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ASPECTS OF CORPORATE GOVERNANCE IN THE COMPANIES BILL, 2008 – A CRITICAL AND COMPARITIVE ANALYSIS

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Research dissertation presented for the approval of the Senate in fulfilment of part of the requirements for the Master of Laws (Commercial Law) in approved courses and a minor dissertation. The other part of the requirement for this qualification was the completion of a programme of courses.

I hereby declare that I have read and understood the regulations governing the submission of Master of Laws dissertations, including those relating to length and plagiarism, as contained in the rules of this University, and that this dissertation conforms to those regulations.

Signed: Signed by candidate Dated: 15 September 2008

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CHAPTER 1
INTRODUCTION

1.1 The importance of good governance

While the role corporate governance should play in a corporation is understood differently from profession to profession and from country to country, its theme has always been to answer this question: in whose interests does a company operate? What we are able to garner from differing opinions is that corporate governance is a concept which is neither irrelevant to the modern corporation nor is it an 'arcane and technical topic'[1]. Rather, it is an area of business and the law that has, in only the last decade, been revived and re-debated with renewed interest and enthusiasm. It is acknowledged there is indeed a link between poor corporate governance practices in major corporations and the downturn in an economy, due possibly to the failings of these corporations[2]. So too has it been identified that willingness of shareholders to pay a premium for their investments in a corporation is linked to their confidence in good corporate governance structures within that corporation[3]. The OECD's Directorate for Financial Enterprise Affairs concludes that '[g]ood corporate governance plays a vital role in underpinning the integrity and efficiency of financial markets.'[4]

However, an examination of the failings of major corporations does not always point to poor governance. The relationship between a corporation and its governance structures is far more complex than this. Mervyn King illustrates that 'Enron[5] had all the trappings of good governance', but because corporations are run by people, being inherently flawed, prejudiced and susceptible to influence, governance which is simply box-ticking will not do a good corporate governance structure justice[6]. David Nurek's similar observation is that "many governance failures have taken place in companies where the form was present but the substance was not."[7] Wixley & Everingham make an illuminating point in this regard: "the very nature of business is to take risks...[i]nevitably this means that some enterprises will perform poorly...and,

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[1] *Corporate Governance in the New Century*; Salacuse, The Company Lawyer, Vol 25 pgs 69-83 at 69
[2] *Ibid*
[3] *Corporate Governance*; Wixley & Everingham; pg 6
[4] Organisation for Economic Co-operation and Development; *Improving Business Behaviour: Why we need Corporate Governance*; www.oecd.org
[5] Some of the recent major corporate governance scandals involved the following companies: Tyco, Adelphia, Worldcom, Global Crossing in the United States; BCCI Bank and the Maxwell sagas in the United Kingdom and Masterbond, IGI Insurance, Tollgate, Cape Investment Bank, Sechold, Prima Bank, Saambou, Leisurenet and Fidentia in South Africa
[6] *The Corporate Citizen*, Mervyn King
[7] *Nice Guy No More*, Financial Mail, cover story, 14 July 2006

in extreme cases, enterprises will fail. Good corporate governance is not a guarantee against failure, but it should ensure that there is adequate disclosure of the risks undertaken and that, where enterprises do run into difficulties, these are...adequately communicated to stakeholders."[8]

One of the main concerns of corporate governance is the allocation of power in the upper echelons of a corporation[9]. Principal to this concern is the supervision of a company's board of directors (the management) by a company's shareholders (the owners)[10] and accountability of the management to the owners.[11] Every regime must decide how these relationships are to be regulated – whether legislation will mandate a framework to be adhered to by all companies, from the smallest to the largest; whether only the larger companies will be bound by such legislation as a result of the diminished bargaining power of their stakeholders, or whether only the most pertinent aspects of corporate governance are regulated and the remainder are left to the control of the market forces[12].

The two arch models which emerged through history can loosely be categorised as a 'shareholder-centered model' and a 'pluralist model'. The names speak for themselves: the shareholder-centered model favours shareholder primacy in major decision-making and protection, with the goal of the corporation being the maximisation of shareholder value. Conversely, the pluralist model views the concerns of the corporation as wider than simply relating to shareholder interests. The interests of the broader community of stakeholders, such as employees, creditors, investors and even the public at large in the form of environmental, social and political concerns[13] should also be catered for, and are on an equal footing to shareholders' rights.

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[8] *Corporate Governance*; Wixley & Everingham; pg 5 – 6

[9] *Corporate Governance in the New Century*, Salacuse, The Company Lawyer, Vol 25 pgs 69-83 at 78

[10] In three-tier systems, like many countries in the European Union, the board oversees the management and the board in turn is accountable to the shareholders.

[11] *Corporate Governance*; Wixley & Everingham; pg 7

[12] Alan Greenspan's response to the collapse of Enron was only a call for stronger regulation mainly in the area of accounting rules. He maintained, however, that the primary solution rested with market forces. The idea behind Greenspan's theory that stronger CEO role in relation to accounting and disclosure is still the most effective model of corporate governance is that regulation inhibits entrepreneurship and that market forces will squeeze out companies who inflate their earnings through reduced investment by wary investors, making such companies susceptible to take-over. He states that "investment firms are well aware that security analysis without credibility has no market value." The counter-argument is that 'naïve reliance on free-market checks and balances...was at the heart of Enron's collapse.' (The New York Times, *Greenspan Says Enron Cure Is in Market, Not Regulation*, by Richard W. Stephenson, 27 March 2002, from http://query.nytimes.com.)

[13] The Kyoto Protocol, when it became international law on 16 February 2005, has put increased pressure on 36 member countries, which in turn has increased the pressure on large corporations, to reduce their carbon footprint by reducing their Greenhouse Gas emissions. As a result, a new market for

Salacuse points out that we should not pigeon-hole any economy solely in either of the 'shareholder-centered' or 'pluralist' baskets, as economies whose corporate law is generally classified in either of these can and do display elements of the other theory.[14] Globalisation and multiple listings of public companies on the stock exchanges of various countries have had the result of the theories of corporate governance becoming blurred over the state boundaries. It is still possible though, on certain major elements, to distinguish the United States and United Kingdom preferred model of shareholder empowerment over the pluralist models of the European Union and Japan.[15]

Some would argue the development of a middle ground 'enlightened shareholder value' model[16] is already evident in certain regimes. This model earned its enlightened status by viewing the interests of the shareholders as being those of stakeholders in certain circumstances and is favoured by proponents of the shareholder-centered model in that it does not entail the sidelining of the goal of shareholder value maximisation whilst catering for the concerns of other interest groups[17]. The model makes sense: for example, while "sweat-shop" labour may be cheap, and by using it a corporation can enormously reduce its manufacturing costs, international outcry against corporations which exploit this social flaw can lead to enormously reduced sales at retail level. The corporation does not care for the interests of the sweat-shop employees, it merely recognises the use of "sweat-shop" labour tarnishes its public reputation and that by disassociating itself with such practices, it is in fact enhancing shareholder value and profits through long-term sustainability.

1.2 **The roots of South African company law and corporate governance influences**

South African company law, as enacted in the first post-Union company legislation of national application – the Companies Act of 1926 ("the 1926 Act") – found its roots in

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carbon emissions credit trading has developed, with large corporations securing profits of millions by selling off their unused credits. (Ganga, V & Armitage, S: *The Kyoto Protocol, Carbon Credit Trading and Their Impact on Energy Projects in Europe and the World*, [2005] I.E.L.T.R. Issue 4, Sweet & Maxwell)

[14] *Corporate Governance*; Wixley & Everingham; pg 7

[15] *Ibid*

[16] "*Company Law for the 21st Century*", Policy Paper by the Department of Trade and Industry, 2004, page 25

[17] *Ibid*

the Transvaal Companies Act[18]. This Act was based almost entirely on the English Companies (Consolidation) Act of 1908 ("the 1908 Act"), which in turn can be traced back through amending legislation to the birth of the Anglo-Saxon model of corporate governance: the landmark Joint Stock Companies Act of 1844. This Act was important for corporate governance since it was the first legislation to recognise the independent legal personality of the company[19] and therein, board accountability to the shareholder owners. The shareholders in turn would appoint independent auditors to scrutinise financial records.[20] Limited liability corporations owned by wealthy family groups flourished in the industrial revolution with their primary objectives to make their wealthy owners even wealthier – in other words, the maximisation of shareholder profits[21].

What South Africa inherited when it embraced the 1908 Act,[22] was a company history dating back to the famous "The Bubble Act" wherein the government of the day sought to prohibit the formation of joint-stock companies as a result of the unprecedented economic boom in late eighteenth and early nineteenth centuries – the time when United States and United Kingdom corporate governance practices were developing in line with each other[23] - thereby shifting the risk inherent in 'untrustworthy' capital funding to the trusted common law partnership.[24] Thereafter, the 1929 English Companies Act defined the relationship between a holding and subsidiary company,[25] introduced the concept of redeemable preference shares, and extended the duty of disclosure in relation to financial statements of companies.[26]

South African company law, at this stage, was behind the developments of its English counterpart, and so the Lansdown Commission was appointed to investigate

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[18] 31 of 1909

[19] Although for all intents and purposes, the joint stock company was still regarded as a partnership and named as one. The liability of its shareholders was in fact, unlimited and they were held fully liable for all the debts of the company. *Basic Company Law*, R C Beuthin, Butterworths, Durban / Pretoria, 1984, page 6, footnote 1

[20] *Corporate Governance*; Wixley & Everingham; pg 3

[21] *The Corporate Citizen*; M. King; pg. 6

[22] The 1908 Act introduced the concept of a prospectus, making compulsory the furnishing of written information for the offering of shares and debentures as well as introducing liability for directors for untrue statements contained in the prospectus. It furthermore established the concept of the private company which was distinguished from the public company for its prohibition against offering its shares to the public. (*Company Law*, Cilliers & Benade, Second Edition, Butterworths, 1973, page 15)

[23] *The Myth of the "Anglo-Saxon Model of Corporate Governance"*, Professor Bob Garett, pg 2 from Unit for Corporate Governance in Africa at http://www.governance.usb.ac.za

[24] *Corporate Law*, Cilliers & Benade, 3rd Edition, Butterworths, 2000, page 21, footnote 23

[25] Interestingly, and it is submitted, in error, clause 35 of the Bill states that "[a] company...must at all times have at least one share issued to at least one person other than – (i) a company that is part of the same group of companies; or (ii) a juristic person that is controlled by one or more companies within the same group of companies." It is unclear what the purpose of this provision is.

[26] *Company Law*, Cilliers & Benade, Second Edition, Butterworths, 1973, page 15

the proposed amendment of the 1926 Act to keep in line with the most recent changes to English legislation.[27] The Commission recommended a near complete adoption of the English amendments to date and this was enacted through the Companies Act of 1939. Various commissions thereafter enacted further developments in the English law.

Adopting a foreign Act almost wholesale has the inevitable result that the concomitant jurisprudence is adopted alongside and so South African judges found themselves following a long line of English case law as persuasive authority in creating their own precedents, further entrenching the English corporate governance ideologies into our company law, although where South African social dictates called for a differing decision, such parting of ways was not denied. In fact, it is arguable the existing form of corporate governance assisted business models that entrenched abusive apartheid practices.

When the shareholdings of many of the wealthy family-owned enterprises were indirectly bought out by financial institutions in the second half of the twentieth century through share schemes, the majority of shareholders were now the employees of these corporations – previously sidelined stakeholders – and traditional corporate governance was forced to reform.[28]

The report of the Van Wyk De Vries Commission of 1970, closely following the Jenkins Commission in the United Kingdom, recommended certain marked changes to existing company law. These included *inter alia*[29]: the introduction of companies with share capital, the abolition of the *ultra vires* doctrine, the introduction of no par value shares, the introduction of the statutory derivative action for shareholders and the institution of a Standing Advisory Committee on company law. The Commission led to the enactment of the 1973 Act ("the Act"), South Africa's present Companies Act.

Notably, the corporate governance elements of the Act are somewhat limited. Transparency, accountability, reporting on unethical behaviour and institutional shareholder activism, are not actively encouraged in any manner. In calling for statutory amendment, King has criticised, *inter alia,* section 424 as being expensive

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[27] *Ibid*, page 16
[28] *Ibid*
[29] All contained in *Corporate Law*, Cilliers & Benade, 3rd Edition, Butterworths, 2000 at page 24

and difficult to implement as a mechanism for shareholders to remove delinquent directors, and section 247, relating to directors' and officers' liability insurance as being 'ambiguous'.[30]

In the late 1980's and early 1990's scandals involving the failure of major corporations renewed interest in the idea of accountability as a key element of good governance. Unsurprisingly, the role of the auditor and methods of accounting, coupled with wariness of greed in directors and the shareholder objective of achieving short-term profitability to the detriment of long-term sustainability, were identified as major contributors to these failings.[31]

In 1992, the United Kingdom commissioned the 'Cadbury Report', the first definitive work of its kind, which set out good governance practices in the hope of improving industry standards. The South African King Report on Corporate Governance followed suit in 1994 and was the first time South African company law was forced to look critically at its corporate governance regime in light of the developments abroad. The King Report was reviewed in 2002 and followed with the 'King II Report', still hailed by many practitioners and academics as the most definitive and authoritative South African work on corporate governance to date, the adherence to which has been rendered compulsory in relation to companies listed on the Johannesburg Securities Exchange, banks, financial and insurance companies and public sector enterprises to which the Public Finance Management Act[32] and Local Government Municipal Finance Management Bill[33] is applicable, as well as to governmental departments acting in terms of the Constitution or other legislation.[34]

It is unsurprising that South African corporate governance has largely followed the English approach, favouring the shareholder-centered model. The United Kingdom's Financial Reporting Council stated in its report entitled "*The UK Approach to Corporate Governance*": "[t]he assessment of whether the company's governance practices are effective should be made by the intended beneficiaries – i.e. the

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[30] King, M; *King Report on Corporate Governance for South Africa 2002*, incorporating the Code of Corporate Practices and Conduct, (Institute of Directors in South Africa) paragraph 2.5.2

[31] *Corporate Governance*; Wixley & Everingham; pg 5. The role of the auditor and methods of accounting were also viewed as contributors, however, the provisions of the Bill relating to accounting practices are beyond the scope of this paper.

[32] 1 of 1999

[33] B1-2002

[34] *Corporate Governance*; Wixley & Everingham; pg 8

shareholders."[35] In defining directors' fiduciary duties, South African case law is clear that the role of directors is to maximise the welfare of the company, being the general body of shareholders, and no-one else.[36]

The literature surrounding the proposals for company reform in South Africa was greatly in favour of the adoption of an enlightened shareholder value model and in doing so, "to take account of, for example, employee relationships, the local community and the physical environment, in deciding how the interests of shareholders are most effectively advanced."[37] Coupled with this is South Africa's unique position in dealing with black-economic empowerment. Politically redistributive legislation in the form of the Broad-Based Black Economic Empowerment Act[38] requires companies to adopt a "tick-box" approach to ensuring the required percentage of, *inter alia*, 'black' management and ownership in a corporation. In certain cases, medium to large corporations inevitably find themselves employing and remunerating management in a manner that does not necessarily equate with the experience or expertise of the individual employed.

Any new company legislation would have to take into account not only the trends in international corporate governance, in order to encourage international investment, but would also have to grapple with the manner in which corporate governance, as an essential method of power allocation and protection, should be regulated in our unique corporate law regime in a manner that best serves those it seeks to protect – that is, if it should be regulated at all.

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[35] Financial Reporting Council, "*The UK Approach to Corporate Governance*", November 2006 at www.frc.org.uk

[36] From English law, see *Greenhalgh v Arderne Cinemas Ltd* [1951] Ch 286 291; [1950] 2 All ER 1120 1126 (CA); *Harris v North Devon Rail Co* (1855) 20 Beav 384

[37] "*Company Law for the 21st Century*", Policy Paper by the Department of Trade and Industry, 2004

[38] 53 of 2003

CHAPTER 2
THE COMPANIES BILL[39]

2.1 A new regime

With the introduction of the Companies Bill[40] ("the Bill") into legislation, Company Law in South Africa as we have known it will shortly be altered as drastically as it was 35 years ago. The tongue in cheek banter of certain drafters of the Bill is that they are optimistic that the similarity in the numerical ordering of the Bill (which will shortly be Act 61 of 2008) to the existing Companies Act (61 of 1973) ("the Act"), forebodes well for their years of hard labour and the Bill should accordingly reap as much success as our existing Act. Others are far less optimistic, or humorous.

Practitioners are not out of line in asking why we should tamper with legislation that has proven to work so well or why we are replacing the Act wholesale, when the Department of Trade and Industry ("the DTI") can simply replace in a piecemeal fashion, sections of the Act which are found to be problematic or contrary to the direction in which the South African government wishes to see its company law regime develop, as it has recently done with the Corporate Laws Amendment Act.[41] It goes without saying that certainty in law is the cornerstone of a successful legal system, but are these criticisms simply the complaints of the few who dislike change, or are their concerns more substantial?

The DTI was careful to point out in 2004 "[i]t is not [their] aim simply to write a new Act by unreasonably jettisoning the body of jurisprudence built up over more than a century. The objective of the review is to ensure that the new legislation is appropriate to the legal, economic and social context of South Africa as a constitutional democracy and open economy. Where current law meets these objectives, it should remain as part of company law."[42]

The public consultation phase of the introduction of the Bill was completed in June 2008 and the Bill has been signed into law by the President, the commencement date estimated as early 2010. We can therefore expect the current draft of the Bill is

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[39] As at 15 September 2008, the 2008 draft of the Companies Bill is being amended by the State Law Advisors. Further amendments to the Bill are expected to be published within the next few days. Accordingly, this paper will examine the Bill as it stands at 31 August 2008.
[40] 61 of 2008
[41] 24 of 2006
[42] "*Company Law for the 21st Century*", Policy Paper by the Department of Trade and Industry, 2004

more or less, for better or worse, the draft which will become our new Companies Act.[43]

2.2 Corporate Governance in the Companies Bill

The explanatory memorandum for the Bill states that one of its aims is to "encourag[e] transparency and high standards of corporate governance."[44] Recent scandals in the United States, United Kingdom and South Africa involving gross abuse of corporate personality by large multi-nationals as well as tremendous focus on corporate social and environmental responsibility has resulted in a renewed interest in the tightening of corporate governance provisions in legislation globally.

Identifying four basic rights of shareholders,[45] the DTI's Policy Paper stated that company law should ensure shareholders are accorded these rights, and that they are protected through effective recourse mechanisms when violated.[46] The paper stated that the right to vote and the right to information are absolute rights, and that the scope of all the rights should be determined in the legislation as opposed to in contract. The DTI clearly held the right of access to information to be a paramount right to shareholders. It proposed this right be protected through ensuring that

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[43] A few of the changes which will be taking place, many of which have corporate governance implications and some of which will be looked at more closely in this paper, are as follows:

(a) A simplification and alteration of the process of company formation;
(b) The introduction of a Memorandum of Incorporation ("the Memorandum") which will be a company's 'constitution' with alterable and non-alterable provisions;
(c) The introduction of a capital maintenance scheme based on solvency and liquidity and the abolition of the concepts of par value shares and nominal value;[43]
(d) The introduction of corporate governance which enhances shareholder control in the form of shareholder meetings and new provisions with regard to applying to court to limit a director's power to operate as a director as well as a general limiting of directors' powers;
(e) The introduction of provisions relating to directors duties, to operate in conjunction with the existing common law;
(f) Significant alterations relating to notification of share purchases and compulsory acquisition of minority shareholding in takeover scenarios;
(g) Fundamental changes relating to the law relating to major company transactions such as the disposal of the whole or greater part of the assets of a company;
(h) The introduction of an extended right of standing for certain remedies; a general expansion of available remedies as well as an expansion of the stakeholders to whom these remedies are available;
(i) The major decriminalization of many areas of company law;
(j) The expansion of the available forums for dispute resolution;
(k) Extensive institutional reform in the form of the introduction of the Companies and Intellectual Property Commission, replacing the current Companies and Intellectual Property Registration Office; the transformation of the existing Securities Regulation Panel into the Takeover Regulation Panel and the introduction of the completely new Companies Ombud;
(l) New and more extensive auditing requirements for companies across the board;
(m) The introduction of a completely new business rescue plan to replace the current judicial management system where interests of employee stakeholders are provided with recognition.

[44] Memorandum, Companies Bill, 61 of 2008, Summary of Changes, 11 July 2008, pgs 8 and 9
[45] The right to capital, the right to income, the right to vote and the right to information.
[46] *Ibid*

shareholders are provided with information that is publicly available, shareholders should be provided with sufficient and timeous information to prepare for meetings and there must be full and complete disclosure of material information, with a minimum of annual financial statements.[47]

In the area of directors and board structures, the paper proposed the traditional unitary board structure be retained[48] but that an element of stakeholder representation on the board is introduced.[49] Interestingly, this is the first time Department has recommended that rules relating to directors' conduct, although developed for years through the common law, are even if to a small extent, regulated statutorily. It was also recommended legislation should stipulate that directors are to disclose any business opportunities presented to them to the company, if the director reasonably believes the company may be interested in the opportunity. A director is also required to disclose relevant "material" information, not known to the other directors.[50]

Regarding the reporting and disclosure element of the Department's proposal, the DTI highlighted the importance of transparency in company administration and maximum disclosure of information in order to properly ascertain the financial position of a corporation. Once more, the proposition of a greater stakeholder role is evident in the suggestion that not only shareholders should have access to this information, but key stakeholders, such as employees and creditors, too.[51] The DTI proposed to widen the disclosure requirement to include along with financial information, a corporation's compliance with public-interest legislation such as the Broad-Based Black Economic Empowerment Act[52] and legislation dealing with environmental and labour issues.[53]

Chapter 2 Part F of the Bill deals specifically with corporate governance, but we find the reach of corporate governance extending to numerous other areas of the Bill. Examining the Bill in its entirety, it becomes clear its tenor is overwhelmingly one of freedom of choice. It entrenches certain mandatory provisions which are either alterable or non-alterable in a company's Memorandum of Incorporation ("the

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[47] *Ibid*
[48] Corporations in the European Union follow a two-tier board structure comprising directors and managers. South Africa follows the unitary system where the directors are the managers.
[49] *Ibid* footnote 47
[50] *Ibid*
[51] *Ibid*
[52] 53 of 2003
[53] *Ibid* footnote 51

Memorandum") – akin to the constitution of the company.[54] Those who form a company are accorded the greatest possible rights to choose how they wish their company's governance to be structured. It goes without saying that as with the present model articles contained in Table A and B of the Act, smaller companies are unlikely to make substantial changes to the Schedule 1 standard form Memorandum.

