate structure, thus a change in management, or even other

³⁰ Du Toit & Pienaar (2011) *PELJ* 34.

³¹ E Lederman "Models for imposing corporate criminal liability: from adaptation and imitation toward aggregation and the search for self-identity" (2000-2001) 4 *Buff Crim L Rev* 641 686.

³² Lederman (2000-2001) *Buff Crim L Rev* 690.

³³ Principles 2 and 3 affirm the importance of an ethical corporate culture and that an organisation should be seen as a responsible corporate citizen.

³⁴ Jordaan defines corporate culture as an "attitude, policy, rule, course of conduct or practise existing within the body corporate generally or in the part of the body corporate in which the relevant activities take place"; L Jordaan "New perspectives on the criminal liability of corporate bodies" (2003) *Acta Jur* 48 64.

³⁵ Borg-Jorgensen & Van der Linde (2011) *TSAR* 697.

employees, would not bring about material changes in the structure of the company. Instead, the individuals within the company would adapt to adhere to the company's goals. Their freedom is thus inhibited by the corporate policy and customs within the company. In contrast, the company's identity remains constant.³⁶ This model is in line with the perpetuity of companies, thus their liability should not be limited to the constraints of human conduct or *mens rea*.

If a company endorses risk taking behaviour, employees' reckless conduct would be approved, either expressly or tacitly. In the absence of a culture of compliance within the company, the corporate decisions taken within the company could be immoral or illegal.³⁷ In this regard the individualistic model to corporate criminal liability hinders the accountability of a company, because a single individual's conduct cannot necessarily be imputed to the company nor identified as the directing mind of the company.³⁸ Thus a company could escape liability and bad decision-making by means of a complex organisational structure.

2.2 Law and economics

Economic considerations play a pivotal role in the development of modern company law.³⁹ Bearing in mind the importance of economic efficiency, it should be examined whether or not the rules of attribution are efficient in assigning risk and potential liability to the company.

In the relationship between the company and the shareholders or the directors, the company would be the principal and the latter act as the agents of the company.⁴⁰ The problem that arises with this relationship, is the fact that directors often act in their own interest instead of furthering the interests of the company. This phenomenon is described as the agency problem.⁴¹ Jensen and Meckling, however, argue that given reasonably efficient markets and economically rational individuals, the possibility of agency costs will be anticipated by the various parties and reflected in the prices of

³⁶ Lederman (2000-2001) *Buff Crim L Rev* 691.

³⁷ C Parker "Compliance professionalism and regulatory community: the Australian trade practices regime" (1999) 26 *J Law & Soc* 215 227.

³⁸ Jordaan (2003) *Acta Jur* 58.

³⁹ KJ Hopt "Comparative company law" in M Reimann & R Zimmermann (eds) *The Oxford Handbook of Comparative Law* (2006) 1161 1184.

⁴⁰ Cassim "Legal Concept" in *Contemporary* 52.

⁴¹ R Watson & M Ezzamel "Financial structure and corporate governance" in K Keasey, S Thompson & M Wright (eds) *Corporate Governance* (2005) 54; BR Cheffins *Company Law: Theory, Structure and Operation* (1997) 45.

securities.⁴² Furthermore the underlying managerial contracts will also be altered to reflect a change in managerial behaviour to absorb the potential risk the agency problem poses.⁴³ It has been argued that shareholders face adverse agency costs if the managers are not properly monitored and held accountable.⁴⁴

Coase theorised the company as a “nexus of contracts”⁴⁵ – a construction that has been criticised as being too narrow.⁴⁶ To diminish a company to a mere vehicle which minimises transaction costs creates a fiction that is inconsistent with the social reality.⁴⁷ It also negates the moral responsibilities of companies, because there is no need to ascribe moral consciousness to such an artificial construct.⁴⁸ However, this corporate consciousness is necessary to ensure compliance with regulation. It is vital to rethink the nature of the firm, because the possible negative externalities it holds for groups other than shareholders would instead warrant a construction of the company as a social institution with a wider stakeholder impact.

2.3 Corporate criminal liability

Section 332 of the Criminal Procedure Act 51 of 1977 (“CPA”) provides a comprehensive framework designed to ensure criminal prosecution of corporations.⁴⁹ In South African law a company is held criminally liable on a derivative basis by way of vicarious liability.⁵⁰

However, vicarious liability in this context differs from delictual liability in the sense that the corporate entity is still deemed to have fault, whereas the employer’s fault is usually not relevant under true vicarious liability.⁵¹ This model of attribution is an

⁴² Jensen & Meckling (1976) *JFE* 345. Agency costs are the summation of costs incurred to monitor that a company is managed in the shareholder’s best interests, hence they include monitoring costs, bonding costs and residual costs.

⁴³ Watson & Ezzamel “Financial structure and corporate governance” in *Corporate Governance* 45.

⁴⁴ 46.

⁴⁵ R Coase “The nature of the firm” (1937) 4 *Economica* 386; EF Fama “Agency problems and the theory of the firm” (1980) 88 *J Pol Econ* 288. This model entails that a firm should be regarded as a platform where various parties to the company agree to the terms by which they supply the firm’s inputs and receive remuneration accordingly.

⁴⁶ Watson & Ezzamel “Financial structure and corporate governance” in *Corporate Governance* 47; J Kay & A Silberston “Corporate Governance” (1995) *NIER* 84 88.

⁴⁷ J Parkinson “Models of the Company and the Employment Relationship” (2003) 41 *BJR* 481 489.

⁴⁸ Parkinson (2003) *BJR* 490.

⁴⁹ *S v Coetze* 1997 3 SA 527 (CC) para 18.

⁵⁰ C Van der Bijl “Corporate ‘assault’: bullying and the aegis of criminal law (Part 2)” (2014) 4 *TSAR* 760 760.

⁵¹ Kemp et al *Criminal Law* 218.

entrenchment of the identification or direct model, which has been criticised by various academics as a legal construct not necessarily consistent with corporate reality.⁵²

2 3 1 The aggregation dilemma

Section 332(1) of the CPA requires that a statutory or common-law offence, needs to be committed by a director or servant before a company could be held criminally liable. However, this does not mean that a prosecution or conviction of a natural person is a requisite to prosecute the juristic person. The dilemma of this requirement, is the fact that an individual's conduct might not amount to meet the necessary standard to impose criminal liability. Consequently, neither the company, nor the individual could be held liable. In terms of the principle of aggregation⁵³ the conduct of various actors is combined in order to prove the different elements of a crime and meet the standards to enforce criminal liability. This principle relates to the common purpose doctrine.⁵⁴ However, its applicability within the section 332(1) context remains uncertain.⁵⁵ It is argued that the actor responsible for the criminal conduct cannot be distinct from the person in whom the fault resides, because the unlawful act and fault are inextricably interwoven.⁵⁶ There remains uncertainty whether different mind-sets could be combined to establish negligence or a particular form of intent or even the conduct of different individuals.⁵⁷

Originally corporate criminal liability is founded on a derivative basis, by way of the doctrine of identification, in other words the directing minds doctrine. Vicarious criminal liability only supplements the general approach with regard to certain offences.

2 4 Concluding remarks

Although the directing minds doctrine, as developed in the *Lennard's* case, is considered to be the traditional method of attribution, it is necessary to question its

⁵² Du Toit & Pienaar (2011) *PELJ* 98; Van der Bijl (2014) *TSAR* 761; Borg-Jorgensen & Van der Linde (2011) *TSAR* 453, Jordaan (2003) *Acta Jur* 49.

⁵³ E Emeseh "Corporate responsibility for crimes – thinking outside the box" (2005) 1 *U Botswana LJ* 28 46. This principle (or doctrine) of aggregation therefore retracts from the notion of focusing on one individual whose conduct and will can be attributed to the company for purposes of liability.

⁵⁴ The common purpose doctrine seeks to impute the conduct of one member of a group to the other members of a group, provided that there is a shared intention among the members of the group. The requirements for the application of the doctrine was originally set out in *S v Safatsa* 1988 SA 1 868 (A) and confirmed in *S v Mgedezi* 1989 1 SA 867 (A) 705I – 706C.

⁵⁵ Borg-Jorgensen & Van der Linde (2011) *TSAR* 463.

⁵⁶ 462.

⁵⁷ In the aftermath of *S v Suid-Afrikaanse Uitsaaikorporasie* 1991 2 SA 698 (W) this uncertainty became poignant. The court proceeded to make certain assumptions based on the evidence and facts at hand, despite that the particular individual who committed the unlawful conduct could not be identified.

relevance and efficacy in modern company law. Additionally, it should be deliberated if these rules of attribution create an economically efficient outcome or create a risk-taking environment. Therefore, its application in criminal liability of companies in both South African and English law will be considered in order to explore a prospective realignment of the *status quo*.

3 Outline of chapters

In Chapter 2 the basic legal principles pertaining to the two conflicting theories of the nature of corporate personality will be discussed, as well as its influence on the attribution of corporate liability. Furthermore, Coase's theorem on the nature of the firm and what the "nexus of contracts" entails will be discussed. Following the notion of contractarian thinking, an alternative model focussing on function rather than the nature of corporate personality will be explored.

Chapter 3 will continue to explore the rules of attribution with reference to *Meridian Global Funds Management Asia Ltd v Securities Commission*,⁵⁸ as well as the development of the directing minds doctrine. The dichotomy between the rules of attribution and the rules of agency will be analysed, including the uncertainty regarding the application of the rules in complex modern corporate structures.

In Chapter 4, the dilemma of corporate criminal liability will be discussed, for it is in this field of law that the greatest doubt about the use of the directing minds doctrine has been raised.⁵⁹ The critique against South Africa's model for corporate criminal liability has long since been criticised as being unrealistic.⁶⁰ Therefore the English realist model found in the Corporate Manslaughter and Corporate Homicide Act will be examined, as well as its success in practice as an alternative model for South Africa. The Australian Criminal Code is regarded as the blueprint for incorporating corporate culture into corporate criminal liability, which will be explored as a basis for an alternative regulatory framework. Lastly, the influence of the deterrence theory in the efficacy of corporate criminal punishment will be discussed.

⁵⁸ 1995 2 AC 500 (PC).

⁵⁹ Naudé *Reg sposisie van die maatskappydirekteur* 14.

⁵⁹ 15.

⁵⁹ Borg-Jorgensen & Van der Linde (2011) *TSAR* 454.

⁵⁹ JM Burchell *Principles of Criminal Law* 5 ed (2016) 461.

⁶⁰ Burchell *Principles* (2016) 461.

Chapter 5 will explore corporate liability from a law and economics perspective. Building on Coase's theorem and the nature of the firm, the focus of this chapter will firstly be the agency problem, as discussed by academic authors such as Jensen, Meckling, Fama, Alchian and Demsetz. Moreover, the behaviour of directors will be examined and the influence of the agency problem on risk aversion and criminal liability.

Based on these theories, it will be evaluated whether an overarching model for ascribing liability to companies could be developed, especially with regards to the will and mind of the company. However, an anthropomorphic approach to companies has also been criticised and one should bear in mind that the company remains an artificial creature of statute.

4 Research question and research aims

The research question addressed in this thesis is to determine whether the current models of attribution are efficient in establishing corporate liability. Traditionally, the theories of corporate personhood have dictated whether corporate liability should be imposed or not. The purpose is to explore these theories and their influence (or hindrance) in establishing corporate liability, as well as the possibility of alternative models of attribution. Especially in the realm of corporate criminal liability, the need arises to hold companies accountable for corporate wrongdoing. In light of the criticism raised against the identification model, the status quo of corporate criminal liability in South Africa is compared to the organisational theory as an alternative model, with specific reference to the models followed in English and Australian law. Lastly, the economic justification for the current model of attribution will be explored with reference to the agency problem.

Economic analysis and company law are inextricably linked.⁶¹ It is presumed that the agency problem inhibits economic efficiency and creates inefficient risks. In addition to corporate criminal liability theory, the agency problem will be discussed, by way of analysis of the underlying incentives for directors to act in their self-interest instead of promoting company's interests, as well as efficacy of the safeguards, for example corporate governance and personal liability of directors.

⁶¹ Hopt "Comparative Company Law" in *Comparative Law 1184*.

The traditional approach to attributing both will and conduct to a company is the direct method or directing minds doctrine. Juxtaposed to this model, is the realist model. The assumption is made that companies have a unique corporate culture, which forms the basis of the realist model and that the directing minds doctrine does not sufficiently address various relationships / liability whether internal or external in a company. The directing minds doctrine is furthermore not suitable for purposes of ascribing corporate criminal liability, especially in terms of determining fault and conduct. Based on the analogies in English and Australian law, the possibility of a single legal framework to attribute conduct and will to a company in light of the realist theory will be examined in South African law.

5 Methodology

As a point of departure, the directing minds doctrine will be analysed in the South African context, with reference to its origin in common law. This will be done by studying primary sources (specifically case law) and secondary sources (academic journals and text books in particular).

Due to South African company law's origin in English law, these two jurisdictions will be compared with one another. However, this will not be an all-encompassing comparative study, but merely an allusion to the similarities between the application of the attribution rules, as well as the difference in application between the systems.⁶² English law follows a realist approach to corporate criminal liability with regards to certain statutory offences, whereas South African law focusses on vicarious liability.

Owing to the underlying agency problem in company law, especially in terms of director's incentives, an economic analysis of the law will also be followed. The question arises whether the current rules of attribution are sufficient in absorbing the unnecessary risk that the principal-agent relationship poses for the company, in particular shareholders' interests. In this regard, academic writings of Coase, Alchian, Demsetz, Fama, Jensen, Meckling and Posner (among others) will be analysed.

Recent developments in English law to follow a realist approach for certain statutory offences,⁶³ necessitates an enquiry whether a similar approach could be followed in South African law. Reference will be made to both legislation and case law, as well as

⁶² Compare the Corporate Manslaughter and Corporate Homicide Act 2007 to s 332 of the CPA.

⁶³ Corporate Manslaughter and Corporate Homicide Act 2007; Bribery Act 2010.

academic journals. Additionally, the realist theory will be contrasted to the vicarious liability method followed under the CPA as a viable alternative. Examples from other jurisdictions, e.g. Australia, will also be alluded to in order to enhance the understanding of the realist model.

Chapter 2: Corporate personality

1 Introduction

According to Cassim the separate legal personality of a company is one of the cornerstones of company law.⁶⁴ All human beings are regarded as legal persons, meaning they have the capacity to be the bearer of rights and to incur obligations. In contrast, a juristic person is a mere legal construction, which has no physical existence.⁶⁵ In the late nineteenth century Lord Chancellor Baron Thurlow stated that corporations have “no soul to be damned, no body to kick”.⁶⁶ Due to its artificial nature, a company cannot perform acts which are inherently human, for example entering into a marriage or appearing in court in person.⁶⁷ Despite the fact that a company remains a legal construct without a physical existence, it possesses separate legal personality, whereby it can be the bearer of certain rights and incur obligations.⁶⁸

Section 19 of the Companies Act 71 of 2008 (“Companies Act”) governs the legal status of companies, which states that from the date and time that the incorporation of a company is registered, it is a juristic person with all the legal powers and capacity of an individual, except to the extent that (1) a juristic person is incapable of exercising any such power or having such capacity or (2) the company’s memorandum of incorporation provides otherwise.⁶⁹ Furthermore, the Constitution of the Republic of South Africa, 1996 (the “Constitution”) provides that a juristic person is entitled to the same protection awarded to an individual under a constitutional democracy. Section 8(4) of the Constitution specifically states that a juristic person enjoys the same

⁶⁴ R Cassim “The Legal Concept of a Company” in FHI Cassim (ed) *Contemporary Company Law* 2 ed (2012) 28-65 31.

⁶⁵ Cassim “Legal Concept” in *Contemporary* 31.

⁶⁶ Although this statement cannot be found in any reported judgments or other primary source, it has often been cited in case law, for example in *Lennard’s Carrying Co Ltd v Asiatic Petroleum Co Ltd* 1915 AC 705 HL 713 (“Lennard’s”); *Commissioner for Inland Revenue v Richmond Estates (Pty) Ltd* 1956 1 SA 602 (A) 606; *Manong & Associates (Pty) Ltd v Minister of Public Works* 2010 2 SA 167 (SCA) para 4 (“Manong”).

⁶⁷ In *Yates Investments (Pty) Ltd v Commissioner for Inland Revenue* 1956 1 SA 364 (A) the court stated that a company may only be represented in court proceedings through legal counsel acting on its behalf. However, this rule was extended to non-legal representation in *Manong* para 10, where the Supreme Court of Appeal stated that the court has a residual discretion to allow non-legal representation if it ensures the administration of justice.

⁶⁸ ML Benade “Verontagsaming van die selfstandigheid van die maatskappy-regspersoon” (1967) 30 *THRHR* 213 213.

⁶⁹ This is specifically stated in section 19(1)(b).

fundamental rights (specifically those stated in the Bill of Rights) as natural persons insofar as these rights may be exercised by a juristic person.⁷⁰

A company is a separate legal entity, distinct from the board of directors managing it or the shareholders who are seen as its owners. The limited liability flowing from separate legal personality is a fundamental principle of company law and modern-day business as a whole.⁷¹ Nevertheless, the limited liability is enjoyed by the shareholders and not the company, which will normally be held liable for its debts. It furthermore creates an incentive to invest capital into a business venture, because the risk of potential liability is minimised to the original investment, which in turn generates economic growth and employment opportunities.⁷² In *Dadoo Ltd v Krugersdorp Municipal Council*⁷³ the Appellate Division held that the separate legal personality of a company is not merely an artificial or technical concept, but a “matter of substance”.⁷⁴

When the separate legal personality of a company is established, the purpose thereof should be borne in mind, for the specific juridical origin and aetiology should not be mistaken for a self-generated abstraction. Thus, a purposive approach to separate legal personality is necessary.⁷⁵ If a jurist is confronted with the question if a

⁷⁰ Although a juristic person has a right to be treated equally to other persons and may sue for defamation, as found in *Dhlomo v Natal Newspapers (Pty) Ltd* 1989 1 SA 945 (A); *Caxton Ltd v Reeva Forman (Pty) Ltd* 1990 3 SA 547 (A); and *Financial Mail (Pty) Ltd v Sage Holdings Ltd* 1993 2 SA 451 (A) (“*Financial Mail*”) respectively, this right is not on par with the personal nature of an individual’s claim. A juristic person may protect its right to privacy, which was held in *Financial Mail* 462; *Investigating Directorate: Serious Economic Offences v Hyundai Motor Distributors (Pty) Ltd; In re Hyundai Motor Distributors (Pty) Ltd v Smit NO* 2001 1 SA 545 (CC) para 17 (“*Hyundai*”); *Platinum Asset Management (Pty) Ltd v Financial Services Board; Anglo Rand Capital House (Pty) Ltd v Financial Services Board* 2006 4 SA 73 (W) 106-7. However, in *Hyundai* para 18, the Constitutional Court reiterated that the context within which these rights operate, may differ and should not be equated to one another, for privacy as a right “becomes more intense the closer it moves to the intimate personal sphere of the life of human beings”. The underlying rationale for this reasoning is found in the principle that juristic persons are not bearers of human dignity, which is the underlying value protected by the right to privacy. Therefore the extent to which a natural or juristic person might enjoy a fundamental right, might differ. Cassim “Legal Concept” in *Contemporary* 32.

⁷¹ In *Salomon v Salomon & Co Ltd* 1897 AC 22 (HL) (“*Salomon*”) the separate legal personality of a company was established as a fundamental principle in company law. As a general rule, the shareholders of a company can therefore not be held liable for the debts and liabilities of the company, even if the company could be seen as the *alter ego* of the sole shareholder. In the absence of gross abuse of the separate juristic personality, the company remains a legal person in its own right. In describing the legal principle, Lord Macnaghten (50-51) stated the following: “The company is at law a different person altogether from the subscribers to the memorandum; and, though it may be that after incorporation the business is precisely the same as it was before, and the same persons are managers, and the same hands receive the profits, the company is not in law the agent of the subscribers or a trustee for them.” Cassim “Legal Concept” in *Contemporary* 33-35.

⁷² Cassim “Legal Concept” in *Contemporary* 35.

⁷³ 1920 AD 530.

⁷⁴ 550.

⁷⁵ Benade (1967) *THRHR* 215.

particular problem should be solved with sole reference to the separate *persona* of the juristic person without considering the composition thereof, the purpose of the provision should be ascertained. Benade emphasises that clarity regarding the various considerations should exist.⁷⁶ On the one hand, a jurist might regard the nature of the juristic person as a pre-requisite for further inquiry or a first stepping-stone to solve the problem.⁷⁷ Therefore, it is necessary to define the juristic person, in other words the company, properly. Otherwise a more fitting approach, as Benade proposes, might be to accept the existence of a juristic person as a matter of fact and merely evaluate the purpose of the particular rules or provisions in question.⁷⁸ In this sense the confusion regarding the nature of the corporation is eliminated and a more functional approach is followed, whereby the efficacy of the rules is examined. If the need for defining the nature of a corporation is ignored, the dilemma of finding a suitable theory is eliminated.

Determining the nature of corporate personality has been the concern of many academic writers, especially in the realm of corporate criminal liability.⁷⁹ Two opposing theories seem to dominate the debate regarding the true nature of corporate personality. A company is often described as a “metaphysical entity”, which is a clear rhetoric of the organic theory. In contrast, the traditional fiction theorists will steer clear of attributing human qualities to artificial beings.⁸⁰ Neither the organic theory nor the fiction theory can be seen as the correct approach to corporate personality, for a simple question such as “what is a corporation?” leads to many complexities. Therefore, in order to understand the need to hold company’s criminally liable, these opposing theories should be explored.

1.1 Confronting the question of “what is a corporation?”

Foster states that it is necessary to address the fundamental issue, or as he calls it, the “semantic question” when exploring corporate theory. This question can either be expressed by asking “What is the corporation?” or by rephrasing it to enquire what is meant by using the word “corporation”.⁸¹ According to Hart, our approach to defining

⁷⁶ Benade (1967) *THRHR* 215.

⁷⁷ (1967) *THRHR* 220.

⁷⁸ 215.

⁷⁹ L Jordaan “New perspectives on the criminal liability of corporate bodies” (2003) *Acta Jur* 48 63.

⁸⁰ MS Blackman *The fiduciary doctrine and its application to directors of companies* LLD Thesis University of Cape Town (1970) 8.

⁸¹ NHD Foster “Perception, Language and “Reality” in Corporate Law Theory” (2006) 17 *KCLJ* 299 299.

what corporate personality entails leads to an anomalous situation.⁸² He argues that the common mode of definition is not suited for legal analysis and often complicates the exposition.⁸³ The request for definitions in analytical jurisprudence has led to a divorce between jurisprudence and the study of law; based on the notion that certain fundamental principles cannot be explained without referring to a philosophical argument. However, Hart suggests that legal notions can be interpreted by methods which are adapted to their special character.⁸⁴

The semantic question at hand has great ambiguity, for it could demand a definition, a purpose, justification or the origin of the legal institution.⁸⁵ In order to free this question from its risk of confusion, Hart states that it should be rephrased to clarify the need for a definition.⁸⁶ Instead of asking what a corporation is, the request should be phrased as "What is the meaning of the word 'corporation'?".⁸⁷ Hart rephrases the statement that a company is a separate entity from its aggregate of members to: "The name of a limited company is used in conclusions of law which apply legal rules in special circumstances in a manner distinct from though analogous to those in which such rules are applied to individuals apart from such circumstances."⁸⁸ Hart states that this restatement shows that companies are not fictitious or anomalous entities, but as new use of legal rules emerges, as well as the expressions involved in the use of these rules, though it might be analogous, it is still different.⁸⁹

⁸² HLA Hart "Definition and Theory in Jurisprudence" (1954) 70 *Law Q Rev* 37 38.

⁸³ Hart (1954) *Law Q Rev* 37.

⁸⁴ 37.

⁸⁵ 37.

⁸⁶ Hart states that the approach to the definition is wrong, for the search for the definition of certain fundamental legal notions have led to theories of juristic thought which are often irreconcilable. Hart (1954) *Law Q Rev* 37; 39.

⁸⁷ The reason for the anomalous interpretation of "What is a corporation?" is that the common use of the words are known, but the meaning in a legal context differs from that of most ordinary words. Moreover, in defining what the word "corporation" means, a clear connection to ordinary words and their factual meaning seems to fade. In other words, one could say that words fail to give meaning to the question of what a corporation is or should be. Although a corresponding relationship between these legal words and other definite attributes, such as kinds of persons, things, qualities and material or psychological processes are identified, they are not a precise equivalent, but a mere connection to the legal word. Hart uses the example of describing a corporation as something which is not an aggregate of persons. The notion that fundamental corporate theory is based on the definition of a corporation leads unnecessary complexity. The triad of theories known as the fiction, realist and concession theory contradict each other, but provide no clearer indication of what is understood by a corporation. Hart (1954) *Law Q Rev* 38-41.

⁸⁸ 53.

⁸⁹ 53.

The traditional theories of corporate personality fail to accurately describe the meaning of expressions associated with or used for corporate bodies. Despite a mutual hostility among the traditional theories, it is assumed that these expressions should describe something or embody a particular meaning.⁹⁰ Separate and incompatible accounts of its peculiarity are then given as a complex, recondite or fictitious entity. The peculiarity, however, lies in the “distinctive characteristics of expressions used in the enunciation and application of rules”.⁹¹

Although the extent of legal rules and thus the scope of corporate legal personality is of importance, it is the moral existence of corporate entities that often perplexes most.⁹² Instead of over-stating the semantic question, “What is a corporation?” Hart enquires under what circumstances the law should ascribe liabilities on companies.⁹³ This might clarify which factors judges consider when legal rules imposed on individuals are extended to corporate entities, for example criminal liability for crimes involving a particular intent or knowledge on the part of the wrongdoer.⁹⁴ The predominant analogy used to extend liability to corporate bodies, is that of an individual held liable for the conduct of her servant during the course of employment, in other words vicarious liability. According to Hart, this analogy of vicarious liability was used to extend the liability of companies from contract to ordinary torts and ultimately to torts involving malice.⁹⁵ In English law the vicarious liability model has not been used to govern corporate criminal liability. In contrast, section 332 of the Criminal Procedure Act 51 of 1977 creates a comprehensive legislative framework which governs corporate criminal liability in South Africa based on the vicarious liability analogy.⁹⁶

Hart criticises the vicarious liability analogy as a means to impose criminal liability on companies, especially for crimes involving knowledge and intention, this analogy is “useless”.⁹⁷ In the development of corporate criminal liability in English law, judges have sought an alternative option: the conduct and mental states of those substantially

⁹⁰ Hart (1954) *Law Q Rev* 55.

⁹¹ 55.

⁹² 55.

⁹³ 56.

⁹⁴ 56-57.

⁹⁵ Therefore the law of principal and agent has been developed to incorporate limited companies. Hart (1954) *Law Q Rev* 57.

⁹⁶ The South African position regarding delicts, however, is not necessarily derived from the vicarious liability analogy, but focuses on the identification doctrine of the directing mind and will.

⁹⁷ Hart (1954) *Law Q Rev* 57.

carrying on the work of the company can be imputed to it. The crux of the alternative source of analogy, is the question if a company “can” be held liable for crimes requiring a particular *mens rea*. However, the corporate criminal liability has often been overshadowed by the question of what a company is. Often the semantic question has been seen as an instrumental inquiry to deduce if corporate criminal liability should be imposed. Courts have reverted to statements such as “A company is a mere abstraction, a fiction, a metaphysical entity” or “A company has no mind and therefore cannot intend”.⁹⁸ To a certain extent, the debate regarding the nature of the firm has safeguarded the company from criminal prosecution. Moreover, these statements seem to be eternal *dicta* on the nature of corporations given by using definitions and they suggest that any legal statements regarding corporations must be in line with its “nature”, otherwise it is logically inconsistent.⁹⁹ Hart suggests that something greater than the analogies used to impose corporate rights and duties, which have originally been granted to individuals limits or restricts its application. Both the fiction and realist theories pose irrelevant barriers which could inhibit the application of corporate rights and duties.¹⁰⁰

1 2 The corporation as an organisational structure

Hansmann and Kraakman explain that a corporation has five core structural characteristics, namely: (1) legal personality, (2) limited liability, (3) transferable shares, (4) delegated management under a board structure, and (5) shared ownership by the contributors of capital (typically the shareholders).¹⁰¹ The combination of these characteristics is highly complementary, for they provide an optimal organizational structure for production.¹⁰² At the same time, these characteristics could create

⁹⁸ Hart (1954) *Law Q Rev* 57.

⁹⁹ 57.

¹⁰⁰ In a strict application the fiction theory holds that a company cannot be found guilty of a crime, for it has no mind or conscience. According to the realist theory a company cannot be bound by an agreement which empowers another company to direct its business and employ personnel, because it would negate the company to a tool and disregard its real will.

¹⁰¹ J Armour, H Hansmann, RR Kraakman & M Pargendler “What is Corporate Law” in J Armour, RR Kraakman, P Davies, L Enriques, H Hansmann, G Hertig, KJ Hopt, H Kanda, M Pargendler, W-R Ringe & EB Rock (eds) *The Anatomy of Corporate Law: A Comparative and Functional Approach* 3 ed (2017) 1-28 1;5.

¹⁰² These characteristics are not necessarily commonplace in all corporate structures. Certain corporate legislation might be more flexible and firms could opt-out of the structure to address specific needs, for example non-profit companies or personal liability companies. Armour et al “Corporate Law” in *Anatomy* 1;5.

tensions and trade-offs which contribute to the agency problems which corporate law seeks to address.¹⁰³

Ultimately, a pluralist approach to the foundation of a corporation offers a more efficient outcome whereby social welfare is maximised. The interests of shareholders are the predominant interest in most systems of company law, however, shareholder primacy has been criticised and the following suggestions have been made: (1) to redistribute the risks and benefits of business activities among those involved in the enterprise; (2) to ensure a reduction in the harmful impacts on the environment and society as a result of company behaviour; (3) a broadening of participation in corporate decision-making to incorporate democratic principles; and (4) greater accountability.¹⁰⁴ Recognising a wider range of interests, or promoting the so-called stakeholder theory, is based on the premise of efficient wealth creation.¹⁰⁵ According to Kelly and Parkinson, the current corporate governance structure seeks to solely promote the interests of the shareholders and to manage the appointment of the board.¹⁰⁶ In addition, it tries to ensure the appropriate allocation of power between shareholders and the board of directors.¹⁰⁷ In the aftermath of the Enron scandal and the 2007-2008 financial crisis, however, the need to evolve corporate governance beyond the shareholder theory has emerged.¹⁰⁸

Furthermore, the normative goal of corporate law is to purportedly serve the interests of society as a whole.¹⁰⁹ Given the importance of corporate social responsibility and the shareholder-stakeholder debate, one could argue that an appropriate goal of corporate law would be to advance aggregate welfare of both the firm's shareholders and other stakeholders, such as its employees, creditors,

¹⁰³ Ownership and management of assets are separated in corporations, therefore management could abuse its fiduciary position. In order to ensure that management act in the interest of shareholders in an honest manner, agency costs arise. Foster (2006) *KCLJ* 302.

¹⁰⁴ G Kelly & J Parkinson "The Conceptual Foundations of the Company: a Pluralist Approach" in J Parkinson, A Gamble & G Kelly (eds) *The Political Economy of the Company* (2000) 113-139 113.

¹⁰⁵ RE Freeman & DL Reed "Stockholders and Stakeholders: A New Perspective on Corporate Governance" (1983) 25 *Cal Mgmt Rev* 88 88; T Donaldson & LE Preston "The Stakeholder Theory of the Corporation: Concepts, Evidence, and Implications" (1995) 20 *Acad Manage Rev* 65.

¹⁰⁶ Kelly & Parkinson "Conceptual Foundations" in *Political Economy* 113.

¹⁰⁷ JG Hill "The Rising Tension between Shareholder and Director Power in the Common Law World" (2010) 18 *CGIR* 344 345.

¹⁰⁸ BR Cheffins "The Corporate Governance Movement, Banks, and the Financial Crisis" (2015) 16 *Theoretical Inquiries L* 1 5; Hill (2010) *CGIR* 344.

¹⁰⁹ Armour et al "Corporate Law" in *Anatomy* 22.

customers and (possibly) the social and natural environment.¹¹⁰ If corporate law could be structured in such a way as to achieve this goal, a socially efficient outcome would be reached.

