THE OWNERSHIP AND CONTROL ARCHITECTURE OF SOUTH AFRICA'S STATE-OWNED COMPANIES AND ITS IMPACT ON CORPORATE GOVERNANCE

BY

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DECLARATION

I, Tebello Thabane, hereby declare that the work on which this thesis is based is my original work (except where acknowledgements indicate otherwise) and that neither the whole work nor any part of it has been, is being, or is to be submitted for another degree in this or any other university. I authorise the University to reproduce for the purpose of research either the whole or any portion of the contents in any manner whatsoever.

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NOTE ON METHODOLOGY, REFERENCING, AND PUBLISHED ARTICLES

This thesis is purely theoretical and desk-based, and critically engages both primary and secondary works. The primary works include domestic and foreign legislation, case law, codes of corporate governance, regulations, and government policy papers. Secondary works include books, journal articles, and theses. Additionally, the thesis considers research reports, newspaper articles and internet sources.

On referencing, this thesis generally complies with the University of Cape Town Faculty of Law's Research, Writing, Style and Referencing Guide. For ease of reference and convenience, each chapter provides the full citation of all its sources, regardless of whether such sources were cited in other chapters. This is to avoid the reader having to page from one chapter to another to find the full citation of sources.

Reference is made to my own published articles to support some of the claims made in this thesis. These are: Tebello Thabane 'The removal of directors in state-owned companies: Shareholders' franchise in jeopardy? *Molefe and others v Minister of Transport and others*' *South African Mercantile Law Journal* 30 (2018) 155–171; and Tebello Thabane 'Pathological corporate governance deficiencies in South Africa's state-owned companies: A critical reflection' *Potchefstroom Electronic Law Journal* 21 (2018) 1–31 (with Elizabeth Snyman-Van Deventer). Where support is drawn from these works, they are acknowledged and referenced accordingly.

ABSTRACT

This thesis examines the ownership model and various control arrangements of state-owned companies (SOCs) to establish how the division of corporate power between the boards of directors and shareholder-representatives and the exercise of corporate power by these organs impact corporate governance. The thesis makes several claims. First, it argues that the architecture of ownership and control is not underpinned by a sound theoretical base and lacks a clear and consistent economic and political logic. Second, the motivations for state ownership are vague and contradictory, resulting in an irrationally amorphous ownership model. Third, shareholder control powers are excessive, often abused, and lead to shareholder proximity to the locus of governance, which engenders interference and erodes boards' autonomy and authority to govern effectively. Fourth, the legal and regulatory regime governing SOCs is plural, complex, fragmented, and contradictory. Collectively, these and other conceptual flaws have an adverse impact on governance.

To address the flaws, the true nature and role of SOCs as entities of a special kind designed to fulfil an overarching public interest mandate need to be reimagined. To realise the public interest mandate, SOCs must be governed in the public interest. This has several aspects. The first is the truncation of excessive shareholder powers and the elimination of interference by removing SOCs from direct political control and placing them under an independent and professional shareholder entity akin to Singapore's state holding company, Temasek. The second aspect is a rethink and expansion of the duties of SOCs' directors by introducing a novel duty to act in the public interest, in addition to their traditional duties. The third aspect is that the legal and regulatory framework must be de-layered, responsive, and complementary to accommodate and give impetus to the public interest approach to corporate governance. Ultimately, these changes must culminate in a nuanced and bespoke architecture of ownership and control that is minimalist and structured and that can, arguably, address the idiosyncratic governance challenges that confront South African SOCs.

ABBREVIATIONS

ACSA	Airports Company South Africa
AGM	Annual General Meeting
ANC	African National Congress
BRICS	Brazil, Russia, India, China, South Africa
CCS	Competition Commission of Singapore
CEO	Chief Executive Officer
CIPC	Companies and Intellectual Property Commission
COO	Chief Operating Officer
CRO	Chief Reorganisation Officer
CSR	Corporate Social Responsibility
DFIs	Development Finance Institutions
DPE	Department of Public Enterprises
EDD	Economic Development Department
ESV	Enlightened Shareholder Value
GLC	Government-Linked Company
GSM	Government Shareholder Management
IoDSA	Institute of Directors in Southern Africa
IRBA	Independent Regulatory Board for Auditors
JSE	Johannesburg Stock Exchange Management
MAS	Monetary Authority of Singapore
MEC	Minerals–Energy Complex
MNCs	Multinational Companies
MOI	Memorandum of Incorporation
MSA	Municipal Systems Act 32 of 2000
NDP	National Development Plan 2030
NDPP	National Director of Public Prosecutions
NDR	National Democratic Revolution
NEDLAC	National Economic Development and Labour Council
NPA	National Prosecuting Authority
NPC	Non-profit Company
OECD	Organisation for Economic Co-operation and Development
OUTA	Organisation Undoing Tax Abuse
PAP	People's Action Party
PEGC	Public Entities Governance Council
PFMA	Public Finance Management Act 1 of 1999

PIC	Public Investment Corporation
PP	Public Protector
PRASA	Passenger Rail Agency of South Africa
PRC	Presidential Review Committe
REDISA	Recycling and Economic Development Initiative of South Africa
SAA	South African Airways
SABC	South African Broadcasting Corporation
SAICA	South African Institute of Chartered Accountants
SANRAL	South African National Roads Agency Limited
SAPO	South African Post Office
SASAC	State-owned Assets Supervision and Administration Commission of the State Council
SCA	Supreme Court of Appeal
SCOPA	Standing Committee on Public Accounts
SGX	Singapore Stock Exchange
SOC	State-owned Company
SOE	State-owned Enterprise/Entity
SWF	Sovereign Wealth Fund
TCTA	Trans-Caledon Tunnel Authority
ToRs	Terms of Reference
UK	United Kingdom
USA	United States of America

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CHAPTER 1

INTRODUCTION: PROBLEMATISATION OF CORPORATE GOVERNANCE IN STATE-OWNED COMPANIES

1. BACKGROUND AND CONTEXT

Recently, the spotlight has been shone on South Africa's state-owned companies (SOCs) like never before. SOCs are at the centre of the state capture phenomenon, which involves the repurposing of various state institutions and entities for nefarious interests.[1] SOCs are also in the spotlight because of their perennially poor operational and financial performance, as well as their systemic and enduring governance challenges, aptly referred to as 'pathological corporate governance deficiencies'.[2] Despite these intractable challenges, the state ownership of these companies continues. This is perhaps necessitated by the fact that SOCs play a vital role in economy through the provision of infrastructure, utilities, transport (air and rail) energy, broadcasting, telecommunications, and finance (banking and insurance). They are also among the biggest employers in the economy.

Before their catastrophic financial woes, many SOCs played an important revenue generating role for the state. At some point, their total revenues represented 8.7% of Gross Domestic Product (GDP).[3] Given their strategic importance to the economy, it is therefore necessary to conduct a scholarly inquiry into the fundamental causes of the corporate governance weaknesses

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1 See generally Haroon Bhorat et al *Betrayal of the Promise: How the Nation is Being Stolen* (2017). See also Michaela Martin and Hussein Solomon 'Understanding the phenomenon of "state capture" in South Africa' (2016) 5 *Southern African Peace and Security Studies* 21–34. See further the terms of reference (ToRs) of the 'Judicial commission of inquiry into allegations of state capture, corruption and fraud in the public sector including organs of state' Proclamation 3 of 2018 (The commission is chaired by Deputy Chief Justice Raymond Zondo and is hereafter referred to as the 'Zondo Commission').

2 See Public Protector *When Governance and Ethics Fail* (2014), available at http://www.pprotect.org/?q=content/investigation-reports-categories (accessed 15 April 2020). See also Tebello Thabane and Elizabeth Snyman-Van Deventer 'Pathological corporate governance deficiencies in South Africa's state-owned companies: A critical reflection' (2018) 21 *Potchefstroom Electronic Law Journal* 1–32.

3 OECD 'Corporate governance: State-owned enterprise reform' *South Africa Policy Brief* (2015) available at www.oecd.org/southafrica (accessed 15 March 2021).

that arguably lead to poor operational and financial performance and vulnerability to corruption and capture.

To be sure, SOCs have been a longstanding feature of the South African economy from the early decades of the twentieth century.[4] In the 1980s and 1990s, at the height of a growing international trend towards liberalisation and privatisation, calls were made for their privatisation.[5] The apartheid government embraced this call in 1987 and started laying off some strategic SOCs, ostensibly to reduce the state's participation in the economy, reduce government spending, and bolster the fiscus for a government that was under international sanctions, and was being increasingly isolated by the international community.[6] However, the privatisation drive never really gained traction due to the negotiations that were taking place in preparation for the new democratic order.[7] The new democratic government also succumbed to international pressure and adopted a privatisation policy after the first democratic elections of 1994, although it did not proceed speedily

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4 The state established the Department of Posts and Telegraphs in 1910; Eskom (previously Electricity Supply Commission – ESCOM) in 1922; South African Railways and Harbours (SARH) in 1926; and the Iron and Steel Corporation (Iscor) in 1928. These were followed by South African Airways (SAA) in 1934; the South African Coal, Oil and Gas Corporation (SASOL) in 1950; the South African Broadcasting Corporation (SABC) in 1950; Telkom (previously South African Post and Telecommunications) in 1958; Transnet (previously South African Transport Services (SATS)) in 1981; the Development Bank of Southern Africa (DBSA) in 1983; Denel in 1992; the Airports Company South Africa (ACSA) in 1993; the Government Employees Pension Fund (GEPF) in 1996; the Public Investment Corporation (PIC) in 2004; and the Government Employees Medical Scheme (GEMS) in 2005, to mention some.

5 The privatisation wave that started in the United Kingdom (UK) reached Africa in the late 1980s. See Marco Becht, Patrick Bolton and Ailsa Röell 'Corporate governance and control' ECGI Working Paper Series in Finance Working Paper No 02/2002 (2005) 4–5, available at http://ssrn.com/abstract_id=343461 (accessed 10 May 2019).

6 See David Johannes Fourie 'The restructuring of state-owned enterprises: South African initiatives' (2001) 23 *Asian Journal of Public Administration* 205–216. See also Reuel Khoza and Mohamed Adam *The Power of Governance: Enhancing the Performance of State-owned Enterprises* (2007) 124–142.

7 Jerome Afeikhena 'Privatisation and regulation in South Africa: An evaluation' Paper presented at the 3rd International Conference on Pro-Poor Regulation and Competition: Issues, Policies and Practices, Cape Town, 7–9 September 2004, available at www.niep.org.za (accessed 25 April 2016). The author notes that the ANC and its alliance partners opposed privatisation on the eve of the new democratic order, seeing it as a 'ploy to deny the incoming government the jewels of the state' (at 7). See also Jardine Conrad 'Privatisation and trade union rights in South Africa' (1997) 4 *International Union Rights* 6–7.

with it; the general approach was to place more emphasis on restructuring rather than privatisation.[8]

In 2000, the state adopted a policy framework for an accelerated agenda for the restructuring of state-owned enterprises (SOEs) that marked a clear policy shift from privatisation to restructuring.[9] This framework focused on five key areas, one of which was the improvement of corporate governance and appropriate standards of ethics and probity within SOCs. This goal was largely unachieved, hence the commissioning of the Presidential Review of SOEs a decade later in 2010.[10] This review also saw the improvement of corporate governance within SOCs as instrumental to their commercial viability and to the delivery of public goods.[11] Despite these two reviews, both of which provided elaborate recommendations, there has been a constant decline in the governance of SOCs, the delivery of public goods, and overall financial performance.

Factors that contribute to poor governance in SOCs include poor oversight by the shareholder, interference in operational matters, and lack of compliance

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8 Afeikhena op cit note 7 at 12. See also William Gumede 'The political economy of state-owned enterprises restructuring in South Africa' (2016) 6 *Journal of Governance and Public Policy* 69–97. The author notes that the restructuring of SOEs has been compromised by ideological conflicts within the ANC.

9 Policy Framework for an Accelerated Agenda for Restructuring of State-Owned Enterprises at 4, available at https://www.gov.za/documents/policy-framework-accelerated-agenda-towards-restructuring-state-owned-enterprises (accessed 25 April 2018).

10 Presidential State-Owned Enterprises Review Committee Report 2013 (PRC Report). This report was preceded by the Green Paper on the role of state-owned entities in a developmental state (2010), which emphasised the centrality of SOCs in a developmental state. It provides recommendations on the review of SOCs, available at https://www.gov.za/sites/default/files/gcis_document/201409/presreview.pdf (accessed 1 March 2020).

11 Among the 21 terms of reference (ToRs) of the Committee, the following touch directly or implicitly on issues of corporate governance: ToR 6: the efficiency and effectiveness of SOEs with respect to service delivery; ToR 7: current policy and regulatory framework and the impact thereof on the management of SOEs; ToR 8: the balance of social, political and economic imperatives in delivering objectives for SOEs; ToR 11: shareholder oversight and governance of SOEs; and ToR 12: recruitment, selection and appointment of boards and executive management of SOEs. Public goods are generally goods and services provided by the state for the general welfare of the citizens and not for profit. For various conceptions of this term, see Anton Anatole *Not for sale: In defense of public goods* (2019) 1–92.

with best corporate governance practices.[12] Other challenges experienced by SOCs are a high turnover of boards, high-handed actions by boards, poor strategic direction, the development of turn-around strategies without implementation, and reckless trading. The vexed question is: what leads to these enduring governance deficiencies? To fully comprehend the causes and extent of the deficiencies, it is important to properly problematise corporate governance in SOCs.

1.1 THE PROBLEM

The systemic governance failures in SOCs are not attributable to any one cause. Instead, several and otherwise dissonant problems collectively constitute what can be called a 'meta-problem' or a 'problematique' of poor corporate governance in South African SOCs.[13] These include the problem of theoretical clarity (or the lack therefore) regarding state ownership of corporations. The second problem relates to operational and financial inefficiencies and the consequent call for the privatisation of SOCs. The third problem concerns the location of the ownership model of SOCs within the existing typology of ownership models. The fourth problem relates to the role of the shareholder in the governance of SOCs. The fifth problem concerns what appears to be the convergence of ownership and control in SOCs and the related question of the division of corporate power between shareholder representatives and boards of directors. The last problem concerns the efficacy of the legal and governance framework of SOCs.

Admittedly, these problems appear somewhat dissonant as observed above; however, this thesis will argue that they coalesce to constitute a meta-problem of ineffective corporate governance of SOCs. Reasonably, therefore, a meta-

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12 Adèle Thomas 'Governance at South African state-owned enterprises: What do annual reports and the print media tell us?' (2012) 8 *Social Responsibility Journal* 448–470. The author catalogues corporate governance transgressions at five strategic SOCs.

13 On the notion of a 'problematique' and 'meta-problem' see Hasan Özbekhan, Erich Jantsch and Alexander Christakis 'The predicament of mankind: Quest for structured responses to growing world-wide complexities and uncertainties' (1970) available at http://sunsite.utk.edu/FINS/loversofdemocracy/Predicament.PTI.pdf (accessed 10 February 2020).

problem calls for a holistic and structured solution. This thesis explores these problems and ultimately proposes a possible holistic solution.

1.1.1 Theoretical underpinnings of state ownership

Corporate governance owes allegiance to law, economics, management and politics in almost equal measure; and as a result, it lacks an overarching paradigm, which creates a sense of 'intellectual vertigo' among scholars.[14] Pettigrew laments that corporate governance 'lacks any form of coherence, either empirically, methodologically or theoretically with only piecemeal attempts to try and understand and explain how the modern corporation is run.'[15] Indeed, corporate governance is a subject that is relentlessly searching for a paradigm and a widely accepted theoretical base.[16] One's understanding and interpretation of corporate governance largely depends on the entry discipline. If one enters the discourse from a legal perspective, one is bound to view it differently to one who approaches it from an economics perspective. This is because different disciplines often emphasise different areas.[17] Turnbull correctly observes that 'each [discipline] may view corporate governance in a different way, somewhat like the apocryphal group of blind people trying to identify an elephant through touch by each describing quite different parts of the animal.'[18] The question that arises from these observations is: on what theoretical framework is corporate governance in SOCs anchored?

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14 John Pound 'The rise of the political model of corporate governance and corporate control' (1993) 68 *New York University Law Review* 1003–1071 at 1006.

15 Andrew Pettigrew 'On studying managerial elites' (1992) 13 *Strategic Management Journal* 163–182, quoting Bob Tricker *Corporate Governance: Principles, Policies and Practices* (2012) 77.

16 Bob Tricker *Corporate Governance: Principles, Policies and Practices* (2012) 76–77. See also RH Coase 'The nature of the firm: Meaning' in OE Williamson and SG Winter (eds) *The Nature of the Firm: Origins, Evolution and Development* (1991) 72.

17 This study has a legal bias. The architecture of ownership and control of SOCs and how it affects the running of these corporations is largely analysed from a legal perspective.

18 Shann Turnbull 'Corporate governance: Its scope, concerns and theories' (1997) 5 *Corporate Governance: An International Review* 180–205 at 180.

1.1.2 The role of SOCs in the economy: Revisiting the privatisation debate

In examining the cause and extent of corporate governance failure in SOCs, it is necessary to rationalise their very existence in an emerging economy like South Africa. It is important to reflect on whether the 'leviathan' should continue to be an economic player and, if so, whether it should be a dominant or a minority shareholder and under what type of ownership and control arrangement it should operate.[19] This thesis moves from the premise that a developmental state with a chequered history and inequality like South Africa cannot afford the absence of a strong and efficient SOC sector that is efficiently governed, and has the capacity to deliver public goods, address inequality, and stimulate and transform the economy.[20] This view is fortified by studies that show that developed economies graduated from enervating underdevelopment as a result of deliberate and direct state intervention in the economy through SOCs.[21]

The position advanced here is, however, contested by privatisation enthusiasts.[22] They argue that SOCs are used to benefit cronies and politically connected individuals in a 'state capture' project whose tentacles have seemingly penetrated every nook and cranny of the country's political economy. They argue further that privatisation can result in a panoply of advantages, such as efficiency, quality, cost cutting and customer

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19 For the various forms and the extent of state ownership, see Aldo Musacchio and Sergio Lazzarini *Reinventing State Capitalism: Leviathan in Business, Brazil and Beyond* (2014). The authors describe the government as the all-powerful leviathan.

20 By all accounts, South Africa is regarded as one of the most unequal societies in the world, mainly because of decades of colonialism and apartheid. Some correctly assert that the socio-economic transformation agenda can be achieved only by continued state ownership. Nyawo Gumede and Kwame Asmah-Andoh 'Prescriptions of the National Development Plan for state-owned enterprises in South Africa: Is privatisation an option?' (2016) 51 *Journal of Public Administration* 265–277.

21 Hans Christiansen 'The size and composition of the SOE sector in OECD countries' OECD Corporate Governance Working Papers, No 5 (2011). See also Jerry Mitchell *The American Experiment with Government Corporation*s (1999). See further Raymond Vernon and Yair Aharoni (eds) *State-Owned Enterprise in the Western Economies* (2014).

22 John Kane-Berman 'Privatisation or bust' (2016) 27 *Liberty Policy Bulletin of the Institute of Race Relations* available at https://irr.org.za/reports/atLiberty?b_start:int=12 (accessed 10 March 2020).

satisfaction.[23] In effect they regard privatisation as the panacea for all the failings of SOCs.

It is somewhat simplistic and unrealistic to view privatisation in and of itself as guaranteeing improved efficiency and quality. History is replete with the failures and successes of privatisation. Therefore, there are mixed results.[24] The premise that state ownership is synonymous with inefficiency (the inefficiency bias) is rebuttable. It is conceded that SOCs are prone to inefficiency, deficits and capture due to their proximity to political interests. However, this thesis will argue that the solution to these challenges lies in the reinvention of SOCs through an appropriate ownership and control model, corporate governance reform and 'pragmatic privatisation',[25] as opposed to 'big bang privatisation'.[26] As Pargendler correctly observes:

> Despite waves of privatization around the world, state ownership of enterprise remains significant. The focus of scholars and policymakers has accordingly shifted from the defense and promotion of privatization to the *design and improvement of corporate governance practices* in state-owned enterprises (SOEs).[27]

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23 John Goodman and Gary Loveman 'Does privatization serve the public interest?' (1991) *Harvard Business Review* 26–38.

24 See Ram Mohan 'Privatisation: Theory and evidence' (2001–2002) 36 *Economic and Political Weekly* 4865–4871. See also OECD *Privatisation and the Broadening of Ownership of State-Owned Enterprises* (2018). See also Tomas Piketty *Capital and Ideology* (2020) 595–598 where the author demonstrates how big bang privatisation can lead to oligarchic and kleptocractic economies.

25 Ben Fine 'Privatization: Theory and lessons from the UK and South Africa' (1997) 10 *Seoul Journal of Economics* 373–414. The author argues that the success of privatisation lies in a number of factors, including markets, the international position of a country, technological considerations, and political contexts, to mention a few. Therefore, it must be carried out with caution. See also D Reedy and PS Moodley 'Privatisation of public corporations in South Africa: The issue re-examined' (1993) 23 *Africanus* 72–79. See further Goodman and Loveman op cit note 23 on the notion of 'pragmatic privatization'.

26 On the perils of 'big bang' or mass privatisation and its infeasibility for developing economies, see Shu-ki Tsang 'Against "big bang" in economic transition: Normative and positive arguments' (1996) 20 *Cambridge Journal of Economics* 183–193. See also Sumit Majumdar and Gautam Ahuja 'Privatisation: An exegesis of key ideas' (1997) 32 *Economic and Political Weekly* 1590–1595. On the reinvention of SOCs to serve a developmental agenda, see generally United Nations *Public Enterprises: Unresolved Challenges and New Opportunities* (2008).

27 Mariana Pargendler 'The unintended consequences of state ownership: The Brazilian experience' (2012) 13 *Theoretical Inquiries in Law* 503–523 at 503 (emphasis added).

To buttress the argument that a rethink of an ownership and control architecture and corporate governance reform will allow for SOCs to be efficient and viable, reliance is largely placed on the Singaporean experience, which is discussed in chapter 6.[28]

1.1.3 Locating South Africa within a taxonomy of ownership models

There are four ownership and control arrangements: the decentralised model, the dual model, the centralised model, and the twin-track model. Under the decentralised model, state ownership is dispersed across government ministries. No single agency or ministry exercises shareholder powers and provides oversight over the running of SOCs. In the case of the dual model, two ministries collectively share the ownership responsibility for SOCs; these are usually 'common' ministries, such as the finance ministry and a sector ministry. As the name suggests, the centralised model centralises the ownership function in one ministry, agency, or some other entity. The twin-track model vests ownership functions in two distinct shareholders, each in charge of a track or portfolio of SOCs, typically divided into commercial and non-commercial SOCs.[29]

Where South Africa falls within this taxonomy is far from clear. On the face of it, ownership appears to be centralised in the dedicated Department of Public Enterprises (DPE). Yet, different sector ministries fulfil ownership functions over other sector-specific SOCs, which means that the ownership function is also dispersed across ministries, rendering the model somewhat decentralised. However, there are instances where the finance and sector ministries concurrently discharge shareholder functions over certain SOCs, thus giving the impression that the model is also dual in nature. What is clear is that the South African arrangement cannot be easily defined as a particular model. Does the type of ownership model have a bearing on the practice of

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28 In addition to the example of Singapore, studies have shown that state ownership is also successful in the Asian 'miracle economies'. See Dan Puchniak 'Multiple faces of shareholder power in Asia: Complexity revealed' in Jennifer Hill and Thomas Randall (eds) *Research Handbook on Shareholder Power* (2015) 511–534.

29 These models are fully examined in chapter 4 (para 4.2.1), where their advantages and disadvantages are explored. Later, in chapter 7 (para 7.5), the thesis proposes a suitable model for South Africa.

corporate governance and does the lack of clarity on the nature of the South African model contribute towards poor corporate governance within SOCs? These issues are addressed in the chapters that follow.

1.1.4 The shareholder intervention/interference debate

There is a raging debate among scholars around the issue of board insulation and shareholder democracy.[30] Board insulation advocates essentially contend that good corporate governance demands that boards be insulated from shareholder pressure to protect the long-term interests of corporations, their long-term shareholders, and other stakeholders. They also argue that unstable capital markets and short investor horizons create 'short-termism', which occurs when corporations pursue opportunities that are profitable only in the short term, and negatively affect the long-term profitability and sustainability of the business. Therefore, board insulation is fundamentally aimed at protecting the company. This is achieved by protecting shareholders from themselves as well as protecting directors against 'malevolent or officious shareholder interference' with governance duties.[31]

The idea of 'director primacy' is logically connected to the notion of board insulation.[32] According to this idea, shareholders should not participate in directing the corporation since that is the province of directors, who in any event owe fiduciary duties to the corporation itself and not to the shareholders. Additionally, if shareholders were allowed to participate or interfere, this would render the board a mere advisory body rather than an authoritative organ, as contemplated by corporate law and corporate governance principles.

Thus far, the question of whether SOCs, given their role in achieving developmental goals, require more shareholder intervention in their running than is the case with ordinary private and public companies remains unanswered. This work probes the nature, mode and desirability of

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30 The debate is explored in chapter 2 (paras 2.2.3 and 2.2.5).

31 Michael Whincop 'The role of the shareholder in corporate governance: A theoretical approach' (2001) 25 *Melbourne University Law Review* 418–465 at 419.

32 This is dealt with more fully in chapter 2.

shareholder intervention and the consequent effect on corporate governance in SOCs.

1.1.5 Separation of ownership and control in SOCs

As Berle and Means correctly noted, the power of the modern corporation's owner to direct the corporation is somewhat diminished.[33] The power, responsibility and substance that have always been an essential part of ownership are now placed in the hands of the board of directors and it is in its hands that the real power to direct the corporation lies.[34] This notion of separation of ownership and control holds that the centrality and authority of the board of directors in governing the corporation is a sacrosanct hallmark of the modern corporation.[35] In fact, it has been argued that the separation is so efficient that 'one ought not [to] lightly interfere with management or the board's decision making authority' in the running of corporations.[36]

The extent and desirability of the separation (or convergence) of ownership and control in SOCs and its impact on corporate governance requires a detailed investigation. This thesis undertakes this investigation by, among other means, inquiring whether the legal and governance framework promotes separation or convergence of ownership and control, and considering the effect thereof on corporate governance.

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33 Adolf Berle and Gardiner Means *The Modern Corporation and Private Property* (1932) 65. For a critical engagement with the authors' views, see generally William Bratton 'Berle and Means reconsidered at the century's turn' (2000–2001) 26 *Journal of Corporation Law* 737–770; William Bratton and Michael Wachter 'Shareholder primacy's corporatist origins: Adolf Berle and the modern corporation' (2008–2009) 34 *Journal of Corporation Law* 99–152; Kelli Alces 'Revisiting Berle and rethinking the corporate structure' (2009–2010) 33 *Seattle University Law Review* 787–808; Gerald Davies 'The twilight of the Berle and Means corporation' (2010–2011) 34 *Seattle University Law Review* 1121–1138; and Dalia Tsuk 'From pluralism to individualism: Berle and Means and 20th century American legal thought' (2005) 30 *Law and Social Inquiry* 179–227. All these authors challenge Berle and Means' conception of the modern corporation.

34 Beardsley Ruml 'Corporate management as a locus of power' (1951) 29 *Chicago-Kent Law Review* 228–246.

35 For a comprehensive exposition of this notion, see Eugene Fama and Michael Jensen 'Separation of ownership and control' (1983) 26 *Journal of Law & Economics* 301–326.

36 Stephen Bainbridge *Corporate Governance after the Financial Crisis* (2012) 211–212.

1.1.6 Division of corporate power in SOCs

The law delineates corporate power between company organs. In terms of the common law and statute, several doctrinal rules entrench the managerial powers of directors to run the business and affairs of the company. For instance, the proper plaintiff rule[37] and the doctrine of separate legal personality[38] reflect and reinforce the now trite position that the board is the mainstay of corporate governance. Notwithstanding ownership rights, shareholders are separate from the company and have no direct mandate to represent the company in its business and affairs. Only in exceptional circumstances may shareholders be permitted to act in matters that are conventionally within the board's purview. Even then, they must satisfy certain conditions before being permitted to 'intrude' in company affairs. This is the case with the shareholders' derivative action, for example.[39]

Shareholders are, however, not powerless; they enjoy proprietary or residual powers. For instance, shareholders have the power to make changes to the company's memorandum of incorporation (MOI), control the composition of the board of directors, the appointment of auditors, and the consideration of the annual financial statements at an annual general meeting (AGM).[40] The law also permits, and governance codes encourage, shareholders to proactively scrutinise the board and management actions in conducting the business and affairs of the company, otherwise referred to as shareholder activism, or, more recently, as 'shareholder-driven corporate governance'.[41]

It is imperative to evaluate the equilibrium between managerial powers and shareholder's residual powers and determine how the organs of SOCs exercise

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37 *Foss v Harbottle* (1843) 67 ER 189 at 203–204. In terms of this decision, in any action in which a wrong is alleged to have been done to a company, the proper plaintiff is the company itself, which should be represented by its directors or management.

38 The legal principle that a company is separate from its shareholders was stated in the leading case of *Solomon v Salomon & Company Ltd* [1897] AC 22 (HL) and has been incorporated in all company law statutes, including s 19 of the Companies Act 71 of 2008.

39 Section 165 of the Companies Act 71 of 2008. See the discussion of the derivation action to protect interests in chapter 5 (para 5.3.2(A)).

40 Irene-Marie Esser and Michele Havenga 'Shareholder participation in corporate governance' (2008) 22 *Speculum Juris* 74–94.

41 See generally Anita Anand *Shareholder-Driven Corporate Governance* (2020) 1–12.

their powers. Ultimately, it is important to reflect on how the division and exercise of these corporate powers impact the overall governance of SOCs.

1.1.7 The (in)effectiveness of the legal and governance framework

Corporatised state entities are subject to the same corporate laws as are other companies in South Africa. In addition, they are subject to laws and protocols that are applicable only to government entities, for example, the Public Finance Management Act (PFMA)[42] and the Protocol on Corporate Governance in the Public Sector (Protocol).[43] In some jurisdictions, scholars have argued that SOCs should be regulated by a separate statute, which would suit their peculiar needs and characteristics and avoid duplication and conflict with general statutes applicable to all types of companies.[44] Interestingly, this view is endorsed by the report of the Presidential Review Committee on SOEs (PRC).[45] Yet, the highly influential Organisation for Economic Co-operation and Development (OECD) guidelines on the corporate governance of SOEs advocate a unitary regulatory regime for all corporations, regardless of whether they are state-owned or not.[46]

Another view is that SOCs require 'regulatory dualism'. Essentially, this allows for 'regulatory diversification' considering that 'actors being regulated are not homogenous in their needs for regulation' and thus require 'two or more parallel forms of regulation, with each form designed to deal with the characteristics of a distinct set of actors'.[47] This appears to be the current position in South Africa. It is important to inquire into these divergent

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42 Public Finance Management Act 1 of 1999 (PFMA).

