

UNIVERSITY OF CAPE TOWN

FACULTY OF LAW

**WHAT IS THE ROLE OF THE SHAREHOLDERS VIS-A-VIS
OTHER SECURITY HOLDERS WITHIN THE CONTEXT OF
SHAREHOLDER CORPORATE GOVERNANCE WITH
RESPECT TO SOUTH AFRICAN COMPANIES ACT 2008?**

A minor dissertation presented in partial fulfilment of the requirements

for the

Degree of

MASTER IN LAWS IN COMMERCIAL LAW

By

MARY REBA CHABEDA MALEYA

CHBMAR001

Supervisor: Associate Professor Tshepo Mongalo

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DECLARATION

Research dissertation presented for the approval of senate in partial fulfilment of the requirements for the degree of master of laws in Commercial Law. The other part of the requirements 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 dissertation, including those relating to length and plagiarism, as contained in the rules of the university, and that this dissertation conforms to those regulations.

Signed by candidate

Mary Reba Maleya Chabeda

February 2010

DEDICATION

This thesis is dedicated to God Almighty for his favour, grace and blessings to me and my family.

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Special thanks go to my supervisor, Associate Professor Tshepo Mongalo for his advice, patience, direction and guidance from the beginning, during the course and to the completion of writing this thesis.

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ABSTRACT

Post-Apartheid South Africa is an altogether different place politically, socially and economically. Due to the rapid changes since 1994, several laws have been amended or repealed to reflect the newly found democracy. One such law is the Companies Act.

This paper examines the proposed Companies Act 71 of 2008 together with its 1973 counterpart with special emphasis on the definition and role of the shareholder for corporate governance purposes.

In this paper, I seek answers to the following questions: Has the definition of the term shareholder for purposes of corporate governance changed in the proposed Act? Can one confer upon other security holders rights previously exclusively reserved for the traditional shareholder? What the real implications are if any, of such conferment? Whether effectively the position of the traditional shareholder has been usurped or weakened or remains the same? Whether there is a shift in the corporate governance ideology within the new proposed legislation in the South African context and who the real beneficiaries are?

In seeking answers to the above questions, this paper consequently examines the various definitions of a shareholder including those under the current and proposed Companies Acts and further carries out a comparative analysis between South Africa and a three other jurisdictions. It also examines the definitions and rights accruing to the other security holders not traditionally deemed as shareholders. It then examines whether there has been conferment of governance rights previously exclusive to traditional shareholders upon these other security holders and the effects of such conferment if any. Lastly, the paper examines whether there is a paradigm shift in corporate governance ideology within the jurisdiction and whether or not it is ideal for the South African context.

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CHAPTER 1

INTRODUCTION AND BACKGROUND

1.1 Introduction and overview of the Companies Act 2008

1.1.1 Brief Historical Background of South Africa's Business Environment

Prior to 1994, the South African corporate environment was that of exclusion. The country's Constitution allowed for discrimination in all levels of society in a system known as apartheid. This included small and medium businesses as well as companies.

Indeed it has been noted that business was central to the economy that sustained the South African state during the apartheid years. Certain business were involved in helping to design and implement apartheid policies while other business benefited from co-operating with the security structure of the former state. Most white-owned business benefited from operating in a racially structured context.¹

[Apartheid] was a system of racial minority rule that was both rooted in and sustained by white minority socio-economic privilege at the expense of the historically oppressed black majority. Apartheid was highly associated with unequal distribution of income wealth and opportunity that largely corresponded to the racial structure of the society.²

Apartheid was not a sustainable ideology as the world was now celebrating a new set of ideologies after the collapse of the cold war which had dominated most of the 80's and early 90's between the Western Europe and Soviet bloc countries .

These attitudes could not be promulgated any longer and in 1994 a democratic election was held which placed the black majority in power. As a result, many laws needed to be reviewed and some repealed to reflect the newly found freedom and politico-socio atmosphere of the now newly democratized South African nation. One such law was the Constitution.

¹ Nicoli Natrass 'The truth and reconciliation commission on business and apartheid: critical evaluation' (July 1999) 98(392) *African Affairs* 373 at 374.

² Ibid at 376.

From then onwards, there has been widespread reform and many other laws have been amended, reviewed or repealed to be in alignment with the post-apartheid Constitution or simply to reflect current global economic trends. One such statute is Companies Act³.

1.1.2 Companies Act Overview

The Companies Act of 1973⁴ (also referred to hereinafter as the 'Current Act') was first enacted more than 30 years ago. Since 1974, the manner in which business was conducted throughout the world has undergone radical change with some of the main reasons being the ascendance of the free enterprise system, the ease of global travel and the telecommunication revolution, in particular within the realm of electronic communication.

These factors, among others, have resulted in an exponential increase in global and cross-border transactions and the emergence of stock markets and mutual funds as the vehicles through which trillions of dollars have been invested to enable people living in different countries to invest their funds throughout the world.

We have also witnessed the emergence of the private sector as a key player in industries which were hitherto either monopolised or dominated by State owned entities (hereinafter 'SOEs'), such as power, telecommunications and transport. Few would argue that this revolution in business practice has not been beneficial for the global economy.

Unfortunately, the increased role and influence of the multi-national corporation has led to abuse by some of their controllers' powers, to the severe detriment of the public at large. There are many such examples: Enron, Arthur Andersen and Parmalat are cases in point.

The reaction of governments and regulators to this abuse has been to increase considerably the disclosure of information required by corporations and to impose more stringent accounting requirements, stricter regulation of public companies, and more stringent rules as to the manner in which companies, and directors in particular, discharge their duties and responsibilities to investors and third parties with whom they transact.

³ Act 61 of 1973.

⁴ Ibid.

Although the Standing Advisory Committee on Company law in South Africa had over the years made a number of recommendations for the amendment and improvement of the Companies Act 26 of 1973 (the Act has been amended more than 40 times), it is perhaps fair to say that the Act had not been subjected to a comprehensive review to reflect the fundamental developments that had and continue to take place in South Africa and elsewhere.⁵

The effect was a cumbersome and outdated 'cut and paste' piece of legislation hence the urgent need to reform South African company law in order to bring it in line with international best practice and to enhance transparency and good corporate governance.

This resulted in the publication of the Companies Bill 2007, which is now the Companies Act of 2008⁶ (hereinafter also referred to as the 'Proposed Act') and comes into effect in 2010.

The Proposed Act seeks to achieve the most efficient and workable company law regime by simplification, flexibility, corporate efficiency, transparency and predictable legislation.

It is noteworthy to state that before the reforms on the Current Act now embodied in Proposed Act, there had been some major amendments in 2006 through the Corporate Laws Amendment Act⁷. The Act⁸ was meant to amend specific sections deemed necessary in the short term prior to the completion of South Africa's corporate law reform process and pending the coming into force of the Proposed Act. These changes were warmly welcomed by the business community as they had been long overdue.

This notwithstanding, the Proposed Act inter alia introduces a number of significant principles such as:

- a) The introduction of new definitions and generally modernizing company law as a whole;
- b) It also introduces the solvency and liquidity test;

⁵ Jopie Pretorius 'The future of South African company law?' (2004) Vol 12, Issue 2 *Juta's Business Law*, 66.

⁶ Act 71 of 2008.

⁷ Act 24 of 2006.

⁸ Ibid.

- c) Further, the Proposed Act provides for provisions and procedures relating to certain 'Fundamental Transactions', namely schemes of arrangement and disposals of businesses or the greater part of a company's assets are radically changed;
- d) The Proposed Act also brings our company law in line with best practices internationally, especially in relation to public companies and offers of securities to the public;
- e) The Proposed Act extensively changes the provisions relating to meetings of shareholders and directors (including voting) and communications in order to give more flexibility and to modernise the Current Act;
- f) It also introduces flexibility in the design of company by, for example, scrapping par value shares and share premium. Only no par value shares will exist;
- g) The Proposed Act further introduces a new business rescue regime which replaces the current judicial management system of failing companies;
- h) It also introduces protections for minority shareholders by introducing several new remedies and procedures while retaining almost all such protections which are presently contained in the Current Act;
- i) It introduces a host of new provisions which promote transparency, high standards of corporate governance and accountability;
- j) The duties and responsibilities of directors and therefore personal liability of directors are greatly increased. In particular, the Proposed Act codifies the common law duties of directors;
- k) It makes company law simpler to administer, enforce and understand;

- l) It retains all the new principles introduced by the 2006 Act⁹, as previously described;
- m) It also creates new statutory bodies which will administer and enforce the Proposed Act and, in some instances, provide alternative methods to resolve disputes; and
- n) The Act hugely decriminalises our company law and only retains a handful of the more serious offences and replaces them with a system of administrative enforcement and fines.¹⁰

1.2 The Current Act versus the Proposed Act Definitions: Is it just semantics?

The focus of this thesis shall not be on reforms of the whole statute but mainly a comparison of definitions in the Current Act vis-à-vis the Proposed Act and any possible effect or consequence of such definitions or interpretations, specifically focusing on the term 'shareholder'.

I shall begin with the dictionary meaning in attempting to decipher what the Proposed Act defines a 'shareholder' as. According to the Black's Law dictionary a 'shareholder' is defined as:

'One who owns or holds a share or shares in a company, esp. a corporation. - Also termed a *share owner* ;(in a corporation) *stockholder*.'¹¹

This definition above is the basic meaning most people, whether legal or business oriented, have assigned to the term 'shareholder'.

However to put this in the South African legal perspective, we need to know what the statute definition is. Accordingly, the Current Act states as follows:

Who are members of a company?

- 1) The subscribers of the memorandum of a company shall be deemed to have agreed to become members of a company upon its incorporation, and shall forthwith be entered as members in its register of members.

⁹ Ibid.

¹⁰ Carl Stein 'The reform of South Africa's company law.' Available at www.law24.com [Accessed 6th August 2009].

¹¹ Bryan Garner *Black's law dictionary* 7ed (1999) 1380.

- 2) Every other person who agrees to become a member of a company and whose name is entered in its register of members shall be a member of the company.

- 3) A company shall, subject to the provisions of its articles, enter in the register as a member, *nomine officii* of the company, the name of any person who submits proof of his appointment as the executor, administrator, trustee, curator or guardian in respect of the estate of a deceased member of the company or of a member whose estate has been sequestrated or of a member who is otherwise under disability or as the liquidator of any body corporate in the course of being wound up which is a member of the company, and any person whose name has been so entered in the register shall for the purposes of this Act be deemed to be a member of the company.

- 4) Subject to the provisions of section 213 (1) (b), the bearer of a share warrant may, if the articles of the company so provide, be deemed to be a member of the company within the meaning of this Act, either for all purposes or for such purposes as may be specified in the articles.¹²

From the foregoing, it is clear that the Current Act does not expressly define the term 'shareholder'. We can therefore only infer that the definition of the term 'shareholder' falls within the meaning of the term 'members' in section 103 above which includes subscribers to the memorandum of the company and anyone whose name is included in the register of the Company.

To further investigate, other inferences may be drawn from English case law which has tried to distinguish and define the terms 'shareholder' and 'member'. In *Inland Revenue Commissioners v Tring Investments Limited* Macnaghten J noted that:

... In the ordinary way, the term 'a member of a company' is synonymous with the term 'shareholder' but, for the purposes of the statutes relating to income tax, the term has been specially defined as "any person having a share or interest in the capital or profits or income of a company".¹³

Macnaghten J's definition is self explanatory and straightforward. However according to the Halsbury's Laws of England, a 'member' has been described as:

...those persons (including corporations, if any) who collectively constitute the company or in other words its corporators. A member is not necessarily a

¹² Companies Act (note 3) s103.

¹³ [1939] 2 All ER 105.

shareholder because an unlimited company or a company limited by guarantee may exist without a share capital.¹⁴

The Halsbury definition tries to distinguish between companies with shares and those without shares and in doing so states that a 'member' needs not be a 'shareholder'. This creates room for debate which we shall not investigate for now but shall instead focus on the South African position.

Various scholars have agreed that under South African company law, the terms 'member' and 'shareholder' have often been used as having a synonymous meaning. More specifically a 'member' has been defined as:

... [a person with] an interest in the company entitling him inter alia and subject to the constitution, to (a) a share in profits of the company (b) attendance and a vote at meetings of the company ;and (c) a share in the surplus assets (if any) when the company is wound up.¹⁵

From the foregoing submissions, it is my view that the term 'shareholder' would rightfully fall within the meaning of 'members' under South African law and is in fact usually used interchangeably to mean the same thing.

Having clarified the definition of the 'shareholder' as understood within the current South African context, I would like to refer back to our earlier discussion in paragraph 1.1.2 (a) above and state that it is clear that the Proposed Act seeks to expressly define more corporate law jargon than its predecessor did to avoid inferences and ambiguities such as those discussed hereinabove, and also make understanding of company law simpler for all.

In doing so, section 2 of the Proposed Act defines the term 'shareholder' as follows:

'...subject to section 57(1), [shareholder] means the holder of a share issued by a company and who is entered as such in the *certificated or uncertificated securities* register, as the case may be.'

Section 57(1) goes on to state that:

'In this Part[F], shareholder means a person who is entitled to exercise *any voting rights* in relation to a company, *irrespective of the form, title or nature of the securities* to which those voting rights are attached.'¹⁶

¹⁴ Lord Mackay of Clashfern '*Halsbury's laws of England*' Volume 7(1) Reissue 4ed (2004) para 750, 525.

¹⁵ JT Pretorius et al '*Hahlo's South African company law through the cases*' 6ed (1999)175.