The most evident influence on the drafters of the Bill, was the United States Model Business Corporations Act ("the Model Corporations Act"), wherein flexibility is paramount and directors are accorded the freedom to manage their company in a manner which encourages entrepreneurship, while at the same time ensuring limitations on the weaknesses in corporate governance, labelled as contributing to the recent corporate scandals. In the DTI's memorandum highlighting the summary of changes to the 2007 draft, following the public comment phase, the Department noted that of the four stakeholders identified as being at risk, investors were by far the most vulnerable.[55] The smaller the company, the greater the ability of the investor to protect himself contractually, but the larger the company, the more diluted his bargaining power will become, depending on the size of the investor. This is increased exponentially in a public company where the investor is not a director. It was submitted that the drafters sought to correct this concern through increasing the regulations surrounding accounting and disclosure requirements and improving access to information. The question of whether or not the Bill encapsulates an enlightened shareholder value model therefore becomes more of an issue the larger the company becomes.

We must therefore ask:

(a) Were the drafters correct in the manner in which they chose to regulate corporate governance partially through the Memorandum?

(b) Does the Bill go far enough in its protection of stakeholders through provisions which aim to increase transparency and accountability?

(c) While the Memorandum is the document which gives life to the shareholder's creation of their own company, does the Bill provide adequate remedies and

[54] In terms of clause 15 of the Bill, except to the extent that the Memorandum provides otherwise, the board may make, amend or repeal any necessary or incidental rules relating to the governance of the company in respect of matters that are not addressed in the Bill or Memorandum.
[55] Memorandum, Companies Bill, 61 of 2008, Summary of Changes, 11 July 2008, pgs 8 and 9

workable mechanisms for shareholders to hold their directors accountable for failing to act in their interests?

This paper will examine whether the Bill indeed lives up to the ideals stated in the DTI's Policy Paper. In particular, this paper will examine the provisions which purport to enhance flexibility, transparency and accountability and thereafter look at what remedies and enforcement mechanisms are available to stakeholders. A comparative analysis of the company legislation of the United States and the United Kingdom provides insight into provisions and concepts with which we are not altogether familiar.

CHAPTER 3
CONSEQUENCES OF ENHANCED FLEXIBILITY
Part A: Shareholder rights generally

International investors have voiced considerable concerns over the alleged extensive dilution of shareholder rights under the Bill. British Fund Manager Hermes launched a scathing criticism of the Bill, informing the Portfolio Committee on Trade and Industry that the Bill could make South Africa "notably less attractive" as an investment destination.[56] The concerns raised by Hermes focussed on the quality of the Bill that many commentators believe is its greatest innovation: its flexibility. One of the major criticisms was that in order to reap the benefits of the flexibility of the Bill, shareholders are expected to have an 'unrealistically detailed knowledge' of the Memorandum in order to ensure they have been accorded rights which should have been theirs in the first instance.[57] Other than a concern over the ability to pass major transactions *sans* shareholder approval, Hermes highlighted that the ability of the company to lower the approval level for special resolutions and raise the level for ordinary resolutions could heavily reduce shareholder power.[58]

In seeking to provide maximum freedom to initial shareholders to structure their company in any manner within the parameters of the Bill, whilst acknowledging that a board of directors needs to be in a position where it is able to execute day-to-day decisions unimpeded by "red-tape", this subchapter will analyse whether the provisions of the Bill allow an element of power to be retained by initial and subsequent shareholders.

3.1 Shareholder rights in capital maintenance and fundamental transactions

It is immediately evident there is a shift away from shareholder power in respect of certain fundamental transactions and capital maintenance provisions under the Bill. The ability to alter majorities and the balance of control in a company lies in the hands of those who have the right to alter such company's capital. Since 1999,[59] capital maintenance has been based on the "solvency and liquidity test"[60] which the

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[56] Business Report, '*New Law will scare off Investors*', Monday, 18 August 2008
[57] *Ibid*
[58] *Ibid*
[59] Corporate Laws Amendment Act of 1999
[60] Under section 90 of the Act, the solvency and liquidity test requires the board to believe that the company is, or would after the distribution be able to pay its debts as they became due in the ordinary

board must be satisfied has been met, but this test has usually always been subject to shareholder approval and / or the requirement that the transaction is allowable in the company's articles.[61]

Under the Bill, where a company repurchases its own shares, clause 48 read with clause 46 states that this transaction is subject to the approval of the directors and that the solvency and liquidity test must be satisfied. This provision is unalterable in the Bill. The requirement that the repurchase must be authorised by either the Memorandum or by resolution of the shareholders as contained in the 2007 draft of the Bill has been removed.[62] When compared to the equivalent provision in the Act, Section 85 states that the company's articles must authorize the repurchase and a special resolution of the shareholders is required. This power is therefore taken away from the shareholders in the Bill.

The power in respect of the restructuring of authorised share capital of a company, while remaining in the hands of the directors, can be shifted to the shareholders in the Memorandum under clause 36(3) of the Bill. Under Section 75 of the Act, the articles must permit the transaction, and a special resolution of shareholders is also required. Initial shareholders must therefore be vigilant to secure this right in the Memorandum should they so wish.

Clause 38 of the Bill allows the board to issue shares and a special resolution of the shareholders is only required in limited circumstances. Section 221 of the Act on the other hand, requires an ordinary resolution by the shareholders. The power to issue shares similarly carries with it the power to alter the control of a company – an important right which, it is submitted, should always be subject to shareholder oversight. Contrary to clause 38 of the Bill, shareholder oversight should therefore be the norm, rather than the exception.

The provision dealing with distributions to shareholders has not been altered negatively in the Bill. Whilst remaining subject to the solvency and liquidity test, clause 46 of the Bill places the power to authorise a distribution by resolution in the hands of the board, whilst under Section 90 of the Act, the board must similarly be satisfied that the solvency and liquidity test is satisfied and the distribution must be

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course of business and that the consolidated assets of the company, fairly valued, would, after the distribution, be less than the consolidated liabilities of the company.

[61] See sections 85, 90 and 98 of the Act by way of example.

[62] Clause 51(3) of the 2007 Bill

authorised by the company's articles. A special resolution of the shareholders to alter the articles will be required where the articles do not allow such distribution.[63]

Financial assistance provided by a company to a shareholder for the purchase or subscription of its shares is dealt with under clause 44 of the Bill and states to the extent that the Memorandum provides otherwise, the board may authorise the financial assistance. The distinction between private and public companies, as contained in the 2007 draft, has been removed. This provision is alterable, but the default lies with the board. Under the Act, Section 38[64] specifies that the articles must permit the transaction, as well as requiring a special resolution of the shareholders.

A further concerning change is noted when comparing clause 27(3) of the 2007 Bill to the 2008 draft. Under the 2007 draft, non-adherence to the solvency and liquidity requirements triggered notification by the board of such non-adherence to the shareholders. While this was never a requirement under the Act or the 2008 Bill, it begs the question: why are shareholders no longer to be notified of lack of compliance? It is submitted that the requirement of notification is important for open and transparent communication to shareholders which would have improved the corporate governance of the 2008 Bill.

The fact that in the majority of these transactions, shareholders are no longer accorded the right to sanction the conduct of the board, considerably reduces their powers. This is particularly the case for subsequent shareholders, where the initial shareholders did not alter the alterable provisions of the Memorandum in their favour. Subsequent shareholders will be forced to rely on altering the Memorandum after the company's incorporation, provided that they have the necessary majority to do so. Clause 16 of the Bill requires the passing of a special shareholders' resolution, which was tabled by either the Board or the shareholders entitled to exercise at least ten percent of the voting rights to be voted, in order to alter the provisions of the Memorandum.[65] As will be noted in paragraph 3.6 below, the voting requirements to pass a special resolution may be decreased to sixty percent by the shareholders. Should the initial shareholders have stipulated this lower requirement in the Memorandum, subsequent shareholders may have less trouble altering the

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[63] *Henochsberg on the Companies Act*, Volume 1, Fifth Edition, updated June 2008, Lexisnexis, Durban, pg. 186(3)
[64] As amended by the Corporate Laws Amendment Act of 2006
[65] The word "voting rights" is used presumably because voting rights in relation to shares, even of the same class, can vary.

Memorandum to favour them. Where this is not the case, it is clear that the subsequent shareholders find themselves in a difficult position.

3.2 Shareholders acting other than at meeting

Currently under the Act, any meeting at which a special resolution is to be passed must be called on twenty-one clear days' notice to the shareholders.[66] The Act already provides a measure of flexibility in allowing shareholders to choose the manner in which they go about passing their resolutions, which is particularly useful for smaller companies. Notably, section 199(3) stipulates that the majority in number of members having the right to vote at the meeting and holding in aggregate, not less than ninety-five percent of the voting rights of those members, may agree that a resolution is passed as a special resolution, where less than twenty-one clear days' notice has been provided. The resolution needs to be lodged together with the prescribed form. Further to this, with the written consent on the prescribed form of all the members of a company, a special resolution may be passed at a meeting where no notice has been given.[67]

The equivalent clause in the Bill, clause 60, increases the ease with which shareholders take decisions other than at meetings and, it is submitted, introduces a more favourable mechanism for passing resolutions. This clause entitles them, rather requiring the unanimous or ninety-five percent threshold, to submit the resolution to be voted on to the shareholders entitled to vote in relation to that decision for consideration, and then entitling the shareholders to vote on the resolution in writing within twenty business days.[68] A resolution taken in this manner, if it meets the voting threshold requirements for either ordinary or special resolutions, is accorded the same weight as if it was voted at a properly constituted meeting.[69] The shareholders are given the same rights to take decisions in this manner when voting on the election of directors.[70]

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[66] The Act uses the word 'members' whereas the Bill uses the word 'shareholders'. This paper will follow the terminology of the Bill.
[67] Section 199(3A)
[68] Clause 60(1)(a) and (b)
[69] Clause 60(2)(a) and (b)
[70] Clause 60(3)

Within ten business days after adopting the resolution or electing the director, the company must deliver a statement to all the shareholders entitled to vote on that decision, describing the results of the vote, the consent process or the election.[71]

3.3 Shareholder meetings

The threshold for calling shareholder meetings determines what portion of minority shareholders are afforded the ability to exercise their rights to have matters of importance to them deliberated upon. It is important that where minority shareholders are granted such rights, the provisions prevent potential abuse through frivolous or vexatious conduct of such minorities.

Under the Act, where an annual general meeting is not or cannot be held, or any matter which was meant to be dealt with in the meeting was not dealt with, the company or any single shareholder may apply to the Registrar to call or direct the calling of a general meeting, which will be deemed to be an annual general meeting.[72] The Registrar will provide such directions as he sees fit in relation to the holding and conduct of the meeting, modification or supplementing of the articles, directing that any number of persons are deemed to constitute the meeting and do forth.[73]

Provided it is not contrary to the Act or the articles of a company, any general meeting may be called by two or more shareholders holding not less than 1/10th of the company's issued share capital or, where a company does not have share capital, by not less than five percent in number of shareholders of the company.[74] It is therefore clear where a shareholder holds 1/5th of the shares of a company, he may not himself call a meeting, as the requirement is that there must be two or more shareholders. However, notwithstanding anything to the contrary in a company's articles, the directors must convene a general meeting if one hundred members of the company or members holding not less than 1/20th of the capital of the company carrying voting rights at general meetings, at the date of lodgement of a requisition, or, where the company has no share capital, one hundred members or members representing not less than 1/20th of the total voting rights of all the members having

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[71] Clause 60(4). The only proviso to this section, contained in clause 60(5), is that any resolution which is required to be decided at an annual general meeting of the company in terms of the Bill or the Memorandum cannot be concluded in this manner.
[72] Section 179(4)(a). This is on payment of the prescribed fee.
[73] *Ibid*
[74] Section 180

the right to vote at general meetings, request a meeting to be held.[75] Section 181(1) differs from section 180(2) in that under section 180, the members demanding the meeting need not carry any voting power at such meeting.[76] A single shareholder, holding not less than 1/20th of the issued share capital, may requisition a meeting, provided that it is validly requisitioned under section 181, although the meeting must be quorate to be effective.[77] Should the meeting not be quorate, the shareholder has recourse to the court under section 183.[78]

In clause 61, the Bill widens the standing to call a meeting by allowing the board, or any other person specified in the Memorandum or rules, to call a shareholders' meeting at any time, subject to the specified voting percentage requirements.[79] Comparably, section 183 of the Act allows merely the Registrar, a director or a shareholder to apply to court to call a general meeting, which shall be granted if the court thinks fit. Other than this wide right to call meetings, there are specified instances in which shareholder meetings *must* be held. These are:

1. whenever the board is required, by either the Act or the Memorandum of Incorporation, to refer a decision to the shareholders;[80]

2. whenever a vacancy arises on the board and it is required to be filled;[81]

3. whenever otherwise required when it is demanded in terms of subsection (3) or mandatorily stipulated for public companies in terms of subsection (7);[82] or

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[75] Section 181(1). If the directors do not call a meeting within the time specified in the Act, despite receiving a proper request, the requisitionists or any of them numbering more than fifty or representing more than ½ of the total voting rights of all of them, may on notice to the company convene a meeting. (Section 181(3)). Any reasonable expense incurred by the requisitionists as a result of the directors' failure to convene a meeting must be repaid to them by the company, but any sum repaid will be retained by the company out of any sums due or to become due from the company by way of fees in respect of their services to those directors who were knowingly a party to the default. (Section 181(5)) It is a criminal offence for any director or officer who is knowingly a party to a failure to convene a meeting. (Section 181(6))

[76] *Henochsberg on the Companies Act*, Volume 1, Fifth Edition, updated June 2008, Lexisnexis, Durban, pg 330

[77] *Ibid,* pg 331

[78] In terms of section 183 of the Act, a shareholder, director or the Registrar may apply to court to call a general meeting.

[79] Clause 61(1)

[80] Clause 61(2)(a)

[81] Clause 61(2)(b)

[82] Clause 61(2)(c)(i)

4. when it is required in terms of the Memorandum.[83]

It is submitted that points 1 and 4 above appear to fulfil the same requirement. The Bill increases the percentage requirements from the 1/10th and 'two or more' shareholders stipulation, or 1/20th and one shareholder with voting rights, in the Act to twenty-five percent, but which may be called by a single shareholder holding the requisite percentage of voting rights. The requirements are therefore greatly increased in the Bill.

Clause 61(3) states that the board or any other person mentioned in the memorandum or rules *must* call a shareholders meeting if one or more written and signed demands for such a meeting is delivered to the company and:

1. each demand specifies the purpose of the proposed meeting; and

2. in aggregate, demands for substantially the same purpose are made and signed by the holders ("a[t] the earliest time specified in any of those demands"[84]) of at least *twenty-five percent* of the voting rights entitled to be exercised in relation to the matter to be discussed. The Memorandum may specify a lower percentage than the stipulated twenty-five percent.[85]

The increasing of the specified percentage for demanding a meeting has been greatly criticised as being exceptionally high. While it is correct that this it tempered by being alterable in the Memorandum, international norm in this regard is ten percent.[86] This criticism is premised on the basis that shareholders are expected to have a knowledge of company law which is far beyond that of the average investor. If we take heed of Harold Williams'[87] observation in 1981 that "...the traditional concept of the investor is becoming obsolete. The linkage between ownership and participation in the equity markets is, to put it mildly, strained. Increasingly, the so-called investor is often nothing more than a short-term speculator in the company's income stream",[88] then it is submitted that this criticism is warranted, particularly in light of the fact that while we may expect our South African investors to have a basic

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[83] Clause 61(2)(c)(ii)
[84] It would appear that the Bill contains a spelling error here: "as".
[85] Clause 61(4)
[86] Business Report, '*New Law will scare off Investors*', Monday, 18 August 2008.
[87] Former Chairman of the Securities and Exchange Commission
[88] Quoted in R Sobel, *Dangerous Dreamers* (1993) 112 Juta Business Law and again in *The Future of South African company law?* Pretorius, J; Juta Business Law, Vol 12, Part 2 at 74

knowledge of their rights under South African law, the same may not necessarily be said international investors. The remedies are available to these investors and how effective they will be in enforcing their remedies, therefore comes under increased scrutiny.[89]

The clause places greater rights in the hands of single shareholders to be heard above the twenty-five percent of the company through a safeguard against calling meetings for unwarranted purposes. Where it is considered the call for a meeting is frivolous, vexatious or has been called to reconsider a matter already decided by the shareholders, a company, or any shareholder thereof, may apply to court for an order setting aside the demand.[90] In this manner, the company or any of its shareholders have recourse to the court where they believe a meeting was unnecessarily demanded. The disadvantage, as is always the case with the right of legal action, is that the burden of legal fees may be severe for a single shareholder or even the company, to bear. In this regard it is submitted that perhaps the company or any of its shareholders should have recourse to the Commission or Ombud, as an alternative.

Another example of the Bill providing shareholders with greater flexibility in determining their own matters, is the fact that the board is bestowed with the power to determine the location of shareholders meetings, and the meeting can be held anywhere in the world. This power can be taken away from the directors in the Memorandum.[91] For subsequent shareholders, where the initial shareholders did not alter this provision in the Memorandum, it may be more difficult to place this power back in their hands, depending on the percentage required in the resolution to alter the Memorandum.[92] It is submitted that the default position to determine the location of shareholder meetings should rest with the shareholders themselves.

As an attempt to increase shareholder activism in public companies, shareholder meetings must be reasonably accessible within the Republic for electronic participation, irrespective of where in the world the meeting is held.[93] It remains to be seen how 'reasonably accessible' is interpreted. While it has been practise for some

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[89] See Chapters 4 and 5 of this paper.
[90] Clause 61(5)
[91] Clause 61(9)
[92] See paragraph 3.6 below dealing with shareholder resolutions and the power to stipulate different percentages for different resolutions.
[93] Clause 61(10). The electronic participation must be in accordance with clause 63(2).

years for shareholders to opt in their shareholders agreements to conduct meetings electronically, this clause is nevertheless welcomed into our legislation.

If a company cannot convene a meeting because it has no directors, or because all its directors are incapacitated, any other person authorised by the Memorandum may call a meeting, or where no other person has been authorised to do so, the Companies Ombud, on request by any shareholder, may issue an order for the shareholders to convene in the manner specified by the Ombud.[94] If a company fails to call a meeting, other than for reasons of non-existence or disqualification of its directors, a shareholder may apply to court to order a meeting. The company *must* compensate a shareholder who applies to the Companies Ombud or to court, for the costs of the proceedings, unless they are found to be frivolous, vexatious or called to reconsider a matter already decided.[95] It is submitted that the directors found to be wanting should be made to compensate the shareholder rather than the company. Forcing the company to compensate a single shareholder's legal costs may indirectly reduce shareholder value for the majority, where it was in fact the conduct of the directors which lead to such action by the shareholder.

3.4 **Conduct of meetings**

The option of a shareholders' meeting being conducted entirely by electronic communication, mentioned above in 3.2, is an important innovation in the flexibility provided by the Bill.[96] The definition of 'electronic communication' is the same as it is in section 1 of the Electronic Communications and Transactions Act ("the ECT Act")[97]. Furthermore, one or more shareholders may participate in meetings by electronic communication in a shareholders' meeting that is being held in person, as long as the electronic communication enables all persons participating in the meeting to communicate concurrently with each other without an intermediary,[98] and provided they can participate reasonably effectively in the meeting. This right to communicate and meet electronically may be prohibited in the Memorandum should the shareholders so wish.[99] Access to the medium or means of electronic communication

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[94] Clause 61(11)
[95] Clause 61(13)
[96] Clause 63(2)(a)
[97] 25 of 2002
[98] 'Intermediary' is defined in the ECT Act as 'a person who, on behalf of another person, whether as agent or not, sends, receives or stores a particular data message or provides other services with respect to that data message'.[98] 'Person' includes a public body.[98]
[99] Clause 63(2)

is at the expense of the shareholder or proxy, unless the shareholders determine otherwise.[100]

The Companies Act of the United Kingdom does not appear to expressly permit or prohibit any meetings of directors or shareholders to be conducted electronically, although it allows for notification by and to directors and members, such as the declaration of a director's interest to be in electronic form or communication via websites.[101] The Model Corporations Act only expressly permits directors' meetings to be held electronically and the requirement in this regard is that "all directors participating may simultaneously hear each other during the meeting."[102]

Two further changes in this clause in the Bill are that voting is exercised by means of polling and abstention from voting by a person present at a meeting is taken to be a vote in opposition of the proposed resolution.[103] Under the Act, it has been stated that a poll is the only method whereby a resolution can be accurately passed, as voting rights under section 197 of the Act are exercised by a show of hands – one shareholder, one vote. A poll can only be demanded by not less than five shareholders having the right to vote or by a shareholder or shareholders holding not less than 1/10th of the total voting rights of all the shareholders entitled to vote at the meeting, or by a shareholder or shareholders entitled to vote and holding not less than 1/10th of the total issued share capital of the company.[104]

The poll voting method is important as the Bill mimics the Model Corporations Act, which also follows the 'one vote per share'[105] method, but allows the Memorandum to specify the 'preferences, rights, limitations and other terms associated with' a particular class of shares.[106] Similarly, the articles of an American corporation may provide for multiple or fractional votes per share, or that some classes have a single vote per share or multiple votes, or even that certain classes constitute separate voting groups and may vote separately on a matter.[107] Accordingly, holding a share in a particular class will not be illustrative of what the voting rights or limitations are attached to such share: one will have to look to the Memorandum for greater insight.

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[100] Clause 63(3)(b)
[101] Section 293 and Schedule 5 Part 4
[102] §8.20(b)
[103] Clause 63(5)
[104] Section 198(1)(b)(i), (ii) and (iii)
[105] Model Business Corporations Act, pg. 7-32
[106] Clause 36 of the Bill, 2008
[107] Model Business Corporations Act, *ibid* at 72

The Memorandum may provide that classes of the same shares carry different preferences, rights, limitations and other terms.[108]

The idea behind this share structuring in the Model Corporations Act is that the ability to specify the rights and entitlements of each class of shares assists in planning closely-held business ventures where the contributions of those participating vary in kind or amount[109]. A disadvantage, however, is that voting may be come unnecessarily complicated. As a caveat, it is submitted that shareholders are required to be particularly careful when purchasing shares of a particular class and assuming that they are acquiring particular voting rights. Stakeholders are furthermore to be wary about assuming that a particular shareholder is a majority shareholder having control of a company, when in fact he may hold a minority of voting rights.