43 Protocol on Corporate Governance in the Public Sector (2002) (Protocol).

44 This proposal was made in respect of Brazil but rejected. See Musacchio and Lazzarini op cit note 19.

45 PRC Report op cit note 10.

46 Specifically, the guidelines recommend that states should subject SOCs to the same regulatory regime, accounting and auditing standards as other corporations, because this appears to augur well for efficiency and good corporate governance. See OECD *OECD Guidelines on Corporate Governance of State-Owned Enterprises* (2015). Recommendations relevant to this thesis are discussed in various chapters of the thesis.

47 See Ronald Gibson, Henry Hansmann and Mariana Pargendler 'Regulatory dualism as a development strategy: Corporate reform in Brazil, the US and the EU' (2011) 63 *Stanford Law Review* 475–538 at 480.

approaches and their impact on corporate governance by testing the efficacy of regulatory dualism and juxtaposing it with the viability of a unitary regulatory regime characterised by an overarching statute and a single governance code for SOCs.[48]

1.2 RESEARCH QUESTIONS

The fundamental question addressed by this thesis is whether, if at all, the ownership and control architecture of South Africa's SOCs is conceptually flawed and therefore impedes effective corporate governance.

To answer this question, it is necessary to examine the theoretical underpinnings of the current ownership and control model and the governance challenges presented by this model. It is also vital to examine the extent to which the legal and regulatory framework that gave rise to and sustains the model impacts the governance of SOCs. Additionally, the nature of state ownership and the extent to which it aids or impedes effective governance require examination. Equally, the nature of control arrangements and how these arrangements impact corporate governance need to be considered. Furthermore, it is necessary to inquire whether the model includes mechanisms that enhance corporate governance. Finally, it is worth examining whether jurisdictions with successful SOCs, for example, Singapore, can provide lessons for South Africa.[49]

1.3 FOCUS AND APPROACH OF THE INQUIRY

1.3.1 The approach of the thesis

Corporate governance can be approached from different disciplines. This thesis approaches the inquiry from a legal perspective. The thesis recognises that corporate governance cannot be 'unhinged'[50] from the law because it primarily concerns the effective discharge of directors' legal duty of care, skill and diligence and the fiduciary duties. It also concerns the discharge of shareholders' legal responsibilities and oversight. Thus, the examination of

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48 See chapter 7 (para 7.4).

49 Reasons for choosing Singapore for comparative purposes are stated in para 1.4 below and elaborated fully in Chapter 6

50 Khoza and Adam op cit note 6 at 28, citing an interview with Michael Katz.

the effectiveness of corporate governance in SOCs must focus on how SOCs' organs discharge their legal duties and responsibilities and the presence and efficacy of the various legal and regulatory checks and balances between the organs, which ultimately enable the boards to govern effectively and shareholders to provide meaningful oversight.

1.3.2 Objectives of the thesis

Corporate governance scholarship in South Africa assigns rather scant attention to the public sector, particularly SOCs.[51] The aim of this study is to enhance scholarly discourse on the governance of South African SOCs. Furthermore, the thesis intends to elevate the current debate around the governance of SOCs from public rhetoric and political-speak, particularly as it relates to state capture, state ownership and control arrangements, to finding a theoretically sound explanation for the so-called 'pathological corporate governance deficiencies' within SOCs. After examining the causes

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51 See, for example, Khoza and Adam op cit note 6. This is an important contribution; however, it focuses mainly on Eskom and is therefore limited in its scope. See also Sam Koma 'Conceptualisation and contextualisation of corporate governance in the South African public sector: Issues, trends and prospects' (2009) 14 *Journal of Public Administration* 451–459. The author contextualises corporate governance in the broader public sector without necessarily examining the causes of governance deficiencies and proposing comprehensive solutions. See L McGregor 'Are state owned companies in Africa a lost cause?' (2015) 58(1) *The Thinker* 66–70. This article provides a useful but broad account of issues without much nuance. See also Philip Aka 'Corporate governance in South Africa: Analyzing the dynamics of corporate governance reforms in the "rainbow nation"' (2007–2008) 33 *North Carolina Journal of International Law & Commercial Regulation* 220–291. The author deals with corporate governance reforms generally, yet there is no deliberate effort to focus on SOCs. The PRC Report op cit note 10 makes wide-ranging recommendations on how SOCs should be reformed. However, the report is at best inchoate for lack of a sound normative basis to anchor the committee's recommendations. Furthermore, the recommendations are high level and lack sufficient detail to inform exactly what is envisioned for the reformed SOCs. In addition, some of the recommendations are untenable, as will be argued in this thesis. Recently, some commentators have provided more nuanced but piecemeal and issue-based contributions. See for instance Riekie Wandrag 'The legal framework of SOEs' boards: Appointment and dismissal of board members and executives of Eskom, PRASA and the SABC' (2018) available at https://dullahomarinstitute.org.za/ (accessed 1 March 2020); Wandrag Riekie 'Governance of state-owned companies' in A Loubser and DP Mahony *Company Secretarial Practice* (2018) 29-2–29-3; and Lukas Muntingh 'Appointing directors to the boards of state-owned enterprises: A proposed framework to assess suitability' (2020), available at https://dullahomarinstitute.org.za/ (accessed 1 March 2020). This thesis closes the gaps in the discourse by providing a holistic view of the problems and solutions.

and extent of the decline in corporate governance, the study aims to conceptualise a nuanced and bespoke governance and regulatory paradigm underpinned by sound theoretical perspectives that can ensure the effective governance of SOCs.[52]

1.3.3 Limitations and delimitations

It is worth noting that SOCs are not homogeneous. They are founded by different statutes, they have different shareholder-representatives, their boards of directors are appointed and removed differently, and some are corporatised and listed while others are not. Furthermore, SOCs exist in three different spheres of government, namely, the national, provincial and municipal levels. Some of these SOCs have socio-political objectives, others have commercial objectives, while others have dual objectives. Lastly, some SOCs provide more political capital to politicians than others, which may explain why there is more political interest in their affairs.

Notwithstanding these significant differences between SOCs, there is consensus that the entire sector is experiencing poor corporate governance. For this reason, this thesis unavoidably ventures into making some generalisations. In providing examples to illuminate the issues, this thesis has a bias towards failing national government SOCs that have generated a lot of public interest and debate from a governance perspective. These include Eskom, South African Broadcasting Corporation (SABC), Passenger Rail Agency of South Africa (PRASA), Telkom, South African Airways (SAA) and Transnet. This focus is however justified because it presents all manifestations of poor governance thus painting a fuller picture of the *status quo*. A generalised approach is also justified by the fact that the focus of this

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52 For effective corporate governance to take root, the respective roles of the board, management and shareholders; their relationships inter se; and their relationships with other stakeholders like Parliament must be rationalised and clearly delineated in the legal and regulatory framework, and each stakeholder must perform its roles without encroaching on the terrain of others. On the notion of effective corporate governance, see Business Roundtable Principles of Corporate Governance (2016), available at https://corpgov.law.harvard.edu/2016/09/08/principles-of-corporate-governance/ (accessed 2 January 2020). This thesis adopts this conceptualisation of 'effective corporate governance'.

thesis is on the architecture of ownership and control that is applicable to the entire SOCs sector.

Although this thesis undertakes the ambitious task of critically reviewing the architecture of ownership and control and proposing solutions; it neither seeks to provide a blueprint for corporate governance in SOCs *per se* nor prescribe a definitive reform agenda. Instead, it seeks to conduct an in-depth examination of the state ownership model and the control arrangements and to draw insights from jurisdictions whose models deliver relatively well on corporate performance and governance.

It must be noted that the ownership and control arrangements are examined only as they relate to the major SOCs contained in Schedule 2 of the PFMA. These are corporatised entities that are subject to company law rules and corporate governance codes. Other state entities contained in Schedule 3 of the PFMA are beyond the scope of this work largely because they are too diverse and most of them do not have the traditional corporate structure.[53]

1.3.4 Terminology

Corporate governance does not have a standard accepted definition. That said, the common definition is the one articulated by the United Kingdom (UK) Cadbury Report and adopted with slight variations in many codes across the world, including the South African King Code.[54] This definition simply views corporate governance as 'the system by which companies are directed and controlled.'[55] The definition appears succinct, yet it is deceptively simple for its lack of nuance. A more comprehensive and nuanced definition of corporate governance, which is adopted in this thesis, is:

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53 These entities include regulatory bodies, commissions, councils, boards, tribunals, and funds.

54 The first King Report on Governance for South Africa (1994) is known as 'the King Report' while the first King Code of Governance Principles for South Africa (1994), in which provisions of the King Report are enshrined, is referred to as 'the King Code'. Collectively, these King Report and Code are referred to as 'King I'. They were followed by King II (2002), King III (2009) and the latest version, King IV (2016).

55 Adrian Cadbury 'Report of the Committee on the Financial Aspects of Corporate Governance' (1992) (the Cadbury Report). For a critique of the Cadbury definition, see Cally Jordan 'Cadbury 20 years on' (2013) 58 *Villanova Law Review* 1–24 at 3.

> the process of controlling management and of balancing the interests of all internal stakeholders and other parties who can be affected by the corporation's conduct in order to ensure responsible behaviour by corporations and to achieve the maximum level of efficiency and profitability for a corporation.[56]

This definition emphasises the need for control in order to achieve efficiency and profitability, which seem to elude many SOCs in South Africa.

Another useful definition of corporate governance is advanced by the King IV Code. This Code defines corporate governance as 'the exercise of ethical and effective leadership by the governing body towards the achievement of the following governance outcomes: ethical culture, good performance, effective control, and legitimacy.' The Code notes that 'ethical leadership' is characterised by integrity, competence, responsibility, accountability, fairness, and transparency. These aspects allow the board to anticipate and prevent possible adverse effects on the corporation's operations, the economy, society, and the environment.[57]

This definition will be applied throughout this thesis. The thesis will test whether boards of SOCs are characterised by integrity, competence, responsibility, accountability, fairness, and transparency. The thesis will also test the legitimacy of SOCs' boards and whether they truly exercise effective governance of SOCs. In short, the thesis will use the King IV Code principles as the barometer against which to examine the governance of SOCs.

The architecture of ownership and control is conceptualised broadly to mean the ownership model and control arrangements as shaped by the legal and regulatory regime, state ownership policy and other governance frameworks. The robustness of this architecture depends largely on corporatisation, state ownership concentration, listing, and the applicability of competition rules to SOCs. It is also affected by the definition, delineation, and exercise of powers by stakeholders, particularly the board, shareholder-representatives,

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56 Jean Jacques du Plessis, Anil Hargovan and Mirko Bagaric *Principles of Contemporary Corporate Governance* (2012) 6–7. This thesis does not, however, regard profitability as the endgame of SOCs; the public interest is regarded as the ultimate priority. This point is made more forcefully in the chapters that follow.

57 See 'Glossary of Terms' of the King IV Code (2016).

bureaucrats, and Parliament – the latter two being peculiar to SOCs. Taken together, these facets constitute an architecture of ownership and control of SOCs.[58]

The thesis mainly uses the term 'state-owned company' or 'SOC' in line with the Companies Act.[59] Neither the Companies Act nor the PFMA employs the commonly used terminology of 'state-owned enterprise' (SOE). Rather, the Companies Act uses 'state-owned company' while the PFMA uses 'national public entity', which is defined as a national government business entity in the form of a company, fund or corporation.[60] However, the term 'enterprise' literally refers to a business or company. For this reason, it is difficult to reject the 'SOE' terminology even though it finds no expression in legislation. This thesis will therefore use the terms interchangeably, with 'SOC' being the dominant term.[61] However, a deliberate distinction between the terms will be made in chapter 7.[62] Other terms used interchangeably with 'SOC' and 'SOE' are 'company' and 'corporation'. It is also important to note that the terms 'shareholder', 'shareholder-representative', and 'shareholder-minister' are ascribed the same meaning, unless stated otherwise.

1.4 THESIS OVERVIEW

This thesis comprises eight chapters. This chapter provided the background and context and highlighted the key issues that will be addressed throughout the thesis. Chapter 2 explores a theoretical basis for the thesis. It engages with several corporate governance approaches and theories and highlights

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58 Technically, 'control' of the company can happen in two ways: through voting rights associated with shares or through appointment or election of directors who control the majority of votes on the board (see s 2(2) of the Companies Act). In the context of this thesis, however, control is used to refer to the power to direct the business and affairs of the company. For a similar conception see, Blanché Steyn and Lesley Stainbank 'Separation of ownership and control in South African-listed companies' (2013) 16 *South African Journal of Economic and Management Sciences* 316–345.

59 In terms of s 1 read with s 8(2)*(a)*, a SOC is an enterprise that is registered in terms of the Companies Act as a company, and is either listed as a public entity in the PFMA or owned by a municipality as contemplated in the Municipal Systems Act 32 of 2000 (MSA).

60 See s 1 of the PFMA.

61 Using the two terms interchangeably is practical as most of the literature also uses them interchangeably.

62 See chapter 7 para 7.5.2.

their inadequacies. The chapter mainly argues that these approaches and theories are developed in the context of privately or publicly held companies and therefore cannot fully explain the governance dynamics in SOCs, given the nuances and peculiarities of SOCs, as well as the objective realities in which they operate. Chapter 2 then develops a new approach called a 'public interest approach to corporate governance in the public sector'. The chapter defines the contours of this approach, its relationship with other approaches and theories, and anticipates its possible limitations.

Chapter 3 critically analyses the legal and regulatory framework. It focuses mainly on three types of regulation, namely 'soft regulation', 'hard regulation', and 'judicialised' and 'quasi-judicialised' regulation. The chapter argues primarily that the framework is fragmented and causes onerous 'over-regulation' and, in some instances, 'regulatory uncertainty', both of which have a negative impact on corporate governance within SOCs.

Chapter 4 is concerned with the notion of state ownership, particularly the motivations of state ownership, and the role, powers, and influence of shareholder-representatives in the governance of SOCs. The chapter argues that the ownership model permits and, to some extent, promotes shareholder proximity to the locus of governance, resulting in interference in operational matters and thus compromising the governance of SOCs. In response to this, the chapter argues for a greater separation of ownership and control.

Chapter 5 explores the control arrangements of SOCs. In particular, the chapter examines the extent to which boards direct SOCs. In this regard, the roles and duties of directors are assessed, and it is argued that these roles and duties must be refined in order to assert the primacy of boards, which is essential for effective governance.

A comparative analysis of an ownership and control model in Singapore is undertaken in chapter 6. Singapore is a common-law country and, like South Africa, its company law and corporate governance codes are derived from English law. Singapore follows a centralised ownership model, in terms of which the ownership functions in state corporations are discharged by a state holding company. This arrangement, coupled with other factors, has earned

Singapore international acclaim for having the most efficiently governed and commercially viable SOCs. For this and other reasons explored more fully in chapter 6, the chapter focuses on Singapore as a source of possible lessons.[63] Other jurisdictions with supposedly efficient SOCs, such as those in Europe, and the Nordic and Gulf regions, are not considered because of their markedly different legal, political and economic systems, which would make borrowing from such jurisdictions unfeasible.

Chapter 7 synthesises various proposals made throughout the thesis and distils lessons from Singapore and the OECD Guidelines on Corporate Governance of SOEs. It also affirms, adapts, and rejects some recommendations of the Presidential Review Committee. The chapter primarily conceptualises a bespoke ownership and control model for South Africa. Chapter 8 concludes the work and highlights the contribution of this thesis to the field of corporate governance of SOCs.

63 See chapter 6 para 6. The comparison with Singapore and the lessons learned follows the comparative techniques in the study of commercial law and corporate governance as proposed by Peter de Cruz *Comparative Law in a Changing World* (2015).

CHAPTER 2

THEORISING CORPORATE GOVERNANCE IN STATE-OWNED COMPANIES: A PUBLIC INTEREST APPROACH

2 INTRODUCTION

This chapter aims to develop a theoretical framework for corporate governance in SOCs. A sound theoretical base is vital for a critical analysis of the impact of the ownership and control architecture on the governance of SOCs, because any analysis must be located within a normative paradigm to transcend mere description.[1] To understand this paradigm an exploration of the competing theses of corporate governance *convergence* and *path dependence* is necessary.[2] It will be argued that neither thesis is fully applicable to SOCs.

The exploration of these theses is followed by a critical examination of various corporate governance theories and their limitations when applied to SOCs. In this regard, it will be argued that the main corporate governance theories explain the governance interplay within privately or publicly held corporations; however, the governance dynamics at play call for a theoretical approach that considers the distinctive nature of SOCs. After exposing the limitations of existing theories, it is argued that a SOCs-specific theory or approach that considers their nuances, peculiarities, and the objective realities of South Africa is necessary.

2.1 CONVERGENCE AND PATH DEPENDENCE THESES[3]

In their paper hyperbolically titled 'The end of history for corporate law', Hansmann and Kraakman argue that, despite institutional differences in different jurisdictions, there is 'normative global convergence' of corporate law and governance practices.[4]

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1 Stephen Bainbridge *The New Corporate Governance in Theory and Practice* (2008) 2.

2 Path dependence or global convergence, depending on where one falls on the debate, are important in comparative corporate governance as they shape ownership and governance around the world. See Lucian Bebchuk and Mark Roe 'A theory of path dependence in corporate governance ownership and governance' (1999) 52 *Stanford Law Review* 127–170.

3 For a magisterial discourse on these two theses, see Jeffrey Gordon and Mark Roe (eds) *Convergence and Persistence in Corporate Governance* (2004). For a summarised version of the debate, see Jennifer Hill 'The persistent debate about convergence in comparative corporate governance' (2005) 27 *Sydney Law Review* 743–752.

4 Henry Hansmann and Reinier Kraakman 'The end of history for corporate law' (2000–2001) 89 *Georgetown Law Journal* 439–468. For a critique of the thesis see Leonard Rotman 'Debunking the "end of history" thesis for corporate law' (2010) 33 *Boston College International and Comparative Law Review* 219–272 and David Kershaw 'No end in sight for the history of

They claim that this legal convergence has resulted in 'a broad normative consensus' that corporations are managed in the interest of shareholders alone – the shareholder-oriented approach. According to these proponents of the convergence thesis, the broad normative consensus has been a consequence of the so-called 'force of logic', 'force of example', and 'force of competition'.[5] In essence, they argue that it is only logical to make the interests of shareholders central to the running of the corporation because such interests cannot be adequately protected by contractual arrangements. Furthermore, logic dictates that shareholders who enjoy strong control rights are motivated to maximise shareholder value. Thus, convergence is a *fait accompli* – and hence their bold declaration of the 'end of corporate history'.

Before considering whether the convergence thesis is applicable to SOCs, it is useful to offer a general critique of the thesis. The starting point is perhaps the famous corporate law debate between Berle and Dodd in the pages of the *Harvard Law Review* in the 1930s.[6] Berle argued that the powers granted to the board and management of a corporation are at all times exercisable only for the 'rateable benefit' of the shareholders.[7] This view was persuasively challenged by Dodd who believed that a corporation as an economic institution has both a social service and a profit-making mandate.[8] Dodd's views seem to have prevailed since contemporary company law recognises the interests of a multiplicity of stakeholders, as indicated later in this chapter.

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corporate law: The case of employee participation in corporate governance' (2002) 2 *Journal of Corporate Law Studies* 34–81.

5 Hansmann and Kraakman op cit note 4 at 455.

6 For a comprehensive review of the theories underpinning the positions adopted by both Berle and Dodd, see David Millon 'Frontiers of legal thought: Theories of the corporation' (1990) 201 *Duke Law Journal* 216–225.

7 Adolf Berle 'Corporate powers as powers in trust' (1931) 44 *Harvard Law Review* 1049–1074. Berle later submitted in response to Merrick Dodd that 'the view that business corporations exist for the sole purpose of making profits for their stockholders' could not be abandoned 'until such time as you are prepared to offer a clear and reasonably enforceable scheme of responsibilities to someone else.' A Berle 'For whom corporate managers are trustees: A note' (1932) 45 *Harvard Law Review* 1365–1372 at 1367.

8 Merrick Dodd 'For whom are corporate managers trustees?' (1932) 45 *Harvard Law Review* 1145–1163 at 1148. Berle later conceded that Merrick 'pragmatically' won the debate on the question 'for whom are corporate managers trustees'. See Adolf Berle 'Corporate decision-making and social control' (1968) 24 *The Business Lawyer* 149–157 at 150. See also Adolf Berle *The 20th Century Capitalist Revolution* (1954) 169.

Turning to the applicability or otherwise of the convergence thesis to SOCs, it can be argued that the very nature of SOCs means that the narrow shareholder-oriented approach does not apply to them. They are by nature located within the 'state-oriented approach' where they usually serve a public interest mandate of delivering public goods as well as contributing to the national fiscus. The narrow shareholder-oriented approach by contrast focuses only on shareholder-wealth maximisation. Therefore, convergence around the shareholder-oriented approach and the corporate governance theories that explain the governance of publicly or privately held corporations cannot adequately explain the governance challenges besetting SOCs and the solutions thereto, given SOCs' peculiar characteristics and specific governance approach.[9]

The rival thesis to convergence is path dependence whose chief proponents are Bebchuk and Roe.[10] They argue that different types of corporate ownership and governance, namely diffused ownership, concentrated ownership, and labour-influenced ownership (co-determination) will persist in various jurisdictions, despite the forces of globalisation. This is because each country's corporate ownership and governance system is path dependent.[11] Differences in culture, ideology and politics influence the type of corporate law and the approach to governance.[12] For instance, a country with a social democratic ideology will have a different ownership and governance outlook to one with neo-liberal capitalist leanings or the so-called 'highly individualistic Reagan–Thatcher style of capitalism'.[13]

This latter point is particularly relevant in the context of SOCs. Ideology and politics determine whether the state intervenes in the economy through SOCs or not. Neo-liberal capitalist economies like the United States of America (USA) and the United

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9 Amir Licht argues that 'national cultures' can metaphorically be considered 'mother of path dependence'. See Amir Licht 'The mother of all path dependencies: Toward a cross-cultural theory of corporate governance systems' (2001) 26 *Delaware Journal of Corporate Law* 147–205 at 203. See further Amir Licht 'Legal plug-ins: Cultural distance, cross-listing, and corporate governance reform' (2004) 22 *Berkeley Journal of International Law* 195–239.

10 Bebchuk and Roe op cit note 2. See also Mark Roe 'Path dependence, political options, and governance systems' in Klaus Hopt and Eddy Wymeersch (eds) *Comparative Corporate Governance: Essays and Materials* (1997) 165–184.

11 Bebchuk and Roe op cit note 2 at 138.

12 See generally Mark Roe *Political Determinants of Corporate Governance: Political Context, Corporate Impact* (2003). See also P Gourevitch 'The politics of corporate governance regulation' (2002) 112 *Yale Law Journal* 1829–1880.

13 Douglas Branson 'The very uncertain prospect of 'global' convergence in corporate governance' (2001) 34 *Cornell International Law Journal* 322–362 at 326.

Kingdom (UK) loathe state intervention in the economy. For example, the UK divested state corporations during the Thatcher years in what was known as 'big-bang privatisation'.[14] Countries with social democratic leanings, like South Africa, China and those in the Nordic region, ideologically view SOCs as central to their development.[15] Despite global pressures from the Bretton Woods Institutions and lately credit rating agencies, the developing social democratic states resist the outright privatisation of SOCs precisely because of their ideological orientation and developmental trajectory.

Corporate ownership and control systems are therefore not converging towards any specific approach, let alone the shareholder-oriented approach. But they are also not static.[16] A realistic view is that various ownership and governance systems will influence each other, leading to some form of 'hybridisation' over time,[17] particularly because there is a wave of 'international standards' affecting many areas, including governance-related matters.[18] It is argued further that, in fact, these international standards and the hybridisation of systems are nothing more than a cross 'bastardisation' of rules and practices, which is not new, especially in South Africa.

As Hahlo and Khan rightly observed, '[i]deas have wings. No legal system of significance has been able to claim freedom from foreign inspiration.'[19] Consequently, it is submitted that there will be a 'gradual hybridisation' of corporate ownership and control systems as far as the governance of SOCs is concerned. Jurisdictions will borrow from each other those aspects of ownership and

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14 See generally Jerry Mitchell *The American Experiment with Government Corporations* (2005). See also Matthew Bishop and David Thompson 'Privatization in the UK: Deregulatory reform and public enterprise reform' in V V Ramanadham (ed) *Privatization: A Global Perspective* (2005) 3.

15 See PRC Report op cit note 10.

16 Major corporate scandals such as Enron have triggered some important shifts throughout the world, for example, globally standardised accounting, independent directors, and the separation of the CEO and board chair roles. See Sanford Jacoby 'Corporate governance in comparative perspective: Prospects for convergence' (2000) 22 *Comparative Labor Law and Policy Journal* 5–32 at 31.

17 Cally Jordan 'The conundrum of corporate governance' (2005) 30 *Brooklyn Journal of International Law* 983–1028 at 994–995. See also Kellye Testy 'Commentary: Convergence as movement: Toward a counter-hegemonic approach to corporate governance' (2002) 24 *Law and Policy* 433–440. For a dissenting view on hybridisation, see William Bratton and Joseph McCahery 'Comparative corporate governance and the theory of the firm: The case against global cross reference' (1999–2000) 38 *Columbia Journal of Transnational Law* 213–297.

18 In the SOC sector, many countries, including those outside the EU, follow the highly influential *OECD Guidelines on Corporate Governance of State-Owned Enterprises* (2005).

19 Herman Robert Hahlo and Ellison Kahn *The South African Legal System and its Background* (1973) 484.

governance arrangements that resonate with their own systems. Hence, this thesis will later examine the Singapore model and influential foreign standards for insights on how ownership and control arrangements influence the governance of SOCs, with a view to borrowing aspects that may be appropriate for the South African context. In what follows, a critical examination is made of various theories in search of a theoretical base that can address the central question of how the obtaining ownership and control architecture of SOCs impacts their corporate governance.

2.2 CORPORATE GOVERNANCE THEORIES

2.2.1 Agency theory and the 'infinite agency dilemma' in SOCs

The agency theory is probably the most prominent corporate governance theory. At its heart is the premise that the separation of ownership and control allows those serving as agents (directors) of principals (shareholders) to take decisions that may be inconsistent with shareholder wealth maximisation.[20] As Adam Smith famously observed:

> The directors … being the managers rather of other people's money than of their own, it cannot well be expected that they should watch over it with the same anxious vigilance with which the partners in a private company frequently watch over their own. Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company.[21]

What Smith observed is a classical agency problem. Berle and Means also asserted that the separation of ownership and control leads to directors not controlling with the same vigilance as shareholders would, and renders the latter 'practically powerless' because the responsibility and substance that are integral to the notion of ownership have now been transferred from shareholders into the hands of directors.[22] What makes directors even more powerful compared to shareholders is the reality of information asymmetry.[23] Directors have information that shareholders

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20 Eugene Fama 'Agency problems and the theory of the firm' (1980) 88 *Journal of Political Economy* 288–307. On separation of ownership and control see Eugene Fama and Michael Jensen 'Separation of ownership and control' (1983) *Journal of Law and Economics* 301–325. See also Adolf Berle and Gardiner Means *The Modern Corporation and Private Property* (1932) 6.

21 Adam Smith *The Wealth of Nations* (1776) 1283.

22 Berle and Means op cit note 20 at 64. The authors' assertion that shareholders are 'practically powerless' is not entirely correct. Shareholders still enjoy several remedies that are meant to protect their investments. These include the derivative action and the ultimate remedy of removal. See chapter 4 (para 4.2.3).

23 Shaker Zahra and Igor Filatotchev 'Governance of the entrepreneurial threshold firm: A knowledge-based perspective' (2004) 41 *Journal of Management Studies* 885–897 at 889.

do not have. Compounding this reality is the fact that, by law, directors have the ultimate responsibility of directing the corporation in the corporation's interest and not even in the interest of shareholders.[24] For this reason, there is a constant need to ensure that investors' capital is not misappropriated by directors. This danger assumes that parties to the agency relationship are 'utility maximisers' and therefore the agent will act in ways that are inimical to the principal's interests.[25] The misappropriation of investors' capital may take different forms – these are the so-called agency costs. Jensen and Meckling define these agency costs as 'the sum of the costs of creating and structuring contracts between the principal and the agent, the monitoring expenditures by the principal, the bonding expenditure by the agent, and the residual loss.'[26]

The agency problems are more acute in SOCs. Studies have revealed that agency costs are lower in SOCs with mixed ownership, that is, when they are owned by the state and private investors.[27] This is attributable to the fact that SOCs with mixed ownership operate in an open market where they are confronted with market dynamics such as competition and demanding regulatory environments. The converse is not necessarily the case for SOCs that are wholly owned by the state. They often enjoy monopolies, they are shielded from harsh market dynamics, and they are beneficiaries of regular bailouts.

The other peculiar agency problem confronting SOCs is that they are not owned by directors or by those who serve as shareholder-representatives. It is a situation of agents supervising other agents while the principal (the public) is not easily determined. This gives rise to excessive managerial and directorial fiat, adventurism and opportunism. SAA and Eskom are good examples of SOCs that are routinely bailed out by the state. This situation allows directors to pursue personal interests without worrying about the consequences of their actions and the possible collapse of these corporations.

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24 Section 66(1) of the Companies Act.

25 Michael Jensen and William Meckling 'Theory of the firm: Managerial behaviour, agency costs and ownership structure' in Michael Jensen *A Theory of the Firm: Governance, Residual Claims, and Organizational Forms* (2000) 86.

26 Ibid. Residual loss refers to the reduction of shareholder value caused by the divergence of interest between the agent and the principal. See also Eugene Fama and Michael Jensen 'Agency problems and residual claims' (1983) 26 *Journal of Law and Economics* 327–349.

27 Stuart Locke and Geeta Duppati 'Agency costs and corporate governance mechanisms in Indian state-owned companies and privately-owned companies – A panel data analysis' (2014) 11 *Corporate Ownership and Control* 8–17.

It has been argued that SOCs experience the double agency problem because different groups of people have influence in strategic and operational decisions, thus creating accountability and control deficits.[28] However, a closer look at agency costs in SOCs reveals that they accrue at multiple levels. These include the level of managers, shareholder-representatives, oversight bodies (like Parliament), and possibly the level of the ruling political party, which usually defines the ideological orientation of the state and the role of SOCs in economic development and deploys its cadres to serve in SOCs. Some of these stakeholders may have interests that are parallel to those of SOCs. It is therefore plausible to define these as 'infinite agency costs' because none of these stakeholders are the real owners of SOCs. Instead, they are agents charged with different formal and informal responsibilities towards SOCs and they all rent-seek in one way or the other.[29]

2.2.2 Principal costs theory

An alternative to the 'infinite agency costs dilemma' presented above is the newly conceived theory of 'principal agency costs'.[30] This theory posits that the principal, or the shareholder-representative in the case of SOCs, introduces costs that undermine corporate governance if such a principal wields excessive control powers and influence over the corporation. This is particularly the case if the shareholder lacks expertise and has conflicts of interest in relation to the corporation. It will be argued in chapter 4 that the division of corporate power in SOCs favours shareholder-representatives, resulting in convergence of ownership and control. It will also be argued that this distribution of power results in interference that undermines boards and thus introduces 'principal costs'.