¹⁶ Emphasis in italics in s2 and s57 (1) is my own.

From the Proposed Act definition, we have to examine whether the law expands the meaning of what is traditionally known as 'shareholder' to include other security holders such as debenture holders or not. However what is clear from the section 57 definition is that for purposes of governance, 'shareholders' shall be deemed to include all security holders with voting rights.

*Who then is a security holder?*¹⁷

In order to understand the meaning of who 'a security holder' is, one must first understand what the definition of a security is.

According to Black's law dictionary a 'security' is defined as follows:

A security indicates an interest based on an investment in a common enterprise rather than direct participation in the enterprise ... a security is any interest or instrument relating to finances including a note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest, or participation in a profit sharing agreement ...¹⁸

It is common knowledge that in most listed companies the capital structure is made up of share capital and debt.

Share capital is constituted by shares, also referred to as stock, which may normally be divided into different classes by the memorandum or articles of a company entirely dependent on the company's capital requirements. The divisions are broadly based on the nature of rights afforded to them with regard to dividends, general voting at meetings and participation in distribution of assets on liquidation.

In broad terms the three main classes of shares may be described as ordinary shares, preference shares and deferred shares. The articles may authorize a company, by special resolution, to convert any of its shares into that of another class and thus vary the rights that attach thereto.

On the other hand debt may be in form of debentures which in turn include debenture stocks, bonds and any other securities whether constituting a charge on the assets of a company or not; or creditors.

¹⁷ Note that for the purpose of this thesis, any references to companies shall mainly be on those companies that are publicly listed on the Johannesburg Stock Exchange unless otherwise stated.

¹⁸ Garner (note 11) at 1358.

Debentures may also be divided into different classes such as redeemable or irredeemable debenture which they may be converted to, further they may also be converted into other forms of securities such as shares.

The discussion on securities and the rights accruing to them shall be resumed in chapter 2 in more detail.

For now the next question we should examine is, whether there is intention in the Proposed Act to confer rights to other persons other than the traditional shareholder and whether it is indeed feasible.

1.3 Can shareholder rights be conferred to persons other than shareholders and if yes how?

The general position for most jurisdictions including South Africa is that within corporations, the general meeting and the board of directors are the two main corporate governance organs.

All major decisions regarding the structure and fate of the company such as alterations in the memorandum and articles, alterations of capital, variation of shareholder rights, disposal of the undertakings or major assets of the company, amalgamations and reconstructions and the voluntary winding up of the company have to be approved by the shareholders. This because in effect, they are the owners of the undertaking.

The board on the other hand is the controlling mind of the corporation which has power vested in it by the memorandum or the articles.

The shareholders are therefore the supreme organ and can act in place of the directors and may even ratify ultra vires acts of the company or a director if such act was necessary for the smooth running of the company.¹⁹

Can one therefore purport to confer voting rights to other security holders?

Professor Tracy²⁰ says that indeed the law is fairly well established on this. He goes on to state that:

- a) Without consent of the state, a corporation cannot confer voting rights upon holders of fixed obligations;
- b) With such consent, voting rights may be conferred;

¹⁹ Bamford V Bamford [1969]1 All ER 969(CA).

²⁰ John Evarts Tracy 'The problem of granting voting rights to bondholders' (1934)2 *The University of Chicago Law Review* 208 at 212.

- c) Consent of the state may be conferred by a permissive general statute unless there shall be a provision in the state constitution expressly providing that the voting rights shall be on the stock holders;

Professor Tracy speaks on this issue from the American perspective and states that the right to vote at corporate elections or any other right held by the shareholders can be lawfully conferred upon holders of securities of corporations.²¹

He states that:

It seems fairly certain, therefore that the right to vote at corporate elections can lawfully be conferred upon holders of securities of corporations organized under the laws of any of the above six states and of any other states which may adopt similar legislation.²²

He quotes an excerpt from section 36 of the General Corporation Act of Michigan, which reads as follows:

Every corporation formed existing under this Act ,may make suitable provision in its articles and thereby, to the extent, in the manner and subject to the conditions provided in the articles, confer upon the holders of any bonds or debentures issued or to be issued by any such corporation, whether secured by mortgage or otherwise, the power to vote in respect to the corporate affairs and management of the corporation to the same extent and in the same manner as shareholders of the of the said corporation, as may be provided in the articles and, in case of default in payment of principle or interest on such bonds or debentures, or otherwise, or in any other case confer upon such bondholders or debenture holders the same right of inspection of the corporate books ,accounts and records of any such corporation, and also any other rights which the shareholders of the corporation have or may have by reason of the provisions of the statutes of this state or pursuant to the provisions of the articles.²³

The provisions of above Act were very explicit and granted voting rights and any other rights held by the shareholders to the debt holders through the articles of association of the corporation.

²¹ Ibid at 213.

²² Ibid .The six states referred to are Delaware , Louisiana, Michigan , Nevada, Ohio and Virginia.

²³ Provisions of the Michigan General Corporation Act of 327 of 1931 were repealed by the Michigan Business Corporation Act 284 of 1972.

This Act was however later repealed by the Michigan Business Corporation Act.²⁴ It is however noteworthy to state that section 450.1391 of the said Michigan Business Corporation Act which repealed section 36 of the General Corporation Act, notwithstanding with less detail, still provides for the inspection and voting rights of bondholders. The section states that:

(1) A corporation, in its articles of incorporation, may confer upon the holders of bonds issued or to be issued by it, rights to inspect the corporate books and records and to vote in the election of directors and on any other matters on which shareholders of the corporation may vote to the extent, in the manner, and subject to the conditions prescribed in the articles. The articles may grant to the board the power to confer such voting or inspection rights under the terms of any bonds issued or to be issued by the corporation.²⁵

It is therefore clear from statute above and legal scholars that it is indeed possible for the right to vote at corporate elections to be conferred upon holders of securities of corporations organized under the laws of a state with the legislation allowing for such clause.

From the preceding discussion, it is my view that a country's Constitution or whichever supreme law is in place must give effect to legislation governing matters of corporations. Once the corporation laws in place have the pre-requisite provisions, and depending on the wording of such provisions, the companies can thereafter give effect to the said provisions and translate them into their articles of association which in turn give effect to the rights of shareholders, debt holder's or other security holders within the corporation.

How then can such rights be conferred?

The answer to this question may vary depending on the wording of the provisions of one statute to the next.

A company that wishes to confer any such rights on any security holder must consider the following check-list:

- Does the state confer statutory right on a company through legislation?
- What are the conditions /provisos attached to the statutory right?
- Has the company fulfilled the conditions aforementioned?

²⁴Michigan Business Corporation Act 284 of 1972.

²⁵ Ibid.

- Does the company constitution i.e. the articles of association reflect the existing / new position?

To begin with, the statute providing for any such right should clearly and unambiguously provide as such. In doing so, the provision should clearly state how it should be applied.

The statutory provisions may automatically confer the rights upon a certain class of persons or may provide for further conditionality. For example; the provision may state that any corporation wishing to rely on the statutory provision must specifically provide for the same in its articles of association.

Some legal minds may further require or insist that there should be a clause in the articles of association of a company specifically stating which security holders have such rights conferred upon them or require that the specific rights be enumerated and also that the articles specifically state when the rights may or should be exercised.

If the statutory provision provides that a general or specific clause be inserted in the articles of association, then a meeting of the shareholders would have to be called to amend the articles in the case of an already formed company. This process should not differ from the acquisition or conferment of any other statutory right.

1.4 A Comparative Study of other Jurisdictions

Are there jurisdictions with provisions which allow for security holders to exercise voting rights other than shareholders?

1.4.1 United Kingdom Position

English law and legal systems have largely influenced world legal systems over the years including that of South Africa. This has been due to its detailed and sound decisions, good grasp on complex legal matters in many areas including corporate law and corporate governance.

To begin with, in order to incorporate a company under the English legal system, one has to be in compliance with the Companies Act²⁶ and further depending on what kind of business the company carries on, other subsidiary legislation such as insurance, financial services Acts et cetera may be applicable.

²⁶ U.K Companies Act of 2006.

The Act²⁷ leaves an enormous amount of discretion to the individual companies as to the detailed management of affairs and secondly it covers both public and private companies.²⁸

The corporate structure in the UK is similar in many ways to that of South Africa. The members form the company and its memorandum of articles. The members also appoint directors who form a single tier board.²⁹

Who then is a 'member' or 'shareholder' under the English Act³⁰ ?

The Act does not define the word 'shareholder' but defines the word 'member' to mean:

- (1) The subscribers of a company's memorandum are deemed to have agreed to become members of the company, and on its registration become members and must be entered as such in its register of members.
- (2) Every other person who agrees to become a member of a company, and whose name is entered in its register of members, is a member of the company.³¹

This definition almost resonates with that of the Current South African Act aforementioned in paragraph 1.2 and consequently we can make similar inferences i.e. the meaning of the term 'shareholder' is included within the meaning of the term 'member' or that terms can be used or are used interchangeably.

However on the other hand, and departing from the South African Act³² position, it is interesting to note that the English Act³³ accommodates and recognizes companies that wish to grant voting rights to debenture holders in addition to ordinary and preference shareholders.

The Act provides as follows:

- (1) For the purposes of this Chapter debentures issued by a company to which subsection (2) applies are treated as shares in the company if they carry voting rights.
- (2) This subsection applies to a company that has voting shares, or debentures carrying voting rights, which are admitted to trading on a regulated market.³⁴

²⁷ Ibid.

²⁸ Arthur R Pinto and Gustavo Visentini *The legal basis of corporate governance in publicly held corporations: a comparative approach* vol 1 (1998) 220.

²⁹ Ibid at 226.

³⁰ U.K Companies Act (note 26).

³¹ Ibid s112.

³² Companies Act (note 3).

³³ U.K Companies Act (note 26).

³⁴ Ibid s990 (1) and (2).

From the above section, it is clear that the Act³⁵ envisages a situation where security holders may have voting rights and participate in voting just like their ordinary and preference shareholder counterparts even though it does not explicitly confer the said rights.

Further in defining 'voting rights' the Act states that:

'[Voting rights are] rights to vote at general meetings of the company in question, including rights that arise only in certain circumstances.'³⁶

In my view, the Act distinguishes between the general rights to vote on any occasion on one hand, and rights to vote in particular circumstances on the other. Notably the Act seems to make provision for both scenarios in its definition as seen above.

1.4.2 Canadian Position

Under its Constitution Act of 1867, incorporation power is given to both the provincial and the federal governments. Section 92(11) of the Constitution allocates to the provincial legislatures 'The Incorporation of Companies with Provincial Objects'. This does not restrict the activities of provincially incorporated corporations to substantive areas reserved to provincial legislative competence. On the contrary these corporations can engage in activities within the federal legislative sphere in so far as they are in compliance with applicable federal legislation.³⁷

In general, federal corporations are obligated to comply with provincial legislation in the same way as natural persons or provincial corporations however a province may not condition the right of a federal corporation to do business within a province or to bring a suit in the courts of a province upon compliance with licensing requirements for extra provincial corporations.³⁸ It is therefore clear that federal incorporation is no licence to ignore provincial law.

The result therefore of the dual incorporation law systems is that in general there is no constitutional reason why federal incorporation is more desirable than a

³⁵ Ibid.

³⁶ Ibid s953(9), 971(1), 991(1) and 992(2).

³⁷ Buckley FH et al *Corporations: principles and policies* 3ed (1995)156-157. These principles were re-emphasized in *Alberta Government Telephones V CRTC* [1989]2 S.C.R.225.

³⁸ This was the principle upheld in the cases of *John Deer Plow Co. V Wharton* [1915] AC 330 PC and *Great West Saddlery Co. V King* [1921] 2 A.C 91. Also see Buckley FH et al *Corporations: principles and policies* '3ed (1995) 158.

provincial one because both systems have their pros and cons and therefore it really is up to the incorporators to decide what system works best for the company.³⁹

Under the federal system, one can incorporate a company under the Canada Business Corporations Act (hereinafter 'CBCA')⁴⁰.

On reviewing the CBCA for any provisions allowing or granting similar rights to both security holders and shareholders, there is no provision for this whatsoever. The CBCA maintains the traditional corporate governance position where the centres of control are left to the traditional shareholders and the board of directors.

Even though the CBCA does not define the terms 'shareholder' or 'member'⁴¹, all the references made regarding or relating to the election of and appointment of directors⁴² or any other matters relating to the company at shareholder meetings are directed to the traditional shareholder⁴³.

To compare and contrast the federal with the provincial legislation, I arbitrarily opt for Quebec and Ontario provincial statutes for the purpose my study.

The Quebec's Companies Act⁴⁴, does not depart from the spirit of the provisions in the CBCA. It goes on to conservatively define a 'shareholder' as:

'...every subscriber to or holder of stock in the company, and includes the representatives of the shareholder.'⁴⁵

The Act further affirms this position in section 48 by granting voting rights specifically to shareholders of different classes only and not to any other security holder.⁴⁶

The Ontario Business Corporation Act⁴⁷ also does not deviate from the CBCA position or Quebec Companies Act position as seen in its definitions and interpretations section. This section defines 'voting security' as:

'...any securities *other than a debt obligation* of a body corporate carrying a voting right either under all circumstances or under some circumstances that have occurred and are continuing.'⁴⁸

³⁹ Buckley FH (note 37) 159.

⁴⁰ Canada Business Corporations Act of 1985

⁴¹ Ibid 85 s24(3) and (4).

⁴² Ibid s106(b).

⁴³ Ibid s138(3.1).

⁴⁴ Quebec Companies Act of 1981.