Another concerning fact to note is that in terms of clause 36(3)(a) of the Bill, directors are bestowed with the power to increase or decrease the number of authorised shares,[110] to the extent that this is limited by the Memorandum. This is not limited by the requirement that the shares are not yet issued, which it is submitted would provide a necessary safeguard for shareholders.

3.5 Meeting quorum and adjournment

For the purposes of corporate governance, the lower the quorum requirements of a company, the greater the ease with which majority groups are able to exercise a measure of control over unwary minority groups in the conduct of business of the company. Section 190 of the Act states that the meeting of a public company is quorate where three members entitled to vote, are personally present, and in the case of a private company, provided the private company does not have only one member, two members entitled to vote must be personally present (unless the articles of a company provide for a greater minimum number). No resolution passed at a meeting that is not quorate is valid. Where a meeting is commenced which is quorate for discussing particular business at the meeting (i.e. two members of the private company are present), the meeting may not pass a resolution if the two

[108] Clause 37(1)
[109] Ibid at 7-33
[110] Clause 36(3)(a)

members do not together hold at least ¼ of the voting rights entitled to vote at the meeting.

Comparing this provision to the equivalent in the Bill, we note increasingly the importance of a Memorandum which is drafted in a manner which accurately reflects the shareholders' will. The Bill provides that a shareholders' meeting may not commence until sufficient shareholders are present to exercise, in aggregate, at least twenty-five percent of all the voting rights entitled to be exercised in respect of at least one matter, and a matter to be decided cannot be considered unless sufficient shareholders are present entitled to exercise, in aggregate, at least twenty-five percent of all the voting rights on that matter, at the time the matter is called on the agenda.[111] This provision has therefore remained unchanged from the Act to the Bill, save for one important aspect: the twenty-five percent requirement can either be increased or decreased in the Memorandum.[112] The Bill does not set a minimum or maximum quorum voting right percentage and therefore it would appear that this lies solely at the discretion of the shareholders. This would enable a block of majority shareholders to set the quorum in the Memorandum to ensure that, to the extent that the minority are not active enough, they meet and decide matters with greater ease. While this is not necessarily unwanted, again it is noted that subsequent shareholders may find themselves in a position of weakness.

In addition to the above, if a company has more than two shareholders, a meeting cannot commence or a matter commence to be debated until at least three shareholders are present and the twenty-five percent requirement or other figure specified in the Memorandum are satisfied.[113] Thus, in a company with three shareholders, there must always be one hundred percent attendance at meetings to meet the quorum requirements. The Bill does not distinguish between public and private companies as the Act does.[114] It is submitted that this may place an increased administrative burden on smaller companies to secure high levels of attendance at shareholder meetings, despite being able to lower the quorum in the Memorandum, however, the advantage of coupling voting power with numbers of shareholders is

[111] Clause 64(1)
[112] Clause 64(2)
[113] Clause 64(3)(a) and (b)
[114] Section 190(a) and (b)

that it prevents the position where a single majority shareholder may constitute a quorum and take decisions by himself.[115]

Clause 64(9) states that after a quorum has been established for a meeting or a matter to be considered, the meeting may continue or the matter considered, unless there is not at least one shareholder present with voting rights entitled to be voted, unless the Memorandum specifies otherwise.[116] This clause appears contradictory to clause 64(3)(a) and (b) which requires that a company with more than two shareholders must meet the quorum requirements specified in the Bill or Memorandum and have at least three shareholders present at the meeting. One could perhaps interpret this in a non-contradictory manner by arguing that the three shareholders are not all required to have voting rights. In terms of subclause (9), only one of them is required to hold voting rights, unless the Memorandum calls for more such shareholders with voting rights.

3.6 **Shareholder resolutions**

An interesting use of the flexibility of the Bill will be put to test in the percentages required to pass ordinary and special resolutions. Under the Act, a special resolution is passed where members holding in aggregate not less than ¼ of the total voting rights of all the members entitled to vote[117] are present at a meeting, in other words, where the meeting s quorate, and not less than ¾ of those members entitled to vote and present, in number,[118] vote in favour of the special resolution.[119]

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[115] If, within one hour after the appointed meeting time, there are not sufficient persons for a quorum to commence the meeting, the meeting must be postponed for one week. (Clause 64(4)) If there are not sufficient persons for a quorum to consider a particular matter, it can be postponed to later on the agenda in the meeting, or if there is not any other business, the meeting must be postponed for a week. (Clause 64(6)(a) and (b). The one hour and one week requirement can similarly be altered in the Memorandum. (Clause 64(4)(b)(i) and (ii) The person presiding at the meeting can extend this one hour requirement himself for a reasonable period if there are exceptional circumstances as to why the shareholders are not present. The Bill lists weather, transportation and electronic communication problems in this regard.

[116] Clause 64(a)

[117] Where a company is limited by guarantee, the requirement is not less than ¼ of the members entitled to vote must vote in favour.

[118] Where a poll has been demanded, the requirement is that not less than ¾ of the total votes to which the members present are entitled to vote must vote in favour of the resolution.

[119] Section 199(1)(a) and (b). Where less than ¼ of the total votes of all the members entitled to attend the meeting and to vote, or in a company limited by guarantee, less than ¼ of the members of the company, are present at a meeting called for the purpose of passing a special resolution, the meeting will be adjourned for between seven and twenty-one days. (Section 199(2)(a)) At the adjourned meeting, the members who are present (regardless of whether less than ¼ of the total votes are represented at the meeting) may deal with the business of the company and pass a resolution which will be deemed to be a special resolution if ¾ vote in favour of such resolution. (Section 199(2)(b)).
By way of example: a public company has 100 shareholders entitled to vote each with one vote, holding one percent each of the issued share capital. At least three of them need to be present at the meeting

The Bill commences the equivalent section by providing any two shareholders, together, with the right to propose a resolution concerning any matter in which they are entitled to vote.[120] This may be a lower requirement from the existing ten percent of the issued share capital or five percent of the shareholders required to call a meeting under the Act, as the two shareholders together may hold less than ten percent of the share capital or equate to less than five percent of the members. The proposing shareholders may require how and when the resolution is to be considered by the shareholders. The Bill, rightly it is submitted, specifically excludes the proposal from the clause 6(4) prospectus requirements,[121] but requires that it must be stated with sufficient clarity and specificity and accompanied by sufficient information or explanatory material so as to enable a reasonably alert shareholder entitled to vote on the resolution to decide whether to participate and seek to influence the outcome of the vote or not.[122] In light of the visible attempts of the Bill to increase shareholder activism, it is submitted that the expectations of a 'reasonably alert shareholder' under the Bill may be more than what could have been demanded under the Act.

Introducing an element of enhanced transparency in the conduct of meetings, the Bill allows any director or shareholder to apply to court before the start of the meeting for relief if he or she feels that the requirements of clarity, specificity and sufficient information have not been met.[123] The court may require the shareholders who proposed the resolution to compensate the Applicant for the costs of the proceedings is he or she is successful.[124] Essentially, shareholders could be made to compensate a director who applies to court to make them alter their resolution. It is submitted that this provides an element of unnecessary power to a director over the shareholders and the Bill should not accordingly have extended this right to directors. If the resolution is approved without challenge, then there is no recourse for a dissatisfied shareholder or director.

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and those three need to hold at least ¼ of the total voting rights. ¼ of the total voting rights is twenty-five shareholders. At least ¾ of the twenty-five need to vote in favour. Therefore, a minimum of nineteen votes in favour is needed to pass the special resolution, regardless if the other six vote against the resolution. The special resolution passes at 19/100.

[120] Clause 65(3)(a)

[121] State what this is

[122] Clause 65(4)(a) and (b)

[123] Clause 65(5)

[124] Clause 65(5)(b)(ii)

Under the Bill, an ordinary resolution is passed when fifty percent of the voting rights exercised on the resolution support its adoption.[125] The Memorandum can require a higher percentage for approval of an ordinary resolution or one or more higher percentages of voting rights to approve ordinary resolutions concerning different matters. A special resolution is passed when seventy-five percent of the voting rights exercised on the resolution support its adoption.[126] The Memorandum may require a lower percentage of voting rights for any special resolution or different lower percentages for different special resolutions. This is subject to the requirement that at all times, the difference between voting rights in respect of special and ordinary resolutions is not less than ten percent.

It would therefore appear that the highest requirement for a special resolution can be seventy-five percent and the lowest for an ordinary resolution is fifty percent. If the margin must always be ten percent, then the threshold for a special resolution, depending on whether or not the threshold for an ordinary resolution has been altered, is between sixty and seventy-five percent. On the other hand, the threshold for an ordinary resolution may be between fifty and sixty-five percent.

Coupling the quorum requirements and voting thresholds under the Bill, the threshold to pass a special resolution could be exceptionally low. If one takes a scenario where the quorum is set at ten percent by the shareholders in the Memorandum, and the requirement for special resolutions is set at sixty percent, then the approval of only six percent of persons present and entitled to vote is required to pass the special resolution.[127] The converse is also true: where shareholders set the quorum at fifty percent and retain the special resolution at seventy-five percent, the approval of thirty-seven and a half percent of persons present and entitled to vote is required to pass the resolution. Decisions to amend the Memorandum, to approve the voluntary wind-up of a company or to approve a proposed fundamental transaction must be

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[125] Clause 65(7)
[126] Clause 65(9)
[127] Example 1 – Ordinary Resolution: 100 shareholders present and entitled to vote
100 votes are exercised:
51 vote for
49 vote against
The ordinary resolution is passed 51/100.
Example 2 – Ordinary Resolution:
100 shareholders present and entitled to vote
100 votes are exercised:
26 vote for
24 vote against
50 abstain (deemed to be votes against in terms of Clause 63(5))
The ordinary resolution is not passed. It fails at 26/100, rather than being passed at 26/50.

made by special resolution, which transactions the Memorandum can add to but not reduce.[128]

Clause 65 has been criticised as holding the ability to heavily reduce shareholder power.[129] It is submitted this criticism is somewhat exaggerated in relation to initial shareholders. Firstly, the default position is the fifty – seventy-five percent norm. The initial shareholders themselves choose if they want to alter this. Secondly, the Memorandum can only be altered by a special resolution of the shareholders. Thus where the shareholders wish to amend the percentages of resolutions, this will itself have to be taken by special resolution of the shareholders themselves. Thirdly, the clause is tempered by the fact that shareholders may still ensure the maximum percentages are in place for approval of fundamental transactions. Lastly, the shareholders themselves may choose at the formation of the company whether they wish to determine that a special resolution in relation to amending the Memorandum is to be sixty percent. The difficulty is more evident in the case of subsequent shareholders who may not possess the requisite majorities to alter the Memorandum to increase there power where this is been reduced through the choice of the initial shareholders.

Clause 65 is, in fact, in line with the Model Corporations Act, which requires the quorum and percentage of shareholders who voted on changing the quorum or voting requirements of any particular transaction to be adopted by the same vote and voting groups required to take action under the quorum and voting requirements then in effect or proposed to be adopted, whichever is the greater.[130]

Regarding the rights of shareholders generally, the fears of Hermes and other large investors may indeed be well-founded. The power in respect of important aspects of corporate governance appears to have shifted from the shareholders under the Act to the board under the Bill and it is indeed correct, that where such power can be shifted to the shareholders under the Memorandum, this is in regard to rights that shareholders previously had. The flexibility of the Bill is best capitalised on by the initial shareholders, by allowing them to place powers in their hands over those of the directors. The concerns in this regard are two-fold: firstly, depending on how the initial shareholders have structured the company, it may be more difficult for

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[128] Clause 65(11)
[129] See footnote 130 below.
[130] § 7.27(a) and (b). The Model Corporations Act does not, however, require a margin of ten percent.

subsequent shareholders to secure their rights, and secondly, where shareholders maximise their powers against the directors in the Memorandum, their lack of detailed knowledge of company law and over-involvement in the day-to-day running of the business may result in the limited growth of the company.

Part B: The power of shareholders over directors

Notwithstanding the fact that shareholders will be well advised to ensure the Memorandum achieves their desired balance of power in fundamental transactions, the question which follows is what power shareholders retain over their directors with respect to qualifications, disqualifications, ineligibility and powers of removal.

3.7 Board, directors and prescribed officers[131]

An important aspect of the governance of a company consists of who are considered as the directors of a company, and consequently, who may be held liable for failing to fulfil the function and duties associated with directors.

The Act defines a 'director' widely as 'includ[ing] any person occupying the position of director or alternate director of a company, by whatever name he may be designated.'[132] It is therefore clear that a person who acts as a director under the Act will be treated as a director by whatever name he is known.[133] 'Officer' is defined as 'includ[ing] any managing director, manager or secretary' of a company.[134] Section 208 stipulates that until the first directors have been appointed, every subscriber to the memorandum will be deemed to be a director. Section 211(3) stipulates that any person appointed to act as director or officer must within twenty-eight days of the appointment lodge a consent to act with the Registrar of Companies, but failure to

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[131] As with the present position under the Act where the articles may allow for delegation of duties to board committees, so too does the Bill allow the board to delegate its' authority to any number of 'board committees'. (Clause 72(1)(a) and (b)) This is particularly useful for large companies where the board is not always in a position to dedicate itself fully to the investigation of all issues it must decide on, prior to taking a decision. The committee may include persons who are not directors, provided that those persons are not ineligible or disqualified and that those persons don't have a vote on a matter to be decided by a committee, however, this provision is alterable in the Memorandum. (Clause 72(2)(a)(i) and (ii)).King is of the opinion that the existence of non-board members on a committee should be the exception rather than the rule. Shareholders will thus have to ensure that the Memorandum allows for a limited number of or no non-board members on committees should it so wish. The committee may consult with or receive advice from any persons and it has the full authority of the board in respect of a matter referred to it. All of these requirements are also alterable by the Memorandum.
The safeguard to shareholders and stakeholders in the Act is maintained in the Bill whereby the mere creation of a committee, delegation of powers to the committee or any action taken by a committee does not satisfy compliance by a director with his duties owed to the company. (Clause 72(3))This fact is unalterable in the Memorandum. This would therefore require that a director must still have some bearing on the decisions of the committee and ensure that they carry out their functions in accordance with the required duties of the board to its shareholders. A director will be absolved from liability for a harmful business decision if, in carrying out his duties he relied on information supplied by a committee of which he was not a member, unless he had reason to believe that the actions of the committee did not merit confidence. (Clause 76(5)(c))

[132] Section 1(1)

[133] van Dorsten, JL, *The law of Company Directors in South Africa*, Second Edition, Meridian Press CC, 1999, page 12

[134] *Ibid*

comply with this provision will not affect the validity of the appointment, although the director will be guilty of an offence.[135] Furthermore, any acts taken by a director who afterwards discovers that his appointment was invalid or defective for some or other reason, will not affect the validity of those acts.[136] This recognition of *de facto* directors provides a measure of protection for third parties contracting with the company who can be safe in the knowledge that their contracts are valid and binding notwithstanding a defect in the appointment of a director.[137]

The Bill defines a director as 'a member of the board of a company, as contemplated in section 66, or an alternate director of a company'[138]. 'Prescribed officer' is defined as 'the holder of an office, within a company, that has been designated by the Minister in terms of section 66(11)'.[139] In clause 66, the Bill expressly recognises *ex officio* directors, who may be specified in the Memorandum by virtue of the office, title, designation or similar status that they hold,[140] considered to be directors, provided they are not disqualified or ineligible under the specific clauses of the Bill, and provided further that they have delivered to the company a written consent to serve as director[141], as well as alternate directors.[142] What is the position where an *ex officio* director, carrying out the functions of a director and making decisions which significantly affect the business of a company has not been named in the Memorandum and has not signed and delivered to the company a consent to act as director? This would appear to be taken care of in clause 66(5)(b)(ii), which holds a person subject to all the duties and liabilities of a director of a company, where that person 'holds office or *acts in the capacity*[143] of an ex officio director of a company'. Thus, while clause 75, dealing with a director's personal financial interests, clause 76, dealing with standards of director's conduct, and clause 77, dealing with liability of directors and prescribed officers are identical in their applicability clauses, stating that the use of the word 'director' in the relevant sections, includes 'alternate directors', 'prescribed officers' or members of a board committee or of the audit committee, and not mentioning *ex officio* directors, it is arguable that by virtue of clause 66(5)(b)(ii), they can also be held subject to those provisions.

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[135] Section 211(4)
[136] Section 214
[137] van Dorsten, JL, *The law of Company Directors in South Africa*, Second Edition, Meridian Press CC, 1999, page 21
[138] Clause 1
[139] *Ibid*
[140] Clause 66(4)(a)(ii)
[141] Clause 66(7)(a) and (b)
[142] Clause 66(4)(a)(iii)
[143] My italics

Presently, every public company must have a minimum of two directors and every private company, a minimum of one director.[144] Furthermore, subject to the articles (Table A Article 78 for private companies), the number of directors of a company *may* be determined and the first directors may be appointed in writing by a majority of the subscribers to the memorandum.[145]

Subsequent directors are appointed by the general meeting, alternatively, by the board, if authorised by the articles, or even by agreement by shareholders or persons who are not shareholders. Section 210 states that their appointment must be voted on individually, unless a unanimous resolution has been moved providing that two or more directors shall be appointed by a single resolution.[146] The approved motion for their appointment shall then be treated as a vote in favour of their appointment.

The Bill states that except to the extent that the Bill or Memorandum provide otherwise, the business and affairs of a company are managed by or under the direction of the board of directors.[147] A private company must have a minimum of one director and a public company, a minimum of three directors, but the Memorandum may increase this minimum number.[148]

The Bill introduces an element of stakeholder involvement by allowing any person so named in the Memorandum to appoint or remove directors,[149] but in the case of a "for-profit company",[150] the Memorandum must allow the shareholders to appoint at least fifty percent of all directors and fifty percent of all alternate directors.[151] This ensures initial control by the shareholders over the majority of directors. The term for which such director serves is indefinite or for the period as set out in the Memorandum.[152] The Bill furthermore accords the directors with the power to elect directors on a temporary basis to fill vacancies until properly elected in terms of the

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[144] Section 208(1)
[145] Section 209
[146] As stated in *Aitchison and Another v Dench and Another* 1964 (2) SA 525 (T) at 516-7 as deriving from English Company Law, quoted in van Dorsten, JL, *The law of Company Directors in South Africa*, Second Edition, Meridian Press CC, 1999, page 38, this is to prevent a block of candidates being voted on together.
[147] Clause 66(1)
[148] Clause 66(2)(a) and (b). The maximum numbers of shareholders has now been removed from the Bill entirely. It will accordingly be possible for a private company to comprise an unlimited number of shareholders. It is submitted that this
[149] Clause 66(4)(a)(i)
[150] Other than a state-owned enterprise.
[151] Clause 66(4)(b)
[152] Clause 68(1)

Bill or Memorandum, however, the Memorandum may also take away this power and place it in the hands of another person.[153] Here one would expect to find key stakeholders such as a trade union or other employee representative or key supplier being named as being entitled to appoint a director in the Memorandum.

The named stakeholders would be entitled to appoint their "director representative" to the board, however, the director could find himself in a precarious position, as nominated directors currently find themselves. Subject to the directors' fiduciary duties, and since, as will be seen in Chapter 4 below, the Bill does not mandate an enlightened shareholder value model in relation to directors' duties, the director could be held liable for voting in the interests of his appointees, the named stakeholders, to the detriment of the general body of shareholders and could therefore be liable for failing to bring his mind to bear on the matter before him.[154] Unlike section 180 of the United Kingdom Companies Act,[155] the directors are given no guidance as to whose interests they must be acting in.

The default position with remuneration under the Bill is that the company may pay remuneration to its directors for their services. This provision, oddly, is alterable in the Memorandum. Remuneration can only be paid to directors in accordance with a special resolution of the shareholders taken in the previous two years, although this requirement can be amended in the Memorandum. Under the Act, the directors' remuneration must be allowable under the articles, and the amount is generally determined by the shareholders in general meeting,[156] thus the Bill raises the bar to a special resolution for the determination of the amount of remuneration. The default in the Bill is contrary to the recommendations of King and the provisions of the Model Corporations Act which provide that unless the articles of a corporation provide

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[153] Clause 68(3)

[154] In the *Fisheries Development Corporation of SA Ltd v Jorgensen* 1980 (4) SA 156 (W) the court at 163 stated that in dealing with nominee directors: '[a] director is in that capacity not the servant or agent of the shareholder who votes for or otherwise procures his appointment to the board...The director's duty is to observe the utmost good faith towards the company, and in discharging that duty he is required to exercise an independent judgment and to take decisions according to the best interests of the company as his principal. He may in fact be representing the interests of the person who nominated him, and he may even be the servant or agent of that person, but, in carrying out his duties and functions as a director, he is in law obliged to serve the interests of the company to the exclusion of the interests of any such nominator, employer or principal. He cannot therefore fetter his vote as a director, save in so far as there may be a contract for the board to vote in that way in the interests of the company, and, as a director, he cannot be subject to the control of any employer or principal other than the company.'

[155] Section 180 of the United Kingdom Companies Act is looked at in paragraph 4.2 of this paper in relation to director's duties.

[156] Article 54, Table A

otherwise, the board fixes the compensation to be paid to directors.[157] King's opinion is that remuneration is the responsibility of the board, but that in large companies, a remuneration committee, consisting largely of independent, non-executives must make recommendations to the board in relation to each director's pay.[158]

The Bill appears to provide an added measure of protection for shareholders by according them the power to veto excessive director remuneration. While excessive director remuneration was acknowledged to be a contributor to corporate governance failures, the reality is that many shareholders are not always aware of industry standards of remuneration. The risk they run lies in refusing to adequately compensate their directors, leading in turn, to the resignation of these directors. The requirement of the rigmarole of a special resolution could also result in time delays for directors requesting a pay increase. On the other side of the coin, the fact that the special resolution in relation to remuneration could effectively require sixty percent approval, a smaller majority could be ruling the company, leading to a larger sidelined and therefore dissatisfied minority in relation to remuneration issues. It is submitted that shareholder approval is welcomed as a measure of oversight but that this should perhaps have been limited to an ordinary resolution. Mandatory remuneration committees for public companies and widely-held private companies with large boards, consisting of independent non-executives, as King has suggested, should also have been included in this provision.

3.8 Ineligibility and Disqualification of Directors or Prescribed Officers

Understanding that the '[s]hareowners are responsible ultimately for electing or removing board members, and [that] it is in their interests that the board is properly constituted',[159] likewise, the ability to dictate the ineligibility and disqualification of directors is an important mechanism of shareholder control over directors.