In contrast, however, the goal of corporate law could be defined more narrowly, whereby shareholder primacy is the directive.¹¹¹ The reasoning behind a restricted approach is that the pursuit of wealth maximisation would have a ripple effect which would ultimately lead to advancing social welfare.¹¹²

Whether these goals of corporate law (be it the narrow interpretation focusing on wealth maximisation or the pursuit of aggregate social welfare) is achieved, should be explored. Easterbrook and Fischel emphasise the question of what the goal(s) of corporations should be.¹¹³ Is the primary objective to make a profit or to maximise social welfare?¹¹⁴ If wealth maximisation is pursued, should the profit be long-term or short-term? The writers argue that these questions are irrelevant, for it is the contractual freedom of the original corporate investors to determine the objectives of the corporation.¹¹⁵

If the corporation deviates from its original purpose, a complaint for breach of contract will arise and not some derogation from an ideal of corporate governance.¹¹⁶ The role of corporate law is the adoption of certain default rules, which will govern the internal and external relationships, unless it is altered by the shareholders.

Normally the expectation exists that residual risk-bearers contract for a promise to maximise the long-term financial wealth of the firm, which in turn would increase their initial shareholding investment. Apart from the shareholders who receive variable returns, other participants contract for fixed pay-outs, for example salaries and interest. As opposed to the shareholders as residual risk-bearers, these other participants do not bear the risk on the margin. In their relationship with the company,

¹¹⁰ According to Armour, Hansmann, Kraakman and Pargendler, it is difficult to define the term "aggregate welfare", for it is both pecuniary and non-pecuniary in nature. Armour et al "Corporate Law" in *Anatomy* 22-23.

¹¹¹ Armour et al "Corporate Law" in *Anatomy* 23.

¹¹² If other stakeholders contract with the corporation, they will enter negotiations based on the premise that they will be better off themselves as a result. Therefore, it is in the best interest of a corporation (and ultimately the shareholders) that corporate transactions are beneficial to all parties involved. Armour et al "Corporate Law" in *Anatomy* 23.

¹¹³ FH Easterbrook & DR Fischel *The Economic Structure of Corporate Law* (1991) 35.

¹¹⁴ Easterbrook & Fischel *Economic Structure* 36.

¹¹⁵ 36.

¹¹⁶ 36.

the shareholders (or investors) should accept the structure of risk inherently built into the firm.¹¹⁷

If political society wishes to alter corporate behaviour, the choice of maximand is important.¹¹⁸ If wealth is a maximand, corporate conduct could change by imposing monetary penalties. Due to the fact that a company's wealth will decrease, managers will ultimately attempt to avoid conduct which could lead to monetary penalties. Easterbrook and Fischer illustrate this incentive scheme by way of a pollution tax: if companies are taxed based on their emissions, they will emit less in order to save costs.¹¹⁹ Simultaneously, companies will behave as if other stakeholders' interests are incorporated into company decision-making. Society, therefore, takes advantage of the wealth-maximising incentives inherent to the firm in order to change its behaviour in a cost-effective way. Although this might lead to an increase in societal wealth, Easterbrook and Fischer argue that this approach does not presuppose that political society should attempt to alter firm behaviour to account for the welfare of non-participants. They argue that it is merely a positive externality flowing from the firm's original incentive to be wealth-maximising.¹²⁰ Moreover, society has a choice to either conscript to the firm's strength and primary goal of maximising wealth by changing the prices it confronts or by changing its structure so that wealth maximisation is less likely.¹²¹

Either way, an agency problem is imminent; a manager serving two masters (shareholders on the one hand and society on the other) has been freed of both and is answerable to none.¹²² The manager is faced with a demand from both groups, but could ultimately serve the interests of only one group.¹²³ In the case of wealth maximisation the shareholders' interests will prevail, which would cause a rise in agency costs and a decrease in social welfare.

¹¹⁷ Easterbrook & Fischel *Economic Structure* 37.

¹¹⁸ 37.

¹¹⁹ Although this argument seems like an easy solution to ensure lower carbon emissions, the tax burden will ultimately be borne by consumers and not corporations.

¹²⁰ However, Easterbrook and Fischer do not address the optimal ways to deal with pollution, bribery, plant closings, and other decisions that affect people who are non-participants to the corporate contract. Easterbrook & Fischel *Economic Structure* 37-38.

¹²¹ Structural change is deemed to be less appropriate, for the negative outcomes are greater than the positive impact on society. A price change might yield a greater positive outcome than a structural one. Easterbrook & Fischel *Economic Structure* 38.

¹²² Easterbrook & Fischel *Economic Structure* 38.

¹²³ 38.

A change in incentives might be a better solution to address other stakeholders' interests. Easterbrook and Fischel argue that certain rules should be established that attach an additional cost to certain acts, for example pollution and layoffs, while managers are free to maximise the wealth of shareholders subject to social constraints.¹²⁴ According to Adam Smith's invisible hand theory, by maximising the wealth of equity holders, other constituencies will automatically be benefitted.¹²⁵ These other participants' roles should be seen as complementary rather than antagonistic.¹²⁶ Another option is to establish property rights, so that social costs are regarded as private ones by the firm.¹²⁷

2 The Theory of the Firm

In conceptualizing corporations, be it through the traditional models or alternative models, the rights and obligations assigned to corporate entities are defined more clearly.¹²⁸ Accordingly, Petrin illustrates the varying outcomes each theory (be it the traditional or the modern alternative) has on corporate rights and duties.¹²⁹

Understanding the precise legal nature of corporations has long since been a contentious issue.¹³⁰ It is not uncommon that a particular school of thought on corporate personality will criticise an opposing theory as being illogical and unrealistic, for it is not aligned with basic legal principles.¹³¹ It is held that "the juristic controversy over the nature of corporate personality is dead";¹³² however, Hart views it as an opportunity to learn the different ways of its development.¹³³ Instead of determining

¹²⁴ *Economic Structure* 38.

¹²⁵ Easterbrook & Fischel *Economic Structure* 38.

¹²⁶ According to Easterbrook and Fischel, each party to a transaction in a market economy would be better off, because a successful firm provides job security for workers and goods and services for consumers. If the consumers' demand rises, the firm's profit will also increase and in turn higher employment rates will ensue. Greater prosperity for shareholders, employees and communities are a positive externality flowing from better consumer goods and services. Moreover the increased firm wealth, could lead to better working conditions, investing in cleaner production methods and reducing pollution, for environmental concerns are often neglected in the pursuit of maximising productivity. *Economic Structure* 38-39.

¹²⁷ Easterbrook & Fischel *Economic Structure* 39.

¹²⁸ Benade (1967) *THRHR* 213; M Petrin "A Balancing Approach to Corporate Rights and Duties" in B Choudhury & M Petrin (eds) *Understanding the Company: Corporate Governance and Theory* (2017) 232-250 232.

¹²⁹ Petrin "Balancing Approach" in *Understanding the Company* 232.

¹³⁰ Benade (1967) *THRHR* 213.

¹³¹ Blackman *Fiduciary doctrine* 9.

¹³² Hart (1954) *Law Q Rev* 49.

¹³³ Hart tries to describe the difficulty in the development of corporate personality theory, by using an example of an "intelligent lawyer innocent of theories of corporate personality" who was educated in a legal system where only individuals are ascribed rights and duties and all legal theory is banned. He

the nature of the firm, the focus shifts towards the question if the particular nature is at all capable of juristic formulation and in the case where such a juristic formulation is present, what its legal significance would be.¹³⁴ These theories are characterised to determine whether or not certain rights and duties should be extended to corporate actors. Moreover, the method of ascribing these rights and duties are explored. Unlike Hart suggests, the debate regarding the legal nature of corporate personality is not dead, but remains alive.

According to Blackman, the nature of the relationship between the board of directors (or director) and the company is the foundation of ascertaining the nature of corporate personality.¹³⁵

Developing a single theory, which could account for the foundation of corporate personality seems far-fetched, however, each developed legal system seems to favour a particular school of thought.¹³⁶ In South Africa, the predominant theory seems to be the fiction theory due to its strong roots in English law.¹³⁷ Given its importance in South African law, as well as its influence on the traditional theories regarding the nature of the firm, the fiction theory should be explained. In addition, the aggregate theory, which has similar reasoning as the fiction theory, will be explored.

2 1 Fiction theory

The nature of juristic persons and whether their status within a broader legal framework could be “scientifically” explained, became a prevalent topic among legal scholars in the nineteenth century.¹³⁸ One of the predominant theories developed in this time, is the so-called fiction theory. This theory is deemed to be the most orthodox approach to the nature of corporate personality,¹³⁹ and is rooted in Roman law, where the artificial character of legal entities is emphasised.¹⁴⁰ The legal scholar, Carl

would then be introduced to a legal system (in Hart’s example the English legal system) which shows how rights and duties are imposed on certain corporate bodies in practice. According to Hart, the observer will learn that a one-person company is awarded certain rights with consequences which are partly similar and partly different from the individual comprising the one-person company. Hart (1954) *Law Q Rev* 49-50.

¹³⁴ It would seem that determining the nature of a company is judicially irrelevant when determining corporate conduct. Benade (1967) *THRHR* 216.

¹³⁵ Blackman *Fiduciary doctrine* 8.

¹³⁶ Benade (1967) *THRHR* 216.

¹³⁷ 216.

¹³⁸ M Petrin “Reconceptualising the Theory of the Firm” (2013) 118 *Penn St L Rev* 1 5; 9.

¹³⁹ Blackman *Fiduciary doctrine* 9.

¹⁴⁰ Petrin (2013) *Penn St L Rev* 5.

Friedrich von Savigny, who is regarded as the most renowned proponent of this theory, firmly believed that the juristic person is a creature of statute and can have no independent existence other than that which is created by legislation.¹⁴¹ Accordingly, in establishing the scope of legal personality, the legislative framework will be the crux of the inquiry. Being a product of law, a corporation can have no autonomous conduct apart from the acts of the individuals constituting the collective and whose acts are attributed to the corporation by way of a further fiction.¹⁴² Legal capacity (and the recognised rights and duties associated therewith) is therefore extended to juristic persons only by way of pure fiction.¹⁴³

Given the artificial nature of corporate personality, Von Savigny argued that these rights and duties are limited primarily to property.¹⁴⁴ A further consequence of the fiction theory, is the fact that a corporation cannot incur civil or criminal liability.¹⁴⁵ The underlying reasoning is that a fictional will is imputed by the law, therefore any unlawful conduct will not be sanctioned by statute, particularly in the case of crimes requiring a particular state of mind, either negligence or intent.¹⁴⁶

In both English and American corporate law, the fiction theory has been popularised in the early twentieth century.¹⁴⁷ In *Trustees of Dartmouth College v Woodward*¹⁴⁸ Chief Justice Marshall characterised a corporation as an “artificial being, invisible, intangible and existing only in contemplation of law”. Therefore, as a creature of law, a corporation could only possess those properties which its founding document conferred upon it.¹⁴⁹ The belief that incorporation should be regarded as a privilege, thus the state has the liberty to impose the necessary restrictions to regulate corporate behaviour, forms the foundation of the concession theory, which is deemed to be a derivative of the fiction theory. The view that a corporation is an “abstraction” was reiterated in *Lennard’s*, where Viscount Haldane stated the following:

¹⁴¹ Blackman *Fiduciary doctrine* 9-10.

¹⁴² 9.

¹⁴³ Petrin (2013) *Penn St L Rev* 5-6.

¹⁴⁴ FC von Savigny *System des heutigen römischen Rechts* (1840) Vol II 238-239, 314, as stated in Petrin (2013) *Penn St L Rev* 6.

¹⁴⁵ Petrin (2013) *Penn St L Rev* 6.

¹⁴⁶ Hart (1954) *Law Q Rev* 58; Blackman *Fiduciary doctrine* 12; Petrin (2013) *Penn St L Rev* 6.

¹⁴⁷ Petrin (2013) *Penn St L Rev* 5.

¹⁴⁸ 17 US (1 Wheat) 518 (1819) 636.

¹⁴⁹ Petrin (2013) *Penn St L Rev* 9.

“A corporation is an abstraction. It has no mind of its own any more than it has a body of its own; its active and directing will must consequently be sought in the person of somebody who for some purposes may be called an agent, but who is really the directing mind and will of the corporation, the very ego and centre of the personality of the corporation.”¹⁵⁰

Geldart and Maitland both opined that the fiction theory could not be seen as the point of departure in English corporate law, for they identified many company law rules which could not be aligned with the fiction theory.¹⁵¹ However, the courts differed from Geldart and Maitland’s opinion and relied on the *dicta* of the *Salomon* case. In other words, the separate existence of a company from its members was reiterated. This statement in *Salomon* was originally based on Lord Coke’s decision in the Case of *Sutton’s Hospital*¹⁵² which regarded a company as an abstract and fictional entity. Due to the fact that it is a construct of law, it cannot commit treason, nor be outlawed or excommunicated, for it has no soul.¹⁵³

The notion of a company as an abstract being, a core principle of the fiction theory, was generally accepted as the *status quo*. However, due to its unrealistic consequences, courts and legislatures developed certain exceptions to the original strict application of the fiction theory. Especially in the realm of criminal law (as well as the law of delict) the need to hold companies accountable for wrongful conduct became apparent.¹⁵⁴ In order to determine the wrongfulness of a company, a directing mind of the company had to be identified, whereby a particular director’s or high managerial officer’s will could be attributed to the company in particular circumstances. Although English law has opted for judicial development to hold companies liable in criminal law, the South African legislature imposes criminal liability for any wrongdoing by the company where its interests are furthered.¹⁵⁵ According to

¹⁵⁰ 713.

¹⁵¹ Benade (1967) *THRHR* 216-217.

¹⁵² (1612) 77 Eng Rep 960.

¹⁵³ Benade (1967) *THRHR* 217.

¹⁵⁴ 217.

¹⁵⁵ Section 332 of the Criminal Procedure Act 51 of 1977, particularly ss 1 states the particular persons whose conduct can be imputed, as well as the relevant circumstances under which corporate criminal liability arises. This provision is broader than the potential scope of the directing minds doctrine, because any employee’s conduct (or even a third party’s conduct) can be imputed to the company. Not only should the employee be acting within the scope of her employment, if the interests of the company are furthered, liability can also be imposed.

Benade, the application of the directing mind doctrine is based on the realist theory and not the fiction theory, which denies the separate existence of a company.¹⁵⁶

Benade questions whether South African company law is at all founded on philosophical legal theory about the nature of the legal person.¹⁵⁷ With reference to scholars such as Nékám, Hart, Wedderburn, and others, Benade states that the searching in the uncertain realm of metaphysics is irrelevant when dealing with concrete legal problems.¹⁵⁸ In Nékám's seminal work on corporate personality theory *The Personality Conception of the Legal Entity*,¹⁵⁹ the author argues that any entity can be awarded legal personality if the community views the entity as worthy of legal recognition. Therefore, public policy dictates whether an entity should be awarded legal personality, irrespective of its (lack of) physical existence or abstract nature. However, if human characteristics or metaphors, such as a company has no body to kick or soul to be damned is used, an abstract being can only be viewed in two ways: the entity is compared to its human equivalent and treated accordingly or it is solely a creature of statute with no separate existence apart from its abstract nature and rights granted in terms of the law. Although both views have led to different theories, namely the realist and fiction theories, the fundamental assumption of both theories is the comparison to the human being.¹⁶⁰

The need to define a corporation, company or entity as a thing, has been negated by certain legal scholars. In *Farmers' Loan & Trust Co v Pierson et al* Judge Bijur states the following:

“The concrete import of these views is that a corporation is more nearly a method than a thing, and that the law in dealing with a corporation has no need of defining it as a person or an entity, or even useful and usual collection of jural relations, each one of which must in every instance be ascertained, analysed and assigned to its appropriate place according to the circumstances of the particular case, having due regard to the purpose to be achieved. A confirmation of the accurate of this analysis of the corporate form is found in the fact that the word “corporation” has a variable, not a constant, meaning”¹⁶¹

¹⁵⁶ (1967) *THRHR* 218.

¹⁵⁷ 219.

¹⁵⁸ 221.

¹⁵⁹ A Nékám *The Personality Conception of the Legal Entity* (1938).

¹⁶⁰ Benade (1967) *THRHR* 221-222.

¹⁶¹ 222 NYS 532 1927.

With reference to the abovementioned quotation, Benade states that there are no set criteria to determine the characteristics of a juristic person. Accordingly, there can be no sound definition of a company. Instead, the distinguishing factors are governed by societal needs and can only be assessed after the fact and not predetermined criteria.¹⁶² However, by eliminating the question of “what is a corporation” it is possible to accommodate the juristic person in the legal framework, by determining the purpose of assigning certain rights or duties to a company. A shift from the rigid system of definition towards a flexible, purposive approach is made.¹⁶³

2.2 The aggregate or ‘contractualist’ theory

During the nineteenth century a competing theory was developed in England, which became more dominant in the United States during the latter half of the century. The aggregate theory stated that corporations were aggregations of the human individuals whose relationships were structured in a particular way in terms of mutual agreements. Accordingly, the rights and duties of the corporation were indirectly or derivatively those of the individuals comprising the legal entity.¹⁶⁴

In *Santa Clara County v Southern Pacific Railroad Co*¹⁶⁵ the aggregate view of the corporation was accepted as the foundation for corporate theory in the United States.¹⁶⁶ The notion of the company as an artificial entity was rejected and instead the focus shifted towards the underlying proprietary rights of the shareholders. Thus, a corporation was merely an association of individuals.¹⁶⁷

Based on policy considerations, such as fairness, regarding a company as an aggregate of individuals comprising it is more acceptable than following the realist notion of viewing a company as a separate entity.¹⁶⁸ Whether the overemphasis on the shareholders instead of the corporation itself can be aligned with basic principle of separate juristic personality of a company is unclear.

¹⁶² Benade (1967) *THRHR* 222.

¹⁶³ 223.

¹⁶⁴ Thus in order to determine the content of these rights and duties, the particular individual's rights and duties had to be defined and attributed to the corporation. Petrin (2013) *Penn St L Rev* 9.

¹⁶⁵ 118 US 394 (1886).

¹⁶⁶ SJ Padfield “Corporate Social Responsibility and Concession Theory” (2015) 6 *Wm & Mary Bus L Rev* 1 26.

¹⁶⁷ Padfield (2015) *Wm & Mary Bus L Rev* 27.

¹⁶⁸ Benade (1967) *THRHR* 224.

The premise of this theory is individualism. According to methodological individualism, only individuals act and thus only individuals are responsible. Corporate action or corporate responsibility is nothing more than the aggregate of its individual actors.¹⁶⁹ Hayek, as the proponent of methodological individualism, stated that there is no other way to understand “social phenomena”, except by relying on individual actions directed towards others and which is guided by their expected behaviour.¹⁷⁰ Deduced from Hayek’s understanding of methodological individualism, is that only individuals are “real” in a social construct, whereby social phenomena such as corporations remain abstractions which can only be observed indirectly.¹⁷¹ Therefore, when dealing with a corporations, its “realness” is reliant on the individuals’ attributes which comprise it.

Nevertheless, the notion that only individuals are real beings, whilst corporations are legal fictions is false. Certain attributes of a company are observable, for example its assets and decision-making procedures, while an individual’s personality and conscience are not. Therefore, Fisse and Braithwaite argue that individuals and companies are both abstract and real.¹⁷² They argue that methodological individualism cannot account for the “corporateness” of both corporate action and responsibility, especially in the realm of corporate crime.¹⁷³

In contrast to methodological individualism, is the theory of methodological holism based on collectivism, whereby the collective will of society is not limited to the consciousness of society’s individuals, but rather the individual is influenced by the “evolutionary social forces”.¹⁷⁴ Fisse and Braithwaite argue that neither theory, be it methodological individualism or methodological holism are persuasive, but state that corporations and individuals have a mutual influence on one another.¹⁷⁵ Moreover, a company cannot be reduced to an aggregation of individuals, but is system which consists of various expectations of how different problems should be resolved.¹⁷⁶

¹⁶⁹ B Fisse & J Braithwaite “The allocation of responsibility for corporate crime: individualism, collectivism and accountability” (1988) 11 *Syd LR* 468 475.

¹⁷⁰ FA Hayek *Individualism and the Economic Order* (1948) 6.

¹⁷¹ Fisse & Braithwaite (1988) *Syd LR* 476.

¹⁷² 476.

¹⁷³ B Fisse & J Braithwaite *Corporations, Crime and Accountability* (1993) 19.

¹⁷⁴ Fisse & Braithwaite (1988) *Syd LR* 477.

¹⁷⁵ “Institutions are constituted by individuals and individuals are socially constituted by institutions.” Fisse & Braithwaite (1988) *Syd LR* 478.

¹⁷⁶ 479.

Dodd reiterated that a company should be more than a mere aggregate of individuals.¹⁷⁷ Traditionally, the law regards a company as a separate legal entity. However, it is believed that its entity character is conferred to it by the state, which “magically produces a *e pluribus unum*”.¹⁷⁸ Even in Viscount Haldane’s rhetoric on the nature of a corporation, it is found that a company is referred to as an abstraction and a creature of statute. These idiosyncrasies of a company as a fiction have been criticised by legal scholars such as Dodd, who argue that a company should be viewed as it really is. From the nature of the company, it is more than a mere aggregate of individuals, and not merely a fiction of law. Thus, it is a real entity with an essence different from the individuals comprising it.¹⁷⁹

2 3 Modern organic theory

Due to the shortcomings found in the fiction theory, particularly in holding corporations liable for unlawful acts (either for criminal transgressions or delicts), an alternative theory of corporate personality was developed in the late nineteenth century.¹⁸⁰ The modern organic (or real entity) theory is based on the premise that legal entities are not fictions, but should be regarded as “real” beings. Otto von Gierke, one of the leading advocates of the modern organic theory, was strongly opposed to the Roman theory of the *persona ficta*, and rather opted for the old Germanic concept of the reality of the collective entity.¹⁸¹ In contrast to the fictionists, who denied the reality of collective or corporate will,¹⁸² Von Gierke argued that the “*reale Gesamtperson*” is capable of forming an independent will and conduct.¹⁸³ Maitland, who translated Von Gierke’s works into English and introduced these realist thoughts to the Anglophone world, stated the following regarding the real entity theory:¹⁸⁴

“[The corporation] is no fiction, no symbol [...] no collective name for individuals, but a living organism and a real person, with body and members and a will of its own. Itself can will, itself can act [...] It is not a fictitious person [...] It is a group-person, and its will is a group-will.”

¹⁷⁷ Petrin (2013) *Penn St L Rev* 24.

¹⁷⁸ EM Dodd “For Whom are Corporate Managers Trustees?” (1932) 45 *Harv L Rev* 1145 1160.

¹⁷⁹ Dodd (1932) *Harv L Rev* 1160.

¹⁸⁰ Petrin (2013) *Penn St L Rev* 6.

¹⁸¹ SJ Naudé *Die reg sposisie van die maatskappydirekteur met besondere verwysing na die interne maatskappyverband* (1970) 15.

¹⁸² D Gindis “From fictions and aggregates to real entities in the theory of the firm” (2009) 5 *JOIE* 25 32.

¹⁸³ Naudé *Maatskappydirekteur* 15.

¹⁸⁴ FW Maitland “The Corporation Sole” (1900) 16 *Law Q Rev* 335 335-336.

Therefore, both Maitland and Von Gierke argue that corporations are real beings capable of real volition.¹⁸⁵ The writings of these scholars are regarded as the first generation of entity theory. A second generation of entity theorists opposed the notion of a “supra-individual *geist*”.¹⁸⁶ It was argued that the corporate entity is not a rational being and could have no will.¹⁸⁷ This reasoning is similar to the premise of the orthodox fiction theory, that the proposition “A corporation is a person” is either a metaphor or legal fiction.¹⁸⁸ However, Machen elaborates further that despite corporate personality being a legal fiction, the entity itself is not.¹⁸⁹ In this sense, Machen concedes to the reality of corporate entities, but denies that the entity has personality.¹⁹⁰ While Machen’s statement that personification is a mere metaphor, it did not accommodate the view that certain autonomous powers and rights vested in corporations.¹⁹¹ Machen commented that guilt is personal, thus it is impossible for a corporate body to be associated with it. Furthermore, though rights are attributed to the company, the company is merely a vehicle to ultimately assign those rights to the humans comprising the company.¹⁹² Mark argues that Machen’s assertion is rooted in the partnership analogy, which regarded a corporation as nothing more than its corporators and their benefit.¹⁹³ Similarly to the reasoning of the partnership analogy, the proposal that personification of a company is solely a metaphor is flawed.¹⁹⁴

Many scholars have viewed corporate personality as the legal relationships which are generated by the material operations of the company.¹⁹⁵ This proposed a less anthropomorphic analysis of a corporation by looking at the corporation’s structure,

¹⁸⁵ Gindis (2009) *JOIE* 32.

¹⁸⁶ 33.

¹⁸⁷ Machen states that a corporation has no will which could be affected by threats of legal punishment, therefore a corporation cannot be a real person, if “person” is used in the ordinary sense of the word. AW Machen “Corporate Personality” (1911) 24 *Harv L Rev* 253 265.

¹⁸⁸ Machen (1911) *Harv LR* 266.

¹⁸⁹ He states that the union of the members is no fiction, as well as their cooperation to act as one person. (1911) *Harv L Rev* 266.

¹⁹⁰ GA Mark “The Personification of Business Corporation in American Law” (1987) 54 *U Chi L Rev* 1441 1473.

¹⁹¹ Mark (1987) *U Chi L Rev* 1473.

¹⁹² Machen (1911) *Harv L Rev* 265.

¹⁹³ (1987) *U Chi L Rev* 1473.

¹⁹⁴ 1473.

¹⁹⁵ 1474.

especially its management, to determine corporate will.¹⁹⁶ According to Mark, the real entity theory was legitimated and strengthened by the ascendance of management.¹⁹⁷

By virtue of the fact that a corporation is distinct from its members, it should be recognised that its mind is distinct from the minds of its members.¹⁹⁸ Practically, the mind of the company is seated at the top of the hierarchical structure, namely the board of directors and senior management.¹⁹⁹ Although the real entity theory was not as successful in common law countries as in continental jurisdictions, courts in England and Wales and the United States increasingly incorporated the theory into their judgments. In the landmark *Salomon* case, which upheld the separate legal personality and limited liability of a company as the cornerstone of corporate law, the House of Lords found the company's existence to be "real", thus rejecting the notion that it was nothing more than a myth or fiction.²⁰⁰ *Salomon* has been described as a "watershed decision" that changed the course of the way English jurists thought about a company.²⁰¹ Even in the South African context, the *Salomon* case is fundamental to the structure of company law, therefore it is imperative that the development of the modern organic theory remains relevant in the study of corporate personality.

Once it was accepted that a company was a real entity rather than a legal fiction, it was consequently asked what animated the company and how the company was controlled.²⁰² Furthermore, due to the departure from the fictional or artificial nature of a company, the modern organic theory offered the possibility to hold a company (criminally or delictually) liable for unlawful conduct.²⁰³

The modern organic theory describes the relationship between the board of directors and the general meeting as a structural one, for these two bodies are regarded as the "organs" of the company.²⁰⁴ In its relationship to the general meeting,

¹⁹⁶ Mark (1987) *U Chi L Rev* 1474.

¹⁹⁷ Freund describes the "notion of undivided control over property within a corporation" as the essential function of management in a corporation. Due to the nature of corporate relationships, the usual link between ownership and control does not exist, for the shareholder renounces control over corporate property and is freed from the responsibility of how control is exercised. In its place, one finds management. Mark (1987) *U Chi L Rev* 1474.

¹⁹⁸ HJ Laski "The Personality of Associations" (1916) 29 *Harv L Rev* 404 415.

¹⁹⁹ Mark (1987) *U Chi L Rev* 1475.

²⁰⁰ As per Lord Halsbury at 30.

²⁰¹ S Watson "How the company became an entity: a new understanding of corporate law" (2015) 2 *JBL* 120 136.

²⁰² Watson (2015) *JBL* 136.

²⁰³ Petrin (2013) *Penn St L Rev* 12.

²⁰⁴ Blackman *Fiduciary doctrine* 2.

the board functions as a federation rather than a subordinate or superior, however, the board is the primary organ of the company.²⁰⁵ If a director assumes office, she becomes part of the structure of the company, which in turn gives rise to the fiduciary duty.²⁰⁶ Therefore a director or the board is given certain powers to act on behalf of the company, because an undertaking to act has been made.²⁰⁷ According to Blackman, it is necessary that these powers are exercised for the benefit of the company. However, he argues that such reconciliation is only found if the organic theories are prevalent.²⁰⁸

The idea that a corporation is distinct from its members encourages a similar reasoning that its mind is distinct from the minds of its members.²⁰⁹ The corporate mind is normally found in the management hierarchy and not in the shareholders. Shareholders merely invested in a corporation and subscribed to the unity of a single corporate mind. Regarding the management hierarchy as the corporate mind is found on the principle of representation as a basis for all corporate action. Due to the development of large modern entities, the continuing joint control of corporate property became impossible. As a solution, the shareholder majority appointed representatives to manage the affairs of a company. The human beings in a corporation merely act as its instruments, acting in pursuit of the corporation's purpose and determining how to interpret its purpose. It has been held that a change in management structure would not necessarily effect a change in operations. Likewise, a change in shareholders would not change the entire structure of the entity.²¹⁰

Although the organic theory acknowledges the "real" existence of a company by likening it to a living organism, it does not adequately address the dilemma that a company cannot act by itself.²¹¹ The acts of certain high-ranking individuals within the company were attributed to the company, which resulted therein that corporate criminal liability could be imposed. Nevertheless, because a legal entity could only act

²⁰⁵ RC Beuthin "The Range of a Company's Interests" (1969) 86 SALJ 155 156.

²⁰⁶ Blackman criticised this approach, stating that the duty should flow from the office as opposed to because of it.

²⁰⁷ Blackman *Fiduciary doctrine* 3.

²⁰⁸ Although if the organic theory is to be rejected, Blackman argues that directors could still be held liable as representatives or agents (following a broad interpretation), whereby the problem as to the exact nature of representation could be avoided. *Fiduciary doctrine* 3-4.

²⁰⁹ Mark (1987) *U Chi L Rev* 1475.

²¹⁰ 1475.

²¹¹ Petrin (2013) *Penn St L Rev* 7.

through its organs, it solely relied on the unlawful conduct of said organs. As a result, the conduct of lower-level employees was insufficient to ascribe corporate criminal liability, because they were not considered to be organs.²¹² Due to the importance of the seniority of the person committing the offence, the real entity theory was still an inefficient model of corporate personality to impose corporate criminal liability.

3 From nature to function

According to Petrin the century old theories relating to the nature of the firm still pervade important areas of contemporary company law.²¹³ Moreover, a renaissance in the traditional theories suggest that the principles, specifically of the real entity theory, are well suited to address contemporary legal problems.²¹⁴

However, the trichotomy of the reality-fiction-aggregate debate in both civil and common law jurisdictions, has led to some scholars arguing for a different theoretical approach.²¹⁵ It is argued that the traditional theories of the firm should incorporate the economic aspects and functions of legal entities, instead of focusing solely on the nature of the firm. Therefore, the debate surrounding the nature of the firm was partly silenced by a functional approach to corporate entity theory in the 1970s.²¹⁶ The most notable theory to emerge from this period is the nexus of contracts theory of corporations, which was originally theorised by Ronald Coase in his seminal work *The Nature of the Firm*.²¹⁷ Jensen and Meckling further developed the image of a firm as a nexus of contracts.²¹⁸ The nexus of contracts theory states that a firm is an economic entity, which serves as a single contracting party that coordinates the activities of suppliers of inputs and the consumers of products and services.²¹⁹ Although the nexus of contracts theory is regarded as a step towards a functional approach in corporate law theory, it still shows elements of both the traditional fiction and aggregate theories.²²⁰ The remnants of the traditional theories are evident in the references to a firm as a construct of explicit and implicit contracts between its constituencies, as well

²¹² Petrin (2013) *Penn St L Rev* 8.

²¹³ 32.

²¹⁴ Petrin (2013) *Penn St L Rev* 15; Gindis (2009) *JOIE* 27.

²¹⁵ Petrin (2013) *Penn St L Rev* 33.

²¹⁶ 33.

²¹⁷ RH Coase "The Nature of the Firm" (1937) 4 *Economica* 386.

²¹⁸ M Jensen & W Meckling "Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure" (1976) 3 *JFE* 305.

²¹⁹ Armour et al "Corporate Law" in *Anatomy* 6.