⁴⁵ Ibid s3(4).

⁴⁶ Quebec Companies Act (note 44).

⁴⁷ Ontario Business Corporations Act of 1990.

⁴⁸ Ibid s1. Note that emphasis in italics is my own.

The Act also grants the right to vote strictly to shareholders and does not make reference to any other security holders.⁴⁹

Notwithstanding the foregoing, it is important to note that debenture holders have the right to vote in the event that their interest is in arrears. This position was long-established under case law as seen in *Weddell Vs Ritchie*⁵⁰ where the question was raised as to whether:

- i. The holders of bonds were entitled to vote at a general meeting when the interest upon the bond is in arrears, and;
- ii. If yes, the extent to which the bondholders held the said voting rights.

The Appellate court replied in the affirmative to the first issue and as relates the second stated that if the Act provided that they would have equal rights to shareholders then that would be the position.

From the above discussion, it is clear that the Canadian position on the definition and role of the shareholder is conservative because all the Acts reviewed, both federal and provincial, maintain the traditional centres of authority within the corporate governance structure.

1.4.3 American Position

Other than its obvious geographical proximity with Canada, the American legal framework is a little similar to that of Canada. Both systems are two tier i.e. federal and state system and federal and provincial system respectively.

The laws of the United States of America are divided into Federal and State law as aforementioned. Federal law, simply put is the umbrella law that governs all the states that comprise the United States of America and is enacted by the United States Congress while state law is enacted by and governs the individual states.

State law usually provides the rules and regulations governing the relationship between shareholders and managers and governs incorporation of corporations in general.

Among the many states that comprise the United States of America, Delaware has the most sophisticated and advanced company law, corporation law

⁴⁹ Ibid s102(1).

⁵⁰ [1905] Carswell Ont 297, 10 O.L.R 5 (Ont C.A).

codes and corporate governance. Indeed fifty-six percent of the largest listed companies in America are incorporated in Delaware and further forty-five percent of the companies traded on the New York Stock exchange are similarly incorporated in the state of Delaware. These statistics are significant because Delaware law is applied to the internal affairs of these companies. Thus, Delaware statutory and case law is significant to the understanding of the regulation of publicly held companies.⁵¹ For this reason closer examination of the Delaware Corporation law is inevitable.

In examining the said law, the Delaware General Corporation Code narrowly defines a stockholder as follows:

...holder of record of stock in a stock corporation, or a person who is the beneficial owner of shares of such stock held either in a voting trust or by a nominee on behalf of such person, and also a member of a non-stock corporation as reflected on the records of the non-stock corporation.⁵²

Despite this, the Code further distinguishes the voting rights of the various security holders including but not limited to the stockholders. As relates the rights of debenture or bond holders, the code reads as follows;

Every corporation may in its certificate of incorporation confer upon the holders of any bonds, debentures or other obligations issued or to be issued by the corporation the power to vote in respect to the corporate affairs and management of the corporation to the extent and in the manner provided in the certificate of incorporation and may confer upon such holders of bonds, debentures or other obligations the same right of inspection of its books, accounts and other records, and also any other rights, which the stockholders of the corporation have or may have by reason of this chapter or of its certificate of incorporation. If the certificate of incorporation so provides, such holders of bonds, debentures or other obligations shall be deemed to be stockholders, and their bonds, debentures or other obligations shall be deemed to be shares of stock, for the purpose of any provision of this chapter which requires the vote of stockholders as a prerequisite to any corporate action and the certificate of incorporation may divest the holders of capital stock, in whole or in part, of their right to vote on any corporate matter whatsoever, except as set forth in paragraph (2) of subsection (b) of § 242 of this title.⁵³

⁵¹ Pinto and Visentini (note 28) at 254.

⁵² Delaware General Corporation Law Code s 220(2) .Available at <http://delcode.delaware.gov/title8/c001/sc07/index.shtml> [Accessed on 27th August 2009].

⁵³ Ibid s221.

From the foregoing it is clear that the laws of an individual state may permit the companies incorporated under them to confer voting rights to security holders and in effect refer to them as 'stockholders', albeit through the certificate of incorporation.

This trend is seen in a number of other states across the United States of America including Michigan mentioned in 1.3 above notwithstanding the fact that the wording may have been slightly varied from one state to the next. These states inter alia include California⁵⁴, Kansas⁵⁵, Louisiana⁵⁶, Maryland⁵⁷, Minnesota⁵⁸, Oklahoma⁵⁹, Virginia⁶⁰ and New York⁶¹.

In conclusion, this chapter has given us a better understanding of the Proposed and Current Act definitions of the term 'shareholder' and we are able to recognize the meanings appropriated to the term under both the South African and English law.

Further, we have been able to establish that indeed rights may be conferred to bondholders or other security holder through legislation and that such legislation may further specify any additional conditions required by a company before the rights are thus conferred.

Lastly, this chapter has provided a comparative analysis of selected jurisdictions and confirmed that some jurisdictions explicitly confer rights upon debenture holders similar to those of shareholders, in other jurisdictions such

⁵⁴ California Corporations Code s204(a) (7). Available at <http://www.leginfo.ca.gov/calaw.html> [Accessed on 18th August 2009].

⁵⁵ Kansas Corporations Code s17-6511. Available at http://law.justia.com/kansas/codes/chapter17/statute_8122.html [Accessed on 18th August 2009].

⁵⁶ Louisiana Corporations and Associations Code s12- 75(H). Available at <http://law.justia.com/louisiana/codes/html>. [Accessed on 18th August 2009].

⁵⁷ Maryland Financial Institutions Code s3-312 .Available at <http://law.justia.com/maryland/codes/gfi/3-312.html> [Accessed on 18th August 2009].

⁵⁸ Minnesota Business Corporations Code s302A.445(4).Available at <http://law.justia.com/minnesota/codes/300/302a-s445.html> [Accessed on the 20th August 2009].

⁵⁹ Oklahoma Corporations Code s18-1066 .Available at <http://law.justia.com/oklahoma/codes/os18.html> [Accessed on the 20th August 2009].

⁶⁰ Virginia Corporations Code s 13.1-662 .Available at <http://law.justia.com/virginia/codes/toc1301000/13.1-662.html> [Accessed on the 27th August 2009] .

⁶¹ New York Business Corporation Code s518 (c).Available at http://law.justia.com/newyork/codes/business-corporation/bsc0518_518.html[Accessed on the 27th August 2009].

interferences may be implied within statute and in others, no rights whatsoever are granted.

CHAPTER 2

RIGHTS OF SECURITY HOLDERS UNDER THE 1973 ACT

In order to analyse and understand the provisions of the Proposed Act, one must have a good understanding of what securities are provided for and available to listed companies under the Current Act. This information builds on what was briefly discussed paragraph 1.2 of the previous chapter.

The focus of this chapter therefore shall be on the various securities available and the corresponding rights accruing to each security holder broken down under the following sub-headings: shareholders, debenture holders and hybrid securities.

2.1 Shareholders

It is the case in most jurisdictions that the shareholder, more so the ordinary shareholder, has the majority of exercisable rights within a company by virtue of the fact that they are the residual owners of the company. There is a whole bundle of rights attaching to a shareholder vested by law and also including all the rights embodied in the constitution of the company.

These rights generally include:

- The right to attend and vote at meetings.
- The right to share in the company's earnings or participate in dividend
- The right to receive information about the company.
- The right to stand for the office of director.
- The right to partake in the proceeds of the company on liquidation.
- Pre-emptive rights over the new issues of shares.
- The rights to sell or trade their shares.

One can say that the shareholder principally has three main rights enumerated below which are;

- i. The right to attend and vote meetings of members.

- ii. The right to participate in dividends.
- iii. The right to participate in the surplus assets of the company in the event of winding up.⁶²

2.1.1 The right to attend and vote in meetings⁶³

Of all the rights of shareholders, the right to attend meetings and vote is the most fundamental for purposes of corporate governance. This is because shareholders or members are one of the two most important organs in a company, the other being the board of directors.

Shareholders determine the content of the memorandum and the articles of association and in doing so determine the managerial powers vested upon the managers or directors of the company and as such theoretically wield the most power. These powers can only be exercised through a vote which is done through company meetings.

There are two kinds meetings; the day to day decisions which are made by the board of directors and the executive management , since it would be impossible to call meetings every time a decision had to be made due to the sheer numbers and dispersion of the shareholders on one hand, and meetings of members on the other.⁶⁴

Who may vote at meetings?

The Act is clear on this issue .Section 193 on voting by the shareholders provides that:

- 1) Subject to the provisions of sections 194 and 195 and to the exceptions stated in section 196, every member of a company having a share capital shall have a right to vote at meetings of that company in respect of each share held by him.
- 2) Every member of a company limited by guarantee shall, unless the articles otherwise provide, have the right to vote at meetings of that company and shall have one vote.

From this section, it is clear that the Act envisages voting rights vested in the holders of share capital of the company only. No inferences are made of other

⁶² Tshepo Mongalo *Corporate law and corporate governance: A global picture of business undertakings in South Africa* (2003) 125-126 and RC Williams *Concise corporate and partnership law* 2ed (1997) 207-208.

⁶³ Companies Act (note 3) s193-198.

⁶⁴ Mongalo (note 62) at 248.

persons other than members of the company who, for all intents and purposes, include ordinary and preference shareholders. Note however that in the case of preference shareholders, the Act allows for the limiting of such rights by the articles except in certain specified circumstances.⁶⁵

What matters are decided at members meetings?

Matters are resolved in a company by resolution, either special or ordinary. Depending on the gravity of the matter, the resolution will either be special or ordinary. A special resolution requires a 75% majority of persons present and voting while an ordinary resolution requires a simple 51% majority.

Typical matters resolved by special resolution include ; converting one type or form of company into another type or form⁶⁶ , change of name ⁶⁷, alteration of objects and powers⁶⁸ , alteration , removal or incorporation of conditions in the memorandum ⁶⁹, alteration of articles ⁷⁰ alteration of share capital⁷¹ , authorising payment of interests on shares out of capital⁷² , authorising issue of shares of par value at a discount ⁷³, acquisition of own shares⁷⁴ , conversion of shares into stock and vice versa⁷⁵ , payment or any benefit or advantage to any director⁷⁶ ,approval of share option schemes for directors⁷⁷ , making loans to directors ⁷⁸, approval of

⁶⁵ Companies Act (note 3) s194(1) provides:

Notwithstanding the provisions of section 193 (1), the articles of a company may provide that preference shares shall not confer the right to vote at meetings of the company except-

(a) during any period determined as provided in subsection (2) during which any dividend or any part of any dividend on such shares or any redemption payment thereon remains in arrear and unpaid; or

(b) in regard to any resolution proposed which directly affects any of the rights attached to such shares or the interests of the holders thereof, including a resolution for the winding-up of the company or for the reduction of its capital.

⁶⁶ Ibid s23-25.

⁶⁷ Ibid s44.

⁶⁸ Ibid s55.

⁶⁹ Ibid s56.

⁷⁰ Ibid s62(1) .

⁷¹ Ibid s75.

⁷² Ibid s79.

⁷³ Ibid s81.

⁷⁴ Ibid s85.

⁷⁵ Ibid s100.

⁷⁶ Ibid s227.

⁷⁷ Ibid s223.

⁷⁸ Ibid s226(2)a.

payments to directors for loss of office⁷⁹, getting an inspector appointed by the minister to investigate company affairs⁸⁰, winding-up by the court⁸¹, voluntary winding up⁸², sanctioning an arrangement between the solvent company and its creditors⁸³, sanctioning acceptance of shares in another company in exchange for assets of company wound-up voluntarily⁸⁴ and disposal of records of company wound-up voluntarily by members⁸⁵. All other matters are resolved by ordinary resolution.

The meetings, and especially the Annual General Meeting (AGM), have always been the domain of the shareholders who are supposed to play critical role in corporate governance in exercising their powers to discipline the management and improve the standards of the company. Whether this is or has been the case has been the subject of many a debate whose jury is still out.⁸⁶ We shall however critically analyse this right to vote and attend meetings in light of the Proposed Act in latter chapters of this paper.

2.1.2 The right to participate in dividends

A company has the power to distribute its divisible profit by way of dividend unless its memorandum prohibits the payment of dividend to its members. In doing so, a company must always look at its articles which provide how any revenue or expense should be treated.

One must note however that the annual general meeting is usually given the power to declare dividend subject to the amount recommended by the directors. Note however that the directors may be vested with this power in the articles to declare the dividend.

Unless otherwise provided in the articles, a company is under no obligation to declare a dividend and it need not distribute all or even the available profits to the shareholders. Further, a shareholder, whether ordinary or preference is only entitled

⁷⁹ Ibid s227.

⁸⁰ Ibid s258.

⁸¹ Ibid s344(a).

⁸² Ibid s349.

⁸³ Ibid s389.

⁸⁴ Ibid s390.

⁸⁵ Ibid s422.

⁸⁶ Tshepo Mongalo 'The myth of director appointment by shareholders and shareholder activism in listed companies' (2004) (1) *Tydskrif vir die Suid-Afrikaanse Reg* 96 at 98.

to a final dividend provided profits are available for dividend and in fact such dividend has been declared as provided for in the articles. Only then can a shareholder claim payment.⁸⁷

It is clear that this right arises from the articles and not the Act and further, despite the shareholders having a right to dividend, this right has its limits as aforementioned unlike the right to vote and attend meetings.

2.1.3 The right to participate in the surplus assets of the company in the event of winding up

In the process of winding up or dissolution of a company's existence, members have a large role to play and have rights accruing there from.