Persons unable to hold office under the Act include a body corporate, a minor or other person under legal disability, a person who is the subject of an order under the Act disqualifying him from acting as a director, and save under a court order: an un-rehabilitated insolvent, any person removed from an office of trust on account of misconduct, any person who has at any time been convicted of theft, fraud, forgery,

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[157] § 8.11
[158] King, M; *King Report on Corporate Governance for South Africa 2002*, incorporating the Code of Corporate Practices and Conduct, (Institute of Directors in South Africa) paragraph 2.5.2
[159] *Ibid*, Chapter 5, paragraph 1

uttering a forged document, perjury or any offence under the Prevention of Corruption Act,[160] or any offence involving dishonesty or in connection with the promotion, formation or management of a company, and who has been sentenced for such offence to imprisonment without the option of a fine or to a fine exceeding R100,00.[161] The articles of a company can specify further grounds for disqualification.[162] It is a criminal offence for a disqualified person to be appointed or to act as a director of a company and who purports to act as a director.[163]

Section 219 spells out that a court may make an order directing that for a certain period of time, a person, director or officer will not without the leave of the court be a director or in any way, directly or indirectly concerned with or take part in the management of the company. The instances of such an order arise where:

(a) such person, director or officer was convicted of a fraud in connection with the promotion, formation or management of a company;[164] or

(b) the court has made an order for the winding-up of the company and the Master has made an order under the Act stating that in his opinion, a fraud has been committed by such person in connection with the promotion or formation of the company or by any director or officer in relation to the company since its formation;[165] or

(c) in the course of the winding-up or judicial management, it appears that such person has been guilty of a section 424[166] offence, whether convicted or not, or has otherwise been guilty while an officer of the company of any fraud in relation to the company since its formation;[167] or

(d) a declaration has been made in respect of that person under section 424(1).[168]

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[160] 6 of 1958
[161] Section 218(1)
[162] Section 218(3)
[163] Section 218(2)
[164] Section 219(1)(a)
[165] Section 219(1)(b)
[166] Section 424 deals with personal liability of directors for fraudulent or reckless conduct.
[167] Section 219(c)
[168] Section 219(d)

The order may be made by the court with the jurisdiction to wind up the company on application by the Master or Attorney-General in terms of section 401 of the Act or the liquidator or judicial manager, or by any person who is a *creditor* or *is or has been a member* of such company, or even by the court itself, where a person, director or officer has been convicted under paragraph (a) above.[169]

Ineligibility has remained largely the same under the Bill as under the Act. Those named as ineligible from becoming directors are juristic persons, un-emancipated minors or persons under similar legal disabilities or persons who do not satisfy the qualification requirements in a company's Memorandum.[170] Grounds for disqualification are: if a court has prohibited a person from becoming a director or declared him or her delinquent, if the person is an un-rehabilitated insolvent, is prohibited in terms of any public regulation from being a director, has been removed from an office of trust for misconduct involving dishonesty or has been convicted of specified crimes involving *inter alia* theft, fraud, forgery, perjury, misrepresentation or dishonesty.[171] As with the articles under the Act, the Memorandum may add additional grounds for ineligibility or disqualification.[172]

An innovation introduced to the Bill in this clause is that the Memorandum may specify minimum qualifications for directors of a company – a first in South African law as currently, there are no provisions whereby specified qualification requirements for directors may be imposed.[173] It has often been acknowledged that the ability to lead companies and recognise business opportunities rarely relates to a person's qualifications. In South Africa, where education and employment are pressing economic issues, we have to ask whether allowing shareholders, who are not necessarily bestowed with an intimate knowledge of the businesses in which they invest or the gift of entrepreneurship, to set qualification standards for their directors in the Memorandum, is wise. The counter-argument is that there may, however, be very good reasons for shareholders to require at least one director with a suitable qualification in one of the areas of a company's business which may be highly technical or specialised. Furthermore, shareholders, in being given the freedom to make these choices, must similarly learn from their mistakes, alternatively, they may

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[169] Section 219(2)(a)
[170] Clause 69(7)
[171] Clause 69(8)
[172] Clause 69(6)
[173] Although it is submitted that it is correct that minimum qualifications for directors should not be determined in the Bill, it is preferable that shareholders may decide whether the people they choose to direct their company are bestowed with the necessary expertise to do so.

simply amend the Memorandum where the provisions do not suit a particular appointment which they wish to make. Under the Act currently, it is also rarely the case that a director is appointed who is not in some manner suitably qualified in the opinion of his appointees. It is submitted that the freedom accorded by this clause is welcomed into the law, but that its misuse will remain a concern.

Although application for rehabilitation is currently available to a director under the Act,[174] the Bill introduces the notion of automatic rehabilitation after a certain lapse of time, similar to that found in the Insolvency Act.[175] Clause 69(9) states that the disqualification ends at the later of five years after the date of removal from office or the completion of the sentence imposed for the offence, or after any extension granted by a court in terms of subclause (10). In terms of subclause (10), the Companies Commission can, before the expiry of a person's period of disqualification, apply to court to extend the period of disqualification. The extension cannot operate for more than five years at a time and must be necessary to protect the public, having regard to the reason for the person's disqualification. Although automatic rehabilitation under the Insolvency Act is after a period of ten years from the date of declaration of insolvency, this accords with the Bill in that, where a person is declared insolvent at the same time as his disqualification, he may not after his five year period has passed, be appointed as a director, since, provided he has not been rehabilitated under the Insolvency Act, he remains an un-rehabilitated insolvent.

Shareholders and other interested stakeholders would have to keep a vigilant watch on the time-periods in order to provide timeous notice to the Commission to oppose an application for rehabilitation, unless it is envisaged the Commission will undertake this task, which is unlikely. This provision is perhaps not entirely welcomed, as the burden is placed on shareholders and other stakeholders to require the Commission to oppose automatic rehabilitation, rather than requiring a director to apply to court in every case. The courts have made it clear that '...the passing of years does not *per*

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[174] Section 218(1)(d) grants an unfettered discretion on courts to grant or refuse an application for rehabilitation. The court in *Nusca v Da Ponte and Others* 1994 (3) SA 251 (BG) stated at 262-263 that the factors which the court would take into account in granting a rehabilitation would be: '(a) [t]he conduct of the applicant since his conviction...(b) [t]he likelihood of the applicant repeating his former criminal conduct...(c) [t]he time lag between the conviction and the application...(d) [w]hether the company is a private or public company... (e) [t]he attitude of the shareholders and their associates... (f)...whether in all the circumstances the applicant has satisfied the Court that he has rehabilitated himself... (g)...whether an applicant is able to demonstrate that since his misdemeanour he has displayed the requisite probity and trustworthiness to be entrusted with the fiduciary position of a director of a company...'

[175] Act 24 of 1936

se provide evidence of reform...'.[176] It is submitted that the period of five years is therefore somewhat arbitrary and the Bill clearly does not go far enough to discourage abuse of corporate governance structures by directors, or provide a substantive process for the adequate assessment of disqualified directors to return to their positions of power in companies. Where the Bill seeks to protect shareholders and to introduce an element of stakeholder interest in corporate governance, it fails to deal with the reform of those directly responsible for poor corporate governance in the first place.

It is furthermore a pity that the Bill does not impose a duty on boards or the company to ascertain whether potential directors are disqualified, prior to their appointment.[177] While the provisions regarding the maintenance of the registry of disqualified directors has been kept[178] and there is a duty on the company to not knowingly permit a disqualified person from becoming a director,[179] it is submitted that this provision could have been couched in more prescriptive terms. Presently the JSE listings requirements and the Banks Act[180] require investigation into the background of directors prior to their appointment.

3.9 **Removal of directors**

The right of shareholders to remove a director before his term of office has expired is a far-reaching right, providing shareholders with a measure of control over the directors, and limiting the security of tenure of a director, save where the shareholders are precluded from removing a director by agreement.[181]

Under the Act, notwithstanding anything in a company's memorandum, articles or any agreement between it and any director, the shareholders may remove a director by ordinary resolution, before the expiry of his period of office.[182] Special notice of the proposed removal shall be lodged with the company, and the director has a right to

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[176] *Ex parte Tayob and Another* 1990 (3) SA 715 (T) at 722
[177] King, M; *King Report on Corporate Governance for South Africa 2002*, (Institute of Directors in South Africa), Chapter 7, paragraph 4
[178] Clause 69(13)
[179] Clause 69(3)
[180] Act 94 of 1990
[181] The provision originated from English Company Law, where company control lies very much in the hands of the directors. This provision therefore enabled 'the shareholders to assert themselves against the directors...', from Palmer's *Company Law* 23rd ed at 813 as quoted in *Barlows Manufacturing Co Ltd and Others v RN Barrie (Pty) Ltd and Others* 1990 (4) SA 608 (C) at 611-612 as quoted in van Dorsten, JL, *The law of Company Directors in South Africa*, Second Edition, Meridian Press CC, 1999, page 74
[182] Section 220(1)(a)

be heard on the proposed resolution at the meeting.[183] Where the director has made written representations of a reasonable length and requests their notification to the members, then provided the representations are not received too late, the company will state in the notice that the representations have been made and send a copy to every member of the company.[184] If the representations were not sent out to the members, the director can require that they are read out at the meeting.[185]

The representations will not be sent out or read at the meeting if on application by the company or any other person who claims to be aggrieved, the court is satisfied that the rights under that section of the Act are being used to "secure needless publicity for a defamatory matter".[186] This section potentially allows any person external to the company to make application to stop the representations being read out. The court may also award the company's other person's costs of the application are paid by the director, notwithstanding that he is not a party to the proceedings.[187] A director is still entitled to whatever damages he may have suffered as a result of the termination of his appointment as director.[188]

Under the Bill, although the Memorandum may place the power to appoint directors in anyone's hands, as in the Act, despite anything to the contrary in the Memorandum or rules, or in any agreement between a company and a director, or between the shareholders and a director, a director may be removed from the board by ordinary resolution, voted on by persons entitled to vote in accordance with the removal of that director.[189] Such director must be afforded the opportunity to make representations in person or by way of a representative, to the meeting before the resolution is voted upon.[190]

However, if a company has more than two directors, a shareholder or director may allege that a director is ineligible or disqualified in terms of the Bill, incapacitated, is no longer resident in the Republic where he is the only remaining director in the Republic or he has neglected or been derelict in respect of his duties, in which case, the board must determine by resolution and may remove him.[191] This provision does

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[183] Section 220(2)
[184] Section 220(3)
[185] Section 220(4)
[186] Section 220(5)
[187] Section 220(6)
[188] Section 220 (7)
[189] Clause 71(1)
[190] Clause 71(2)(b)
[191] Clause 71(3)

not appear to be alterable by the Memorandum. This important right to remove directors is therefore shifted to the board in larger companies where the board may be more sympathetic to their fellow directors. Where the company has fewer than three directors, the abovementioned provisions do not apply to it, however, in those circumstances, any shareholder or director may apply to the Companies Ombud to make a determination of ineligibility, disqualification, incapacitation, non-residence, negligence or dereliction of duties, as the case may be.[192]

Similar to the Act, the director must be given a copy of the resolution and a statement setting out the reasons for the proposed resolution, with *sufficient specificity to reasonably permit* the director to prepare and present a response and make a presentation at the meeting before the resolution is voted.[193]

If the meeting finds the director ineligible or disqualified, either the director, *or the person who appointed him* in terms of clause 66(4)(a)(i), may apply within twenty business days to a court to review the decision.[194] This places more power in the hands of the persons named in the Memorandum to secure their right to have their chosen director on the board. Under the Act, the only recourse for the director to overturn a resolution removing him is where the shareholders were bound by agreement not to vote on his removal from office, where removal would amount to breach of contract or wrongful dismissal, or where the director is also a shareholder with sufficient voting power to sway the decision in his favour.[195] These rights are maintained in subsection (9) which preserves the common law in that notwithstanding anything contained in clause 71 of the Bill, any right that a removed director may have at common law to apply to court for damages or other compensation for loss of office or loss of any other offices as a consequence of being removed as a director, is retained.[196]

On the flip side of the coin, where a meeting finds a director not ineligible, disqualified or negligent as the case may be, any director who voted otherwise on the resolution, or any holder of voting rights entitled to be exercised in the election of that director, has the right to apply to court to review the determination of the board.[197]

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[192] Clause 71(8)
[193] Clause 71(4)
[194] Clause 71(5)
[195] van Dorsten, JL, *The law of Company Directors in South Africa*, Second Edition, Meridian Press CC, 1999, page 76
[196] Clause 71(9)
[197] Clause 71(6)

CHAPTER 4
ENHANCED TRANSPARENCY AND ACCOUNTABILITY

Subsequent to the flood of corporate governance scandals worldwide, accountability of the board to the shareholders, and transparency in all dealings of the board and its directors, were considered by some to be paramount in solving the ensuing investment crisis. Shareholders should be best placed to determine whether their company is indeed being operated in their best interests. To what extent does, and should, the Bill cater for the needs of stakeholders? This Chapter seeks to determine whether the Bill indeed goes far enough in its protection of shareholders and stakeholders of large companies through the provisions which seek to enhance transparency and accountability.[198]

4.1 Directors personal financial interests

Under the present Act, a director's duty to disclose his interest in contracts connected to the company or its business exists both at common law as a fiduciary duty and under section 234 of the Act. The purpose of its existence is to ensure that the transaction entered into by the company is one at "arms'-length", in order that a director continues to act openly and in good faith towards the company, being the general body of shareholders. Corporate governance is interested in the extent of the disclosure and to whom it is made. While disclosure to the remaining members of the board would deprive the company of the services of the interested director in relation to such a contract, certain commentators would argue that good governance dictates that the disclosure is made to the shareholders.[199]

At common law, unless the articles provide otherwise, full disclosure must be made to the general meeting who must then sanction the contract.[200] Sanction can therefore take place by ordinary resolution. Under the Act, a director of a company who is directly or indirectly and materially interested in a contract or proposed contract must declare his interest and its full particulars to the board.[201] The contract

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[198] A large aspect of this requirement has been sought to be answered with the new accounting requirements introduced. The changes to the auditing and financial reporting sections of the Bill and the Corporate Laws Amendment Act of 2006 could be the topic of another thesis in itself and accordingly this paper will not be dealing with this section in any great length.

[199] van Dorsten, JL, *The law of Company Directors in South Africa*, Second Edition, Meridian Press CC, 1999, page 260

[200] *Re Faure Electric Accumulator Co* (1888) 40 Ch 141; *Selangor United Rubber Estates Ltd v Craddock* (No.3) [1968] All ER 1073

[201] Section 234

must be of significance in relation to a company's business,[202] and be entered into in pursuance of a resolution taken, or to be taken, at a directors' meeting, or be entered into by a director or officer of the company who either alone, or together with others, has been authorised by the directors to enter into such a contract, or a contract of a similar nature.[203] It is a criminal offence for a director or officer to fail to comply with such provisions of the Act.[204] The declaration of a director's interest must be made at or before the directors' meeting where the question of confirming or entering into the contract is first discussed.[205] If it is in writing, it needs to be read out at the meeting. If the director in question cannot make the declaration at the first meeting, he can make the declaration at the very next meeting and explain why he was unable to provide it at or before the first meeting.[206]

Subject to section 36,[207] and notwithstanding anything to the contrary in the articles, no resolution which concerns a contract or proposed contract referred to in section 234 will be valid unless sections 234 and 235 are complied with.[208] Essentially therefore, the contract will only be valid externally to the company and damages actions for unauthorised acts of the board will flow internally.

The director, or officer, who is materially interested in the contract or proposed contract will, before entering into the contract, declare his interest in the manner prescribed by the Act, and will not enter into such contract unless and until a directors' resolution has been passed approving his entering into the contract.[209] Where a director or officer only becomes materially interested in a contract after it was entered into, he or she must declare his or her interest and its full particulars in a written notice to the directors. It is also a criminal offence to fail to comply with this section.

Every company is obliged to keep at its registered office "or at the office where it is made up", a register of interests in contracts in one official language and the particulars of any declarations made under sections 234, 234(3)(b), 235 or 237.[210] It

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[202] This phrase was considered at length in the decision of *Stellenbosch Farmer's Winery Ltd v Distillers Corporation (SA) Ltd and Another* 1962 (1) SA 458 (A)
[203] Section 234(2)(a) and (b)
[204] Section 234(4)
[205] Section 235
[206] Section 235(2)
[207] Section 36 deals with the *Ultra Vires* doctrine.
[208] Section 236
[209] Section 237
[210] Section 240

is the auditor's duty to satisfy him or herself that the register and declared interests have been minuted in accordance with the Act.[211]

Unlike the Act, the Bill caters for the scenario where a director is the only director but does not hold all the beneficial interests in a company, as well as where a 'related person', as defined,[212] holds a personal financial interest in a matter. Clause 75 explicitly does not apply to the scenario where a director is the only director of a company and holds all the beneficial interests of all the issued shares of that company, in respect of a proposal to remove a director from office, or in respect of a decision which *may* generally affect all of the directors of a company in their capacity as such or a class of persons, even if the director is a member of that class, but not where he or a related person is the only member of that class.[213]

It is unclear how this last exception is to be applied. Is it some form of a business judgment rule in that it is sufficient if a director reasonably believed that the decision may generally affect all the directors and had reasonable grounds for so believing? Alternatively, is it objective in that the decision must have affected all of the directors in some manner? The extent of the word 'generally' would need to be tested in case law.

Where a director is the only director of a company, personal financial interests are to be disclosed to the shareholders.[214] In every other case, disclosure is to the board.[215] Where a person is the *only* director of a company but does not hold all the beneficial interests of all issued shares, he is prohibited from:

(a) approving or entering into any agreement in which he or a related person has a personal financial interest; or

(b) as a director, determining any other matter in which he or a related person has a personal financial interest,

unless the agreement or determination is approved by an ordinary resolution of shareholders after the director has disclosed the nature and extent of that interest to

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[211] Section 241
[212] See footnote 218 below.
[213] Clause 75(2)
[214] Clause 75(3)
[215] Clause 75(4)

the shareholders.[216] Although the use of the word 'after' appears to imply that the director's conduct cannot be ratified by the resolution *ex post facto*, subsection (7)(b) specifically states that a decision, transaction or agreement is valid despite any personal financial interest of a director if it has been ratified by an ordinary resolution of shareholders. Further to this, any interested person may apply to court to declare a transaction or agreement, approved by the board or shareholders in which a director failed to disclose information as required by the section, to be valid.[217]

In terms of clause 2 of the Bill, natural persons are related if they are married, or live together in a relationship similar to marriage, or are separated by no more than three degrees of natural or adopted consanguinity[218] or affinity.[219] Natural and juristic persons are related if the individual directly or indirectly controls the juristic person in accordance with subsection (2).[220] Two juristic persons are related if either of them controls the other or the business of the other as determined in subsection (2), either one is a subsidiary of the other, or a person directly or indirectly controls each of

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[216] Clause 75(3)

[217] Clause 75(8)

[218] One will recall from the law of persons that consanguinity is based on descent from a common ancestor, hence the root of the word *blood* from the word *sanguine*. Consanguinity is divided into relationships in the direct line, where persons are descended from each other, and relationships in the collateral line, relationships between persons who share a common ancestor[218]. According to Boberg, 'each step of ascent or descent between the persons in question, along a route starting with the one, passing upwards to the first common ancestor and downwards again to the other, is a degree.'[218] A grandson and his great-grandfather are related in the third degree by consanguinity. So too are an aunt or uncle and a niece or nephew related in the third degree. Siblings are the closest collateral relations being in the second degree. There is no first degree collateral. Cousins, being relations in the fourth degree, are thus allowable relations. So too are second cousins. (Boberg, Law of Persons)

[219] Affinity is where persons are related through marriage. The relationships subsist between a person and his or her spouse's relations. Mothers-in-law and fathers-in-law and their daughters-in-law and sons-in-law are related in the first degree by affinity. Step brothers and sisters with no common ancestors are not related at all, as is the case with spouses of siblings, and therefore permitted. (Boberg, Law of Persons)

[220] Clause 2(2):

"For the purpose of subsection (1), a person controls a juristic person, or its business, if –

(a) in the case of a juristic person that is a company –
  (i) that juristic person is a subsidiary of that first person, as determined in accordance with section 3(1)(a); or
  (ii) that first person, together with any related or inter-related person, is –
    (aa) directly or indirectly able to exercise or control the exercise of a majority of the voting rights associated with securities of that company, whether pursuant to a shareholder agreement or otherwise; or
    (bb) has the right to appoint or elect, or control the appointment or election of, directors of that company who control a majority of the votes at a meeting of the board;
(b) in the case of a juristic person that is a close corporation, that first person owns the majority of the members' interest, or controls directly or has the right to control, the majority of members' votes in the close corporation;
(c) in the case of a juristic person that is a trust, that first person has the ability to control the majority of the votes of the trustees or to appoint the majority of the trustees, or to appoint or change the majority of the beneficiaries of the trust; or
(d) that first person has the ability to materially influence the policy of the juristic person in a manner comparable to a person who, in ordinary commercial practice, would be able to exercise an element of control referred to in paragraph (a), (b) or (c)."

them or the business of each of them, as determined in accordance with subsection 2. Three or more persons are inter-related if the first and second such persons are related, the second and third such persons are related and so forth, in an unbroken series.

It is submitted that for the sake of clarity and certainty, as in the Model Corporations Act, the Bill should have spelt out the degrees of consanguinity. The Model Corporations Act defines a related person of a director as his child, grandchild, sibling, parent, or any spouse thereof or his spouse, spouse's parent or sibling, or an individual having the same home as the director or a trust or estate of which an individual specified above is a substantial beneficiary, or a trust, estate, incompetent, conservatee or minor of which the director is a fiduciary.[221] The Bill's prohibited relations are, rightfully it is submitted, wider than those of the Model Corporations Act.

"*Personal financial interest*" in relation to a person is defined in clause 1 as meaning 'a direct financial interest of that person, of a financial, monetary or economic nature, or to which a monetary value may be attributed, but [b] does not include any interest held by a person in unit trust or collective investment scheme in terms of the Collective Investment Schemes Act, 2002 (Act No.45 of 2002), unless that person has direct control over the investment decisions of that fund or investment.'

Unlike in the Act, materiality is not a prerequisite for disclosure. The 2007 draft of the Bill used the words "conflicting personal interest". It would appear therefore that all direct financial, economic or monetary interests of any nature and size must be disclosed, and it remains for the board and shareholders, or just shareholders where there is only one director, to determine whether the interest is material or conflicting.