2.2.3 Shareholder democracy

According to the shareholder democracy argument, the primary objective of the company is to maximise shareholder value.[31] Yet shareholders are relegated to the

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28 John Child and Suzana Rodrigues 'Corporate governance and new organizational forms: Issues of double and multiple agency' (2003) 7 *Journal of Management and Governance* 337–360 at 338.

29 Rent-seeking occurs where an individual (or an entity) seeks to increase their own wealth (rent) disregarding the wealth of the company or society. See Anne Krueger 'The Political Economy of the Rent-Seeking Society' (1974) 64 *American Economic Review* 291–303.

30 Zohar Goshen and Richard Squire 'Principal costs: A new theory for corporate law and governance' (2017) 117 *Columbia Law Review* 767–830.

31 On shareholder wealth maximisation, see, for example, Stephen Bainbridge 'In defense of the shareholder wealth maximization norm: A reply to Professor Green' (1993) 50 *Washington and*

margins when it comes to attaining this objective since major corporate decisions originate from the board.[32] It has been argued that the board should not enjoy control over 'constitutional decisions' that alter the fundamental corporate governance arrangements.[33] Instead, shareholders should be empowered to intervene in critical corporate decisions.

The argument that shareholders are not as empowered is implausible. For instance, under the Companies Act, the amendment of a company's MOI may be initiated at any time by either the board or shareholders entitled to exercise at least 10 per cent of the voting rights.[34] Additionally, the Companies Act affords shareholders the power to remove directors by ordinary resolution at any time. All that is required is for such directors to be issued with a notice of intention to remove them and to afford them the opportunity to make representations before their removal.[35] Clearly,

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Lee Law Review 1423–1448; and Mark Roe 'The shareholder wealth maximization norm and industrial organization' (2001) 149 *University of Pennsylvania Law Review* 2063–2082.

32 See mainly Lucian Bebchuk 'The case for increasing shareholder power' (2005) 118 *Harvard Law Review* 833–914 at 836; Lucian Bebchuk 'Investors must have power, not just figures on pay' *Financial Times* 27 July 2006. Other proponents include William Feis 'Is shareholder democracy attainable?' (1976) 31 *The Business Lawyer* 621–644; Lisa Fairfax 'Making the corporation safe for shareholder democracy' (2008) 69 *Ohio State Law Journal* 53–107; Franklin Latcham and Frank Emerson 'Proxy contest expenses and shareholder democracy' (1952) 4 *Western Reserve Law Review* 5–18; David Millon 'Radical shareholder primacy' (2013) 10 *University of St. Thomas Law Journal* 1013–1044; Dino Falaschetti 'Shareholder democracy and corporate governance' (2009) 28 *Review of Banking & Financial Law* 553–580; Adolf Berle 'For whom corporate managers are trustees: A note' (1932) 45 *Harvard Law Review* 1365–1372; Milton Friedman and Rose Friedman *Capitalism and Freedom* (40th Anniversary ed. 2002) 133; James Hanks 'Playing with fire: Nonshareholder constituency statutes in the 1990s' (1991) 21 *Stetson Law Review* 97–120; Jonathan Macey 'An economic analysis of the various rationales for making shareholders the exclusive beneficiaries of corporate fiduciary duties' (1991) 21 *Stetson Law Review* 23–44; Gordon Smith 'The shareholder primacy norm' (1998) 23 *Journal of Corporate Law* 277–324. For a historical evolution of shareholder power, see Donald J Smythe 'Shareholder democracy and the economic purpose of the corporation' (2006) 63 *Washington and Lee Law Review* 1407–1420. See also Dalia Tsuk Mitchell 'Shareholders as proxies: The contours of shareholder democracy' (2006) 63 *Washington and Lee Law Review* 1503–1578; Lucas Morel 'The separation of ownership and control in modern corporations: Shareholder democracy or shareholder republic – A commentary on Dalia Tsuk Mitchell's "Shareholders as proxies: The contours of shareholder democracy"' (2006) 63 *Washington and Lee Law Review* 1593–1600. For a critique of shareholder democracy, see Larry Cata Backer 'Direct shareholder democracy: Reflections on Lucian Bebchuk' (2006) 2 *Corporate Governance Law Review* 375–384. See also Grant Hayden and Matthew Bodie 'Shareholder democracy and the curious turn toward board primacy' (2010) 51 *William and Mary Law Review* 2071–2122.

33 Bebchuk 'The case for increasing shareholder power' op cit note 32 at 837.

34 Section 16(1)*(a)* of the Companies Act.

35 Section 71(1) and (2) of the Companies Act. See also *Minister of Defence and Military Veterans v Motau* 2014 (8) BCLR 930 (CC) and *Molefe and Others v Minister of Transport and Others* (17748/17) [2017] ZAGPPHC 120 (10 April 2017). See further Tebello Thabane 'The removal of directors in state-owned companies: Shareholders' franchise in jeopardy? *Molefe and others v Minister of Transport and others'* (2018) 30 *South African Mercantile Law Journal* 155–177. The

therefore, shareholders already enjoy some measure of *de jure* democracy and have in some instances been complicit in recent corporate failures and scandals.[36] More power does not enhance shareholder wealth but rather imperils it, because shareholders are principally motivated by wealth maximisation and this has 'toxic side effects' as it may not always be the best course to pursue for the corporation at a particular time.[37]

In the context of South African SOCs, shareholder-representatives have been complicit in poor decisions that have cost the corporations both financially and reputationally.[38] For instance, it was held in *SOS and Others v SABC and Others* (hereafter the *SOS* case) that '[t]he critical systemic causes of governance failures and mismanagement were found to have been caused by Ministerial interference in the governance and operations of the SABC.'[39] It is therefore submitted that the answer does not lie in shareholders arrogating to themselves more decision-making power but in directors being true fiduciaries of the corporation.

2.2.4 Stakeholder theory and the enlightened shareholder value approach

The stakeholder theory is best described by rejecting the justifications for shareholder primacy and shareholder wealth maximisation. The latter rest on at least four propositions:[40] First, the directors' role is to run the corporation on behalf of shareholders. As such, the latter are best suited to provide guidance on how the corporation must be run. Second, it would be more efficient if directors pursue shareholder wealth maximization rather than pursue varied and often conflicting

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author questions the decision in *Molefe* to the extent that it requires shareholders to provide reasons for removing directors.

36 William Bratton and Michael Wachter 'The case against shareholder empowerment' (2010) 158 *University of Pennsylvania Law Review* 653–728 at 723. See also chapter 4 (para 4.3).

37 Lynn Stout 'The mythical benefits of shareholder control' (2007) 93 *Virginia Law Review* 789–809. See also Lynn Stout 'The toxic side effects of shareholder primacy' (2012–2013) 161 *University of Pennsylvania Law Review* 2003–2023.

38 Examples abound. See, for instance, the Public Protector's report on the South African Broadcasting Corporation (Report Number 23 of 2013/2014) 'When governance and ethics fail' <http://www.gov.za/sites/www.gov.za/files/WHEN%20GOVERNANCE%20FAILS%20REPORT%20EXEC%20SUMMARY17Feb2014.pdf>. The roles of various shareholder-representatives and their impact on the governance of SOCs will be critically examined in chapter 4.

39 (81056/14) [2017] ZAGPJHC 289 (17 October 2017) (unreported) para 1. In this case, the shareholder-representative had amended the MOI of SABC, giving herself the power to interfere in the appointment and removal of executive directors.

40 See Andrew Keay 'Tackling the Issue of the corporate objective: An analysis of the United Kingdom's 'enlightened shareholder value approach'' *Sydney Law Review* 29 (2007) 577-612, 583-584.

interests of various stakeholders. Third, pursuing divergent interests would be impossible and would possibly result in directors not serving any of the stakeholders. Finally, there is no need for directors to serve other stakeholders as their interests can be protected under contract.

In terms of the stakeholder theory, therefore, the idea that shareholders own the company and that directors act as their agents is technically incorrect.[41] A company is a separate legal entity in law and shareholders do not own it; they only own shares in it, and such shares are not the sum of the company. This rejection of the shareholder primacy norm represents what has been called a 'communitarian' view in terms of which companies must serve broader public purposes and not pursue narrow shareholder wealth maximisation.[42] It is argued later that SOCs must serve the entire public as an all-encompassing stakeholder because SOCs are by definition owned by the entire public.

The nature of a stakeholder and who are stakeholders in SOCs is not always clear. In its basic form, 'the term stakeholder includes a wide range of interests such as those of any individual or group that may be affected by the activities of the company.'[43] The term has also been defined in a more nuanced way, which sees corporate stakeholders as 'individuals and constituencies that contribute, either voluntarily or involuntarily, to its wealth-creating capacity and activities, and that are therefore its potential beneficiaries and/or risk bearers.'[44] It is clear from these definitions that the corporation, by its nature, creates interdependencies between

41 Ibid.

42 See generally Andrew Keay 'Shareholder primacy in corporate law: Can it survive? Should it survive?' (2010) 7 *European Company and Financial Law Review* 369–413; Andrew Keay 'Stakeholder theory in corporate law: Has it got what it takes? (2010) 9 *Richmond Journal of Global Law and Business* 240–300; Andrew Keay 'Moving towards stakeholderism? Enlighten shareholder value, constituency statutes and more: Much ado about little?' (2011) 22 *European Business Law Review* 1–49; Andrew Keay 'Good faith and directors' duty to promote the success of their company' (2011) 32 *The Company Lawyer* 138–143; Andrew Keay 'Risk, shareholder pressure and short-termism in financial institutions: Does shareholder value offer a panacea?' (2011) 5 *Law and Financial Markets Review* 435–448; Rehana Cassim and Femida Cassim 'The reform of corporate law in South Africa' (2005) *International Company and Commercial Law Review* 411–418 at 411–412; Irene-Marie Esser 'The protection of stakeholder interests in terms of the South African King III Report on Corporate Governance: An improvement on King II' (2009) 21 *South African Mercantile Law Journal* 188–201.

43 Christine Mallin *Corporate Governance* (2004) 43.

44 Lee Preston, James Post and Sybille Sachs *Redefining the Corporation: Stakeholder Management and Organizational Wealth* (2002) 19.

shareholders, employees, creditors, the environment, and the community within which it operates, thus making all these groups legitimate stakeholders.[45]

In the case of SOCs, the entire public, as such, fits the definition of stakeholder. Every single citizen contributes towards the wealth creation of SOCs through the payment of taxes. When SOCs succeed, the public is the beneficiary since profits are ploughed back into the fiscus to benefit the entire public. When losses are incurred, the government bails out SOCs by using the fiscus, thus redirecting funds that would otherwise be invested in social upliftment projects. It is therefore plausible to argue that all citizens are SOCs' shareholders while others will also be employees, creditors and community members in areas where SOCs operate. Accordingly, the public is an all-encompassing stakeholder. Incidentally, no other type of corporation has this multi-dimensional stakeholder.

The stakeholder approach has been criticised for being implausible. However, King IV and the new Indian Companies Act suggest otherwise.[46] Section 166(2) of the Indian Act specifically provides that a director is obliged to act in good faith and to promote the best interests of the company, its shareholders and employees, the community, and the environment.[47] This section theoretically balances all stakeholder interests without creating any hierarchy. However, it has been suggested that the stakeholder approach is 'practically worthless' for it fails to provide guidance to directors on how to rank competing stakeholder interests and some stakeholders have no enforceable remedies in this regard.[48]

The difficulty of balancing competing interests seems to be overstated. Courts, corporate managers, and governments are constantly involved in balancing different interests and scenarios. Cassim et al offer a plausible solution for balancing divergent corporate interests. They persuasively submit that the balancing exercise should be done on a case-by-case basis and must involve a consideration of whether a reasonable and informed outsider would find it legally, morally and ethically

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45 John Matheson and Edward Adams 'A statutory model for corporate constituency concerns' (2000) 49 *Emory Law Journal* 1085–1136.

46 Principle 16 of King IV provides that '[i]n the execution of its governance role and responsibilities, the governing body should adopt a *stakeholder-inclusive* approach that balances the needs, interests and expectations of material stakeholders in the best interests of the organisation over time.'

47 Indian Companies Act, 2013.

48 Tshepo Mongalo *Corporate Actions and the Empowerment of Non-Shareholder Constituencies* (unpublished PhD thesis, University of Cape Town, 2015) 56.

justifiable to pursue the interests of a particular stakeholder in the circumstances.[49] This approach would allow directors to serve the company and its stakeholders justly and this will best suit SOCs as they have a complex stakeholder mix, where all citizens are shareholders but others wear other stakeholder caps in addition to being shareholders. Giving practical meaning to all stakeholder interests, therefore, requires SOCs to be governed in the public interest as this inherently serves all stakeholders.

Due to misgivings around the shareholder primacy and stakeholder approaches, South Africa and the UK adopted what is considered a compromise, namely, the enlightened shareholder value approach (ESV). As the name suggests, the ESV approach is based on shareholder primacy, where directors are expected to act in the collective interests of shareholders. The approach eschews narrow shareholder short-termism in favour of a more inclusive approach that prioritises long-term benefits.[50] However, under the ESV approach, other stakeholders' interests are secondary to those of shareholders. The former can be pursued only if they maximise value for shareholders in the long run. Therefore, under this approach, profit maximisation remains the primary preoccupation of directors.[51]

2.2.5 Director primacy and board insulation

Corporate law bestows directors with the ultimate authority to control the corporation, in the corporation's best interests. To be sure, the Companies Act requires that '[t]he business and affairs of a company *must* be managed by or under the direction of its board, which has the *authority* to exercise all of the powers and perform any functions of the company'.[52] The King Code echoes the Companies Act in this regard.[53] These instruments provide for what has been dubbed 'director primacy', where the collective authority of directors is sovereign and trumps the power of shareholders.[54]

The law protects directorial discretion and authority in several ways. First, directors are insulated from liability for negligence where they have exercised their discretion

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49 FHI Cassim et al *Contemporary Company Law* 2 ed (2012) 496.
50 Keay op cit note 40 at 590.
51 Section 76(3)*(b)* of the Companies Act.
52 Section 66(1) of the Companies Act (emphasis added).
53 Section 49 of the PFMA, read with s 50 and Principle 6 of King IV.
54 The chief proponent of the director primacy theory is Bainbridge op cit note 31.

negligently and contrary to their duty to act in the best interests of the company and with care, skill and diligence.[55] Doctrinally termed the 'business judgment rule', the rule dictates that directorial decisions must be respected even if, with hindsight, they were in fact not in the best interests of the corporation, provided they were informed, not motivated by self-dealing, and there was a rational basis for believing them to be in the best interests of the corporation.[56] Second, allowing directors the latitude to direct corporations without fear of liability when their decisions are reviewed gives them the necessary space to take risks, innovate, and be adventurous, all of which are vital for any business to prosper. Third, business decisions are increasingly complex and are often made in uncertain circumstances. Thus, shareholders and judges, not being business experts, must defer to directors. Fourth, although shareholders (and other stakeholders) have the power to institute the derivative action to protect the corporation, they must overcome many procedural and substantive hurdles before they can invoke the action.[57] This is a clear indication of director primacy in corporate affairs, such as litigation. In the US case of *Marx v Akers*, the court held that:

> By their very nature, shareholder derivative suits infringe upon the managerial discretion of corporate boards … Consequently, we have historically been reluctant to permit shareholder derivative suits, noting that the power of courts to direct the management of corporation's affairs should be 'exercised with restraint'.[58]

This assertion holds true in South Africa.[59] Nevertheless, shareholders still enjoy limited *de jure* democracy but only as an accountability mechanism for directors and a means to protect their investments.[60]

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55 Section 76(3)*(b)* and *(c)* of the Companies Act.

56 Section 76(4) of the Companies Act. See also Linda Muswaka 'Shielding directors against liability imputations: The business judgment rule and good corporate governance' (2013) 1 *Speculum Juris* 25–40. See also chapter 5 (para 5.4.3).

57 Section 165 of the Companies Act.

58 *Mark v Akers* 666 N.E.2d 1034, 1037 (NY 1996), quoted in Bainbridge op cit note 1 at 131.

59 The courts can permit a derivative action only where the applicant is acting in good faith, the matter involves a serious question of material consequence to the company, and it is in the best interests of the company to grant the action. See generally Helena Stoop 'The derivative action provisions in the Companies Act 71 of 2008' (2012) *South African Law Journal* 527–553, and Maleka Cassim *The New Derivative Action under the Companies Act: Guidelines for Judicial Discretion* (2016). See also chapter 5 (para 5.4.2).

60 On the rationale for limited shareholder voting rights and why they are the only stakeholders with voting rights, see Stephen Bainbridge 'The case for limited shareholder voting rights' (2006) 53 *UCLA Law Review* 601–636.

Evidently, the law favours director primacy over shareholder democracy. The vexed question is why the law unequivocally provides for director hegemony in corporate affairs. It is arguably because a consensus-based governance approach like shareholder democracy is fraught with difficulties. For instance, there is usually information asymmetry among shareholders. They also have divergent interests – some have long-term investment horizons, while others subscribe to short-termism.[61]

In contrast, director primacy appears to be the most efficient way of mediating competing stakeholder interests while insulating directors from undue shareholder pressure.[62] To buttress this point, it is noted that director primacy, with its imperfections, has been allowed to thrive by the market for the simple reason that it is both efficient and practicable compared to shareholder democracy.[63] If it were not a better system, the market (and arguably the law) would have long abandoned it.

The notion of director primacy and insulation has, nevertheless, been challenged on the basis that, left unchecked, the insulation of managers would exacerbate the agency problem within corporations. This is conceded, although it can be argued that agency costs are unavoidable. Regardless of the influence at the disposal of shareholders, there will always be a degree of agency costs. What is important is for such costs to be mitigated through clearly defined shareholder expectations and the enforcement of directors' duties.

Instructively, director primacy and insulation 'fare poorly whenever there is a dominant shareholder.'[64] SOCs are characterised by concentrated state-ownership, with the state being the sole (or dominant) shareholder. Does this therefore suggest that director primacy would be ineffective in SOCs? Is it even desirable for directors to enjoy sovereignty in controlling state-owned corporations? Put differently, does the nature and role of SOCs in achieving developmental goals instead require the dilution of directors' powers in favour of more shareholder intervention to protect

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61 Short-termism occurs when corporations pursue opportunities that are profitable only in the short term, and negatively affect the long-term profitability and sustainability of the business.

62 See, for example, Stephen Bainbridge 'Director primacy and shareholder disempowerment' (2006) 119 *Harvard Law Review* 1735–1758 at 1744–1751; William Bratton and Michael Wachter 'The case against shareholder empowerment' (2010) 158 *University of Pennsylvania Law Review* 653–728 at 653–654 and 657–659.

63 Bainbridge op cit note 1 at 56–57.

64 Bainbridge op cit note 2 at 12.

public assets than would be the case in other corporations? Incidentally, these questions have received little or no attention in legal and governance discourse.

Answering the questions posed above is not the immediate task of this chapter. That said, it is briefly submitted that absolute director primacy would be undesirable given the nature of SOCs (namely, state ownership). However, shareholder intrusion also has adverse effects on corporate governance, as correctly observed in the *SOS Support Public Broadcasting Coalition and Others v South African Broadcasting Corporation SOC Limited and Others* (*SOS* decision).[65] Thus, a happy medium between the two will be explored, with the emphasis being on a 'deferential approach' by the shareholder-representatives. The precise role and duties of the parties and the balance between board authority and accountability enforcement by shareholder-representatives will be canvassed in subsequent chapters, which address the role, powers, duties, and authority of SOCs' directors and shareholder-representatives.

2.2.6 Political logic theory

The influence of politics and the role of culture in the governance of corporations, particularly state-owned ones, cannot be discounted. According to the political logic theory, national corporate champions are used to pursue an assortment of objectives that have political dividends. These are economic, social and political in nature and are aimed at earning legitimacy, and thereby stability, for the political elite.[66] These socio-economic and political imperatives have a direct bearing on SOCs' ownership arrangements and on how they are directed. As will become apparent in chapter 6, the success of SOCs like Temasek has earned the Singaporean government and rulling party a significant measure of legitimacy.

In terms of the political logic theory, therefore, SOCs are used for legitimacy management. Aspects of this theory hold true in South Africa as well. For instance, the political orientation of the ruling party is to steadfastly pursue a so-called 'national democratic revolution' (NDR).[67] SOCs are seen to be central to the NDR and

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65 (81056/14) [2017] ZAGPJHC 289 (17 October 2017).

66 See A Shome 'Singapore's state-guided entrepreneurship: A model for transitional economies?' (2009) 11 *New Zealand Journal of Asian Studies* 318 and Jiangyu Wang 'The political logic of corporate governance in China's state-owned enterprises' (2014) 47 *Cornell International Law Journal* 631–670.

67 The NDR is described as 'a revolution led by progressive motive forces (mainly oppressed and exploited) to defeat repressive and colonial regimes and build people's democracies.' See Blade

the developmental state, with its socialist leanings.[68] To build a developmental state, the ruling African National Congress (ANC) develops policies for a spectrum of societal issues and deploys its cadres to all strategic institutions, including SOCs, to translate such policies into government policies, implement them, and ultimately earn legitimacy for the ruling party.[69]

2.3 LIMITATIONS OF CORPORATE GOVERNANCE THEORIES

The limitations of corporate governance theories and approaches must be understood in the context of the nature of SOCs. A singular feature of a SOC is ownership by the state. Theoretically, a SOC is owned by every member of the public – something unique to the SOC. No other business vehicle has such infinite ownership or, more appropriately, shareholder indeterminacy. Other distinctive features of a SOC are that, unlike other corporations that indirectly experience government control primarily through regulation, a SOC is directly controlled by government often as a dominant (or sole) shareholder. Government also controls SOCs through industrial policy and regulation. Furthermore, the government controls corporate policy and board and executive appointments (and removals). As will be demonstrated in the chapters that follow, SOCs are complex corporations with intricate mandates and a multiplicity of oversight bodies, and they are governed by both public and private law. In fact, characterising them as *sui generis* corporations would not be implausible.

It is submitted that the shortcomings of the theories and approaches discussed above, and in the context of this thesis, lie primarily in their failure to take cognisance of the *sui generis* nature of SOCs. These theories are conceptualised primarily for public corporations with dispersed ownership.[70] They nevertheless have attractive features but still fall short when applied to SOCs. For instance, the

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Nzimande 'What is the National Democratic Revolution?' (2006) 66 *Umsebenzi Online* at https://www.sacp.org.za/content/what-national-democratic-revolution (10 January 2020).

68 ANC 52nd National Conference: Resolution 1.7 on Economic Transformation (20 December 2007) emphasises the need for economic transformation for the developmental state. Available at http://www.anc.org.za/content/52nd-national-conference-resolutions (accessed 10 January 2020).

69 Those in government develop government policy in line with the broad party policy prescripts. Arguably, however, the party has not earned legitimacy despite some of its policies being sound because of lack of implementation and rampant corruption particularly within SOCs.

70 The mainstream corporate governance scholarship has largely ignored corporate types that do not fit the Anglo-Saxon model with a unitary board and dispersed ownership.

stakeholder theory is attractive because it recognises various interests, including the rights of the immediate community within which corporations operate and the environment. However, the established categories of stakeholders are too limited in the context of this thesis because SOCs have an intricate stakeholder mix that includes the public as an all-inclusive stakeholder.

Director primacy correctly emphasises autonomy and authority, which are indispensable for the board to truly govern the company. This, however, seems difficult because SOCs are politically and administratively superintended by a dominant (or sole) shareholder-representative. The political logic theory correctly puts the political utility of SOCs at the centre of analysis. Yet, this is not the whole story. SOCs have a diverse and multi-layered governance system that is legal, political, and market-driven. The inadequacy of these theories and approaches, as applied to SOCs, therefore begs the question: what approach or theoretical paradigm can be employed to properly anchor the governance of SOCs in a developmental state like South Africa? An answer to this question is attempted in the following section of this chapter.

2.4 THE ANCHORING APPROACH TO THE GOVERNANCE OF SOCs

It is clear from the foregoing discussion that 'there is no unified theory that explains all of corporate governance'.[71] It has, in fact, been cautioned that conceptualising 'a general theory of corporate governance [would be] certainly premature and probably overoptimistic'.[72] For this reason, this thesis attempts a SOC-specific approach to anchor an analysis of their ownership and control architecture as *sui generis* corporations. In what follows, an approach to 'corporate governance in the public interest' is explored to elucidate, in a modest fashion, how SOCs should be governed, given the challenges of shareholder indeterminacy, the complex role and influence of shareholder-representatives, and the political dynamics inherent in them.

2.4.1 Understanding public interest

The notion of public interest is commonly invoked in legal and political discourse, yet it is not widely understood. The starting point in unpacking the notion is perhaps an understanding of the term 'public'. Bentham observes that '[t]he community [or public] is a fictitious body, composed of the individual persons who are considered

71 Bainbridge op cit note 1 at 16.

72 Bob Tricker *Corporate Governance: Principles, Policies and Practices* (2012) 78.

as constituting as it were its members.'[73] The public is therefore the sum of members of a community or society. What then is public interest?

It would seem that an act or policy is in the public interest 'when the tendency it has to augment the happiness of the community is greater than any it has to diminish it.'[74] Happiness itself is improved when 'the basic needs of the members of the group are provided, or if the distribution of the benefits and burdens is just.'[75] Yet what is in the interest of the greater majority does not necessarily mean that the greater majority must reap direct benefits. To illustrate this point, it was held in *Clinical Centre (Pty) Ltd v Holdgates Motor Co (Pty) Ltd* that public interest may still be served even if the public at large does not benefit, and only a section of the public benefits. What matters is that the general interests of the community are served, and this may occur where a segment of the community reaps direct benefits.[76] In line with this view, the Australian case of *McKinnon v Secretary, Department of Treasury* explained that:

> The public interest is not one homogenous undivided concept. It will often be multi-faceted and the decision-maker will have to consider and evaluate the relative weight of these facets before reaching a final conclusion as to where the public interest resides. This ultimate evaluation of the public interest will involve a determination of what are the relevant facets of the public interest that are competing and the comparative importance that ought to be given to them so that 'the public interest' can be ascertained and served.[77]

This means that public interest is elastic. Therefore, its determination requires a never-ending re-examination of the objective reality of the public.[78] Instructively, public interest can also be seen to denote 'an interest of everyone the satisfaction of which is out of most individuals' hands, such that the interest is not likely to be protected or advanced *unless it is furthered by the state.*'[79] It is contended that SOCs,

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73 Jeremy Bentham *A Fragment on Government and an Introduction to the Principles of Morals and Legislation* (edited by Wilfrid Harrison 1960) 126. See also the version of Jean-Jacques Rousseau *The Social Contract and Discourse on the Origin of Inequality* (edited by Lester Crocker 1967).

74 Bentham op cit 127.

75 Theodore Benditt 'The public interest' (1973) 2 *Philosophy and Public Affairs* 291–311 at 295.

76 1948 (4) SA 480 (W).

77 [2005] FCAFC 142 (2 August 2005) para 12.

78 Wolfgang Friedmann 'The changing content of public interest: Some reflections on Harold D Lasswell' in Carl Friedrich (ed) *The Public Interest* (1967) 80–87 at 85. See also Adolf Homburger 'Private suits in the public interest in the United States of America' (1974) 23 *Buffalo Law Review* 343–410 at 387. See further Cheryl Loots 'Locus standi to claim relief in the public interest in matters involving the enforcement of legislation' (1987) 104 *South African Law Journal* 131–148 at 132.

79 Benditt op cit 295 (emphasis added).

being extensions of the state, are uniquely positioned to advance public interest within their sphere of influence and delivery.

One of the difficulties with the notion of public interest is that it is not readily clear how and who authoritatively decides what is in the public interest. After surveying case law, Rycroft argues that public interest must be decided 'according to a common-sense view of the circumstances'.[80] In line with this view, it is argued that deciding what is in the public interest involves a pragmatic inquiry where the competing interests of different members or sections of the public are delicately balanced, taking into consideration what is reasonably and legally justifiable in the circumstances.

Who decides what is in the public interest remains a problematic aspect of the concept, largely because it is routinely abused to camouflage self-interest.[81] That said, it is argued that public interest must be invoked only by those who are charged with official responsibility and are accountable for their actions, such as directors, prescribed officers, and shareholder-representatives of SOCs. In this way, the safeguards put in place for them to discharge their duties can be appealed to in assessing whether they are indeed pursuing public interest or other nefarious interests. A duty to consider public interest and its relationship with the duty to act in the best interest of the corporation will be explored in chapter 5 to give effect to the notion of corporate governance in the public interest.

2.4.2 Contextualising public interest in SOCs

To properly contextualise public interest in SOCs, it is important to consider the nature and purpose for which they exist. As already mentioned, SOCs exist to discharge a public interest mandate, namely, the delivery of public goods and/or contribution towards the national fiscus. They are economic enablers that provide, among others, infrastructure, energy, and capital (development banks). By way of illustration, Transnet has a mandate to provide cost-effective and efficient port, railway and pipeline infrastructure with the aim of lowering the cost of doing business and thus fostering economic growth in the country. The same applies to state utilities like Eskom.

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80 Alan Rycroft 'In the public interest' (1989) 106 *South African Law Journal* 172–183 at 179. For the historical evolution of the concept, see Walton Hamilton 'Affectation with public interest' (1930) 39 *Yale Law Journal* 1089–1112.

81 Carol Lewis 'In pursuit of the public interest' (2006) 66 *Public Administration Review* 694 –701 at 694.

Clearly, the mandate of SOCs is not exclusive wealth maximisation, as is often the case with other corporations. Some circumstances may warrant that SOCs provide services at a loss, provided doing so accords with their public mandate of delivering public goods. Therefore, appropriately contextualised, SOCs exist to serve the public interest. As such, they can be regarded as 'public interest corporations' and for that reason they must be governed in the public interest, as reasoned below.[82]

2.4.3 Corporate governance in the public interest

An important question that needs to be addressed as far as the governance of SOCs is concerned is the following: in whose interest are they governed? Are they governed in the interest of shareholders and who might those be? It is difficult to identify SOCs' shareholders with precision. SOCs are, by definition, owned by the public. This presents the challenge of shareholder indeterminacy since the public is rather amorphous and abstract. To overcome this challenge, it is submitted that the idea of governing SOCs in the public interest would be plausible. What this entails is explained next.

Profit maximisation may be seen to equate to public interest in that the profit made by SOCs would be ploughed back into the fiscus and would thereby benefit the public.[83] This is the so-called economic view of the corporation. It is submitted, however, that sometimes profit maximisation may have a deleterious effect on the long-term horizon of the company specifically and the economy generally, for example, where it would require a SOC to lay off multitudes of employees in order to declare a dividend.[84] In those circumstances, pure profit maximisation would be socially, politically, and economically harmful to the broader public. It is for this reason that governments bail out large corporations, both state-owned and private, to preserve jobs and to shield the economy from the negative effects of huge job losses.

The view that SOCs must be governed in the public interest and that this does not necessarily mean profit maximisation would not offend directors' duties as there is

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82 This redefinition of SOCs is explored more fully in chapter 5 (para 5.4) and chapter 7 (para 7.3).

83 Richard Jolly 'Government-owned corporations: Public ownership, accountability and the courts' (2000) 24 *Australian Institute of Administrative Law Forum* 17–33 at 22.