²²⁰ Petrin (2013) *Penn St L Rev* 34.

as its portrayal as an aggregate of various inputs producing goods and services collectively.²²¹ Furthermore, the view of a legal entity as a fiction is centralised by this theory, for the fiction is the nexus, which is at the core of the interwoven explicit and implicit contracts.²²²

Petrin argues that the modern theories of the firm focus exclusively on corporate governance issues which arise between shareholders and directors.²²³ These theories assume that non-corporate laws will govern corporate responsibility with other stakeholder groups, for example employees, creditors and the environment. Accordingly, these modern theories, particularly the nexus of contracts, fall silent regarding to corporations' rights and duties.²²⁴ However, the nexus of contracts does voice an alternative to the general silence with regards to the beneficiaries of corporate activities. Shareholders are regarded as the primary beneficiaries of the corporation and directors' (and managers') prerogative should be to maximise shareholders' wealth, unless they are given a different directive from shareholders. The contractarians advance the shareholder primacy model, whereby other stakeholders' interests are disregarded. Moreover, corporate social responsibility and other moral duties are often denied by contractarians, due to the fictional nature of the firm which precludes any such obligations.²²⁵ However, if defined rights and duties were attributed to legal entities in terms of the nexus of contracts model, it would be unsustainable. The reason being, that the nexus itself is nothing more than the web of interconnected individuals based on their contractual relationships and any additional rights or liabilities cannot be imposed on the nexus.²²⁶ Any rights and duties are borne by the individuals or constituencies who form part of the nexus, which reiterates the contractarian model's reliance on the traditional fiction and aggregate theory.²²⁷

²²¹ SM Bainbridge *The New Corporate Governance in Theory and Practice* (2008) 28; Easterbrook & Fischel *Economic Structure* 12.

²²² Petrin (2013) *Penn St L Rev* 34.

²²³ 35-36.

²²⁴ It has been held that the orthodox corporate theories have little to say about the corporation itself and even less about its supposed responsibility, as stated by L Johnson "Law and Legal Theory in the History of Corporate Responsibility: Corporate Personhood" (2012) 35 *Seattle UL Rev* 1135 1163.

²²⁵ Petrin (2013) *Penn St L Rev* 39.

²²⁶ 41.

²²⁷ 41.

The problem with the nexus of contracts theory is that it disregards the complexities of a company. The contract is reduced to nothing more than a sophisticated contract, which is “descriptively inaccurate and intellectually incoherent.”²²⁸

3 1 Theoretical influence on corporate rights and duties

Although South African company law is deeply rooted in English law, the influence of the United States should not be undermined.²²⁹ With regards to the development of the theory of corporate personality, adherence should be given to the Anglo-American view of the corporate entity.

The traditional theories of corporate law, namely the fiction, aggregate and reality theory, have a strong hold on modern day corporate law.²³⁰ In the realm of constitutional law, the United States Supreme Court has in various cases held, that a corporation was akin to a real person and should therefore be warranted certain constitutional rights.²³¹ Recently in *Citizens United v Federal Election Commission*,²³² (“Citizens United”) the Supreme Court opted to strike down the legislative provisions relating to corporate election contributions based on the modern organic and aggregate theories. It was held that a corporation is also entitled to political speech rights, stating that a corporation could be regarded as an association of individuals, thus emphasising that a corporation is akin to an individual in this regard.²³³ In *Burwell v Hobby Lobby Stores Inc*²³⁴ the scope of a corporation’s religious rights had to be determined. Following a similar reasoning to *Citizens United*, the Supreme Court reiterated that corporations are legal fictions, for it is merely an organisational form used by individuals to achieve a desired purpose. Therefore, the purpose of imposing constitutional rights on a corporation is to protect the individuals comprising it.²³⁵ This

²²⁸ MA Eisenberg “The Conception that the Corporation is a Nexus of Contracts, and the Dual Nature of the Firm” (1999) 24 *J Corp L* 819 836.

²²⁹ Benade (1967) *THRHR* 213.

²³⁰ Petrin (2013) *Penn St L Rev* 32.

²³¹ These rights would include the right of commercial speech, protection against unreasonable searches and seizures and freedom of the press. Petrin (2013) *Penn St L Rev* 18.

²³² 558 US 310 2010.

²³³ The dissent (held by Stevens J), however, opted to invoke the orthodox fiction theory, stating that a corporation is nothing more than an artificial being, lacking a conscience, beliefs, thoughts, desires and feelings. This rhetoric seems similar to Lord Thurlow’s observation that a company “has no soul to be damned and no body to be kicked”. Petrin (2013) *Penn St L Rev* 18.

²³⁴ 134 S Ct 2751 2014 (“*Hobby Lobby*”).

²³⁵ *Hobby Lobby* 2768.

reasoning, however, seems fundamentally flawed, for it disregards one of the principles of company law, namely separate legal personality and limited liability.

Petrin argues that the need for corporate social responsibility is based on the real entity theory.²³⁶ This notion that the fiction theory is incapable of advocating corporate social responsibility originated in the scholar Merrick Dodd's writings.²³⁷ In order to address the disparities in the shareholder primacy model, directors or managers could depart from maximising shareholder wealth and pursue a broader societal interest. Although this idea seems to be in conflict with the original nexus of contracts theory, England has sought legislative reform to incorporate a broader stakeholder approach. The Companies Act 2006 includes a statutory duty of directors to also promote the success of the company. This includes an obligation to have due regard for the impact of the company's activities on employees, the local community and the environment.²³⁸ Although this is an innovative legislative step, the application of these broader fiduciary duties seems to be unclear.

3.2 Contemplating a balancing approach?

Due to the inconsistent application of the fiction-aggregate-reality trichotomy, as well as the inefficiency of the modern approach, Petrin envisages a novel functional approach to corporate personality.²³⁹ The traditional approaches have often led to a debate about nothing, for the nature of the firm cannot be thoroughly explained in any theory. Therefore, the question "what is a corporation," has proven to be one of endless discussion and little certainty. Although legislators, courts and academics seem to use this question as point of departure, the outcome is often inconsistent. The underlying values and policies of these traditional theories are regarded as arbitrary.²⁴⁰

A new approach to conceptualising a firm is proposed; a balanced or functional approach which focuses on the function of a firm instead of its nature. It is argued that this approach is more flexible and suitable to determine corporate rights and duties than the traditional theories.

²³⁶ Petrin (2013) *Penn St L Rev* 23.

²³⁷ Dodd (1932) *Harv L Rev* 1146.

²³⁸ S 172 Companies Act 2006.

²³⁹ Petrin (2013) *Penn St L Rev* 42.

²⁴⁰ 42.

As a point of departure, the approach is still rooted in economic considerations, however, a broader social view is incorporated. Moreover, how the theory of the firm developed should not be exclusively applied in corporate law.²⁴¹ Determining the rights and duties of a legal entity in relation to external parties should not be dictated by the “real” or “fictional” nature of the firm, nor the internal contractual relationship (as described by the nexus of contracts), instead the focus of the inquiry should be the broader economic and social function, purpose, and effects of the corporation.²⁴² The functional approach is partially found in the realm of legal pragmatism or realism, for the scholar John Dewey advocated that a legal entity should be defined in terms of its consequences and the notion that it is a “right-and-duty-bearing-unit” constructed by law.²⁴³ The “law”, however, does not determine rights and duties in isolation and as a result, the functional approach goes further to identify specific elements and considerations used to conceptualise the firm. In conceptualising the firm, the functional approach requires a two-stage inquiry: firstly, the economic function and secondly the social function of a firm needs to be determined.²⁴⁴

3.2.1 Economic aspects

In terms of the economic function of a firm, it is firstly an asset partitioning function,²⁴⁵ for the assets of the firm are separate from those of its shareholders and creditors. Secondly, it reiterates the limited liability which a company provides, or in other words the liability partitioning function. In this sense the shareholders are not liable for the debts of the company over and above the capital they originally invested.²⁴⁶ These

²⁴¹ Petrin (2013) *Penn St L Rev* 42-43.

²⁴² According to Petrin and other scholars, the United States' Supreme Court has shown an inability to develop a coherent theory of corporate personality. Therefore Petrin argues that the traditional and modern theories of corporate personality should not be at the centre of defining the nature of legal entities. Instead, a corporation should be seen as a vehicle created by the legislature to enable individuals to achieve their ultimate goals, namely effective and convenient business dealings. If the purpose of corporate entities is viewed in this manner, one can derive that corporations will have those rights and duties which is assigned to them either by way of statute or court judgments, and these rights and duties are determined by what the firm should achieve and its influence on society. Petrin (2013) *Penn St L Rev* 43.

²⁴³ J Dewey “The Historic Background of Corporate Legal Personality” (1926) 35 *Yale LJ* 655 656; Petrin (2013) *Penn St L Rev* 43.

²⁴⁴ Petrin (2013) *Penn St L Rev* 43.

²⁴⁵ Hansmann and Kraakman describe the role of asset partitioning as the company's most important element which in turn could be divided into two forms. Firstly, the company's creditors have limited means to hold the individual shareholders of the company liable for its debts. Secondly, the creditors of the individual shareholders have no direct claim against the company's assets, but yield to the company's creditors. H Hansmann & R Kraakman “The Essential Role of Organizational Law” (2000) 110 *Yale LJ* 387 393-398.

²⁴⁶ Petrin (2013) *Penn St L Rev* 44.

abovementioned attributes ensure that a company serves its economic function to maximise the wealth of shareholders by pursuing a profit-making goal.²⁴⁷

Apart from these core economic attributes, Petrin argues that a company's rights (whether constitutional, statutory common law based) should reflect the core economic function and purpose of the company.²⁴⁸ If a company is awarded a constitutional right, for example a right to privacy, freedom of expression or freedom of religion, a sufficiently strong link to its economic function should exist.²⁴⁹ However, in the absence of such an economic link, specific non-economic rights could also be awarded to companies based on its social function and purpose.²⁵⁰

Although a company enjoys certain rights, its corresponding duties should also be assessed. Economic analysis has suggested that it would be efficient to hold corporations liable for their criminal and delictual acts.²⁵¹ According to Petrin, if companies are held liable for their criminal or delictual conduct, it would enhance loss prevention, lead to cost-internalisation and facilitate efficient risk-allocation.²⁵² Economic theory proposes that in order to reach optimal production capacity, goods and services should reflect their true cost on society. Thus, there should be an internalisation of business risks, whereby third-party liability (especially in the case of criminal offences or delicts) could be accounted for in the price structure of goods and services, so that unnecessary risks could be minimised to ensure cost-efficiency.²⁵³

Moreover, corporate liability for crimes and delicts should not be limited to the conduct and will of senior management, but should be attributed from employees at all hierarchical levels of the company.²⁵⁴ In this sense economic theory is broader than real entity theory, because it does not distinguish between the status or seniority of a particular individual responsible for the wrongful conduct. The only matter of

²⁴⁷ In the case of non-profit companies other goals will be pursued as stated in the MOI.

²⁴⁸ Petrin (2013) *Penn St L Rev* 44.

²⁴⁹ Although this might be a preliminary condition, some writers argue that awarding certain rights have been motivated by ideological means. Petrin (2013) *Penn St L Rev* 44-45.

²⁵⁰ Petrin (2013) *Penn St L Rev* 46-48.

²⁵¹ The inability of the traditional theories, especially the fiction and aggregate theories, to impose delictual and criminal liability has been one of the reasons for the development of the alternative theories.

²⁵² M Petrin "The Curious Case of Directors' and Officers' Liability for Supervision and Management: Exploring the Intersection of Corporate and Tort Law" (2010) 59 *Am U L Rev* 1661 1703-1705.

²⁵³ Petrin (2013) *Penn St L Rev* 45; 49.

²⁵⁴ 45.

importance is that the costs of all crimes and delicts are internalised.²⁵⁵ However, contemporary legal rules governing corporate criminal liability, as well as tortious (delictual) liability, are primarily based on the notion that a senior corporate official's wrongful conduct is necessary to impose liability, which is rooted in both the fiction and real entity models.²⁵⁶ The reliance on the traditional models of attribution has led to legal scholars seeking judicial reform, because of inefficient mechanisms to hold corporations liable for either delictual or criminal conduct.²⁵⁷ If a functional approach instead of the traditional models is followed, the economic considerations (particularly the loss internalisation) would ensure a different methodology which would account for criminal and tortious conduct throughout the organisational structure is implemented.²⁵⁸ Although the economic considerations provide a mechanism to ensure that a cost structure is developed which would account for the total costs of torts (delicts) and crimes, the question arises if this model is sufficient to incentivise a behavioural change. Petrin argues that economic considerations are an important aspect of the firm, but should not be the exclusive function of the firm; its social function and purpose should not be underestimated.²⁵⁹

3 2 2 Social aspects

The social function is purported to serve the wider societal needs, while the economic function is focussed on the shareholder's role in the company. In combination with the economic function, the social function forms an integral part of the inquiry to characterise the company. Societal effects, which may be connected to

²⁵⁵ Petrin (2013) *Penn St L Rev* 45.

²⁵⁶ In the United States, for example, criminal liability or punitive damages may only be imposed in corporate defendants if the basis for liability is the misconduct of a senior corporate official. Similarly, the Corporate Manslaughter and Corporate Homicide Act 2007 ("CMCHA") in England and Wales relies on the failure of senior management to organise and manage the activities of the company in such a way, which failure would result in a contravention of a rule. The CMCHA promotes the reliance on organisational fault instead of individual culpability or wrongdoing as a means to impose corporate criminal liability. It states that no individual whose conduct amounts to manslaughter needs to be identified nor any individual whose will and conduct will be attributed to the company. Only a rule by which certain persons' organisational failings can be attributed to the company needs to be determined. In establishing these rules, the emphasis is placed on senior management – an approach likened to the identification model. Section 1(3) of the CMCHA reads that corporate guilt arises "only if the way in which its activities are managed or organised by its senior management is a substantial element in the breach." Although the CMCHA relies on organisational fault, the importance of senior management in establishing corporate liability is still apparent. PL Davies & S Worthington *Gower's Principles of Modern Company Law* (2016) 186; Petrin (2013) *Penn St L Rev* 45.

²⁵⁷ Petrin (2013) *Penn St L Rev* 45.

²⁵⁸ 45-46.

²⁵⁹ 46.

economic consequences, could either be positive or negative.²⁶⁰ Certain companies may have a broader impact on society, for example non-profit companies, therefore their primary purpose is to pursue non-economic interests. In the case of profit companies, the social function of a company is less evident for it does not relate to the company's core purpose.

The question of whether companies should have societal duties remains a contested issue. The functional approach does not endorse either side of the debate directly, however, with the increasing impact that large corporations have on society, the idea that social considerations should be included in corporate decision-making becomes apparent.²⁶¹ The functional approach also encourages the notion of a minimum standard of corporate behaviour in relation to the public, as envisaged by Milton Friedman. Although Friedman stated that the only social responsibility a company bears is to increase profits, reiterating wealth maximisation as primary objective of the company, it also had to conform to the basic rules of society, whether it is regulated through law or ethical custom.²⁶²

A broader approach to corporate duties has been advanced in certain jurisdictions. In Canada, the Supreme Court has held that directors may have an obligation to consider the impact on corporate stakeholders during decision-making.²⁶³ Directors should also act in the best interest of the corporation viewed as a good corporate citizen.²⁶⁴ In English law a statutory fiduciary duty rests on directors to promote the success of the company.²⁶⁵ An obligation to consider the impact of corporate conduct on a company's employees, the community and the environment is included in this duty, which is a clear indication of the underlying influence of the stakeholder theory. South African legislation provides for the partial codification of the common-law

²⁶⁰ Although a company could create greater job opportunities, it could also adversely affect the health and safety of employees and the environment. The advancement of new technologies would increase productivity, but could cause a decrease in employment levels (especially in unskilled or low-skilled labour sectors). Petrin (2013) *Penn St L Rev* 46.

²⁶¹ Especially with regards to externalities, where a company can reasonably foresee the harm its production would cause may outweigh other benefits, imposing corporate duties could be justified.

²⁶² M Friedman "The Social Responsibility of Business to Increase its Profits" *New York Times Magazine* 13-09-1970 available at: <http://www.nytimes.com/1970/09/13/archives/a-friedman-doctrine-the-social-responsibility-of-business-is-to.html> <accessed 10-09-2018>..., as quoted by Petrin (2013) *Penn St L Rev* 47-48.

²⁶³ *BCE Incorporated v 1976 Debentureholders* 2008 3 SCR 560 para 66 ("BCE").

²⁶⁴ However, the Supreme Court in *BCE* para 66 held that if the best interests of stakeholders do not coincide with those of the corporation, the latter's interests should prevail. The reasonable expectation of stakeholders should be that the directors owe a duty to act in the best interest of the company.

²⁶⁵ S 172 of the Companies Act 2006.

fiduciary duties in sections 75 and 76 of the Companies Act, although the primary beneficiary of these duties is the company.²⁶⁶

3.2.3 Towards a balancing approach

In determining the ultimate economic and social function of the company, a balancing approach is needed. It is important to bear in mind that the role of the functional approach is not to determine the nature of the firm, but instead its role or function in the wider societal context. Although economic considerations are the starting point of the analysis, the social function of a firm should not be undermined. The primary objective of the economic function is to protect a company's economic rights, namely the liability and asset partitioning function, as well as the internalisation of business risks. On the other hand, the social function of a company is to incorporate a social dimension in the definition of corporate rights and duties.²⁶⁷

The purpose of the functional approach is not to give clear-cut solutions to the legal problems, which academic writers, courts and legislators opt to solve by looking at the nature of the firm. This approach is not a solution in itself, but rather a more appropriate legal framework to analyse these problems.²⁶⁸ In criminal law, the functional approach would free courts and legislators from the restrictions of both the fiction theory and the real entity theory.²⁶⁹ Due to the reliance on the economic consideration to internalise the total cost of business activities and social considerations of public health and safety and environmental protection, a framework is created by which companies could be held liable for the misconduct of employees at all hierarchical levels.²⁷⁰

²⁶⁶ FHI Cassim “The Duties and the Liability of Directors” in FHI Cassim (ed) *Contemporary Company Law* 2 ed (2012) 505-594 509.

²⁶⁷ It could firstly determine which non-economic rights should be granted to a company, given the difference between a non-profit company and a profit-maximisation company. Secondly, the social function is instrumental in the analysis of corporate duties, especially in holding a company liable for criminal or delictual conduct. Lastly, the social function serves as a means to counterbalance the company's (economic) rights. Although it may be in a company's interest to be awarded a particular right which relates to its profit-seeking goal, the overall social burden may dictate otherwise. Petrin (2013) *Penn St L Rev* 49.

²⁶⁸ Petrin (2013) *Penn St L Rev* 49.

²⁶⁹ The impossibility of locating a high managerial agent in a large company with a complex organisational structure whose will and conduct is attributable to the company has proven to be the failure of the fiction theory. Furthermore the reliance on certain “organs” who manage the company seems to be outdated with the structure of modern company law.

²⁷⁰ However, included in this all-encompassing criminal liability the due diligence defence would not hold. Firms would therefore not be able to mitigate their criminal liability by proving that effective monitoring systems were in place, as well as self-reporting and cooperation with the government. This could be problematic and counterintuitive, because firms would not be incentivised to implement safety mechanisms and protocol. Moreover, certain writers corporate criminal liability should be limited to the conduct of directors and high managerial agents, for they are ultimately responsible for corporate policy,

Especially in terms of crimes requiring *mens rea*, the functional approach would be an efficient means to ensure corporate criminal liability. In contrast to the traditional organisational theory, a company's state of mind is independent from the collective state of mind of those individuals comprising the company if the functional approach is implemented.²⁷¹ The approach offers the possibility to aggregate the states of minds of various corporate actors to determine the company's own knowledge.²⁷² Contrary to the traditional models of attribution which sought to hold a company vicariously liable for criminal conduct, the modern approaches offer an alternative for imposing corporate criminal liability directly. This alternative approach is deemed to be on par with modern corporate environments, as well as the complex decision-making structures within these entities. Previously, the intricate corporate structures in large companies made it impossible to pin-point a responsible individual whose misconduct could be attributed to the company.²⁷³ By establishing a model where the company's own knowledge is used to impose criminal liability, the burden of establishing corporate *mens rea* is lightened.

Petrin argues that a paradigm shift is needed to incorporate direct liability and accommodate the reality of modern corporate structures and decision-making.²⁷⁴ The inefficiency of the traditional theories stems from the fact that both the fiction theory and real entity theory are based on the assumption that corporations act through individual organs or agents, whilst the functional approach is not bound to these orthodox theories. Instead, the functional approach advocates the idea that a company should bear responsibility for the harm associated with its business activity, which is independent of individual misconduct and the notion that corporations are incapable of possessing *mens rea*.²⁷⁵

In his concluding remarks, Petrin states that the economic and social factors comprising the functional approach are more concrete than the abstract theories

the company's ethos and have an ability to conform corporate behaviour. Petrin (2013) *Penn St L Rev* 51-52.

²⁷¹ 52.

²⁷² The approach to determine corporate *mens rea* has been referred to as the "corporate scienter", as discussed in SF Sperino "A Modern Theory of Direct Corporate Liability for Title VII" (2010) 61 *Ala L Rev* 773 796-798.

²⁷³ Sperino (2010) *Ala L Rev* 797.

²⁷⁴ (2013) *Penn St L Rev* 52.

²⁷⁵ 52-53.

relating to the nature of the firm.²⁷⁶ In turn, this results in a more goal-orientated and transparent approach.

4 Conclusion

A company is awarded separate legal personality and is thus the bearer of rights and obligations. Although this is one of the cornerstones of company law, the specific juridical origin should not be negated for a self-generated abstraction. A purposive approach is necessary to determine the function of upholding the separate legal personality in a particular instance. Too often the separate *persona* or artificial nature of a company prevents the imposition of corporate liability.

Following the rhetoric of case law, however, the theory of corporate personality remains relevant when determining corporate liability. The semantic question of “what is a corporation” is often regarded as the gatekeeper to ascertain whether corporate liability should be imposed. Nevertheless, the theories of corporate personality which underpin this question have led to unsustainable anomalies. Especially in the realm of corporate criminal liability, the corporate personhood theories have prevented efficient corporate punishment.

Hart suggests that the focus should not be on the definition of a corporation, but rather what is meant by corporate personhood, thereby reiterating the possibility of a purposive or functional approach to corporate personality. If one shifts the focus from the nature of a company to rather identify under which circumstances corporate liability should be ascribed, the outcome may be more efficient.

The most orthodox corporate personality is the fiction theory, which is premised on the artificial character of a company. Therefore, the will and conduct of a company can only be established by means of attribution. Traditionally, the fiction theory “protected” companies from corporate criminal liability, due to their absence of an inherent blameworthiness normally required for criminal liability. A further development in the abstract theory of corporate personhood, was the aggregation theory. Although this theory is dominant in the United States, a company cannot be reduced to an aggregation of individuals. There is a need for a holistic approach which addresses

²⁷⁶ (2013) *Penn St L Rev* 53.

intricate modern organisational structures. Proponents of the realist theory argue that companies are moral agents with social and ethical responsibilities.

Due to the fiction-aggregate-realist trichotomy, a purposive approach has been suggested which diverts from the nature of the firm to the function of the firm. Law and economics scholars have proposed that a company is a “nexus of contracts”, whereby the internal and external relationships are governed. Although this is a departure from the orthodox theory, the remnants thereof are still evident through reference to “legal fictions”.²⁷⁷

A true departure from the limitations of the nature of the company analysis, is a functional approach which incorporates economic and social considerations, whereby corporate criminal liability could be imposed on a company. As Petrin proposes, a functional approach will overcome the need to identify a responsible individual whose conduct and will can be attributed to the company. Nevertheless, the current legal framework suggests that attribution rules are integral in corporate liability. Whether these rules are still relevant will be explored in the following chapter.

²⁷⁷ Jensen & Meckling (1976) *JFE* 307.

Chapter 3: The corporate attribution rules revisited

1 Introduction

Due to the abstract nature of a company, it lacks the required *actus reus* and *mens rea* necessary to incur criminal or delictual liability. Nevertheless, there is a need to hold a company liable for its unlawful conduct.²⁷⁸ In order to address this dilemma of a company's artificial nature, corporate law creates a legal framework by which the will and conduct of natural persons can be deemed to be that of the company. Typically, the conduct and will of a company are attributed by means of legal fictions.²⁷⁹ In *Meridian Global Funds Management Asia Ltd v Securities Commission ("Meridian")*²⁸⁰ Lord Hoffmann emphasised the rules of attribution as a means to ascribe conduct and will to the company as follows:

“A company exists because there is a rule (usually in a statute) which says that a *persona ficta* shall be deemed to exist and to have certain of the powers, rights and duties of a natural person. But there would be little sense in deeming such a *persona ficta* to exist unless there were also rules to tell one what acts were to count as the acts of the company. It is therefore a necessary part of corporate personality that there should be rules by which acts are attributed to the company. These may be called ‘the rules of attribution.’ The company’s primary rules of attribution will generally be found in its constitution, typically the articles of association [or Memorandum of Incorporation (“MOI”)]” [own insertion]²⁸¹

These persons whose conduct and will are attributed to the company do not act on behalf of the company in an agency relationship, but their conduct and will are that of the company itself. This mode of attribution is known as the directing mind or alter ego doctrine. Although the doctrine was initially developed in a civil law context,²⁸² it has application in both civil and criminal jurisdictions.²⁸³ Especially where criminal or delictual liability requires a particular state of mind (*mens rea*, negligence, knowledge), the doctrine will be relevant. In the realm of corporate knowledge, the distinctions

²⁷⁸ JM Burchell *Principles of Criminal Law* 5 ed (2016) 458.

²⁷⁹ A Griffiths *Contracting with Companies* (2005) 2.

²⁸⁰ 1995 2 AC 500 (PC).

²⁸¹ 506.

²⁸² *Lennard's Carrying Co Ltd v Asiatic Petroleum Co Ltd* 1915 AC 705; 1914-1915 All ER 280 (HL) 283 (“*Lennard's*”).

²⁸³ MS Blackman, RD Jooste & GK Everingham *Commentary on the Companies Act* (RS 4 2007) 4-123.

between actual knowledge, constructed knowledge and imputed knowledge could be problematic.²⁸⁴

The purpose of this chapter is to examine the development of the rules of attribution and the relevance thereof in modern corporate law.

2 Critique on the corporate attribution rules

According to Worthington, there is a presumption that the rules of corporate attribution and agency are undisputed.²⁸⁵ The problem, however, is that with an increase in misbehaving corporate actors, the description and application of the relevant rules have become uncertain. Worthington states, that three problems with corporate attribution has arisen.²⁸⁶ Firstly, the so-called poignant issue of corporate attribution itself, particularly whose acts could be contributed to the company and for what purposes can those acts be deemed to be the company's. For example, would an illegitimate purpose negate the attribution of an agent's conduct to the company or would it be paramount in attributing corporate criminal liability? Secondly, the issue of actual authority creates uncertainty regarding the attribution rules. Lastly, the problem relating to ostensible authority and the appropriate legal response thereto if unauthorised employees intimate to third parties that a corporate contract has been properly concluded.

Worthington argues that the main reason for uncertainty stems from the failure to address corporate form and to create a concise legal context for corporate attribution rules.²⁸⁷ With regards to the rules of attribution, Lord Hoffmann's judgment in *Meridian*²⁸⁸ is paramount in classifying the rules of attribution as primary, general and special, as well as determining a company's directing mind and will.²⁸⁹

The crux of Worthington's exposition of *Meridian* is found in the question of whose conduct or knowledge should be imputed to the company "for this purpose".²⁹⁰

²⁸⁴ Blackman et al *Commentary* (RS 4 2007) 4-124 referring to *Infiniteland Ltd v Artisan Contracting Ltd* 2006 1 BCLC 632 (CA) 662.

²⁸⁵ S Worthington "Corporate attribution and agency: back to basics" 133 (2017) *Law Q Rev* 118 118.

²⁸⁶ Worthington (2017) *Law Q Rev* 118.

²⁸⁷ 118.

²⁸⁸ 506-507.

²⁸⁹ Worthington (2017) *Law Q Rev* 119.

²⁹⁰ *Meridian* 507 as per Lord Hoffmann's own emphasis; Worthington (2017) *Law Q Rev* 119.

In answering this question, due regard should be given to the company's separate legal personality, as well as the vital qualifier of "for this purpose". Worthington states that the court's reasoning in *Stone & Rolls Ltd (In Liquidation) v Moore Stephens (A Firm)* ("Stone & Rolls")²⁹¹ illustrates the importance of these questions in determining the directing mind and will of a company.²⁹²

In the *Stone & Rolls* case, the company had a sole shareholder who was also the sole director of the company. The company was set up with the sole purpose of defrauding banks. Once the fraud had been discovered, both the money and the shareholder/director had disappeared. After the company was put into liquidation, the liquidator sued the auditors, Moore Stephens, for their negligent failure to discover the fraud earlier. In their defence, Moore Stephens relied on the *ex turpi causa* illegality defence, claiming that the company could not benefit from its own illegal conduct, namely the fraud committed prior to liquidation.²⁹³

The key question was whether Stone & Rolls had the intention to benefit from its own illegal conduct. The House of Lords held that the question was difficult and the final decision that the company could not sue its auditors was decided by a 3:2 split.

The majority's conclusion has been criticised for being a "perverse result",²⁹⁴ as the auditors could escape liability for negligence to the detriment of the defrauded company and ultimately its creditors. Furthermore, Worthington states that it is impossible to discern a coherent ratio from the case. The focus of her analysis, however, is firstly how the court failed to recognise the framework issues relating to corporate attribution, namely upholding the company's separate legal personality and secondly to give due regard to Lord Hoffmann's vital qualification of "for this purpose" when applying the attribution rules.²⁹⁵

2 1 Separate legal personality of companies

The separate legal personality developed in the seminal case of *Salomon v Salomon & Co Ltd* ("Salomon")²⁹⁶ is one of the cornerstones of modern company law. In turn, corporate attribution is the method of ascribing acts, knowledge and intention

²⁹¹ 2009 1 AC 1391.

²⁹² (2017) *Law Q Rev* 119.

²⁹³ 120.

²⁹⁴ 120.

²⁹⁵ 120.

²⁹⁶ 1897 AC 22 (HL).

to companies, therefore it demands due regard to the separate juristic existence of a company when imputing these attributes.²⁹⁷

In the *Stone & Rolls* case, Worthington argues that the House of Lords neglected to appreciate the importance of separate legal personality in three instances: firstly, a special status had been ascribed to one man companies; secondly, considering the role and duties of auditors in such companies; lastly, determining the particular harm suffered as a consequence of the auditors.

In the first instance, the question in *Stone & Rolls* was whether the company itself was seeking to benefit from its own illegal conduct. Reference to the attribution rules is necessary to answer this question, however, the rules would not change depending on the wrongdoing of those owning or controlling the company.²⁹⁸ Worthington argues, that if there were innocent directors or shareholders, the result would still be that the company could be held directly responsible for its own illegal conduct and could thus seek to litigate to its own advantage.²⁹⁹ Irrespective of this reasoning, the court still concluded that only a one man company should be precluded from litigating, as it is only in these type of companies who would be benefitting from their own illegal conduct.

Ultimately, this reasoning is misaligned with the principles set out in the *Salomon* case, for a one man company does not equate to one man. Nor is the decision in *Stone & Rolls* one of piercing the corporate veil, but one of corporate attribution. The purpose of the attribution rules is to ascribe independent corporate acts to the company.³⁰⁰

Secondly, the court's disregard for the *Salomon* principle is found in its analysis of the auditors' liability. In determining whether the company could sue the auditors for their breach of their duty of care and skill in both contract and tort, the court failed to draw a clear distinction between the company and the individuals comprising it. Inevitably, the court held that the company could not sue for the losses accumulated as a result of the auditors' failure to adhere to their duty of care.³⁰¹

²⁹⁷ Worthington (2017) *Law Q Rev* 121.

²⁹⁸ 121.

²⁹⁹ 121.

³⁰⁰ 121.

³⁰¹ 121.

Thirdly, the misappropriation of the separate legal personality lies in the assumptions made about the claim instituted by the company. The multiple frauds were reduced to a single “pipeline” fraud and thus the accepted notion was created that the company based its claim against the auditors on the original fraud against third party banks.³⁰² The failure to regard the fraud as separate instances, led to the wrong emphasis, for the court considered the funds coming into the company and those flowing out to be the same fraud. This is not correct. The company claimed that the auditors failed to detect the fraud of the funds going out of the company and not those coming into the company. Following this reasoning, it is clear that the company was the innocent victim of the fraud and not the instigator of the corporate fraud, for there was no corporate benefit.

It is evident, that the separate corporate personality should be upheld when applying the rules of attribution, thus the distinction between the company itself and the corporate actors should be maintained.

Worthington continues her critique on the court’s decision in *Stone & Rolls*, by contextualising the rules of attribution to “*for this purpose*”, as originally qualified by Lord Hoffmann in *Meridian*.³⁰³

2 1 1 Context and the rules of attribution

As mentioned above, one of the key qualifiers for the rules of attribution, is for which purpose should a natural person’s conduct, knowledge and will be attributed to the company. Although a managing director might have broad knowledge within the company structure, for the purpose of a particular transaction, her knowledge might not be sufficient to be attributed to the company. Therefore, Worthington states that generalisations are impossible and the contextual analysis is pivotal.³⁰⁴

However, in *Stone & Rolls* the emphasis fell on a generalisation of the rules of attribution and the context sensitivity of the rules ignored. The court held that the sole

³⁰² Worthington (2017) *Law Q Rev* 123.

³⁰³ 124.