To begin with, the company may be wound up by a court or voluntarily .In the event that the company is wound up voluntarily, this may be done either by members or creditors.⁸⁸

The members have a right to vote by special resolution and resolve that the company be wound up.⁸⁹ To have effect though, the resolution must be registered as required under the Act⁹⁰ and security furnished to the satisfaction of the Master for the payment of debts or without such security, proof that the Master has dispensed with the requirement of the security.

Further under liquidation by the court, the liquidator thus appointed must in the administration of the assets of the company have regard to the directions of the creditors, members or contributories given by resolution at a general meeting.⁹¹ It has however been submitted that members will only have a say if there is a possibility of payment of a dividend to them.⁹² This dilutes the members' position and strips them of their full rights.

⁸⁷ HS Cilliers and ML Benade *Company law* 4ed (1982) 408-409.

⁸⁸ Companies Act (note 3) s343 (1).

⁸⁹ Ibid s349.

⁹⁰ Ibid s200.

⁹¹ Ibid s387(1).

⁹² Cilliers and Benade (note 87) at 588.

On winding up of a company and in the event that there is surplus of assets over liabilities, distribution of such proceeds shall be subject to the provisions of the Insolvency Act⁹³.

The Act provides for all other interests to rank before the rights of any shareholder. Costs of liquidation and winding up must be paid first, then secured creditors, preferential creditors and unsecured creditors, then lastly members, in that order.

Any surplus assets available after payment of all the other claims must be distributed among the members according to their rights and interests. However this also means that in the event that the proceeds are not sufficient to cover all the costs and liabilities, the shareholders will have to forfeit their share capital and bear the loss up to their liability limit.⁹⁴

2.2 Debenture holders

There has never been a precise definition of the word 'debenture'⁹⁵ but according to the Companies Act, a debenture includes debenture stock, debenture bonds, and any other securities of a company whether constituting a charge over the assets of a company or not.⁹⁶

It has always been the legal position that debenture holders are creditors and not members of the company. A debenture is seen as a document which records debt owing by a company and therefore the debenture holder is a creditor not a member. Consequently, references to members in the Act as previously discussed in Chapter 1 are not deemed to include debenture holders. It is noteworthy to say however that, there are some instances where a 'member' can also be a debenture holder.⁹⁷

What are the debenture holders' rights?

⁹³ Act 24 of 1936.

⁹⁴ Cilliers and Benade (note 87) at 661-666.

⁹⁵ In *Coetzee v Rand Sporting Club* 1918 WLD 74 Ward J in analysing the term quotes Bowen LJ precisely in *English and Scottish Mercantile Investment Company v Brunton* [1892]2QB 700 at 712 saying: 'It seems that there are three usual forms of debentures... the first is a simple acknowledgment under seal, of debt; the second an instrument acknowledging the debt, and charging the property of the company with repayment; and the third an instrument acknowledging the debt, and charging the property with repayment and further restricting the company from giving any other prior charge.'

⁹⁶ Companies Act (note 3) s1.

⁹⁷ Williams (note 62) at 208.

A debenture holder may derive rights from three intertwined sources; legislation, the memorandum and articles of association of a company and from the contract between the security holder and the company.

The Current Act gives a company the power to borrow under section 34 and schedule 2. This section is permissive and not mandatory thus making the power subject to the memorandum and articles of association which may explicitly allow, qualify, limit or completely exclude this power.

The rights of a debenture holder nonetheless may be divided into two categories; contractual rights and statutory rights. Some of the rights may however overlap.

2.2.1 Statutory rights

These are rights that are generally derived from legislation and inter alia include:

- Rights to obtain copies of and inspect the trust deed.⁹⁸
- Right to receive copies of the annual report, auditors' report and financial statements.⁹⁹
- Right to demand for the appointment of a judicial manager.¹⁰⁰
- Right to apply for winding up of the company if the company fails or is unable to pay its debts.¹⁰¹
- In the event of winding up or liquidation, the debenture amount and interest outstanding ranks in priority to any share capital with secured debentures ranking before unsecured debentures.¹⁰²

2.2.2 Contractual rights

Contractual rights are the terms and conditions set down in the individual debenture deeds or agreements entered into which inter alia may include:

- Entitlement to interest under the debenture instrument and repayment of the debenture amount on maturity.

⁹⁸ Companies Act (note 3) s130

⁹⁹ Ibid s302.

¹⁰⁰ Also known as the receiver manager in other jurisdictions .Ibid s 427(2).

¹⁰¹ Ibid s343 (2).

¹⁰² Cilliers and Benade (note 87) at 544-549 and the Insolvency Act (note 93).

- Provisions of acts of default and rights as to the call up the full debt amount in the event of default by the company aforementioned.
- Authority to modify their rights under the debt instrument with the consent of the majority of the debenture holders

Of these rights, the most important for the purposes of corporate governance is the right of the creditors to apply for the judicial management or the winding up of the company.

This is because the measures are pervasive and affect all the company's stakeholders and not just a particular class of rights. Case law has stated that on the commencement of the winding up process, the business is henceforth carried on not for the benefit of members of the company but with a view only to its winding up and the distribution of its assets among its creditors and when satisfied the division of any balance among the contributories.¹⁰³

Further to this, the powers of directors cease¹⁰⁴ and in the event that a company is wound up by the court, the company's assets are liquidated and distributed with members ranking as the last recipients of the proceeds after all other claims are satisfied.

One must however note that the rights of the debenture holder cease to exist once the debt and any interest owing is fully repaid by the company or is extinguished by conversion to shares or other legal means.

2.3 Other security holders

Who are the other security holders and what are their rights?

Holders of securities that are neither debt nor equity securities fall under a category referred to as hybrid securities. Hybrid securities have characteristics of both debt and equity and may include preference shares, convertibles and equity warrants.

¹⁰³ *Letsitele Stores (Pty) Ltd V Roets* 1958 (2) SA 224 (T).

¹⁰⁴ In *AMS Marketing Co (Pty) Ltd v Holzman* 1983(3) SA 263(W) Leveson AJ stated at 269-270 that: 'I am of the opinion that the liquidator enjoys a dual capacity. In one sense he is a primary organ of the company in whom the powers formerly residing in the directors are vested. In the other his position is similar to that of a trustee of an insolvent estate having the power to recover assets, realize them and distribute the proceeds to the persons entitled.'

2.3.1 Preference shares

Preference shares and ordinary shares are the most common classes of shares found in public companies and represent the equity of the company.

Despite the fact that preference shares will usually have almost the same characteristics and rights as ordinary stock as discussed in paragraph 2.1 above, preferred stock or shares are an intermediate class of security between equities and debt.

One must note that preference shares can only be found where another class (usually ordinary shares) exists and that these shares have a preference over ordinary shares, which preference may relate to dividends or to repayment of capital when a company is wound up.

If the company issuing the stock is liquidated, they carry the right to receive any outstanding dividend on the stock and or a return of capital in priority to ordinary shareholders. In short, they hold both equity and contractual rights hence their hybrid nature.

Since the preference shares are capital stock, this may entitle the holders to some degree of control depending on whether or not they contain voting rights. The rights attaching to the preference shares are usually set out in the memorandum or articles of association of the company that issues them.

One of the main distinguishing rights of the preference shares is that they usually enjoy a preferential right to dividends however, this is subject to the availability of sufficient profits for distribution and declaration of such dividend in a manner prescribed by the articles.¹⁰⁵

Another right of the preference shareholder is that they have preferential rights to repayment of capital in the event of winding up of the company. Usually the preference shareholders will enjoy a preference in the repayment of their capital, however in the event there is a surplus after repayment of ordinary shares, they may not participate in such surplus depending on the wording of articles of the company.

Another right of the preference shareholder is the right to vote however, this right is also subject to provisions of the company's articles. There are instances

¹⁰⁵ Cilliers and Benade (note 87) at 153.

where the Act gives compulsory rights despite such exclusion under the company's articles. These are provided in section 194(1) which states that:

Notwithstanding the provisions of section 193 (1)¹⁰⁶, the articles of a company may provide that preference shares shall not confer the right to vote at meetings of the company except-

- (a) During any period determined as provided in subsection (2) during which any dividend or any part of any dividend on such shares or any redemption payment thereon remains in arrear and unpaid; or
- (b) In regard to any resolution proposed which directly affects any of the rights attached to such shares or the interests of the holders thereof, including a resolution for the winding-up of the company or for the reduction of its capital.¹⁰⁷

From the foregoing it is clear that the preference shareholders despite having preference when it comes to dividend and pay out of capital during liquidation of the company, their rights are limited to what the memorandum and articles provide for and nothing more.

2.3.2 Convertibles

These are bonds or stock which can be converted, at the election of the holder of the convertible security, into any other class of shares, usually common stock, of the issuing company.

Convertible shares or debentures for instance are shares or debentures which a shareholder or debenture holder has the right to convert after a given date, all or part of the shares or debentures, into another class of shares. The price at which the conversion takes place is usually specified in the conditions on which the shares or debentures are issued.

The Act makes reference to conversions while dealing with the various securities. To begin with the Act does not permit variation or abrogation of the rights

¹⁰⁶ Section 193(1) provides for voting rights by members in a company, it reads as follows: 'Subject to the provisions of sections 194 and 195 and to the exceptions stated in section 196, every member of a company having a share capital shall have a right to vote at meetings of that company in respect of each share held by him.' Section 194 qualifies this right with respect to preference share holders.

¹⁰⁷ Companies Act (note 3) s194 (1).

of any class of shares unless specifically done in a manner provided for in the memorandum or articles of association.¹⁰⁸

The Act further provides for conversion of shares whether issued or not, into shares of another class subject to section 56(1) and 102.¹⁰⁹

Even though the Act does not explicitly provide for convertible debentures, there is an implied inference as to the existence of the same. In section 124(1), a company may issue debentures which are fully convertible into fully paid ordinary shares at the option of the holder.¹¹⁰

The presumption therefore is that, the memorandum and articles of the company shall in each case provide for the manner in which the debentures, stock or shares shall be converted, when and what rights shall accrue to the new securities once converted.

2.3.3 Equity Warrants

Equity warrants are another form of hybrid securities. They are options issued by the company that allow the holder of the warrant to purchase a specific number of shares at a specified price within a specified time.

They are often issued together with bonds or existing equities and are sometimes detachable from them and separately tradable. When the holder of the warrant exercises it, he pays the money directly to the company, and the company issues new shares to the holder.

Section 101(1) of the Current Act provides that issue of such warrants shall be subject to authorization by the company's articles. The share warrants shall entitle the bearer thereof to the shares or stock therein specified, and consequently the rights that accrue to the particular shares acquired shall attach at the time specified.

One must however note that the share warrants are contractual rights and are subject to the terms and conditions entered into by the holders and only become equity once the option is exercised.

It is noteworthy to state that all the securities provided for under the Current Act have found expression in Chapter 2 of the Proposed Act which provides for

¹⁰⁸ Ibid s56(1).

¹⁰⁹ Ibid s75(1)(i).

¹¹⁰ Cilliers and Benade (note 87) at 146.

ordinary¹¹¹ and preference shares¹¹², debentures¹¹³, convertibles and share options or warrants¹¹⁴.

All in all this chapter has given an overview of the various securities and the rights accruing to the holders thereof for ease of understanding the next chapters. In view of the foregoing and with reference to the above, ordinary shareholders shall forthwith be referred to in this paper as traditional shareholders while debenture holders and hybrid security holders shall be referred to as non-traditional shareholders .

¹¹¹ Companies Act (note 6) s35-36.

¹¹² Ibid s37.

¹¹³ Ibid s43.

¹¹⁴ Ibid s42.

CHAPTER 3

WHAT ARE THE CONSEQUENCES OF SECTION 57(1) OF THE PROPOSED ACT?

Now that we have a better understanding of the various securities and the rights accruing to the holders, we should be able to critically analyse whether or not the non-traditional shareholders are encroaching upon the traditional shareholders governance rights or whether in fact their rights are left intact.

In doing so, I would like to begin with trying to establish what the intentions of the drafters of the Proposed Act seem to have been and secondly, the consequences on corporate governance within the company that flow from inserting section 57 (1) in the Proposed Act.

But before looking at the specific provisions of the Current and Proposed Act, it is important to begin with looking at the general perception and attitudes that the Department of Trade (hereinafter 'DTI') and other relevant stakeholders held towards the review of the Current Act.

As discussed in chapter 1, it is my observation that the DTI and the related stakeholders in carrying out reforms and overhauling the Companies Act, sought to radically modernize South African company law in general. This was a deliberate effort to bring it in line with international best practice, which meant, changing the perception and interpretation of fundamental aspects of company law and corporate governance within the jurisdiction.

In what is stated as a 'significant departure' from present company law and regulations, the DTI in a press release on the publishing of the Companies Bill 2008 (hereinafter 'the Bill') for public comment stated that:

...the new draft Companies Bill will have far-reaching effects upon the business environment in South Africa... In a move to "modernise" the

Companies Act of 1973...the new Bill will "align SA with international jurisdictions" and catch-up with "post-1994 South Africa".¹¹⁵

This in itself gives a strong indication of movement away from the traditional corporate governance conceptions to a more modern, all inclusive and versatile approach which ultimately called for borrowing from other jurisdictions and introduction of aspects not previously found within the current legislation.