84 Admittedly, labour laws on retrenchments can mitigate the impact of retrenchments, however, large scale retrenchments have negative long-term effects as such they must be avoided where possible.

no legally enforceable duty to maximise corporate profits.[85] In fact, directors enjoy a discretion to curtail profits to ensure that the corporation becomes a good corporate citizen. The Companies Act specifically 'reaffirm[s] the concept of a company as a means of achieving [both] economic and social benefits.'[86] King IV recognises the fact that corporations are an integral part of society and, for this reason, they should be considered as citizens that enjoy rights and have responsibilities.[87] The Johannesburg Stock Exchange (JSE) Listing Requirements also underscore the importance of public interest considerations in the pursuit of business because listed companies actively market and pursue investments from the South African public.[88] Since SOCs are publicly owned, they bear even more public responsibilities than do private corporations.

The notion of public interest is further embraced by s 72(4) of the Companies Act. It provides for the creation of a social and ethics committee for certain corporations if public interest dictates this.[89] The Companies Regulations specifically require SOCs to have a social and ethics committee.[90] The role of this committee is to ensure that the company is a good corporate citizen by contributing to the community where it operates,[91] complying with environmental, health and safety imperatives,[92] addressing consumer relationships,[93] and upholding employees' rights.[94] To give effect to these public goals, the Companies Act introduced a new concept of a 'public interest score' as a means to determine, inter alia, whether companies other than SOCs and listed companies need to establish a social and ethics committee and have

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85 Einer Elhauge 'Sacrificing corporate profits in the public interest' (2005) 80 *New York University Law Review* 733–869.

86 Section 7*(d)*.

87 Principles 13, 16 and 17.

88 JSE Listing Requirements, see objectives, available at https://www.jse.co.za/content/JSERulesPoliciesandRegulationItems/JSE%20Listings%20Requirements.pdf (accessed 10 May 2020).

89 See generally Michele Havenga 'The social and ethics committee in South African company law' (2015) 78 *Journal of Contemporary Roman-Dutch Law* 285–292. See also Henk Kloppers 'Driving corporate social responsibility (CSR) through the Companies Act: An overview of the role of the social and ethics committee' (2013) 16 *Potchefstroom Electronic Law Journal* 166–199. See further Irene-Marie Esser and Piet Delport 'The protection of stakeholders: The South African social and ethics committee and the United Kingdom's enlightened shareholder value approach (2017) 50 *De Jure* 97–110.

90 Company Regulation 43(1).

91 Company Regulation 43(5)*(a)*(ii)*(bb)*.

92 Company Regulation 43(5)*(a)*(iii).

93 Company Regulation 43(5)*(a)*.

94 Company Regulation 43(5)*(a)*.

their financial statements audited.[95] Companies with a score of above 500 points are obliged to audit their books and set up a social and ethics committee. The public interest score is calculated as a sum of a number of points equal to the average number of employees, third party liability of the company, turnover, and the number of individuals with beneficial interest in the company. In essence, a company with many employees, high turnover, more liability exposure, and many shareholders will be required to have a social and ethics committee and have its books audited. The rationale seems to be the protection of the public (employees, creditors, shareholders, and the general public) since operations of companies with a public interest score that exceeds 500 will invariably affect more members of the public and therefore public interest dictates that they be protected by law.

A close reading of King IV, the Companies Act and the Regulations thereto, and the JSE Listing Requirements suggests that certain corporations do not solely exist for profit maximisation. Accordingly, there is room for public interest considerations in corporate governance, particularly for SOCs. This simply means that no specific stakeholder is favoured *a priori* and that profits should not be pursued at all costs. Rather, the corporation should be governed in a manner that confers a 'general benefit to the greatest majority' even if this means sacrificing profits. Having regard to the specific business decision at issue, the context and the fact that there will be conflicting stakeholder interests, governing in the public interest would therefore require directors of SOCs to consider fairness and equity rather than 'narrow stakeholder interests'. This is consistent with the view that–

> corporate governance today requires more than profit making … there is increasing recognition of an ethical responsibility and *public interest obligation* falling upon the leaders of our major corporations, both public and private.[96]

In *South African Broadcasting Corporation SOC Ltd and Others v Democratic Alliance and Others*, the Supreme Court of Appeal (SCA) took cognisance of the centrality of public interest as an 'overarching theme and objective' in the governance of the SABC.[97] Consistent with this decision, it is submitted that a public interest approach means that public interest considerations must permeate the entire governance system as opposed to the limited issues addressed by, for example, the social and

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95 Company Regulation 26(2).

96 Jeff Shaw 'Company directors: Ethical and public interest responsibilities' (2001) 73 *Australian Quarterly* 7–8.

97 2016 (2) SA 522 (SCA) para 49.

ethics committee. It also means that a public interest approach is much broader than the pluralist approach, as demonstrated next.

2.4.4 Reconciling a public interest approach with the stakeholder approach

In terms of the stakeholder approach, directors are obliged to consider all stakeholder interests in the governance of the corporation. This means that directors must balance different stakeholder interests. In terms of the public interest approach, however, different interests are not merely balanced against each other, but are viewed through a public interest lens. To illustrate, profit maximisation and the interests of employees, creditors, and the community may give way to the interests of the greater majority, who may not be employees, creditors or the immediate community within which the SOC operates. This means that, under the public interest approach, narrow stakeholder interests are not simply pitted against each other; instead, they are purposefully balanced with what is in the interest of the entire public.

It is submitted that if the narrow interests of a recognised stakeholder are sacrificed at the altar of public interest, that particular stakeholder whose interests are sacrificed nevertheless benefits, in the greater scheme of things, because public interest is inherently beneficial to the entire public, inclusive of that stakeholder. This then aligns neatly with the public ownership nature of SOCs.

2.4.5 Justifying a public interest approach to corporate governance in SOCs

Whilst being a significant departure from the current system, where corporations are practically governed primarily for wealth maximisation and predominantly in the interests of shareholders, the public interest approach is not so radically different as to be unfeasible. Indeed, many areas of the law are underpinned by the notion of public interest, and decision-makers are often compelled to act in the public interest in many respects. Where they falter, the courts step in to determine and enforce the public interest.[98]

As demonstrated already, even in a corporate setting, the pursuit of public interest is not novel. The Companies Act and King IV variously recognise the notion of public

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98 See for example, *Roberts v Chairman, Local Road Transportation Board and Another* (1) 1980 (2) SA 472 (C) and *Bamford v Minister of Community Development and State Auxiliary Services* 1981 (3) SA 1054 (C).

interest. The public interest approach argued for in this chapter, therefore, simply broadens and entrenches the approach by suggesting that public interest be *the* overarching consideration in the governance of SOCs.

This suggestion can be justified on instrumental and normative grounds. At an instrumental level, South Africa is still grappling with the effects of decades of racially induced inequality and therefore requires both state and private business to act in concert, and in the public interest, in transforming society. From a normative perspective, it can be claimed that the pursuit of public interest inherently serves the entire public, considering the nature of SOCs as *sui generis* corporations owned by multi-dimensional stakeholders, namely the public.

2.4.6 Possible limitations of a public interest approach

The anchoring of the governance of SOCs on the notion of public interest may be questioned because the notion appears nebulous to some.[99] However, that does not warrant avoiding it as an anchoring approach. It has been correctly observed that 'much of the vagueness of public interest disappears when placed in a specific context.'[100] It can even be argued that its pliability may be its strength, in that what is in the interest of the public changes over time and is dependent on circumstances, thus allowing directors the latitude to exercise their business judgment on a case-by-case basis as they ordinarily do.

The fact that public interest is not conclusively defined in any statute or case law in South Africa and elsewhere may be considered another limitation of the concept. However, complex concepts defy rigid definitions in law. For instance, the useful but complex notions of reasonableness and *boni mores* are not prescriptively defined in law. This is because these notions require flexibility, and prescriptiveness would lead to absurdity in instances where certain cases do not fit the pre-defined categories. Courts have set out non-exhaustive criteria and consider public policy goals in either the letter and spirit of the law or national policy documents to aid in determining what is in the public interest in a particular case.[101]

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99 See generally Anita Anand *Shareholder-Driven Corporate Governance* (2020) preface xi.

100 Ronald Pennock 'The one and the many: A note on the concept' in Carl Friedrich (ed) *The Public Interest* (1967) 177–182 at 178.

101 See the discussion of *Organisation Undoing Tax Abuse NPC and Another v Myeni and Another* (15996/2017) [2019] ZAGPPHC 957 (12 December 2019); *Ferreira v Levin* 1996 (1) SA 984 (CC); and *Recycling and Economic Development Initiative of South Africa v Minister of Environmental Affairs* 2019 (3) SA 251 (SCA) in chapter 5 para 5.3.2.

It may be argued that requiring directors to direct in the public interest would pose a challenge because the public is an amorphous abstraction, which may in effect result in the directors being accountable to no one. However, this view would be problematic because state organs are accountable to the public and courts have consistently tested their actions against the public interest. It is therefore possible to act in the interest of everyone. A SOC, being a corporatised extension of the state, should similarly act in the interest of the public.

Another possible limitation for the purposes of this thesis may be that the proposed approach of the public interest is limited to the governance of SOCs. The approach does not seem to fit publicly or privately held corporations where the primary reason for incorporation is profit generation. That said, 'situation-specific [and corporate type specific] mini-theories [and approaches] often are more useful for making legal [and governance] decisions than a single unified theory.'[102] Put differently, a public interest approach does not have to explain corporate governance in all types of corporations for it to be a sound approach to governance. A SOC is a *sui generis* corporation and it is therefore desirable to develop a specific approach that takes its distinctive nature into consideration.

2.5 CONCLUSION

This chapter set out to explore an anchoring approach for the governance of SOCs. To this end, it first examined existing approaches and theories of corporate governance and tested them in the context of SOCs. It found that these approaches and theories are not entirely applicable because a SOC is a peculiar corporation with indeterminate shareholders represented by a dominant, and sometimes sole, political representative with a complex stakeholder mix and intricate mandates. To respond to this *sui generis* nature of the SOC, the chapter argued for a 'public interest approach to corporate governance' as an anchoring approach that would inherently serve the public as an all-encompassing stakeholder. It anticipated possible objections to this approach and essentially argued that they would be exaggerated as the courts and directors often balance competing interests.

The chapter also argued that the idea of a social and ethics committee and the public interest score seem to introduce public interest considerations into company law

102 Bainbridge op cit note 1 at 16.

and corporate governance; therefore, the approach argued for is not entirely novel. The approach simply entrenches public interest as an overriding consideration in the governance of SOCs. The notion of corporate governance in the public interest is both explanatory and evaluative: it helps explain the nature of SOCs as public interest corporations but also lays out benchmarks against which corporate decisions in SOCs can be assessed. Hopefully, this approach provokes and modestly contributes to the debate around how and for whom SOCs are governed. The next chapter critically examines the legal and regulatory framework within which SOCs operate and determines how the framework impacts the governance of SOCs.

CHAPTER 3

THE IMPACT OF REGULATORY PLURALISM AND COMPLEXITY ON THE GOVERNANCE OF STATE-OWNED COMPANIES

3. INTRODUCTION

This chapter provides a deeper understanding of the notion of corporate governance regulation, particularly as it relates to SOCs. It does so by critically evaluating the regulatory universe applicable to SOCs. As will become apparent in this chapter, the governance of SOCs occurs within a plural regulatory universe characterised by an intricate system of norms, principles, and practices that are engendered, monitored, and enforced by public and private actors as well as state and non-state actors. This chapter therefore assesses the impact of this complex regulatory universe on the overall governance of SOCs. This is done against the realisation that a coherent, predictable, efficient, and accessible regulatory universe enables sound corporate governance.[1]

In evaluating the regulatory universe and its impact on the governance of SOCs, this chapter follows two lines of inquiry: the first is doctrinal (positivist) and principled reasoning, and the second is instrumental, policy-oriented, and forward-looking reasoning.[2] This two-pronged approach is necessary largely because corporate governance regulation is in the main a combination of soft and hard regulation. Accordingly, doctrinal reasoning is suitable for

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1 John Yasuda 'Regulatory governance' in Christopher Ansell and Jacob Torfing (eds) *Handbook on Theories of Governance* (2016) 428–441 at 428. See also Joseph Stiglitz 'Regulation and failure' in David Moss and John Cisternino (eds) *New Perspectives on Regulation* (2009) 11–23. See further Joan Gabel et al 'Evolving regulation of corporate governance and the implications for D&O liability: The United States and Australia' (2010) 11 *San Diego International Law Journal* 366–409 at 366–375.

2 The analysis of the regulatory scheme will be textual but also teleological to the extent that the public interest goals of SOCs come into play. On these modes of reasoning, particularly as applied to the notion of regulation, see Christine Parker, Colin Scott, Nicola Lacey and John Braithwaite (eds) *Regulating Law* (2005) 4–5. See also Craig Paul 'Pringle: Legal reasoning, text, purpose and teleology' (2013) 20 *Maastricht Journal of European and Comparative Law* 3–11.

examining the normative aspects of corporate governance regulation while instrumental reasoning is suitable for engaging the policy aspects of the regulatory scheme.

3.1 REGULATORY THEORY

Before engaging in a critical evaluation of the nature of the regulatory framework, it is worth pausing to consider the broader notion of regulation in the context of SOCs.[3]

3.1.1 Regulation defined[4]

Regulation is defined as an activity aimed at 'influencing the flow of events'.[5] In reality, however, the exerting of influence on the flow of events is far more intricate than this deceptively simple definition acknowledges.[6] Another definition understands regulation as mainly state-centred legislative action combined with administrative enforcement, otherwise known as command-and-control.[7] It is however trite that regulation has transcended the public sphere and is now equally engendered within and driven by the private sphere. Therefore, in the context of this thesis, a more comprehensive definition is preferred: one that conceives of regulation as 'the act or process of controlling by rule or restriction [or persuasion]'[8] using a broad set of binding legal norms contained in statute (and regulations), case law and non-binding (voluntary) practices often designed and enforced by non-state actors and contained in so-called self-regulation codes. Collectively, these strands of regulation comprise the regulatory universe within which corporations exist

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3 For a comprehensive account of the theory of regulation applied in diverse contexts, see Peter Drahos (ed) *Regulatory Theory: Foundations and Applications* (2017).

4 For purposes of this thesis, regulation encompasses both binding laws and non-binding instruments.

5 Christine Parker and John Braithwaite 'Regulation' in Mark Tushnet and Peter Cane (eds) *The Oxford Handbook of Legal Studies* (2012) 119.

6 The flow of events may be influenced by issues outside the traditional regulatory instruments, for example, corporate culture, the political system, and other non-regulatory realities.

7 Parker and Braithwaite op cit 126–127. See also Barak Orbach 'What is regulation?' (2012) 30 *Yale Journal on Regulation* 1–10.

8 Bryan Garner and Henry Campbell Black *Black's Law Dictionary* (2019).

and operate. Among other things, this regulatory universe sets out numerous standards of governance, defines processes for compliance monitoring, and adumbrates mechanisms for standards of enforcement.[9] This chapter evaluates these aspects in the context of SOCs.

As previously noted, regulation may emanate from the corporate sector without much attention from the state. In other instances, it emanates from the state through legislation. Furthermore, regulation emanates from a combination of state and private sector-driven efforts. This taxonomy is expounded upon in turn.

3.1.2 Regulatory taxonomy

At a philosophical level, scholars of regulation are engaged in an intellectual debate where one school of thought strenuously advocates the robust regulation of business, in various ways, while the opposing side strongly argues for deregulation.[10] At a practical level, however, corporations (including SOCs) are regulated by the state and the market, and these two types of regulation are intricately symbiotic. Deregulation as a school of thought has failed to gain much traction, both in theory and practice. Therefore, weighing in on this philosophical debate will obscure the aim of this chapter, which is to assess the actual impact of the current regulatory scheme on the governance of SOCs.[11]

State regulation and market regulation are taxonomised as command-and-control regulation and self-regulation respectively. There are also various hybrid forms of regulation. These types of regulation are all discussed in turn

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9 Christine Parker, Colin Scott, Nicola Lacey and John Braithwaite (eds) *Regulating Law* (2005) 1.

10 See David Levi-Faur 'Regulation and regulatory governance' in David Levi-Faur (ed) *Handbook on the Politics of Regulation* (2011) 3–21.

11 Ian Ayres and John Braithwaite *Responsive Regulation: Transcending the Deregulation Debate* (1992) 3. The authors have correctly observed that the debate on regulation versus deregulation is unappealing because 'in reality regulation occurs in "many rooms"'.

to establish a firm foundation for a critical evaluation of the different strands of regulation of South African SOCs later in this chapter.

A. Command-and-control regulation

Broadly conceived, command-and-control regulation is a type of regulation where the flow of events and corporate behaviour are determined by a uniform set of legal rules. Failure to comply with these rules attracts some form of sanction. In the context of corporate governance, this type of regulation refers to legally enforceable rules that dictate the 'who, what and how' of the governance of corporations, giving rise to 'regulatory legalism'.[12]

The rationale behind command-and-control regulation is located within the long history of corporate failures. This regulation is premised on the view that corporations will exploit gaps in the market to maximise profits. Left unchecked, these corporate escapades may lead to economic crises with far-reaching effects. Therefore, regulatory instruments must be put in place to prevent the exploitation of the market and to achieve other societal goals, such as 'fair' markets.[13] For these regulatory instruments to be effective in their deterrence and punishment of reckless behaviour, they must be binding and attract sanctions for non-compliance, so the argument goes.

Adherents of command-and-control regulation acknowledge that strict legal rules may not always achieve regulatory efficiency but argue that they are relatively efficient in comparison to other types of regulation. They catalogue the advantages of this form of regulation to include greater consistency,

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12 See Levi-Faur op cit 7–11; see also John Braithwaite 'Responsive regulation for Australia' in Peter Grabosky and John Braithwaite (eds) *Business Regulation and Australia's Future* (1992) 81–98 at 81. Braithwaite critiques 'regulatory legalism' as a myopic form of regulation that is concerned only with enforcement of rules without considering the public purpose behind such rules.

13 Joseph Stiglitz 'Regulation and failure' in David Moss and John Cisternino (eds) *New Perspectives on Regulation* (2009) 11–23. Examples of areas where command-and-control is firmly entrenched include competition, prohibition and punishment of insider trading, conflicts of interest, disclosure requirements, corporate opportunities, mergers and acquisitions, etc. These are all aimed at achieving some modicum of fairness in the business world.

predictability, accessibility, exposure to judicial review, and less likelihood of manipulative behaviour.[14]

In his thesis of 'constitutive regulation', Shearing offers a compelling critique of command-and-control regulation, and indeed other types of regulation, arguing that they focus on rule compliance achieved through either coercion or co-operation, instead of focusing on the achievement of the real goals behind regulation. In the case of capital markets, for example, he submits that regulation should be aimed at and measured by the levels of liquidity of the market and the ability to inspire confidence, rather than compliance with a set of binding or voluntary rules for its own sake.[15] It is submitted that this should also be the case with SOCs. The efficiency of their regulation should be measured by their ability to deliver public goods and the confidence that the markets and the public have in them. Presently, however, many SOCs are financially unsound and neither the market nor the public has confidence in them. Thus, through the constitutive regulation lens, their regulation may be viewed as a failure.

B. Self-regulation

Self-regulation is a malleable term, which may mean a 'corporatist arrangement' where the corporate sector regulates its own affairs, or regulation that is devoid of direct or indirect state intervention.[16] Self-regulation may be driven by market dynamics that incentivise corporations to operate transparently to inspire investor confidence, among other incentives.[17] Corporate governance codes and principles of good practice arguably fall within this category. However, although initiated by the

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14 Howard Latin 'Ideal versus real regulatory efficiency: Implementation of uniform standards and "fine-tuning" regulatory reforms' (1985) 37 *Stanford Law Review* 1267–1332 at 1271.

15 Clifford Shearing 'A constitutive conception of regulation' in Peter Grabosky and John Braithwaite *Business Regulation and Australia's Future* (1993) 67–79 at 75.

16 Julia Black 'Constitutionalising self-regulation' (1996) 59 *Modern Law Review* 24–55 at 27.

17 David Graham and Ngaire Woods 'Making corporate self-regulation effective in developing countries' (2006) 34 *World Development* 868–883.

corporate sector, self-regulation is also deliberately designed to complement state regulation.

Self-regulation may also denote a 'delegated arrangement' whereby a public policy function is delegated to the corporate sector to institutionally regulate the market and its participants.[18] As Black observes, there are four species of self-regulation. These include mandated, sanctioned, coerced, and voluntary self-regulation.[19]

It has also been argued that self-regulation is a response to the failure or inefficiency of command-and-control regulation because the latter is inflexible, not adaptable and cumbersome. Self-regulation supposedly offers several benefits, including cost-effectiveness, since its development and enforcement rest with the corporate sector and not the state.[20] Because self-regulation is developed by corporate experts who understand their industry, it purportedly responds better to corporate challenges than command-and-control regulation. It has also been lauded for its flexibility and adaptability in response to rapidly changing market dynamics. Since self-regulatory instruments are developed by the industry, it is argued that compliance therewith is more likely to be secured than compliance with top-down command-and-control instruments. The success of self-regulation, especially voluntary self-regulation, is allegedly not achieved by the threat of sanctions; rather, it is largely driven by a business case perspective – that it makes good business sense to comply with the regulations. Therefore, it depends on a combination of consensus, coaxing, collaboration, and goodwill within the corporate sector.

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18 Eric Mayer 'Regulatory enforcement in the Australian economy' in Peter Grabosky and John Braithwaite (eds) *Business Regulation and Australia's Future* (1992) 97–106 at 101. See also Rebecca Ong Yoke Chan 'Mobile communication and the protection of children' (PhD thesis, Leiden University 2010) ch 9 (Self-regulation) 239–268 at 241.

19 Black op cit (footnotes omitted).

20 Shearing op cit 68.

Nevertheless, self-regulation often fails and this is evidenced by ever-increasing corporate scandals and market failure.[21] Companies such as Steinhoff, PricewaterhouseCoopers (PWC), KPMG and McKinsey & Company have been implicated in grave accounting and auditing lapses bordering on, at the very least, corporate corruption.[22] This has occurred despite heavy self-regulation of the industry by the South African Institute of Chartered Accountants (SAICA), the Independent Regulatory Board for Auditors (IRBA), the Institute of Directors in Southern Africa (IoDSA), and the JSE, among others. The high rate of non-compliance with regulatory standards and principles and the lack of transparency in the response by regulatory agencies is a growing concern with self-regulation throughout the world. The complete lack of response or unenthusiastic response may be viewed as a means of covering up corporate malfeasance or evading some otherwise far-reaching remedies that may be available in legislation.[23]

The other concern with self-regulation relates to 'regulatory capture', where industry appropriates public power to develop regulations self-interestedly and not in the public interest.[24] Therefore, the regulatory orthodoxy that promotes self-regulation as the better form of regulation is not borne out by evidence of regulatory efficiency, accountability, and transparency. Hybrid forms of regulation have therefore emerged in response to the limitations of self-regulation.

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21 For a critique of the current regulatory orthodoxy that favours self-regulation and 'agencification' of regulation, see Tom Christensen and Per Lægreid 'The new regulatory orthodoxy: A critical assessment' in David Levi-Faur (ed) *Handbook on the Politics of Regulation* (2011) 361–372.

22 For an in-depth analysis of the collapse of Steinhoff, see James-Brent Styan *Steinhoff: Inside SA's Biggest Corporate Crash* (2018). The author chronicles the rise and fall of the Steinhoff empire and the power plays within its board of directors.

23 On the limitations of self-regulation from a legal perspective, see generally Harvey Levin 'The limits of self-regulation' (1967) 67 *Columbia Law Review* 603–644.

24 Michael Levine and Jennifer Forrence 'Regulatory capture, public interest, and the public agenda: Toward a synthesis' (1990) 6 *Journal of Law, Economics, and Organization* 167–198.

C. Co-regulation and meta-regulation

As pointed out already, both command-and-control regulation and self-regulation have strengths and weaknesses. Therefore, the view that portrays command-and-control regulation 'as top-down, cumbersome, and resource intensive, and voluntary [self-regulation] standards as bottom up, relatively flexible, and particularistic' fails to acknowledge the complexities of regulation and the symbiotic nature of these two types of regulation which, in some cases, defy rigid compartmentalisation.[25]

Research has proven that legal regulation that is unresponsive to non-legal normative values often fails to achieve its regulatory goals.[26] Hence, in reality, the co-existence of self-regulation and command-and-control approaches has been preferred for the regulation of almost all aspects of corporate undertakings, resulting in some sort of 'co-regulation'.[27] As argued later in this chapter, co-regulation in SOCs is arguably broader, resulting in a heightened plurality of regulation in comparison to ordinary public corporations. Perhaps this is unavoidable, given that SOCs are by nature an amalgam of commercial and non-commercial interests, both of which are in the public interest. For that reason, their regulation is situated in command-and-control regulation, which suggests state involvement, and self-regulation, which is synonymous with industry-driven regulation.

For co-regulation to be effective, the private regulators in charge of industry regulation must possess the requisite autonomy, expertise and resources to discharge their regulatory responsibilities. Additionally, and perhaps most importantly, self-regulation must occur within the ambit of a broader co-regulation framework, where the state has articulated clear objectives for, and

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25 Darren Sinclair 'Self-regulation versus command and control: Beyond false dichotomies' (1997) 19 *Law and Policy* 529–559 at 531, quoting Alastair Iles 'Commentary' (1996) 38 *Environment* 4–5.

26 Parker et al op cit 7.

27 Edward Balleisen and Marc Eisner 'The promise and pitfalls of co-regulation: How governments can draw on private governance for public purpose' in David Moss and John Cisternino (eds) *New Perspectives on Regulation* (2009) 127–149 at 129.

exercises oversight over private and quasi-public regulators. This is often referred to as 'meta-regulation', which is essentially a process of 'regulating the regulators, whether they be public agencies, private corporate self-regulators or third-party gatekeepers.'[28]

To have effective meta-regulation, all role players must have the requisite expertise and capacity to evaluate their regulatory performances and must discharge their regulatory responsibilities transparently. There are many examples of regulatory bodies failing to hold auditors, accountants, and directors involved in the so-called capture of SOCs to account. The SAICA, IRBA, and IoDSA processes to hold audit firms, auditors, and directors professionally liable for their role in the corporate governance failures in SOCs have at best been marred by a lack of transparency and at worst have been a sham. This is because these private and quasi-public regulators are themselves not regulated in a meta-regulation fashion. Consequently, the 'private regulatory tail … wag[s] the commonweal's dog'.[29] In other words, the fact that there is no concerted regulation of regulators in South Africa results in regulatory lapses being largely unaddressed, which in turn creates a sense of impunity for those involved in either deliberate or inadvertent corporate governance failures. In the long run, this weakness in design impacts negatively on the overall governance of SOCs.

Regulation in South Africa manifests in soft, hard, and judicial (as well as quasi-judicial) regulation, and these forms of regulation are ordered in a pyramid fashion, but this does not necessarily reflect the importance or efficacy of one over another.

3.1.4 Regulating SOCs in the public interest

An argument advanced in the previous chapter is that SOCs are inherently public interest corporations because they are constituted by and often

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28 Christine Parker *The Open Corporation: Effective Self-Regulation and Democracy* (2002) 15.

29 Balleisen and Eisner op cit.

sustained by public resources to discharge a public mandate.[30] Consequently, their 'internal' governance should be in the public interest. That argument is taken further in this chapter, which suggests that the 'external' governance or regulation of SOCs should also be in the public interest. Internal governance refers to the directing of the SOC by its board of directors as well as the powers that are delegated to executive management. External governance or regulation refers to oversight over the corporation imposed by either legislation or self-regulatory codes. It is submitted that both forms of governance must be in pursuance of the public interest.

In his definition of regulation Mitnick submits that 'regulation is the public administrative policing of a *private* activity with respect to a rule prescribed in the public interest.'[31] A dissection of this definition reveals that regulation is aimed at private activities, is achieved through administrative tools, and occurs in the public interest. Accordingly, the endgame in regulation is the protection of the public interest against private commercial interests. Similarly, the objective of regulation in SOCs should be the protection of public interest, especially because SOCs are publicly owned (in the broad sense).

Public interest regulation entails the regulation of commercial interests within the confines of public law. This type of regulation is underpinned by the values and principles that shape public law and administration, namely, accountability, transparency, equity, and freedom.[32] It follows that the self-regulatory codes and state regulation (legislation) that are applicable to state

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30 In terms of s 1 of the PFMA, SOCs are funded from the National Revenue Fund or through taxes. See also Terance Corrigan 'Corporate governance in Africa's state-owned enterprises: Perspectives on an evolving system' South African Institute of International Affairs Policy Briefing 102, Governance and APRM Programme, 2014 where he unpacks the public nature of SOCs.

31 Barry Mitnick *The Political Economy of Regulation* (1980) 7, quoted in Jørgen Grønnegård Christensen 'Competing theories of regulatory governance: Reconsidering public interest theory of regulation' in David Levi-Faur (ed) *Handbook on the Politics of Regulation* (2011) 96–110 at 96 (emphasis added).

32 See, for example, s 195 of the Constitution which espouses the basic values and principles governing public administration.

commercial and non-commercial interests must be informed by these principles and values if they are to be public interest-centred.

The lax response to grand corporate governance failures in SOCs illustrates that the regulatory bodies have failed to uphold the fundamental principles of transparency and accountability. It is therefore important to determine when self-regulation works and when it fails, so as to design appropriate complementary regulatory responses to address the gaps.[33] In this way, the public interest can be entrenched in regulation.

The regulatory design of SOCs must foster several things in order to imbed the public interest in regulation. First, corporate efficiency in the delivery of the public mandate must be observed. This means that service delivery and the economic performances of SOCs must be achieved in the most efficient way possible. In this regard, the mandates and targets of SOCs must be clearly defined in regulatory instruments to avoid confusion. Soft budget constraints must also be avoided as they incentivise laxity.[34] Instead, competition must be fortified. Second, regulation must align the public mandate of SOCs with broader national development priorities, which are presumably in the public interest. Finally, regulation at all levels must be characterised by the values of accountability, transparency, and equity, as suggested above. For regulation to be truly public interest-centred, it is submitted further that these constitutional values must be taken as both complementary and mutually reinforcing.[35]

Having laid down the above conceptual and definitional groundwork, it is now appropriate to explore the regulatory design of the governance of SOCs in

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33 Shearing op cit 69.

34 According to Maskin, '[a] soft budget-constraint arises whenever a funding source finds it impossible to keep an enterprise to a fixed budget, i.e., whenever the enterprise can extract ex post a bigger subsidy or loan than would have been considered efficient ex ante.' See Eric Maskin 'Theories of the soft budget-constraint' (1996) 8 *Japan and the World Economy* 125–133 at 125.

35 On centring public interest in regulation, see Scott Hempling 'The "public interest": Who has a definition?' available at http://www.scotthemplinglaw.com/essays/the-public-interest-who-has-a-definition (accessed 14 August 2018).

South Africa and closely examine its impact on the overall governance of the sector.