Where a director of a company other than a company under subsection (2)(b) or (3)[222], has a personal financial interest in a matter to be considered at a board meeting, or knows that a related person has a personal financial interest in the matter, that director is mandated to follow certain steps detailed in the Bill.[223]

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[221] §8.60(3) Model Business Corporations Act

[222] In other words, not a company where a director holds all the beneficial interests of all the issued share capital of the company and is the only director, or a company where a person is the only director but does not hold all the beneficial interests of all the issued share capital.

[223] In terms of Clause 73(3), the director must:

(a) *must* disclose the interest and its general nature before the matter is considered at the meeting;

If a director acquires a personal financial interest in an agreement or other matter in which the company has a material interest, or knows that a related person has acquired a personal financial interest after the agreement or other matter was approved by the company, the director must *promptly* disclose to the board[224] the nature and extent of the interest and the material circumstances relating to the director or related person's acquisition of that interest.[225]

Like the Model Corporations Act, the Bill requires disclosure to the board. Alarmingly, clause 75(5)(d) mandates exactly what the rule was aimed at preventing: the director is required to leave the meeting and not vote on any matter regarding the contract. The company therefore loses the benefit of his expertise in relation to that matter. While it is conceivable that many directors would prefer that disclosure is made to a more sympathetic board, it is submitted that the decision to sanction personal interests in contracts should remain with the shareholders, who are less likely to be unduly permissive.

Comparably, the Model Corporations Act adopts a "bright-line" test by defining 'conflicting interest' as the interest a director has in respect of a transaction whether effected or proposed, if the director knows at the time of commitment that he or a related person is a party to transaction or has a beneficial interest in or is so closely linked to the transaction and of such financial significance to the director or a related person that the interest would reasonably be expected to exert an influence on the director's judgment if he was called on to vote on the transaction.[226]

(b) *must* disclose to the meeting any material information relating to the matter, and known to the director;
(c) *may* disclose any observation or pertinent insights relating to the matter if requested to do so by the other directors;
(d) if present at the meeting, *must* leave the meeting immediately after making any disclosure contemplated in paragraph (b) or (c);
(e) *must not* take part in the consideration of the matter, except to the extent contemplated in paragraphs (b) and (c);
(f) while absent from the meeting in terms of this subsection –
    (i) is to be regarded as being present at the meeting for purpose of" a quorum for the constituting of the meeting; and
    (ii) "is not to be regarded as being present at the meeting for the purpose of determining whether a resolution has sufficient support to be adopted; and
(g) *must not* execute any document on behalf of the company in relation to the matter unless specifically requested or directed to do so by the board."

'Material information' is not defined in the Bill. My italics have been used above.

[224] Disclosure is to the shareholders where a director is the only director.

[225] Clause 75(6)

[226] § 8.60(1)(i). § 8.60(1)(ii) deals with disclosure in relation to other parties having an interest in the transaction who are related to the director in some manner.

The "bright-line" test of the United States is preferable in that it brings more to bear on the mind of the director. The transaction must be of such significance to the director that his judgment would reasonably be swayed in voting. This requirement hits at the crux of the purpose of the provision – namely, that not all transactions are of such a nature that a director would reasonably be swayed in his voting. The manner in which this clause has been drafted in the Bill is too wide, allowing almost any transaction to fall within its scope, and it is submitted that it should include an element of materiality and some requirement that the director knew at the time of entering into the transaction that he was required to make the disclosure.

4.2 Standards of director's conduct

Directors and certain officers of a company are required to display a standard of conduct towards their company. This standard is encompassed under two duties: the fiduciary duties and the duty of care and skill. These duties are to a certain extent contained in the Act, but are generally to be found in our history of case law and their interpretation by our courts.

The fiduciary duties are broadly, the duty not to exceed their powers,[227] the duty to exercise their powers for a property and authorised purpose, which can be broken down into the duties to act *bona fides* in the best interests of the company as a whole and not to exercise their powers for a purpose not authorised by the memorandum or articles,[228] the duty to exercise independent and unfettered discretion,[229] the duty not to act for the company in a matter in which a director has an interest and the duty to disclose a director's interest in a company contract; the duty not to make a secret profit without the consent of the company,[230] the duty not to take corporate opportunities,[231] the duty not to act in competition with the company[232] and the duty

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[227] See *Bellairs v Hodnett* 1978 (1) SA 1009 (A) and *Atlas Organic Fertilizers (Pty) Ltd v Pikkewyn Gwhano (Pty) Ltd* 1981 (2) SA 173 (T)

[228] See *Dodge v Ford Motor Co* 170 NW 668 (Mich 1919); *Parke v Daily News* [1962] 2 All ER 929; *Hogg v Cramphorn* [1966] 3 All ER 420 (Ch); *Howard Smith v Ampol Pertroleum Ltd* [1974] 1 All ER 1126 (PC)

[229] See *Selangor United Rubber Estates Ltd v Cradock* [1968] 2 All ER 1073; *Coronation Syndicate v Lilienfeld and the New Fortuna Co Ltd* 1903 TS 489; *Fulham Football Club v Cabra Estates PLC* [1994] 1 BCLC 363

[230] See *Regal (Hastings) Ltd v Gilliver* [1942] 1 All ER 378 (HL); *Gencor ACP Ltd v Dalby* [2000] BCLC 734; *Inland Export Finance Ltd v Umunna* [1986] BCLC 460; *Peso Silver Mines Ltd v Cropper* (1966) 56 DLR 2d 1

[231] See *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168; *Industrial Development Consultants Ltd v Cooley* [1972] 2 All ER 162; *Bellairs v Hodnett supra* at fn 98

[232] *Atlas Organic Fertilizers (Pty) Ltd v Pikkewyn Gwhano (Pty) Ltd supra* fn 98 and *Bellairs v Hodnett supra* fn 98

not to use confidential information for the director's own purposes or to disclose confidential information of the company.

The duty of care and skill as it stands in the common law is the duty to treat the company with the same care as a the proverbial "reasonable man" would in conducting his own affairs and the same degree of skill which may reasonably be expected from someone of that director's own knowledge and experience. Encapsulated in the duty of care and skill is what is known as the "Business Judgment Rule".[233]

The debate over whether director's duties should be codified is a long-standing one.[234] The duties are in many instances vague, unclear and confusing and arguably the majority of directors today would not be able to name the full set of duties which they owe to their company. Surely directors could only benefit from having some manner of educating themselves in respect of what is required of them?

King argued strongly in favour of codifying these duties in legislation, and published along with the first King Report in 1994, a Code of Best Practice, setting out the responsibilities of directors on a board. However the counter-argument is that it would be impossible to include the duties in all their nuances in legislation or codified form without leading to an erosion of the duties as they presently stand at common law. The middle ground adopted at least as far as the 2007 draft was concerned, was to codify the duties to a certain extent, while retaining a provision referring to the preservation of the common law relating to these duties.

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[233] Discussed further below.
[234] Esser & Coetzee; *Codification of director's duties – an option for South Africa?*; The Quarterly Law Review for People in Business, Volume 12, Part 1, pg 26

Subclauses 3(a) and (b) of clause 76[235] echo the common law fiduciary duties while subclause 3(c) contains the duty of care and skill. The Bill retains the traditional subjective-objective approach in respect of the latter duty in requiring that a director must act with the standard of care, skill and diligence that may reasonably be expected of a person (objective) carrying out the same functions in relation to the company as those carried out by that director (subjective) and having the general knowledge, skill and experience of that director (objective). Directors are not required

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[235] Clauses 76(2) to (4) state as follows:

"(2) A director of a company must –

(a) not use the position of director or any information obtained while acting in the capacity of a director–

(i) to gain an advantage for the director, or for another person other than the company or a wholly-owned subsidiary of the company[235]; or

(ii) to knowingly cause harm to the company or a subsidiary of the company; and

(b) communicate to the board at the earliest practicable opportunity any information that comes to the director's attention, unless the director –

(i) reasonably believes the information is –

(aa) immaterial to the company; or

(bb) generally available to the public, or known to the other directors; or

(ii) is bound not to disclose that information by a legal or ethical obligation of confidentiality.

(3) Subject to subsections (4) and (5), a director of a company, when acting in that capacity, must exercise the powers and perform the functions of director –

(a) in good faith and for a proper purpose;

(b) in the best interests of the company; and

(c) with the degree of care, skill and diligence that may reasonably be expected of a person –

(i) carrying out the same functions in relation to the company as those carried out by that director; and

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

(4) In respect of any particular matter arising in the exercise of the powers or the performance of the functions of director, a particular director of a company –

(a) will have satisfied the obligations of subsection (3)(b) and (c) if –

(i) the director has taken reasonably diligent steps to become informed about the matter;

(ii) either –

(aa) the director had no material personal financial interest in the subject matter of the decision, and had no reasonable basis to know that any related person had a personal financial interest in the matter; or

(bb) the director complied with the requirements of section 75 with respect to any interest contemplated in subparagraph (aa); and

(iii) the director made a decision, or supported the decision of a committee or the board, with regard to that matter, and the director had a rational basis for believing, and did believe, that the decision was in the best interests of the company; and

(b) is entitled to rely on –

(i) the performance by any of the persons –

(aa) referred to in subsection (5); or

(bb) to whom the board may reasonably have delegated, formally or informally by course of conduct, the authority or duty to perform one or more of the board's functions that are delegable under applicable law; and

(ii) any information, opinions, recommendations, reports or statements, including financial statements and other financial data, prepared or presented by any of the persons specified in subsection (5)."

to have any particular standard of skill or knowledge, so they can only be held against their own standards, provided that a reasonable person in their position would have acted the same.[236]

Subsection (5), being a list of persons whom a director may rely upon in the performance of his duties, is an innovation in the Bill, which we have not seen in South African legislation previously. Persons expressly mentioned are employees of the company whom the director reasonably believes are reliable and competent in the functions performed or the information, opinions, reports or statements provided as well as legal counsel, accountants, or other professional persons retained by the company, the board or a committee as to matters involving skills or expertise the director reasonably believes are matters within the particular person's professional or expert competence, or as to which the particular person merits confidence.[237]

Subsections (4) and (5) are a statutory form of the Business Judgment Rule ("the Rule"), as developed through our case law and originating in the United States.[238] The Rule limits the stringent effect of the duty of care and skill in that a director who was in the circumstances, sufficiently informed about his decision such that it was a rational and reasonable decision is absolved from personal liability where the decision was wrong or harmful to the company. The Rule's roots lie in the acknowledgment that the most difficult decisions to assess are business decisions. Without the benefit of hindsight it is almost impossible, even after having evaluated all the risks, to judge with certainty, at the outset, whether a business judgment will be correct. The Rule therefore prevents a situation where judicial officers, with the benefit of hindsight, judge that a business decision was taken incorrectly and penalise a director accordingly. The inevitable result of such an approach is to hamper entrepreneurship and informed risk-taking. Trial and error has taught us that business is about taking risks –the higher the risk, the higher the reward.

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[236] It was stated in *Re Brazilian Rubber Plantations and Estates Ltd* [1911] 1 Ch 425 (CA) at 437 that '[a] director's duty has been laid down as requiring him to act with such care as is reasonably to be expected from him, having regard to his knowledge and experience. He is, I think, not bound to bring any special qualifications to his office. He may undertake the management of a rubber company in complete ignorance of everything connected with rubber, without incurring responsibility for the mistakes which may result from such ignorance, while if he is acquainted with the rubber business he must give the company the advantage of his knowledge when transacting the company's business.'

[237] A director is also entitled to rely on a committee of the board of which the director is not a member, unless the director has reason to believe that the actions of the committee do not merit confidence.

[238] Jones, E; *Directors' Duties: Negligence and the Business Judgment Rule*; (2007) 19 SA Merc LJ pg. 326

The 1994 King report recommended that the Rule be brought into the Act to limit the duty of care and skill in the hope that it would encourage commercial ventures through informed risk-taking. At the time, King faced numerous counter-arguments, including, firstly that the Rule blurred the distinction between the fiduciary duties and the duty of care and skill. Secondly, an examination of the Act reveals that section 248 already to some extent codified the Rule.[239] Thirdly, our case history has not been inundated with cases of liability for breach of the duty of care and skill, thus there is clearly not a dire need to reduce potential liability of directors even further.[240]

The approach taken by the Bill in codifying the Rule is far wider than the provisions of section 248. Not only must the director have acted reasonably and honestly, but he must have taken reasonably diligent steps to become informed about his decision, he must have had no material interest in the matter or declared his interest, and he must have had a rational basis for honestly believing in his decision. The objective elements in the codified Rule therefore temper it and make it, it is submitted, a far more reasoned, practical and therefore favourable approach to section 248. Directors who read the Bill will now have more of a sense of what is required of them, in making business decisions. While it is true that case law has not revealed a dire need to incorporate the Rule in legislation, in doing so, South Africa is keeping abreast with international developments.

A comparative analysis reveals that section 180(2) of the Australian Corporations Act, states as follows:

> 'A director or other officer of a corporation who makes a business judgment is taken to meet the requirements of subsection (1), and their equivalent duties at common law and in equity, in respect of the judgment if they:
>
> (a) make the judgment in good faith and for a proper purpose; and
> (b) do not have a material personal interest in the subject matter of the judgment; and
> (c) inform themselves about the subject matter of the judgment to the extent that they reasonably believe to be appropriate; and
> (d) rationally believe that the judgment is in the best interests of the corporation.

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[239] Section 248 states that in proceedings for negligence, default, breach of duty or breach of trust against a director, officer or auditor of a company, where the Court finds the person is liable or may be liable, but that he had acted honestly and reasonably, and that, regarding all the circumstances of the case, he ought fairly to be excused for his liability, the court can relieve him from liability, partially or wholly. Before the proceedings against the director, officer or auditor are instituted, he or she may, if he or she believes such proceedings will be instituted, apply to the court for relief him or herself, and the court will have the same powers of absolution.

[240] Jones, E; *Directors' Duties: Negligence and the Business Judgment Rule*; (2007) 19 SA Merc LJ pg. 326

> The director's or officer's belief that the judgment is in the best interests of the corporation is a rational one unless the belief is one that no reasonable person in their position would hold.'

The Australian approach has followed the subjective method in the requisite elements numbered (a) to (d) which are then tempered by the objective 'reasonable man' standard thereunder. Furthermore, the Model Corporations Act similarly contains a codification of the Rule.

An interesting approach has been adopted in the United Kingdom in section 172(1) of their Companies Act. The provision dealing with a director's duty to promote the success of the company is particularly interesting for the reason that in determining what is in the interests of the shareholders, it provides somewhat of a guide to directors as to who the company is, and in doing so, has indirectly introduced an element of enlightened shareholder model. Headed "[d]uty to promote the success of the company", the provision goes on to state that "[a] director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its *members as a whole,*[241] and in doing so, have regard (amongst other matters) to—

> (a) the likely consequences of any decision in the long term,
> (b) the interests of the company's employees,
> (c) the need to foster the company's business relationships with suppliers, customers and others,
> (d) the impact of the company's operations on the community and the environment,
> (e) the desirability of the company maintaining a reputation for high standards of business conduct, and
> (f) the need to act fairly as between members of the company."

Furthermore, the provision spells out how it is to be utilised by directors. It states that where the company's purpose is other than to benefit its members, then directors can consider that in promoting the objectives of other stakeholders they are in effect promoting the interests of the company.[242] These duties are subject to enactments or rules requiring the consideration of creditor's rights.[243]

In comparison, South Africa's provision on directors' duties, in so far as it would point to an enlightened shareholder model, is still disappointingly conservative.

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[241] My italics
[242] UK Companies Act, 2006, Section 172(2)
[243] Section 172(3)

The concern with legislating director's standards of conduct when there is a wealth of case and common law on the subject runs the risk of usurping the delicate development of this important part of our law. The 2007 draft Bill was a compromise position in that Clause 91(6) retained the common law, by referring to the duties in the section being concurrent with or in addition to those under the common law. The 2008 draft does not mention the word 'common law' in the entire section dealing with directors' standards of conduct. Should this omission have been a glaring error, the reality is that litigating on this section would not be problematic since it is noted under clause 77(2), that a director's liability is linked to his breach of a common law fiduciary duty. Thus, where a judge is faced with a decision dealing with an allegation of breach of a fiduciary duty, the legislation enjoins him to refer to the common law.

Mindful of the fact that the Act may be taken to supplant centuries of common law, the United Kingdom makes mention of the common law in codifying the directors' duties twice. Firstly, section 170(3) stipulates that: "[t]he general duties are based on certain common law rules and equitable principles as they apply in relation to directors and have effect in place of those rules and principles as regards the duties owed to a company by a director." Secondly, subsection (4) states that: "[t]he general duties shall be interpreted and applied in the same way as common law rules or equitable principles, and regard shall be had to the corresponding common law rules and equitable principles in interpreting and applying the general duties."[244]

4.3 Liability of directors and prescribed officers

The instances of directors' liability under the Act are numerous, although the Bill takes a noticeable step away from criminal sanction. For the purposes of good governance, legislation dealing with the liability of directors is important in relation to whom the liability is extended. The provisions extending personal liability should ensure that the contraventions are sufficiently serious in order to prevent instilling fear in directors from taking business risks and decisions.

As mentioned in paragraph 4.2 above, while the common law is no longer referred to by name in relation to specifying a director's duties under the Bill, reference thereto is

[244] The duties applicable to shadow directors are also the same as they would be in the common law – Section 170(5).

found in clause 77, dealing with directors' liability.[245] Subsection (2) specifies that a director may be held liable, *inter alia*, "in accordance with the principles of the common law relating to breach of a fiduciary duty for any loss, damages or costs sustained by the company as a consequence of any breach by the director of a duty contemplated in" the section dealing with disclosure of personal financial interests, use of his position or information obtained whilst acting as a director to gain an advantage for the director or to knowingly cause harm to the company or its subsidiary, or for failing to act in good faith and for a proper purpose or in the best interests of the company.

Furthermore, loss, damages or costs sustained by a company in accordance with the common law of delict for breach the duty of care and skill, any other provision of the Bill, or any provision of the Memorandum, can also be claimed from a director.[246] It is submitted that this provision should adequately cure the lacuna in the codification section.

The Companies Act of the United Kingdom, while retaining reference to the common law in the codification sections, similarly makes mention of the common law in setting out the consequences of breach of the codified directors' duties in stating that "[t]he consequences of breach (or threatened breach)...are the same as would apply if the corresponding common law rule or equitable principle applied."[247]

Under the Act, directors can be held personally liable for the debts of the company where they permit an unauthorised loan to be made to a holding company or fellow subsidiary,[248] where personal liability is provided for in the memorandum,[249] where the company commences business before the issue of a certificate to commence business,[250] where there has not been proper use or disclosure of the company's name and registration number,[251] where the directors have misapplied, retained or liable or accountable for the company's money or property,[252] where they carry on company business recklessly or fraudulently,[253] where a director fails to ensure that a

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[245] This was also the case in clause 93(6) of the 2007 draft stating: "[t]he provisions of this section are in addition to any rule of the common law that is consistent with this section."
[246] Clause 77(2)
[247] Section 178(1) UK Companies Act
[248] Section 37(3)
[249] Section 53
[250] Section 172(5)(b)
[251] Section 50(3)
[252] Section 423
[253] Section 424

company's stationery and negotiable instruments contain the company's name and registration number,[254] where the company's auditor resigns and the directors fail to fill the vacancy created within three months[255] and where the director is guilty of insider trading.[256] A director's liability for breach of fiduciary duties is considered *sui generis* and the director is liable to the company for their breach.[257] Breach of certain duties may attract criminal sanction.[258]

The Bill states in somewhat of a laundry-list fashion, instances other than those mentioned in subclause (2) where a director may attract liability. He can be held liable for loss, damages or costs sustained by the company as a direct or indirect consequence of the director having acted for the company or binding the company in any way, knowing he lacked the authority to do so,[259] where he acquiesced in the company carrying on business recklessly, with gross negligence, with intent to defraud, for any fraudulent purpose or under insolvent circumstances,[260] where he was party to an act or omission by the company despite knowing such act or omission was calculated to defraud a creditor, employee or shareholder of the company, or had another fraudulent purpose,[261] where he signed, consented to or authorised the publication of false or misleading financial statements, or a prospectus or written statement containing an untrue statement, or a statement to the effect that a person consented to act as a director where no such consent was given, and the director knew the statement was false, misleading or untrue,[262] where he was present at and participated in the making of a decision being adopted by written consent of the majority of directors in terms of clause 74 and he did not vote against (i) the issuing of unauthorised shares, despite knowing the shares hadn't been authorised in terms of clause 36,[263] (ii) issuing authorised securities, despite knowing the issue was inconsistent with clause 41,[264] (iii) granting options to persons contemplated in

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[254] Section 50
[255] Section 280
[256] The Insider Trading Act, 135 of 1998
[257] *Cohen NO v Segal* 1970 (3) SA 702 (W) at 706
[258] Such as acting fraudulently or recklessly and insider trading.
[259] Clause 77(3)(a)
[260] Clause 77(3)(b)
[261] Clause 77(3)(c)
[262] Clause 77(3)(d). Here, the provisions of clause 104(3) limit may the liability of the director in that he is absolved from liability where the statement did not purport to be the statement of an expert, and he believed that the statement was true and had reasonable grounds to believe so, and where the statement does purport to be the statement of an expert, it was a correct and fair copy of an extract from the report or valuation and the person had reasonable grounds to believe and did believe the expert was competent to make the statement and consented to the issue of the prospectus and didn't withdraw the consent before the prospectus was filed or before any allotment under the prospectus or before acceptance of the offer.
[263] Clause 77(3)(e)(i)
[264] Clause 77(3)(e)(ii)

terms of clause 42(2), despite knowing that authorisation in terms of clause 36 had not taken place[265], (iv) providing financial assistance in a manner inconsistent with clause 44,[266] (v) providing financial assistance to directors in a manner inconsistent with the Memorandum,[267] (vi) a resolution approving a distribution contrary to clause 46,[268] (vii) a buy-back contrary to clause 46 or 48,[269] (vii) an allotment contrary to the relevant provision of Chapter 4 of the Bill.[270] The list of instances of liability in the Bill appears to exceed that in the Act.

Where the board made a decision contrary to the Bill in terms of the provisions stipulated in (i) to (viii) above, the company or any director who has been or may be held liable for contravention of the section can apply to court for an order setting aside the board's decision. The court can make an order setting aside the decision as requested, in whole or in part, absolutely or conditionally, and any further order that is just and equitable including an order to rectify the decision, reverse any transaction or restore any consideration paid and requiring the company to indemnify any director who has been or who may be liable under the section, including indemnification for the costs of the proceedings under the section.[271] It would appear therefore that only the shareholders in general meeting are afforded the right to apply to court to set aside a decision of the board.