In addition to the DTI view, the South African Institute of Professional Accountants (hereinafter 'SAIPA') in their review of the Bill asserted this position in saying that:

... it was widely felt by stakeholders and commentators that the time had come to replace the existing, archaic provisions relating to specific forms of debentures, as found in the Companies Act, 1973. Section 43¹¹⁶ achieves that goal by providing for a general scheme designed to protect the interests of holders of securities other than shares, without making unnecessary distinctions based on artificial categorization of the debt instrument they hold.¹¹⁷

SAIPA further noted in a subsequent paragraph that the Bill provided for appointment of the directors by persons other than shareholders, provided that the memorandum and articles provided for them.¹¹⁸

Further, the King III report has a detailed chapter focusing on the managing of stakeholder relationships which involves deliberately balancing, managing, engaging with stakeholders, ensuring transparency and effective communication between all the interests within a company.¹¹⁹

These observations indicate a gradual shift in favour of the other security holders other than the traditional shareholders.

¹¹⁵ Department of Trade and Industry's article 'DTI publishes long-awaited draft companies bill'. Available at http://www.sabinet.co.za/sabinetlaw/news_par364.html [Accessed 1 October 2009].

¹¹⁶ Companies Act (note 6).

¹¹⁷ See SAIPA 'Basic guide to company bill 2008' page 4. Available at www.saipa.co.za [Accessed 01 October 2009].

¹¹⁸ Ibid.

¹¹⁹ Institute of Directors in Southern Africa 'King III draft report on governance for South Africa' 2009 at 110-129.

But on looking at the Bill and subsequently the Proposed Act, one seeks clarity and understanding as to the intentions underlying section 57(1) as read together with section 2 of the Proposed Act.

Does South African corporate law and governance therefore seek to move towards the stakeholder approach away from shareholder dominance approach, if yes, how would this be accomplished?

To answer these questions we must re-examine the wording of these sections with more detail. Section 2 states that:

...subject to section 57(1), [shareholder] means the *holder of a share* issued by a company and who is entered as such in the certificated or uncertificated securities register, as the case may be.¹²⁰

While section 57(1) goes on to state that:

In this Part [F], shareholder means a person who is entitled to exercise *any voting rights* in relation to a company, *irrespective of the form, title or nature of the securities* to which those voting rights are attached.¹²¹

On reading of the text of section 2, it is clear that the intention and meaning of the term 'shareholder' reflects the age old meaning; person who holds shares within a company, that is, the residual owner of the company.

Further to this, no distinction is made between the different classes of shareholders within the section 2 definition. The meaning here is plain and consequently no inference or implied meaning of the term is imputed.

Before beginning an analysis of section 57(1) provisions, it is noteworthy to state that the case in most companies is that the ordinary shareholder holds the majority of voting rights (hence governance control) even though other security holders may hold some as seen in the previous chapter. Stevens¹²² analyzes this and states that:

... it has been necessary to infer that the general rule of law applies; that is, the right to vote is one of the inherent rights of a shareholder, and he

¹²⁰ Emphasis in italics my own.

¹²¹ Emphasis in italics my own.

¹²² WHS Stevens 'Stockholders' voting rights and the centralization of voting control' (May 1926) 40(3) *The Quarterly Journal of Economics* 353-392.

therefore possesses full voting power share for share with every other share, in the absence of specific contract limiting or abridging this right.¹²³

Hanks¹²⁴ further asserts that:

At common law, in the absence of a contract to the contrary, only stockholders have any property rights in the corporation. Other persons dealing with the corporation have been left to protecting themselves by contract.

From these excerpts it is evident that traditionally, voting at meetings was the domain of the shareholders. However, over the years we have seen that the rights to vote on specific matters have been gradually extended to different classes of shares or other securities.

Now as relates section 57(1), one must note that the section introduces a new aspect to the definition of a shareholder for the purpose of governance, which is, the issue of ‘...any voting rights...’

Further to this new insertion, now shareholders for purposes of governance need not relate specifically to holders of shares, but may include securities of any ‘...form, title or nature...’ who hold any voting rights.

The Proposed Act does not specify what kind or type of ‘voting rights’ it is referring to but instead uses the word ‘any’ to define the said rights.

In trying to understanding the phrase ‘any voting rights’¹²⁵ above, one ought to understand that different types or variations of voting rights may exist within a company. A company may have various classes of shares or different securities with different voting rights which may be summarized below as follows:

- i. Shares with full voting rights, usually common stock or ordinary shares but sometimes where the memorandum and articles permit, preference shares as well.

¹²³ Ibid at 357.

¹²⁴ JJ Hanks ‘Non-stockholder constituency statutes: an idea whose time should never have come’ (December 1989) 3(12) *Insights* 20 at 22.

¹²⁵ Companies Act (note 6) s57(1).

- ii. Non-voting stocks which usually are preferred stock .The holders' rights are limited and they have no voting powers whatsoever, nor are they entitled to notice of any meeting of the stockholders.
- iii. The third category is those shares with limited voting rights. Besides the strictly non-voting issues, there are also a few shares (usually preference) that approach very closely to this non-voting category but are slightly better off because they have some, albeit limited, voting control which they may exercise.
- iv. Some voting rights may be fixed. This means that the rights apply continuously and throughout the existence of the security. Some rights may be contingent on the happening of a certain event such as winding up of a company , unpaid or dividends in arrears which accrue to debenture holders and preference shareholders.
- v. Some other securities are specifically non-voting for directors, but may have full voting rights on all other matters. This is usually reserved for debenture holders.
- vi. Some companies may have securities with full voting rights and in addition, have preferred voting rights on the happening of a contingent event.¹²⁶
- vii. Lastly, other than the ordinary and preference shareholders, debenture holders can also be conferred upon full voting rights.¹²⁷

As previously discussed, the conferment of any voting rights would vary in accordance with each country's legislation, the particulars of a company's constitution and or its articles of association or the specific contractual obligations the security documents provide for.

¹²⁶ Stevens (note 122) at 357-367.

¹²⁷ Williams (note 62) at 208.

In other words, voting rights may present themselves in various legal forms and are exercisable by such holders in so far as they are in line with general law and company law and the company's constitution.

Does section 57(1) therefore shift the status quo or does it reaffirm an already existing position?

In order to establish whether the Act gives any clarity on the way in which we should approach or reconcile ourselves with this issue of possession of 'voting rights' by other security holders, we must seek answers to the following questions:

3.1 How does the Act intend to apportion the rights, if at all, among the traditional shareholders and the non-traditional shareholders?

Professor Tracy says that the answer to this question depends on the terms of the statute. In saying so we must therefore revert back to what statute provides.¹²⁸

The Proposed Act does not give a clear indication as to how voting rights are to be apportioned. In fact section 57(1) merely states that: a [new] shareholder is '...a person ...entitled to exercise any voting rights...'

The Act does not specify whether or not the voting rights should be those currently held by the security holder or if contingent rights also count as 'voting rights' i.e. those held by debenture holders during the winding up of a company or in the case outstanding dividends accruing to preference shareholders.

Further the Act does not say anything about process by which one acquires the right to vote, that is, 'the how'. The Act is silent on these matters and leaves one to infer its meaning or intent.

The norm under South African law is that once the Act gives generalized permission, the debt instrument, common law and the companies' articles in the case of debentures or the articles and common law in the case of preferred shares, will provide for the manner in which to provide for the voting powers in the event of default of debt payments or unpaid dividends.

In other jurisdictions such as the United States of America, the statute conferring such right would provide that a company insert a general clause in its

¹²⁸ Tracy (note 20) at 213.

articles on the manner in which the right is acquired, the exact rights acquired and the conditions upon which the rights are acquired.¹²⁹

In my view to avoid ambiguity, each company would have to outline in the memorandum and articles of association in a detailed manner what 'voting rights' qualify as such and also outline the procedure with which it aims to achieve the requirements of the Proposed Act.

3.2 What then is the effect of section 57(1) on governance of South African companies?

The Current Act naturally provides for meetings of the company. The Act provides the manner in which members or shareholders are to be called for meetings, number of times meetings are to be held, the manner in which the proceedings are to be carried out during the meetings, the quorum required for the meetings and also provides for representation by proxies in case the members or shareholders cannot attend meetings as required.¹³⁰

The Act devolves a lot of power and gives leeway to the shareholders to customize the running of the company in a manner suitable to the company's circumstances and to use methods within their reach to enable smooth running of the company. This has been done by using the proviso '...Unless the articles of a company otherwise provides ...' across the relevant sections in the Act.¹³¹

In so doing, the shareholder as an owner of the business is theoretically supposed to be the one who ultimately determines how the company is run, ensuring that the company's constitution reflects the desired direction but practically this has proved not to be the case.¹³²

It is the fiduciary duty of the directors of a company to convene a shareholders' meeting failure of which members may do so under section 180 and 181 of the Act, the court under common law or section 183 of the Act, or the registrar of companies under section 179 and 182 of the Act.¹³³

¹²⁹ Ibid at 214.

¹³⁰ Companies Act (note 3) s179 – 192.

¹³¹ Ibid s 186, 187,189,190,191 and 191.

¹³² See Mongalo (note 86) at 96-114.

¹³³ Mongalo (note 62) at 251-252.

Have additional voting rights therefore been conferred upon non-traditional shareholders?

From plain reading the provisions of Part F of Chapter 2 of the Act, there are no new voting rights being conferred upon the other security holders. One must therefore look to the Act, memorandum and articles or other security instruments provided to confirm whether or not voting rights accrue to particular security holders or not .

This is evidenced in various sections across Part F which provide that the Act only allows for participation of the non-traditional shareholders in so far as the memorandum and articles of a company confer rights or permit such participation by them.

Notably, there is repeated use of the words ‘... [Shareholders] entitled to exercise the voting rights ...’¹³⁴

These provisions clearly indicate that no new rights are being conferred but voting rights that already exist are merely being referred to. This means that no voting rights have been transferred to non-traditional shareholders that they already did not possess.

Notwithstanding the above observation, is the governance structure thus altered by the new definition in the Proposed Act?

We already know from previous discussion within this paper that voting and attendance of meetings has traditionally been the domain of the traditional shareholder. In order to establish whether the governance structure has been altered in the Proposed Act, there must be a critical analysis of Part F with specific emphasis on voting and company meetings.

To begin with there are rights that accrue to shareholders as regards participation and voting at meetings. These rights generally comprise governance rights .These rights have been summarized for ease of understanding by Zetzsche as calling or convening rights, requisition rights, eligibility rights, the right to present proposals, the right to elect directors and the right to vote on other matters, the right

¹³⁴ See Companies Act (note 6) s60 (1), 63(4), 68, 71 interalia.

to receive communication and lastly enforcement of these rights as against board or the company.¹³⁵

I shall review these rights and any other relevant rights with respect to both the Current and Proposed Acts as follows:

a) Calling and convening rights

In all jurisdictions, shareholders can either force management to convene a shareholders' meeting, call for the meeting themselves, or apply for a court order to call the meeting. Each of these acts would constitute a 'calling right' if the management did not call a meeting despite a requisition notice. The laws of most jurisdictions will either provide for a threshold share requirement for shareholders to be able to call the meeting or establish a regime through which a court can be applied to in order to compel a meeting.¹³⁶

The Current Act is no exception as it provides that:

...If for any reason an annual general meeting of a company is not or cannot be held as provided in this section or any matter required by this Act to be dealt with and disposed of at such meeting is not dealt with thereat, the Registrar may, on application by the company or any member or its or his legal representative and on payment of the prescribed fee, call or direct the calling of a general meeting...¹³⁷

The Proposed Act provides that '...the board of the company or any other person specified in the company's memorandum ...may call a shareholders' meeting any time.'¹³⁸

From the forgoing, it is clear that the duty to call for a meeting falls on the board of directors first. The power of the directors to call a general meeting is a fiduciary power of a discretionary nature which must be exercised in good faith in the interest of the company as a whole however, where the directors fail to do so the Act provides that any other person given such authority by the memorandum may do

¹³⁵ Dirk A Zetzsche 'Shareholder interaction preceding shareholder meetings of public corporations: A six country comparison'(2005)1 *European Company and Financial Review* 107 at 116.

¹³⁶ Ibid at 117.

¹³⁷ Companies Act (note 3) s179 (4) (a) and s182 on calling of general meetings on requisition by members.

¹³⁸ Companies Act (note 6) s61 (1).

so.¹³⁹ The Act does not specify the persons it contemplates to be given such authority, however, the Act clearly specifies in section 61(11) (b) that:

...if no person has been authorized as contemplated in paragraph (a), the Companies Tribunal, on a request by any shareholder, may issue an administrative order for a shareholders meeting to be convened on a date, and subject to any terms, that the Tribunal considers appropriate in the circumstances.

Now that the shareholder for the purposes of corporate governance has been extended to all security holders with voting rights, the above excerpt clearly confers rights to the new shareholders to apply to the Companies Tribunal to have a meeting called. This unmistakably is an extension of the traditional shareholders' rights to the non-traditional shareholders which were not previously available to them.

b) Right to receive communication and notices.

Under the Current Act, at least 21 days must be given for an annual general meeting and at least 14 days.¹⁴⁰ Section 187 further provides that unless the articles of a company otherwise provide, notice of a meeting of a company shall be served on every member of the company in the manner in which notices are required to be served.

The spirit of the 1973 Act is carried on in the Proposed Act which provides that:

'The company must deliver a notice of each shareholders meeting in the prescribed manner and form to all of the shareholders of the company...'¹⁴¹

This again is clearly another extension of traditional shareholder rights to the non-traditional shareholder in the new proposed legislation which allows them to know when and where the meetings are to be held and what business shall be transacted in order for them to decide whether or not to attend the meeting or whether to send proxies to attend on their behalf. This is unlike the Current Act which only contemplated participation by the traditional shareholders. As a result,

¹³⁹ Cilliers and Benade (note 87) at 273.