3.2 THE REGULATORY UNIVERSE OF SOCs: AN OVERVIEW

The regulatory scheme applicable to SOCs can be conveniently divided into three broad categories.[36] The first category is 'hard regulation', which essentially comprises all binding statutes and regulations. It will be clear when examining this category that SOCs, unlike other companies, are subject to laws that are applicable only to them because they are public-sector entities as well as laws that are generally applicable to all types of corporations.[37] The second category is 'soft regulation' and focuses on non-binding but persuasive principles and practices. To the extent that these principles and practices are an extension of statutory obligations, they should be seen as auxiliary to binding regulations. Like hard regulation, there are certain soft regulatory mechanisms that are applicable only to public sector entities. The last category is 'judicialised and quasi-judicialised regulation', which is regulation of SOCs emanating from binding judicial and tribunal pronouncements. It will be argued that SOCs are subject to more layers of regulation than is the case with other types of corporations, thus buttressing the view expressed earlier that SOCs are corporations of a special kind. However, whether the multi-layered and seemingly extensive regulation enhances corporate governance or imperils it remains a vexed question.

In determining the efficacy of the regulatory scheme and how it impacts on the governance of SOCs, the following hallmarks of a sound regulatory scheme will be tested. First, are the legal principles and practices enforceable

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36 See John Farrar 'Corporate governance and the judges' (2003) 15 *Bond Law Review* 65–101 at 67. See also Jean Jacques du Plessis et al *Principles of Contemporary Corporate Governance* (2005) 112–124.

37 Legislation that is applicable to SOCs by virtue of them being state entities includes: the Promotion of Access to Information Act 2 of 2000; the Promotion of Equality and Prevention of Unfair Discrimination Act 4 of 2000; the Promotion of Administrative Justice Act 3 of 2000; the Preferential Procurement Policy Framework Act 5 of 2000; and the Intergovernmental Relations Framework Act 13 of 2005. These Acts are not explored in this work as they do not have a direct bearing on corporate governance issues in SOCs.

and implementable, and are the additional non-binding rules consistent with the binding framework? Second, does the regulatory scheme clearly distinguish the various functions of the state vis-à-vis SOCs? Third, is the scheme coherent and coordinated? Fourth, does the scheme observe competition and other market fundamentals? Finally, and perhaps most importantly, does the regulatory scheme promote and foster the division of corporate power in the form of separation of ownership and control? This latter characteristic will, however, be canvassed fully in subsequent chapters that examine the powers, duties and roles of directors and shareholders and how these impact on the overall governance in SOCs.

3.3 HARD REGULATION

3.3.1 The Public Finance Management Act and Treasury Regulations

SOCs are mainly regulated by the PFMA, the main object of which is to secure the sound management of public funds in a transparent and accountable manner.[38] While the PFMA principally governs matters of financial management within the state and its entities, many of its provisions have a direct bearing on the governance of SOCs. From the shareholder (state) perspective, the PFMA requires SOCs to establish effective planning and sound budgeting mechanisms through which the National Treasury can monitor their financial performance, and which can then be used by the 'executive authority' to test their compliance with the PFMA. The executive authority is typically a member of the executive under whose portfolio the SOC falls and who is accountable to Parliament for the SOC's performance (also known as the shareholder-representative).[39]

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38 See the Preamble to the PFMA.

39 Section 52 of the PFMA provides that SOCs must submit annual corporate plans to shareholder ministers detailing strategic objectives, key performance measures, revenue projections, expenditure, and borrowings. See further, Treasury Regulation 29.1 and National Treasury Practice Note 4 of 2009/10. Additionally, ss 55(2) and 54(2) of the PFMA read with Treasury Regulation 28.3 require the boards to develop a 'materiality framework', which sets out the types of transactions and thresholds that require shareholder approval. This should be juxtaposed with s 115 of the Companies Act which restricts shareholders' approval powers to fundamental transactions.

The relationship between the shareholder-representative and the SOC is primarily governed by a 'shareholder's compact', which is an agreement that records the key performance areas (public interest mandate) of the SOC.[40] This compact must contain a statement of 'strategic intent' aimed at communicating the SOC's long-term perspective along the national development priorities as well as clarifying its strategic objectives.[41] Notwithstanding the concluding of a shareholder's compact annually, many SOCs continue to underperform while their governance deteriorates to disquieting levels. Therefore, the efficacy of the shareholder's compact as a governance instrument is questionable.

The PFMA also confers 'ownership control' over the SOC on the shareholder-representative. Section 1 defines ownership control as:

> [T]he ability to exercise any of the following powers to govern the financial and operating policies of the entity in order to obtain benefits from its activities:
> *(a)* To appoint or remove all, or the majority of, the members of that entity's board of directors or equivalent governing body;
> *(b)* to appoint or remove that entity's chief executive officer;
> *(c)* to cast all, or the majority of, the votes at meetings of that board of directors or equivalent governing body; or
> *(d)* to control all, or the majority of, the voting rights at a general meeting of that entity.

An examination of this section, read together with s 63(2) of the PFMA, reveals a conflation of roles that are typically reserved for the boards with those roles that are distinctly shareholder roles in nature.[42] For example, the Companies Act provides that:

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40 See Treasury Regulation 29.2.

41 The statement of 'strategic intent' is typically a product of government policies, stakeholder consultations and assessment of the particular SOC by the shareholder-representative to ensure that the overall long-term goal of the SOC accords with the national development goals. The statement of strategic intent must always be reflected in the SOC's shareholder compact, corporate planning, and executive performance contracts.

42 Section 63(2) vests executive ownership control powers in the shareholder-minister which entails ensuring that SOCs comply with the Act.

> The business and affairs of a company *must* be managed by or under the direction of its board, which has the *authority to exercise all of the powers and perform any of the functions* of the company.[43]

The import of this section is to centralise corporate power in the board and inherent in the board's executive power and authority is the responsibility to appoint executives. Yet, with SOCs, ss 1 and 63(2) of the PFMA shift the responsibility to appoint and remove executives to the shareholder-representative.[44]

In line with this PFMA arrangement, clause 14 of the MOI of Eskom, for instance, gives the shareholder-representative the *exclusive* authority to appoint (and, by necessary implication, to remove) the group chief executive. The South African National Roads Agency Limited (SANRAL) Act also confers similar powers on the shareholder-representative.[45] It will be argued later that this approach is inconsistent with the conventional notion of separation of ownership and control as it creates two centres of corporate power.

The reach of the PFMA extends beyond the regulation of financial management. In some respects, it overlaps with the Companies Act. For instance, it also provides for the appointment (and removal) of directors, standards of directors' conduct, conflicts of interest, directors' personal liability, the role and function of the board, board committees, audits, and financial records.[46] The overlap between the PFMA and the Companies Act has a direct bearing on the quality of corporate governance in SOCs as it

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43 Section 66(1) (emphasis added).

44 See the definition of ownership control in s 1 of the PFMA. See also Lukas Muntingh 'Appointing directors to the boards of state-owned enterprises: A proposed framework to assess suitability' (2020) 24, available at https://dullahomarinstitute.org.za/ (accessed 1 March 2020). See further Riekie Wandrag 'The legal framework of SOEs' boards: Appointment and dismissal of board members and executives of Eskom, PRASA and the SABC' (2018) available at https://dullahomarinstitute.org.za/ (accessed 1 March 2020).

45 South African National Roads Agency Limited Act 7 of 1998, ss 12 and 20 on the appointment and removal of the chief executive officer respectively.

46 See ss 36, 49, 50, 51, 55, and 58–62 (as amended).

creates a lot of confusion. By way of illustration, both Acts (and the Treasury Regulations) require that audit committees must be established. On the one hand, the PFMA[47] and the Treasury Regulations[48] provide that most of the members of the audit committee must be non-executive directors. The Act also contemplates that some of the committee members may in fact not be directors.

On the other hand, the Companies Act specifically provides that a member of the audit committee *must* be a director of the company.[49] Furthermore, under the Companies Act,[50] the audit committee is elected by shareholders at an annual general meeting, yet the PFMA prescribes that the audit committee must be appointed by the board in consultation with the executive authority (shareholder-representative).[51] Furthermore, the PFMA does not insist on the independence of all the audit committee members, while the Companies Act does.[52] These examples exemplify the overlap and inconsistency between the two Acts, and also demonstrate that compliance and governance could, in the circumstances, be problematic, burdensome and confusing.

Other than the overlap between these Acts, the PFMA also regulates certain matters that are not regulated by the Companies Act. These include the powers of the executive authority (shareholder-representative) to approve annual budgets, corporate plans, and the shareholder's compact.[53] In addition, the PFMA regulates the procurement of goods and services, participation in public–private partnerships, borrowing, and funding by government.[54] This highlights that SOCs are indeed more regulated than other public companies.

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47 Sections 76(4)*(b)* and 77*(a)*.
48 Treasury Regulation 3.1.
49 Section 94(4)*(a)*.
50 Section 94(2).
51 Treasury Regulation 3.1.2.
52 Section 77*(a)*(i) provides that at least one of the three members of the audit committee must be independent. It does not require that all three be independent as the Companies Act insists.
53 Sections 51 and 52 read with Treasury Regulation 29.
54 Section 66 read with Treasury Regulations 16 and 32.

As previously observed, the provisions of the PFMA are elaborated upon in the Treasury Regulations. Additionally, the National Treasury from time to time issues practice notes, guidelines, and circulars on issues regulated by the PFMA.[55] These constitute an additional layer of regulation that does not apply to other public companies. Again, this illustrates that SOCs are over-regulated. Studies have established that over-regulation compromises governance and hurts performance.[56] It is therefore not implausible to speculate that over-regulation contributes to the weak and declining standards of governance across the SOC sector.

3.3.2 Regulation of SOCs under the Companies Act

Major public entities listed in schedule 2 of the PFMA are defined as SOCs in the Companies Act. Although incorporated under the Companies Act, SOCs may not always be fully regulated by this Act.[57] Section 9(2)*(a)* specifically gives the shareholder-representative the latitude to absolve the SOC from compliance with the Companies Act either 'totally, partially or conditionally'. In *Minister of Defence and Military Veterans v Motau and Others* the Constitutional Court observed that:

> The effect of that provision [s 9(2)*(a)*] is that state-owned companies are for all intents and purposes to be treated as public companies unless a cabinet member has procured an exemption (in whole or part) from the obligations to comply with the Companies Act.[58]

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55 Edward Nathan Sonnenbergs Incorporated, Department of Public Enterprises Legislative Review Project Report 'Relationship between the new Companies Act and other legislation regulating SOE' (2010) 17 (on file).

56 Bruno Valentina and Claessens Stijn 'Corporate governance and regulation: Can there be too much of a good thing?' (2007) World Bank Policy Research Working Paper No. 4140. Available at SSRN: https://ssrn.com/abstract=964802 (accessed 20 January 2020).

57 In terms of s 9(1), all provisions of the Companies Act applicable to public companies are also applicable to SOCs; however, the SOC can be absolved in terms of subsections (2) and (3).

58 *Minister of Defence and Military Veterans v Motau and Others* 2014 (5) SA 69 (CC) para 74.

The exemption may ostensibly exist to accommodate the *sui generis* nature of SOCs.[59] However, s 9(2)*(b)*, which applies to SOCs owned by municipalities, clearly states that the purpose of any exemption or modified application of the Companies Act should be to avoid an 'overlap or duplication' with another applicable regulatory scheme. It is not immediately apparent why the reasons for exemption with respect to major public entities listed in schedule 2 of the PFMA are not spelt out, as is the case with municipal SOCs. Lack of legislative guidance on this issue invariably gives the shareholder-representative unfettered discretion to decide whether to absolve the SOC from compliance with the Companies Act.

Commenting on the discretion given to the shareholder-representative to decide whether or not the Companies Act will apply to a SOC either totally, partially or conditionally in terms of s 9, Bronstein and Olivier make a compelling argument:[60]

> This inelegant and overly discretionary procedure is evidence of the fact that the drafters saw the need to create safety valves in a cobbled together regulatory scheme which had not really grappled with the specific issues facing state owned enterprises.

An example of an entity that has been wholly exempt from the application of the Companies Act, without clear reasons for such exemption, is PRASA.[61] Yet, in practice, there is confusion regarding the applicability of the Companies Act to the entity. As observed elsewhere, the confusion has not only engulfed PRASA itself but has, in some instances, even affected the

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59 SOCs may also design MOIs that take their state-ownership nature into consideration on matters that are unregulated by the Act in terms of s 15(2) and by taking advantage of the alterable provisions of the Companies Act. See, for example, s 31(2) and (3) of the Legal Succession to the South African Transport Services Amendment Act 9 of 1989.

60 A similar point is made by Victoria Bronstein and Morne Olivier 'An evaluation of the regulatory framework governing state-owned enterprises (SOEs) in the Republic of South Africa' Annexure to the PRC Report.

61 See s 31(2) and (3) of the Legal Succession to the South African Transport Services Amendment Act 9 of 1989.

courts.[62] This is probably because reasons for the exemption are not stated. Indeed, this is a further example of the inelegance and confusing nature of the regulatory framework applicable to SOCs.

To address the problem of the Companies Act being inconsistent with other legislation, such as the PFMA in the case of SOCs, s 5(4)*(a)* of the Companies Act provides that 'the provisions of both Acts apply concurrently, to the extent that it is possible to apply and comply with one of the inconsistent provisions without contravening the second.' In effect, the application of this provision involves a two-stage enquiry: it must first be established whether there is a conflict between the two statutes, and where there is an indisputable conflict, it must be determined whether it is nevertheless possible to apply the one statute without contravening the other.[63] If the answer to both questions is in the affirmative, then the SOC will be expected to comply with both statutes. Although this approach appears to be reasonable and seemingly aimed at complementarity, it nevertheless creates over-regulation from a corporate governance perspective, thus leading to an inefficient regulatory design.[64]

Since there may be irreconcilable inconsistencies between the Companies Act and other dominant legislation, such as the PFMA,[65] s 5(4)*(b)* of the Companies Act, read with s 3(3) of the PFMA, provides that the latter Act prevails in cases of irreconcilable conflict. From a corporate governance perspective, this is problematic in at least two ways. The first apparent difficulty is that it may create legal uncertainty. The second challenge is that it requires the boards of SOCs to be sufficiently legally sophisticated to discern legal inconsistencies, the extent of their complexity, and then opt to apply the PFMA and not the Companies Act.[66] The exercise of assessing legal

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62 See Tebello Thabane 'The removal of directors in state-owned companies: Shareholders' franchise in jeopardy? *Molefe and others v Minister of Transport and others*' (2018) 30 *South African Mercantile Law Journal* 155–171 at 163.

63 For a detailed analysis of s 5(4), see Jacqueline Yeats (ed) *Commentary on the Companies Act of 2008* (2018) 1–99.

64 Bronstein and Olivier op cit.

65 See the list of dominant legislation in s 5(4)*(b)*(i)*(ee)*.

66 Bronstein and Olivier op cit.

inconsistencies is in fact an interpretative one requiring legal skills that the board collective may not necessarily possess.

Inconsistent regulation is also problematic for shareholder-representatives, particularly where their powers are inconsistently defined in different statutes. This was the case in *SOS Support Public Broadcasting Coalition and Others v South African Broadcasting Corporation SOC Limited and Others*.[67] The court had to decide whether s 71 of the Companies Act was applicable to the removal of directors of the SABC, or whether the procedures in ss 15 and 15A of the Broadcasting Act had to be followed.[68] The court held that the removal provisions of the Companies Act that were relied upon by the shareholder-representative could not trump the Broadcasting Act, because the latter was specifically enacted to govern the affairs of the SABC.[69] This illustrates the challenges presented by inconsistent regulation.

Notably, the Companies Act leaves issues inherent to the running of the affairs of the company to the general discretion of the board, which in turn delegates certain of its powers to management. This discretion is, however, curtailed by the provisions of the PFMA, particularly on matters of the procurement of goods and services, the power to conclude transactions beyond a certain threshold (materiality), budgeting and financial planning, borrowing, and corporate plans.[70] These provisions therefore amount to a limitation of the board's authority and may look like over-regulation at first glance, because public companies are ordinarily not subjected to this kind of shareholder oversight. However, it is submitted that, in the case of SOCs, this level of

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67 *SOS Support Public Broadcasting Coalition and Others v South African Broadcasting Corporation SOC Limited and Others* (81056/14) [2017] ZAGPJHC 289 (17 October 2017). For a discussion of this case, see Rehana Cassim 'Removing directors of state-owned companies: *SOS Support Public Broadcasting Coalition v South African Broadcasting Corporation SOC Limited* (81056/14) [2017] ZAGPJHC 289' (2019) 40 *Obiter* 147–162.

68 *SOS v SABC* para 5.

69 *SOS v SABC* para 141. It was held that even though the Broadcasting Act is not listed under the Companies Act as one of the statutes that trumps the Companies Act, the latter was nevertheless invalid to the extent that it breaches ss 7(2) and 16 of the Constitution. See paras 144–145.

70 Edward Nathan Sonnenbergs Report op cit 9.

shareholder oversight may be justifiable to the extent that the shareholder ensures that the SOC meets the public interest mandate and spends public funds in a transparent and accountable manner.

3.3.3 SOCs and competition

Competition is foundational to the market economy. It ensures the best products, services, and prices for citizens and in the process eliminates inefficient corporations that cannot compete on these fronts. It can be argued that the utility of competition in a market economy is therefore closely aligned with the public interest as conceptualised by Bentham, because it ensures the best products and services at the best possible prices to most citizens. Conversely, anti-competitive conduct may possibly be antithetical to the public interest.[71]

The Competition Act was enacted with public interest objectives in mind. For instance, the Act regulates anti-competitive conduct that puts employment at risk, compromises small businesses, and harms businesses owned by previously disadvantaged individuals. The Act also strives to protect and promote national industries in the international market.[72] For corporations to

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71 See the conceptualisation of public interest by Jeremy Bentham in chapter 2 (para 2.4.1). On the alignment of competition with public interest, see generally SF Sommerfeld 'Free competition and the public interest' (1948) 7 *University of Toronto Law Journal* 413–446. In terms of s 8 of the Competition Act 89 of 1999, anti-competitive conduct manifests in abuse of dominance.

72 See the Preamble and s 2 of the Competition Act 89 of 1998. See also Government Gazette 40039/4: Competition Act (89/1998): Competition Commission South Africa: Guidelines on the Assessment of Public Interest: Provisions in Merger Regulation. See also James Hodge, Sha'ista Goga and Tshepiso Moahloli 'Public interest provisions in the South African Competition Act: A critical review' in Kasturi Moodaliyar and Simon Roberts (eds) *The Development of Competition Law and Economics in South Africa* (2013) 1–15. See further Omphemetse Sibanda 'Public interest considerations in the South African anti-dumping and competition law, policy, and practice' (2015) 14 *International Business and Economics Research Journal* 735–744. On South African competition law and the background to the public interest provisions generally, see Philip Sutherland and Katharine Kemp *Competition Law of South Africa* (2017) (LexisNexis Online). See also Simon Roberts 'The role for competition policy in economic development: The South African experience' (2004) 21 *Development Southern Africa* 227–243 at 234. See further Trudi Hartzenberg 'Competition policy and practice in South Africa: Promoting

succeed in the marketplace, they must be run competitively, yet the public goals of SOCs may in some instances require them to operate uncompetitively. To survive despite operating in this way, SOCs must therefore engage in several practices that appear somewhat anti-competitive.

First, due to their legally imposed public interest mandate, SOCs must render services that may not be profitable. For instance, it may be in the public interest to provide postal services in rural areas where service volumes are low or to provide utilities to informal settlements at lower rates, thus leading to losses. To meet these public interest goals, SOCs receive state aid in the form of capital injections from the fiscus, as well as government loans and guarantees.[73] This gives them an advantage over other corporations that may be competing with them. Second, some SOCs have legally protected monopolies that they may abuse to the detriment of other corporations that compete on the margins of such monopolies. Third, SOCs, due to state aid and sometimes dominance, may be inclined to engage in predatory pricing, which entails pricing goods or services below commercially rational levels, ostensibly to force competing corporations to exit the market. Fourth, SOCs are usually exempt from paying tax and thus may have lower operating costs than competing corporations.[74] Finally, some SOCs may enjoy preferential treatment in government procurement due to, among other reasons, the inherent inter-governmental relationships and information asymmetry whereby competing corporations would not have access to certain government information, which the SOC, as a state entity, may have.[75]

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competition for development' (2006) 26 *Northwestern Journal of International Law and Business* 667–686.

73 Antonio Capobianco and Hans Christiansen 'Competitive neutrality and state-owned enterprises: Challenges and policy options' OECD Corporate Governance Working Papers No. 1 (2011) 5–7, available at https://doi.org/10.1787/22230939 (accessed 10 March 2020).

74 For example, see s 8(1) of the Eskom Conversion Act 13 of 2001, which provides that the Income Tax Act does not apply in respect of the receipts and accruals of Eskom.

75 For a more elaborate analysis of SOCs' incentives for anti-competitive behaviour, see Jason Aproskie et al 'State-owned enterprises and competition: Exception to the rule?' Genesis Analytics (2014) available at http://www.compcom.co.za/wp-content/uploads/2014/09/State-owned-entities-and-competition-8th-Annual-Competition-Conference-2014-Aproskie-Hendriksz-and-Kolobe.pdf (accessed 8 August

The impact of this apparent preferential treatment of SOCs and the manner in which they are governed cannot be ignored. Since they are shielded from harsh market conditions in the ways explained above, their boards may be inclined to govern poorly. It is submitted that the conduct of their boards must be closely monitored to avoid the exploitation of public interest considerations or complacency. The regulation of competition where SOCs are involved is important not only for their survival, but for the continued existence of competing corporations and the health of the economy.

It has been observed that the equal and consistent application of laws and regulations helps achieve 'competitive neutrality' between SOCs and other corporations, so that 'no business entity is advantaged (or disadvantaged) solely because of its ownership.'[76] In the discussion of the Competition Tribunal decisions it will be demonstrated that SOCs have on many occasions been found to have failed to act in the public interest in competition matters.

3.3.4 The founding legislation of SOCs

Some SOCs started as government departments and were later transformed into parastatals, until they were corporatised by founding legislation and the Companies Act.[77] They are therefore creatures of statute. Typically, the founding statutes provide for the legal succession of the parastatal into a corporation, its public mandate, and related matters, such as the applicability of the Companies Act to the newly formed SOC and the relationship between the state and the company.[78]

2018). See also Phoebe Bolton 'The regulation of preferential procurement in state-owned enterprises' (2010) 1 *Journal of South African Law* 101–118.

76 World Bank Group *Corporate Governance of State-owned Enterprises: A Toolkit* (2014) 36.

77 Corporatisation essentially refers to the transformation of parastatals into incorporated corporations that are owned by the state but operate substantially independently of the state. See Michael Whincop 'Another side of accountability: The fiduciary concept and rent-seeking in the governance of government corporations' (2002) 25 *University of New South Wales Law Journal* 379–407 at 380.

78 See, for example, the Preamble to the Legal Succession to the South African Transport Services Act 9 of 1989 (as amended) establishing PRASA.

Regarding the applicability of the Companies Act, the founding statutes of different SOCs adopt different positions. The Legal Succession to the South African Transport Services Act (PRASA Act) provides that the Companies Act shall not be applicable to PRASA unless the shareholder-representative elects otherwise.[79] With Eskom and SAA, the opposite is the case. Both the Eskom Act and the SAA Act provide that, with effect from the date of conversion into a corporation, the Companies Act shall be applicable, subject to the provisions of the founding statutes.[80]

Clearly, the legal framework establishing SOCs is not uniform and the limited application or lack of application of the Companies Act does not seem to have any explicable rational basis. In the case of a total *a priori* exemption adopted by the PRASA Act, it may be argued that it offends s 9(3)*(a)* of the Companies Act, which provides that the exemption may be granted only if there is an alternative regulatory scheme whose aims are aligned to the purposes of the Companies Act. The proper approach would therefore be non-exemption, adopted by both the Eskom and SAA Acts.

The variable application of the Companies Act to what appear to be similarly situated SOCs, like SAA and PRASA (they are both transport provision SOCs), is unexplained. It is therefore tempting to view this as irrational differentiation that has governance implications. This is because the binding norms and standards of directors' conduct are spelt out in the Companies Act. Although the PFMA also provides for directors' conduct in s 50, it is submitted that this Act does so mainly from the public finance management perspective, as opposed to the general corporate governance perspective advanced by the Companies Act in s 76. Thus, ideally, the duties of the directors of SOCs should flow from the Companies Act, unless there is a rational basis for the exclusion of this Act.

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79 See s 31(1) and (2) of the South African Transport Services Act 9 of 1989 (as amended).

80 See s 4(1) and (2) of the Eskom Conversion Act 13 of 2001 and s 5*(a)* of the South African Airways Act 5 of 2007.

3.3.5 The common law and SOCs

The notion of regulation encompasses several aspects, including 'the making of laws, the interpretation of laws to determine what is required to comply with them and, in turn, the actions taken to *enforce* these laws in cases of non-compliance.'[81] This view of regulation therefore embraces common law, which is borne from custom and judicial precedent. Corporate governance regulation by common law takes place around directors' duties since their partial codification has left their common law iteration intact. The Act only partially outlines directors' duties while the common law provides a complete spread and precise content.[82] Examples of where the courts have regulated the corporate affairs of SOCs are discussed below under 'judicialised regulation'.

3.3.6 Commentary

The above exploration of the hard regulation of SOCs reveals the extent of normative plurality or a proliferation of regulation. To be sure, this is not necessarily problematic for sound governance, provided that the regulatory instruments are enforceable, implementable, coherent, and co-ordinated; foster competitive neutrality; and accentuate the separation of ownership and control. Yet, the hard regulation of SOCs is characterised by conflicting normative instruments that flout the conventional separation of ownership and control by giving both the board and the shareholder-representative executive powers. The framework also creates a compliance burden due to unnecessary duplication and overlaps. Furthermore, the framework unreasonably expects boards to have the legal sophistication to navigate what

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81 Du Plessis op cit 116, citing Helen Bird et al 'ASIC enforcement patterns' Research Report, Centre for Corporate Law and Securities Regulation (2003) (emphasis added).

82 The rationale behind codification is the accessibility of the duties. The fact that the Act only partially codifies the duties means that the common-law duties are still preserved to the extent that they do not conflict with their codified counterparts. See Yeats op cit 2–1277; and Piet Delport (ed) *Henochsberg on the Companies Act 71 of 2008* (SI 16, May 2018) 295; and *Phillips v Fieldstone Africa (Pty) Ltd* 2004 (3) SA 465 (SCA) 477H. The duties of directors of SOCs will be discussed more fully in chapter 5 (paras 5.4.1–5.4.3).

is otherwise an interpretation labyrinth instead of providing clear norms that are coherent and easily implementable.

3.4 SOFT REGULATION

3.4.1 The King IV Code and sector supplement on SOCs

The King Code regime is an attempt to institutionalise corporate governance in South Africa.[83] Some of the principles and practices contained in these codes complement the Companies Act. The codes are applicable to all companies including SOCs. In the latest instalment of the codes, there is a special supplement that regulates SOCs as unique public corporations. King IV specifically acknowledges that good corporate governance is paramount for the success of SOCs.[84] The sector supplement on state-owned entities attempts to customise corporate governance principles and practices to meet the specific needs and requirements of SOCs.[85] It essentially provides guidance and direction on how King IV should be interpreted and applied by SOCs. Effectively, therefore, all the King IV principles and practices are applicable to SOCs as guided by the sector supplement. Since the sector supplement was recently introduced, it is still too early to examine its impact on the quality of governance in SOCs; it suffices to observe that governance has deteriorated in the sector despite the previous King Codes.

Interestingly, the sector supplement notes that SOCs have a public interest mandate and for that reason are set up to be responsible corporate citizens and that this is fundamental to their core purpose.[86] This assessment of SOCs reinforces the point made earlier in this thesis, namely that SOCs are public interest corporations that must be governed with public interest considerations in mind.

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83 See David Walker, Matodzi Ramashia and Faith Rambau 'Chapter 22: South Africa' in Willem Calkoen (ed) *The Corporate Governance Review* (2013) 304–314 at 304.

84 King IV consists of 17 overarching governance principles. These are amplified by 'recommended practices' that provide guidance on the practical ways of achieving the principles.

85 See Principle 4 of the King IV sector supplement for SOEs.

86 See Principle 1.3 of the King IV sector supplement for SOEs.

As previously observed, some of the principles and practices contained in King IV and the accompanying sector supplement are contained in legislation such as the Companies Act. For instance, in line with s 66(1) of the Companies Act, principle 6 of the King IV sector supplement on SOCs emphasises that 'the accounting authority should serve as the focal point and custodian of corporate governance in the SOE'. In this regard, the King regime reinforces legislation. The fact that the King principles are, in some respects, similar to legislation does not necessarily mean that they duplicate or overlap with legislation. In fact, King IV notes that the applicable legislation only sets the minimum standards to be complied with, while the King regime (Code and supplements) sets the bar higher. Therefore, SOCs must endeavour to achieve the higher standard in the interest of sound corporate governance.[87] In instances of clear conflict between the King regime and any legislation, the former yields to the latter. However, King IV cautions that conflict arises only where its principles and provisions of legislation are evidently irreconcilable, not when they are merely different.

One of the challenges with the King regime is that it is a self-regulation mechanism that relies on the willingness of each SOC to implement the mechanism. Consequently, the King regime faces the same efficacy limitations as other self-regulation instruments.[88] The new philosophy of apply *and* explain that underpins King IV assumes that all the corporate governance principles will be automatically applied, and an explanation offered on how they have been applied. However, in practice this does not aid compliance *per se*, because the King Code remains an unlegislated instrument to the extent that its principles and practices have not also been legislated.[89]

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87 See Principle 2 of the King IV sector supplement for SOEs.

88 See the limitations of self-regulation discussed in para 3.1.2 above.

89 The apply and explain philosophy adopted in King IV notes that all principles contained in the King Code are aspirations and ideals fundamental to sound corporate governance. Therefore, it is assumed that corporations will *apply* them. Additionally, corporations are expected to *explain* the practices they have followed in achieving the application of the principles. For a detailed account of the evolution of the philosophy underpinning the King Codes, see Parmi Natesan 'Onwards and upwards for corporate governance' (2017) 1 *The Corporate Report: Facilitating Business in South Africa* 9–12.

The King regime is neither mandated nor sanctioned self-regulation. It is a purely voluntary self-regulation mechanism, and compliance with it is often low, compared with other forms of self-regulation. The other challenge is that the King regime is overseen by an unlegislated voluntary body (IoDSA) that does not possess any enforcement powers. Furthermore, IoDSA itself operates in an environment that lacks 'regulation of the regulators', otherwise known as 'meta-regulation'. All these detract from the efficacy of the King regime as a mechanism for regulating the governance of SOCs.

3.4.2 The Protocol on Corporate Governance in the Public Sector

In 1994, the new democratic government recognised that the control and governance of SOCs was not standardised. In 1997, the government adopted the Protocol on Corporate Governance in the Public Sector (Protocol) as a response to the gap in governance standards and with the aim of inculcating sound corporate governance in SOCs. The adoption of King I by the private sector three years previously also gave impetus to the adoption of the Protocol.[90] The Protocol was substantially revised in 2002 to align it with King II, international developments, and new legislation, such as the PFMA.