Liability under the clause is joint and several[272] and is limited by a three year prescription period arising from the date of the act or omission giving rise to the liability.[273] Subclause (9) provides a further element of Business Judgment Rule protection for a director under proceedings other than for wilful misconduct or wilful breach of trust. Where a director is or will be liable, but has acted honestly and reasonably and having regard to the circumstances of the case, it would be fair to excuse the director, the court may excuse him wholly or in part. The proceedings in respect of wilful misconduct or wilful breach of trust are excluded since a director can never be excused for intentionally acting in a manner inconsistent with his duties towards his company.

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[265] Clause 77(3)(e)(iii)
[266] Clause 77(3)(e)(iv)
[267] Clause 77(3)(e)(v)
[268] Clause 77(3)(e)(vi)
[269] Clause 77(3)(e)(vii)
[270] Clause 77(3)(e)(viii)
[271] Clause 77(5)
[272] Clause 77(6)
[273] Clause 77(7)

4.4 Indemnification and Director's Insurance

Another important aspect of any corporate governance regime concerns to what extent a company may indemnify a director for negligence in carrying out his duties and whether the company is entitled to insure the director against such an eventuality. The balance that is required to be struck here is between a shareholder's interest in the company not indemnifying directors for matters where they should rightfully be held personally liable, and allowing a director the freedom to take informed business risks without fear of personal liability.

Section 247 of the Act is formulated as a general prohibition coupled with an exception. The starting point is, correctly, that any provision purporting to exempt any director, officer or auditor from liability in respect of negligence, default, breach of duty or breach of trust, or to indemnify him from any such liability is void. The exception to this prohibition is that the company may take out insurance as indemnification against any liability of any director or officer towards the company, for negligence, default, breach of duty or breach of trust.

A company is entitled to indemnify a director, officer or auditor for any liability incurred in defending legal proceedings in which judgment is given in his favour or in which he is acquitted or in which legal proceedings are abandoned, or in connection with an application under section 248 in which relief is granted to him by the court.[274]

The Bill retains much of the provisions of the Act, but goes further in certain respects. 'Director' includes alternate director, prescribed officer, a member of a board committee or the audit committee and, for the reasons stated above, *ex officio* directors.[275] It is express in stating that any provision in any agreement, the Memorandum or rules or a resolution to the extent that a director is absolved from liability for breach of a duty in section 75 (failing to disclose a personal financial interest), clause 76 (failing to act in accordance with a directors' standards of conduct) or liability under section 77, or which negates or limits any legal consequences for wilful misconduct or wilful breach of trust by a director, is void.[276]

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[274] Section 247(2)
[275] Clause 78
[276] Clause 78(2)

Unless the Memorandum provides otherwise, the company may advance expenses to a director to defend legal proceedings arising out of his service to the company and may directly or indirectly indemnify a director for litigation expenses if the legal proceedings are abandoned or exculpate the director, or if they arise in respect of any liability for which the company may indemnify the director in terms of subsections (4) and (5) of clause 78.[277]

A company may not indemnify a director for any liability arising from section 77(3)(a), (b) or (c),[278] or any wilful misconduct or wilful breach of trust.[279] A company can indemnify a director for anything other than the above, except to the extent that the Memorandum provides otherwise.[280]

A company may purchase insurance to protect a director against liability or expenses against which the company is entitled to indemnify such director in terms of subsection (4); and to protect the company against the expenses it is entitled to advance or indemnify the director in respect of subsections (3)(a) and (b) and any liability which the company is entitled to indemnify the director against in terms of subsection (4), except to the extent stated otherwise in the Memorandum.[281] It is submitted that this clause in the Bill successfully achieves the intended balance highlighted above.

4.5 **Access to Information for Shareholders**

It is essential for purposes of corporate governance that shareholders are in a position to access information about their company's financial position, in order to make informed decisions. The debate between the drafters of the Bill was whether these access rights should be extended beyond shareholders to other interested persons.

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[277] Clause 78(3)
[278] Clause 77(3): where a director caused loss, damages or costs to the company (a): in acting in the name of the company, signing anything on behalf of the company or purporting to bind the company or authorise the taking of any action by or on behalf of the company, despite knowing the director lacked the authority to do so; (b) where a director acquiesced in the carrying on of the company's business despite knowing that it was being conducted in a manner prohibited by section 22(1); or (c) by being a party to an act or omission by the company, despite knowing that the act or omission was calculated to defraud a creditor, employee or shareholder of the company, or had another fraudulent purpose.
[279] Clause 77(5)
[280] Clause 77(4)
[281] Clause 77(6)

Part C of Chapter 2 of the Bill is headed 'transparency, accountability and integrity of companies'. Within this part of the Bill are provisions dealing specifically with access to information by shareholders.

Clause 26 enables persons having a beneficial interest in any securities of a company to inspect and copy the company's Memorandum and any amendments thereto and the company's rules, a record of the directors including details of any person who served as a director for a period of seven years after the person ceased to act as director and all the information contained in the company's record of directors, reports presented at the annual general meeting,[282] annual financial statements,[283] notices and minutes of all shareholder meetings including all resolutions[284] and any document made available by the company to the holders of securities in relation to such resolution, copies of any written communication sent generally by the company to all holders of any class of shares[285], the company's security register, the company's register of company secretaries and auditors, if applicable to such company[286] and any information accessible in terms of additional information rights granted by the Memorandum.[287]

Such rights of access can either be exercised by direct application to the company in writing or in accordance with the provisions of the Promotion of Access to Information Act ("PAIA")[288].

Furthermore, the Bill expressly mentions that the rights of access granted in terms of the clause are in addition to any rights under section 32 of the Constitution, PAIA or any other public regulation.[289] It is an offence for the company to fail to accommodate any reasonable request for access or to unreasonably refuse access to a record which a person has a right to inspect or to otherwise impede, interfere with, or attempt to frustrate the reasonable exercise by any person of the rights under clause 26.[290]

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[282] For seven years after such meeting.
[283] For seven years after the statements were issued.
[284] For seven years after the adoption of such resolutions.
[285] For a period of seven years after the date on which the communication was issued.
[286] All contained in clause 26 of the Bill, 2008.
[287] But such rights may not negate or diminish any mandatory protection of any record as set out in Part 3 of the Promotion of Access to Information Act, 2 of 2000.
[288] 2 of 2000
[289] Clause 26(3)
[290] Clause 26(5)

Clause 31 provides that in addition to the clause 26 rights, a person holding or having a beneficial interest in any securities in a company is entitled without demand, to receive notice of the publication of any annual financial statements, setting out the steps required to obtain a copy of the statements[291] and on demand, to receive without charge a copy of *any* annual financial statements of the company.[292]

Clause 31 goes on to provide important rights to judgment creditors which will assist greatly in insolvency proceedings. Where a judgment creditor receives a *nulla bona* return from the sheriff in relation to the movable property of the company, within five days of making a demand, the judgment creditor is entitled to receive without charge, a copy of the latest annual financial statements of the company or where the company is required to produce annual financial statements, financial statements dated no more than sixty business days before the date on which they are provided to the judgment creditor.[293]

Currently, the position regarding access to information by shareholders as stated by the Supreme Court of Appeal in the case of *Clutchco v Davis*,[294] is that a shareholder has no right of sight of the minutes of directors' and managers' meetings maintained in terms of section 242 or the accounting records of first entry maintained in terms of section 284.[295] Where a shareholder wishes to have access to items to which he is not entitled in terms of the Act, in terms of PAIA, he is required to that the access sought is 'required' for the exercise of protection of the rights being asserted, which in that case were the section 252 rights to relief from oppressive or prejudicial conduct.[296]

Clause 26 of the Bill has been criticised as not being 'not sufficiently wide enough to over outside parties...[like] the public [and] the media – the focus is on holders of a "beneficial interest" in the company.'[297] Furthermore, the DTI have conceded that as

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[291] Clause 31(1)(a)
[292] Clause 31(1)(b). My italics.
[293] Clause 31(2)(a) and (b)
[294] 2005 (3) SA 486 (SCA)
[295] *Ibid*, at [14], although a shareholder is entitled to receive copies of the annual financial statements (ss286, 302 and 309) and to obtain copies of the minutes of the company's general meetings (ss204 and 206).
[296] *Ibid*, at [18]. The facts of this case showed that the Respondent's complaints were not of a serious enough nature. There was no detailed criticism of the auditors advanced and the Respondent's modus operandi in wanting to reconstruct the books of the company were not detailed enough or accompanied by the reports of experts. The decision of the court *a quo* in granting access to the records was therefore overturned.
[297] Fraser, G; Companies Act Online, Issue 21, pg 4 at www.companiesactonline.co.za

with section 113 of the Act, the register of members should be open for inspection by directors and members.[298]

If we follow the reasoning of the Supreme Court in *Clutchco*, then there may be sound reasons for denying access to members of the public in general to certain company records.[299] It is submitted that, contrary to the above criticisms of the Bill, clause 26 as it presently stands, coupled with the right to resort to PAIA, caters for sufficient access to the correct interest holders. While it is arguable that an enlightened shareholder value model of corporate governance would dictate that access should be provided to a greater variety of stakeholders, companies that do not ordinarily have to publish their financial information to the general public should not be made to provide access to their financials to simply any person for any reason.

In terms of clause 33 of the Bill, every company is required to file an annual information return after the end of its financial year. It is presumed that this will be filed with the Companies Commission. This must be adhered to within the prescribed period, be in the prescribed form and accompanied by the prescribed fee.[300] The clause states that the company must include in the return a copy of its annual financial statements, if it is required to prepare such statements and any other prescribed information.[301] In every such annual return, the company must delegate a director, employee or other person who is responsible for the company's compliance with the requirements of Part C, as well as Chapter 3, if applying to such company.

The clause is clearly applicable to all companies, regardless of the size of the company. Whether the provision is unduly burdensome to the small family-owned enterprise remains to be seen and would depend largely on the size of the return and the type of information that is required to accompany it. It is also unclear what the consequences of the failure to submit the return will be or what the liability of the prescribed director, employee or other person, for false, untrue, inaccurate or misleading information contained therein. If the information return is purely for the purposes of the Commission and will not be published or available for public or at last, shareholder or other stakeholder scrutiny, it is questionable what the purpose of

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[298] *Ibid*

[299] *Clutchco ibid* at 277. At [17] the court stated that '[i]n enacting PAIA, Parliament could not have intended that the books of the company, great or small, should be thrown open to members on a whiff of impropriety or on the ground that relatively minor errors or irregularities have occurred.'

[300] Presumably, this will be stipulated in regulation by the Minister.

[301] Clause 33(1)(a) and (b)

the return is and whether the Commission will *mero motu* take any steps against a company should it discover that an investigation of a company is warranted by virtue of the information return it has submitted.

4.6 Enhanced accountability and transparency under Chapter 3

The entire third chapter of the Bill consists of provisions devoted to enhancing transparency and accountability. These provisions are, rightfully it is submitted, applicable to all public companies. Where a company is a listed entity and there is a conflict between the listings requirements and any part of the Chapter, then both sets of rules will apply to the extent that they will not be in conflict with each other. Where it is impossible to reconcile an inconsistency, the provisions of the Bill will prevail over the provisions of the listings requirements. Part D, clause 94, dealing with audit committees only applies to a certain extent to companies to which the provisions of section 64 of the Banks Act[302] applies. They are also applicable to state-owned enterprises, except to the extent exempted in terms of clause 9 and subject to subclause (3), and to private companies which have stipulated in the Memoranda that they wish to be bound.

Shareholders of small companies may therefore choose if they wish their company to be subject to additional accountability and transparency requirements. Compliance with these provisions would necessarily increase administration costs. The Bill has therefore singled out those companies which may pose an accountability and transparency risk for shareholders, such as public companies, and compliance with the provisions is therefore mandatory. On the other hand, in those companies where shareholders themselves are running the company, they have the choice whether or not to comply.

The clauses contained in Chapter 3 specify that companies to which the Chapter applies are required *inter alia*, to appoint and register a company secretary and an auditor to keep records of such appointments.[303] A juristic person or partnership may be appointed to act as company secretary.[304] The company secretary is the person

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[302] Act 94 of 1990
[303] Clauses 85 and 86
[304] Clause 87. The company secretary is accountable to the board and the duties include providing guidance to directors on their duties, responsibilities and powers, keeping the directors informed of the law surrounding or affecting the company, reporting failures to comply with the Bill to the board, ensuring that minutes of all meetings are properly recorded in accordance with the Bill, certifying the annual financial statements whether the company has filed returns and notices in accordance with the

named in clause 33(3) of the Bill who is designated in the annual transparency and accountability report as the person responsible for the company's compliance with Chapter 3 Part C and Chapter 3.[305]

Chapter 3 Part C deals with appointment,[306] resignation and vacancies,[307] rotation,[308] and rights and restricted functions of auditors.[309] Part D contains, clause 94, dealing with audit committees – arguably one of the most important sections in relation to transparency and accountability, one of the duties of which is to appoint an auditor, who, in the opinion of the committee, 'is independent of the company'.[310] According to King, audit committees are ideally required to comprise a majority of independent, non-executive directors. The audit committee is required to exercise an independent and impartial judgment – independently of the board – and should not be swayed by the dictates of the board or the CEO.[311]

Increasing the requirements from "at least two", in the 2007 draft Bill, to at "least three" members, in the 2008 draft, the Bill states that every member of the audit committee must:

(a) be a director who satisfies the requirements in respect of qualifications specified by the Minister;[312]

(b) not be involved in the day-to-day management of the business or have so been involved for the previous three years;[313]

(c) not be a prescribed officer or full-time executive employee of the company or another related or inter-related company or have been such an officer or employee during the three preceding financial years;[314]

Bill and that they are true, correct and up to date and ensuring that a copy of the annual financial statements at sent to every person entitled to receive a copy in terms of the Bill (Clause 88).

[305] Clause 33(3)
[306] Clause 90
[307] Clause 91
[308] Clause 92
[309] Clause 93
[310] Clause 94(7)(a)
[311] Reference
[312] Clause 94(4)(a) read with 94(5). This is a first of its kind in our law and welcomed by King proponents as a change from the 2007 Bill. This has already been a requirement for many years in the United States as evident in the Sarbanes-Oxley Act of 2002.
[313] Clause 94(4)(b)(i)
[314] Clause 94(4)(b)(ii)

(d) not be a material supplier or customer of the company, such that a reasonable and informed third party would conclude in the circumstances that the integrity, impartiality or objectivity of the director is compromised by the relationship;[315] and

(e) not be related to any of the abovementioned people.[316]

The introduction of independent directors is a new piece to the corporate governance framework of the Bill. All the above factors are designed to ensure independence, yet unlike the 2007 draft,[317] the word 'independent' is not explicitly mentioned. Secondly, while the Bill spells out a detailed test for persons 'related' to the company, it is immediately evident that persons 'related' to the company are not excluded from acting on the remunerations committee. It is submitted that while the Bill correctly requires independence from members of the remuneration committee, the test propounded does not go far enough to ensure that such persons are entirely independent and the possibility therefore exists that such 'independents' may become sidelined in their decision-making. A system of compulsory rotation could assist in maintaining such independence.

4.7 Rights of creditors and other stakeholders under Business Rescue Provisions

The business rescue provisions of the Bill have been considerably controversial in the media. The principal concerns raised center around creditors, whose rights are adversely affected by the wide-reaching powers of the supervisor to cancel any agreements which a company undergoing business rescue has entered into.

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[315] Clause 94(4)(b)(iii)
[316] Clause 94(4)(c)
[317] 2007 Draft: Clause 100:
"(2): An audit committee must have at least two members, each of whom must -
(a) be a director of the company; and
(b) not be -
(i) involved in the day to day management of the business;
(ii) a full-time salaried employee of the company or its group, or have been such an employee at any time during the previous three financial years; or
(iii) related to an individual contemplated in sub-paragraph (i) or (ii); and
(c) act independently in the performance of the committee's functions.
(3) For purposes of subsection (2), a director acts independently if that director –
(a) expresses opinions, exercises judgment and make decisions impartially; and
(b) is not related to -
(i) the company or to any shareholder or other director of the company; or
(ii) a material supplier or customer of the company, such that a reasonable and informed third party would conclude in the circumstances that the integrity, impartiality or objectivity of that director is compromised by that relationship."

An 'affected person' is defined under the Bill as a shareholder, creditor, registered trade union representing the employees of the company or any employees or their respective representatives, where they are not members of trade unions.[318]

Either the board of directors may resolve that business rescue proceedings commence,[319] alternatively, the affected persons may apply to court to order a company to commence the proceedings.[320] Where the board resolves that proceedings must be commenced, an affected person may apply to court to set aside the resolution.[321] Furthermore, all affected persons have a right to participate in the application.[322] Creditors have always had the right to apply for the winding up of a company as a measure of debt collection, however, it is now also an option for the employees of a failing company with a hope of recovery, or even a trade union, to make application to court to ensure that the process of recovery is seen to fruition.

Clause 136, while protecting the interests of employees in stating that their employment continues except in accordance with the ordinary course of attrition or in accordance with the applicable labour laws,[323] stipulates that in respect of any contracts to which the company is a party at the commencement of business rescue, the supervisor may cancel or suspend, entirely, partially or conditionally the provisions of such contract.[324] This clause is subject to sections 35A and 35B of the Insolvency Act.[325]

As a matter of course, such third party with whom a contract has been altered or cancelled may institute an action against the company for the extent of its damages sustained,[326] however the desirability of such a powerful provision in the hands of the supervisor must necessarily be called into question. The provision has caused great concern to large financial institutions like banks, since damages may not always adequately compensate a breach of contract. It is submitted that the converse which

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[318] Clause 128(1)(a)(i), (ii) and (iii)
[319] Clause 129(1)(a) and (b) – where the company is financially distressed, as defined and there appears to be a reasonable prospect of rescuing the company.
[320] Clause 131(1)
[321] Clause 130. The grounds for challenge are that there is no reasonable basis for believing that the company is financially distressed, there is no reasonable prospect for rescuing the company, or the company has failed to satisfy the procedural requirements of section 129.
[322] Clause 130(4)
[323] Clause 136(1)(a) and (b)
[324] Clause 136(2)
[325] 24 of 1936
[326] Clause 136(3)

must be borne in mind is that the company going into business rescue is in a position where it was contemplated that such a company was in any event likely to renege on its contracts and that perhaps in the circumstances, damages at the earlier stage is better than damages where a company is actually insolvent. The concern is of course, that the supervisor's actions in cancelling a contract are a form of anticipatory breach which may not have been warranted in the circumstances. The innocent party will therefore always be in a disadvantaged position.

Directors are required to act almost entirely under the command and supervision of the supervisor.[327] He is accorded wide rights to apply to court to remove any director for *inter alia*, impeding the supervisor in his performance of the powers and functions of the supervisor.[328] As a protection to shareholders, any alteration to the classification or status of any issued shares is invalid, except to the extent that the court orders otherwise, or to the extent contemplated in an approved business rescue plan.[329] In terms of clause 152(3)(c), shareholders of a class which is proposed to be altered in any way, are provided with the right to vote on such proposition.

Employees,[330] creditors[331] and shareholders[332] are provided with the rights to:

(a) notice of each court proceeding, decision, meeting or other relevant event concerning the business rescue proceeding;
(b) participate in any court proceedings as aforesaid;
(c) vote to approve a business rescue plan.

Employees are furthermore accorded the rights to form a committee of employee representatives, be consulted by the supervisor, review any business rescue plan, present and make submissions to meeting of holders of voting rights in terms of clause 152(1)(c), propose the development of an alternative plan and present an offer to acquire the interests of one or more affected persons.[333]

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[327] Clause 137(2)(a) – (d)
[328] Clause 137(5)
[329] Clause 137(1)(a) and (b)
[330] Clause 144(3)(a), (b) and (f)
[331] Clause 145(1)(a), (b) and (2)(a)
[332] Clause 146(a), (b) and (d)
[333] Clause 144(3)

Creditors are accorded the right to formally and informally participate in the proceedings, propose alternative plans and present an offer to acquire the interests of any or all the other creditors in the manner set out in clause 153. They are also entitled to form a creditor's committee and through the committee to be consulted by the supervisor.[334]

Shareholders are entitled to formally participate in the proceedings, propose an alternative business rescue plan and present an offer to acquire the interests of any or all of the creditors or other holders of the company's securities in the manner set out in clause 153.[335]

It is submitted that in recognising that the ceasing of operations by a company has implications far beyond its mere shareholders, the Bill has accorded wide rights to interested stakeholders to apply for, or oppose an application for business rescue, whilst providing mechanisms whereby such stakeholders are able to participate in the proceedings. The Bill is, however, unclear on the exact efficacy of these stakeholders' rights of participation. Employees may vote to approve a business rescue plan, only to the extent that they are creditors of the company,[336] thus trade unions and employees who are not creditors must be satisfied with mere consultation on the proposed business rescue plan.

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[334] Clause 145(1)(c), (d), (2)(a)(b)(i) and (ii) and (3)
[335] Clause 146(c), (d) and (e)(i) and (ii)
[336] Clause 144(3)(f)

CHAPTER 5
REMEDIES AND ENFORCEMENT

Where shareholders and interested stakeholders are unable to protect themselves adequately against wrongdoing by a corporation or its directors through contract or the Memorandum, as fashioned by the initial shareholders, the standing and remedies entrenched in the Bill are an important mechanism to restore the faith of investors, creditors and the public in business, by enabling them to hold a corporation accountable for its actions.

5.1 Extended standing to apply for remedies

An element of an enlightened shareholder value model is evident in the Bill extending remedies for standing to beyond those who may ordinarily seek to enforce rights under the Act. Echoing section 38 of the Constitution,[337] the Bill expressly allows the possibility of class action suits to be brought against corporations. Class action suits are prevalent in the United States, but historically unknown in South African law, until fairly recently.

Any application made in terms of the Bill to a court, the Companies Ombud, the Panel or the Commission, may be brought by such person himself, by a person acting on behalf of a person who cannot bring the application in their own name, by a person acting as a member of or in the interest of a group or class of affected persons, or by an association acting in the interests of its members, or acting in the public interest, with the leave of the court.[338] With South African courts approaching the development of class action suits exceptionally cautiously, particularly those brought in the public interest, the full effect of this clause may take some years of legal development to be brought to fruition.