³⁰⁴ (2017) *Law Q Rev* 124; E Ferran “Corporate Attribution and the Directing Mind and Will” (2011) 127 *Law Q Rev* 239 239; *Moulin Global Eyecare Trading Ltd (In Liquidation) v Commissioner of Inland Revenue* 2014 3 HKC 323 at para 41; *Bilta (UK) Ltd (In Liquidation) v Nazir* 2016 AC 1 paras 41, 181, 191 and 202 (“*Bilta*”).

director and shareholder was the directing mind and will of the company and accordingly his fraud could be regarded as the company's fraud.

Although there is a distinction between the primary, general and special rules of attribution, there is no "magic hierarchy": they merely describe various way to identify a person whose acts would be attributed to the company within a specific context.³⁰⁵ Furthermore, the liability which flows from attribution is a direct liability, thus it is different from its alternative, namely vicarious liability.³⁰⁶

In addition, the Hampshire Land principle³⁰⁷ states that the knowledge of an agent is not attributable to the principal, if the knowledge relates to the agent's own breach of duty to the principal.³⁰⁸ In *Stone & Rolls* the argument was made that the initial fraud could not be attributed to the company due to the Hampshire Land principle and thus the *ex turpi* defence raised by the auditors would not hold. This argument is flawed, as the purpose of the rules of attribution is that knowledge and will, irrespective of their legality, could be attributed to a company to ensure its compliance with the *mens rea* requirement.³⁰⁹ Simultaneously, if a person is being sued by their companies, they cannot escape liability by claiming that their own conduct, knowledge and will attributed to the company resulted in the company waiving liability.³¹⁰ In *Bilta*, the court stated the following to this effect:

"It is self-evidently impossible that the officer should be able to argue that the company either committed or knew about the breach of duty, simply because the officer committed or knew about it. This is so even though the officer is the directing mind and will of the company [...] Any other conclusion would ignore the separate legal identity of the company, empty the concept of duty of content and enable the company's affairs to be conducted in fraud of creditors"³¹¹

2.2 Attribution versus authority

The rules of attribution address the framework within which companies operate, whilst authority determines the finer mechanisms of the broad structure. Nevertheless, the central question for both attribution and authority remains the same, namely whose

³⁰⁵ Worthington (2017) *Law Q Rev* 125.

³⁰⁶ 125.

³⁰⁷ *Re Hampshire Land Co (No.2)* 1896 2 Ch 743.

³⁰⁸ *Stone & Rolls* para 43.

³⁰⁹ Worthington (2017) *Law Q Rev* 126.

³¹⁰ 127.

³¹¹ Para 42.

acts are imputed to the company for that particular purpose. With regards to the latter, authority governs validity of contracting with third parties.

Worthington raises the issue if a corporate actor would have actual authority to act in conflict with the company's interests.³¹² According to the principles set out in *Freeman & Lockyer v Buckhurst Park Properties (Mangal) Ltd*,³¹³ a third party must rely on ostensible authority grounds and not actual authority. This is referred to as the orthodox or "no actual authority" approach.³¹⁴

In *Hopkins v TL Dallas Group Ltd*³¹⁵ Lightman J held that if an act carried out by an agent is contrary to the interests of her principal, then the act will not fall within the ambit and purpose of the express or implied actual authority. As a result, the transaction will be void, unless the third party can rely on ostensible authority.³¹⁶

An alternative to the orthodox approach, is the "abuse of actual authority" approach. According to this approach, the act of an agent would not cease to bind a principal, even if the said conduct was fraudulent or in the agent's self-interest, be it in accordance with actual or ostensible authority.³¹⁷

The problem with the orthodox approach, is that it creates a dichotomy between the internal and external relationships of the company. In the case of the internal relationships, the orthodox approach might hold, as there is a breach of duty between the principal and the agent. The dilemma stems from the question of whose conduct will be regarded as that of the company.³¹⁸ Similarly to committing unlawful acts, companies may conclude contracts which are not in their best interest, and to which they will be legally bound.

If the "abuse of actual authority" approach is followed, the confusion between the internal and external relationships may be solved.³¹⁹ In terms of the external relationships, the question regarding authority will be limited to the scope of the individual's role within the company.³²⁰ If the conduct is beyond the scope of the

³¹² (2017) *Law Q Rev* 132.

³¹³ 1964 1 All ER 630 CA; 1964 2 QB 480 at 506.

³¹⁴ Worthington (2017) *Law Q Rev* 132.

³¹⁵ 2004 EWHC 1379 (Ch); 2005 1 BCLC 543.

³¹⁶ Worthington (2017) *Law Q Rev* 134.

³¹⁷ *Macmillan Inc v Bishopgate Investment Trust plc (No 3)* 1995 1 WLR 978 984; 1995 3 All ER 747 753.

³¹⁸ Worthington (2017) *Law Q Rev* 135.

³¹⁹ 137.

³²⁰ 138.

individual's authority, ostensible authority will be relevant. If the conduct is within the scope of an individual's authority, but an abuse thereof, the company may seek to reprimand the individual internally.³²¹

The third problem Worthington addresses in her article, is that of ostensible authority.³²² Recently, the dilemma of ostensible authority has also been relevant in South African law: first with the partial codification of the *Turquand* rule in section 20(7) of the Act, followed by two cases on the application of ostensible authority and estoppel, namely *One Stop Financial Services (Pty) Ltd v Neffensaan Ontwikkelings (Pty) Ltd (The CRL Trust as Intervening Creditor)*³²³ and *Makate v Vodacom (Pty) Ltd*.³²⁴ These developments, however, are beyond the scope of this thesis and will therefore not be discussed in detail.

3 Rules of attribution versus the rules of conferring authority and the rules of agency

Being an artificial entity, a company cannot act itself; nor can it have a state of mind.³²⁵ However, due to its corporate personality, it is necessary for the law to attribute the acts and states of mind of certain natural persons to the company. The rules of attribution should be distinguished from the rules conferring authority and rules of agency. The relationship of a director to the company is quite similar to that of an agent.³²⁶ The most renowned example is the fact that a director acts for the benefit of another person, whether it be the company itself, its shareholders or other stakeholders, and not for the benefit of herself. However, if a director acts beyond her authority, she will incur liability.³²⁷ The analogy between a director and agent is not as strong in the current Companies Act, as presumed under the 1973 Act. Previously, a director enjoyed no original powers to act, but was confined to those powers conferred on her.³²⁸ Section 66(1) of the current Companies Act provides directors with original

³²¹ Worthington (2017) *Law Q Rev* 138.

³²² 139.

³²³ 2015 4 SA 623 (WCC).

³²⁴ 2016 4 SA 121 (CC).

³²⁵ Blackman et al *Commentary* (RS 4 2007) 4-123.

³²⁶ R Cassim "Governance and the Board of Directors" in FHI Cassim (ed) *Contemporary Company Law* 2 ed (2012) 400 412.

³²⁷ Cassim "Governance" in *Contemporary* 412.

³²⁸ 412.

powers and duties, changing the position of the director in relation to the company considerably.

According to section 66(1) of the Companies Act, the business and affairs of the company must be managed by or under the auspices of the board of directors. In turn, the board of directors has the authority to exercise all of the powers, as well as conduct any of the functions of the company, except to the extent that the Act or the memorandum of incorporation provides otherwise. Furthermore, a company has the same capacity as an individual, as stated in section 19(1) of the Companies Act, unless the memorandum of incorporation provides otherwise. Since the enactment of the Companies Act, the doctrine of constructed notice has been abolished, except to the extent that it applies to ring-fenced companies or personal liability companies. Therefore, one can assume that in the normal course of business, a company's capacity will not be restricted. From this reasoning, one can deduce that the board of directors has the necessary power and authority to conduct the affairs of the company, due to the provisions in the relevant legislation.

The company may also conclude service contracts with other employees to conduct certain transaction, and if duly authorised, their conduct will legally bind the company.³²⁹ In this instance, it might be difficult to determine whether it is an agent acting on behalf of the company or whether it is the company itself acting. However, under normal circumstances, the question would be irrelevant: if the person is acting as an agent, the principal (the company) will be bound, due to the law of agency and if the conduct is perceived as that of the company, it will be bound as it has the necessary contractual capacity.³³⁰

Given these two theories regarding the nature of the acts of these persons, be it in a principal-agent relationship or as direct attribution, the result will not always be the same. In certain circumstances, the company will only incur liability if the acts of certain people are regarded to be that of the company.³³¹ Especially in the case of corporate criminal liability, this distinction becomes relevant. According to Blackman, the

³²⁹ Blackman et al *Commentary* (RS 3 2006) 4-125.

³³⁰ Similar reasoning could be applied for delictual liability, in other words, an employee can bind the company delictually by way of the doctrine of vicarious liability, or the company is directly liable for a delict due to its own conduct. Blackman et al *Commentary* (RS 3 2006) 4-125.

³³¹ Blackman et al *Commentary* (RS 3 2006) 4-125.

doctrine of vicarious liability has no place in criminal law.³³² Thus, if the principal-agent theory is followed in the context of criminal law, the company will not incur criminal liability for the acts committed when acting within the scope of the company's business affairs. Similarly, a principal will not be held vicariously liable for the delicts committed by its agents. In this sense, the agency theory fails to ensure that companies are held liable for their unlawful conduct. Lastly, if the law specifically provides that a person will only be contractually bound if she concludes the contract herself, a company will not be bound based on the agency theory.³³³

The leading case on attribution rules, is *Meridian*, where Lord Hoffmann states the following:

“The company’s primary rules of attribution will generally be found in its constitution, typically the articles of association, and will say things such as ‘for the purposes of appointing members of the board, a majority vote of shareholders shall be a decision of the company’ or ‘the decisions of the board in managing the company’s business shall be the decisions of the company’. There are also primary rules of attribution which are not expressly stated in the articles but implied in company law, such as ‘the unanimous decision of all the shareholders in a solvent company about anything which the company under its memorandum of association has power to do shall be the decision of the company’.”³³⁴

However, Blackman concludes that the dicta of Lord Hoffmann is not correct.³³⁵ Lord Hoffmann is confusing the fundamental question of whether a company should be bound by a transaction, thus if the company has the authority and capacity to enter a contract, with whether the acts of those persons acting to be attributed to the company itself, thus should there be a direct mode of attribution or are they acting according to the agency theory. There is a nuanced difference between the primary rules of attribution to which Lord Hoffmann refers and the direct rules of attribution. The rules of a company’s constitutional documents are power-conferring rules and not rules of attribution.³³⁶

³³² *Commentary* (RS 3 2006) 4-125.

³³³ 4-125.

³³⁴ 506.

³³⁵ *Commentary* (RS 3 2006) 4-125.

³³⁶ Blackman et al *Commentary* (RS 3 2006) 4-126.

Furthermore, the common law doctrine of ‘unanimous assent’³³⁷ is another example of a power-conferring rule. According to the unanimous assent rule, if all shareholders agree to something that the majority could have decided upon formally in a general meeting, by passing an ordinary resolution to that effect, their unanimous assent would be binding on the company. Having the same effect as an ordinary resolution passed at a general meeting, it is important to note that these resolutions do not constitute acts or states of mind, but are merely binding decisions on the company in an informal manner.³³⁸ Nevertheless, the unanimous assent rule is often confused with the directing minds doctrine. Especially in *Multinational Gas and Petrochemical Co v Multinational Gas and Petrochemical Services Ltd* (“Multinational Gas”),³³⁹ the court held that if shareholders unanimously assent to a matter, a state of mind is attributed to the company, thereby the company itself gives consent.³⁴⁰ This notion is in conflict with the separation of powers provided for in a company’s constitutional documents, as well as section 66(1) of the Companies Act, which provides that the business and affairs of the company are managed by the board of directors. In this instance, it is the rules governing the powers of a company and not the acts or state of mind of the company that is in question.³⁴¹

3 1 The rules of attribution versus the rules of agency explained:

To illustrate the confusion between the rules of attribution and those of agency, it is necessary to refer to *Meridian* once more:

“These primary rules of attribution are obviously not enough to enable a company to go out into the world and do business. Not every act on behalf of the company could be expected to be the subject of a resolution of the board or a unanimous decision of shareholders. The company therefore builds upon the primary rules of attribution by using general rules of attribution which are equally available to natural persons, namely, the principles of agency. It will appoint servants and agents whose acts, by a combination of the general principles of agency and the company’s primary rules of attribution, count as the acts of the company. And having done so, it will also make itself subject to the general rules by which liability for the acts of others can be

³³⁷ The unanimous assent rule is found in section 60 of the Companies Act.

³³⁸ Blackman et al *Commentary* (RS 3 2006) 4-126.

³³⁹ 1983 1 Ch 258; 1983 2 All ER 563 (CA).

³⁴⁰ Blackman et al *Commentary* (RS 3 2006) 4-126.

³⁴¹ 4-126.

attributed to natural persons, such as estoppel or ostensible authority in contract and vicarious liability in tort.”³⁴²

Although the primary rules of attribution are supplemented by the general rules of attribution, such as the law of agency, estoppel, ostensible authority and vicarious liability which apply to natural and juristic persons, it might be necessary for special rules of attribution in exceptional cases if the primary and general rules do not amount to imposing liability on corporations.³⁴³ Especially in the realm of criminal law, there is a need for special rules of attribution,³⁴⁴ but as stated in *Meridian*, the special rules are a matter of “construction rather than metaphysics”.³⁴⁵

In *Meridian*, the Privy Council was overly cautious in emphasizing the need for interpretation and that liability would not extend beyond the directing mind and will of the company:

“...[we] would wish to guard [ourselves] against being understood to mean that wherever a servant of a company has authority to do an act on its behalf, knowledge of that act will for all purposes be attributed to the company. It is a question of construction in each case as to whether the particular rule requires that the knowledge that an act has been done, or the state of mind with which it was done, should be attributed to the company”³⁴⁶

Especially in the case of regulatory offences, there is a need to attributed the state of mind of a lower level employee who is authorised to act for the company will be readily attributed to the company for the purposes of criminal liability.³⁴⁷

A company always has the authority to appoint an agent to act on its behalf, and if the agent acts within the scope of her authority, the company will be bound.³⁴⁸ The question as to whether the act should be regarded as an act of the company itself or that of an agent, is a completely different matter. As a rule of thumb, the acts of an agent are not attributed to the company. However, a company may incur vicarious liability, based on the principle whereby knowledge is imputed to the company by

³⁴² 506.

³⁴³ F McAuley & JP McCutcheon *Criminal Liability* (2000) 386.

³⁴⁴ *Meridian* 507.

³⁴⁵ 511.

³⁴⁶ 511.

³⁴⁷ McAuley & McCutcheon *Criminal Law* 387.

³⁴⁸ Blackman et al *Commentary* (RS 3 2006) 4-127.

means of the rules of agency and not the directing mind doctrine.³⁴⁹ This would occur, where an agent has a duty to acquire the knowledge in question for the company. Vicarious liability could also arise by way of delictual acts committed by employees during the scope of their employment, even if it was the employee's sole benefit.³⁵⁰ Despite Blackman's view that vicarious liability in criminal law is impossible, section 332 of the Criminal Procedure Act provides that, for the purposes of holding a company criminally liable, an act committed with or without a particular intent by either a director or servant of such a company in the scope of their employment or in furthering or endeavouring the interests of the company, must be deemed to have been the conduct (with the same intent, or lack thereof) of the company itself.

4 The application of the directing mind doctrine

The question of when to apply the directing minds doctrine is not always clear. According to the dicta of Lord Hoffmann in *Meridian*, the rules of attribution will only apply if there is rule which applies to a natural person and the state of mind of that person. In criminal law, where the *actus reus* and *mens rea* of the defendant herself is relevant, these rules of attribution will apply.³⁵¹

Deduced from the judgment in *Meridian*, is that as a general rule, the board of directors and the managing director act as the representatives of the company and only if the company cannot be held liable under this theory, the rules of attribution will be invoked to hold the company liable.³⁵² By following this approach, the impression is given that the judiciary has the first opportunity to decide whether a company should be liable or not. If it is decided that a company should be held liable, a court will first consider the rules of agency, where after the rules of attribution will be considered.

According to Blackman, it is submitted that the rules of attribution be applied if the conditions set for their application are present.³⁵³ Whenever the acts and states of mind are those of the directing mind of the company, the rules of attribution should be applied. Therefore, the rules of attribution should not be a default alternative mechanism if the rules of agency do not amount to corporate liability. If directors

³⁴⁹ Blackman et al *Commentary* (RS 3 2006) 4-127.

³⁵⁰ 4-127.

³⁵¹ *Meridian* 507.

³⁵² Blackman et al *Commentary* (RS 3 2006) 4-128.

³⁵³ 4-128.

transact on behalf of the company, the company itself should be regarded as the transacting party, whereby the agency theory is abandoned altogether for purposes of determining company liability.³⁵⁴ Although the result of holding the company liable will be the same, the rules of attribution offer a more consistent theory of determining corporate liability. In order to understand this mechanism of imposing corporate liability, one could once again refer to the dicta of Lord Hoffmann in *Meridian*:

“One possibility is that the court may come to the conclusion that the rule was not intended to apply to companies at all: for example, a law which created an offence for which the only penalty was community service. Another possibility is that the court might interpret the law as meaning that it could apply to a company only on the basis of its primary rules of attribution, i.e. if the act giving rise to liability was specifically authorised by a resolution of the board or a unanimous agreement of the shareholders. But there will be many cases in which neither of these solutions is satisfactory; in which the court considers that the law was intended to apply to companies and that, although it excludes ordinary vicarious liability, insistence on the primary rules of attribution would in practice defeat that intention. In such a case, the court must fashion a special rule of attribution for the particular substantive rule. This is always a matter of interpretation: given that it was intended to apply to a company, how was it intended to apply? Whose act (or knowledge, or state of mind) was for this purpose intended to count as the act etc of the company? One finds the answer to this question by applying the usual canons of interpretation, taking into account the language of the rule (if it is a statute) and its content and policy.”³⁵⁵

Conduct or will should only be attributed to the company when legislation expressly or implicitly requires a court to do so. Hence, the question should not be one for company law at all. Blackman argues that no company law doctrine of the directing mind exists, for the rules of company law that impose liability on the company are based on the rules of agency, thus contractual and delictual liability are imposed on the company if, according to the rules of agency, one person is liable for the acts of another.³⁵⁶

Despite Lord Hoffmann’s attempt to create certainty regarding when to apply the rules of attribution, the legal application thereof remains precarious.³⁵⁷ Firstly, the

³⁵⁴ Blackman et al *Commentary* (RS 3 2006) 4-128.

³⁵⁵ 507.

³⁵⁶ Blackman et al *Commentary* (RS 3 2006) 4-129.

³⁵⁷ 4-129.

doctrine described by Lord Hoffmann is contrary to authority on the matter.³⁵⁸ Furthermore, the position is unclear if there is no statute to interpret, as well as if the company has committed a delict or common-law crime. Moreover, where the directors themselves commit the crime, it is uncertain if the company should still be held liable, as their conduct would not have been authorised. Would it then be necessary to determine legal disciplines other than company law, to determine whether these acts and states of mind could be attributed to the company?³⁵⁹

The rules of attribution apply to a company's external relationships, thus in the company's dealings with third parties. In the case of internal relationships, the doctrine relating to the rules of attribution will not be relevant. In *R v Gomez*,³⁶⁰ the court held, that where a company is accused of a crime, it is the conduct and will of those who are deemed to be the directing minds of the company, whose will and conduct are attributed to the company. In the case where those acting as the directing mind and will of the company are accused of criminal conduct, there is a distinction between their conduct and that of the company. Similarly, a person cannot circumvent fraud charges, based on the assumption that if such a person acts as the directing mind and will of a company, the company will be deemed to have full knowledge of the relevant facts and it could thus not be deceived.³⁶¹

In *Multinational Gas* the directors of the company entered into certain contracts with the approval and consent of all shareholders. However, as a result of those contracts, the company suffered immense losses and was consequently placed in liquidation. Its liquidator sought to hold the directors liable for the losses suffered on the basis that they had been negligent in entering into the contracts. The Court of Appeal held that due to the shareholders' consent and approval of the contracts, the shareholders had made the acts of the directors the company's own conduct and thus nullified the company's action.

³⁵⁸ For example, the dicta of Viscount Haldane in *Lennard's* on what the doctrine of the directing mind and will entails.

³⁵⁹ Blackman et al *Commentary* (RS 3 2006) 4-129.

³⁶⁰ 1993 All ER 1 (HL) 40.

³⁶¹ Blackman et al *Commentary* (RS 3 2006) 4-129.

5 Determining the doctrine of the directing mind and will

When determining the directing mind and will of a company, courts seek to identify the person or body who is in *de facto* control of the relevant operations of the company.³⁶² Moreover, the directing mind and will of a company has to be a lawful directing mind and will.³⁶³ Implicit in this, is that the relevant legal rules should be adhered to. In terms of the previous Companies Act 61 of 1973, a company had to be formed for a lawful purpose.³⁶⁴ In English law, section 7(2) of the Companies Act 2006 provides that a company may not be formed for an unlawful purpose.³⁶⁵ Although the current Companies Act does not explicitly have the same wording, the general purpose provision found in section 7 of the Companies Act, states that company law legislation should promote compliance with the Bill of Rights found in the Constitution of the Republic of South Africa, 1996.³⁶⁶ One could interpret this provision to include that a company may only be formed and operate for a lawful purpose. Axiomatically, only a lawfully appointed board of directors can delegate authority to persons who will act as the controlling and directing minds of the company.³⁶⁷

Servants or agents of a company would not normally be regarded as the company's alter ego. It is usually the board of directors, managing directors or certain senior officials within the company, those involved in policy decisions and management functions, who are deemed to be the alter ego of the company.³⁶⁸ Lower-level employees merely act out instructions from above and if they are given some measure of discretion in performing their duties, the impact would be too trivial to regard them as the directing mind and will of the company.³⁶⁹ Normally, the directing mind and will can be found in a sub-committee of the board,³⁷⁰ as well as the managing director.³⁷¹

³⁶² As stated in *Lennard's* 705 713; *Levy v Central Mining & Investment Corporation Ltd* 1955 1 SA 141 (A) 150.

³⁶³ *Gainsford NO v Gulliver's Travel (Bruma) (Pty) Ltd* 2009 JDR 0570 (GSJ); 2009 JOL 23787 (W) ("Gainsford NO") para 90.

³⁶⁴ B Galgut, JA Kunst, P Delport & Q Vorster *Henochsberg on the Companies Act 61 of 1973 Vol 1 Chapter IV* 5 ed (SI 33 2011) 53.

³⁶⁵ D French *Mayson, French and Ryan on Company Law* 34 ed (2017) 49.

³⁶⁶ S 7(a).

³⁶⁷ *Gainsford NO* para 90.

³⁶⁸ *Tesco Supermarkets Ltd v Nattrass* 1972 AC 153 171; 1971 2 All ER 127 (HL) 132.

³⁶⁹ Blackman et al *Commentary* (RS 3 2006) 4-130.

³⁷⁰ According to the authors of *Commentary*, citing *Secretary for Inland Revenue v Trust Bank of Africa Ltd* 1975 2 SA 652 (A) and *CIR v Nedbank Ltd* 1986 3 SA 591 (A).

³⁷¹ *Oatorian Properties (Pty) Ltd v Maroun* 1973 3 SA 779 (A) 787; *El Ajou v Dollar Land Holdings plc* 1994 2 All ER 685 (CA) 705 ("El Ajou"); *Consolidated News Agencies (Pty) Ltd (in liquidation) v Mobile Telephone Networks (Pty) Ltd and another* 2010 3 SA 382 (SCA) 393 ("CNA").

An ordinary director is typically not regarded as the directing mind, because she has no comprehensive power or authority.³⁷²

Although certain positions are more susceptible to be regarded as the directing mind of a company, the directing mind need not always be that of the person or persons involved in general management and control of the company.³⁷³ Ultimately, the application of the directing mind doctrine calls for a contextual analysis of the circumstances. Blackman reiterates that the directing mind doctrine could be applied to different persons in respect of different activities.³⁷⁴ In *CNA*, the Supreme Court of Appeal referred to the decision in *El Ajou* and applied the decision in *Canadian Dredge and Dock Co Ltd v R*³⁷⁵ regarding who could be regarded as the directing mind and will of a company. It has been emphasised that the directing mind doctrine is not limited to a director of a company, but could be extended to any natural person who has the management and control in relation to the act or omission in question.³⁷⁶ Therefore the person who has control and management at a particular point in time could be the directing mind for that specific purpose.³⁷⁷

In *Canadian Dredge* the court held:

“The act will be considered to be that of the directing mind as long as it is performed by the person in question within the sector of the company operation assigned to him by the company, which sector may be functional or geographic, or be the entire undertaking of the company. No formal delegation is necessary, nor does it matter that the directors are unaware of the activity in question nor, in fact, that the conduct had been expressly prohibited by the company.”³⁷⁸

In *El Ajou* Rose LJ broadened the scope of the directing minds doctrine, by stating the following:

“First, the directors of a company are, *prima facie*, likely to be regarded as its directing mind and will whereas particular circumstances may confer that status on non-

³⁷² *El Ajou* 705; *CNA* 393.

³⁷³ Blackman et al *Commentary* (RS 3 2006) 4-130.

³⁷⁴ 4-130.

³⁷⁵ 1985 19 DLR (4th) 314 (SCC) (“*Canadian Dredge*”).

³⁷⁶ *CNA* para 30.

³⁷⁷ *Simon NO v Mitsui and Co Ltd* 1997 2 SA 475 (W) 526I-531A; *CNA* para 29; N Locke “The Approach of the Supreme Court of Appeal to the Enterprise Reality in Company Groups [Discussion of *Consolidated News Agencies (Pty) Ltd (in liquidation) v Mobile Telephone Networks (Pty) Ltd and another* 2010 3 SA 382 (SCA)]” (2012) 23 *Stell LR* 476 481.

³⁷⁸ 330-331.

directors. Secondly, a company's directing mind and will may be found in different persons for different activities of the company.”³⁷⁹

These cases, however, should be read in context,³⁸⁰ for the different courts strive to determine whether it was the company which has spoken or acted to a particular effect through the voice or conduct of its human agents and should therefore be held liable or whether the conduct of the human agent was too far removed to be fairly attributed to the company.

Following the judgment in *El Ajou*, it might be possible for a non-executive director to be regarded as the directing mind of the company, even though such a director is not typically involved in the day-to-day business of the company.³⁸¹ Furthermore, if the act was beyond the authority of the person in question, it might still be regarded as the conduct of the directing mind,³⁸² provided that the act is performed by the person in question within the sector of company operation assigned to that person, albeit functional or geographic, or the entire undertaking of the company.³⁸³

Although the identification of the directing mind is primarily a constitutional question depending on the conferral of power by the memorandum of incorporation, determining the directing mind is not a purely formal analysis constricted to the founding documents of the company.³⁸⁴ The crux of the analysis, is to identify the person who is in actual control of the operations of the company or the relevant part thereof.³⁸⁵ Furthermore, although the company's memorandum of incorporation could confer powers, it is necessary to determine how those powers are delegated and who ultimately exercises those powers. Therefore, it is possible that the directing mind and will of a company is not found in the director, but rather a senior manager or other employee who has control over a certain part of the company's operations.³⁸⁶

³⁷⁹ *El Ajou* 699. Hoffmann LJ at 706 reiterated the notion that different persons may be regarded as the directing mind and will of the company for different activities.

³⁸⁰ CNA para 31.

³⁸¹ *El Ajou* 696.

³⁸² *Canadian Dredge* 331.

³⁸³ *Canadian Dredge* 330.

³⁸⁴ Blackman et al *Commentary* (RS 3 2006) 4-131.

³⁸⁵ In *MCI WorldCom International Inc v Primus Telecommunications Inc* 2004 1 BCLC 42 (QBD) 58, the court referred to the “ultimate decision-taker” in ascertaining the directing mind of the company.

³⁸⁶ Blackman et al *Commentary* (RS 3 2006) 4-131.

Once knowledge has been attributed to the company, it remains the knowledge of the company in subsequent stages of the transaction, even if the person originally identified as the directing mind is no longer part of the company.³⁸⁷

The writers of *Commentary* argue that the conclusion of the decision in *Meridian*, is that the directing mind doctrine does not form part of company law, however, it has been submitted that the question before the court was much narrower, namely to which hierarchical level does the doctrine apply.³⁸⁸ In company law, the doctrine does not permit one to focus on lower-level employees. Nevertheless, if a particular statute provides for a broader analysis, it would be possible for a court to pursue broader application of the doctrine.

In *Re Bank of Credit and Commerce International SA (in liquidation) (no 15): Morris v Bank of India (“Re Bank”)*³⁸⁹ the court approached the rules of attribution in a slightly different manner, by stating that the question of attribution should be justified by an interpretation of the statutory provision in question, in other words the primary rules of attribution. Once these primary rules of attribution would defeat the policy behind the provision, the attribution would be applied according to the facts on a case by case basis.

The court proceeded to list certain factors to ascertain if a person could be regarded as the directing mind and will.³⁹⁰ Firstly, the natural person's importance or seniority in the hierarchy of the company; it is easier to attribute a senior managerial officer's will and conduct than a low-level employee. Secondly, if there is a freedom to act according to the natural person's own discretion in the context of a particular transaction and not the board's, attribution is easier. Thirdly, the degree to which the board is informed, as well as the extent to which it was put on enquiry. The court stated that “the greater the grounds for suspicion or even concern or questioning, the easier it is to attribute, if questions were not raised or answers were too readily accepted by the board.”³⁹¹ If there is a series of transactions, it would be easier to impute a person's conduct and will as the directing mind of the company.

³⁸⁷ *EI Ajou* 706; Blackman et al *Commentary* (RS 3 2006) 4-132.

³⁸⁸ Blackman et al *Commentary* (RS 3 2006) 4-132.

³⁸⁹ 2005 2 BCLC 328 (CA) 360-1.

³⁹⁰ *Re Bank* 361.

³⁹¹ *Re Bank* 361.

These factors stated in *Re Bank* were incorporated by the Supreme Court of Appeal in the CNA judgment, to determine whether certain employees could be regarded as the directing mind and will of the company.³⁹²

Ultimately, the court in *Re Bank* identified an individual who had a large measure of responsibility within the company transactions, as well as independent discretion to determine whether to continue with a transaction or not. With respect to the relevant transaction, the individual was the “relevant decision-maker,” as the board of directors had delegated the supervision of the transactions, as well as the final decision to proceed with a transaction to the individual in question. Thus, the board delegation was not a mere instruction to conclude a transaction, but greater responsibility and discretion.³⁹³

Prior to *Meridian*, it seemed possible to reach an identical result by relying on company law principles in applying the doctrine of attribution. In addition thereto, by applying justice and common sense, in contrast to the policy of the provision in question, justice and good sense relied on in *Re Bank*.³⁹⁴ The confusion regarding the company law principles relating to the rules of attribution might stem from vagueness relating to these principles. For example, if the directing mind ceases to act in the best interest of the company, those acts cannot be attributed to the company. Accordingly, the doctrine does not apply if the relevant conduct is in conflict with the interests of the company and any benefit of the person is irrelevant. Similarly, if the person identified as the directing mind acts solely for personal benefit, the rules of attribution will not apply, even in the absence of any intentional harm.

In *Canadian Dredge*, the court explained when the doctrine will not be applied:

“Where the directing mind conceives and designs a plan and then executes it whereby the corporation is intentionally defrauded, and when this is the substantial part of the regular activities of the directing mind in his office, then it is unrealistic in the extreme to consider that the manager is the directing mind of the corporation, his entire energies are, in such a case, directed to the destruction of the undertaking of the corporation.

³⁹² Para 31.

³⁹³ As determine by the court a quo, *Re Bank of Credit and Commerce International SA (in liquidation) (no 15): Morris v Bank of India* 2005 2 BCLC 328 (ChD) 351.

³⁹⁴ Blackman et al *Commentary* (RS 3 2006) 4-133.

When he crosses that line he ceases to be the directing mind and the doctrine of identification ceases to operate.”³⁹⁵

6 Conclusion

The legal nature of the corporation, as well as the fundamental principle of separate legal personality must be maintained when applying the rules of attribution.³⁹⁶ As one of the cornerstones of company law, the distinction between the individual and the individual’s company should be maintained. Furthermore, there is no hierarchy among the primary, general and special rules of attribution as developed by Lord Hoffmann in *Meridian*. The fundamental question underlying these rules, is whose acts should be attributed to the company for the particular purpose? Ultimately, a contextual analysis should be followed when applying the rules of attribution. Corporate attribution seeks to identify whose acts should be imputed to the company; whether those acts are in breach of a person’s duty to the company is a separate question.³⁹⁷ The rules of attribution are key to the operational structure of a company; thus, it is imperative that the basic principles are clearly understood and applied in case law. Moreover, the role of corporate attribution and agency rules should not be undermined in corporate regulation.