The Protocol has no legal force. It is an aspirational instrument designed to guide SOCs towards sound corporate governance. It guides both the boards and shareholder-representatives on the practical implementation of the myriad rules and regulations applicable to SOCs. This is particularly important because several founding statutes of SOCs lack specificity on governance matters. The Protocol was therefore conceived to provide the foundation for the regulatory framework that governs the relationship between shareholder-representatives and the boards of SOCs. It also compliments the PFMA and its governance instruments, such as the shareholder's compact.

90 Protocol on Corporate Governance in the Public Sector (2002) 1–2.

The Protocol seeks to amplify, not replace, the King regime.[91] However, since the 2002 version of the Protocol, the King Code has been revised twice (King III and King IV) and the 2008 Companies Act has come into force, while the Protocol remains unchanged. It is therefore an outdated regulatory instrument. In an attempt to address some of the gaps in the Protocol, a handbook on appointments in the public sector was adopted in 2008 to generally provide guidance on the appointment of persons to serve on SOCs' boards; nevertheless, the appointment of directors who lack skills, experience, and integrity has been on the rise since 2008.[92] This therefore places the ineffectiveness of these instruments beyond question.

3.4.3 Lenders and credit ratings' influence on corporate governance

Although most SOCs operate with state aid in near-monopoly conditions, there are several indirect ways in which the market regulates them at best, or at a minimum influences their corporate governance. For instance, lenders and issuers of debt tend to base their decisions to lend (or not to lend) and the cost of lending on the quality of corporate governance in the companies seeking their funding. This was the case in August 2016 when Futuregrowth, an institutional investor, decided to suspend lending to major SOCs following its observation of a 'creeping sense of governance degradation' within the sector.[93]

Lending in the debt market is also influenced by credit ratings. Credit ratings are in turn influenced by, among other factors, the quality of corporate governance. A poorly governed company is likely to default in making debt repayments, which then attracts a poor credit rating. A poor rating is unattractive to lenders and may lead to expensive debt. This is the situation in which many SOCs have found themselves in the past few years. Standard

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91 Presentation by the DPE to the Portfolio Committee (November 2002) 'The Protocol on Corporate Governance in the Public Sector and Governance Status of SOEs' (on file).

92 Department of Public Administration 'Handbook for the appointment of persons to boards of state and state-controlled institutions' (2008, published in January 2009).

93 Futuregrowth invests more than R185 billion. See Futuregrowth 'SOE governance unmasked' available at www.futuregrowth.co.za/.../futuregrowth_soe-governance-unmasked_electronic.pdf (accessed 18 September 2019).

and Poor's Global Ratings (S&P), Fitch Ratings (Fitch) and Moody's Investor Services (Moody's) have all downgraded the ratings of Eskom, SAA and Transnet due to poor governance and political interference.[94] Recently, government as the shareholder has responded positively by replacing both the boards and executive management in some SOCs. The newly appointed boards and executives are investigating and reversing several questionable decisions made by their predecessors. All these efforts have begun to bear fruit because the rating agencies have firstly acknowledged them and, secondly, the efforts have halted further downgrades. This clearly demonstrates the power of rating agencies in indirectly regulating corporate governance in SOCs or at least positively influencing the quality of governance.

3.4.4 Commentary

A plethora of soft regulatory instruments has not necessarily improved governance in SOCs. This is largely because the instruments often conflict or overlap and are in some instances outdated. The overlap and duplication also create over-regulation which impacts compliance negatively. However, not all soft regulation is ineffective. Some instruments or at least some of their aspects have gained 'hard law effects' because they expand on legislative provisions.[95] The lenders with their sheer power of the purse have demanded improved governance in SOCs, while credit rating agencies have exerted pressure by punishing poor governance with negative ratings. Collectively, both the lenders and the ratings agencies have positively influenced the governance of the sector.

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94 See, for example, 'Downgrade for Eskom ratings, Jabu Mabuza vows to act' available at https://www.timeslive.co.za/news/south-africa/2019-11-06-downgrade-for-eskom-ratings-jabu-mabuza-vows-to-act/ (accessed 10 April 2020). See also Riekie Wandrag 'Governance of state-owned companies' in A Loubser and DP Mahony *Company Secretarial Practice* (2018) 29-2–29-3.

95 This phenomenon is happening across many jurisdictions, as observed by Scheuch. See Alexandra Scheuch 'Soft law requirements with hard law effects? The influence of CSR on corporate law from a German perspective' in Jean du Plessis, Umakanth Varottil and Jeroen Veldman (eds) *Globalisation of Corporate Social Responsibility and its Impact on Corporate Governance* (2018) 203–229.

3.5 JUDICIALISED AND QUASI-JUDICIALISED REGULATION

The regulation of SOCs does not begin and end with hard and soft regulation, although these types of regulation cover most regulatory issues. As will be recalled, the working definition of regulation adopted in this thesis conceives of regulation as including the influence of courts' and tribunals' decisions on corporate governance. This type of regulation may conveniently be called the 'judicialised regulation' of SOCs. By its nature, it is triggered when other types of regulation have been ineffective. Alternatively, it becomes relevant when interpreting and enforcing other types of regulation, particularly hard regulation. In essence, this is a 'highly formal, legalistic and judicialized mode of governance'.[96] In what follows, a few decisions by the courts, the Competition Tribunal, and the Companies and Intellectual Property Commission (CIPC) are discussed to demonstrate that they constitute an important layer of regulation of SOCs. This is followed by a brief discussion of oversight bodies such as Parliament and the Office of the Public Protector.

3.5.1 Corporate governance through the courts

Courts and litigation have become avenues for the enforcement of corporate governance standards, leading to what may be called 'corporate governance by the judges' or 'judicialised governance'.[97] At the core of corporate governance is legislation, the interpretation of which is the province of the courts. Legislation is supplemented by soft governance principles that the courts rely on to fill the gaps in legislation, arguably leading to some sort of justiciability of corporate governance principles and standards.

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96 Daniel Kelemen and Alec Stone Sweet 'Assessing "The transformation of Europe": A view from political science' Yale Law School, Public Law Working Paper No. 295 (8 May 2013). Available at SSRN: https://ssrn.com/abstract=2262387 (accessed 20 May 2020).

97 Farrar op cit. The author grapples with the justiciability of modern corporate governance and examines how this results in what he calls 'corporate governance by the judges'.

In *Minister of Water Affairs and Forestry v Stilfontein Gold Mining Co Ltd and Others,* the court referred to the King Code in interpreting directors' duties and the social responsibility of the company.[98] The notion of *ubuntu* as an underpinning philosophy that should guide all board decisions in line with the King Code was stressed by the court in *South African Broadcasting Corporation Limited v Mpofu and Another*.[99] Regarding the applicability of the King Code, the court held that the conduct of SOCs must be measured against the King Code, which enjoins them to adhere to best practices. The court went further to hold that directors should not only comply with the minimum statutory standards but must also seek to follow the best available practices.[100] This decision was cited with approval by Davis J in *Mthimunye-Bakoro v Petroleum Oil and Gas Corporation of South Africa (SOC) Limited and Another*.[101]

In *SOS Support Public Broadcasting Coalition and Others v South African Broadcasting Corporation SOC Limited and Others*, the shareholder-representative's powers of appointment, removal, suspension, and discipline of directors were challenged. The court held that the executive directors were to be appointed solely by the non-executive directors, without any requirement of approval by the shareholder-representative. The court further struck out the clause of the MOI that purported to vest the disciplinary power

98 2006 (5) SA 333 (W) para 16.7.

99 [2009] 4 All SA 169 (GSJ).

100 At para 29.

101 2015 (6) SA 338 (WCC). Other cases where the courts have endorsed corporate governance principles as contained in the King Codes and the JSE listing requirements include the following: *Democratic Alliance v South African Broadcasting Corporation SOC Ltd and Others* 2016 (3) SA 468 (WCC); *Mbethe v United Manganese of Kalahari (Pty) Ltd* (42213/2014) [2016] ZAGPJHC 8 (11 February 2016); *Myburgh v Barinor Holdings (Pty) Ltd and Another* (C 820/13) [2015] ZALCCT 1; *Caxton and CPT Publishers and Printers Limited v Media 24 Proprietary Limited and Others* (136/CAC/March 2015) [2015] ZAWCHC 209 (25 November 2015); *Bytes Technology Group and Others v Michae*l (4586/10, 23511/11) [2014] ZAGPPHC 926 (25 November 2014); *Levenstein v S* [2013] 4 All SA 528 (SCA); *Kalahari Resources (Pty) Ltd v ArcelorMittal SA and Others* [2012] 3 All SA 555 (GSJ); *Council for Medical Schemes and Another v Selfmed Medical Scheme and Another* (561/2010) [2011] ZASCA 207 (25 November 2011); *United Peoples Union of South Africa v Registrar of Labour Relations* (J2252/09) [2011] ZALCJHB 275 (15 February 2011); and *Randles v Chemical Specialist Ltd* [2010] 7 BLLR 730 (LC).

over executive directors in the shareholder-representative. The court held that a proper reading of the SABC founding legislation, the Broadcasting Act, the Companies Act and the Constitution demanded that this power vest solely in the board.[102]

These cases illustrate the power of the courts to regulate by aligning corporate decisions in SOCs with the conventional rules, principles, and practices. However, as a Delaware court held, the courts enforce only the core aspects of corporate governance that find expression in legal duties or those that give content to the duties. Other aspirational principles of corporate governance are highly desirable as they help directors to avoid liability but are not justiciable.[103]

3.5.2 Companies and Intellectual Property Commission decisions

The mandate of the CIPC is to monitor compliance with the Companies Act.[104] Over the years, the CIPC has found that most SOCs fail to prepare financial statements in accordance with international financial reporting standards, as required by both the Companies Act and the PFMA.[105] The CIPC has also established that some audit committee members were involved in the day-to-day management of SOCs, thus lacking independence as required by s 94 of the Companies Act.[106] It is worth pausing and recollecting that the PFMA does

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102 *SOS v SABC* para 148.

103 *Brehm v Eisner* 746 A.2d 244 at 256 and n 29 (Delaware Supreme Court 2000). Delaware is an influential jurisdiction on corporate law and its decisions on general principles of corporate law are persuasive. In this regard, the Delaware decision is likely to be followed by South African courts.

104 See s 187(2)*(b)*. With respect to SOCs, the CIPC focuses mainly on the following: s 30 – the preparation of annual financial statements; s 34 – additional accountability requirements for certain companies that require a SOC to comply with the extended accountability requirements as set out in Chapter 3 of the Act; s 45 – loans or other financial assistance to directors; s 61(7) – shareholders' meetings; s 66 – board, directors and prescribed officers; s 84 – application of the enhanced accountability requirements to SOCs; s 86 – mandatory appointment of company secretary; s 90 – appointment of auditor; s 92 – rotation of auditor; s 94 – audit committees; Regulation 42 – qualifications for members of audit committees; and Regulation 43 – appointment of a social and ethics committee.

105 Section 29(1) and s 55(1)*(a)* and *(b)* respectively.

106 Tina Rabilall 'The CIPC as the regulator of state-owned companies' (on file).

not require the same level of independence of audit committee members that the Companies Act requires.[107] It is therefore possible that these SOCs were following the PFMA and in so doing they infringed the provisions of the Companies Act. This highlights the inconsistency of the regulatory framework.

Returning to the findings of the CIPC on SOCs' compliance with the Companies Act, the CIPC also found that there was a failure to comply with the sections of the Act regulating loans and financial assistance to directors. Furthermore, the boards of SOCs failed to effectively prevent irregular and wasteful expenditure and to put in place control systems to safeguard and maintain assets.[108]

In response to the realisation that some boards of SOCs were not discharging their duties with the necessary skill, care, and diligence reasonably expected of directors, the CIPC issued compliance notices directing them to comply or face probation under s 162 of the Act. The CIPC has also been innovative with its compliance notices. For instance, it issued a compliance notice directing the CEO and executive director of Telkom to attend corporate governance classes on directors' duties after an irregular loan of R6 million was extended to the chief financial officer. The CIPC also ordered the reversal of the loan.[109]

3.5.3 Competition Tribunal decisions

In interpreting the Competition Act, the Competition Tribunal has consistently held that 'public entities enjoy neither preference nor prejudice by virtue of their official status when their actions are considered in terms of the Act'.[110] In line with this, the Tribunal has held that, in spite of their public

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107 See section 3.3.1 above.

108 Rabilall op cit (note 106).

109 Christopher Spillane 'Telkom CEO sent on corporate-governance course after CFO loan' available at https://www.bloomberg.com/news/articles/2014-02-24/telkom-ceo-sent-on-corporate-governance-course-after-cfo-loan (accessed 1 May 2020).

110 *Phutuma Networks (Pty) Ltd v Telkom Ltd* (37/CR/Jul10) para 24.

mandate, SOCs cannot engage in anti-competitive behaviour.[111] Indeed, where their corporate decisions have muscled out competition, the Tribunal has reined them in. On two separate occasions, the Tribunal has found the conduct of SAA to be anti-competitive and has imposed hefty fines.

In *Competition Commission and South African Airways,* the Tribunal found that two incentive schemes of SAA contravened the Competition Act.[112] These schemes, referred to as the 'override incentive scheme' and the 'explorer scheme', gave incentives to travel agents to divert passengers from competitors of SAA. The Tribunal held that SAA was a dominant player in the domestic market and that its schemes were exclusionary and tantamount to abuse of a dominant position.[113] Another case was lodged by Comair against SAA on similar grounds. The Tribunal found SAA to have again abused its dominant position – a decision challenged unsuccessfully by SAA at both the Competition Appeal Court and the High Court.[114] Similarly, Telkom was found to have abused its market dominance and was fined.[115] It is submitted that, ordinarily, hefty fines imposed for anti-competitive behaviour should have a positive effect on corporate governance, because the board would in future guard against abusing the corporation's dominance. In the case of SAA, however, this was not the case, largely because of soft budget constraints that enable the corporation to ask the shareholder for endless bailouts.[116]

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111 However, in *AEC Electronics (Pty) Ltd v Department of Minerals and Energy* (48/CR/Jun09) para 18, the Tribunal ruled that only practices of SOCs themselves are subject to review and not the decisions of the state functionaries. This ruling is problematic because shareholder-representatives often make decisions that advantage SOCs.

112 [2005] ZACT 50 (28 July 2005).

113 For the jurisprudence of the Tribunal regarding SAA, see Helen Jenkins, Gunnar Niels and Robin Noble 'The South African Airways cases: Blazing a trail for Europe to follow?' Presentation to the 3rd Annual Competition Conference (14 August 2009) available at www.compcom.co.za/wp-content/uploads/…/The-South-African-Airways-cases.pdf (accessed 10 June 2018).

114 *Comair Limited v South African Airways (Pty) Ltd* [2017] 2 All SA 78 (GJ).

115 *Competition Commission of South Africa v Telkom SA Ltd and Others* [2010] 2 All SA 433 (SCA).

116 The former board chairperson of SAA brazenly told the court that 'SAA belongs to the government 100% … they wouldn't allow it to fail' See *Organisation Undoing Tax Abuse and Another v Myeni and Others* (15996/2017) [2020] ZAGPPHC 169 (27 May 2020) para 262.

3.5.4 Remedial action by the Office of the Public Protector

The Office of the Public Protector (PP) has had a far-reaching impact on the governance of SOCs. The PP derives its mandate from the Constitution.[117] Its powers are to investigate any conduct in the public administration in any sphere of government that is alleged to be improper or to result in any impropriety or prejudice, and to take appropriate remedial action.[118]

Many reports of the PP are critical of corporate governance in SOCs, but only two are explored here to demonstrate the usefulness of the institution in enforcing corporate governance in SOCs. The first report, entitled 'When governance and ethics fail', relates to corporate governance deficiencies in the SABC.[119] The PP was called upon to investigate the questionable qualifications of the former chief operating officer (COO) of the public broadcaster. The PP found that the COO had misrepresented his qualifications, that he operated above the law, that his appointment was irregular, and that his excessive salary progression was absurd. The report further established that the then shareholder-representative unduly interfered with the operations of the SABC. The PP concluded by rebuking the board, indicating that its governance of the SABC was 'symptomatic of pathological corporate governance deficiencies' and that the board failed 'to provide strategic oversight to the national broadcaster as provided for in the SABC Board Charter and King III Report'.[120] The PP's remedial action was that the board should institute disciplinary action against the COO.

The second report investigated the role of the chief executive officer of PRASA and other functionaries in the improper award of tenders, maladministration,

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117 Section 182 of the South African Constitution.

118 Section 182(1)*(a)*, *(b)*, and *(c)* of the South African Constitution read with s 8(1) of the Public Protector Act 23 of 1994.

119 Public Protector 'When governance and ethics fail' Report No. 23 OF 2013/2014. Available at http://www.pprotect.org/?q=content/investigation-reports (accessed 20 May 2020).

120 At page 22.

conflicts of interest, financial mismanagement, nepotism, and the improper handling of whistle-blowers, among others.[121] The remedial action included that PRASA must review the policies that manage conflicts of interest and the supply chain. The PP furthermore directed the board to institute forensic investigations and the shareholder-representative to monitor compliance.

Both these reports show that the internal governance of SOCs is often ineffective and that the PP's remedial action is useful as an additional layer of regulation or as a regulation enforcement mechanism. However, in an ideal governance model, the boards and shareholders should have the appetite and capacity to address all the governance challenges facing SOCs. The involvement of the PP is an indication that the boards and shareholders are in fact ill-equipped to effectively govern. This point is explored fully in chapters 4 and 5.

3.5.5 Parliamentary oversight of SOCs

The Constitution of South Africa empowers the National Assembly to play an oversight role in respect of the executive and all public institutions.[122] To discharge this function, the National Assembly is expected to scrutinise and oversee all executive action.[123] At the same time, the Constitution requires cabinet members (shareholder-representatives) to regularly report to the National Assembly on matters under their control, such as on SOCs answerable to them.[124]

One of the ways in which the National Assembly, through its portfolio committees, scrutinises and oversees the work of SOCs is by evaluating their

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121 Public Protector 'Derailed: A report on an investigation into allegations of maladministration relating to financial mismanagement, tender irregularities and appointment irregularities against the Passenger Rail Agency of South Africa (PRASA)' Report No. 3 of 2015/16. Available at http://www.pprotect.org/?q=content/investigation-reports (accessed 20 May 2020).

122 Section 55(2).

123 Section 42(3).

124 Section 92(3)*(b)*.

tabled annual reports.[125] Different portfolio committees focus on different SOCs or issues. For instance, the Standing Committee on Public Accounts (SCOPA) focuses on SOCs' compliance with the PFMA, Treasury Regulations, the audit committee and the accounting officer's management report. Other committees generally deal with the technical aspects of SOCs' annual reports, with a particular focus on the discharge of their service delivery mandates, an evaluation of financial (under-)performance and its impact on service delivery, and measures put in place to address the problems.[126]

Recently, the portfolio committees have focused on issues of poor corporate governance. Yet the committees have not always had the courage to interrogate dubious corporate governance decisions. Many portfolio committees have only recently undertaken inquiries aimed at establishing the causes of the collapse of governance in SOCs. One such inquiry was conducted to ascertain the fitness of the SABC board.[127] The committee found that the board failed to discharge its duties regarding the financial management and sustainability of the corporation. It was also established that the governance woes at the broadcaster were partly a result of the interference and incompetence of the shareholder-representative.[128]

It is perhaps worth observing that the newly found courage of the National Assembly and the fragmented way in which it is addressing the governance challenges in SOCs is an indication that the institution is not a bastion of corporate governance regulation and enforcement. This is because the National Assembly operates in the domain of politics. Its decisions to act (or not to act) against corporate governance weaknesses and malfeasance are

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125 In terms of s 65 of the PFMA, the executive authority (shareholder-representative) of a SOC is expected to table the annual reports of the SOC within six months of the end of its financial year.

126 See National Treasury Report entitled 'Governance oversight role over state-owned entities (SOEs)' (on file).

127 See 'Final report of the ad hoc committee on the SABC board inquiry into the fitness of the SABC board, dated 24 February 2017' available at https://pmg.org.za/committees/ (accessed 1 May 2019).

128 At para 39.1.1.

sometimes influenced by party political interests, which may not always be aligned with the public interest and good governance.[129]

3.5.6 Commentary

The judicialised and quasi-judicialised regulation of SOCs is partly effective because it is backed by the authority of the court, the tribunal or the National Assembly. Yet, this regulation is not ideal because it reveals the ineffectiveness of the boards of directors, which are the primary corporate organs vested with the power to govern. In the case of the National Assembly, political dynamics sometimes limit its willingness to intervene and steer SOCs in the right direction. The CIPC has innovatively used compliance notices to influence governance in SOCs but these have been infrequent. The PP has also had a profound effect on the governance of SOCs, although remedial action is often challenged in courts, resulting in delayed implementation.

3.6 REGULATORY QUANDARY

The preceding discussion shows that the many ways of regulating SOCs present more challenges than opportunities. The framework is, in some important respects, inconsistent and incompatible. It is also characterised by duplication and overlap. A further challenge is the non-regulation of the regulators, which leads to them being unable to work in a complementary manner. This presents what Teubner calls 'regulatory trilemma', which is a regulatory environment that lacks effectiveness, responsiveness, and coherence.[130] The net effect of this disjointed regulatory framework administered by uncoordinated regulators on the overall governance of SOCs can only be negative. To restore sound governance in the sector, a more

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129 See generally Haroon Bhorat et al *Betrayal of the Promise: How the Nation is being Stolen* (2017).

130 Gunther Teubner and Bremen Firenze 'Juridification: Concepts, aspects, limits, solutions' in Gunther Teubner (ed) *Juridification of Social Spheres: A Comparative Analysis of the Areas of Labor, Corporate, Antitrust and Social Welfare Law* (1987) 3–48 at 19–22. See further Parker and Braithwaite op cit 126–127. The authors unpack Teubner's regulatory trilemma.

cohesive system overseen by regulators in a coordinated fashion is required.[131] Such a system would ensure:

> greater consistency and predictability of results [of regulation], greater accessibility of decisions to public scrutiny and participation, increased likelihood that regulations will withstand judicial review, reduced opportunities for manipulative behavior by agencies in response to political or bureaucratic pressures, reduced opportunities for obstructive behavior by regulated parties, and decreased likelihood of social dislocation and 'forum shopping' …[132]

A cohesive regulatory system would lead to what is otherwise known as 'responsive regulation', which, on the one hand, reinforces the positive aspects of compliance by providing support to corporations and by recognising their compliance efforts and achievements. On the other hand, it prescribes enforcement practices and sanctions, in the event of non-compliance, in a pyramid fashion.[133]

3.7 CONCLUSION

This chapter set out to examine the impact of the regulatory design on the governance of SOCs. It began by briefly theorising regulation and conceptually situating different forms of regulation of SOCs in three categories: hard, soft and judicialised regulation. It emerged that the regulation of SOCs transcends these forms of regulation and that it is also located at the intersection of public law (the PFMA and founding legislation) and private law (the Companies Act and the King Codes).

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131 Similar to the one in Singapore: see chapter 6 (para 6.2).

132 Howard Latin 'Ideal versus real regulatory efficiency: Implementation of uniform standards and "fine-tuning" regulatory reforms' (1985) 37 *Stanford Law Review* 1267–1332 at 1274. The author's views are framed in environmental regulation, but they are equally cogent in the broader context of regulation.

133 Jenny Job, Andrew Stout and Rachael Smith 'Culture change in three taxation administrations: From command-and-control to responsive regulation' (2007) 29 *Law & Policy* 84–101 at 86. See also John Braithwaite 'The essence of responsive regulation' (2011) 44 *UBC Law Review* 475–520 at 481.

The central argument advanced in this chapter is that the regulatory scheme is not only plural and complex, but also fragmented, and it effectively creates onerous over-regulation, which leads to regulatory quandary and uncertainty. These then collectively impact adversely on corporate governance within SOCs and renders them unable to deliver on their public interest mandate and susceptible to serving nefarious interests. Therefore, the failure of SOCs seems to turn mostly on the failure of the regulatory design to the extent that, broadly viewed, it determines how SOCs are owned and controlled.

CHAPTER 4

STATE OWNERSHIP AND THE ROLE OF SHAREHOLDER-REPRESENTATIVES IN THE GOVERNANCE OF STATE-OWNED COMPANIES

4. INTRODUCTION

This chapter has three aims. First, the chapter seeks to understand the rationale of state ownership in South Africa in both a historical and a contemporary context. Second, it critically examines the current ownership model by locating it within the established taxonomy of state ownership models. Third, the chapter critically evaluates the role and powers of shareholder-representatives within the existing ownership paradigm. It specifically enquires whether the powers, multiple roles of shareholder-representatives, and the plurality of oversight mechanisms lead to 'intervention' or 'interference' in the business affairs of SOCs, and how such intervention or interference affects their governance. Primarily, this chapter is concerned with the impact that different aspects of state ownership and shareholder powers have on the overall governance of SOCs.

4.1 STATE OWNERSHIP RATIONALE

State ownership is probably as old as states themselves. Since Roman times and the mercantilist period governments have owned enterprises for one reason or another. State enterprises were the linchpin of the Industrial Revolution. They also featured prominately after the Great Depression so that 'even advanced capitalist states began to turn to state enterprises to subsidize services and products deemed necessary for the survival of society.'[1] State enterprises also played a central rebuilding role after World War II. They also played a major role in some states in the aftermath of the 2008 global financial crisis.

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1 Nancy Clark *Manufacturing Apartheid: State Corporations in South Africa* (1994) 2. The author provides a useful account of the history of state corporations, with a particular focus on South Africa.

After the end of the Cold War, many countries privatised their SOCs, particularly western economies. However, emerging economies, such as those in the BRICS bloc, Asia and the Nordic region, retained theirs and introduced new ones for a variety of reasons. Common reasons were the need to support national economic and strategic interests; to protect key and sensitive aspects of the domestic economy from foreign control; to venture into capital-intensive areas of the economy shunned by the private sector; to create or maintain state ownership because market regulation would be unviable or ineffective if left to the private sector; and to establish monopolies around public goods like energy, water, infrastructure, and others.[2]

It has been observed that 'the motivations for state ownership can wax and wane over time, but SOEs appear to be an enduring feature of the economic landscape and will remain an influential force globally for some years to come.'[3] Indeed, in the case of South Africa, as demonstrated next, state ownership rationale has changed from the apartheid period to the post-apartheid period.

4.1.1 Pre-1994 context: SOCs as apartheid anchors

SOCs have been an enduring feature of the South African economy. They served the apartheid regime with distinction. During that dark period, they had multiple roles, one of which was to be economic enablers that supplied strategic and cheap inputs for the industrialisation of the economy, such as energy and infrastructure in the so-called minerals–energy complex.[4] They

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2 See OECD *Ownership and Governance of State-owned Enterprises: A Compendium of National Practices* (2018) 16–22; see also J Heath and W Norman 'Stakeholder theory, corporate governance and public management: What can the history of state-run enterprises teach us in the post-Enron era?' (2004) 53 *Journal of Business Ethics* 247 at 255.

3 PriceWaterHouseCoopers *State-Owned Enterprises: Catalysts for Public Value Creation?* (2015) 4, available at https://www.pwc.com/gx/en/psrc/publications/assets/pwc-state-owned-enterprise-psrc.pdf (accessed 1 July 2019).

4 A minerals–energy complex (MEC) is a system of industrialisation where certain core sectors of the economy, namely, mining and electricity, are mutually reinforcing as a system for accumulation, to the detriment of other sectors of the economy. See Ben

also served the strategic purpose of providing race-based jobs that empowered the white minority, also called 'civilised labour', by reserving jobs for them at the top of the labour hierarchy.[5] At the same time, SOCs were used to subjugate the black majority. For instance, Armscor was instrumental in quelling the 1976 Soweto uprising and similar disturbances by manufacturing and supplying weapons to the apartheid police.[6] Furthermore, SOCs played the role of counteracting the dominance of foreign companies in the economy, particularly in the mining sector.[7] At the height of apartheid, Armscor helped to insulate the regime from international sanctions by, among other things, beneficiating natural resources so that the country could be energy- and fuel-secure. Clark succinctly summarises the nature and role of these apartheid-era SOCs as follows:

> State corporations, rather than embodying narrow political interests, operated on a complex series of political and economic planes. They did not function exclusively as pork barrels, or solely as part of the security apparatus, or, alternatively, as 'tools of capital'. Their histories reveal that, rather than being monolithic and changeless institutions operating under predetermined objectives, they were ever-changing organizations affected by … complex problems … attendant on enforced racial stratification in South Africa.[8]

It can therefore be asserted that the basic premise underlying these erstwhile corporations was that South Africa was an apartheid state-cum-emerging economy, and it was therefore critical for the state to create dynamic national champions that could advance the politico-economic aspirations of the apartheid state while fighting sanctions and thwarting economic domination

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Fine and Zavareh Rustomjee *The Political Economy of South Africa: From Minerals-energy Complex to Industrialisation* (1996).

5 Edwin Ritchken 'The evolution of state-owned enterprises in South Africa' in OECD *State-owned Enterprises in the Development Process* (2015) 176–177, available at https://www.oecd-ilibrary.org/finance-and-investment/state-owned-enterprises-in-the-development-process_9789264229617-en (accessed 10 July 2019). See also Clark op cit note 1 at163.

6 Clark op cit note 1 at preface.

7 Merle Lipton *Capitalism and Apartheid South Africa, 1910–1986* (1989). SOCs were used to protect the local economy against foreign domination by propping up white oligarchs.

8 Clark op cit note 1 at preface xiii.

by international players.[9] These SOCs succeeded in sustaining the entire apartheid eco-system until the early 1990s, when the apartheid project crumbled because of unrelenting domestic and international pressure.

Due to damaging international sanctions, the apartheid government had to reduce spending and generate income. To this end, it resorted to privatising some SOCs. This coincided with the then-increasing international trend and pressure to liberalise and privatise. Although the apartheid government embraced privatisation, the latter never gained traction due to the transition negotiations that were taking place for establishing the new democratic order. The incoming government viewed the privatisation of strategic SOCs as a way of denying it the jewels of the state. Clark observes that white labour also opposed privatisation, fearing that the drive for profits would result in cheap black labour being favoured after privatisation.[10]

In summary, the basic rationale for state ownership during apartheid was both political and economic. SOCs were instruments of subjugation and racialised domestic economic development, and they were also competitive global players that sought to drive the South African economy while preserving its apartheid character.

4.1.2 Post-1994 context: SOCs as vehicles for socio-economic transformation

After the new democratic government came into power, the international pressure to privatise continued. The government gave in to some extent by adopting the privatisation policy. Yet, it did not go full steam ahead with the policy.[11] Instead, the general approach was a greater emphasis on restructuring.[12] The ANC government had a different view about the role of

9 Ritchken op cit note 5 at 177.

10 Clark op cit note 1 at 168.

11 James Jude Hentz 'The two faces of privatisation: Political and economic logics in transitional South Africa' (2000) 38 *Journal of Modern African Studies* 203–223.