¹⁴⁰ Companies Act (note 3) s186(1).

¹⁴¹ Companies Act (note 6) s62 (1).

involvement by the non-traditional shareholders, participation in and awareness of company affairs shall be greatly improved under the Proposed Act.

c) Requisitioning rights and the right to present proposals

Members of the company who wish to propose a motion and make a statement with respect to that motion or a statement with respect to business to be dealt with at the annual general meeting are authorised by section 185 of the Current Act to convey such representations to members through the company.¹⁴² From the wording of the Current Act, it is obvious that the members i.e. the ordinary and preference shareholders were the only persons contemplated as proposers of resolutions.

Under the Proposed Act, section 61(3) implies that a shareholder may make a demand for a meeting specifying what they intend to be discussed in such meeting. Section 61(6) further reinforces this implication by stating that a shareholder who makes a demand for a meeting may withdraw the same. Section 65(3) (a) however provides that:

‘Any two shareholders of a company may propose a resolution concerning any matter *in respect of which they are each entitled to exercise voting rights...*’¹⁴³

One notes from the wording of the above provisions that despite the extension of rights to non-traditional shareholders in section 61(3) and (6) above, there is qualification of such rights by section 65(3). It is evident that a shareholder will only be permitted to propose a resolution if they have the right to vote on the matter in respect of which they are proposing and not on all or any other matters.

This in effect claws back the rights thus extended to the non-traditional shareholder since unlike them, more often than not the traditional shareholder may vote on most matters and therefore carry the day.

d) Right to vote on matters and elect directors.

¹⁴² Cilliers and Benade (note 87) at 278. See Also Companies Act (note 3) s185.

¹⁴³ Emphasis in italics my own.

This is the major right which is usually attached to the shareholders governance role. This in effect is the focal point of the governance within a company.

In the South African context as previously noted, the Act proceeds from the general principle that every member of a company shall have a vote (in a company with share capital every member has one vote in respect of each share held by him, while in a company limited by guarantee each member has one vote) unless otherwise provided for by the articles.¹⁴⁴

We have already established earlier in this chapter that only in so far as any other security holder is permitted to vote on a particular matter will this right accrue to them. Where such holder does not possess such voting right, then they shall not have the right to vote on any matter including the election of company directors.

This right clearly has been protected under the Proposed Act for the benefit of the traditional shareholders only and as such, no extension has been granted to the non-traditional shareholders as is the case with the other governance rights discussed.

e) Shareholder Agreements

This right is closely connected with the right to vote at meetings. While directors cannot validly enter into an agreement to vote in a certain way under South African law, shareholders are at liberty to enter into contracts in terms whereof they undertake to vote and conduct themselves in a particular way.¹⁴⁵ This position is shared by English law which adheres to the notion that the right to vote is a right of property and therefore voting agreements are a valid exercise of property rights and are enforceable provided they are not in contravention with general law.¹⁴⁶

The Current Act does not specifically provide for these agreements but does not seem to prohibit them either. One is left to infer their applicability in section 198(2) which reads:

...any member (including a body corporate) or his proxy shall be entitled to exercise all his voting rights as determined in accordance with the provisions of this Act, but shall not be obliged to use all his votes or cast all the votes he uses in the same way.

¹⁴⁴ Cilliers and Benade (note 87) at 284-285. See also Companies Act (note 3) s193.

¹⁴⁵ Cilliers and Benade (note 87) at 287-288.

¹⁴⁶ P G Xuereb *The Rights of shareholders* (1989)101.

One can therefore infer that that the shareholder is permitted to vote in any way so long as his/her actions are within the confines of the Companies Act and the law in general.

The Proposed Act does not seem to permit or prohibit the use of shareholder agreements either. The question that arises therefore is whether a non-traditional shareholder can be party to a shareholder agreement or not.

The answer to this question may vary depending on the purpose for which the shareholder agreement was created. This is because a shareholder agreement is a contract by which the shareholders define the relationships among themselves, between themselves and the corporation.¹⁴⁷ It only binds the parties to the agreement as a matter of contract. Since it is regulated by contract law and not the Companies Act, shareholders will usually enter into such agreements on their own terms for a host of objectives such as: restriction to transfer of shares, prohibition against pledging shares for collateral or may relate generally to the activity of the company. Thus depending on their need, shareholders may enter into such arrangements on their own accord.

In view of the foregoing, I believe that with the new definition of shareholders under section 57(1), even a non-traditional shareholder may be party to shareholder agreements depending on whether their rights are in alignment with those of the traditional shareholders and further, whether they would like to consolidate their actions as a body of shareholders within the company.

This in my view would not have much effect on corporate governance structure within the company because the agreements would have to refer back to the voting capacity of each shareholder whether traditional or not and further establish which shareholders would want to join in agreement and act in a certain way. Ultimately, it would come down to the individual shareholder needs.

f) Enforcement of the governance rights

In order for persons or any group of persons to enjoy any rights conferred upon them, there must be methods with which to enforce the same. As noted in earlier paragraphs, there seems to be gradual extension of some governance rights to

¹⁴⁷ Kerry M Lavelle 'Drafting shareholder agreements for the closely-held business' (1991) 4 *De Paul Business Journal* 109 at 110.

non-traditional shareholders under the Proposed Act previously reserved for traditional shareholders. These rights need protection and enforceability in order for them to be meaningful.

What are the mechanisms put in place under the Proposed Act to ensure full enjoyment of these rights?

The first case in point is section 61(5) of the Proposed Act which provides that any shareholder or the company may apply to court for an order setting aside a demand to call for a shareholders meeting if such demand is frivolous.

Under the Current Act, any such an application would be reserved for traditional shareholders, however now with the new definition of shareholders under Proposed Act there is inclusion of the non-traditional shareholder.

Secondly even though previously mentioned, it is noteworthy to state that section 61(11) provides that both traditional and non-traditional shareholders may seek recourse from the Companies Tribunal on request by a shareholder in the event that a company is unable to convene a meeting as required. Again here we see an extension of additional rights to the non-traditional shareholders.

Further, section 61(12) of the Proposed Act provides that where a company fails to convene a meeting for any reason (other than when it has no directors or all the directors are incapacitated) as required by the memorandum or shareholders or within the time stipulated, a shareholder may apply to court requiring the company to convene a meeting. Again we see that the indeed the authority to make such application seems to include the traditional as well as the non-traditional shareholder.

Fourthly, section 65(5) provides further enforcement rights to both traditional as well as non-traditional shareholder by providing that in the event a resolution does not satisfy the formal requirements, a shareholder may apply for leave to the court for an order to restrain the company from putting the order to vote or may apply to court to require the proposing shareholders to alter the resolution to be in conformity with the requirements.

It is not clear from the text whether a shareholder not entitled to vote on that particular resolution may make the application, however, in my view it seems open to all shareholders. Permission to make such an application in effect prevents the

traditional shareholders from flouting the requirements of the articles of association and comparable procedural matters of the company.

Lastly as relates matters of disclosure of directors' interests, the Proposed Act provides that any interested person may apply to court to declare a transaction valid, which transaction had been approved by the board or shareholders despite the directors' failure to disclose their financial interest on the same.¹⁴⁸ Although not strictly relating to the new shareholders, this article gives power to both traditional and non-traditional shareholders as well as other interested stakeholders to participate in governance of the company for the company's benefit.

g) Costs

The cost of any application to court or to the office of the registrar whatever the case may either encourage or prevent activism among shareholders. It therefore is prudent for company law and the articles of a company to provide for compensation mechanisms for persons applying to court for various remedies whether on behalf of the company, the body of shareholders or both.

Under the Current Act there is no direct provision for compensation of shareholders who make applications. The Act only provides that an order as relates to costs may be made by the registrar or the court where such an application is made.¹⁴⁹ The main problem with this is that it is usually a long process that is deterrent to activism of the shareholders which in turn leads to poor governance within the company.

The Proposed Act recognizes this obstacle and provides in section 61(13) that the company must compensate a shareholder who applies to the Companies Tribunal in terms of subsection (11) and to court in terms of subsection (12) respectively. Even though the shareholder cannot not in all instances seek quick compensation for costs of applying to court, the shareholder has been given these two avenues within the Proposed Act. This is a step in the right direction which should encourage activism within the company because as aforementioned one of the main reasons for lack of filing suits against the board, company or the body of shareholders has been the prohibitive cost factor.

¹⁴⁸ Companies Act (note 6) s75 (8).

¹⁴⁹ Companies Act (note 3) s185 (5).

Other than the above mentioned remedies, we also have the shareholders derivative action which we shall look at in greater detail in the next chapter.

To conclude this chapter, one can comfortably state that indeed the Proposed Act seems to have extended a number of governance rights to the non-traditional shareholders which were originally reserved for the traditional shareholder. One must however note that even though these rights have been extended, there is no conferment of voting rights to the non-traditional shareholders that did not previously exist and voting on matters remains dominated by the traditional shareholder.

On the whole, I believe that the corporate governance structure in the context of the proposed new legislation, seems to be shifting to a more stakeholder friendly approach than was in the under the Current Act whose main emphasis is on the shareholder.

CHAPTER 4

THE EFFECT OF THE S.57 (1) ON THE DUTIES OF DIRECTORS AND SHAREHOLDER REMEDIES

In order to analyse the effect of Section 57(1) on the broader corporate governance structure, some of the questions we seek to answer are: what effect does section 57(1) have on the directors as fiduciaries of the company and also whether the new shareholder is adequately protected under the Act.

I shall start by examining the effect of section 57(1) on the new shareholder with respect to the directors' duties of care and skill and fiduciary duties as part of the governance structure.

4.1 Directors' duties

To begin with, a brief overview of the directors' duties before probing the effect of section 57(1).

Duty of Care and Skill

It is traditional that the duties of directors fall into two broad categories, these are; the common law duties of care and skill and fiduciary duties. As relates the duty of care and skill, a director is required to behave like a reasonably diligent person having both:

- a) The general knowledge skill and experience that may reasonably be expected of a person carrying out the same functions as carried out by that director in relation to the company and
- b) The general knowledge, skill and experience that director has.¹⁵⁰

Ideally, a director who breaches this duty is liable in delict or tort to pay damages. However, courts have been very reluctant to interfere with the enterprise of companies due to the subjective nature of this test. The test varies from director to

¹⁵⁰ The standards of current South African company law under s76(3)(c) of the Proposed Act are the same as the English common law position. The proposed South African law has simply codified the common law position in brief therefore for the substantive law, one has to refer to the common law position for interpretation. Also see Blackman M R et al *Commentary on the Companies Act* vol 2, 2ed (2002) 8-189 to 8-194-1.

the next the result being that very low standards are set for directors which render them somewhat immune from actions.

Fiduciary Duty

In addition to the duty of care and skill, there is also the fiduciary duty. This duty requires the director to act in good faith, for the interests of the beneficiary and also act with single minded loyalty. To ensure that a fiduciary does not breach this core duty, the fiduciary relationship imposes a ring of prophylactic duties around them. The fiduciary must not without the informed consent of their beneficiary place himself/herself in a position where his/her interests conflict or make any profit from his/her position other than agreed remuneration or otherwise act for their own benefit or the benefit of a third person. The fiduciary cannot use his/her position to benefit, whether directly or indirectly.

This fiduciary obligation is absolute in character meaning the fiduciary is liable if they obtained a profit or benefit regardless of whether or not they could have obtained the advantage for their beneficiary and regardless of whether or not the beneficiary also benefited. It is irrelevant that the fiduciary acted in good faith.¹⁵¹

To emphasize the importance of both these duties, Romer J stated in *Re City Equitable Fire Insurance Company* that:

If the directors act within their powers, if they act with such care as is reasonably expected from them having regard to their knowledge and experience and if they act honestly for the benefit of the company they represent they discharge both their equitable as well as their legal duty to the company.¹⁵²

Despite the age of the case, this position rings true to date. Under the Proposed Act fiduciary duties, normally under the common law, have been codified and fall within Part F of Chapter 2 within sections 75 to 77. One therefore questions whether with the more inclusive definition of shareholders in section 57(1) the obligations are thus extended. Before answering these questions, we must first ask ourselves the following:

To whom are these fiduciary duties owed?

¹⁵¹ Ibid at 8-35-8-36. Also see Ben Pettet *Company Law* 1ed (2001) 177-190.

¹⁵²[1925] 1 Ch 407 at 428-429.

In the case of *Hutton v West Cork Railway* the court said that ‘...the law does not say that there are to be no cakes and ale, but there are to be no cakes and ale except as are required for the benefit of the company.’¹⁵³

Thus as early as 1883, the question regarding what constitutes the interests of the company seemed to have been settled. Accordingly ever since, the interests of the company have always been equated with the interests of the members or shareholders. This position has been enunciated in cases such as *Parke v Daily News Limited*¹⁵⁴ and *Kinsela v Russel Kinsela Limited*¹⁵⁵. In the latter case, the court emphasized that the proprietary interests of shareholders entitle them as a general body to be regarded as the company when questions of the duty of directors arise.¹⁵⁶

What in actual fact is meant by the term ‘the company’?

Under the South African law, when it is said that a director must act in good faith towards the company and for the advancement of the company’s interests, the implication of this is that the members as a group will derive their benefit from the well being of the company.¹⁵⁷ The result of this is that both the obligations of skill and care and the fiduciary duty rest on directors to promote the interests of members.