³⁹⁵ *Canadian Dredge* 351.

³⁹⁶ Worthington (2017) *Law Q Rev* 142.

³⁹⁷ 143.

Chapter 4: Corporate criminal liability

1 Introduction

The need for corporate criminal liability has increased with an increase in corporate crime.³⁹⁸ Whether it is to address corruption, environmental offences, tax evasion, collusion or corporate homicide, as a creature of statute there should be a means to regulate corporate entities.³⁹⁹ According to Wells, corporate criminal liability is characterised by three features: corporate personality, corporate responsibility and corporate culture.⁴⁰⁰ Firstly, corporate personality flows from the assumption that a company has a separate legal existence, thus acts as a legal person.⁴⁰¹ Secondly corporate responsibility could be characterised as role responsibility, capacity responsibility, causal responsibility and liability responsibility.⁴⁰² Finally corporate culture is indicative of a company as an autonomous actor in its own right, which transcends individuals' contributions.⁴⁰³

As a point of departure, companies are awarded legal personality. It should, however, be borne in mind that this construct remains an artificial one.⁴⁰⁴ Therefore, it can normally only act through authorised people, for example the board of directors. However, if a company commits a crime (which would not be authorised conduct), it becomes problematic to attribute will and conduct to the company.⁴⁰⁵ Moreover, as

³⁹⁸ JM Burchell *Principles of Criminal Law* 5 ed (2016) 458.

³⁹⁹ In South African law a complex regulatory regime has been developed whereby various corporate crimes are addressed, for example s 73A of the Competition Act 89 of 1998 imposes liability for collusion, s 24 of the National Environmental Management Act 107 of 1998 (which address environmental authorization for property development), s 24 of the Occupational Health and Safety Act 85 of 1993 (which relates to injuries in the workplace and corporate homicide) and s 3 of the Prevention and Combating of Corrupt Activities Act 12 of 2004.

⁴⁰⁰ C Wells "Corporate Criminal Liability in England and Wales" in M Pieth & R Ivory (eds) *Ius Gentium: Comparative Perspectives on Law and Justice* 9 (2011) 91-94.

⁴⁰¹ The various theories supporting the construction of legal personality have been discussed in Chapter 2.

⁴⁰² Role responsibility relates to the various roles that individuals play within an organisation, as well as the accompanying duties these roles impose. Capacity responsibility refers to the attributes necessary to deem a person a responsible agent, which could be problematic in corporate responsibility, for it assumes human consciousness. Causal responsibility is the link between role and capacity responsibility on the one hand and liability on the other. Liability responsibility is described as the *raison d'être* for establishing the previously mentioned responsibilities. Wells "Corporate Criminal Liability" in *Ius Gentium* 95-96

⁴⁰³ Wells "Corporate Criminal Liability" in *Ius Gentium* 96.

⁴⁰⁴ R Cassim "The Legal Concept of a Company" in FHI Cassim (ed) *Contemporary Company Law* 2 ed (2012) 28-31.

⁴⁰⁵ F McAuley & JP McCutcheon *Criminal Liability* (2000) 379.

creatures of statute, it would not be the intention of the legislature to permit criminal conduct. Nevertheless, the fault and conduct of its directors or employees are traditionally ascribed to the company to determine corporate criminal liability.

As discussed in Chapter 2, there are two broad theories for corporate personality, namely the fiction theory and the realist theory. South Africa follows a derivative model of vicarious liability, which forms part of the individualist theory, whereby fault and conduct are imputed to ascribe criminal liability to a company, rather than a realist one. The derivative model is clearly illustrated in section 332 of the Criminal Procedure Act 51 of 1977 (“CPA”), which generally governs corporate criminal liability in South Africa. This model has, however, been criticised as being too abstract and not catering for the intricate organisational structures of large modern corporations.⁴⁰⁶

The identification model is the primary model of attribution in English law. The foundation of this model lies in the directing minds doctrine, whereby the corporation’s fault and conduct are imputed from the board of directors or those with the power to set corporate policy (for example prescribed officers).⁴⁰⁷ In this regard it is paramount that the person be regarded as an “alter ego” of the company.⁴⁰⁸

This chapter will explore the various models of corporate criminal liability, with special reference to both the individualist and realist theory underlying corporate liability. The question to be answered is whether the South African model is on par with international trends and whether reform to a non-derivative model is needed. Moreover, the constitutionality of section 332(1) of the CPA will be analysed, following a similar rational to the Constitutional Court’s reasoning in *S v Coetzee*.⁴⁰⁹

The alternative models based on corporate fault found in English and Australian law will be discussed as viable alternatives for South Africa. These jurisdictions have opted

⁴⁰⁶ L Jordaan “New perspectives on the criminal liability of corporate bodies” (2003) *Acta Jur* 48 48; PG du Toit & GJ Pienaar “Korporatiewe identiteit as die basis van strafregtelike aanspreeklikheid van regspersone (2): die praktyk” (2011) 14 *PELJ* 98 98; Burchell *Principles* 461.

⁴⁰⁷ A “director” is described in s 1 of the Companies Act 71 of 2008 (“Companies Act”). A “prescribed officer” is defined in s 1 of the Companies Act, read in conjunction with regulation 38, GN R 351 in GG 34239 of 26-04-2011.

⁴⁰⁸ In *H L Bolton (Engineering) Co Ltd v T J Graham & Sons Ltd* 1956 All ER 624; 1957 1 QB 159 at 173 (“*HL Bolton*”) it is reiterated that a company could be compared to a human body, but certain employees only fulfil an instrumental function, whereas others (such as the directors or managers) represent the directing mind and will of the company and ultimately controls its actions.

⁴⁰⁹ 1997 3 SA 527 (CC) (“*S v Coetzee*”).

for an organisational model, focusing on corporate culture rather than the identification of specific individuals to ascribe liability onto the company.⁴¹⁰

Lastly, the deterrence theory will briefly be explored with reference to the efficacy of sanctions on corporate actors.

2 Historical background to corporate criminal liability

In a modern company, the board bears responsibility for policy decisions, as well as the general administration of the company. In South African law, section 66(1) of the Companies Act sets out the broad competencies of the board as follows:

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

Moreover, the memorandum of incorporation (“MOI”) of a company will provide for the appointment of a board of directors, set out the various powers vested in the board and usually confers the company’s capacity and authority to the board of directors.

The day-to-day management, however, is usually delegated to the managing director or directors, either by way of board resolution or the MOI. According to Pinto and Evans⁴¹¹ these organs within a company are important for holding a company criminally liable. If one were to identify the acts of the company itself, these organs’ conduct will necessarily be attributed to the company.

It is argued, that the recognition of a company as a legal person with rights and obligations led to the need for corporate criminal liability.⁴¹² Traditionally the maxim *societas delinquere non potest*⁴¹³ precluded companies from being held criminally liable.⁴¹⁴ This maxim was predominant in continental jurisdictions and influenced the South African scholars De Wet and Swanepoel. Since the late twentieth century,

⁴¹⁰ Du Toit & Pienaar (2011) *PELJ* 115.

⁴¹¹ A Pinto & M Evans *Corporate Criminal Liability* 2 ed (2008) 14.

⁴¹² Pinto & Evans *Corporate Criminal Liability* 15.

⁴¹³ Meaning “a legal entity cannot be blameworthy” according to EB Diskant “Comparative Corporate Liability: Exploring the Uniquely American Doctrine Through Comparative Criminal Procedure” (2008) *Yale LJ* 126 129.

⁴¹⁴ This notion that a company is incapable of bearing criminal responsibility was upheld by Von Savigny in *System des heutigen römischen Rechts* Vol II (1840). In South African law, De Wet did not support the idea of corporate criminal liability. Instead he followed the rhetoric of Von Savigny and argued that criminal liability should be restricted to individuals only. JC De Wet & HI Swanepoel *Strafreg* 4 ed (1985) 53-62.

continental jurisdictions, such as the Netherlands, Belgium and France, have incorporated the notion of corporate criminal liability.⁴¹⁵ Nevertheless, the maxim is still upheld in contemporary German law.⁴¹⁶ On the other hand, in common law jurisdictions, the original rejection of corporate criminal liability was founded on the principle that a corporation is incapable of forming a will and acting accordingly. In the late 1800s, case law held that a company cannot act of its own accord, for it has no independent person; it is reliant on directors, who are the agents of the company.⁴¹⁷ Lord Chancellor Baron Thurlow described the dilemma as a lack of a “body to be kicked” or a “soul to be damned”.⁴¹⁸ Holding a company criminally liable is challenging.⁴¹⁹ Partly, due to the fact that a company remains an abstraction or metaphysical entity,⁴²⁰ and accordingly lacks the necessary guilty conscience necessary to commit a crime. This notion is in conflict with criminal law’s emphasis on an individualistic model of responsibility and punishment.⁴²¹ Therefore, the required inherent blameworthiness which forms the cornerstone of criminal responsibility remains problematic in the case of corporate criminal liability.⁴²²

Originally corporate criminal liability had limited application, extending to cases of public nuisance, criminal libel and a breach of statutory duty. The reason for the limited scope of corporate liability, was the rationale that a master should not be held criminally liable for the conduct of his servants, unless he sanctioned the conduct or aided and abetted the criminal acts. In *R v Stephens*⁴²³ Bramwell B stated that he

⁴¹⁵ PG du Toit *Die strafregtelike aanspreeklikheid en straftoemeting aan regspersone* LLD Thesis Northwest University Potchefstroom (2010) 61.

⁴¹⁷ As stated in *Ferguson v Wilson* 1866 LR 2 Ch App 77 89 and quoted in Pinto & Evans *Corporate Criminal Liability* 17.

⁴¹⁸ As quoted in Burchell *Principles* 460.

⁴¹⁹ A company is awarded rights and duties in terms of private law, as stated in section 8(4) of the Constitution of the Republic of South Africa, 1996 (“Constitution”), but it lacks the necessary moral faculties needed for criminal liability.

⁴²⁰ As stated in *Lennard’s Carrying Co Ltd v Asiatic Petroleum Co Ltd* 1915 AC 705 713 (“Lennard’s”) and *The Pharmaceutical Society v London & Provincial Supply Association Ltd* 1880 5 App Cas 857 (HL) respectively.

⁴²¹ Traditionally, criminal law centralises around personal guilt. If the accused’s mental state cannot be determined, it seems that no criminal responsibility can arise. M Pieth & R Ivory “Emergence and Convergence: Corporate Criminal Liability Principles in Overview” in M Pieth & R Ivory (eds) *Ius Gentium: Comparative Perspectives on Law and Justice* 9 (2011) 3 4; Pinto & Evans *Corporate Criminal Liability* 18.

⁴²² Kemp et al *Criminal Law* 242.

⁴²³ 1886 LR 1 QB 702.

wanted to refrain from diverting from the general rule that a principal could not be held criminally responsible for the act of his agents.

However, a need to develop corporate criminal liability beyond its limited application became apparent. Bearing the assumption that a company cannot think nor act for itself in mind, a method was sought by which the *actus reus* and *mens rea* of a company could be ascertained.⁴²⁴ Therefore, the courts developed various models to overcome the hurdle of an inapt moral compass.

3 Two opposing theoretical views: the individualist versus the realist

Originally, criminal law developed as a countermeasure to individual wrongdoing. Accordingly, the assumption is made that perpetrators are human in nature and can be held accountable for their immoral or illegal conduct.⁴²⁵ Consequently, the abstract nature of corporations is not in accordance with the basic principles of criminal law, which seek to reprimand blameworthy individuals.⁴²⁶ Due to the rapid development of corporate entities and the pivotal role they play in modern day society, the need arises to also hold them accountable. In the absence of a moral conscience, it is easier for such an entity to commit an offence, since in itself it has no knowledge of right or wrong. Therefore, in developing corporate criminal liability, due regard has been given to the various theoretical approaches to corporate personality.⁴²⁷

The approaches to corporate criminal liability are found on a spectrum which varies from the nominalist or individualistic approach on the one hand, to the realist's approach on the other hand.⁴²⁸ In terms of individualist theory, a company is merely constituted by individuals and their fault and conduct should consequently be imputed to the juristic person before any corporate criminal liability could arise. For this purpose, either the identification doctrine (also known as the directing mind principle)

⁴²⁴ This view of corporate personality is known as the nominalist or fiction theory of corporate personality, which is founded on the principle that a company is nothing more than a legal construct. Von Savigny explains that juristic persons are merely products of law for legal purposes. It remains a collective of the individuals comprising the company and nothing more. If the company acts, it does so by way of human representation. Pieth & Ivory "Emergence and Convergence" in *Ius Gentium* 6.

⁴²⁵ Kemp et al *Criminal Law* 241; Jordaan (2003) *Acta Jur* 48.

⁴²⁶ V Borg-Jorgensen & K Van der Linde "Corporate criminal liability in South Africa: time for change? (Part 1)" (2011) 3 *TSAR* 452 453.

⁴²⁷ Borg-Jorgensen & Van der Linde (2011) *TSAR* 453.

⁴²⁸ Pieth & Ivory "Emergence and Convergence" in *Ius Gentium* 48-49; Jordaan (2003) *Acta Jur* 48ff; Burchell *Principles* 460.

or vicarious liability as model is traditionally followed.⁴²⁹ A corporation remains an abstract or fictional being, which lacks a substantive individual identity and consequently independent corporate fault.⁴³⁰

In terms of realist theory a company is regarded as a separate corporate entity and not an artificial embodiment of different individuals.⁴³¹ Therefore a company has a unique legal (and possibly moral) existence.⁴³² Affirmation of the unique attributes of a juristic person, is found in the promotion of corporate entities of themselves as distinct with individualistic features and distinguishing them in society from the humans associated with them.⁴³³ Fault should be founded on the corporate culture within the company and not pinned on a single individual's thoughts. Bearing in mind the intricate organisational structures within companies, it might be more rational to follow a holistic approach to corporate criminal liability.⁴³⁴

Moreover, Foerschler is of the opinion that a corporation should be regarded as an intentional agent in its own right.⁴³⁵ In realising the corporate entity as an intentional agent of own accord, criminal liability should be based on a proper understanding of the nature of the decision-making process, as well as the internal structure within a particular entity.⁴³⁶ Once the organisational theory is considered, it becomes clear that the aggregation of individuals' conduct and fault cannot amount to corporate criminal liability. Corporate conduct is not merely the summation of different decisions by various individuals, but rather an intricate mosaic of differing decisions, institutional

⁴²⁹ These modes of attribution are known as the derivative models of corporate criminal liability. Jordaan (2003) *Acta Jur* 49; DM Farisani "The regulation of corporate criminal liability in South Africa: a close look (Part 1)" (2006) *Obiter* 263 265-266.

⁴³⁰ Jordaan (2003) *Acta Jur* 50; Borg-Jorgensen & Van der Linde (2011) *TSAR* 453.

⁴³¹ Borg-Jorgensen & Van der Linde (2011) *TSAR* 454.

⁴³² McAuley & McCutcheon *Criminal Liability* 379; PG du Toit & GJ Pienaar "Korporatiewe identiteit as grondslag van die strafregtelike aanspreeklikheid van regspersone (1): teoretiese grondbeginsels" (2011) 14 *PELJ* 33 33.

⁴³³ Du Toit *Strafregtelike aanspreeklikheid* 108; Borg-Jorgensen & Van der Linde (2011) *TSAR* 454.

⁴³⁴ Fisse and Braithwaite argue that the two obstacles faced if one holds large modern corporations liable is firstly, that the individual accountability are undermined by prosecuting corporations rather than the individual wrongdoers. Secondly, in theory the sanctioning methods employed presupposes that corporations will use internal disciplinary systems to ensure individual accountability. Whether these mechanisms are sufficient to ensure its retributive effect is uncertain. Therefore, by merely paying a fine as means of a sanction does not warrant accountability or responsibility; it is an easy way out. B Fisse & J Braithwaite "The allocation of responsibility for corporate crime: individualism, collectivism and accountability" (1988) 11 *Syd LR* 468 468-469, B Fisse & J Braithwaite *Corporations, Crime and Accountability* (1993) 1-2; Du Toit *Strafregtelike aanspreeklikheid* 107

⁴³⁵ A Foerschler "Corporate criminal intent: toward a better understanding of corporate misconduct" (1990) *Cal L Rev* 1287 1302.

⁴³⁶ Foerschler (1990) *Cal L Rev* 1302.

procedures and structures.⁴³⁷ Therefore, both the conduct and fault of the company should be evaluated from the perspective of the corporate culture in its entirety, rather than focussing on the individual pieces of the puzzle.

Although the corporate conduct is imputed with reference to individual decision-making, this should not be the sole consideration in determining liability. A corporation should be regarded as a collective entity and liability should be ascribed similar to the common purpose doctrine. Moreover, systemic failure rather than the default of individuals are often the causes of harm.⁴³⁸

As mentioned above, a company has separate juristic personality;⁴³⁹ hence by ascribing criminal liability with reference to individual contribution and mind-set, the purpose of the separation is hindered. Lederman argues that the self-identity model of a corporation is based on the assumption that it has a set of values and morals, which could simultaneously influence and constrain the thinking and behaviour of the people within its framework.⁴⁴⁰ Thus the corporate identity of a company is distinguishable from the individuals' embodying it; ascertaining the fault of juristic persons should be based on this identity rather than illogical modes such as vicarious liability.

In applying the realist theory, it is necessary to determine what the corporate identity or corporate culture of a company is.

3 1 The scope of corporate identity

The corporate identity model is firstly founded on the principle that the unique identity of a juristic person would influence its adherence to legal rules.⁴⁴¹ The King Code of Governance for South Africa 2016 ("King IV") encourages responsible

⁴³⁷ Du Toit & Pienaar (2011) *PELJ* 34.

⁴³⁸ McAuley & McCutcheon *Criminal Liability* 379.

⁴³⁹ s 19(1)(b) of the Companies Act.

⁴⁴⁰ E Lederman "Models for imposing corporate criminal liability: from adaptation and imitation toward aggregation and the search for self-identity" (2000-2001) 4 *Buff Crim L Rev* 641 686; Du Toit *Strafregtelike aanspreeklikheid* 114.

⁴⁴¹ Lederman (2000-2001) *Buff Crim L Rev* 690.

corporate citizenship⁴⁴² and an ethical framework to promote this goal,⁴⁴³ whereby the unique corporate culture is confirmed. Even section 7 of the Companies Act, which relates to the objectives of the Companies Act, states that a company should promote adherence to the Bill of Rights, as entrenched in the Constitution. In determining the company's identity, reference should be made to the control and monitoring mechanisms set in place, along with the general ethos and working environment within the company.⁴⁴⁴ These factors could encourage the compliance with legal rules and regulations, but on the other hand negligent or capricious conduct might be promoted if the control mechanisms are not properly implemented. Whether adherence to the principles of King IV is sufficient to establish a law-abiding corporate environment remains uncertain; partly because the board of directors remains the focal point (and not the company *per se*) and partly due to the fact that it is regarded as soft law.⁴⁴⁵

Corporate identity or culture is thus not found in the aggregation of the will and conduct of various individuals, but rather the unique attributes found in the internal structure of the company. This culture forms the core of the company and remains constant irrespective of any personnel changes: rather it shapes the frame of mind and conduct of its members. A company's corporate identity can be determined with reference to the written or unwritten policy documents, custom, goals of the company, monitoring systems to ensure compliance and whether unlawful conduct is rewarded by the company. Furthermore, corporate decisions cannot be attributed by a directing mind, but are made in collaboration with differing levels of decision-making within the company.⁴⁴⁶ Often an offence is the likely result of a failure in the corporate structure in more than one section, which makes it impossible to pin the conduct on a specific

⁴⁴² King IV defines corporate citizenship as the recognition that an organisation plays an integral role in the broader society in which it operates, which on the one hand provides it standing as a separate juristic person with certain rights, but simultaneously it also has obligations and responsibilities. It also entrenches the fact that the broader society acts as a licensor of the organisation. By defining corporate citizenship, King IV builds on the King Code of Corporate Governance 2009 ("King III"), which stated that responsible corporate citizenship implies an ethical relationship between the company and its environment (including the socio-economic sphere). Although the underlying philosophy of King IV remains the same, it concretises this ethical relationship into rights and obligations.

⁴⁴³ Principles 1-3.

⁴⁴⁴ Du Toit & Pienaar (2011) *PELJ* 36.

⁴⁴⁵ Soft law refers to the fact that King IV is not legislation, but merely a guideline to ensure proper corporate behaviour. Only if a company is listed on the Johannesburg Stock Exchange, ("JSE"), do the rules of the JSE necessitate adherence to the principles of the King Code.

⁴⁴⁶ Du Toit & Pienaar (2011) *PELJ* 57.

individual.⁴⁴⁷ Thus a systemic approach based on realism, would ensure that a company can be held liable.

The identity of the juristic person could be determined and corporate behaviour of the entity is predictable. The model is analogous to an individual, since the entity chooses to conduct itself in a certain way, whilst being aware of possible liability. According to Lederman, the juristic person should still be susceptible to change – be it in altering its behaviour and conduct or attitude.⁴⁴⁸

At the core of this model lies the fact that a company is governed by its traditions and corporate structure and not the constant influx of people. A change in management, or even other employees, would not bring about material changes in the structure of the company. Instead, the individuals within the company would adapt to adhere to the company's goals. Their freedom is thus inhibited by the corporate policy and customs within the company. In contrast, the company's identity remains constant.⁴⁴⁹ This approach is in line with the perpetuity of companies, thus their liability should not be limited to the constraints of human conduct or *mens rea*.

If corporate criminal liability is founded in the realm of its organisational structure, the actors within the company would be encouraged to function within the legal framework.⁴⁵⁰ Furthermore, it clarifies what the company's stance towards being a morally sound citizen is; one could argue that the ground-rules are laid down. Where these rules promote the disregard for legal order and regulations, the employees are expected to commit crimes in promotion of the interests of the company. One could argue that by fostering a culture of non-compliance, the company tacitly concedes to criminal behaviour of their employees. Therefore, the corporate culture is inextricably linked to an individual employee's criminal conduct.⁴⁵¹ If a company endorses risk loving behaviour, employees' reckless conduct would be sanctioned, either expressly or tacitly. Due to the lack of personal responsibility within the company, the corporate decisions taken within the company could be immoral or illegal.⁴⁵² In this regard the

⁴⁴⁷ Borg-Jorgensen & Van der Linde (2011) *TSAR* 455.

⁴⁴⁸ Lederman (2000-2001) *Buff Crim L Rev* 690.

⁴⁴⁹ Lederman (2000-2001) *Buff Crim L Rev* 691.

⁴⁵⁰ SM Kriesberg "Decision-making models and the control of corporate crime" (1976) *Yale LJ* 1091 1100.

⁴⁵¹ Du Toit & Pienaar (2011) *PELJ* 37.

⁴⁵² C Parker "Compliance professionalism and regulatory community: the Australian trade practices regime" (1999) 26 *J Law & Soc* 215 227.

individualistic approach to corporate criminal liability hinders the accountability of a company, because a single individual's conduct can neither be imputed to the company nor identified as the directing mind of the company. A company could escape liability and bad decision-making by means of a complex organisational structure.

A further development in terms of realist theory, is the notion of reactive corporate fault.⁴⁵³ This stems from the idea that a company sanctions criminal behaviour, by failing to adopt reasonable remedial procedures in response to the acts or omissions of individuals within the company.⁴⁵⁴ Thus if the company fails to adopt any preventative or corrective measures, it could be deemed to reward the *actus reus* and as a result have reactive fault. Structural reform, internal disciplinary procedures and compensation are factors to consider in determining the reactive fault of a company.

This approach requires a departure from the fundamental principles of criminal law and could result in uncertainty pertaining to which remedial procedures would be sufficient to escape liability.⁴⁵⁵ Despite the possible uncertainty, it might prove to supplement the current derivative approach to corporate criminal liability, as prevalent in South African law.

4 Models of attribution

There are two derivative models which form part of the realm of the individualist model, namely vicarious liability and the doctrine of identification.⁴⁵⁶ In order to understand the need to supplement the individualist model with the realist theory, these two derivative models will accordingly be discussed.

4 1 Vicarious liability

Although there remains a general rule that a person cannot be held liable for the crimes of another unless she authorised the commission or participated in some manner,⁴⁵⁷ South African law has opted for a general vicarious liability model to

⁴⁵³ Fisse & Braithwaite (1988) *Syd LR* 511-522; Fisse & Braithwaite *Corporations* 47-49, 210-213.

⁴⁵⁴ Borg-Jorgensen & Van der Linde (2011) *TSAR* 455.

⁴⁵⁵ 455.

⁴⁵⁶ Pinto & Evans *Corporate Criminal Liability* 19.

⁴⁵⁷ If one considers common law crimes, it would be irrational to impose vicarious liability for common law crimes, if a person was not party to the crime nor had any culpability. Therefore vicarious liability is restricted to statutory crimes, where the legislature expressly or by necessary implication imposes criminal liability on certain categories of people if they stand in a certain relationship, typically the employer-employee relationship. The only requirement is that the criminal conduct should fall within the

impose corporate criminal liability.⁴⁵⁸ This model is found in section 332 of the CPA, which provides a comprehensive framework designed to prosecute corporate offenders.⁴⁵⁹

The rationale for imposing vicarious liability is that an employer will be encouraged to ensure that her employees' conduct is compliant.⁴⁶⁰ Especially if an employer (in this case a company) were to benefit financially, it cannot hide behind an employee's actions and not be prosecuted. Due to the risk it poses if responsibility is delegated, the conduct of employees should ultimately be imputed to the employer.⁴⁶¹ As a juristic person, however, authority needs to be delegated to the board or other employees, but this would imply that lawful conduct is sanctioned and not necessarily criminal behaviour.

By using vicarious liability as a derivative model of attribution, the obstacle of finding fault in an artificial being is removed.⁴⁶² Section 332 of the CPA uses this model to attribute criminal conduct and will to companies.

4 1 1 The South African solution: section 332 of the CPA

If one considers the wording of section 332 of the CPA (especially subsection (1)), the vicarious liability approach is confirmed. It reads as follows:

- (1) For the purpose of imposing upon a corporate body criminal liability for any offence, whether under any law or at common law-
 - (a) any act performed, with or without a particular intent, by or on instructions or with permission, express or implied, given by a director or servant of that corporate body; and

scope of employment or further the interests of the employer. This would safeguard an employer from criminal liability for a rogue employee. CR Snyman *Criminal Law* 6 ed (2014) 242.

⁴⁵⁸ Jordaan (2003) *Acta Jur* 49; CN Nana "Corporate Criminal Liability in South Africa: The Need to Look Beyond Vicarious Liability" (2011) 55 *JAL* 86 86; C Van der Bijl "Corporate 'assault': bullying and the aegis of criminal law (Part 2)" (2014) 4 *TSAR* 760 760.

⁴⁵⁹ *S v Coetzee* para 18.

⁴⁶⁰ Snyman *Criminal Law* 242.

⁴⁶¹ Burchell argues that vicarious liability is a principle which is sound in the law of delict, but its application in criminal law is a "fundamental negation of the principle that criminal liability is based on individual fault (*mens rea*)". Therefore, the same policy considerations for imposing vicarious liability should not apply. JM Burchell *South African Criminal Law and Procedure Vol I: General principles of criminal law* 4 ed (2011) 406.

⁴⁶² Burchell *Principles* 64, 464. According to Jordaan, the legislature follows the premise that a juristic person *per se* lacks both the mental (blameworthy) and physical attributes necessary to commit a crime (2003) *Acta Jur* 50.

- (b) the omission, with or without a particular intent, of any act which ought to have been but was not performed by or on instructions given by a director or servant of that corporate body,

in the exercise of his powers or in the performance of his duties as such director or servant or in furthering or endeavouring to further the interests of that corporate body, shall be deemed to have been performed (and with the same intent, if any) by that corporate body or, as the case may be, to have been an omission (and with the same intent, if any) on the part of that corporate body."

It is apparent in the formulation of section 332(1), that the legislature presupposed that a legal person cannot commit the criminal act itself, nor is it capable of having the required fault.⁴⁶³ A fiction is formulated, whereby certain individuals' conduct and fault are attributed to the company in certain circumstances.⁴⁶⁴ Only if that conduct and fault would amount to criminal liability, could the company be held liable.

The corporate body is thus held liable for the acts of the servant or director during the course of their employment or where the interests of the company are furthered. The unlawful conduct and *mens rea* are ascribed to be that of the company, similarly to the doctrine of vicarious liability in the law of delict.⁴⁶⁵ However, vicarious liability in this context differs from delictual liability in the sense that the corporate entity is still deemed to have fault, whereas the employer's fault is usually not relevant under true vicarious liability.⁴⁶⁶ As a result, the concept of corporate criminal liability is a legal construct which is not necessarily consistent with the corporate reality.⁴⁶⁷

The scope of section 332(1) extends to both crimes requiring fault (referring to both intent and negligence) alongside strict liability.⁴⁶⁸ This broad interpretation was emphasised in *Ex parte Minister van Justisie: In re S v Suid-Afrikaanse Uitsaaikorporasie* ("SAUK"),⁴⁶⁹ where the Supreme Court of Appeal held that on a proper understanding of the wording of section 332(1), a juristic person can be held liable for crimes of negligence committed by its directors or officers.⁴⁷⁰ By reaching

⁴⁶³ I Du Plessis "Die strafregtelike aanspreeklikheid van regspersone: 'n menslike benadering" (1991) 4 *TSAR* 635 639.

⁴⁶⁴ Burchell *Principles* 464.

⁴⁶⁵ Van der Bijl (2014) *TSAR* 760.

⁴⁶⁶ Kemp et al *Criminal Law* 244; Jordaan (2003) *Acta Jur* 48.

⁴⁶⁷ Van der Bijl (2014) *TSAR* 761.

⁴⁶⁸ Kemp et al *Criminal Law* 244; Burchell *Principles* 464; Du Plessis (1991) *TSAR* 637.

⁴⁶⁹ 1992 4 SA 804 (A).

⁴⁷⁰ In *SAUK* the Minister of Justice brought an *ex parte* application seeking to clarify whether section 332(1) firstly applied to crimes of negligence and secondly if the decision in *R v Bennet & Co (Pty) Ltd*

this conclusion, the court confirmed the decision in *R v Bennett & Co (Pty) Ltd.*⁴⁷¹ Furthermore, it shows that a company could be convicted of a crime requiring negligence despite the possibility of it having a due diligence defence.⁴⁷²

Moreover the company may be held liable for not only the positive acts by its employees, but also the omissions committed by employees or possibly authorised third parties, if the interests of the company are furthered.⁴⁷³ Additionally criminal liability would arise for both statutory transgressions and common-law offences.⁴⁷⁴ Whether this should only relate to offences for which a corporate body could in actual fact be held liable, is uncertain.⁴⁷⁵ One could assume that a company should only be found guilty as an accomplice to rape and not be held personally liable.⁴⁷⁶

1941 TPD 194 ("Bennet") was wrong in law. In the aftermath of the *S v Suid-Afrikaanse Uitsaaikorporasie* 1991 2 SA 698 (W) ("Uitsaaikorporasie") a legal uncertainty arose as to the scope of section 332(1) in respect of crimes requiring *culpa*. The majority of the court found that on a proper interpretation of section 332(1) it cannot be found that the legislature attempted to extend the scope of the fiction to include negligence for crimes requiring culpability, due to the express mention of "particular intent". Accordingly the majority rejected the *Bennet* decision. Grosskopf AJ criticised this literal interpretation, because it negates the essence of *culpa* as a form of *mens rea* (as stated at 808A). By quoting *S v Ngubane* 1985 3 SA 677 (A) at 686E-G ("Ngubane"), Grosskopf AJ states that *dolus* implies "no volitional state of mind", while *culpa* may entail "no state of mind". However, in *Ngubane* at 687E it is argued that *culpa* refers to no state of mind, but instead conduct which fails to meet a reasonable standard. In essence, the inquiry is an object one, compared to the subjective nature of determining *dolus*. Therefore in determining the negligence of a company, the subjective state of mind of a natural actor should not be attributed to the company, but rather the conduct itself should be measured against an objective standard. This method is similar to the wrongfulness inquiry, whereby the conduct of the particular person is objectively compared to a reasonable standard and not directly attributed to the company. Finally Grosskopf concludes (809C-H) that crimes of negligence should be included in the scope of section 332(1): firstly because it is improbable that the legislature would include strict liability and intent, but omit negligence and secondly for historical consistency.

⁴⁷¹ 1941 TPD 194. Despite the fact that this case considered section 384(1) of the Criminal Procedure and Evidence Act 31 of 1917 as amended by section 117 of Act 23 of 1939, it is held the wording is similar to section 332(1) of the current CPA.

⁴⁷² Jordaan (2003) *Acta Jur* 53.