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[337] Constitution of the Republic of South Africa, Act 108 of 1996. Section 38 states: "Anyone listed in this section has the right to approach a competent court, alleging that a right in the Bill of Rights has been infringed or threatened, and the court may grant appropriate relief, including a declaration of rights. The persons who may approach a court are -

a. anyone acting in their own interest;
b. anyone acting on behalf of another person who cannot act in their own name;
c. anyone acting as a member of, or in the interest of, a group or class of persons;
d. anyone acting in the public interest; and
e. an association acting in the interest of its members."

[338] Clause 157(1)

The Commission or the Panel may even themselves institute proceedings in the name of a person or apply for leave to intervene in proceedings.[339]

5.2 Protection for whistle-blowers

Encouraging accountability through reporting of contraventions, a welcomed provision in the Bill is the extension to certain specified stakeholders, protection from prosecution for whistle-blowing. The rights in clause 159 in establishing protection for employees are in addition to any rights or protections provided in terms of the Protected Disclosures Act.[340]

Specifically, a shareholder, director, secretary, prescribed officer or employee, registered trade union or other employee representative, supplier of goods or services or employee of a supplier who makes a disclosure under clause 159 will be safe in the knowledge that he has a qualified privilege in respect of the disclosure, and is immune from civil, criminal or administrative liability for the disclosure.[341] Any provision in the Memorandum, rules or any agreement is void to the extent that it is inconsistent with or negates clause 159.[342]

Any disclosure of information, made in good faith to the Commission, Ombud, Panel, a regulatory authority, an exchange, a legal adviser, a director, prescribed officer, secretary, auditor, board or board committee, and in the reasonable belief that at the time of the disclosure, the information showed or tended to show that a company or external company, or director or prescribed officer acting in that capacity:

(a) contravened the Act, or Schedule 6 law[343];

(b) failed or is failing to comply with any legal obligation to which the company is subject;[344]

(c) engaged in conduct that has endangered or is likely to endanger the health or safety of an individual, or damage the *environment*;[345]

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[339] Clause 157(2)
[340] 26 of 2000
[341] Clause 159(4)
[342] Clause 159(2)
[343] Clause 159(3)(b)(i)
[344] Clause 159(3)(b)(ii)
[345] Clause 159(3)(b)(iii)

(d) unfairly discriminated or condoned unfair discrimination against any person as contemplated in section 9 of the Constitution and the Promotion of Equality and Prevention of Unfair Discrimination Act[346];[347] or

(e) contravened any other legislation[348]

will be subject to the privilege.

The persons mentioned who qualify for the protection are entitled to compensation from persons who cause them detriment or who threaten them.[349]

Clause 159(3)(b)(iii) is a wide provision and its application in practice will be interesting to note. Essentially, any person may in good faith disclose to the Commission, information which shows that a company engaged in conduct which is likely to endanger the health or safety of an individual or which may damage the environment. Such conduct may or may not be in contravention of the Bill or other legislation.

The clause is not clear on the powers of the Commission in such a case, since clause 168 only deals with the position where there has been a contravention of the Bill, Memorandum, rules or Takeover Regulations. Coupled with the provisions extending standing to those acting in the public interest, there is a concern that these clauses may give rise to an inundation of complaints by extremist groups where the Commission or Ombud have little or no powers of action. Furthermore, there is a concern that constitutional considerations of equity relating to third parties may come to bear on purely contractual matters where such contractual provisions are not *per se* in contravention of any existing law. While the indirect development of an enlightened shareholder value model of corporate governance may be welcomed, the fear is that these clauses may create considerable uncertainty for companies in the future.[350]

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[346] 4 of 2000
[347] Clause 159(3)(b)(iv)
[348] Clause 159(3)(b)(v)
[349] Clause 159(5)
[350] Public companies must establish and maintain systems to receive clause 159 disclosures confidentially and routinely publicise the availability of the system to the protected persons named in the clause. (Clause 159(7)) Presumably, information contained in reports, on websites and correspondence would suffice.

5.3 Application to protect rights of securities holders

Any shareholder may now apply to court for an order determining the rights of his securities in terms of the Bill, Memorandum, company rules or any debt instrument, or for an order to protect any of his rights and to rectify any harm to him by the company or any directors, to the extent that they are or may be held liable in terms of clause 77.[351] It is expressly stated that the rights of shareholders under this clause are in addition to their rights under the Bill generally or the common law, subject to the Bill.[352]

It is submitted that a mechanism whereby a shareholder is able to obtain a declaratory order is a welcomed remedy under the Bill, although such shareholder would unfortunately be limited by his available finances. It is however, submitted that the extended standing provisions of class actions may assist in alleviating this financial burden.

5.4 Relief from oppressive or prejudicial conduct for directors and shareholders

Presently, section 252 of the Act deals generally with relief for shareholders from oppressive or unfairly prejudicial conduct by their company. Where an act of a company is unfairly prejudicial, unjust or inequitable, or the affairs of a company are being conducted in a manner which is unjust or inequitable to a shareholder or to some of the company's members, he may apply to court for relief.

Where the harm complained of relates to an alteration of the memorandum of the company, a reduction of the capital of the company, variation of rights in respect of shares or the conversion of a private company into a public company or a public company into a private company, the application must be made within six weeks after the date of passing the relevant special resolution.[353]

The court, should it find in favour of the shareholder, has wide powers to make such order as it thinks fit and this may include regulating the future conduct of the

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[351] Clause 161(1)
[352] Clause 161(2). Clause 158(a) furthermore enjoins a court to develop the common law as is necessary to improve the realisation and enjoyment of rights established under the Bill.
[353] Section 252(2)

company or ordering a purchasing of the shares of any members by the company, or the reduction of the company's capital.[354]

Clause 163 of the Bill widens this provision substantially, making it applicable to shareholders and directors, and provides rights of recourse to the court where a single director or prescribed officer is acting in a prohibited manner.[355] A single shareholder or director is given the right to apply to the court for relief where any act or omission of the company or a person related to the company has the result of being oppressive or unfairly prejudicial to, or unfairly disregards the interests of the applicant him or herself, where the business of the company or a related person is being run in a manner which unfairly disregards the interests of the applicant or where the powers of a director or prescribed officer or a person related to the company are or have been exercised in a manner which is oppressive or unfairly prejudicial to, or that disregards the interests of the applicant.[356] The court is similarly afforded wide powers to make any interim or final order it sees fit. The Bill provides an open list of orders which the court may grant in this regard.[357]

It is submitted that this provision may assist smaller companies where a director wishes to take action against a fellow director for acting in a manner contrary to the Bill, however, the provision may prove difficult for a court to make an order in a widely-held company where a single director complains that the board is acting unfairly towards him. Any order would have to be carefully constructed so as not to potentially cause harm to the general body of shareholders, who may disagree with the grievances of the single director.

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[354] Section 252(3)
[355] Clause 163(1)
[356] Clause 163(1)(a), (b) and (c)
[357] The following are listed: a restraint order (Clause 163(2)(a)), an order appointing a liquidator, if the company appears to be insolvent (Clause 163(3)(b)), an order placing the company under supervision and commencing business rescue proceedings (Clause 163(2)(c), an order amending the Memorandum or creating or amending a unanimous shareholders resolution (Clause 163(3)(d)), an order directing a share exchange or issue (Clause 163(3)(e)), an order appointing directors in place of or in addition to any other directors or declaring any person delinquent or under probation (Clause 163(3)(f)), an order directing the company or any other person to restore to a shareholder any part of the consideration that the shareholder paid for shares, or to pay the equivalent value, with or without conditions (Clause 163(3)(g)), an order varying or setting aside a transaction or an agreement to which the company is party and compensating the company or any other party to the agreement or transaction (Clause 163(3)(h)), an order requiring the company within a specified time period to produce to the court or an interested person, financial statements as required by the Act or an accounting in any form directed by the court (Clause 163(3)(i)), an order to pay compensation to an aggrieved person, subject to any other law entitling that person to compensation (Clause 163(3)(j)), an order directing rectification of the registers or other records of a company (Cause 163(3)(k)), or an order for the trial of any issue (Clause 163(3)(l)).

5.5 Dissenting shareholders appraisal rights

The Bill retains the specific transactions mentioned under section 252, but leaves out the conversion of companies into different types of companies. The entirely new rights scheme in the Bill goes much further than section 252 and provides, it is submitted, a more favourable and certain method to follow, with increased transparency relating to major transactions from the outset. Where a company has given notice to its shareholders of a meeting to consider adopting a resolution to:

1. amend the Memorandum by altering the preferences, rights, limitations or other terms of any class of its shares in any manner materially adverse to the rights or interests of the holders of that class of shares;[358] or

2. enter into a transaction contemplated in sections 112[359], 113 or 114;[360]

the notice must include a statement informing the shareholders of their appraisal rights under the clause.[361]

If a shareholder dissents to the proposed resolution, he may at any time before the resolution is voted upon, give his written notice of objection to the company.[362] Within ten days after passing the resolution, the company must give to all shareholders who provided notice of dissent and who did not withdraw their notices or vote in favour of the resolution, notice that the resolution was passed.[363] The shareholder can then demand that the company pay him a fair value for his shares if:

(a) he sent the objection notice (unless the company did not provide notice of the meeting or failed to provide in the notice, a statement of shareholders' rights);[364] and

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[358] Clause 164(2)(a)
[359] Section 112 deals with the disposal of all or the greater part of assets or undertaking; section 113 deals with proposals for amalgamations or mergers and section 114 deals with proposals for schemes of arrangement – so-called fundamental transactions.
[360] Clause 164(2)(b)
[361] It is submitted that there is an error in subsection (2) in that the words from "that notice" under subsection (2)(b) must be contained in a separate paragraph so as to be applicable to both subparagraphs (a) and (b).
[362] Clause 164(3)
[363] Clause 164(4)
[364] Clause 164(5)(a)(i)

(b) if, where the amendment was to the Memorandum, he holds shares of a class that is *materially and adversely* affected by the amendment;[365] and

(c) the company adopted the resolution;[366] and

(d) the shareholder voted against the resolution;[367] and

(e) he has complied with all the procedural requirements of the section.[368]

The Bill requires the shareholder to make a demand within twenty business days after receiving the notice of the passing of the resolution, or if he did not receive the notice, within twenty business days after learning that the resolution was adopted.[369] The shareholder will then have no further rights in relation to those shares, so he will not be entitled to vote in any further meetings, other than his right to be paid a fair value for the shares, unless he withdraws the demand before the company makes an offer or allows an offer to lapse, the company fails to make the offer and the shareholder withdraws the demand or the company revokes the passed resolution giving rise to the shareholder's rights under the section.[370] His rights in respect of the shares will then be fully reinstated.

The company will then send all the shareholders who made demands, a written offer for their shares, which amount must be considered by the company's directors to be the fair value of the shares and accompanied by a statement showing how the value was determined.[371] The offer lapses if it is not accepted within thirty business days after it was made.[372]

Where the company fails to make the offer or the shareholder considers the offer is not fair and it has not lapsed, he may apply to court to determine a fair value for the shares and order that the company pay that value to him after tendering his share certificates.[373] Following the reasoning in *Clutchco*, the shareholder would have to

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[365] Clause 164(5)(a)(ii). My italics.
[366] Clause 164(5)(b)
[367] Clause 164(5)(c)(i)
[368] Clause 164(5)(c)(ii)
[369] Clause 164(7)(a)
[370] Clause 164(9)
[371] Clause 164(11)
[372] Clause 164(12)(b)
[373] Clause 164(14)

make material allegations against the method of calculation of his interest and use the evidence of another financial expert in this regard.

All the shareholders who dissented and who did not accept the offer at the time the application is launched will be joined as parties and are bound by the decision of the court.[374] The court may make any order as to costs, and must make an order requiring that the dissenting shareholders either withdraw their demands in which case they are reinstated with their full rights as shareholders, or to tender their share certificates or take steps to transfer uncertificated securities and the company must pay the fair value to the shareholders, subject to any further conditions the court sees fit to comply with the section.[375]

The date for valuation of the shares must be determined at the time and date immediately before the resolution in question was adopted.[376] This is reasonable in light of the fact that negative publicity surrounding dissatisfied shareholders may cause the share price to drop after the resolution is adopted.

Where compliance by the company with the section or any court order in making payment to a shareholder would result in the company becoming commercially insolvent[377] for the ensuing twelve months, the company can apply to court for an order varying the company's obligations under the clause.[378] The court *may* make an order that is just and equitable having regard to the precarious financial situation of the company and which will ensure that the relevant shareholder is paid as soon as possible.[379] It is submitted that the rights of the court should have been mandatory where the court finds that the company will in all probability be commercially insolvent should it be forced to comply with its financial obligations under the section, since the manner in which the clause is currently drafted leads to the conclusion that where the court does find that the company will be commercially insolvent, that its order does not necessarily have to be just and equitable and ensure that the shareholder is paid as soon as possible.

Where the resolution which gave right to the shareholder's dissenting rights under the clause was one in which two companies amalgamated or merged to the extent

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[374] Clause 164(15)(a)
[375] Clause 164(15)(c)
[376] Clause 164(16)
[377] In other words, unable to pay its debts as they become due in the ordinary course of business.
[378] Clause 164(17)(a)
[379] Clause 164(17)(b)

that the company which the shareholder was a member of has ceased to exist, the obligations of that company become the obligations of its successor, or the merged entity.[380]

The action of demand, tender and payment by a shareholder and company under the section specifically do not constitute a 'distribution', defined in section 1 or acquisition of its shares within the meaning of section 48, which is included in the section 1 definition of 'distribution'.[381] This exclusion is mimicked in section 48, with reference to section 164. This means that, *inter alia*, the solvency and liquidity test, defined in section 4, is specifically not applicable to compliance by a company with its obligations under the section. It would appear that in making an assessment as to whether the company must apply to court for variation of its obligations in terms of section 164(17), it would be the board which would have to decide whether there are 'reasonable grounds' for the belief that the company would be commercially insolvent. The ensuing twelve months would presumably be calculated from the date which the company would have to make the first payment under the section or in terms of an order. If the reasonable belief exists, the section simply says the company *may* apply to court.

The section does not specify what the position is where the directors know that the company will become commercially insolvent and potentially run itself into the ground, and do not apply to court for variation of the payment terms. It is submitted that this would fall under the general duties of the directors under section 76 dealing with standards of conduct and that the directors would then be liable to the remaining shareholders for failing to act in the best interests of the company.[382]

The provisions of the Companies Act of the United Kingdom dealing with unfair or prejudicial conduct are similar to the provisions in the Act. Essentially, a member is entitled to apply to the court by petition for an order on the grounds that the company's "affairs are being or have been conducted in a manner that is unfairly prejudicial to the interests of members generally or of some part of its members (including at least himself), or...that an actual or proposed act or omission of the company (including an act or omission on its behalf) is or would be so prejudicial."[383]

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[380] Clause 164(18)
[381] Clause 164(19)
[382] Section 76(3)(b)
[383] *Ibid*

If the court is of the opinion that the shareholders are indeed deserving of protection, then, like the South African courts, it may make any order that it thinks fit. The Act thereafter lists possible orders such as regulating the future conduct of the company's affairs, authorising civil proceedings to be brought in the name of and on behalf of the company and providing for the purchase of the shares of any members of the company by other members of the company or by the company itself.[384]

It is however clear that the Bill has borrowed significant content of the appraisal rights clause from the Model Corporations Act. In §13.02 a number of corporate actions are listed for which shareholders are entitled to appraisal rights and to obtain payment of the fair value of such shareholders' shares. Essentially, these all result in a fundamental change to the share capital of the company to be affected by the transaction. To be accorded with the appraisal rights, these fundamental transactions must cause reasonable concern regarding the fairness of the transactions.[385]

Appraisal is the only remedy available for completed corporate action, subject to certain exceptions. This is premised on the simple concept of majority rule: the dissatisfaction of a few shareholders should not be allowed to undo a transaction favoured by the majority of the shareholders. The exceptions where judicial review may be permitted are: firstly, where there are serious procedural defects in approving the action; and secondly, where there is fraud or material misrepresentation causing the corporation action to be approved mistakenly.[386]

Although the Bill does not specify that the corporate action may be undone by the court, it is submitted that it would perhaps have been prudent for the Bill to cater for the position where the resolution was passed by reason of procedural irregularities, fraud or material misrepresentation and in such case, allow the court to undo the corporate action, although arguably, the derivative action may be more applicable in such an instance.

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[384] Section 73

[385] The Model Corporations Act includes on the list the conversion of a corporation into a non-profit entity and the conversion of a corporation into an unincorporated entity. It furthermore prohibits appraisal rights from being exercised in certain instances, namely, where shares are listed on the New York Stock Exchange or American Stock Exchange or designated as a national market system security on an interdealer quotation system, or where a corporation has at least two thousand shareholders and the outstanding shares of such class or series of shares has a market value of at least US$20 million, subject to certain exceptions dealing with conflict transactions. (§13.02(8)(b)).

[386] Model Business Corporations Act, 2002, pg. 13-23; 13-24

5.6 Derivative Actions

The derivative action is an oft used and important right of recourse for shareholders to force a company to take action against another person for harm caused to it. It is traditionally utilised by shareholders to pursue wrongful actions by a company's directors. The issue for corporate governance is to what extent the directors should be allowed to determine whether or not to continue with the suit, and whether, in making such a decision, they are acting independently and in good faith.[387]

Under current South African law, the action is partially common law and partially statutory. The equivalent clause in the Bill commences with the abolition of the common law derivative action. The question is whether this section addresses stakeholder concerns. While derivative actions are traditionally only available to shareholders, the Bill has expressly widened the standing to bring derivative actions, thereby indirectly catering for stakeholder interests.

The wheel is set in motion by the service of a demand on the company to commence or continue legal proceedings by a shareholder or person entitled to be registered as a shareholder of the company or a related company, a director or prescribed officer of the company or a related company, a trade union representing the employees of the company or another employee representative, or any other person with the leave of the court granted only if the court is satisfied that it is necessary or expedient to protect a legal right of that other person.[388]

The company can then apply to court within fifteen days to set aside the demand on the grounds that it is frivolous, vexatious or without merit.[389] The procedure advocated by the Bill is robust in that it forces a company and the court to seriously consider the demand of the shareholder.

If the company does not make application to set aside the demand, or if the court refuses to set it aside, the company is then obliged to appoint an independent and impartial person or committee to investigate the demand and report back to the board on various factors, such as any facts or circumstances which may give rise to a

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[387] Model Business Corporations Act, 2002, pg. 7-82; 7-83
[388] Clause 165(2)
[389] Clause 165(3)

cause of action and the probable costs in pursuing a course of action.[390] Within sixty days of the demand being served[391], the company must either initiate or continue with legal proceedings, or take related steps to protect the legal interests of the company, or serve notice on the person refusing to comply with the demand.[392]

The person who made the demand may apply to court to bring or continue legal proceedings in the name of and on behalf of the company and the court may order this only if the company failed to take any steps required of it under the section, appointed a committee or investigator who was not impartial and independent, accepted an inadequate, irrational or unreasonable report, acted inconsistently with a reasonable report of an independent person or committee or who has serve a notice refusing to comply.[393] The court must furthermore be satisfied that the applicant is acting *bona fides*, the proceedings involve the trial of a matter that is of material consequence to the company and it is *in the interests of the company* that the applicant is granted such leave.[394] The Bill provides no guidance as to what the 'interests of the company' are. It is submitted that the extended standing under the derivative action may allow a plausible argument to be raised for an enlightened shareholder value understanding of the 'interests of the company', encompassing at least persons specifically adorned with such standing.

There is a rebuttable presumption that granting leave is not in the best interests of the company where it is established that:

(a) the proceedings are by the company against a third party or by a third party against the company; or

(b) the company has decided not to not to bring, defend, continue with, settle or compromise the proceedings; and

(c) all the directors who participated in that decision acted in good faith and for a proper purpose, did not have a personal financial interest in the decision or were not related to the person who had a personal financial interest in the decision,

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[390] Clause 165(4)(a)
[391] Or within such longer period allowed by the court.
[392] Clause 165(4)(b)
[393] Clause 165(5)
[394] Clause 165(5)(b)

> informed themselves about the subject matter of the decision and reasonably believed that the decision was in the best interests of the company.[395]

It is submitted that it is odd that there is a rebuttable presumption requiring the establishing of such a vast number of factors, which are notoriously difficult to prove, such as those relating to the subjective mindsets of the directors who made the decision. The onus in any event rests on the applicant to show that the proceedings are in the interests of the company and so a rebuttable presumption would surely not assist a company in any manner. The presumption merely shifts the burden of proof onto the company to establish the Clause 165(7) requirements. Would this burden on the company be overcome by mere affidavits to this effect by each of the directors or where this is contested by the applicant, would they have to lead oral evidence to this effect? It is accordingly submitted that this clause should have been omitted.

The court is bestowed with wide powers in being entitled to grant at any time, any order for costs against the applicant, the company or any other party to the proceedings and there is a vague reference to security for costs which may be ordered by the court, but the right to require it prior to the proceedings being launched does not appear to be available.[396] This assists those parties who have a good cause for making application under the section but who may not necessarily be able to afford security and who would otherwise have their claims hampered by a technicality.

Even if the shareholders have ratified or approved any conduct of the company, a person is still not prevented from making a demand and the application for the appropriate relief under the section, and the shareholders' conduct does not prejudice the outcome of any application for leave, but the court may take the ratification or approval into account in making any judgment or order.[397]

When coupled with the extended standing provisions, the right of any person under the clause may be exercised by that person themselves, or on their behalf by the Commission, Panel or another person in terms of clause 157.[398]

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[395] Clause 165(7)
[396] Clause 165(10) and (11)
[397] Clause 165(14)
[398] Clause 165(16)

The Companies Act of the United Kingdom deals with derivative claims in section 260, however, it is submitted that the method followed in the Bill is favourable. Section 260 states that a derivative action may only be brought for a cause of action vesting in the company arising from an actual or proposed act or omission involving negligence, default, breach of duty or breach of trust by a director of the company.[399] The shareholder may still institute the proceedings even where the cause of action arose before he became a shareholder.[400]

A shareholder may bring a derivative claim in two manners. Firstly, where the shareholder makes application to the court to bring a derivative action, he must also apply that the action continue as such. If the court finds that the applicant does not have a *prima facie* case, then the court may dismiss the application.[401] Secondly, where the company institutes a claim and the cause of action could be pursued as a derivative claim, the shareholder may apply to court to continue the claim as a derivative one, provided that it can prove certain facts.[402]

A derivative action may also be brought pursuant to a court order in terms of section 994. This is the equivalent to section 252 under the Act, although under section 994, any shareholder may apply to the court by petition on the basis that the company's affairs are being conducted in a manner which is prejudicial to the shareholders generally or of some part of its shareholders, including the applicant, or that an actual or proposed act or omission would be so prejudicial.[403] The court may make any order it thinks fit[404] and as a result of such order, a shareholder may apply to court in terms of the derivative provisions to continue a derivative proceeding.