The reason for this thinking, as Parkinson argues, is that:

‘...it is doubtful that an inanimate entity can be meaningfully said to have interests, or if it could what would they be...as a result it would be impossible to assign any definite content to a duty framed in terms of benefiting the enterprise as such. Identifying the interests of the company becomes feasible only when the purpose of the enterprise is taken into account and the enterprise’s purpose can be understood only in terms of serving human interests or objectives.’¹⁵⁸

From the foregoing, it is clear that it has been perfectly acceptable for the directors, when engaging in corporate decision making to ignore the interests of the

¹⁵³ 23 Ch D 654 at 673.

¹⁵⁴ [1962]Ch 927 at 963.

¹⁵⁵ (1986)10ACLR 395, CA NSW at 401.

¹⁵⁶ Tshepo Mongalo ‘Corporate governance and the constitution: a case for broadening the stakeholders’ in Du Plessis, M and S Pete (eds) *Constitutional democracy in South Africa 1994-2004* (2004) at 169. Also see Lilia Franca ‘A legal analysis of corporate social responsibility: a comparative approach’ (2006) 21(2) *South Africa Public Review* 286 at 292.

¹⁵⁷ Cilliers and Benade (note 87) at 335.

¹⁵⁸ JE Parkinson *Corporate power and responsibility: issues in the theory of company law* (1993) 76-77.

other stakeholders if taking into account those interests would prejudice the interests of shareholders.

Put simply, the company's interests have always been advanced through prism of shareholders and as a result, the interests of the company equated with the shareholders interests.¹⁵⁹

As previously mentioned the Proposed Act provides for standards of directors under section 76. Section 76(3) (b) requires the directors '...to exercise their powers and perform the functions of a director in the best interests of the company'.

Does section 57(1) consequently impose fiduciary obligations upon the directors with respect to the non-traditional shareholders?

In my view, the answer is yes and no.

Yes because on the face of it, the Act would require that directors act in the best interest of the company. If one views the company through the enlightened shareholder approach or traditional corporate governance approach which supports the common law position¹⁶⁰, then one could extend this argument and say that if the company is equated to shareholders and shareholders have for purposes of governance been defined to include other security holders with voting rights, then it follows that the directors would now owe both traditional and non-traditional shareholders fiduciary obligations.

However if one already views the company interest through the stakeholder 'pluralist' approach which asserts that '...co-operative and productive relationships will only be optimized where directors are permitted or required to balance shareholder interests with those of others committed to the company'¹⁶¹ then, section 57(1)¹⁶² would not affect the fiduciary obligations of the directors. This is because according to the pluralist theory, the directors may, in certain instances ignore the interests of shareholders in favour of other interests in corporate decision making.¹⁶³ In doing so, they would have already extended their fiduciary obligation to

¹⁵⁹ Mongalo (note 156) at 172.

¹⁶⁰ Ibid at 169.

¹⁶¹ Consultation Paper of the United Kingdom's Department of Trade and Industry 'Modern law for competitive economy: the strategic framework' (1999) para 5.1.13.

¹⁶² Companies Act (note 6).

¹⁶³ Mongalo (note 156) at 172-173.

all stakeholders including for example the debenture holders, creditors, employees etc.

In view of this, it is difficult to give a single position on the issue of directors' duties because the Proposed Act is unclear on the preferred approach and has elements of both shareholder primacy and stakeholder protection.¹⁶⁴ Further, companies vary from one to another depending on their culture and environment and as such will adopt different approaches towards the issue.¹⁶⁵

Either way, the non-traditional shareholders stand to benefit from more attention from the directors, which in effect would necessitate alteration of the common law position that has been as aforementioned, the position in South Africa.

The Proposed Act now provides that the '...best interests of the company...'¹⁶⁶ be taken care of by the directors however, it does not clarify what is to be construed as 'best interests'. It is possible that South African courts, as they have done on several occasions in the past, will conclude that a duty owed towards 'the company' in actual fact means a duty towards the shareholders collectively. The new company legislation creates the ideal opportunity to clarify this issue and to eliminate the existing confusion regarding the definition of 'the company'.¹⁶⁷ Nonetheless, we shall have to await South African courts' relevant jurisprudential direction on the interpretation of company and consequently the directors' duties and to whom they are owed.

The questions that the courts ought to be examining and clarifying on the issue of directors duties include; whether the directors duties and obligations shall be applied equally across the board to all the new shareholders and whether the new shareholders shall have standing to sue a director for breach of these duties.

¹⁶⁴ I Esser and JJ Du Plessis 'Stakeholders debate and directors' fiduciary duty' (2007) 19 *SA Mercantile Law Journal* 346 at 362.

¹⁶⁵ It is noteworthy to say that the King II Policy Document proposed a model aimed to achieve balance between the interests of shareholders and those of other stakeholders even when this may have been prejudicial to the maximization of shareholder wealth. Despite this, Havenga expressed doubt as to whether directors' duties would be interpreted as a general obligation to consider other stakeholder interests. See Michele Havenga 'Regulating directors' duties and South African company law reform' (2005)26(3) *Obiter* 609 at 617-618.

¹⁶⁶ Companies Act (note 6) s76(3)(b).

¹⁶⁷ Esser and Du Plessis (note 164) at 357.

4.2 Shareholder remedies

Flowing from the directors duties, the shareholders must have corresponding remedies in the event that the directors breach their fiduciary duty or their duty of skill and care.

In view of this, there are various forms of redress that the shareholder may seek on their own behalf or on behalf of the company however, the focus here shall be on the latter.

In the previous chapter we have seen that indeed the new shareholder may apply to court for various enforcement remedies as relates governance matters, however, in this subchapter we shall be focusing on the shareholder derivative action.

Previously shareholder litigation could take place either under common law or under statute. Litigation under common law was characterized by doctrinal confusion leading to very few reported cases hence its proposed abolition under the Proposed Act.¹⁶⁸ As earlier discussed, it is clear that directors owe their duties to the company as was the rule in *Percival v Wright*¹⁶⁹ and therefore a breach of duty whether due to negligence or breach of fiduciary obligation accrues to the company. Accordingly, where a wrong is committed against a company the directors should litigate on behalf of the company.

Under common law, the doctrine of *Foss V Harbottle*¹⁷⁰ clearly lays down the rules; firstly that a court will not interfere with the internal management of companies and second is that for wrongs committed against the company the proper claimant is the company itself. Another important principle that enforces the Foss doctrine is the majority rule doctrine which emphasizes that in company meetings, the ultimate expression of the will of the company lies with the majority vote of shareholders.

It is obvious that every rule has exception and the Foss doctrine is no exception to this. This is due to the fact that an unrestrained majority rule may cause injustice to the minority shareholders and or the company and its assets. The

¹⁶⁸ Pettet (note 151) at 226. Also see Cilliers and Benade (note 87) at 564-565 and Companies Act (note 6) s165(1).

¹⁶⁹ [1902] 2 Ch 421.

¹⁷⁰ (1843) 2 Hare 461.

exceptions to the Foss doctrine include situations where the majority shareholders through directors have acted ultra vires or illegally or where they have flouted the constitution of the company, or where the personal rights of minority shareholders have been altered by the majority or where there has been fraud on the minority by the majority shareholders or directors.¹⁷¹

When a company does not or will not act against those who have wronged it, a derivative action on behalf of the company may be instituted. Such an action would have to be instituted against the company by somebody acting on his/her own behalf and all other shareholders other than the wrong doers. Such person would then enjoin the company as a nominal defendant. Usually the person who institutes such an action is the traditional shareholder as this is primarily a creation of equity holders¹⁷². The difficulties¹⁷³ plaguing the institution of common law derivative actions have led to a proposal to abolish these shareholder rights through section 165(1) of the Proposed Act which provides as follows:

‘Any right at common law of a person other than a company to bring or prosecute any legal proceedings on behalf of that company is abolished, and the rights in this section are in substitution for any abolished right.’

From the foregoing, it is clear that the Proposed Act now allows for statutory derivative actions only. Under the Current Act statutory derivative suits are provided for under section 266(1) which stated that:

Where a company has suffered damages or loss or has been deprived of any benefit as a result of any wrong, breach of trust or breach of faith committed by any director or officer of that company or by any past director or officer while he was a director or officer of that company and the company has not instituted proceedings for the recovery of such damages, loss or benefit, *any member* (my emphasis) of the company may initiate proceedings on behalf of the company against such director or officer or past director or officer in the

¹⁷¹ Pettet (note 151) at 227-231.

¹⁷² Robert A Malstrom ‘Stockholders’ derivative actions by holders of convertible debentures’ (1973) 6 *Journal of Law Reform* 760 at 761.

¹⁷³ Cilliers and Benade (note 87) at 569-570. Also see RC Williams ‘Can shareholders, aggrieved at the way the directors are running the company, ask the court to intervene?’ (2007) Nov/Dec *The Professional Accountant* 24, which goes on to elucidate the difficulties of the South African shareholder and on locus standi through the case of *Letseng Diamonds Ltd v JCI Ltd and Investec Ltd*. 2007 (5) SA 564 (W). Also see the article by Carl Stein ‘Big business beware – class and derivative actions are coming’ (2009) 9(3) *Apr Without Prejudice* 4-6, where the author avers that the Proposed Act opens up an avenue for both shareholders and stakeholders alike regarding statutory derivative actions, unlike previously where it was the reserve of the traditional shareholder only.

manner prescribed by this section notwithstanding that the company has in any way ratified or condoned any such wrong, breach of trust or breach of faith or any act or omission relating thereto.

It is clear from the language in the excerpt above that only members or traditional shareholders are allowed to institute statutory derivative suits.

In contrast the language of section 165 of the Proposed Act is a lot more accommodating allowing for more persons including shareholders, directors or prescribed officers, trade unions or any other persons allowed by the court to institute such suits.

Section 165(2) provides that:

A person may serve a demand upon a company to commence or continue legal proceedings, or take related steps to protect the legal interests of the company if the person –

- a) Is a shareholder or a person entitled to be registered as a shareholder of the company of a related company.

In my view, whether inadvertently or with intent, the Act allows non-traditional shareholders the opportunity to institute a statutory derivative suit on behalf of the company in the event of breach of directors duties owed to the company. This is because the derivative action of a shareholder flows from breach of duties by the directors which are mainly governance matters and hence tied to the section 57(1) definition.

My view is further asserted by the thinking of Malstrom who states for example that ‘...the right of a convertible debenture holder will depend on how, for these purposes, the law defines shareholder.’¹⁷⁴ Seeing as the Proposed Act for purposes of governance defines a shareholder to include any security holder with voting rights, it would follow that the non-traditional shareholders would be entitled to institute a statutory derivative action alongside other authorised persons.

¹⁷⁴ Malstrom (note 172) at 770.

If this interpretation is correct, then the non-traditional shareholders may impliedly be owed a fiduciary duties and obligations of care and skill by the directors.¹⁷⁵

Other remedies

In addition to the statutory derivative action, the non-traditional shareholder also has additional remedies against the directors under the Proposed Act.

The non-traditional shareholder has the right to apply to court for a declaration that a director is delinquent or should be put under probation. They may apply to court where a director has been rendered ineligible or disqualified under section 69, is under an order of probation under the Close Corporations Act, where a director has grossly abused his position, where he/she took personal advantage of company information, acted in a negligent manner or has been subject to compliance notices.¹⁷⁶

Unmistakably, the Act has elevated the non-traditional shareholders' position to that of the traditional shareholder with regard to remedies against the controllers of the company. There is definitely more protection for the minority interests and the company assets on the whole under the Proposed Act than there was under the Current Act.

4.3 Is the Proposed Act therefore embracing the stakeholder approach as opposed to the shareholder dominance approach?

From previous discussion within this thesis, it is clear that the Proposed Act seems to be moving away from the narrow conception of corporate governance which focused on the traditional shareholder and moving towards a more stakeholder friendly approach. It is clear from the review of the Proposed Act that the drafters seem to have a broader base of stakeholders in mind.

These instances include, the new definition of shareholders under section 57(1) which now include other security holders, notices to attend and involvement and participation in shareholder meetings by these new shareholders, remedies against the company and directors as relates governance issues and remedies such as

¹⁷⁵ Stein (note 173) at 4, directors will be exposed to threat of more derivative actions and consequently personal liability.

¹⁷⁶ Companies Act (note 6) s162.

shareholder derivative suits now available to all shareholders, employees and creditors of the company in question just to cite a few examples.

Is this necessarily a good or a bad thing for purpose of governance of companies?

Unlike South African, American states have embraced a stakeholder approach across a number of states. This has been done through what are referred to as non-shareholder constituency statutes which have been adopted across about twenty-eight states. These statutes fall into four general categories and include permissive statutes, mandatory statutes, conclusive presumption of validity of directors' determination and bondholder protection statutes.¹⁷⁷

It would be prudent to look at and compare the application, operation, advantages and disadvantages of these statutes with the Proposed Act to establish whether indeed the principles are applicable in the South African context even though the statutes are not in the exact same form as the Act.

Hanks on the interpretation and purpose of these statutes states that these statutes may be simply codifying the judicially developed law of Delaware especially when it is in relation to considering the best interests of the corporation. Other scholars have argued that this is a dubious interpretation stating that the legislature intended to do something that common law did not do in affording directors flexibility to fend off hostile tender offers in favour of non-shareholder over shareholders.¹⁷⁸

He further states that these statutes may be equivalent to the business judgement rule, that is, the statutes may only be taken into account where there is a corporate purpose of doing so.¹⁷⁹

Thirdly, he states that the statutes may be meaningless because most of them are not strongly worded and therefore would not add further obligation over and above what the directors are already required to do.¹⁸⁰

¹⁷⁷ JJ Hanks 'Playing with fire: nonshareholder constituency statutes in the 1990s' (1991)21 *Stetson Law Review* 97 at 105-107.