⁴⁷³ In terms of section 332(1) the *omissio* and *commissio* will only be attributed under certain circumstances. If a director or servant commits the offence, it should be done in the course of employment and not in a private capacity. Although it originally seems to be a proper restriction, this limitation is watered down by attributing conduct if the interests of the company are furthered. Therefore, the scope of criminal liability of a company is wider than its civil liability, as stated by Burchell *Principles* 65. See *Bennet*, *R v Booth Road Trading Co (Pty) Ltd* 1947 1 SA 34 (N); *R v Philips Diary (Pty) Ltd* 1955 4 SA 120, *S v Banur Investments (Pty) Ltd* 1969 1 SA 231 (T) and *SA Metal and Machine Co (Pty) Ltd v S* 2010 2 SACR 413 (SCA) ("SA Metal") as examples of acts committed in furthering or endeavouring to further the interests of a company as required in section 332(1).

⁴⁷⁴ Du Plessis (1991) TSAR 636; Van der Bijl (2014) TSAR 763.

⁴⁷⁵ Du Plessis (1991) TSAR 637; Borg-Jorgensen & Van der Linde (2011) TSAR 457; Burchell *Principles* 466; *S v Coetzee* para 214. This principle was applied in *S v Sutherland* 1972 3 SA 385 (N), where it is held that only a natural person is able to hold a liquor licence in terms of legislation and not a company. Therefore, if a company sells liquor in contravention of the licence it cannot be held liable.

⁴⁷⁶ Du Plessis (1991) TSAR 637; Burchell *Principles* 466; J Clough & C Mulhern *The Prosecution of Corporations* (2002) 170. If a company knowingly fosters a work environment in which the sexual assault of its employees is facilitated, or where the risk of sexual assault is not mitigated or prevented,

Even though corporate criminal liability is statutorily governed, it is necessary to assess whether the current legislation is adequate in holding companies liable. If these measures and the underlying theoretical framework prove to be inadequate, judicial reform might be needed.⁴⁷⁷ Burchell argues that a realistic form of corporate responsibility should be sought, because equating the corporation's guilt to that of a natural person is naïve.⁴⁷⁸

It is evident that the company could be held liable not merely for *intra vires* acts or omissions by directors or employees, but also for *ultra vires* acts or omissions, if these endeavours would promote the interests of the company.⁴⁷⁹ However, knowledge on the part of the company is not needed to determine corporate criminal liability.⁴⁸⁰ This could be detrimental to the company, casting the possible net of liability too wide.

Those individuals whose conduct and fault can be attributed to the company, are firstly a director, a servant or a person acting on instruction or with consent of such a director or servant.⁴⁸¹ The term "director" is furthermore defined in section 332(10) of the CPA and refers to those persons controlling or governing the company, or who is a member of such a body.⁴⁸² In the absence of a definition for "servant", the court held in *R v Murray and Stewart*⁴⁸³ that it refers to any person who is employed by the company and performs his or her work under the supervision or control of the company. Although the act refers to those persons acting under instruction or permission (whether directly or indirectly), it has been found that this section should be interpreted narrowly: necessitating a degree of control by the company.⁴⁸⁴

the company could be held criminally liable as an accomplice to rape due to the failure to ensure a safe corporate environment and consciously associating itself with the risk of sexual assault.

⁴⁷⁷ Borg-Jorgensen & Van der Linde (2011) *TSAR* 452.

⁴⁷⁸ Burchell *Principles* 461, 463; Farisani (2006) *Obiter* 273.

⁴⁷⁹ Du Plessis (1991) *TSAR* 640; Nana (2011) *JAL* 94.

⁴⁸⁰ Borg-Jorgensen & Van der Linde (2011) *TSAR* 456.

⁴⁸¹ ss 332(1)(a)-(b).

⁴⁸² Therefore reference is made to the controlling bodies of the company, albeit *de jure* or *de facto*. According to Du Plessis "control" is a broad term, which could include partial independent control or influence of a third party. This principle is also confirmed in *S v Marks* 1965 3 SA 834 (W) 842. Du Plessis (1991) *TSAR* 639.

⁴⁸³ 1950 1 SA 194 (C) 199.

⁴⁸⁴ A literal interpretation of this provision would mean that any independent contractor or third party who acts under instruction or with the necessary consent would be included, even in circumstances where the company had no control over the person. Due to the risk of unlimited corporate criminal liability, a restrictive interpretation is followed. Scott argues that the courts could use vicarious liability as found in private law as authority for this interpretation. WE Scott *Die strafregtelike aanspreeklikheid van regspersone* (1979) 16-17 inaugural lecture held at the Potchefstroomse Universiteit vir Christelike Hoër Onderwys (North West University, Potchefstroom Campus), 29-09-1978 (available at

4.1.2 Would section 332(1) survive constitutional scrutiny?

According to Du Plessis the wording of section 332(1) is too broad and general to allow a narrow interpretation.⁴⁸⁵ Therefore, Borg-Jorgensen and Van der Linde are of the opinion that section 332(1) requires constitutional scrutiny, because the mode of ascribing criminal liability could be in contravention of the constitutionally enshrined presumption of innocence.⁴⁸⁶

Section 8(4) of the Constitution awards protection to juristic persons with regards to the bill of rights, which includes the presumption of innocence found in section 35(3)(h). In *S v Coetzee* section 332(5) of the CPA was declared unconstitutional, because it was inconsistent with a director's or employee's presumption of innocence. Similarly, section 332(1) is broadly formulated, casting the potential liability of juristic persons too wide.

Despite having preventative measures in place to restrict criminal conduct within the company and the exercise of due diligence, a company could still be held vicariously liable.⁴⁸⁷ A defence of due diligence is not considered when determining criminal liability, which seems out of touch with the presumption of innocence. Regardless of the fact that reasonable doubt might exist as to the blameworthiness of the corporation, it could still be held vicariously liable in the absence of fault on the premise that an individual is guilty.⁴⁸⁸ Normally if the state fails to lift its burden of proof beyond reasonable doubt, an accused would be acquitted. Therefore, holding a person, juristic or natural, liable despite the presence of reasonable doubt, infringes on the right to a fair trial.

If one argues that only a natural person can be presumed to be innocent, one presupposes the traditional assumption that a juristic person is not capable of acting with moral blameworthiness, but is constructed by individuals who determine the

https://repository.nwu.ac.za/bitstream/handle/10394/10996/Scott_WE.pdf?sequence=1&isAllowed=y);
Du Plessis (1991) *TSAR* 640; Borg-Jorgensen & Van der Linde (2011) *TSAR* 457.

⁴⁸⁵ Du Plessis (1991) *TSAR* 645.

⁴⁸⁶ Borg-Jorgensen & Van der Linde (2011) *TSAR* 457.

⁴⁸⁷ Burchell argues that the existence of an effective due diligence programme within a company should not preclude it from criminal prosecution, because a deviation from their standards is possible. Therefore Burchell cites BJ Pollack "Time to Stop Living Vicariously: A Better Approach to Corporate Criminal Liability" (2009) 46 *Am Crim L Rev* 1393 1409, who states that due diligence is only a consideration in determining collective intent and a mitigating factor. Burchell elaborates on Pollack's suggestion, by including collective negligence. Burchell *Principles* 465.

⁴⁸⁸ Borg-Jorgensen & Van der Linde (2011) *TSAR* 458.

existence of the company.⁴⁸⁹ Nevertheless, a juristic person may be capable of being awarded the right to a fair trial. Doctrinal theory regarding legal personality should not be the reason for a limitation on such a fundamental right. A general approach should be followed, unless it is self-evident that a right is inapplicable to a company. Moreover, as a person, a company enjoys the same constitutional rights as natural persons insofar as these rights may be exercised by a juristic person, which would include the right to a fair trial.⁴⁹⁰

A juristic person can be the bearer of rights and obligations; therefore, the state has a duty to protect these rights in its administration of justice. The question arises, however, whether the limitation on the right to a fair trial may be justified in terms of section 36 of the Constitution? The state would have to prove the purpose of the infringement and a rational relation between the infringement and this purpose. Although it might be needed to combat high levels of crime, the seriousness of the violation would not necessarily validate the infringement. Rather, it would seem unjustifiable and unreasonable.⁴⁹¹

In analysing the unconstitutionality of section 332(1), the court's analysis of section 332(5) in *S v Coetzee* could be used as a guideline. Previously a director or servant of a company could be held liable of committing any offence on behalf of the company. However, the section still allowed for a defence: if it could be proven that the director or employer had no part to play in the committing of the offence or had taken preventative measures.⁴⁹² Nevertheless, it was held that the reverse onus violated the right to a fair trial (specifically the presumption of innocence), because a director or employee could still be found guilty despite the existence of reasonable doubt. Seeing that the inverse of section 332(1) was declared unconstitutional, it might lead to an anomaly if the latter is still applied in its entirety.

Borg-Jorgensen and Van der Linde argue that section 332(1) might survive judicial scrutiny and possible unconstitutionality, if its ambit is limited.⁴⁹³ If the section is only applied to regulatory offences and directors, it might award an appropriate application.

⁴⁸⁹ 458.

⁴⁹⁰ S 8(4) of the Constitution.

⁴⁹¹ Borg-Jorgensen & Van der Linde (2011) *TSAR* 459.

⁴⁹² 459.

⁴⁹³ 460.

With regards to limiting the scope of section 332(1) to regulatory offences, the purpose of the legislature might be undermined. Surely fraud and theft are important crimes, which often occur in the corporate sphere and companies should henceforth be held criminally liable. Otherwise it would only encourage a rise in criminal activity by way of clever corporate construction. Moreover, it is uncertain what the precise meaning of regulatory offences should be.

In *S v Coetze*, the state argued that in the context of regulatory offences the presumption of innocence applies to a lesser extent.⁴⁹⁴ Therefore they contended that section 332(5) should in essence refer to regulatory offences. Companies seek to take part in regulated activities and consequently have a responsibility towards the public to adhere to the relevant conditions. If they defer from this responsibility, they should be held liable.⁴⁹⁵ Notwithstanding the fact that certain foreign jurisdictions have drawn a distinction between various categories of offences, Langa J held that the ambit of section 332(5) is too wide and such a variety cannot be deemed to be regulatory.⁴⁹⁶

In his minority judgment, Kentridge AJ held that directors should be held liable for regulatory offences, based on the directing mind and will doctrine. Even in the absence of fault, they have chosen to manage the company and should therefore bear the inherent risks involved in these activities.⁴⁹⁷ His reasoning is firstly based on the public interest involved in preventing anti-social or immoral behaviour, secondly the purpose of the legislation would be undermined if the state bore the burden to prove intent or negligence and thirdly, it will ensure that the necessary safeguards are in place to prevent criminal conduct.⁴⁹⁸

Although one could use this reasoning to limit the ambit of section 332(1) this would inhibit the proper application of the act, as mentioned previously. The question would then arise, whether a separate regulatory framework is needed to govern the common law crimes, for example fraud and theft?⁴⁹⁹ Excluding these offences, for which companies are typically prosecuted, would fall short of the purpose of the provision: to hold companies criminally liable. Therefore, such a limitation is not envisioned by

⁴⁹⁴ Paras 32, 210-212.

⁴⁹⁵ Para 95.

⁴⁹⁶ Para 42.

⁴⁹⁷ Para 98.

⁴⁹⁸ Para 97.

⁴⁹⁹ Borg-Jorgensen & Van der Linde (2011) *TSAR* 461.

Borg-Jorgensen and Van der Linde, instead a more robust theoretical approach to corporate criminal liability is sought.⁵⁰⁰

Another limitation to section 332(1) could be found therein, that servants are excluded from the provision. It was held in *S v Coetzee*⁵⁰¹ that the inclusion of servants in the extent of liability was unjustified, therefore a similar reading down of section 332(1) could remedy its unconstitutionality. Instead of following the individualistic model of vicarious liability, one should rather apply the directing mind and will doctrine. As a result, liability will only be imputed by those organs which constitute the directing will of the company, in other words the directors or senior management. This restriction would satisfy the need for corporate criminal liability without imposing an arbitrary burden on corporation. On the contrary, it might bridge the gap between corporations as abstract beings and natural persons.⁵⁰²

The abovementioned reasoning seems to be too esoteric and could be criticised with reference to the organisational theory. In large corporations, responsibilities are often delegated to lower levels of management.⁵⁰³ Although the criminogenic decision is made by senior management or the board of directors, its enactment could be dispersed throughout various command chains.⁵⁰⁴ In light of the doctrine of directing minds, their fault and conduct would not readily be ascribed to the company. Failure to hold large corporations criminally liable would not purport the legislature's intention, but rather negate it.

By virtue of the fact that a company cannot raise a defence, section 332(1) would still be deemed to be unconstitutional, despite the possible limitations on its ambit. Due to the onerous implication of vicarious liability, this section should be scrutinised. A departure from the fault requirement cannot be absolute and a company should be granted to show that it acted with due diligence and implemented certain safeguards to prevent criminal conduct.⁵⁰⁵

⁵⁰⁰ 461.

⁵⁰¹ Paras 26, 55, 73, 101, 111 and 184.

⁵⁰² Borg-Jorgensen & Van der Linde (2011) *TSAR* 461.

⁵⁰³ Nana (2011) *JAL* 100.

⁵⁰⁴ Jordaan (2003) *Acta Jur* 55.

⁵⁰⁵ Borg-Jorgensen & Van der Linde (2011) *TSAR* 462.

4 2 The identification doctrine

Common-law jurisdictions, such as England and Wales, were the first to implore ethical corporate behaviour and hold corporations criminally accountable. Therefore, the deterrent effect of sanctions on company behaviour was explored.⁵⁰⁶ Due to the influence of the industrial revolution, courts were urged to apply the civil law doctrine of vicarious liability in criminal cases. Although this method continued in the United States, it was limited to regulatory offences in England and Wales.⁵⁰⁷

The primary model of attribution in English law is the doctrine of identification. According to the authors of *Gower's Principles of Modern Company Law*, vicarious liability in criminal law is regarded with caution, especially in respect of serious crimes involving *mens rea*.⁵⁰⁸ A model of direct liability is rather followed, whereby the acts and state of mind of certain officers or employees are regarded as those of the company.⁵⁰⁹

In terms of the rules of attribution the question of "who" becomes relevant, in other words whether these rules should be limited to those regarded as the directing mind and will of the company or whether other (lower level) employees are also included.⁵¹⁰ This dilemma is easily determined in the case of regulatory offences based on strict liability, where the legislature intended to attribute the acts of lower level employees to the business of the company.⁵¹¹ Beyond the scope of regulatory offences, imposing criminal liability is governed according to the traditional model of the identification doctrine.

⁵⁰⁶ Pieth & Ivory "Emergence and Convergence" in *Ius Gentium* 7.

⁵⁰⁷ 8.

⁵⁰⁸ PL Davies & S Worthington *Gower's Principles of Modern Company Law* 10 ed (2016) 181.

⁵⁰⁹ Whether there remains a difference between vicarious and direct liability, depends upon the interpretation of direct liability. If the criteria for direct liability is broadly set, it could amount to vicarious liability, while a narrow interpretation might lead to companies escaping criminal liability.

⁵¹⁰ SJ Naudé *Die reg sposisie van die maatskappydirekteur, met besondere verwysing na die interne maatskappyverband* (1970) 39.

⁵¹¹ The leniency of courts to follow this broader interpretation can originally be found in *Moussell Brothers Ltd v London & North Western Railway Co* 1917 2 KB 836 and later in *R v British Steel plc* 1995 ICR 586 CA, where the Court of Appeal applied this approach to so-called hybrid offences where a due diligence defence restricted the strict liability. The fact that the company's senior management had taken precautionary measures to prevent a breach of the statutory duty was insufficient, because those parties in charge of the dangerous operation had to take reasonable care. Therefore, even if junior employees acted contrary to their instruction, the company would not readily have a defence. Davies & Worthington Gower 181.

Originally, the identification doctrine was applied in the area of statutory civil liability and later transplanted to criminal law. In *Lennard's Viscount Haldane* problematised the difficulty of holding a company liable:

“A corporation is an abstraction. It has no mind of its own any more than it has a body of its own; its active and directing will must consequently be sought in the person of somebody who for some purposes may be called an agent, but who is really the directing mind and will of the corporation, the very ego and centre of the personality of the corporation.”⁵¹²

In the aftermath of this decision the doctrine of identification as opposed to vicarious liability was followed as a model for holding a company liable.⁵¹³ As seen in the quoted passage, the identification model is based on the directing minds doctrine, where a certain individual needs to be identified before liability could arise.⁵¹⁴ This is a clear affirmation of the fiction or nominalist theory of corporate personality, whereby a company acts through human representatives and remains an artificial construct.⁵¹⁵ These human representatives can either be the “organs” of the company (in other words the operational staff) or the “brains”, which would be senior management and directors.⁵¹⁶ Although this model of attribution is often characterised as being anthropomorphic,⁵¹⁷ it is reliant on identifying the alter ego within the company.⁵¹⁸

⁵¹² 713.

⁵¹³ Davies & Worthington Gower 181.

⁵¹⁴ The writers of *Gower* argue that Lord Haldane was influenced by German law, where a distinction is drawn between agents and organs within a company. Davies & Worthington Gower 182.

⁵¹⁵ Only if it can be proven that an individual acting as the directing mind and will had the necessary guilt to be attributed, can the company be said to have criminal guilt. Pieth & Ivory “Emergence and Convergence” in *Ius Gentium* 6.

⁵¹⁶ In *HL Bolton* 630 Lord Denning stated that “[a] company may in many ways be likened to a human body. They have a brain and a nerve centre which controls what they do. They also have hands which hold the tools and act in accordance with directions from the centre. Some of the people in the company are mere servants and agents who are nothing more than hands to do the work and cannot be said to represent the mind or will. Others are directors and managers who represent the directing mind and will of the company, and control what they do. The state of mind of these managers is the state of mind of the company and is treated by the law as such [...].” This passage is regarded as the cornerstone for describing the anthropomorphic nature of companies in English law. McAuley & McCutcheon *Criminal Liability* 382-383.

⁵¹⁷ Davies & Worthington Gower 182; Pieth & Ivory “Emergence and Convergence” in *Ius Gentium* 6; Wells “Corporate Criminal Liability” in *Ius Gentium* 93.

⁵¹⁸ In terms of the organic theory, the anthropomorphic imagery used by Lord Denning in *HL Bolton*, was criticised by Von Gierke, who argued for a more robust realist theory. M Keeley “Realism in Organisational Theory: A Reassessment” (1983) 6 *Symbolic Interaction* 279 280 referring to O von Gierke *Political Theories of the Middle Age* (1900).

In order to understand the application of the identification doctrine, the role of the directing mind and will doctrine is of paramount importance, as well as its development in case law.

4.2.1 The development of the directing mind and will

The beginning of the general application of the identification doctrine in criminal law cases where a particular state of mind was required, was marked by the case of *Director of Public Prosecutions v Kent and Sussex Contractors Ltd and another*.⁵¹⁹ However, the application of the directing minds doctrine was largely developed in *Tesco Supermarkets Ltd v Nattrass (“Tesco”)*.⁵²⁰

In *Tesco* the House of Lords determined who would constitute the directing mind and will of a company.⁵²¹ It had been trite law that only the top level senior officers of the company, in other words the board or other senior officers, could act as the mind of the company.⁵²² Managers or lower-level employees were excluded from the rules of attribution pertaining to non-regulatory fault-based offences.⁵²³ In this case, however, the question arose as to whether persons to whom the board delegated their powers could also be regarded as constituting the directing mind and will.⁵²⁴ The court refined the theoretical foundation of the directing mind and will, by describing it as the hierarchical management structure.⁵²⁵

⁵¹⁹ 1944 KB 146. D Kershaw *Company Law in Context* 2 ed (2012) 157.

⁵²⁰ 1972 AC 153.

⁵²¹ *Tesco Supermarkets* was held liable in terms of the Trade Descriptions Act 1968 which allowed for a defence, if the company could prove that reasonable steps had been taken to prevent the criminal conduct of its employees.

⁵²² The court reiterated that the individual does not act on behalf of the company, but instead becomes an “embodiment of the company [...] his mind is the mind of the company” at 154. Therefore, one should distinguish it from the rules of vicarious liability. However, according to Pinto and Evans, if the class of persons identified as the “brains” of the company is limited to only to those entrusted with the exercise of the company’s powers, be it by way of delegation from the board of directors, by the company in general meeting or the memorandum and articles of association, it would limit the efficacy of corporate criminal liability. It would lead to the anomalous situation where only small companies can be held liable, because the board of directors is more readily involved in day-to-day management. Big corporate actors with intricate organograms would be unlikely to incur liability, because the board of directors is deemed to be too far removed from the daily operation of the company and in the absence of criminal conduct by a director or the like. Pinto & Evans *Corporate Criminal Liability* 53-54.

⁵²³ Wells “Corporate Criminal Liability” in *Ius Gentium* 98.

⁵²⁴ Although it is possible to include persons to whom the board delegated certain powers, the court held that the employee was a lower level employee and therefore an investigation as to what board delegation entailed was not made. Lord Reid argued that responsibility for a certain area of the company’s business should be included, while Lord Diplock stated that board delegation in itself proved sufficient. Davies and Worthington Gower 182.

⁵²⁵ V Borg-Jorgensen & K Van der Linde “Corporate criminal liability in South Africa: time for change? (Part 2)” (2011) 4 TSAR 684 685.

Due to the seemingly exhaustive list that *Tesco* provides, Gobert stresses its problematic outcome:

“One of the ironies of [Tesco] is that it propounds a theory of corporate liability which works best in cases where it is needed least and works least in cases where it is needed most.”⁵²⁶

It is argued that the focus of the court in *Tesco* was on the identity of the company officers and not the aim of the relevant statutory provision.⁵²⁷ Moreover, Lord Reid conceded that he prefers to think of the relevant officer identified as the directing mind and will of the company in terms of the *Lennard’s* case as the ego of the corporation rather than its *alter*.⁵²⁸ Not only did this narrow interpretation lead to sharp criticism, but its focus on the top echelon of senior company officers created an incentive to decentralise responsibilities in order to escape criminal liability.⁵²⁹

In *Meridian Global Funds Management Asia Ltd v Securities Commission (“Meridian”)*⁵³⁰ a partial breakthrough with regards to the definition of who constituted the directing mind and will was made.⁵³¹ The case involved imposing administrative penalties for a breach of the securities legislation. Although this case involved a regulatory offence, the vicarious liability model was not available. In the absence of conduct from the constitutional bodies, the question of “who” constituted the company was of importance.⁵³² According to Davies and Worthington, the identification doctrine as developed by Lord Haldane in *Lennard’s* did not describe the correct overarching approach.⁵³³ Therefore, Lord Hoffmann sought to analyse the relevant rule in question and not the company’s internal decision-making structure, thus side-stepping the

⁵²⁶ J Gobert “Corporate Criminal Liability: four models of fault” (1994) 14 LS 393 401.

⁵²⁷ In this case, the Trade Descriptions Act 1968 was a piece of consumer protection legislation aimed at regulating a specific area of business activity. The store manager in question failed to prevent an offence from being committed in his store and was therefore found to be negligent. However, due to the company’s control over the activities of its store managers, the court held that the manager’s conduct could not be attributed to the company. Accordingly, the company could not be held criminally liable for the unlawful conduct of its employees. This application of the identification doctrine in *Tesco* has been questioned, especially since its system to prevent the commission of such offences had failed. Pinto & Evans *Corporate Criminal Liability* 54-55.

⁵²⁸ *Tesco* 171; McAuley & McCutcheon *Criminal Liability* 382.

⁵²⁹ E Ferran “Corporate Attribution and the Directing Mind and Will” (2011) 127 Law Q Rev 239 242.

⁵³⁰ 1995 2 AC 500.

⁵³¹ Davies & Worthington *Gower* 183.

⁵³² 183.

⁵³³ 183.

identification doctrine.⁵³⁴ This alternative method is described as special rules of attribution of acts and states of minds to a company, which differs from the primary rules where the constitutional allocation of power and responsibility is involved (whether it is found in the articles of association, board resolution, shareholders' resolutions and other binding shareholders' decisions).⁵³⁵ Lord Hoffmann formulated the special rules of attribution as follows:

“This is always a matter of interpretation: given that [the substantive rule] was intended to apply to a company, how was it intended to apply? ... One finds the answer to this question by applying the usual canons of interpretation, taking into account the language of the rule (if it is a statute) and its content and policy”⁵³⁶

According to Ferran, Lord Hoffmann opted for an interpretation in *Meridian* in which contextualisation or construction, rather than anthropomorphic imagery of corporate personality, is the key to attribution.⁵³⁷ In this sense, Lord Denning's judgment in *HL Bolton*, which followed a metaphysical approach, is challenged.⁵³⁸ This critique of the metaphysical understanding of corporate personality is deemed to be influenced by Hart, who held that these anthropomorphisms can obscure the essence of corporate rights, obligations and liabilities.⁵³⁹

Although there is a shift from the notion of attributing a creature of statute with human characteristics in *Meridian*, it seems that Lord Hoffmann's remedial effect of an over-reliance on these metaphysical concepts was short lived.⁵⁴⁰ Although the House of Lords in *Stone & Rolls Ltd (In Liquidation) v Moore Stephens (A Firm)*⁵⁴¹ confirmed

⁵³⁴ Accordingly, the construction of the statute or the relevant rule of law had to be analysed to determine who should be regarded as the company for purposes of the identification doctrine. If this reasoning is followed, it would be possible to identify a lower-level employee as the directing mind or will. Thus the scope of the identification doctrine is widened to include individuals who were not originally envisaged by Lord Haldane. In *Meridian* the two individuals identified to constitute the company, were senior investment managers who were not members of the board. However, in considering the purpose of the statute to disclose substantial shareholdings timely, the court held that these individuals could be regarded as the directing minds. Davies & Worthington Gower 183; Ferran (2011) *Law Q Rev* 243.

⁵³⁵ In *Tesco* Lord Diplock reiterated the role of the primary or general rules of attribution, by referring to the importance of a constitutional approach focusing on the articles of association, board resolutions and shareholders' resolution. Ferran (2011) *Law Q Rev* 243.

⁵³⁶ *Meridian* 507.

⁵³⁷ Ferran (2011) *Law Q Rev* 239. This approach's consistency with organisational realities of modern companies was laudable, especially if compared to the hierarchical approach adopted in *Tesco*.

⁵³⁸ Ferran (2011) *Law Q Rev* 239-240.

⁵³⁹ See HLA Hart “Definition and Theory of Jurisprudence” (1954) 70 *Law Q Rev* 37.

⁵⁴⁰ Ferran (2011) *Law Q Rev* 240; 245.

⁵⁴¹ 2009 1 AC 1391.

that the attribution rules developed in *Meridian* did form part of English law,⁵⁴² it opted to rely on the conduct of a key individual who is the “embodiment” of the company, thereby continuing the metaphysical rhetoric criticised by Hart.⁵⁴³ Corporate criminal liability in the context of serious crimes involving *mens rea* is thus still dominated by the narrow identification doctrine.⁵⁴⁴ This continuous emphasis on the identification doctrine and the *de facto* immunity large companies with a diffused managerial structure enjoy, have led to the enactment of the Corporate Manslaughter and Corporate Homicide Act 2007.⁵⁴⁵

4 3 Aggregation

In terms of the aggregation doctrine, instead of identifying one particular officer whose *mens rea* can be attributed to the company, it seeks to aggregate the conduct and will of various persons in the corporation.⁵⁴⁶ Due to the difficulty of pin-pointing an individual responsible for both the conduct and necessary *mens rea* in a large company, this model seeks to overcome that hurdle. Although this reasoning has been rejected by English law in the Zeebrugge case,⁵⁴⁷ it is generally accepted in the United States for holding corporations criminally liable.

4 3 1 *The aggregation dilemma*

Section 332(1) of the CPA requires that an offence, be it a statutory or a common law crime, needs to be committed by a director or servant for a company to be held criminally liable. However, this does not mean that a prosecution or conviction of a natural person is a requisite to prosecute the juristic person.⁵⁴⁸ The dilemma of this

⁵⁴² According to Davies and Worthington these special rules of attribution do not necessarily solve the uncertainty surrounding who should be the relevant person within the hierarchical structure for purposes of the identification rule. Following the contextual approach, it could range from any agent or employee acting within the scope of their authority (similar to the vicarious liability rules) or could be limited to senior managerial positions or merely the board itself. It is argued that the special rules can only apply in the absence of the primary rules. Moreover, its application is limited to a context specific analysis of a particular rule. Gower 183-184.

⁵⁴³ Ferran (2011) *Law Q Rev* 240.

⁵⁴⁴ 246.

⁵⁴⁵ The application of this Act, as well as the Bribery Act 2010, as an alternative model of attribution will be discussed in part 5.1.

⁵⁴⁶ E Emeseh “Corporate responsibility for crimes – thinking outside the box” (2005) 1 *U Botswana LJ* 28 46.

⁵⁴⁷ *R v P&O European Ferries (Dover) Ltd* 1990 93 Cr App R 72 (“P&O European Ferries”).

⁵⁴⁸ In *SA Metal* the appellant appealed against its conviction of contravening section 37(1) of the General Amendment Act 62 of 1955. Therefore the Supreme Court of Appeal had to whether the appellant lacked the reasonable for belief as required by the abovementioned provision. According to section 37(1)(b) the lack of proof to the contrary is sufficient evidence of the absence of reasonable cause. The employee (De Klerk) whose conduct was attributed in terms of section 332(1) of the CPA,

requirement, is the fact that an individual's conduct might not amount to meet the necessary standard to impose criminal liability. Consequently, neither the company, nor the individual could be held liable. In terms of the principle of aggregation the conduct of various actors is combined in order to prove the different elements of a crime and meet the standards to enforce criminal liability. This principle relates to the common purpose doctrine, however, its applicability within the section 332(1) context remains uncertain.⁵⁴⁹ Du Plessis states that the person committing the offence, is the one whose fault is relevant.⁵⁵⁰ It is argued that the actor responsible for the conduct cannot be distinguished from the person in whom the fault resides, because the unlawful act and fault are inextricably interwoven.⁵⁵¹ Furthermore there remains uncertainty whether different mind-sets could be combined to establish negligence or a particular form of intent or even the conduct of different individuals.⁵⁵²

Bearing in mind the current opposition to the individualistic model, aggregation might prove to be an alternative approach to holding large corporations criminally liable. Even if it is not a full departure from the individualistic model, it is pragmatic and would lead to effective prosecution of large entities. Legislative intervention is thus necessary to award legal certainty, specifically to enlighten the aggregation dilemma.⁵⁵³

5 Alternative models influenced by realist theory

As an alternative to the models of attribution influenced by nominalist or individualist theory, England and Australia have enacted legislation which resembles a shift from

was originally convicted by the Regional Court, Kempton Park. However, this conviction was set aside by the South Gauteng High Court. Despite the innocence of De Klerk, the court still held that the appellant's conviction should stand. Therefore, the question before the Supreme Court of Appeal, was whether the High Court erred in its finding, as stated in para 3 of the judgment. The court stated in para 13, that De Klerk was identified as the employee whose conduct was necessarily attributed to the appellant, thus there was no indication that the net was being cast wider. Accordingly, the court erred in holding the appellant criminally liable and it was held that there was a reasonable belief that the contraband was lawfully obtained. In reaching this conclusion, the aggregation dilemma is illustrated. Had the prosecution aggregated the conduct of various individuals, the conclusion may have differed.

⁵⁴⁹ If multiple persons are involved in committing a crime, it is presupposed that all participants share a common purpose and the conduct of any persons involved is attributed to both the whole group and the company. Du Plessis (1991) *TSAR* 641; Borg-Jorgensen & Van der Linde (2011) *TSAR* 463.

⁵⁵⁰ Du Plessis (1991) *TSAR* 641.

⁵⁵¹ Borg-Jorgensen & Van der Linde (2011) *TSAR* 462.

⁵⁵² In the aftermath of *Uitsaaikorporasie* this uncertainty became poignant. The court proceeded in making certain assumptions based on the evidence and facts at hand, however the particular individual who committed the unlawful conduct could not be identified.

⁵⁵³ Borg-Jorgensen & Van der Linde (2011) *TSAR* 463.

this theory to a more realist approach which incorporates the notion of corporate culture.