12 See the background paper to the Presidential State-Owned Enterprises Review Committee Report (2013) (PRC Report) titled 'Restructuring of state-owned enterprises

SOCs in the country's development. Its ideological posture was and continues to be that SOCs are strategic enablers of the developmental state.[13] However, as will become apparent here, the ANC government has lacked ideological and policy discipline because it has oscillated between state ownership and privatisation in a confusing way. The confusion is exacerbated by the lack of an explicit ownership policy that clearly articulates, clarifies and prioritises the national strategic objectives that must be fulfilled through state ownership and that define the role of different stakeholders in governance of SOCs.

To demonstrate the confusion created by the absence of a clear ownership policy: the state semi-privatised some SOCs, but then reversed the transactions after a couple of years. A 20 per cent stake in SAA was sold to Swiss Air in 1999 but reversed in 2001. Another example is the 20 per cent sale of Airports Company South Africa (ACSA) to an Italian airports management firm in 1998 that was reversed in 2005 and then sold to the Public Investment Corporation (PIC), a wholly state-owned corporation.[14] This flirtation with privatisation in the form of mixed ownership is indicative of a lack of policy direction on state ownership and a confused ownership model. A clear ownership policy would inform decisions regarding the creation, termination, retention, or co-ownership of SOCs.[15]

In 2004, the privatisation and restructuring agenda changed. SOCs were now geared towards the realisation of the developmental state.[16] It is important to note that the Freedom Charter advocates state ownership of the strategic sectors of the economy and sees their primary role as the delivery of public goods.[17] It can therefore be argued that the rationale of state ownership for the realisation of the developmental state has its genesis in the Freedom

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in South Africa' available at http://www.thepresidency.gov.za/publications (accessed 21 August 2019).

13 See chapter 1 (para 1).

14 See the ACSA Company Profile, available at http://www.airports.co.za/about-us/airports-company/company-profile (accessed 1 August 2019).

15 An explicit ownership policy is seen as a best practice by the OECD. See OECD op cit.

16 Ritchken op cit note 5 at 168.

17 The Freedom Charter (1955) proclaims that strategic sectors must be under state control.

Charter. In line with this, the DPE adopted a new vision to pursue investment in, and the productivity and transformation of SOCs, in order to unlock growth, drive industrialisation, and create jobs. Linked to this vision is the mission that envisages SOCs as 'strategic instruments of industrial policy and core players in the New Growth Path'.[18] It appears from these objectives that the logic of state ownership is to control the market forces in order to promote capital accumulation (private and public) but in a transformative and inclusive fashion. Implicitly, therefore, SOCs are vehicles of economic growth, service delivery, and transformation. But, are these objectives not inherently competing, and if so, what effect, if any, does that competition have on the governance of SOCs?

4.1.3 Competing objectives and corporate governance

To achieve the strategic objectives of capital accumulation and socio-economic transformation, SOCs tend to pursue dual objectives, also known as the 'double bottom line', that comprise commercial objectives, on the one hand, and non-commercial objectives, on the other. The latter objectives tend to:

> go beyond profitability or even contradict the simple principle of shareholder value maximisation … These non-commercial objectives include the use of public enterprises to promote regional development, job creation, and income distribution; they often involve taking on or maintaining redundant workers, pricing goods and services below market (or sometimes even below costs), locating plants in uneconomic areas, or keeping uneconomic facilities open.[19]

It is contended that most South African SOCs are not commercial entities in the strict sense; rather, they are entities in pursuit of a 'double bottom line'. For example, SAA and Eskom appear to be commercial entities, but deeper scrutiny reveals that they are concerned with objectives that go beyond the logic of profit. To illustrate, reports abound regarding SAA maintaining unprofitable routes to certain African countries with the aim of fostering

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18 See the vision and mission of the DPE at http://www.dpe.gov.za/about/Pages/About-Us.aspx (accessed 12 July 2019).

19 Aldo Musacchio and Sergio Lazzarini *Reinventing State Capitalism: Leviathan in Business, Brazil and Beyond* (2014) 60.

regional development and deepening the country's geo-political influence.[20] Eskom is reportedly purchasing electricity from independent power producers and selling it below cost, and is also reportedly maintaining a bloated workforce.[21] These examples demonstrate that the rationale for state ownership in the post-1994 period is not purely commercial, in that SOCs are used to transform society by pursuing a double bottom line agenda. Whether this is an effective way of pursuing transformation is debatable. As chapter 6 will show, in other countries, SOCs have a purely commercial orientation with the aim of channelling the profits they generate into social welfare. Such SOCs have a single commercial mandate and are run competitively and profitably, like other corporations in the marketplace.

It seems that the double bottom line agenda imposed on South African SOCs renders them susceptible to political interference and corruption. For instance, it has been established that:

> [T]he policy of transforming Eskom and using its considerable procurement budget to empower emerging black businesses was used as a pretext to corrupt the procurement processes at Eskom in order to serve the interests of a network of companies and individuals linked to the Gupta family in particular.[22]

Since the non-commercial objectives are socio-political in nature, they create room for shareholder-representatives (politicians) and other political oversight mechanisms to pressurise SOCs into fulfilling such socio-political objectives. The danger is that multiple, ambiguous, or conflicting objectives may not be easily implementable. This may also give directors the latitude to run SOCs in their own interests. The government may also interfere for political

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20 See 'SAA to dump routes' (2017) available at https://www.news24.com/SouthAfrica/News/saa-to-dump-routes-20170826 (accessed 19 October 2019).

21 See 'Eskom rolls out plan to tackle bloated workforce' (2018) available at https://www.fin24.com/Economy/Eskom/eskom-rolls-out-plan-to-tackle-bloated-workforce-20180403 (accessed 19 August 2019).

22 See Report of the Portfolio Committee on Public Enterprises on the Inquiry into Governance, Procurement and the Financial Sustainability of Eskom, 28 November 2018, para 3.6.1 at page 127, available at https://pmg.org.za/tabled-committee-report/3905/ (accessed 20 December 2019).

expediency, thus creating room for political capture and weak corporate governance.[23]

To sum up, the motivation for state ownership under the apartheid state was different to that of the democratic government. Fundamentally, SOCs were anchors of the apartheid state and their role changed to become vehicles for socio-economic transformation under the democratic dispensation. Yet, the realisation of the transformation agenda in the post-1994 era has been compromised by the absence of a clear ownership policy and competing objectives, which negatively affect how SOCs are governed. Having traced the evolution of the rationale of state ownership, this chapter considers how state ownership is currently organised and determines its effect on corporate governance.

4.2 THE NATURE OF STATE OWNERSHIP IN SOUTH AFRICA

An understanding of the nature of state ownership is important for this work because the execution of shareholder functions and its impact on the overall governance of SOCs is largely determined by the ownership model within which the shareholder-representatives exercise their functions. There is an established taxonomy of ownership models, with each having its own advantages and disadvantages from a corporate governance perspective. Ownership concentration within these models is also an important factor as it determines the relative power that the shareholder-representative wields over the SOC.

4.2.1 An irrational ownership paradigm?

Typically, state ownership takes one of the four forms: decentralised, dual, centralised, or the twin-track model.[24] Under the decentralisation model, state

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23 World Bank Group *Corporate Governance of State-Owned Enterprises: A Toolkit* (2014) 14.

24 See chapter 1 (para 1.1.3). Some parts of this section are drawn from Tebello Thabane *Pathological Corporate Governance Deficiencies in South Africa's State-owned Companies: A Critical Reflection* (LLM dissertation, University of the Free State, 2016).

ownership is dispersed across government departments (ministries). There is no single agency or department exercising shareholder powers and providing oversight over the running of the SOCs. The rationale for and some of the key advantages of this model lie in the sector expertise that various departments have and their capacity to implement a more active industrial policy. With this expertise and the ability to craft and implement an active industrial policy, the sector departments are believed to have the capacity to also play meaningful oversight and shareholder roles over SOCs. A key criticism of the model is that the separation of the ownership function from other roles, such as the regulatory role, presents problems. When a single department plays various roles (ownership, policy formulation, and regulation) in regard to a SOC, such a department necessarily gets 'too close' to the day-to-day affairs of the SOC, which sometimes leads to an inclination to interfere in the mundane business (operational) affairs of the SOC.

With the dual model, two departments collectively share the ownership responsibility for SOCs. Normally, this arrangement involves a sector department and a 'common' department, usually the Treasury. The rationale for the duality of ownership is that the Treasury focuses on the economic efficiency and the impact of SOCs' performance on the fiscus, while the sector department focuses solely on ensuring that SOCs are successfully run from an industrial policy perspective. A clear advantage of this model is the 'enhanced balance between the government's regulatory, industrial policy and financial perspectives' as different departments bring different focuses to the ownership arrangement.[25] However, this may also present a problem because these departments may have conflicting shareholder expectations and objectives, making it difficult for SOCs to fulfil all of them simultaneously. To illustrate the point, the Treasury's objective may be to enforce budget discipline in its quest for fiscal management, while a sector department may

25 William Witherell *Corporate Governance of State-Owned Enterprises: A Survey of OECD Countries* (2005) available at http://www.oecd.org/daf/ca/corporategovernanceofstateownedenterprises/48455108.pdf (accessed 2 August 2019).

have an expansionist objective in line with a set policy, which would then strain the fiscus.

The centralisation model is a novelty. Its main characteristic is that the ownership function is centralised in one department or agency. This model helps to achieve separation of the ownership function from other state functions, such as industrial policy formulation and regulation. It also helps with accountability, as SOCs do not have to achieve conflicting objectives. In countries such as Singapore, this model manifests itself in the form of a state holding company.[26] The ownership of SOCs lies with a single holding company, which owns shares in all SOCs on behalf of the state. Some benefits of this model are that it decreases political interference in the management of SOCs, thus giving their boards more flexibility, autonomy, and authority.[27]

In some countries, major SOCs are coordinated by an agency such as the Chinese State-owned Assets Supervision and Administration Commission of the State Council (SASAC). The primary role of these agencies is to advise other state shareholders and to monitor performance of SOCs. An advantage of this model is that there is policy coherence.[28] Its disadvantage is that it does not shield SOCs from political interference because the coordinating agency is composed of government ministers who often impose political considerations on the boards of SOCs.

Lately, the 'twin track model' has emerged.[29] This model straddles the dual and centralised models. Two categories or portfolios of SOCs are owned and overseen by two different government institutions or departments. Due to the

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26 Ho Khai Leong 'Corporate governance reform and the management of the GLCs: Pressures, problems, and paradoxes' in Ho Khai Leong (ed) *Reforming Corporate Governance in Southeast Asia: Economics, Politics, and Regulation* (2005) 269–299. The author focuses on the evolution of Singapore's Government Linked Corporations (GLCs), paying particular attention to Temasak Holdings, which owns Singapore's commercial GLCs. He also focuses on the ideology underpinning Temasak, as well as the political pressures and paradoxes it faces. See also chapter 6 (para 6.3).

27 OECD *State-Owned Enterprises in the Development Process* (2015).

28 OECD op cit note 27 at 33.

29 This model is applied in Belgium and Turkey. See OECD op cit note 27 at 33.

involvement of two government institutions, the model appears dual in nature. Yet, the fact that a whole portfolio of SOCs is owned by a single institution also makes the model appear centralised. In effect, however, this model is neither dual nor centralised. It is not dual because two government institutions do not simultaneously exercise ownership or shareholder functions over the same SOC. It is also not centralised because one single institution does not exercise ownership functions over all SOCs within the country, as is the case with a centralised model. Therefore, the 'twin track' tag aptly captures the essence of this model: there are two broad portfolios (twin tracks) of SOCs, typically divided along commercial and non-commercial tracks, with two distinct shareholder institutions overseeing each track.

It is important at this juncture to examine the location of the South African ownership model within the taxonomy presented above. As briefly noted in chapter 1, the South African model appears centralised, since a dedicated department (DPE) owns the SOCs.[30] However, further examination reveals that the DPE oversees only a handful of SOCs, while the majority are overseen by different sector departments, thus rendering the model decentralised in nature.[31] Further scrutiny reveals that there are instances where the National Treasury plays what appears to be an ownership function over SOCs that are already overseen by other departments, such as the DPE. This is particularly applicable when we remember that SOCs are primarily subject to the PFMA, whose implementation is overseen by the National Treasury. For instance, all SOCs must consult and get approval from the National Treasury before purchasing or disposing of any significant assets or borrowing beyond a

30 The DPE exercises the ownership function over Transnet, SAA, South African Express, Eskom, Denel, SAFCOL and Alexkor.

31 Several sector ministries own SOCs that fall within their sector. For instance, the Department of Telecommunications and Postal Services owns and oversees the government's shareholding in Telkom, Broadband Infraco, Sentech and the South African Post Office (SAPO), to mention a few. The National Treasury exercises sole ownership control over the Public Investment Corporation (PIC) and the Development Bank of Southern Africa (DBSA), while the Department of Transport owns Airports Company South Africa (ACSA).

certain materiality point.[32] This creates the impression that the South African ownership model is dual.

So, the model is puzzling in that it appears dual but also decentralised. To further illustrate the confusing nature of this model, SAA was transferred from the DPE to the National Treasury in 2004, ostensibly so that the new shareholder-representative (the Minister of Finance) could help to stabilise its financial position. It was unclear why the then shareholder minister of the DPE could not help to stabilise the airline or why the Minister of Finance could not assist with its stabilisation without assuming the role of shareholder-representative.

Strangely, during the transfer of SAA to the National Treasury, other state aviation businesses, like SA Express and Mango Airlines, remained with the DPE, meaning that different state aviation businesses were 'owned' by different shareholders with different shareholder expectations and policy objectives. In 2018, SAA was transferred back to the DPE on the basis that all state aviation businesses ought to be under one shareholder-representative. Interestingly, the financial position of SAA had not improved. In fact, it had worsened compared to 2004, when it was transferred to the National Treasury for financial stabilisation.[33]

Another interesting fact is that ACSA, which operates in the aviation space, is not 'owned' by the same shareholder-representative (the DPE) as are the rest of the aviation businesses; instead, ACSA is owned by the Department of Transport. Recently, the Minister of Energy warned that the fact that Eskom

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32 National Treasury Guideline Framework for Corporate Planning and Shareholder's Compact (2002) para 3.2.4. See also the discussion on the hard regulation of SOCs in chapter 3 (para 3.3).

33 SAA's financial position under the National Treasury has progressively deteriorated. See Ivo Vegter 'SAA must be euthanised to put us out of our misery' available at https://www.freemarketfoundation.com/article-view/saa-must-be-euthanised-to-put-us-out-of-our-misery (accessed 4 August 2019). See also the SAA annual financial reports for the period 2004–2018, available at https://www.flysaa.com/about-us/leading-carrier/media-center/financial-results (accessed 4 December 2019).

does not fall under the Department of Energy, but rather under the DPE, is 'counter-productive'.[34]

From this brief analysis, the following observations can be made: Some SOCs are owned by their sector ministries while others fall within the DPE and not their sector ministries. It is unclear what informs the semi-centralised ownership by the DPE. It is also unclear why SOCs are moved from one shareholder-representative to another. The effect of this confusion in ownership is that different shareholder expectations are imposed on businesses that fall within the same business environment. The confusion also leads to a failure to harness synergies between state corporations that should ideally be in group ownership. It can therefore be concluded that the South African SOC ownership paradigm is perplexing at best and irrational at worst.

4.2.2 Concentrated ownership and limited listing

Concentrated ownership, particularly by the state, has a tendency to compromise corporate governance, especially when the ownership arrangement allows the shareholder-representative to exercise excessive power over the SOC.[35] Where there is mixed ownership, for example, in Telkom and ACSA, corporate governance and overall financial performance tend to be better when compared to SOCs that are exclusively state-owned. To illustrate, Telkom reported a profit of R4.939 billion in 2018 and ACSA reported a profit of R843 million in the same period.[36] Where the state is the

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34 See 'Mantashe criticises Mboweni's recovery plan' available at https://www.enca.com/news/mantashe-criticises-mbowenis-recovery-plan (accessed 30 August 2019). This view seems to be informed by the fact that other SOCs are co-owned by the ministry of finance and a sector ministry but, in the case of Eskom, the sector ministry is excluded.

35 Ginka Borisova et al 'Government ownership and corporate governance: Evidence from the EU' (2012) 36 *Journal of Banking & Finance* 2917–2918. See also Stijn Claessens and Joseph Fan 'Corporate governance in Asia: A survey' (2002) 3(2) *International Review of Finance* 71–103. The authors observe that corporate governance challenges are more pronounced where the government is a controlling shareholder.

36 'Telkom Integrated Report for the year ended 31 March 2018' available at https://telkom.co.za/telkomfoundation/reports.html (accessed 10 January 2020).

sole shareholder, for example, in Eskom and SAA, corporate governance is poor and financial performance is abysmal. In 2018, Eskom reported a staggering loss of R20.7 billion while SAA reported losses for the past seven years, with the latest loss being R5.5 billion.[37] It seems clear that better financial performance and adherence to corporate governance standards in SOCs with mixed ownership can be attributed to non-state shareholders' demands for better returns on investment and limited interference by state shareholder-representatives.

Notably, concentrated ownership by the state is accompanied by a reluctance to list SOCs on the stock exchange. None of the SOCs where the state is the sole shareholder is listed. As observed in chapter 3, listing involves compliance with the listing requirements, which impose stringent corporate governance standards that must be complied with if the listed corporation is to continue being listed. The state's reluctance to list SOCs robs them of an additional avenue that requires compliance with corporate governance standards and exposes companies to the rigours of market discipline, which demand efficiency, transparency, and profitability in order for companies to remain on the stock exchange.

4.2.3 Division of corporate power in SOCs

Corporate power is legally distributed between the board of directors and the shareholders in a general meeting. Each organ is clothed with specific and distinct powers.[38] Historically, the shareholders' general meeting was the

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37 'Eskom Consolidated Financial Statement 2018' available at http://www.eskom.co.za/IR2018/Documents/Eskom2018AFS.pdf and 'SAA Consolidated Financial Statement 2017/18' available at https://nationalgovernment.co.za/entity_annual/1336/2017-south-african-airways-(saa)-annual-report.pdf (accessed 5 August 2019).

38 Irene-Marie Esser and Piet Delport 'Shareholder protection in terms of the Companies Act 71 of 2008' (2016) 79 *Journal of Contemporary Roman-Dutch Law* 1–29 at 8–10; Rehana Cassim 'Governance and shareholders' in Farouk Cassim et al *Contemporary Company Law* 2 ed (2012) 355; Tshepo Mongalo 'The emergence of corporate governance as a fundamental research topic in South Africa' (2003) 120 *South African Law Journal* 173–191 at 180–186; GR Sullivan 'The relationship between the board of directors and the general meeting in limited companies' (1977) 93 *Law Quarterly Review* 569–572.

locus of control and the directors were considered its agents. Since directors were considered the agents of shareholders, who were considered the principals, the directors were subject to total control by the shareholders in the management of the company.[39] The court in *Isle of Wight Railway Co v Tahourdin* held that shareholders were entitled to give directors instructions on how to manage the business and affairs of the company.[40]

A series of cases show that the position of the shareholders' general meeting as the locus of control has since changed. The contemporary position was stated in *Automatic Self Cleansing Filter Syndicate Company Ltd and Cuninghame* where the court held that the new general rule is that the shareholders' general meeting can no longer control the directors in the latter's exercise of their duties, unless the company's constitution expressly permits the shareholders to exercise some form of control.[41] In *Gramophone and Typewriter Ltd v Stanley*, the court went further to clarify that directors were not servants of the shareholders and that the shareholders' general meeting was not legally empowered to interfere with the managerial powers of directors, even if the majority of the general meeting wished to do so.[42] The court in *John Shaw & Sons (Salford) Ltd v Shaw* summarised the position as follows:

> A company is an entity distinct alike from its shareholders and its directors. Some of its powers may, according to its articles, be exercised by directors; certain other powers may be reserved for the shareholders in a shareholders' meeting. If powers of management are vested in the directors, they and they alone can exercise these powers. The only way in which the general body of the shareholders can control the exercise of the powers vested by the articles in the directors is by altering their articles or, if opportunity arises under the articles, by refusing to re-elect the directors of whose actions they disapprove. They cannot themselves usurp the powers which by the articles are vested in the directors any more than the

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39 Keith Aickin 'Division of power between directors and general meeting as a matter of law, and as a matter of fact and policy' (1967) 5 *Melbourne University Law Review* 448–464 at 449.

40 (1884) LR 25 Ch D 320 (CA).

41 [1906] 2 Ch 34.

42 [1908] 2 KB 89 at 105–106.

> directors can usurp the powers vested by the articles in the general body of shareholders.[43]

According to *Wessels & Smith v Vanugo Construction (Pty) Ltd*, any attempt by the shareholders' general meeting to interfere with managerial powers legally vested in directors would result in their resolution being declared invalid.[44] This position was confirmed by the Supreme Court of Appeal (SCA) in *LSA UK Ltd (formerly Curtainz Ltd) and Others v Impala Platinum Holdings Ltd and Others* where the court held that the shareholders' general meeting is only the repository of residual powers that have not been allocated by the company constitution or the Companies Act.[45]

It was observed in *Ben-Tovim v Ben-Tovim* that the question of distribution of corporate power has undergone a big shift. The court stated that:

> The pendulum of the division of powers between the general meeting and the board of directors has through the years swung from the general meeting as the supreme organ to prominence of the articles of association.[46]

The steady development of the common law on the question of the division of power was finally settled by s 66(1) of the Companies Act, which bestowed the board with the power and authority to manage the business and affairs of the company, subject to the provisions of the MOI and the Companies Act. The section effectively gives directors 'literal control' over company business and affairs.[47] This is significant in that the board's powers are no longer delegated by shareholders through the MOI; instead, the powers derive originally from the Act. The effect of this is to place the ultimate power to direct the business and affairs of the company in the hands of the directors.[48] Thus, the Act cements the primacy of directors in corporate governance.

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43 [1935] 2 KB 113 (CA) 134.

44 1964 (1) SA 635 (O) 637.

45 (222/98) [2000] ZASCA 178 (28 March 2000) para 12.

46 2001 (3) SA 1074 (C) 1085–1086.

47 Edward Herman *Corporate Control, Corporate Power* (1981) 19. The author defines 'literal control' as the board's decision-making power.

48 Piet Delport (ed) *Henochsberg on the Companies Act 71 of 2008* (SI 16, May 2018) 248, endorsed by *Pretorius and Another v PB Meat (Pty) Ltd* (1057/2013) [2013] ZAWCHC 89

The fact that case law and the Companies Act have entrenched director primacy does not mean that shareholders are without arrows in their quiver.[49] As observed already, unallocated residual powers reside with the general meeting of shareholders. The other important arrows in the shareholders' quiver that are considered 'potent means of controlling the policies and the activities of the directors of a company'[50] are the substantive powers to alter the constitution of the company by special resolution[51] and the power to remove directors from office by ordinary resolution.[52] The latter powers are also aimed at enforcing managerial accountability.[53] Over and above the substantive powers, shareholders also enjoy extensive approval powers, which they can use as part of checks and balances over directors' decisions.[54]

(14 June 2013) para 25. See also *Kaimowitz v Delahunt and Others* 2017 (3) SA 201 (WCC) para 12.

49 See generally Esser and Delport op cit note 38.

50 Farouk Cassim 'The division and balance of power between the board of directors and the shareholders: The removal of directors' (2013) 29 *Banking & Finance Law Review* 151–168 at 154.

51 See generally s 16 of the Companies Act.

52 See s 71 of the Companies Act. See also Caroline Ncube 'You're fired! The removal of directors under the Companies Act 71 of 2008' (2011) 128 *South African Law Journal* 33–51. The author explores the potent power of shareholders to fire directors. On the shareholders' power to remove directors in SOCs specifically, see Tebello Thabane 'The removal of directors in state-owned companies: Shareholders' franchise in jeopardy? *Molefe and others v Minister of Transport and others*' (2018) 30 *South African Mercantile Law Journal* 155–171 at 163. See also Rehana Cassim 'Removing directors of state-owned companies: *SOS Support Public Broadcasting Coalition v South African Broadcasting Corporation SOC Limited* (81056/14) [2017] ZAGPJHC 289' (2019) 40 *Obiter* 147–162. On the philosophical roots of the power to remove, see Rehana Cassim 'The power to remove company directors from office: Historical and philosophical roots' (2019) 25 *Fundamina* 37–69.

53 On the notion of managerial accountability, see generally Andrew Keay *Board Accountability in Corporate Governance* (2015); Andrew Keay and Joan Loughrey 'The framework for board accountability in corporate governance' (2015) 35 *Legal Studies* 252–279; Andrew Keay 'Company directors behaving poorly: Disciplinary options for shareholders' (2007) *Journal of Business Law* 656–682. See also the Cadbury Report, para 6.1.

54 The general shareholder powers include amending the company's MOI to the extent required by s 16(1)*(c)* and s 36(2)*(a)*; ratifying a consolidated revision of a company's MOI, as contemplated in s 18(1)*(b)*; ratifying actions by the company or directors in excess of their authority (as a result of the company's capacity being restricted), as contemplated in s 20(2); approving an issue of shares or grant of rights in the circumstances contemplated in s 41(1); approving an issue of shares or securities, as contemplated in s 41(3); authorising the board to grant financial assistance in the circumstances contemplated in s 44(3)*(a)*(ii) or s 45(3)*(a)*(ii); approving a decision of the

Herman calls this the 'power to constrain', which is essentially negative in nature and enables shareholders to check certain managerial decisions and choices. This power to constrain is said to be 'latent' in that it is exercised occasionally.[55]

A question posed in chapter 1 was whether the distribution of power in SOCs follows the contemporary position, as discussed above, or whether the pendulum is still stuck on the shareholders' side. Section 1 of the PFMA, read with s 63(2), provides that the 'executive authority' who is a member of cabinet (the shareholder-representative) in whose portfolio a SOC falls and who is accountable to Parliament for that SOC shall exercise 'ownership control powers' over the SOC. Ownership control powers are quite extensive, and include the powers to *govern* the financial and operating policies of a SOC. In particular, the shareholder-representative has the powers: (a) to appoint or remove all, or the majority of, the board of directors; (b) to appoint or remove that entity's chief executive officer (CEO); (c) to *cast* all, or the majority of, the votes at *meetings of that board of directors*; or (d) to *control* all, or the majority of, the voting rights at a *general meeting* of that SOC.[56]

The position of the PFMA presented above gives the shareholder-representative the power to *govern* financial and operating policies. It is submitted that governing operational or governance polices is ordinarily within the realm of the board. For instance, s 15(3) of the Companies Act provides that 'the board of a company may *make, amend or repeal* any necessary or incidental rules relating to matters of *governance* of the company

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board for the re-acquisition of shares in the circumstances contemplated in s 48(8); authorising the basis for compensation to directors of a profit company, as required by s 66(9); approving the voluntary winding up of the company, as contemplated in s 80(1); approving the winding up of a company in the circumstances contemplated in s 81(1); approving the application to transfer the registration of the company to a foreign jurisdiction, as contemplated in s 82(5); approving any proposed fundamental transaction, to the extent required by Part A of Chapter 5; and appointing auditors and audit committee members, as contemplated by s 90 and s 94. Some of these powers are not applicable to SOCs due to the modified application of the Companies Act to SOCs in terms of s 9. Shareholder's approval powers under the PFMA are found in s 54.

55 Herman op cit note 47.

56 See 'ownership control' as defined in s 1 of the PFMA.

if such matters are not covered by the MOI.' Delport correctly submits that 'governance' in the context of s 15(3) means the board's power to make rules for the management of both the internal operations of the company and its relationship with the shareholders.[57] It can therefore be submitted that shareholders do not have a stake in governance matters and that their role is limited to setting a broad constitutional framework through the company's constitution.

Another area in which the PFMA confers extensive powers on the shareholder is with regard to the appointment of the CEO, as argued elsewhere in this thesis.[58] At the risk of belabouring the point, the CEO is a servant of the board who exercises delegated power under the authority and direction of the board, it follows that the board should in fact appoint the CEO, but this is not the position under the PFMA.

The PFMA further confers the power to *cast* the majority of votes at board meetings in the shareholder representative. It is unclear how a shareholder-representative who does not sit on the board can *cast* votes at meetings of the board. In any event, this appears superfluous because the shareholder-representative already *appoints* all or the majority of the board. It therefore follows that the shareholder-representative will indirectly control the votes at the meetings of the board. This power of the shareholder-representative under the PFMA should be compared with the position under the Companies Act where the shareholder has the right to appoint or elect, or control the appointment or election of, directors *who control a majority of votes* at a meeting of the board.[59] This is control of the board through the appointment of the majority of directors and not through the casting of votes. The PFMA is therefore inelegantly drafted in this regard.

The distribution of power under the PFMA appears to favour the shareholder-representative more than is necessary. Therefore, the PFMA, unlike the

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57 Piet Delport 'Company rules' (2017) 10 *Journal of Contemporary Roman-Dutch Law* 657–666 at 659.

58 See chapter 3 (para 3.3.1)

59 Section 2(2)*(a)*(ii)*(bb)* (emphasis added).

Companies Act, has somehow kept the pendulum on the shareholders' side, as far as the control and governance of SOCs are concerned.

4.2.4 Convergence of ownership and control

The idea of the separation of ownership from control in modern corporations was famously espoused by Berle and Means.[60] The authors argued that the power, responsibility and the substance that have always been an essential part of ownership have shifted away from the shareholders and are now firmly placed in the hands of the board of directors.[61] The only real manifestation of shareholders' power is in their right to vote. It must be noted that Berle and Means' conception of the ownership of a company residing with the shareholders was erroneous. It is trite that a company is a separate juristic entity and that shareholders do not own it; they own shares in it.[62] Although legally inaccurate, Berle and Means' conception of ownership is convenient because it links corporate power with share ownership. For that reason, this thesis adopts their conception.

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60 Adolf Berle and Gardiner Means *The Modern Corporation and Private Property* (1932) 70. For the philosophical underpinnings of control, see David Bayne 'Philosophy of corporate control' (1963) 112 *University of Pennsylvania Law Review* 22–67.

61 Berle and Means op cit note 60 at 65 and 129. See also Stephen Marks 'The separation of ownership and control' in Bouckaert Boudewign and Gerrit de Geest (eds) *Encyclopedia of Law and Economics* (1999) 692–710. See further Jennifer Hill 'The rising tension between shareholder and director power in the common law world' (2010) 18 *Corporate Governance: An International Review* 344–359 and Jennifer Hill 'Subverting shareholder rights: Lessons from News Corp's migration to Delaware' (2010) 63 *Vanderbilt Law Review* 1–51. For a critical engagement with the notion of separation of ownership and control, see generally Maurice Zeitlin 'Corporate ownership and control: The large corporation and the capitalist class' (1974) 79 *American Journal of Sociology* 1073–1119, who called the separation of ownership and control a 'pseudofact'. See also W Bratton 'Berle and Means reconsidered at the century's turn' (2000–2001) 26 *Journal of Corporation Law* 737; W Bratton and M Wachter 'Shareholder primacy's corporatist origins: Adolf Berle and the modern corporation' (2008–2009) 34 *Journal of Corporation Law* 99; Kelli Alces 'Revisiting Berle and rethinking the corporate structure' (2010) 33 *Seattle University Law Review* 787–808; Gerald Davis 'The twilight of the Berle and Means corporation' (2011) 34 *Seattle University Law Review* 1121–1138; and Dalia Tsuk 'From pluralism to individualism: Berle and Means and 20th-century American legal thought' (2005) 30 *Law and Social Inquiry* 179–225.