¹⁷⁸ *Ibid* at 106-107.

¹⁷⁹ *Ibid* at 107.

¹⁸⁰ *Ibid* at 107-108.

Lastly, he states that these statutes may represent a revolutionary break from past generations of corporation law. He quotes Dean Robert Clark of Harvard Law School who observed that:

...lawyers, judges and economists usually assume that the more ultimate purpose of a business corporation is to make profits for its shareholders. More precisely, corporate managers are supposed to make corporate decisions so as to maximize the value of the company's shares subject to the constraint of that corporation meeting all its legal obligations to others who are related and affected by it.

What are the advantages and disadvantages of these non-shareholder constituency statutes and by extension the provisions of our Proposed Act?

There are as many opinions on the issue of non-shareholder constituency statutes as there are scholars, some for and some against the idea.

To begin with the advantages, it is believed that where there are more stakeholders involved in the governance of a company, especially the debenture holders, they would be able to conserve the business to prevent waste and to obtain rents and income from the corporation or from mortgaged property without the necessity of receivership in the event that the company was in financial trouble.¹⁸¹ It is argued that if they have been participating in the management of the company affairs, they are fully updated and have no need to worry about their investments because they are fully aware of the activity that has been taking place.

Another argument for embracing non-traditional shareholders in matters of governance is the fact that the company's existence and success are seen as inextricably intertwined with the consideration of interests of all stakeholders in business such as suppliers, customers, lenders such as debenture holders and perhaps society at large. As such, exclusive emphasis on the powers and rights of the traditional shareholder would lead to under investment by other stakeholders thus diminishing potential wealth creation within a company.¹⁸² This essentially means that a company performs better and has more cohesion when every stakeholder's interest is given due consideration.

Another argument for the stakeholder approach is that within most public companies there is separation of ownership and control, the result therefore is the

¹⁸¹ Tracy (note 20) at 230.

¹⁸² Mongalo (note 156) at 172.

management role is delegated to directors. It is felt that shareholders who are supposed to be providing the necessary checks against these agents seem not to be providing them as they are seen as a docile lot who at best are only seen and feebly heard at the annual general meeting.¹⁸³ For this reason, the non-traditional shareholders attending and participating in company meetings (even though not necessarily voting on all matters) should be able to improve the activism within the company's corporate governance structure and ensure that both the directors and traditional shareholders are diligently performing their duties by querying their actions during company meetings and generally in the day to day running of the company.

Additionally the Proposed Act seems to be extending directors fiduciary obligations to the non-traditional shareholders even though this is still subject to the courts' interpretation. It would be catalyst in encouraging diligence in the performance of duties by management.

Another argument for the stakeholder approach is that the traditional shareholder is less vulnerable than the other stakeholders because in the event he /she is dissatisfied with the company's governance, he/she can quickly sell out while the other stakeholders have to wait a little longer before they can remedy the situation as they cannot easily liquidate.¹⁸⁴ Therefore by non-traditional shareholders participating in governance matters of the company, they ensure that all interests are considered and taken care of, not only those of the traditional shareholder. This is done to avoid a situation where the company runs into financial trouble.

Despite the foregoing non-exhaustive list of advantages, many other scholars do not believe in the usurpation of the power and position of traditional shareholders by the other stakeholders. This view is held for the reasons that:

Firstly, the argument that provisions which extend the fiduciary obligation to non-traditional shareholders are superfluous. They argue that under existing corporation law or common law, directors are already required to take into account

¹⁸³ Mongalo (note 86) at 98.

¹⁸⁴ William W Bratton 'Confronting the ethical case against the ethical case for constituency rights' (Fall 1993) 50 *Washington & Lee Law Review* 1449 at 1452.

any factors they believe to be in the best interests of the corporation and not only its stockholders.¹⁸⁵ Orts states that:

When making corporate decisions in practice, directors and managers consider not only the proverbial "best interests of the shareholders," but also a variety of other issues and probable consequences. Managing a large corporation is a complex job. Decisions at every level involve many factors.¹⁸⁶

The article goes on to state that:

... allowing managers to take the interests of a variety of constituencies into account simply acknowledges that ex post second-guessing of managerial decisions which probably does more harm than good. It is best for all parties concerned if courts decline to intrude on the internal process of corporate governance, except where such decisions are clearly motivated by self-interest.¹⁸⁷

These excerpts are self explanatory and capture the essence of the argument against inclusion of non-shareholder constituents in the governance of companies because scholars feel that the right organs for governance are the board and the traditional shareholders and thus their powers should not be interfered with.

Further to the above, some scholars argue that there is lack of clarity when it comes to substantive standards of applying some of the provisions within the statute. For example the director seeking to act in the 'best interests' of the company may wonder how he may give any consideration to the traditional and the non-traditional shareholders since it is difficult enough for directors to determine the best interests of the corporation and its traditional shareholders let alone the other stakeholders.¹⁸⁸ Most times the wording is vague and does not assist the management determine what is required of them.

Thirdly the issue of locus standi of the non-traditional shareholders remains unclear. In some instances there has been confusion whether the board of the directors is liable directly to the non-traditional shareholders¹⁸⁹ and if they are, whether the non-traditional shareholders have standing to sue the directors. Again the

¹⁸⁵ JJ Hanks 'Directors Liability' (1989)3(12) *Insights* 20 at 21.

¹⁸⁶ Eric W Orts 'Beyond shareholders: interpreting corporate constituency statutes'(1992) 61 *The George Washington Law Review* 14 at 43.

¹⁸⁷ *Ibid* at 43.

¹⁸⁸ Hanks (note 185) at 24.

¹⁸⁹ *Ibid* at 25.

statutes are usually subject to interpretation of the courts due to vagueness of their language which could lead to many different interpretations.

Another argument against the non-traditional shareholders or non-stockholder involvement in governance matters is the fact that the non-traditional shareholders are already protected elsewhere by other statutes and or contractual obligations. It has been asserted that there is no need to grant them gratuitous opportunity and afford them double protection at the expense of the traditional shareholders.¹⁹⁰ One can however argue contrary to this supposition, the position of the traditional shareholders has not been worsened but instead that of the non-traditional shareholders has been relatively strengthened and therefore the traditional shareholders should not complain as they have technically not lost their position or power .

Last but not least is the argument that the inclusion of non-traditional shareholder constituents may be deterrent to investment. This is because if directors are permitted to benefit non-traditional shareholders in the absence of any related benefit to traditional shareholders, corporations will find it significantly more difficult to raise equity capital due to the perception by traditional shareholders that their return may be diverted by the board at any time for the benefit of non-traditional shareholders.¹⁹¹ The investors may even prefer becoming bondholders since they seem to be the winners as they are heavily protected by the both statute and contract and many are allowed to vote as well.

From the foregoing, one cannot say whether or not having a more inclusive approach as relates governance within companies is good or bad. It is left for each state, including South Africa with its unique history and mixed approach towards governance matters, to pursue an approach that is best suited for its own circumstances.

I believe however that the more inclusive approach is more advantageous since activism within the company is improved leading to more accountability and diligence on the part of the management which is good for all stakeholders even though it may come at a slightly higher cost.

¹⁹⁰ Ibid.

¹⁹¹ Ibid.

CHAPTER 5

CONCLUSIONS AND OBSERVATIONS

From the foregoing discussion, I would like to summarize my research findings as follows:

To begin with, the Proposed Act now refers to any security holders with voting rights as shareholders with respect to governance matters only, which in effect includes creditors such as debenture holders thus expanding the meaning.

The new definition of shareholders does not seem to include holders of convertible securities where they do not carry voting rights. Such holders shall only be deemed to have voting rights in so far as the securities held inherently carry voting rights or once the securities are converted into securities that carry voting rights¹⁹².

Similarly, holders of equity warrants shall not be deemed to be shareholders since they are not holders of equity, and only until such time that their contract specifies that equity rights accrue to them shall they be deemed to have voting rights and thus referred to as shareholders .

Secondly, statute or legislation may confer voting rights, whether explicitly, impliedly or subject to conditions to any group of security holders. This notwithstanding, the Proposed Act does not confer any voting rights on any group of security holders. It merely refers to voting rights in defining the term 'shareholder' and therefore if a security does not already carry voting rights, its holder is not conferred upon shareholder status.

The Act does not characterize or define what kind /type of 'voting rights' are required for a security holder to be deemed a shareholder. One is therefore left to infer (rightly or wrongly) that both current and statutory or common law contingent rights qualify as such. These would include ordinary shareholders, debenture holders who have voting rights when interest or debt remains outstanding, preference

¹⁹² The few decisions on issues of convertible debenture for instance have refused to recognize that the conversion feature of a bond or a warrant can give status to the holder as either a legal or equitable stockholder. See Malstrom (note 172) at 774.

shareholders when their dividends remain unpaid and in some rare cases holders of equity warrants where such rights are conferred by the articles of the company.

Of the right to vote at meetings, in my opinion, the effect of section 57(1) on the enjoyment of the same is that even though the term 'shareholder' now includes non-shareholder constituencies such as debenture holders, the right to vote by the traditional shareholder has not been usurped by the debenture holders as aforementioned. This right remains intact and the non-traditional shareholder is only allowed to vote on matters that he/she previously could vote on or, over which statute has conferred rights.

Governance rights of the traditional shareholders seem to have been extended to the non-traditional shareholder although not necessarily diminishing those of the traditional shareholders.

These would include rights such as: notices and rights to attend meetings, receiving information from the company and enforcement of remedies originally reserved for traditional shareholders. All these have now been extended to and apply to both traditional and non-traditional shareholders.

On the duties of directors, the Act provides that the director must act in the best interest of the company. However from my discussion one finds that depending on how the management views the term 'company's best interest' they could either ;

- equate the best interests of the company to shareholders under the narrow conceptualisation of corporate governance where the directors owe only shareholders fiduciary duties and the duty of skill and care, or;
- under the pluralist approach ,equate the best interest of the company to all stakeholders thus ensuring that the traditional, non-traditional shareholders and all other stakeholders are owed fiduciary duties and the duty of care and skill by the directors.

Either way under the Proposed Act, both the traditional and non-traditional shareholders whether under the shareholder or stakeholder approach, seem to be owed fiduciary duties and the duty of care and skill by the directors.

Lastly, the non-traditional shareholders are now able to institute statutory derivative actions on behalf of the company. In addition to this right, they also can apply to court to declare a director delinquent or require him to be put under

probation; they may also seek relief from oppressive or prejudicial conduct by an officer or director towards the person or the company.

Does the new definition of shareholders therefore affect the corporate governance framework in South Africa?

From the discussion above, it is obvious that the position of the non-traditional shareholder has been elevated even though not to the level of the traditional shareholder. The non-traditional shareholder shall now be able to enjoy some of the rights previously exclusively enjoyed by the traditional shareholders. They are seemingly moving towards the centre stage of governance within South African companies.

This notwithstanding, the traditional shareholder still has the most rights and is still able to make himself/herself heard through the company meeting which rights have remained undisturbed.

My view however is that, if indeed the non-traditional shareholders acquire a more active role and participate in matters such as attendance of meetings (even though not necessarily voting) which was previously the domain of the shareholders, or questioning the conduct of the directors in carrying out their duties or through the remedies availed for their use, this may agitate the traditional shareholders into a more active role than they have been playing before.

Such activism would also ensure that the directors are thorough in carrying out their duties towards the company due to more scrutiny by the non-traditional shareholders. There would definitely be more accountability, transparency and a higher standard of duty and care than was required before from the directors because non-traditional shareholders such as debenture holders are more likely to want to ensure that the company always has sufficient assets to cover their liabilities. Further, these non-traditional shareholders now have access to remedies previously exclusive to traditional shareholders.¹⁹³ Indeed this might lower the incidences of the companies liquidating or winding up involuntarily.

¹⁹³ Stein (note 173) at 4-6.

In my view, the drafters of the Act seem to have embraced a more stakeholder friendly approach to the governance of companies, also seen in the drafting of King III report ¹⁹⁴ which has a whole chapter on stakeholder relationships.

One must note however that the provisions of the Proposed Act are subject to interpretation of courts that have been bound by law principles developed over the years and are now deeply engrained in the South African legal system. As a result, courts may not readily adopt or be open minded enough to adopt new radical principles.

The drafters of the Act probably foresaw the possible confusion that would arise in the interpretation of the provisions of the Proposed Act i.e. using the English common law and already developed South African jurisprudence, and sought to clarify this position. They have done so by inserting a provision that states that:

When determining a matter brought before it in terms of this Act, or making an order contemplated in this Act—

- a) a court must develop the common law as necessary to improve the realization and enjoyment of rights established by this Act; and
- b) the Commission, the Panel, the Companies Tribunal or a court—
 - i. . . . must promote the spirit, purpose and objects of this Act; and
 - ii. if any provision of this Act, or other document in terms of this Act, read in its context, can be reasonably construed to have more than one meaning, must prefer the meaning that best promotes the spirit and purpose of this Act, and will best improve the realization and enjoyment of rights.¹⁹⁵

This provision has been rightfully inserted to ease the confusion on interpretation that we have seen arising across some of the provisions discussed and hopefully this shall be embraced by the courts in developing new jurisprudence to reflect the spirit of the new law as it was intended. Hopefully, the contentious and ambiguous issues will be addressed and clarified.

Meanwhile, until the Proposed Act comes into force in 2010, all we have to do is wait and see how it all plays out.

¹⁹⁴ King III draft (note 119) at 110-129.

¹⁹⁵ Companies Act (note 6) s158.

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