5.1 The English solution: Corporate Manslaughter and Corporate Homicide Act 2007, the Bribery Act 2010 and beyond

In *Meridian* it is clear that a departure from the identification model occurred.⁵⁵⁴ In terms of statutory crimes, these special rules of attribution focusing on a contextual analysis have dominated the attribution of corporate liability. However, in terms of the common law crime of manslaughter by gross negligence, the Court of Appeal rejected the *Meridian* approach.⁵⁵⁵ Therefore if a company were to be held liable for corporate manslaughter, the prosecution had to identify a responsible individual whose conduct and will could be attributed to the company by way of the directing mind and will test.⁵⁵⁶

After the Zeebrugge ferry disaster in 1986, where a ferry overturned and 193 people lost their lives, a case was brought against P&O Ferries Ltd, accusing the company of corporate manslaughter.⁵⁵⁷ Although Turner J dismissed the case, stating that it would be impossible to hold a company criminally liable for corporate manslaughter, he emphasised the need to identify a controlling mind of the company whose conduct would fulfil the requirements for manslaughter in order prosecute the company successfully.⁵⁵⁸ A company could only be guilty of manslaughter if one of its agents was guilty of manslaughter. Furthermore, this agent had to form part of the directing mind and will of the company.⁵⁵⁹

Due to the shortcomings associated with the identification model, it was impossible to hold large companies with intricate organisational structures accountable. Instead, only small companies could be held criminally liable if serious fatalities occurred.⁵⁶⁰ In 1996 the Law Commission of England and Wales advanced the concept of organisational fault, which would serve as an alternative to the then current model.⁵⁶¹ Instead of identifying a particular individual guilty of manslaughter, management

⁵⁵⁴ Davies and Worthington Gower 183.

⁵⁵⁵ 185.

⁵⁵⁶ *Re Attorney's General's Reference (No 2 of 1999)* 2000 QB 795 CA.

⁵⁵⁷ *P&O European*.

⁵⁵⁸ *P&O European Ferries* 84.

⁵⁵⁹ Kershaw *Company Law in Context* 164.

⁵⁶⁰ Davies & Worthington Gower 185.

⁵⁶¹ Law Commission *Legislating the Criminal Code: Involuntary Manslaughter* Law Com No 237 HC 171 1996.

failure would be sufficient cause to hold a company criminally liable. In light of the criticism against the doctrine of identification as being too restrictive and biased, the flexibility of a systemic and policy-based approach was welcomed.

Although a laborious legislative process followed, the Corporate Manslaughter and Corporate Homicide Act 2007 (“CMCHA”) was eventually enacted, which provides an organisational approach to a statutory offence of corporate manslaughter.⁵⁶² Contrary to the method used to impose liability on individuals, the CMCHA creates an offence for companies if the activities of the company are managed and organised in such a way as to result in a person’s death.⁵⁶³ Additionally, for liability to arise, the way in which these activities are managed or organised should amount to a gross breach of the duty owed by the company to the deceased.⁵⁶⁴ In the absence of a gross breach of the duty of care, the corporation cannot be held criminally liable.

There is no need to identify an individual whose conduct amounts to manslaughter and whose knowledge and will are attributed to the company. Organisational fault on its own will be sufficient to convict a company, irrespective of individual guilt.⁵⁶⁵ However, a rule needs to be identified by which certain persons’ organisational failings can be attributed to the company.⁵⁶⁶ In establishing these rules, the emphasis is placed on senior management – an approach likened to the identification model.⁵⁶⁷ According to section 1(3) of the CMCHA corporate guilt arises “only if the way in which its activities are managed or organised by its senior management is a substantial element in the breach.”⁵⁶⁸ If such failure is present at a subordinate level, the company cannot be guilty. One could argue that a significant failure in lower-level organisational structures will ultimately reflect that senior management had to be aware of these failings.⁵⁶⁹

⁵⁶² In England, Wales and Northern Ireland the felony is referred to as corporate manslaughter, while Scotland opted for corporate homicide.

⁵⁶³ S 1; Davies & Worthington Gower 185.

⁵⁶⁴ The gross breach of duty owed to the deceased is similar to the common law crime of manslaughter by gross negligence. Davies & Worthington Gower 185-186.

⁵⁶⁵ Burchell states that the CMCHA is an improvement on the restrictive directing mind doctrine, however, the emphasis remains on individual rather than corporate fault and the scope of its application is limited to senior officers instead of the systemic failures within the corporation. *Principles* 463.

⁵⁶⁶ Davies & Worthington Gower 186.

⁵⁶⁷ In terms of section 1(1)(a)-(b) senior management has a duty of care to prevent any death resulting from a dangerous situation.

⁵⁶⁸ Thus the manner in which the company is governed by senior management is crucial in determining if a breach has occurred or not. Borg-Jorgensen & Van der Linde (2011) *TSAR* 688.

⁵⁶⁹ Davies & Worthington Gower 186.

The CMCHA draws a distinction between the role of the presiding judge and the jury in respectively determining the existence of a duty and whether the breach was gross.⁵⁷⁰ In terms of section 1(1), the presiding judge should decide whether the organisation bears a duty of care.⁵⁷¹ A gross breach is governed by section 1(4)(b); which requires that the company's activities were managed in such a way that falls short of what can reasonably be expected from the company in such particular circumstances. The question of a gross breach of duty should be decided by the jury.⁵⁷² In determining the occurrence of a gross breach or not, it should be considered whether health and safety measures were complied with or not, the significance of non-compliance and the inherent risk of non-compliance.⁵⁷³ Moreover, the jury may determine the corporate culture of the company, with reference to the attitudes, policies, structures and common practices within the company which could have motivated the non-compliance with the set health and safety requirements.⁵⁷⁴ Additionally, any other matter which might be relevant could also be considered by the jury.⁵⁷⁵ It is clear that the jury is granted a wide discretion to determine if a gross breach occurred, incorporating various factors into the analysis.

A holistic approach, influenced by the notion of organisational fault, is apparent in the CMCHA. Instead of considering a certain level of management, the organisational procedures and activities of the corporation as a whole are examined.⁵⁷⁶ Nonetheless, section 1(3) provides that a substantial part of the breach should be present at senior management level, which is defined as those persons playing a crucial role in deciding how a whole or substantial part of the company's activities are to be conducted or who are involved in managing or organising a whole or substantial part of these activities.⁵⁷⁷

Although the CMCHA attempts to embody the modern concept of an organisational model, it is still unsure whether an employer has a duty to prevent harm if a third party commits an unlawful act.⁵⁷⁸ Especially in the case where the employer facilitated the

⁵⁷⁰ 186.

⁵⁷¹ The relevant duty should be encompassed by the law of negligence and categorised in section 2 of the CMCHA, which has a widely defined list of categories.

⁵⁷² S 8(1)(a)-(b).

⁵⁷³ S 8(2).

⁵⁷⁴ S 8(3)(a).

⁵⁷⁵ S 8(4).

⁵⁷⁶ Borg-Jorgensen & Van der Linde (2011) *TSAR* 689.

⁵⁷⁷ S 1(4)(c).

⁵⁷⁸ Van der Bijl (2014) *TSAR* 770.

harmful conduct, the question arises if it would result in a *novus actus interveniens*, thereby breaking the chain of causation. In terms of English law, the employer could still be held liable as an accomplice.⁵⁷⁹

Despite the effort to entrench the application of organisational fault in the CMCHA, it is limited to crimes of manslaughter or homicide.⁵⁸⁰ Thus, there is still a need to develop the theoretical model beyond this limited application, either through legislation or a systemic change in the court's approach to corporate criminal liability.⁵⁸¹ Whether courts would be robust enough to depart from existing foundational principles is uncertain.

The Bribery Act 2010 ("BA") is another innovative development in legislation to incorporate the organisational model.⁵⁸² The act represented a significant departure from the traditional identification model for crimes involving *mens rea* and instead opted for the *respondeat superior* approach followed by the federal courts in the United States.⁵⁸³ In terms of section 7 of the BA, a company will be held liable if an employee or an associated person bribes someone with the purpose of gaining a business advantage on behalf of the company and can offer no defence.⁵⁸⁴ Contrary to the position in South African legislation, the company will not be held liable if a defence is raised, in other words if adequate measures were implemented to prevent contravention of the BA.⁵⁸⁵ A further development in the realm of corporate criminal liability, was the introduction of the deferred prosecution agreements ("DPA") for economic crimes, including bribery, fraud, tax evasion and money laundering in 2013.⁵⁸⁶ Although the DPA as a tool of enforcement have been criticised,⁵⁸⁷ it provides an innovative solution to ensure corporate retribution.

⁵⁷⁹ A Ashworth *Positive Obligations in Criminal Law* (2013) 79.

⁵⁸⁰ Borg-Jorgensen & Van der Linde (2011) *TSAR* 689.

⁵⁸¹ As seen in the *Meridian* judgment.

⁵⁸² The Organisation for Economic Cooperation and Development's (OECD) Working Group on Bribery found that the identification model for corporate criminal liability was inadequate in realising the UK's obligations in terms of the OECD's anti-bribery convention. Therefore another model for imposing liability was sought in terms of the Bribery Act. See the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions 1997.

⁵⁸³ C Wells "Corporate failure to prevent economic crime – a proposal" (2017) 6 *Crim L Rev* 426 426.

⁵⁸⁴ In *Serious Fraud Office v Rolls-Royce plc* 2017 Lloyd's Rep FC 249, where a deferred prosecution agreement was reached, Leveson J in para 44 reiterated the role of compliance procedures and ethics in establishing guilt in terms of the BA.

⁵⁸⁵ Borg-Jorgensen & Van der Linde (2011) *TSAR* 690-691; Wells (2017) *Crim L Rev* 426.

⁵⁸⁶ Wells (2017) *Crim LR* 426.

⁵⁸⁷ Especially by anti-corruption groups in the case of Rolls-Royce; Wells (2017) *Crim L Rev* 431.

Similarly, the Criminal Finances Act 2017 (“CFA”) provides that corporate criminal liability will be imposed if a company fails to prevent the facilitation of foreign tax evasion, thereby reiterating the need for sound corporate compliance to prevent criminal conduct. The CFA follows the same rationale of the BA, whereby a company will be held criminally liable if it failed to have procedures in place to prevent its employees or associates from facilitating tax evasion. A company may raise a defence, if it properly assessed the risk of facilitation of tax division and subsequently developed a framework whereby the identified risks will be mitigated.⁵⁸⁸ Although such a risk assessment may be deemed excessive and burdensome, the legislature aimed to broaden the duty of corporate compliance.⁵⁸⁹

Although both the BA and the CFA impose corporate criminal liability for the facilitation of certain offences in the absence of adequate preventative measures, Wells categorises these “offences” as an attribution model or mode of participation.⁵⁹⁰ Thereby, reiterating the importance of ethical corporate culture as endorsed by the realist theory.

Whether England and Wales will ultimately introduce a new corporate criminal offence of failure to prevent economic crime, is still to be considered by the legislature. However, it would result in a significant expansion of the scope of corporate criminal liability in English law, should it be adopted.⁵⁹¹

5 2 Australia’s Criminal Code

The most ambitious framework for regulating corporate criminal responsibility is found in part 2.5 of the Australian Criminal Code Act 1995 (“Code”). Even though a federal system is followed in Australia and criminal law is normally governed under state law, the Commonwealth retains legislative power in particular criminal matters. The Code was promulgated to give effect to this overarching legislative power to govern certain criminal law matters.

⁵⁸⁸ A Tuson “Criminal Finances Act 2017: key issues for assessing risk and implementing controls” (2017) 6 *Comp & Risk* 2 2.

⁵⁸⁹ Even in South Africa, King IV stresses the importance of tax compliance. It states that a company should ensure that it is compliant with the applicable laws by introducing a tax policy. Moreover, preventing tax evasion is congruent with responsible corporate citizenship as purported by Principle 3 of King IV.

⁵⁹⁰ Wells (2017) *Crim L Rev* 428.

⁵⁹¹ Wells (2017) *Crim L Rev* 427; Tuson (2017) *Comp & Risk* 2.

Similar to other Anglo-Saxon jurisdictions, an individualistic model for corporate criminal liability was initially followed in Australia, whereby vicarious liability and the doctrine of identification were followed. As a result of the criticisms raised against these modes of attribution, it was found that allocating the directing mind and will was particularly ineffective to regulate corporate criminal liability.⁵⁹² Accordingly the legislature opted to create a regulatory framework for corporate criminal liability which accommodated modern corporate realities. An organisational model which imposed personal corporate liability, based on independent corporate fault and individual corporate culture was developed.⁵⁹³

The Code draws a distinction between the physical and mental elements of an offence. In terms of the *actus reus*, the focus remains on an individual's conduct.⁵⁹⁴ In section 12.1(1) of the Code, express mention is made that criminal liability should be imposed with reference to individual liability, bearing in mind the various modifications embodied in the Code.⁵⁹⁵ If an employee, agent or officer of the company was acting within his or her scope of employment or upon instruction whilst committing the offence, the physical conduct would be attributed to the company.⁵⁹⁶ This provision is similar to section 332(1) of the CPA and could be rationalised in the sense that a company cannot commit the *actus rea* itself, due to its abstract nature. Both positive conduct and omissions would be included in the physical element.

In terms of the mental element, the Code provides for offences requiring either negligence or subjective fault.⁵⁹⁷ Offences of intention, knowledge or recklessness are provided for, which could be attributed to the company.⁵⁹⁸ Intention could be ascribed to the company, if it can be proven that the corporation sanctioned the committing of the offence, be it expressly, tacitly or impliedly.⁵⁹⁹ Authorisation or permission could be found in one of three ways, as proposed by the Code.⁶⁰⁰ The influence of the doctrine of identification is clear in the first two instances, which emphasises the board

⁵⁹² Jordaan (2003) *Acta Jur* 63; Borg-Jorgensen & Van der Linde (2011) *TSAR* 696.

⁵⁹³ Jordaan (2003) *Acta Jur* 63.

⁵⁹⁴ 64.

⁵⁹⁵ At a first glance, it would seem that this is the point of departure, however, if one considers the emphasis on true corporate fault in terms of *mens rea*, this section should be read in context.

⁵⁹⁶ S 12.2.

⁵⁹⁷ Jordaan (2003) *Acta Jur* 63.

⁵⁹⁸ 63.

⁵⁹⁹ S 12.3(1).

⁶⁰⁰ S 12.3(2),

of directors⁶⁰¹ or a high managerial agent.⁶⁰² Either the board of directors or a high managerial agent's intention could be imputed to the company if they directed or tolerated the conduct.⁶⁰³ A high managerial officer is typically an employee, agent or officer whose conduct may be assumed to reflect the corporate policy and ethos, due to the responsibilities they assume.⁶⁰⁴ Although these methods are akin to the directing minds doctrine, it is a variance on the traditional model, because the corporation could raise a defence. If it can be shown that the company exercised due diligence in preventing the conduct, authorisation or permission of the high managerial officer, it may not be held liable.⁶⁰⁵ In respect of the board of directors, however, this defence cannot be raised.⁶⁰⁶ The availability of a due diligence defence, is a positive development, which could be incorporated into South African law to prevent arbitrary imposition of criminal liability in certain instances.

The third method is notably a revolutionary step in corporate criminal liability, for it is underscored by the realist theory. It should be proven that "a corporate culture existed within the [company] that promoted, encouraged, tolerated or led the non-compliance with the relevant provision."⁶⁰⁷ The company itself created an environment and ethos which sanctioned the commission of the offence. Furthermore, if the company "failed to create and maintain a corporate culture that required compliance with the relevant provision"⁶⁰⁸ *mens rea* can be established. The Code defines corporate culture as an "attitude, policy, rule, course of conduct or practice" which exists in the company as whole or in the relevant part where the offences are being committed.⁶⁰⁹ Additionally, the notion of corporate culture is extended, by listing various factors to consider in establishing whether or not the corporate identity or culture has been blemished.

Firstly, if the high managerial agent authorised the commission of an offence of the same or similar nature as the conduct in question, it would be indicative of a corrupt corporate culture. Secondly if a reasonable expectation by an employee, agent or

⁶⁰¹ S 12.3(2)(a).

⁶⁰² S 12.3(2)(b).

⁶⁰³ S 12.3(a)-(b).

⁶⁰⁴ S 12.3.6.

⁶⁰⁵ S 12.3(3).

⁶⁰⁶ Jordaan (2003) *Acta Jur* 64.

⁶⁰⁷ S 12.3(2)(c).

⁶⁰⁸ S 12.3(2)(d).

⁶⁰⁹ S 12.6.

officer exists that their unlawful conduct would be sanctioned by the high managerial officer, it is presumed that the corporate culture is corrupt.⁶¹⁰

In instances where crimes of negligence occur, the Code introduces the principle of aggregation as a model for attribution, whereby the company's conduct in its entirety is examined.⁶¹¹ Furthermore, if inadequate corporate control mechanisms exist to supervise management and conduct of employees to a substantial degree, it might be sufficient evidence to find negligence on the company's part.⁶¹² The failure to provide proper systems which convey information to the relevant stakeholders, would be a further indication of negligent conduct.⁶¹³ Therefore with regards to the negligence inquiry, the Code follows an organisational approach, focusing on the systemic safeguards to prevent unlawful conduct rather than an individualistic theory.

Strict liability is characterised by the absence of the fault element in imposing liability. However, the Code (unlike the South African legislation) provides for a defence of reasonable mistake of fact. If the employee, agent or officer of the company made a reasonable mistake of fact, which lead her to believe that the conduct did not amount to an offence and the company proves due diligence on its part by having preventative measures in place, it might be successful.⁶¹⁴ Despite the possibility of raising a defence, the company would not easily be acquitted. Systemic failure to manage, control, supervise or convey relevant information to employees would negate the due diligence defence. However, the incorporation of the due diligence limit on possible liability, expresses a paradigm shift towards the realist theory in corporate criminal liability.

Although the Code still acknowledges the role of human agency, specifically in the context of attributing the physical element of the offence to the corporation, the main focus is on the attitudes, procedures and practices within the corporation.⁶¹⁵ Though the formal structures are considered, the unwritten rules or ethos could be a valuable indicator of the corporate identity and character. Hence the unique corporate identity of a company should be the focal point in ascribing personal criminal liability on

⁶¹⁰ S 12.4(a)-(b).

⁶¹¹ S 12.4(2).

⁶¹² S 12.4(3)(a).

⁶¹³ S 12.4(3)(b).

⁶¹⁴ S 12.5(a)-(b).

⁶¹⁵ Borg-Jorgensen & Van der Linde (2011) *TSAR* 698.

corporations. However, these underlying moral values within a company might be difficult to prove from an evidentiary perspective.⁶¹⁶ Thus the Code permits the examination of any relevant facts which could indicate a morally dubious corporate culture. Due to the possible uncertainty pertaining to corporate culture, the Code still enforces a hierarchical approach to systemic failure with reference to high managerial actors.

Regardless of the vagueness relating to corporate culture, the Code is the most sophisticated framework for corporate criminal liability from a realist perspective. However, it is argued that it bears little practical significance.⁶¹⁷

6 Too big to jail?

Garrett describes a corporate prosecution as a battle between David and Goliath, where the federal prosecuting system is the so-called little guy, despite its potential ability to hold a corporation criminally liable for the conduct of a single employee.⁶¹⁸ Ultimately, the cost of prosecution is too high to be cost-effective, which leads to many crimes being unsolved or undetected. One of the reasons for inefficient prosecution, is the fact that imposing a fine is not necessarily the optimal sanction for corporate criminal behaviour.

Coffee argued that imposing a fine is an inefficient means to hold an organisation liable for corporate crimes. He suggested an alternative system, where the individual decision-maker is the focus of corporate criminal liability, as well as a system of competitive bids regarding the choice of a fine as an alternative form of punishment.⁶¹⁹

Another option proposed by Du Toit, is that of a share fine, where a company is not sanctioned by way of a heavy fine, but a certain number of shares should be issued to the state. This would water down the value of shares, but the proceeds from the shares could be used to compensate the victims of crimes. Although a monetary sanction is imposed, the liability is not to the detriment of employees or creditors.⁶²⁰

⁶¹⁶ 698.

⁶¹⁷ Du Toit *Strafregtelike aanspreeklikheid* 143.

⁶¹⁸ BL Garrett *Too big to jail: how prosecutors compromise with corporations* (2014) 1.

⁶¹⁹ JC Coffee "Corporate Crime and Punishment: A Non-Chicago View of the Economics of Criminal Sanctions" (1980) 18 *Am Crim L Rev* 419 419.

⁶²⁰ Du Toit *Strafregtelike aanspreeklikheid* 190.

In the social sciences rigid models tend to be short-lived, however, certain perspectives endure. Thus, Coffee advocates that no single economic theory can be developed to analyse criminal sanctions, but the failure to develop a single approach does not condemn the economic analysis of law. The various economic models have an enduring relevance which transcends its original purpose and create a flexibility for creative analysis.⁶²¹

The Chicago scholar, Professor Gary Becker, developed a modern economic theory for the optimal use of criminal sanctions.⁶²² The cost minimisation model recognises three types of costs which are associated with crime, namely (1) the social cost that arises from the illegal conduct; (2) the cost of punishment that result from the imposition of a sanction on the (corporate) offender; and (3) the transaction costs incurred by the judicial system for the apprehension and punishment of offenders.⁶²³ Although other costs could be relevant, the three types of cost identified in the Becker model makes the basic assertion that an optimal system of criminal justice reduces the aggregate of these three costs to a minimum, hence the reference to the “cost minimisation” model.⁶²⁴ Inherently, an optimal system requires certain trade-offs to reach an efficient equilibrium. If the cost to victims (ultimately included in the social cost) reduces, the aggregate costs of criminal sanctions will not decrease if another cost component is increased by more than the corresponding margin. Ultimately, this leads to problematic incentives, especially if the costs of apprehension and criminal sanctions are higher than the harm suffered, thereby not justifying the prosecution of the criminal activity. This creates a public perception that engaging in certain criminal activity has a low risk of being held accountable. Moreover, Coffee argues that one could draw “obvious policy conclusions” from the model suggested by Becker and provide economic justification thereof.⁶²⁵ The theory of optimal use of criminal sanctions which Becker proposes, (also referred to as the Free Market Model)⁶²⁶ has three basic principles, namely (1) the preferred form of sanction, (2) the appropriate cost-bearer and (3) the certainty-severity trade-off. In terms of the preferred form of sanction, fines are regarded as the optimal form of punishment and more efficient than

⁶²¹ Coffee (1980) *Am Crim L Rev* 420.

⁶²² Coffee (1980) *Am Crim L Rev* 420.

⁶²³ GS Becker “Crime and Punishment: An Economic Approach” (1968) 76 *J Pol Econ* 169 180, 207.

⁶²⁴ Coffee (1980) *Am Crim L Rev* 421.

⁶²⁵ 421.

⁶²⁶ 421.

incarceration, because the additional social cost of a fine is lower.⁶²⁷ Secondly, the appropriate person should bear the cost of the criminal sanction. If crimes are committed on behalf of an organisation, as in the case of corporate criminal liability, the organisation and not the individual engaging in the criminal conduct should pay the fine.⁶²⁸ Lastly, certainty-severity trade-off assumes that high penalties are preferred to vigorous law enforcement. It is more cost efficient if the severity of a sanction is raised instead of the probability of conviction. The reason being that it is cheaper to impose a higher sanction than apprehend additional offenders.⁶²⁹

Coffee opposes the Free Market Model, stating that it is merely an economic theory and not the only economic theory of criminal sanctions.⁶³⁰ If the rational-actor model is introduced for the “criminal choice” decision, as Coffee recommends, the policy conclusions would differ from those proposed in the Free Market Model. It is argued, that a nuanced difference in the premises would ultimately alter the policy conclusions. Firstly, the threat of incarceration will have a greater deterrent effect than the threat of a fine. Secondly, penalties focused on individuals and not organisations will have a greater deterrent value. Lastly the certainty of a sanctions and not its severity, is crucial in deterring criminal behaviour.⁶³¹

Du Toit alleges that the various models used to attribute liability rules on juristic persons may have various theoretical premises, but two assumptions are found in every model, namely that a single individual cannot be identified who bears responsibility for corporate conduct and fault and effective deterrence occurs if the corporation instead of the individual is held criminally liable, thereby differing from Coffee’s departure from the Free Market Model.⁶³² Being an abstract being, the individuals comprising a company should not be ignored in the corporate criminal liability inquiry, however, they should not be the centre of the investigation (especially

⁶²⁷ Imprisonment is costly to society, because it is mainly funded through state resources (or ultimately the tax-payer) and it inhibits the offender’s productive capacity.

⁶²⁸ The underlying reason for imposing a fine on the organisation and not the individual, is the assumption that the organisation will discipline the individual or agent acting on its behalf if it is in its interest to do so. Whether internal disciplinary procedure is sufficient to prevent future criminal conduct is uncertain.

⁶²⁹ Posner argues that the costs incurred for raising the likelihood of conviction outweighs the cost of imposing a longer prison sentence, or in the case of corporate offenders, a larger fine. RA Posner *Economic Analysis of Law* 9 ed (2014) §24.1; Coffee (1980) *Am Crim L Rev* 421.

⁶³⁰ Coffee (1980) *Am Crim L Rev* 422.

⁶³¹ 422-423.

⁶³² Du Toit *Strafregtelike aanspreeklikheid* 120.

with regard to corporate fault), but merely an instrument thereof.⁶³³ This approach does not account for the way in which individuals are influenced by corporate structures and culture of companies and what incites unlawful conduct. The role of individuals in corporate criminal liability should not be overlooked, but the influence of corporate structures on individuals' conduct is crucial.⁶³⁴

Schrager and Short define organisational crimes as the following:

"[They] are illegal acts of commission or omission of an individual or a group of individuals in a legitimate formal organization in accordance with the operative goals of the organization, which have a serious physical or economic impact on employees, consumers or the general public."⁶³⁵

According to this working definition developed by Schrager and Short, the influence of corporate culture and corporate structure on the conduct of individuals within a company is illustrated. Du Toit, however, criticises the definition as being too narrow, because corporate criminal liability is limited by the degree of seriousness of the offence. He argues that any prohibited conduct (unless it amounts to a *de minimis non curat lex*) should be regarded as criminal, irrespective of the nature of the offence.⁶³⁶

6 1 Are corporations still too big to jail in light of the CMCHA?

As an alternative model to corporate criminal liability, the CMCHA also proposes a deterrence mechanism. According to section 1(6) of the CMCHA, if a company is found guilty, it could be liable for an unlimited fine. Davies and Worthington pose the question if this sanction is in line with the deterrent aims found in criminal law?⁶³⁷ The reason for their cynicism is that the shareholders and not the senior management responsible for corporate failure will be punished. By imposing a large fine, shareholders' equity will be reduced and share prices might plummet due to the reputational harm caused by corporate crime.⁶³⁸ Another disincentive for corporate wrongdoing, is that shareholders' conduct could be adversarial to director's interest,

⁶³³ 120.

⁶³⁴ LS Schrager & JF Short "Toward a Sociology of Organizational Crime" (1978) 25 *Soc Probs* 407 410.

⁶³⁵ Schrager & Short (1978) *Soc Probs* 411-412.

⁶³⁶ Du Toit *Strafregtelike aanspreeklikheid* 121.

⁶³⁷ Davies & Worthington *Gower* 186.

⁶³⁸ The economic efficacy of imposing a fine as a criminal sanction will be discussed in more detail in a following chapter. It is argued that not all crimes would discourage customers from supporting certain companies nor show that directors did not act in shareholders' best interest, for example international fashion brands using child labour.

for example removal from the board. However, whether or not shareholders will be proactive in holding management accountable depends on the internal structures of the company. Although the CMCHA was designed to combat corporate manslaughter in larger organisations, the involvement of shareholders in these companies are often neglected.⁶³⁹ Davies and Worthington speculate that shareholders might be pressured to take action, if a company could be excluded from a particular part of business as part of the criminal sanction.⁶⁴⁰ However, once again this sanction will place a heavier burden on shareholders than those at fault, namely management.

It is argued that a better deterrent effect is the reputational harm a criminal conviction will impose on management, especially if it is their conduct which leads to the company being guilty of corporate manslaughter.⁶⁴¹ The court also has the power to order a company to give publicity to the fact of its conviction. In terms of section 10 of the CMCHA, non-compliance with a publicity order is a criminal offence in itself. Du Toit mentions that publicity orders might have a necessary deterrent effect in South Africa, rather than imposing larger fines which burden shareholders.⁶⁴²

Lastly, the court may order a convicted company to take steps to remedy the breach leading to the death. In addition, any shortcomings in terms of health and safety regulations in the company's policies, systems or practices should be rectified within certain timeframe.⁶⁴³ To ensure that the organisation abides with the order, a relevant enforcement agency may require evidence that steps have been taken.⁶⁴⁴

7 Conclusion

There is a need to hold companies criminally liable, however, the mechanism of holding them liable is not necessarily efficient. As a point of departure, the legal nature of a company has been a key factor in determining the model of attribution to be followed.

⁶³⁹ Shareholders are more likely to play a passive role in decision-making processes. Therefore the only actors who would pressure senior management, might be institutional investors.

⁶⁴⁰ Gower 186.

⁶⁴¹ Davies & Worthington Gower 186.

⁶⁴² PG Du Toit "Publisiteitsbevele as vonnisopsie vir regspersone" (2016) 19 *PELJ* 2-18.

⁶⁴³ S 9.

⁶⁴⁴ An example would be the Health and Safety Executive. These regulatory bodies are given no greater monitoring role in relation to management in terms of the CMCHA, but they could conduct general inspections more readily. Davies & Worthington Gower 187.

In terms of the individualist or nominalist theory, there is a historic reluctance to impose criminal liability on corporations due to a lack of consciousness and inability to commit unlawful conduct. Nevertheless, the vicarious model followed in South Africa attempts to address the artificial nature of the company by imputing the conduct and will of an individual who is either a director or servant of the company, provided that the relevant individual was at fault and acted within the scope of her employment. Another theory flowing from the nominalist or individualist theory, is the doctrine of the directing mind and will. This model is the dominant theory in English law, however, its narrow function and inability to impute liability for large corporate failure has been criticised.

As an alternative approach to corporate criminal liability, the organisational model determines fault by focusing on the corporate culture in a company, thus its internal policies, decision-making framework, corporate ethos and monitoring systems. The Australian model is regarded as the most sophisticated framework to determine corporate criminal liability. In order to overcome the inefficiencies of the identification or directing mind doctrine, English law has promulgated various legislation which incorporates a realist or organisational approach to corporate criminal liability. Nevertheless, the corporate law reform is focused on regulating non-compliance and does not necessarily address the hurdle of crimes involving *mens rea*.

The possible constitutional scrutiny of section 332(1) of the Criminal Procedure Act has been explored in this chapter, especially due to the absence of a due diligence defence. Imposing criminal liability upon a corporation which has not condemned the offences, would not only be unfair, but is in violation of the constitutionally entrenched presumption of innocence. In turn this could lead to the thwarting of shareholders and employees' expectations. In this regard, the legislative reform in England and Wales could be used as a guideline to determine what the ambit of such a due diligence defence would be.

In South Africa, the theory of corporate personality and the need for a realistic understanding of corporate responsibility is in need of review. However, another obstacle to ensure corporate criminal liability, is the limited option for corporate retribution and punishment. Conservative theory relies on penalties as the effective means to sanction corporations. As seen in this chapter, a fine is an inefficient means to hold a company criminally liable. Other creative penalties are available, such as

publicity orders, corporate probation or deregistration and the judiciary should explore these possibilities.⁶⁴⁵

There is a current trend in corporate criminal liability theory towards corporate failure to prevent economic crime, as seen with the promulgation of the BA and the CFA in England and Wales. One of the rationales for this shift, is that blameworthiness is easier to determine if the enquiry is limited to the public policies in a company. Whether South African law will follow suit is yet to be determined.

⁶⁴⁵ Burchell *Principles* 469.

Chapter 5: Economic considerations

1 Introduction

Economic considerations have been part of company law since the inception of modern company law.⁶⁴⁶ Modern corporate law is focussed on solving the perceived agency problems between shareholders as owners and management as agents caused by the separation of ownership from control in companies.⁶⁴⁷ Watson argues that the ultimate purpose of corporate regulation should be to address these agency problems.⁶⁴⁸

During the eighteenth century, Adam Smith in his seminal work *The Wealth of Nations* originally characterised the agency problem as follows:

“The directors of such [joint stock] companies, however, being the managers rather of other people’s money than of their own, it cannot be well expected that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own. Like the stewards of a rich man, they are easily apt to consider attention to small matters as not for their own master’s honour and very easily give themselves a dispensation from having it. Negligence and profusion, therefore, must always prevail in the management of the affairs of such a company.”⁶⁴⁹

The rules of attribution as described by Lord Hoffmann in *Meridian* form the legal framework whereby either criminal or delictual liability can be imputed to the company.⁶⁵⁰ Furthermore, these rules of attribution are key to the operational structure of a company and it is imperative that the basic principles are clearly understood and applied in case law.⁶⁵¹

Although certainty and consistency in legal rules are pivotal, the distinction between the rules of attribution and the agency problem remains a grey area and a nuanced approach is needed. Moreover, the current legal framework developed for regulating

⁶⁴⁶ KJ Hopt “Comparative Company Law” in Reimann M & R Zimmermann (eds) *The Oxford Handbook of Comparative Law* (2006) 1161-1191 1184.

⁶⁴⁷ S Watson “How the company became an entity: a new understanding of corporate law” (2015) 2 *JBL* 120 120, 122.

⁶⁴⁸ Watson (2015) *JBL* 120.