Arguably, both the United Kingdom Companies Act and the Bill indirectly introduce an enlightened shareholder value model to their corporate law, the United Kingdom through directing that in deciding whether to allow the claim to continue, a court is specifically directed, *inter alia*, to the provisions of section 172, highlighted above, in considering the importance that a shareholder acting in accordance with section 172

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[399] Section 260(3)
[400] Section 260(4)
[401] Section 261(1) and (2)
[402] Section 262(2): "The shareholder must show that (a) the manner in which the company commenced or continued the claim amounts to an abuse of the process of the court, (b) the company has failed to prosecute the claim diligently, and (c) it is appropriate for the member to continue the claim as a derivative claim."
[403] Section 994(1)(a) and (b)
[404] Section 996

would attach to continuing the action,[405] and the Bill, through the extended standing contained in the introduction to the derivative action clause. It is now clear that a class derivative action may be brought by a trade union in the interests of the employees of a company.

Yet again, we see similarity between derivative actions under the Bill and §7.40 of the Model Corporations Act. Unlike the Companies Act of the United Kingdom, the Model Corporations Act similarly commences the action with a demand to the company.[406] If within the specified period,[407] the company has not taken action, or rejected the demand, the shareholder may institute the proceedings. The company can itself initiate an investigation into the demand, in which case, the court will stay the proceedings.[408] However, the corporation may make application to the court, and if:

(a) a majority vote of independent directors, if the independents constitute a quorum, or a majority of a committee consisting of two or more independent directors appointed by a majority vote of independents, whether or not the independent directors constitute a quorum;[409] alternatively,

(b) a panel of one or more independent persons appointed by the court to make a determination whether maintenance of the derivative action is in the best interests of the corporation,[410]

determine in good faith after conducting a reasonable inquiry that the maintenance of the derivative action is not in the best interests of the corporation, the court will dismiss the derivative proceedings.[411]

It is conceivable that the effect of the class derivative action by stakeholders who are not shareholders may have far-reaching effects, however, it is submitted that the procedural mechanism for bringing such a derivative action, borrowed from the Model Corporations Act, adequately protects against an abuse of process. In making application to set aside a demand to institute a derivative action, the court would

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[405] Section 263(3)(b)
[406] §7.42(1) and (2)
[407] This period is ninety days in the United States.
[408] §7.43
[409] §7.44(b)
[410] §7.44(f)
[411] §7.44(a)

have to fully consider the matter and thereafter, if the application is unsuccessful, an investigation by an independent and impartial person will still have to be conducted. The prospects of success are therefore fully and carefully considered before action is eventually instituted.

5.7 Initiating a complaint to the Commission or Panel

In keeping with the extended standing provisions, the Bill provides a further right of recourse to *any person* to lodge a complaint against any person either with the Takeover Panel where the person acted contrary to Part B or C of Chapter 5, or in respect of the Takeover Regulations[412] or to the Commission where such person acted contrary to the Bill, the complainant's rights under the Bill, the Memorandum or the rules.[413]

On the other hand, a complaint may be initiated directly by the Commission or the Panel *mero motu*, or on the request of any other regulatory authority.[414] The Minister may also direct such an investigation.[415]

5.8 Investigation by the Commission or Panel

Once the Panel or Commission has received a complaint, if the complaint appears frivolous or vexatious or does not allege facts that if proven will allow any remedy under the Act, the Panel or Commission may issue a notice stating they will not investigate the complaint.[416] They may also refer the matter to the Companies Ombud or an accredited entity[417] if they feel that this may speedily resolve the issue.[418] They may furthermore direct an inspector or investigator to investigate the complaint.[419] The inspector or investigator may investigate any person named in the complaint or related to a person named in the complaint or any other person whom the inspector or investigator reasonably believes may have information relating to the complaint being investigated.[420]

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[412] Clause 168(1)(a)
[413] Clause 168(1)(b)
[414] Clause 168(2)
[415] Clause 168(3). The time for lodgement of the complaint is limited by the normal three year period of prescription (Clause 219).
[416] Clause 169(1)(a)
[417] Defined in clause 166(3)
[418] Clause 169(1)(b)
[419] Clause 169(1)(c)
[420] Clause 169(3)(a) and (b)

Once the investigation has been completed, the Commission or Panel may excuse any person as a respondent under the complaint,[421] refer the complaint to the Companies Ombud, Commission or Panel,[422] issue a notice of non-referral of the complaint coupled with a statement advising the complainant of their rights,[423] propose that the complainant and any affected person meet with the Commission or Ombud to speedily resolve the matter,[424] commence proceedings in court,[425] refer the matter to the National Prosecuting Authority[426] or in the case of the Commission, issue a compliance notice, or the Panel, refer the matter to the Executive Director.[427]

Furthermore, the Commission and Panel are granted rights to publish the report provided to them by the inspector or investigator, and provide a copy to those persons mentioned in the Bill.[428]

Where the Commission or Executive Director of the Panel chooses to issue a compliance notice, the notice may require the person to whom it is addressed to cease, correct or reverse any action in contravention of the Act,[429] take any action required by the Act,[430] restore assets or their value to a company or any other person,[431] provide a community service[432] or to take any other steps related to the contravention to rectify its effect.[433] If the person to whom the compliance notice is issued does not comply with the notice, the Commission or Executive Director may either apply to court for the imposition of an administrative fine or refer the matter to the National Prosecuting Authority for prosecution as an offence in terms of clause 214(3),[434] but may not do both such actions.[435]

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[421] Clause 170(1)(a)
[422] Clause 170(1)(b)
[423] Clause 170(1)(c)
[424] Clause 170(1)(d)
[425] Clause 170(1)(e)
[426] Clause 170(1)(f)
[427] Clause 170(1)(g)
[428] Clause 170(2)(a) and (b)
[429] Clause 171(2)(a)
[430] Clause 171(2)(b)
[431] Clause 171(2)(c)
[432] Clause 171(2)(d)
[433] Clause 171(2)(e)
[434] Clause 214(3) states that: "It is an offence to fail to satisfy a compliance notice issued in terms of this Act, but no person may be prosecuted for such an offence in respect of a particular compliance notice if the Commission or Panel, as the case may be, has applied to court in terms of section 171(7)(a) for the imposition of an administrative fine in respect of that person's failure to comply with that notice."
[435] Clause 171(7)(a) and (b)

Any person issued with a compliance notice in terms of section 171 can within fifteen business days after receiving the notice,[436] apply to the Companies Ombud[437] or to the Takeover Special Committee,[438] for review of the notice.[439] Where the Commission or Panel issues a notice of non-referral to the complainant, he or she may apply to court for leave to refer the matter directly to court, but no such complaint may be referred directly to court where a person has been excused as a respondent by the Commission or Panel.[440] Once the court has taken on the matter, the orders which it is empowered to make are wide, being based on justice and equity.[441]

5.9 **Administrative Fines**

Only where a person has failed to comply with a compliance notice, the Commission or Panel may apply to court to impose an administrative fine.[442] The fine may not exceed the greater of ten percent of the respondent's turnover for *the period during which the company failed to comply with the compliance notice* or the maximum prescribed by the Minister, which may not be less than R1 000 000,00.[443]

The court is guided by a number of factors set out in the Bill in determining an appropriate administrative fine.[444] It is submitted that this is a welcomed deterrent, akin to the powers of the Competition Commission to impose penalties on companies for prohibited conduct under the Competition Act,[445] although the fines for the Competition Commission are in up to ten percent of a company's turnover for the entire preceding year, and in relation to price fixing, is not limited to turnover in respect of the offending product. In comparison therefore, the fine of Companies Commission may be more limited in scope, although the offending conduct may exceed a period of an entire financial year.

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[436] Or such longer period on good cause shown.
[437] In respect of the Commission having issued the notice.
[438] In respect of the Executive Director having issued the notice.
[439] Clause 172
[440] Clause 174(1)
[441] Clause 174(2)
[442] Clause 175(1)(a)
[443] Clause 175(1)(b)(i) and (ii). My italics.
[444] These include: 'the nature, duration, gravity and extent of the contravention; any loss of damage suffered as a result of the contravention; the behaviour of the respondent; the market circumstances in which the contravention took place; the level of profit derived from the contravention; the degree to which the respondent has co-operated with the Commission or Panel, as the case may be, and a court; and whether the respondent has previously been found in contravention of this Act'. Clause 175(2)(a) – (g)
[445] Act 89 of 1998

To assist the Commission or Panel during any investigation, they are granted the power to issue a summons for any person to appear before them or to deliver or produce any book, document or other object.[446] An inspector or investigator may interrogate and administer and oath to, or accept affirmation from the person named in the summons and retain any book, document or other object for no longer than two months, unless good cause to do so is shown.[447]

A High Court judge or magistrate may issue a warrant to enter and search any premises within the jurisdiction of the judge or magistrate, if, from information on oath or affirmation, there are reasonable grounds to believe that a contravention of the Bill has taken place, is taking place or is likely to take place on those premises or that anything connected with an investigation under the Bill is in the possession or control of a person who is on those premises.[448]

Where a person in control or who owns an article which is to be seized refuses to relinquish possession of the article on the basis that information contained therein is privileged, the person conducting the search may request the registrar or sheriff of the High Court to attach and remove the article for safe custody until the court determines whether the information therein is privileged.[449]

5.10 **Companies Ombud**

The Companies Ombud is an institution which may adjudicate disputes under the Act.[450] After a hearing, the presiding officer must issue a decision, together with written reasons for the decision.[451] The Commission, any applicant or complainant or any other person with a material interest in the hearing, unless that interest is represented by another participant, may participate in the hearing.[452]

Although the Bill does not specify what the penalty is for non-adherence to the decision of the Ombud, it is clear that an order of the Ombud may be filed at the High Court as an order of court, in accordance with that court's rules. The question arises what recourse an aggrieved person has on breach of the Ombud decision by another

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[446] Clause 176(1)(a) and (b)
[447] Clause 176(3)(a) and (b)
[448] Clause 177(1)(a) and (b)
[449] Clause 179(6)
[450] Clause 180(1)
[451] Clause 180(3)
[452] Clause 181

party. Presumably, the party would have to apply to court afresh for damages and / or specific performance to enforce compliance with the order. This significantly increases the legal costs associated with effective recourse to the Ombud, thereby lowering the Ombud's efficacy as a form of alternative dispute resolution.

The concern with the institutional reforms in the Bill, as is the concern with all institutional reforms in legislation, is primarily whether the Department will have sufficient resources and time to ensure that these bodies are in a position to receive and deal adequately with their obligations under the Bill, from the Bill's commencement date. This concern is, however, not sufficient reason to argue against their establishment. The Commission and Ombud serve to open the channels for communication for stakeholders, although non-adherence to an order of the Ombud, albeit an order of court, may still leave an aggrieved party significantly out of pocket.

CONCLUSION

For Professor Williams, the purpose of corporate governance is to restore the trust of the public in corporations.[453] The highly regulatory nature into which corporate law has evolved,[454] is a direct result of the fact that people no longer trust corporations and their ability to act benevolently towards society.[455] His theory is that if the public perceives a corporation as being able, benevolent and an employer of men and women of character, that the community's trust in the corporation will increase, thereby decreasing the corporation's transaction costs.[456] The consequence is that the framework within which corporations operate will become less rules-based and less administratively burdensome.

Closer to home,[457] King highlights the similarities between the notion of sustainability and characteristics of good corporate citizenship and *Ubuntu* – the concept of African humanness, which includes supportiveness, co-operation and solidarity.[458] He states that '[t]he notion of sustainability and the triple-bottom-line in the corporate world is evolving to an approach that recognises the importance of inter-dependant relationships between an enterprise and the community in which it exists. *Ubuntu* has formed the basis of relationships in the past and there is no reason why it could not be extended to the corporate world.'[459]

It is submitted that the purpose of an enlightened shareholder value model of corporate governance, by catering for the interests of the wider body of stakeholders of a corporation in corporate action which affects them, is simply to increase their and the larger public's trust in corporations. The enlightened shareholder value model requires the display of supportiveness, co-operation and solidarity towards a corporation's stakeholders in all the its dealings with stakeholders. This in turn, illustrates the ability and benevolence of the corporation.

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[453] *Restoring Public Trust in Business: The Crucial Role of Good Corporate Governance*; O. F. Williams, Corporate Governance Conference, 11 – 12 August 2005
[454] Evidenced in legislation such as the Sarbanes-Oxley Act in the United States, which has greatly increased auditing costs for US firms.
[455] *Restoring Public Trust in Business: The Crucial Role of Good Corporate Governance*; O. F. Williams, Corporate Governance Conference, 11 – 12 August 2005
[456] *Ibid*
[457] In his paper, Professor William draws on King's applicability of *Ubuntu* to corporate governance in support of his theory.
[458] King, M; *King Report on Corporate Governance for South Africa 2002* (Institute of Directors in South Africa) Chapter 1, paragraph 6
[459] *Ibid*

Sourcing the majority of its influence, particularly in permitting flexibility of construction, from the Model Corporations Act, the Bill allows the initial shareholders, through the medium of the Memorandum of Incorporation, to amend the Bill's 'alterable provisions', and thereby to structure their company in a manner which best suits their requirements. At its core, the Bill retains the 'unalterable provisions', with the board of directors maintaining its key position as the body governing the company.

Included in the core of the Bill are unalterable provisions which seek to widen the rights of standing and available remedies to shareholders and stakeholders, hold the board accountable, encourage reporting of contraventions, promote shareholder activism, promote accountability and transparency in public companies and provide mechanisms of alternative dispute resolution for specific stakeholders. Stakeholders which have received attention under the Bill are shareholders, creditors, employees and trade unions representing the interests of employees.

In Part A of Chapter 3 of this paper, it was illustrated that the Bill shifts default rights in respect of fundamental transactions from shareholders and places them with the board – certain provisions of which are alterable and certain of which are not. Through the medium of flexibility, initial shareholders are able to determine their quorum and voting thresholds in the Memorandum, which, it is illustrated, may lead to a diminishing of fundamental rights for subsequent shareholders. The default position for the calling of meetings by shareholders has been increased above the international norm and has received its fair share of criticism. In Part B, shareholders retain the rights accorded to them under the Act to remove directors and declare them ineligible, while at the same time, the Bill allows anyone named in the Memorandum to appoint directors. Shareholders are furthermore able to specify minimum qualifications for their directors.

Chapter 4 illustrated how the procedure for the declaration of a director's financial interest in a contract connected with his company or its business is more nuanced, however, the procedure for disclosure where there is more than one director, is not entirely favourable. The partial codification of directors' duties is a novel introduction to the Bill, although, the Bill unfortunately did not venture as far as the United Kingdom in assisting directors with the notion of whom the company is.

The codification of the Business Judgment Rule, while greatly criticised, follows international norms, and is a welcomed clarification of the law from the current position in section 248. Access to information has been widened as a general right to shareholders,[460] and the option of complying with the enhanced accountability and sustainability requirements of Chapter 3 of the Bill provides a mechanism for companies who do not fall within the ambit of the Chapter to increase the trust of the public in their perceived ability and benevolence, should they so wish. The Bill has expressly taken then concerns of employees and creditors into account, leaving open the possibility for class actions to be brought in the interests of the general public. Furthermore, business rescue is introduced as an alternative avenue for failing businesses where stakeholders such as shareholders, creditors, employees and trade unions are empowered with rights of participation in the rescue process.

In Chapter 5, the institutional reforms under the Bill introduce the Companies Commission and the Companies Ombud, which – while they are welcomed avenues for increased stakeholder participation in the governance of an entity – carry the concerns that they will be inadequately staffed and trained. The wide powers of search and seizure provided to inspectors and investigators for investigation of alleged contraventions, it is submitted, will assist with their tasks under the Bill, and will not unreasonably infringe on confidentiality. The extended standing provisions and increased whistle blower protection indirectly introduce an element of enlightened shareholder value model to the Bill's corporate governance structure. Furthermore, the provisions dealing with the determination of rights for security holders and appraisal rights will provide additional mechanisms for minority shareholders to take action where they are not satisfied with the manner in which their corporation is being operated. The derivative action, based largely on the Model Corporations Act has now also been brought in line with international procedure. The imposition of administrative fines allow the various institutions to ensure a measure of compliance with their directions to those who are found guilty of contraventions of the Bill, Memorandum or company rules.

The flexibility of the Bill is an innovative mechanism to permit freedom of choice for shareholders, and the drafters were, it is respectfully submitted, wise in allowing shareholders to regulate their corporate governance partially through the

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[460] Trade Unions have recently ensured that this right of access to information extends to them for purposes of participating in business rescue schemes. See *Cosatu Wins Changes in Companies Bill*, Michael Hamlyn, I-Net Bridge, 28 August 2008, Sunday Times Business at http://196.44.3.94:8070/article.aspx?id=832210.

Memorandum. However, while it is true that shareholders are not accorded rights by default in certain fundamental transactions where such rights were accorded to them by default under the Act, the argument that the Bill diminishes shareholder power is stronger in relation to subsequent shareholders, than initial shareholders. It is also noted that unlike the Companies Act of the United Kingdom, the Bill does not provide sufficient guidance to the board as to the extent to which stakeholder interests are to be taken into account in the board's dealings with third parties.

While shareholders may now specify qualifications and grounds for ineligibility and disqualification of directors in the Memorandum, the process for automatic rehabilitation for disqualified directors does not provide for adequate oversight by the Commission. This may result in persons who are not of 'character', holding positions on the board. The same could be said for the lack of screening process of directors accepting positions on the board.

Furthermore, while the shareholders must appoint fifty percent of the directors, and anyone so named in the Memorandum may appoint directors, the power to remove is still held by the shareholders in general meeting, which, depending on how high or low the initial shareholders have set the ordinary resolution threshold, may be easier or even more difficult to exercise, than under the Act. A further concern where shareholders have reduced powers, which cannot be remedied in the Memorandum, is where a company has more than two directors: the board is required to determine the removal. While anyone who voted otherwise may apply for a review the decision, the concern remains that a board may be more sympathetic to wayward directors than the company's shareholders.

In relation to the declaration by directors of interests in contracts with or connected with the company, the test for 'related persons' is correctly wider than that of the Model Corporations Act, although the definition of 'personal financial interest' does not include materiality, and is, as a consequence, unnecessarily wide. This may not be problematic for shareholders and stakeholders, although it will increase the burden on directors for minor disclosures. The new method to be followed for disclosure is stringent, however, problematically for the board and therefore, indirectly problematically for the shareholders, the board loses the disclosing director's expertise on the subject when he is required to leave the meeting.

A further concern for shareholders is that the duty of care and skill has now been tempered even further by the business judgment rule. The converse argument is; however, that they indirectly benefit from the encouragement of entrepreneurship through increased certainty for directors in respect of, at least, the duty of care and skill. The fact that the directors' fiduciary duties have not been fully codified in the Bill, is, it is respectfully submitted, a wise decision by the drafters. The concern that codification could lead to an erosion of the fiduciary duties should not be overlooked, although there still remains a lacuna in respect of educating directors in this area. It is submitted that perhaps a warranty signed by every director of every company that he has read and understood the Code on directors' duties should form part of the acceptance of office by a director, which is lodged with the Commission. The provision in the Bill dealing with directors' liability correctly retains reference to the common law, however, the laundry list of instances of liability may encourage subversion thereof.

The additional transparency and accountability provisions of Chapter 3 are a step in the right direction towards an enlightened shareholder value model, however, the Bill misses the target in that many widely-held, private companies will not get caught in the net, thus, their shareholders and stakeholders will be left wanting, unless the company voluntarily binds itself to the Chapter. It is submitted that the Minister should determine a shareholder threshold over which private companies are obliged to comply with the provisions of Chapter 3.

Business rescue is a welcomed mechanism for saving a failing company and the rights of interested shareholders have been taken into account, although for employees who are not creditors, this is somewhat of a hollow victory as their participation is limited to a consultative basis.

Access to information has correctly been extended only to shareholders, excluding trade unions. The path which the Bill takes is slightly wider than *Clutchco* and, it is submitted, adequately addresses the concerns of confidentiality. Increased protection for whistle blowing over and above the Protected Disclosures Act encourages the reporting of contraventions in a manner which has not been seen before under the existing Companies Act.

The extended standing provisions mimic section 38 of the Constitution in their breadth by providing standing to all interested persons. This may arguably indirectly

introduce an enlightened shareholder value mechanism to the Bill where the court or named institutions are facing an application by persons who are not shareholders.

The available remedies for aggrieved parties have been expanded under the Bill and this indeed provides comfort to such aggrieved parties, particularly when coupled with the extended standing provisions. Any shareholder may now apply for a rights determination and protection order. The court is also granted wide powers in actions involving alleged oppressive or prejudicial conduct and a right of action for such alleged conduct has also been extended to directors. Appraisal rights for dissatisfied minority shareholders have been borrowed from the United States, but, it is submitted, should only be available for completed corporate action to prevent harm to the majority. The procedure for launching derivative actions is also more favourable in the Bill than under the Act.

The Bill's institutional reforms are welcomed alternative avenues to air grievances, although, the concern is whether they will be able to function adequately with South Africa's limited resources. Any person may lodge a complaint, and the Panel and Commission have wide powers of investigation into such complaint, should they not deem the complaint frivolous or vexatious. Compliance notices may be issued or matters referred to the National Prosecuting Authority, and the failure to adhere to a compliance notice may result in the issuance of an administrative fine, damaging, both from a financial and reputation perspective, for corporations. Decisions of the Companies Ombud furthermore carry the weight of an order of court.

Although by no means encompassing a fully enlightened shareholder value model of corporate governance, the Bill manages to strike the right balance between flexibility through freedom of choice for shareholders, and accountability, in small private companies and public companies generally. However, the fact that public and private companies will no longer be limited by a predetermined number of shareholders means that private companies may be exceptionally widely-held. It is here that the flexibility accorded to the initial shareholders, when balanced with the concerns of accountability and transparency are most warranted, and here that the Bill appears to fail in achieving this balance. There are simply not enough mechanisms in the Bill to cater for the concerns of stakeholders of large private companies. Accordingly, in light of the purpose of an enlightened shareholder value model of corporate governance elicited above, these companies should take heed to ensure that they display towards their shareholders and stakeholders the ability and benevolence

which is not mandated from them under the Bill, in order to retain the public's trust in their operations.

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