⁶⁴⁹ A Smith *The Wealth of Nations (Cannan)* 5 ed (2003) 941.

⁶⁵⁰ A Griffiths *Contracting with Companies* (2005)2.

⁶⁵¹ S Worthington “Corporate attribution and agency: back to basics” (2017) 133 *Law Q Rev* 118 143.

corporate liability should have a balanced approach to address the inherent agency problem.

2 Law and economics: addressing the agency problem

The importance of law and economics in the reform of company law, has been reiterated by the Law Commission of England and Wales Consultation Paper of 1998,⁶⁵² in which it emphasised the economic importance of directors acting within clear guidelines.⁶⁵³ Uncertainty leads to unnecessary opportunity costs and inhibits efficient decision-making. Furthermore, as a functional area of law, company law must facilitate commercial realities and enable all stakeholders to reap the benefits of corporate activity.⁶⁵⁴ The rationale was to assess if the existing legal rules promoted allocative efficiency, which in conjunction with dynamic efficiency would ultimately provide for innovation in achieving efficiency.⁶⁵⁵

In essence, the Law Commission of England and Wales (“Law Commission”) stated that agency costs are key to law reform. Agency costs are those costs which are associated with having one’s affairs or property managed by someone else and is an inevitable result of the separation between ownership and control in large corporations, as envisaged by Berle and Means.⁶⁵⁶ The notion that these agency costs could be minimised through legal mechanisms which promote efficiency, are regrettably based on the assumption that shareholders are actively involved in decision-making and monitoring management activities in large corporations.⁶⁵⁷ If one deflects from a legal understanding of the principal/agent relationship and instead opt for the economic concept, where the agency costs are associated with costs arising from delegation and not the precise juridical relationship, true company law reform can occur.⁶⁵⁸ Thus, the juridical relationship is disposed of as a mere legal fiction and substituted by an economic approach to agency.

⁶⁵² Law Commission *Company directors: regulating conflicts of interest and formulating a statement of duties* Law Commission Consultation Paper No 153; Scottish Law Commission Discussion Paper No 105 5.

⁶⁵³ LE Talbot *Critical Company Law* (2008) 176.

⁶⁵⁴ Talbot *Company Law* (2008) 176.

⁶⁵⁵ 176-177.

⁶⁵⁶ 177.

⁶⁵⁷ 177.

⁶⁵⁸ 177.

In its proposal for law reform by means of addressing agency costs, the Law Commission stated the following:

“[E]fficiency will be increased if an incentive structure can be put in place which will align the interests of the parties as far as possible. This set of incentives may be thought of, in a loose sense, as a contract or governance structure which is the result, in part, of bargaining between the parties, even though not all aspects of the arrangement would be regarded as contractual in the juridical sense of constituting a legally binding agreement.”⁶⁵⁹

The contractarian theory underlying the Law Commission’s reasoning above, is based on the law and economics scholars’ theory of the firm, as originally developed by Ronald Coase in his seminal work *The Nature of the Firm*.⁶⁶⁰ Coase characterised the corporation as a set of transactions between those involved in the business, which forms the basis of the contractarian theory.⁶⁶¹ Contractarian scholars applied Coase’s model of the corporation as a set of arrangements (or contracts) between individuals and the corresponding denial of the corporation as an entity, thus reducing the corporation to a mere “nexus of contracts”.⁶⁶² The nexus of contracts model, as developed by Jensen and Meckling, provides that individuals within a business engage in private contracts, which contracts are overseen by management.⁶⁶³ According to Talbot, the company remains a legal fiction, as the discussion regarding the corporate personality of a company is a matter of convenience rather than reality.⁶⁶⁴ Given its fictional nature, managers will act as an agent for the shareholders of the company and not the company itself.⁶⁶⁵

Although the theory of the firm has been an integral part of law and economics, Jensen and Meckling argue that it is rather a theory of markets of which firms are important participants.⁶⁶⁶ The firm is pivotal in organising inputs and outputs in such a manner as to maximise profit, as well as present value.⁶⁶⁷ However, the problem

⁶⁵⁹ Law Commission *Company directors* 31.

⁶⁶⁰ RH Coase “The Nature of the Firm” (1937) 4 *Economica* 386.

⁶⁶¹ Talbot *Company Law* (2008) 125.

⁶⁶² 125.

⁶⁶³ 125.

⁶⁶⁴ Talbot at 125, relying on FH Easterbrook & DR Fischel “The corporate contract” (1989) 89 *Colum L Rev* 1416 1426.

⁶⁶⁵ Talbot *Company Law* (2008) 125.

⁶⁶⁶ MC Jensen & WH Meckling “Theory of the firm: managerial behaviour, agency costs and ownership structure” (1976) 3 *JFE* 305 306.

⁶⁶⁷ Jensen & Meckling (1976) *JFE* 306.

remains how conflicting objectives of individuals can be brought together to find an optimal solution.⁶⁶⁸ In large companies, shareholders are often desensitised from the company, which results therein that shareholders rely on the integrity and skill of managers. This situation poses a risk that managers act in their own self-interest and not those the principal. Inevitably, the traditional theory of the firm ignores the social responsibility vesting in firms.

Corporate law has two functions, namely to regulate the structure of corporate form and the ancillary rules needed to support these corporate structures, as well as controlling the conflicts of interest existing among corporate constituencies.⁶⁶⁹ The conflict of interest existing between “insiders” and the “outsiders” (as described by Armour, Hansmann and Kraakman)⁶⁷⁰ is regarded as the most important conflict which corporate law seeks to regulate. Controlling shareholders and top managers are typically described as the “insiders”, while minority shareholders and creditors form part of the “outsiders”.⁶⁷¹ The conflict which arises, is referred to as the agency problem or principal-agent problem. The nature of the agency problem rests on the principle that one party, namely the “principal” relies on the actions of another party (the “agent”), which would ultimately affect the principal’s welfare.⁶⁷²

Ultimately corporate law seeks to reduce agency costs by realigning the interests of managers and shareholders. Typically, these costs are borne by the shareholders and are not easily quantifiable. Agency costs will result in lower dividends or a decrease in share prices, however, to prove an actual loss on the shareholders’ part will be difficult to determine.⁶⁷³ Nevertheless, markets (especially the financial market and labour market) ensure that managers are incentivised to reduce agency costs. In terms of the contractarian approach, the rules of corporate law within the market will be positioned in such a way as to ensure an optimal solution is found.⁶⁷⁴

⁶⁶⁸ Jensen & Meckling (1976) *JFE* 307.

⁶⁶⁹ J Armour, H Hansmann & R Kraakman “Agency Problems and Legal Strategies” in J Armour, RR Kraakman, P Davies, L Enriques, H Hansmann, G Hertig, KJ Hopt, H Kanda, M Pargendler, W-R Ringe & EB Rock (eds) *The Anatomy of Corporate Law: A Comparative and Functional Approach* 3 ed (2017) 29-47 29.

⁶⁷⁰ Armour et al “Agency Problems and Legal Strategies” in *Anatomy* 29.

⁶⁷¹ The question arises where one could categorise employees, be it as insiders or outsiders. One could argue, that the answer depends on the hierarchical structure of the corporation and where the employee falls on the corporate ladder.

⁶⁷² Armour et al “Agency Problems and Legal Strategies” in *Anatomy* 29.

⁶⁷³ Talbot *Company Law* (2008) 126.

⁶⁷⁴ 126.

3 Risk-bearers, agency problems and the theory of the firm

The separation between ownership and control in companies is an important characteristic in modern company law, however, this separation did not always exist. In the mid-nineteenth century there was no expectation from shareholders that their liability towards third parties would be limited, for a company operated similarly to a partnership.⁶⁷⁵ The shareholders managed the company and thus had direct control over its exposure to risk. Locke argues that the risk to these shareholders was less than to shareholders in modern companies.⁶⁷⁶ This direct control has gone missing in the structure of large modern companies, where the board of directors is responsible for the business and affairs of the company.⁶⁷⁷ Despite the importance of the separation between ownership and control in modern companies, the incentive problems arising from this separation remain problematic and in need of redress.

According to Fama, the incentive problems that arise where decision making in a firm falls within the management activities of the board of directors who are not the firm's shareholders are central in law and economics scholars' research.⁶⁷⁸

Management and risk bearing are central in both the Jensen-Meckling and the Alchian-Demsetz analyses of the firm.⁶⁷⁹ According to Alchian and Demsetz the essence of the classical firm can be identified in the nexus of contracts theory. The contractual structure is characterised as follows: (1) joint input production; (2) several input owners; (3) a common party to all the contracts of the joint inputs; who has the (4) right to renegotiate any input's contract independently of other input owners' contracts; and who ultimately (5) holds the residual claim; as well as the (6) right to sell the central contractual residual status.⁶⁸⁰ The common party or central agent is the firm's owner and the employer.

⁶⁷⁵ N Locke "The Approach of the Supreme Court of Appeal to the Enterprise Reality in Company Groups" (2012) 23 *Stell LR* 476 477.

⁶⁷⁶ Locke (2012) *Stell LR* 477.

⁶⁷⁷ Section 66(1) of the Companies Act states that the "business and affairs of a company must be managed by or under the direction of its board, which has the authority to exercise all of the powers and perform any of the functions of the company" unless the Companies Act or MOI provides otherwise; Locke (2012) *Stell LR* 477.

⁶⁷⁸ EF Fama "Agency Problems and the Theory of the Firm" (1980) 88 *J Pol Econ* 288 288;

⁶⁷⁹ Fama (1980) *J Pol Econ* 290.

⁶⁸⁰ AA Alchian & H Demsetz "Production, Information Costs, and Economic Organization" (1972) 62 *AER* 777 794.

Fama states that, to understand the modern corporation, the manager and the owner of the firm should be separated.⁶⁸¹ The manager is described in points 3 and 4 of the Alchian-Demsetz definition, whilst the owner, as the ultimate risk-bearer, is described in points 5 and 6. According to Fama, retaining the concept of an entrepreneur as both the manager and the owner, prevents a perspective of management and risk bearing as separate factors of production.⁶⁸² If one separates these factors of production, it is possible to analyse the various markets for these factors of production separately. Each factor, be it management or risk bearing, has a market for services that offer alternative opportunities, which in the case of management is a performance incentive.⁶⁸³ The contractual structure enables a particular firm to compete with other firms with similar cooperating factors of production. In modern corporations, the residual risk bearers have markets for their services, namely the capital markets, which enable risk bearers to diversify their production factors with relatively low transaction costs and to hedge against the corporate failure of a particular team (or firm).⁶⁸⁴ The optimal portfolio for any investor is a diversified portfolio across the securities of many firms. However, a diversified portfolio lessens the involvement of an investor in one specific firm and reduces the need for personally overseeing the detailed activity in any of the portfolio firms. Fama concludes that the efficient allocation of risk bearing implies the separation of ownership and control in a firm.

Following this reasoning, it is clear that the managers of a firm are not the owners of capital, but rather the owners of the human capital invested in the firm. The rental rates at which they supply their human capital, will depend on the success or failure of the firm, as well as the managerial labour market.⁶⁸⁵ In turn, success and failure is measured by the efficacy of management to fulfil its function to oversee the contracts among the factors of production and to ensure the long-term sustainability of the firm.

In ensuring that management's and owners' incentives are aligned, it is necessary to determine if the signals provided by both the managerial labour market and the

⁶⁸¹ Fama (1980) *J Pol Econ* 291.

⁶⁸² 291.

⁶⁸³ 291.

⁶⁸⁴ 291.

⁶⁸⁵ 292.

capital market (including other market-induced mechanisms) are sufficient to discipline managers?⁶⁸⁶

3 1 Striking the right balance

According to Fama, the external labour market exercises various direct pressures on the firm to categorise and compensate managers according to performance. Firstly, a successful firm will be a participant in the market for new managers. Potential new managers will be concerned with the key performance measures in the firm and will seek information about the system's responsiveness to reward performance. If the firm is not on par with the competitive managerial labour market, especially its reward system, the firm will lose managers. Furthermore, an internal monitoring of managers will develop as higher-ranking managers will monitor the productivity of lower-level managers. Although the internal monitoring system is typically noted as a top-bottom approach, the inverse monitoring should also be appreciated.⁶⁸⁷ Therefore, all managers (irrespective of hierarchical level) realise that the managerial labour market uses the performance of the firm as a measure to determine each manager's external opportunity wage.⁶⁸⁸

Having gained control of the board, top management may realise that collusion and expropriation of shareholder wealth will be more advantageous than competing with one another.⁶⁸⁹ It is argued, that the appointment of independent non-executive directors will reduce the probability of such collusion and simultaneously, the function of the board as a "market-induced mechanism for low-cost internal transfer of control" might be levered.⁶⁹⁰ Independent non-executive directors will oversee and (to a certain extent) manage the competition among a firm's executive committee.⁶⁹¹ It is deduced that the disciplining of management occurs through both internal and external mechanisms.⁶⁹² Although Alchian and Demsetz originally commented on these control mechanisms, they alluded that the task of disciplining management remains primarily with the risk bearers, thus the shareholders. Although the managerial labour markets

⁶⁸⁶ Fama (1980) *J Pol Econ* 292.

⁶⁸⁷ If the nexus of contracts view of the firm is followed, each manager will be concerned with the performance of managers at every hierarchical level, for her marginal product will likely be a positive function of theirs. Fama (1980) *J Pol Econ* 293.

⁶⁸⁸ Fama (1980) *J Pol Econ E* 293.

⁶⁸⁹ 293.

⁶⁹⁰ 293.

⁶⁹¹ 294.

⁶⁹² 294.

and the possibility of a change of control by way of a fundamental transaction assist in monitoring and disciplining managerial behaviour, the ultimate risk bearers still have the primary disciplinary function.

Despite Alchian and Demsetz' comment, Fama states that if management and risk bearing are viewed as separate factors of production, risk bearers will be more likely to diversify their portfolio and would not be interested in directly controlling the management of a single individual firm. Therefore, those models of the firm advocated by the scholars Alchian and Demsetz, as well as Jensen and Meckling, which focus on the risk-bearers as the primary control mechanism of management, are not effective in addressing the incentive problems arising from the separation of ownership and control, in other words the agency problem.⁶⁹³

Rather, the managerial labour market as the primary control mechanism to discipline and control management, is more viable for the disciplinary function of management in large corporations, where the separation between ownership and control is a reality. If the managerial labour markets are efficient in disciplining managers both internally and externally, the need for a market for hostile takeovers will be a disciplinary mechanism of last resort.⁶⁹⁴ Furthermore, if the wage revision process is sufficient in managing the incentives of management, wage changes will offer another mechanism for disciplining and controlling managerial behaviour.⁶⁹⁵

In conclusion, Fama remarks that if the weight afforded to the wage revision process is the equivalent of the full ex post settling up, the agency problem could be resolved.⁶⁹⁶ However, the desired outcome where the wage revision process results in a full ex post settling up on the part of the manager, is not necessarily achieved.⁶⁹⁷ Instead, there are instances where the weight of the anticipated future wage changes does not offset the potential benefits arising from illicit behaviour, for example the gains from criminal conduct which is not accounted for ex ante in a manager's employment

⁶⁹³ The expensive mechanism of an outside takeover, as proposed by Manne, does not offer a viable alternative for the control of management either, as stated by Fama (1980) *J Pol Econ* 295.

⁶⁹⁴ Fama (1980) *J Pol Econ* 295.

⁶⁹⁵ In this regard, a contemporaneous change in a manager's wealth will be implied by an eventual change (either as an uptick or downward adjustment) in future remuneration, which would result in the effective enforcement of the employment contract, as an ex post settling up will occur. In addition, the wage revision process could be influenced by fluctuations in wages owed by other firms in the market. Fama (1980) *J Pol Econ* 297.

⁶⁹⁶ Fama (1980) *J Pol Econ* 306.

⁶⁹⁷ 306.

contract. Ultimately, whether the wage revision process is effective in imposing *ex post* settling up, remains an empirical issue.⁶⁹⁸ Nevertheless, the general phenomenon is vital to the efficient economic organisation of modern corporations, where ownership and control are separated and incentives are misaligned.

One of the instances where the misalignment between the incentives of ownership and control is evident, is corporate failure and in particular corporate criminal liability. Due to the nuanced distinction between the rules of attribution and that of agency, the role of the agency problem in corporate criminal liability should be explored.

4 Agency theory and the criminal liability of organisations

According to Macey, the conventional assumption, particularly among law and economics scholars, that corporate shareholders ultimately benefit from corporate crime is misplaced. Although it is true that corporate shareholders do benefit *ex post* if corporate crime is undetected, the *ex ante* benefit flowing from corporate activity is uncertain.⁶⁹⁹ Macey argues that the agency cost perspective indicates that the deviation of interests between managers and shareholders (especially in modern corporations) serves as the best justification for corporate crime.⁷⁰⁰

In modern company law, agency theory plays a pivotal role in theoretical analysis. In applying basic principles of agency theory to corporate criminal behaviour, one can firstly deduce that corporate actors are typically risk averse.⁷⁰¹ Criminal activity, on the other hand, assumes risk-taking behaviour. If criminal sanctions have a deterrent effect, it might increase a proclivity to risk aversion on the part of corporate actors. However, excessive criminal enforcement could suppress innovation and creativity, which has a negative impact on social wealth.⁷⁰² The second insight relates to the crux of agency theory, namely that corporate actors will not engage in criminal behaviour to benefit the firm, but rather for their own benefit. A firm's benefit from corporate criminal activity will merely be incidental. Although shareholders will have an *ex post* benefit flowing from the criminal activity, the misalignment in firm- and self-interest,

⁶⁹⁸ Fama (1980) *J Pol Econ* 396.

⁶⁹⁹ JR Macey "Agency Theory and the Criminal Liability of Corporations" (1991) 71 *BUL Rev* 315 319, 334.

⁷⁰⁰ Macey (1991) *BUL Rev* 319.

⁷⁰¹ 319.

⁷⁰² 319.

will not have an *ex ante* benefit for the shareholders.⁷⁰³ The question arises if the primary criminal sanction should not be imposed on the corporate actor herself rather than the firm?⁷⁰⁴

Macey reasons that imposing criminal liability on a firm is not a “bad idea” however, the dilemma of the agency theory in corporate criminal liability should not be ignored.⁷⁰⁵

The assumption held that corporations are risk-neutral in the context of corporate crime should be reviewed. Due to the reasoning that the ultimate decision-makers, namely the board of directors, are typically risk-averse, the corporation should rather be viewed as risk-averse.⁷⁰⁶ If the assumption of the risk-neutrality of a corporation continues, the criminal sanctions imposed will be inefficient.⁷⁰⁷

Although risk-aversion among corporate actors, specifically the board of directors, is preferred, excessive risk-aversion could lead to unnecessary agency costs.⁷⁰⁸ Macey argues that a basic implication of the agency theory, is that corporate criminal behaviour becomes exceedingly rare. Despite elaborate managerial incentive schemes, corporate actors will have to share the benefit arising from corporate conduct with shareholders. Simultaneously, the board of directors could face severe personal liability if it is convicted of engaging in criminal activity.⁷⁰⁹ Ultimately, Macey states that it is mostly small firms engaging in criminal activity and not large, public companies, but given the contemporary examples of Enron, Volkswagen and Steinhoff, this conclusion may need to be reconsidered.⁷¹⁰ Albeit outliers or exceptions, the greater societal impact of these corporate scandals are detrimental. However, given the difficulty of prosecuting corporate criminal behaviour, one should bear in mind the complexity of modern organisational structures and the difficulty of proving corporate fault. Therefore, the low conviction rate for large, public organisations is merely an indication of the impact of risk-aversion and not necessarily the reality of corporate criminal behaviour.

⁷⁰³ Macey (1991) *BU L Rev* 319.

⁷⁰⁴ GM Gilchrist “Individual Accountability for Corporate Crime” (2018) 34 *Ga S U L Rev* 335 355.

⁷⁰⁵ Macey (1991) *BU L Rev* 319.

⁷⁰⁶ 320.

⁷⁰⁷ 320.

⁷⁰⁸ 322.

⁷⁰⁹ 322.

⁷¹⁰ 324.

Given the assumption that corporate actors are risk-averse, there are certain instances where the assumption does not hold.⁷¹¹ In the case of insolvency, the board of directors may be pressured to engage in illegal activity to ensure the financial survival of the company. The corporate culture in the company's industry could be to promote criminal conduct, thus illegal activity becomes standard practice. Furthermore, corporate criminal transgressions could be the result of mistake on the part of the board of directors. Especially in the case of regulatory offences, the company might misinterpret or miscalculate the legality of a certain transaction or the likelihood of criminal prosecution is very low. According to Macey, a "changing political climate [could] transform a seemingly benign act into a criminal event." Therefore, corporate compliance is of utmost importance to ensure the legality of corporate conduct.

Managers of firms on the brink of insolvency, might have a greater incentive for risk-taking behaviour than under normal circumstances.⁷¹² Managers will attempt to protect the firm's factors of production, specifically its human capital, as their human capital investment might devalue in the open labour market.⁷¹³ Moreover, it might be difficult to offer their human capital to other firms in the market if they have a firm specific skill set.

However, if there is a corporate culture among firms in the market to condone illegal behaviour, corporate managers will not be stigmatised if they follow the industry norm.⁷¹⁴ Especially if corporate actors believe it is impossible to succeed in a particular industry without engaging in illegal activity.⁷¹⁵ Although this illegal conduct could be a mild transgression of a legal rule, a lax approach could set a precedent of condoning illicit behaviour.

5 Concluding remarks

In this chapter the role of economic considerations in modern corporate law has been explored, especially in light of the perceived agency problem in corporate law.

⁷¹¹ Macey (1991) *BULR* 325.

⁷¹² 326.

⁷¹³ 326.

⁷¹⁴ 330.

⁷¹⁵ 332.

One of the primary functions of modern corporate law is to address the agency problem and to seek corporate reform.

Simultaneously, the rules of attribution as a means to overcome the artificial nature of the company create a disconnect with the agency problem. Therefore, it is paramount that legal framework regulating corporate liability has a balanced approach to also address the inherent agency problem. In South African law, section 332 of the Criminal Procedure Act focuses on directors and servants to impute both conduct and will to impose corporate criminal liability. Moreover, the notion that during prosecution these directors or servants are merely authorised representatives is stressed in subsection (2).⁷¹⁶

As a means to ensure that legal rules promote efficiencies, a proper understanding of agency costs is instrumental. However, the regulatory framework will remain ineffective if the sole purpose of corporate activities is to promote shareholder wealth, thus if shareholder primacy prevails. A solution lies in an economic understanding of the agency problem instead of a juridical relationship one. Once again, as seen in Chapter 2, a functional alternative to the traditional approach to corporate personality is proposed. The foundation of this paradigm shift is based on the contractarian theory. In terms of this approach, the incentives of risk-bearers being the owners of the firm and managers should be aligned in such a way as to minimise agency costs. Ultimately, corporate law should function to resolve the conflict and not to maintain it.

5 1 Addressing risk allocation efficiently

Although law and economics scholars seek to solve the agency problem, the inherent problem of risk allocation is not necessarily addressed. Due to the separation of ownership and control in modern organisations and the proposal that the markets for corporate owners (risk-bearers) and managers differ, it should be determined whether these markets operate efficiently. Moreover, these markets should be sufficient to discipline managers.

⁷¹⁶ 332 (2) In any prosecution against a corporate body, a director or servant of that corporate body shall be cited, as representative of that corporate body, as the offender, and thereupon the person so cited may, as such representative, be dealt with as if he were the person accused of having committed the offence in question: Provided that- if the said person pleads guilty, other than by way of admitting guilt under section 57, the plea shall not be valid unless the corporate body authorized him to plead guilty.

Based on the assumption that managers are risk-averse, the outcome in the markets for managers are not necessarily efficient. In this respect, markets fail to regulate managers properly and the need arises for regulatory intervention to ensure ethical behaviour.

As an alternative, by focussing on a regulatory environment which encourages compliance and ethical corporate culture instead of the directing mind and will of the company, organisational fault may be addressed more efficiently as the assumption of risk-aversion is removed.

Chapter 6: Conclusion

1 Introduction

A company has no soul to be damned and no body to be kicked. Although this statement is a recurring theme in case law and academic journals regarding corporate liability, it also shows the dilemma of anthropomorphism. Throughout this thesis, the artificial nature of the company has been criticised as a fiction which is irreconcilable with modern reality. With a surge in corporate crime, including health and safety violations, environmental transgressions, tax evasion and corporate homicide, a need for a more robust theory of corporate liability is needed. Due to the difficulties in establishing wrongdoing, individual and corporate responsibility should be evaluated to reflect the true nature of unlawful conduct or omission and its consequences.

In determining whether corporate liability should be imposed, the corporate personality and rules of attribution are a pivotal part of the inquiry. Nevertheless, as seen in Chapters 2 and 3, the theory of corporate personality and the rules of attribution are not set in stone. Moreover, the inherent blameworthiness traditionally required for criminal liability poses an inefficacy in imposing corporate criminal liability, due to the limitations of the individualist theory. In order to establish a comprehensive framework to govern corporate criminal liability, a more realistic concept of corporate liability based on corporate fault is needed. In such a regulatory framework, both collective and individual responsibility for corporate crime are relevant. Instead of limiting the inherent blameworthiness associated with corporate responsibility, a flexible approach which is not constricted to the limits of individualism is recommended. It is proposed, that a company may be held liable for its own fault based on a broad understanding of blameworthiness. Organisational fault is also not confined to the parameters of the directing minds doctrine, but offers a paradigm shift so as to include lower-level employees, internal policies and decision-making structures and corporate ethos. Ideally, a corporation is not akin to individuals, but there are similar characteristics.

2 Recommendations

2 1 The rationale for corporate criminal liability

Chapter 5 explored the dilemma of the agency problem, whereby the self-interest of managers is furthered at the expense of the company's (or the shareholders') interests. It is especially in light of the agency relationship that the need arises for efficient corporate governance to ensure that the interests of agents are aligned with those of the principal. One of the functions of corporate law is to address the conflicts of interests which arise as a result of the separation between ownership and control.

The deviation of interests between managers and shareholders in modern corporations also serve as the best justification for corporate crime. The persistence of the agency problem in modern corporate law suggests that reform is needed. Therefore, as a solution a purposive approach is suggested whereby the focus is not on determining the nature of the company and the consequential need for attribution, but rather for what purpose corporate liability should arise.

Macey argues that corporate criminal behaviour becomes rare if agency theory is properly aligned. The board of directors could face severe personal liability if it is convicted of engaging in criminal activity. Moreover, corporate actors will have to share the benefit arising from corporate conduct with shareholders, even if such benefit does not arise *ex ante* for shareholders.

2 2 Nature versus function

In Chapter 2, a departure from the semantic question of "what is a corporation" was suggested, as corporate criminal liability is often overshadowed by corporate personality theory. In order to avoid esoteric questions of corporate personhood, Hart suggests that one should rather determine for what purpose corporate liability must be imposed in a specific instance. Nevertheless, the rhetoric in case law presupposes the artificial or abstract nature of a company as a point of departure to determine corporate liability. Accordingly, there is a justification for applying the rules of attribution as determined in *Meridian* to impute conduct and will to a company for purposes of corporate liability. However, as seen in Chapter 3, the application of the rules of attribution are not consistent, but are driven by a contextual analysis to infer whether the primary, general or special rules of attribution should apply. Moreover, the

overemphasis on high-ranking managerial officers is not aligned with the reality that unlawful conduct or omission are not necessarily limited to these upper hierarchies.

As an alternative approach to offer a solution to the inconsistent application of the fiction-aggregate-reality trichotomy, as well as the inefficiency of the modern approach, a functional approach to corporate personality is suggested in Chapter 2. The traditional approaches have often led to a debate about nothing, for the nature of the firm cannot be thoroughly explained in any theory. Therefore, the question “what is a corporation,” has proven to be one of endless discussion and little certainty. Although the rhetoric of jurisprudence on the matter seem to use this question as a point of departure, the outcome is often inconsistent, as the underlying values and policies of these traditional theories are arbitrary.

Nevertheless, the purpose of the functional approach is not to solve the dilemma of the nature of the firm, but rather an alternative legal framework to analyse these problems. In criminal law, the functional approach would free courts and legislators from the restrictions of both the fiction theory and the real entity theory. The functional approach includes both economic and social considerations to create a framework whereby corporate liability may be imposed. Economic considerations, such as the internalisation of the total cost of production, and social considerations of public health and safety and environmental protection are explored to determine if a functional approach would suggest that a company be held liable for the misconduct of employees at all hierarchical levels. A new approach to conceptualising a firm is proposed; a balanced or functional approach which focuses on the function of a firm instead of its nature. It is argued that this approach is more flexible and suitable to determine corporate rights and duties than the traditional theories. Moreover, a balanced or functional approach suggests that a company should bear responsibility for the harm associated with its business activity, which is independent of individual misconduct and the assumption that a company is incapable of possessing *mens rea*.

2.3 Attribution versus agency

The need for attribution stems from the fiction theory, whereby a company is regarded as an artificial being and therefore the law attributes the conduct and will of certain individuals, typically the directing mind and will of the company to it.

With an increase in misbehaving corporate actors, the description and application of the relevant rules have become uncertain, especially with regards to the question of whose acts could be contributed to the company and for what purposes those acts can be deemed to be the company's. Although certain managerial positions are more susceptible to be regarded as the directing mind of a company, the directing mind need not always be that of the person or persons involved in general management and control of the company. If one considers the dicta of *Meridian*, a purposive approach to this question is important, thus whose conduct should be imputed to the company for a specific purpose. Ultimately, the application of the directing mind doctrine calls for a contextual analysis of the circumstances.

Section 66(1) of the Companies Act provides that the board of directors manages the business and affairs of the company. This is a new development in South African company law, for the relationship between the company and its directors was previously described as one of agency. However, the remnants of this approach are still evident in the nominalist approach to corporate criminal liability, whereby the individuals within a company are instrumental to ascribe *mens rea* and *actus reus* in terms of section 332(1) of the CPA.

2.4 Towards a modern alternative based on organisational fault

Following the analysis and different interpretations of foreign law, one can criticise the current South African model as being archaic and surreal. Legislative intervention is needed to develop the corporate criminal liability model to reflect modern corporate reality and to conform to international principles. If the legislature fails to incorporate organisational theory into its procedural framework, judicial scrutiny might declare section 332(1) of the CPA unconstitutional. As seen in Chapter 4, despite the proposal to limit the ambit of section 332(1) such limitation would still lead to incoherent consequences.

King IV stresses the need for responsible corporate citizenship by way of implementing an ethical framework which promotes adherence to legal rules and regulations. To adhere to this plea, the primary liability mechanism should note the unique corporate identity and culture within companies and depart from the abstract fiction when imposing corporate criminal liability. As proposed by the Australian Criminal Code, the decision-making framework and internal monitoring systems are

important in establishing the corporate identity and culture within a company. Ultimately, whether corporate criminal liability should be imposed, should be based on the notion of corporate culture and identity instead of the abstract fiction theory. Given the need to hold corporations criminally liable, policy considerations should dictate how such liability should be imposed.

By way of a combination of accomplice liability and organisational theory, corporate criminal liability should be regulated. Accomplice liability refers to the company's role in supporting and encouraging the employee's unlawful conduct. On the other hand, in terms of the organisational theory, the corporate ethos is considered with reference to the reactive or preventative measures in place, the corporate policy framework and objectives of the company, as well as the compensation of previous transgressions. Together with internal monitoring mechanisms, this self-identity model is held to be more effective in proving fault, since it relates to establishing the primary liability of the company. Moreover, in establishing whether there is a legal duty which has reasonably been broken, the objective criteria of corporate ethos, decision-making frameworks and internal monitoring and control measures, will aid in determining negligence.

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A holistic approach to the nature of corporations would recognise the unique identity of each corporation, which is differentiated from its employees or shareholders. There is a need to progress from a strict individualistic approach, focusing on each individual's contribution, to the question of fault and rather ascertain whether there was genuine corporate fault based on corporate culture and identity

3 Conclusion

The need to hold corporations criminally liable has become an undisputed fact. Due to the inefficacy of current corporate theory to address or solve the dilemma of corporate liability leads to an analysis which firstly seeks to offer an alternative approach to corporate personality, by following a functional approach based on economic and social considerations to impose corporate liability. Secondly, a contextual analysis for the rules of attribution is proposed which is not limited to the hierarchical understanding of a corporation. Lastly, to follow a holistic approach to the imposition of corporate criminal liability based on organisational fault is proposed.

As justification for these alternative approaches, the continued agency problem in corporate law is used as a justification to ensure that the conflict created by an artificial understanding of the company and the need for corporate attribution rules are solved. Whether South African law will be transformed by legislative reform is uncertain, therefore, given the importance of contextual analysis in the constitutional dispensation, it is advocated that courts should seek to change the rhetoric of jurisprudence as to include a notion of corporate blameworthiness when imposing corporate liability.

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