62 Section 19(1)*(a)* of the Companies Act. See *Dadoo Ltd v Krugersdorp Municipal Council* 1920 AD 530 at 550–551 and the cases that followed it.

Control is said to be at the core of the corporate system. The Companies Act entrenches corporate control in s 2(2), which provides that a person controls a company or its business if such a person directly or indirectly controls majority voting rights at the shareholders' meeting or where such a person controls the appointment or election of directors who command majority votes at a board meeting.[63] In *De Klerk v Ferreira and Others,* the court examined s 2(2) and concluded that control is not limited to instances where the controlling person has majority voting power (*de jure* control), but extends to circumstances where a person enjoys *de facto* control to materially influence the policy of the company, akin to a person who has *de jure* majority control.[64] The significance of this decision, particularly in the context of SOCs, is that anyone who controls or influences the decisions of SOCs' boards will be deemed to have *de facto* control over such SOCs. For instance, bureaucrats such as the directors general of shareholder-ministries and other prominent politicians like the President are not shareholder-representatives in terms of the PFMA, but they wield a lot of influence and often control SOCs.[65] Therefore, they can be deemed to have *de facto* control.

At this juncture, it is important to observe that control can be divided into three broad categories: outright control, working control, and managerial control.[66] Outright control is typically present when there is a single or dominant shareholder. The dominant shareholder controls the company by virtue of single-handedly appointing or removing directors and deciding the vote on any corporate decision before the shareholders' general meeting. Outside the general meeting of shareholders, the dominant shareholder may exercise influence or control in major board decisions, such as the appointment of the CEO, although technically such decisions are at the sole

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63 See the Companies Act, s 2(2)*(a)*(ii)*(aa)* and *(bb).*

64 2017 (3) SA 502 (GP) para 80.

65 In terms of s 1 of the PFMA, an 'executive authority' (shareholder-representative) is a Cabinet member. See also Affidavit of Barbara Hogan (testimony of 12 to 14 November 2019) at the Commission of Inquiry into State Capture, available at https://sastatecapture.org.za/site/documents (accessed 20 November 2019).

66 For a detailed exposition of the notion of control, see Adolf Berle 'Control in corporate law' (1958) 58 *Columbia Law Review* 1212–1225 at 1213. See also David Bayne 'The definition of corporate control' (1965) 9 *Saint Louis University Law Journal* 445–463.

discretion of the board of directors. Directors owe a fiduciary duty to the company and, in exercising their duties, they should not fetter their discretion. This therefore leaves room for directors to go against the wishes of the dominant shareholder, although they risk being removed. A dominant shareholder also controls the company by influencing fundamental corporate decisions such as expansion, diversification, mergers or dissolution. In this way, ownership and control are said to converge.[67]

Working control occurs where minority shareholders collectively work closely with the board of directors so that the board aligns corporate decisions, such as the election of directors, with the positions and names acceptable to the minority shareholder. Lastly, managerial control occurs where there is no substantial minority shareholders' group that can work collectively to influence the board. This is where the shareholding is widely held by a significant number of shareholders who hold limited shares and who usually vote through a proxy machinery. In such a case, the board as a managing organ of the company wields a lot of control because it can easily influence and direct the proxy machinery, and because holders of small numbers of shares are individually unable to exert control over decisions in the shareholders' general meeting. Usually, in such circumstances, holders of small numbers of shares vote for what is proposed by the board, thus giving the board control over the company. Managerial control is further fortified by the fact that directors are organised and command resources, knowledge, and relationships.[68] According to Berle and Means, because modern corporations are characterised by dispersed shareholding, managerial control is dominant. In this way, ownership is separated from control.[69]

As far as SOCs are concerned, there is no doubt that the state is either a single or dominant shareholder, and thus wields absolute control. Unlike the dominant shareholder in publicly held companies, the state as a shareholder does not influence the board to appoint a favourable CEO. Instead, the

67 Berle and Means op cit note 60 at 70.
68 Herman op cit note 47 at 26–29.
69 Berle and Means op cit note 60 at 84.

shareholder-representative appoints the CEO directly. Instead of the shareholder-representative influencing corporate decisions such as policies that are conventionally within the board's purview, the state as a shareholder directly governs these policies, such as financial and operational policies. It is important to note that this *de jure* control is formally legislated in the PFMA.[70]

There are, however, instances where shareholder-representatives act *ultra vires* the *de jure* powers vested by the PFMA. For instance, the Minister of Finance indicated during his 2019 budget speech that Eskom will receive a bailout of R23 billion over three years and that the financial support was 'conditional on an independent Chief Reorganisation Officer (CRO) being jointly appointed by the Ministers of Finance and Public Enterprises with the explicit mandate of delivering on the recommendations of the Presidential Task Team.'[71]

This decision raises some corporate governance concerns. First, the idea of reorganisation seems to emanate from the Presidential Task Team and not from the board of Eskom. The PFMA, Companies Act and the tenets of good corporate governance dictate that fundamental transactions such as the one contemplated for Eskom must emanate from the board[72] and be approved by the shareholders,[73] and not the other way around. Second, the CRO was appointed by the ministers (shareholder-representatives) as opposed to the board.[74] Ordinarily, independent experts who oversee fundamental transactions are appointed by the board and not by the shareholders.[75] Third,

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70 See the definition of 'ownership control' in s 1 of the PFMA.

71 Tito Mboweni 'Budget Speech (2019)' 9, available at https://www.gov.za/speeches/budget_vote (accessed 1 August 2019).

72 See generally Chapter 5 of the Companies Act. For instance, s 112(3)*(b)*(i) provides that the board must submit a proposal for the disposal of all or the greater part of the assets of a company, accompanied by a written summary of 'the precise terms of the transaction' to be considered by the shareholders.

73 See s 54(2) of the PFMA and s 115(2) of the Companies Act.

74 See Carol Paton 'Pravin Gordhan appoints chief to restructure Eskom' (2019) available at https://www.businesslive.co.za/bd/national/2019-07-30-pravin-gordhan-appoints-chief-to-restructure-eskom/ (accessed 1 June 2020).

75 See, for instance, s 114(2) of the Companies Act.

it is uncertain what role (if any) the CEO and the board of Eskom will play in regard to the reorganisation of the entity. So, the board is governing an entity that is reconfigured by the CRO who it did not appoint and who is presumably not answerable to the board, because the board neither appointed him nor took the decision to reconfigure the entity in the first place.

The actions of the Eskom shareholder-representative are clearly an appropriation of managerial control by the shareholder, which points to convergence of ownership and control. The disadvantage of this convergence is that it leaves the board significantly weak and unable to fully and independently direct the business and affairs of the SOC. Indeed, the *de jure* control of SOCs by shareholder-representatives is pervasive and damaging from a corporate governance perspective. This is exacerbated by shareholder-representatives who occasionally act *ultra vires* their already extensive *de jure* control powers. The damage is further compounded by the fact that bureaucrats in shareholder-ministries may have *de facto* control or influence over SOCs. This therefore reinforces the view that there is in fact profound convergence of ownership and control in SOCs.

4.2.5 Overall impact on corporate governance

The ownership model presented here is irrational: shareholder-representatives enjoy extensive ownership powers that go beyond traditional ownership powers, and the boards set strategic visions for SOCs but are illogically not given the power to appoint executives to implement the strategy. Indeed, it is a model that creates two centres of corporate power, violating the conventional division of corporate power between the board and the shareholder. The arrangement also leaves the board weak against the all-powerful shareholder-representative and the executives appointed by such a shareholder. In the end, a board that does not have the power to decide on strategic matters such as reorganisation and executive appointments is a board with truncated power. Naturally, such a board lacks the necessary authority to direct the business and affairs of the corporation as envisaged by

the Companies Act.[76] Therefore, the board may not really be the focal point and custodian of governance, which partly explains the poor state of corporate governance in SOCs.

4.3 THE ROLE OF SHAREHOLDER-REPRESENTATIVES IN THE GOVERNANCE OF SOCs

Generally, shareholders play a significant, yet limited, role in the governance of companies.[77] Their overarching role is to ensure that companies uphold sound and effective corporate governance standards.[78] The shareholder functions usually involve the power or legal responsibility to set and monitor broad corporate objectives, appoint the board of directors (and if necessary, remove directors), approve certain fundamental transactions, and provide capital. As seen above, some shareholder-representatives have powers beyond what is considered conventional. Myriad government institutions also concurrently play oversight roles over SOCs, which leads to the following question: what is the effect of the additional roles played by shareholder-representatives and the plurality of oversight mechanisms on the overall governance of SOCs?

4.3.1 Multiplicity of roles

The first role of the shareholder-representatives is to set broad policy objectives for the SOC in line with national strategic objectives.[79] These policy

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76 See s 66(1) of the Companies Act read with Principle 6 of the King IV sector supplement on SOCs; and para 5.1.1 of the Protocol on Corporate Governance in the Public Sector (2002).

77 There is a new call for what is called 'shareholder-driven corporate governance' where shareholders are expected to be more involved in the governance of corporations. See Anita Indira Anand *Shareholder-driven Corporate Governance* (2020) 1–12.

78 Irene-Marie Esser and Michele Havenga 'Shareholder participation in corporate governance' (2008) *Speculum Juris* 74–94 at 74. The authors focus mainly on institutional shareholders, but the general thrust of their argument, that shareholders ought to be active but only in limited circumstances, is applicable to shareholder-representatives in SOCs.

79 The national developmental aspirations are espoused in the National Development Plan (NDP), which envisions SOCs as vehicles for the attainment of a transformative and developmental state. See 'National Development Plan 2030: Our Future - Make it Work'

objectives are usually contained in the industrial policy. Apart from their broad policy-making role, shareholder-representatives also facilitate the acquisition of capital for SOCs to achieve the set policy objectives. In practice, the shareholder-representatives also facilitate the acquisition of additional capital (bailouts) in the event that the SOCs face funding challenges that may result from recession, additional policy goals, or weak performance occasioned by, among other things, poor decision-making and poor corporate governance.

Next, the shareholder-representative is responsible for appointing a competent board. Regrettably, the boards of SOCs are not always competent. For example, the Public Protector found that the former Eskom board 'was improperly appointed and not in line with the spirit of the King III report on good Corporate Governance.'[80] The appointment did not accord with the spirit of the King report because the competencies of the appointed directors were questionable and some directors had serious conflicts of interest.

Shareholder-representatives are further charged with the responsibility to monitor the performance of SOCs by interacting with their boards (and executives) through shareholder compacts, corporate plans, and other mechanisms. Apart from the shareholder-representatives' responsibilities, the government itself has the responsibility to pass SOC-specific legislation and other general legal and regulatory instruments and to provide oversight. Effectively, shareholder-representatives fulfil the traditional shareholder functions but also have policy formulation and monitoring responsibilities, as well as legal and regulatory oversight functions.

Inevitably, the multiplicity of shareholder roles presented above may lead to 'conflicts between the state's ownership functions and its policymaking and regulatory functions … and leave the company vulnerable to being used to

438–442, available at https://www.gov.za/issues/national-development-plan-2030 (accessed 11 February 2020).

80 Public Protector 'State of Capture Report' No 6 of 2016/17 at 19, available at http://www.pprotect.org/ (accessed 10 August 2019).

achieve short-term political goals to the detriment of its efficiency."[81] This vulnerability of SOCs to being used to achieve short-term political goals is accompanied by shareholder interference in the operational affairs of SOCs.

4.3.2 Plurality of oversight mechanisms

Apart from the shareholder-representatives discharging shareholder functions, myriad government institutions have different oversight roles in regard to SOCs. For instance, Parliament's Standing Committee on Public Accounts (SCOPA) interrogates SOCs' annual financial statements to assess their financial performance, while various parliamentary portfolio committees evaluate the service delivery performance of SOCs. Chapter 9 institutions, such as the Office of the Public Protector, also provide oversight over SOCs although the Public Protector's oversight function must be triggered by a complaint of maladministration.[82] Additionally, SOCs are subject to the jurisdiction of the Auditor-General, who audits and reports on their financial management. The National Treasury, as an overall fiscal management ministry, also plays an oversight role in regard to SOCs.

The collective oversight exercised by these institutions is, however, fraught with difficulties. Their roles and responsibilities are not clearly delineated, leading to fragmented, overlapping, and ineffective oversight.[83] Some of the oversight institutions, like Parliament, lack the professional capacity to provide meaningful oversight over complex entities that have convoluted mandates and operate in complex environments.[84] Poor oversight and roles

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81 World Bank Group *Corporate Governance of State-Owned Enterprises: A Toolkit* (2014) 13.

82 See, for instance, the Public Protector's reports on PRASA, the SABC and Transnet, available at http://www.pprotect.org/ (accessed 10 June 2019).

83 National Treasuary 'Governance oversight role over state-owned entities (SOE's)' 5-6, available at http://www.treasury.gov.za (accessed 10 January 2020)

84 Academics and civil society organisations have occasionally tried to augment the capacity of various parliamentary inquiries by providing 'independent, accessible, concise, and fact-based accounts of … instances of governance failure and corruption' plaguing SOCs. See, for example, Anton Eberhard and Catrina Godinho 'Eskom Inquiry Reference Book' available at https://pmg.org.za/page/Eskom-Inquiry-Reference-Book (accessed 1 July 2019).

that are not delineated may lead to confusion, particularly on reporting by and accountability of SOCs. Where the lines of reporting and accountability are unclear, governance is likely to be ineffective.

The other challenge presented by multiple stakeholders is what was described as 'infinite agency costs' as well as 'principal costs' in chapter 2. This is a form of rent-seeking where different stakeholders expect SOCs to meet certain objectives that may sometimes be divergent in order to advance their interests.[85]

4.3.3 The intervention/interference debate

It is important to emphasise that, for the purposes of this thesis, shareholder intervention refers to that which is within the prescripts of company law and accepted corporate governance standards. For example, a shareholder-minister's intervention to rescue a SOC in the face of a debilitating financial crisis by injecting additional capital (bailout) would be legitimate. However, where the same shareholder-minister gets involved in what is traditionally board territory, like executive appointments and dismissals, then that would constitute interference, as such involvement is neither within the established division of corporate power between the board and the shareholder nor is it in line with accepted corporate governance standards.

In practice, there is unhealthy shareholder interference in the corporate affairs of South African SOCs. Shareholder-representatives seem to subscribe to the notion of 'shareholder democracy', also sometimes referred to as 'offensive governance', which provides for 'shareholders' [right] to initiate and vote to adopt changes in the company's basic corporate governance arrangement.'[86] A clear example of this occurred when the former SABC

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85 Anthony Bonen 'Shareholders as rent-seekers: Institutional realities of corporate governance and the implications for economic theory' New School for Social Research Working Paper (2016) available at 10.13140/RG.2.1.4255.7527 (accessed 10 March 2020).

86 Lucian Bebchuk 'The case for increasing shareholder power' (2005) 118 *Harvard Law Review* 833 at 836; Lucian Bebchuk 'The myth that insulating boards serves long-term

shareholder-minister irregularly amended the MOI of the corporation in an effort to arrogate to herself the power to directly appoint, suspend, or dismiss executives.[87] In a damning parliamentary report that enquired into the fitness of the SABC board, it was found that shareholder-representative 'irregularly amended' the MOI with the aim of 'concentrating power' in the Ministry and 'unduly pressurised' certain board members to resign. It was also found that the shareholder-representative 'possibly pressurised' the board to appoint certain unqualified executive managers.[88]

Subsequent to the parliamentary report, the court in *SOS Support Public Broadcasting Coalition v SABC* found that the amended SABC MOI and Board Charter unprecedentedly gave the shareholder-representative extensive powers over the GCE, the CFO and the COO, 'including over their appointments, terms, and conditions of appointment, discipline and suspension.'[89]

Another parliamentary inquiry, this time focusing on Eskom, established that the shareholder-representative adopted an 'interventionist approach', particularly regarding operational matters such as procurement. The inquiry also found that the 'government represented by the two former ministers – Gigaba and Brown – was grossly negligent in carrying out its responsibility as the sole shareholder of Eskom.'[90] These two examples of Eskom and SABC illustrate that the board–shareholder interaction is unstructured. The shareholder-representatives regularly engage SOCs outside the mechanisms of shareholder compacts and corporate plans, resulting in interference in day-

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value' (2013) 113 *Columbia Law Review* 1637; Lucian Bebchuk 'Letting shareholders set the rules' (2006) 119 *Harvard Law Review* 1784.

87 See Thulani Gqirana 'SABC "take-over" unconstitutional – DA' available at http://www.news24.com/SouthAfrica/News/sabc-take-over-unconstitutional-da-20151206 (accessed 4 January 2016).

88 See 'The Final Report of the Ad Hoc Committee on the SABC Board Inquiry into the fitness of the SABC Board (24 February 2017)' available at https://pmg.org.za/committee-meeting/24036/ (accessed 1 May 2019).

89 (81056/14) [2017] ZAGPJHC 289 (17 October 2017) para 87.

90 See 'Report on Financial Sustainability of Eskom' op cit note 22 para 3.10 at page 132.

to-day operations, such as procurement. Such interference has led to critical and systemic governance failure and mismanagement.[91]

In addition to the cases cited and the parliamentary inquiries, directors of SOCs have expressed their frustrations about the directing of SOCs affairs. Foremost among the issues they raise is shareholder interference. Recently, a director of Eskom resigned, stating that 'the board was repeatedly stymied by political considerations from taking steps that would help drag Eskom out of the red'.[92] This further proves that political interference is a reality.

Ideally, the shareholder-representatives' overall involvement in the affairs of SOCs should be to pursue the public interest through the acquisition of additional capital, the appointment of boards, and the conclusion of shareholder compacts. The compact should align the particular SOC's objectives with broad national strategic objectives. This 'public interest intervention' would be welcome from a corporate governance perspective because it respects the traditional division of corporate power between the board and the shareholder. Beyond this form of intervention, the shareholder-representatives' excessive power over executives, unstructured engagement with and involvement in operational matters constitute 'unwelcome interference', which has been condemned by various parliamentary committees and the courts.

Perhaps one way of deterring the unwelcome interference by shareholder-representatives is to have them declared shadow directors and to hold them liable for their conduct.[93] In other words, the shareholder-representatives or

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91 On the negative effects of unstructured board-shareholder engagement, see Matteo Tonello 'Global trends in board-shareholder engagement' Harvard Law School Forum on Corporate Governance and Financial Regulation, available at https://corpgov.law.harvard.edu/2013/10/25/global-trends-in-board-shareholder-engagement/ (accessed 10 August 2019).

92 Gaye Davis 'Board: Political interference halting us from saving Eskom' available at https://ewn.co.za/2019/10/30/eskom-board-political-interference-halting-us-from-saving-it (accessed 20 December 2019).

93 On shadow directorship generally, see Kathy Idensohn 'The regulation of shadow directors' (2010) 22 *South African Mercantile Law Journal* 326–345.

bureaucrats who 'without assuming the title of directors, [metaphorically] move into the directors' room or the managerial offices and specifically direct corporate action' must be held to the same standards of conduct and liability that ordinarily apply to directors.[94] In New Zealand, ministers who exercise 'de facto control of the company even in respect of a single issue' may be liable as shadow directors.[95] Even in the absence of a specific law like the one that exists in New Zealand, South African company law seems to 'provide satisfactory regulation and accountability' for those who exercise real control over the corporate affairs of companies.[96] Therefore, shareholder-representatives and other players can be held accountable for interfering with the governance of SOCs.

4.3.4 Overall impact on corporate governance

To some extent, the role of the shareholder and the impact of this role on corporate governance is informed by the model of ownership. If the model intrinsically allows or encourages interference, corporate governance is likely to be adversely impacted. But, where the ownership arrangement puts the shareholder at arm's length concerning corporate decisions, corporate governance is unlikely to be negatively affected by the shareholder. In the preceding discussion, it has been clear that the ownership model allows for the conflation of roles like policy making, monitoring, and legal and regulatory oversight with the traditional roles such as strategic approvals, board appointments, and capital acquisition. The concurrent fulfilment of these roles tends to bring the shareholder-representative 'too close' to the locus of governance, resulting in interference in governance and operations. Such interference introduces 'principal costs' such as conflict of interest and

94 Berle op cit note 66 at1222.

95 Timothy Irwin and Chiaki Yamamoto 'Some options for improving the governance of state-owned electricity utilities' World Bank Energy and Mining Sector Board Discussion Paper No 11 of 2004 at 26, available at https://pdfs.semanticscholar.org/89fe/793f91e2351e76d125bfc946046301b7c59e.pdf (accessed 30 August 2019).

96 Idensohn op cit note 93 at 344.

political interests.[97] Ultimately, the interference weakens the boards and has an adverse effect on their ability to govern effectively.

4.4 TOWARDS SEPARATION OF OWNERSHIP AND CONTROL

The professional running of corporations has been deemed a superior organisational form because it introduces informational, transactional, and productive efficiencies that are often lacking when the corporation is run by a shareholder with capital but no skills.[98] Thus, separation of ownership and control emphasises the centrality and authority of the board of directors in governing the corporation professionally. For this to happen, 'there ought to be a rebuttable presumption in favor of preservation of managerial discretion. The separation of ownership and control mandated … by corporate law has precisely that effect [of preserving managerial discretion].'[99]

The history, political and business culture of government tenders and doing business with the state makes the separation of ownership and control absolutely essential in South Africa.[100] Also, the business environment is characterised by rampant corruption, and a system of cadre deployment wherein the deployed individuals sometimes lack the necessary independence to resist pressure from those who are politically connected. Indeed, the current revelations on state capture and the decline of corporate governance illustrate the real danger of allowing shareholders (political) proximity to SOCs' boards and governance.

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97 Zohar Goshen and Richard Squire 'Principal costs: A new theory for corporate law and governance' (2017) 117 *Columbia Law Review* 767–830.

98 Stephen Marks 'The separation of ownership and control' (1998) *Encyclopaedia of Law and Economics* 692–724 at 695. See also Brian Hindley 'Separation of ownership and control in the modern corporation' (1970) 13 *The Journal of Law and Economics* 185–221.

99 Stephen Bainbridge *The New Corporate Governance in Theory and Practice* (2008) 113.

100 For best practice on fighting corruption and promoting integrity in SOCs, see OECD *OECD Guidelines on Anti-corruption and Integrity in State-Owned Enterprises* (2019) available at www.oecd.org/corporate/Anti-Corruption-Integrity-Guidelines-for-SOEs.htm (accessed 10 March 2020).

Central to the separation of ownership and control is the clear delineation of the roles of various stakeholders. Government departments should remain policy makers and monitors and leave regulatory oversight in the hands of statutory regulators. Further, government should professionalise the ownership function by delegating it to professionals who will fulfil it on behalf of the state. This is the case in New Zealand, where the government established a semi-autonomous unit called the Crown Company Monitoring Unit. The ownership function in Australia is fulfilled by the Office of Government-owned Corporations, and in the United Kingdom by the Shareholder Executive.[101]

Other jurisdictions like Singapore have elected to professionalise the ownership function by establishing a state holding company.[102] From a corporate governance perspective, the benefits of separating government roles and professionalising the ownership function can be summarised as follows: first, the separation will mean that political principals are at arm's length in regard to the operations of SOCs. They will be substituted by professional shareholder-representatives who understand the complexity of SOCs' operations and have the capacity to discharge shareholder functions professionally, without introducing short-term political agendas or principal costs. Second, the boards' authority and autonomy to govern will not be easily interfered with as the role of the professional shareholder-representatives will be clearly defined and in line with the tenets of corporate law. Following from this, the boards will be the focal point of corporate governance, which will in turn have a positive impact on how they govern.

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101 David Scott 'Strengthening the governance and performance of state-owned financial institutions' World Bank Policy Research Working Paper 4321, available at http://documents.worldbank.org/curated/en/345691468165898545/pdf/wps4321.pdf (accessed 30 August 2019).

102 See chapter 6 on Singapore. Achieving this professionalisation in South Africa is explored fully in chapter 7.

4.5 CONCLUSION

This chapter sought to understand the nature and rationale of state ownership in South Africa and the role and impact of shareholder-representatives on the governance of SOCs. The chapter has argued that the motivations of state ownership are somewhat contradictory, and the ownership model in South Africa appears irrational. This leads to a shareholder's (political) proximity to the locus of SOC governance and to the usurpation of the governance function. Although proximity in and of itself is not antithetical to corporate governance, it should ideally be 'public interest intervention' as opposed to sheer 'interference'. An examination of selected SOCs illustrated that in instances of interference, board autonomy and authority are highly compromised, while the converse is not necessarily the case in instances of intervention. Ultimately, the orthodox separation of ownership and control as one of the means of securing board autonomy and authority, which would in turn lead to improved corporate governance, appears to be the best way forward. This assertion is made in light of the idiosyncrasies of the South African environment.

CHAPTER 5

CONTROL OF STATE-OWNED COMPANIES AND THE ELUSIVE QUEST FOR BOARD PRIMACY

5. INTRODUCTION

The previous chapter explored the nature of state ownership and the multiplicity of state roles – as a dominant shareholder, regulator, policymaker, and enforcer – and the impact of these roles on the effective governance of SOCs. This chapter presents the other side of the coin: it examines various control measures, the statutory legal powers of SOCs' directors, and their overall impact on board primacy and ultimately on effective corporate governance.

This chapter pays special attention to the board since it is 'the centre of the enterprise – the "business brain" or central processor – monitoring and coping with the results of the external and internal processes of the whole enterprise'.[1] Managing internal and external processes of the enterprise is the hallmark of the governance function that is conventionally exclusive to the board. For the board to fulfil this governance function, it must be well constituted, possess the requisite capacity (skills, knowledge, and experience) and, crucially, be armed with the necessary autonomy and authority, among other requirements. Therefore, this chapter examines in detail the extent to which the boards of SOCs truly govern the business and affairs of SOCs.

5.1 EXPLICIT AND IMPLICIT ROLES OF SOCs' BOARDS

The explicit and legally prescribed role of the board is to direct the company to the extent permitted by its MOI.[2] Flowing from this role are implicit roles that can conveniently be divided into three broad areas: the strategic and

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1 Bob Garratt *The Fish Rots from the Head* (1997) 9, quoted in Jean Jacques du Plessis, James McConvill and Mirko Bagaric *Principles of Contemporary Corporate Governance* (2005) 56.

2 Section 66(1) of the Companies Act.

advisory role, the executive management monitoring role, and the shareholder and stakeholder relational role, which must all be discharged ethically and effectively.[3] The effectiveness of the board in performing the primary explicit role depends largely on how it fares in performing the implicit roles.

5.1.1 Strategic and advisory role

As previously noted, the primary role of the board is to determine the strategic direction[4] of the SOC in line with the shareholder's policy objectives and national developmental aspirations.[5] To achieve this, the board must appreciate the interrelatedness of the company's core mandate, risks and opportunities, and the overall strategy in the process of value creation.[6]

To attain the strategy, the board must identify and appoint appropriately qualified and experienced executives and delegate the implementation of the strategy to them. Additionally, the board must manage the succession of such executives. As noted previously, the responsibility to appoint the CEOs of SOCs rests with the shareholder.[7] The possible repercussions of this are that a CEO appointed by the shareholder may not be appropriately qualified to execute the company strategy because the shareholder may not fully appreciate the operational complexities and the required skills to deal with them. Furthermore, such a CEO may be emboldened by the shareholder's

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3 These roles were summed up by Rogers CJ in the Australian case of *AWA Ltd v Daniels (t/as Deloitte Haskins & Sells)* (1992) 7 ACSR 759 at 865–856. See also Lynne Dallas 'The multiple roles of corporate boards of directors' (2003) 40 *San Diego Law Review* 781–820. According to Principles 1 and 2 of King IV, boards are required to provide ethical leadership and embed an ethical culture in directing a company.

4 Strategy setting involves 'an iterative process in which the CEO is in charge, because it is the CEO's job to formulate strategy, but the CEO wisely gets the maximum amount of advice from the board' during the development phase of the strategy. Thereafter, the board can ratify and own the strategy. See Roger Martin 'The board's role in strategy' (2018) *Harvard Business Review* available at https://hbr.org/2018/12/the-boards-role-in-strategy (accessed 12 February 2020).

5 See chapter 4 (para 4.3.1).

6 Principle 4 of King IV.

7 See the definition of 'ownership control' in s 1 of the PFMA, where the board is legally empowered to appoint the CEO. See also chapter 3 (para 3.3.1).

support in ways that can strain the relationship between the CEO and the board.[8]

Tied to the role of strategy setting is the board's responsibility to provide strategic counsel to executive management. Since boards are ideally composed of directors with diverse professional expertise and experience, they are poised to provide invaluable wide-ranging counsel to management in strategic decision making. Studies have established that when boards play a meaningful advisory role, companies innovate better and achieve higher value. However, for the board to discharge this advisory role meaningfully, management must be amenable to receiving the board's counsel.[9] In instances where the executive managers are appointed by the shareholder, they may not be amenable to receiving the board's counsel. As observed by the OECD:

> [I]n a minority of countries, SOE boards are not adequately empowered by their governments to assume such a strategic [advisory] role, circumvented for instance by direct ministerial appointments of corporate executive management and/or informal channels of communication and instructions. This may detract from the value-adding of boards.[10]

South Africa seems to fall within the minority of countries where direct ministerial appointments of corporate executives is the norm.[11]

5.1.2 Management monitoring role

In addition to setting the strategy, boards are responsible for monitoring the performance of management in executing the strategy. Not only does the

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8 *Molefe and Others v Minister of Transport and Others* (17748/17) [2017] ZAGPPHC 120 (10 April 2017).

9 Olubunmi Faleye, Rani Hoitashb and Udi Hoitash 'Advisory directors' available at https://ssrn.com/abstract=1866166 (accessed 11 February 2020).

10 OECD *Boards of Directors of State-Owned Enterprises: An Overview of National Practices* (2013) 21, available at https://doi.org/10.1787/20776535 (accessed 18 February 2020).

11 This runs counter to best practice. See OECD *OECD Guidelines on Corporate Governance of State-Owned Enterprises* (2015) 70, available at http://dx.doi.org/10.1787/9789264244160-en (accessed 18 February 2020).

board monitor the execution of strategy, but it also monitors management to ensure that it acts professionally and without any self-dealing at the expense of the company (agency costs).[12]

Agency costs in South African SOCs are infinite because shareholders, boards, management, political parties and trade unions often pursue their narrow interests at the expense of the SOCs.[13] Various boards have failed to monitor all these players against self-dealing, including themselves. By way of example, the decay at Eskom, SAA and PRASA is attributable to self-aggrandisement by some members of executive management, the involvement of boards in tenders, and political pressure by the shareholder, the ruling party and trade unions.[14] In simple terms, boards' failure to 'act with fidelity, honesty, integrity' in order to monitor and curb agency costs from multiple players is a sign of poor corporate governance.[15]

5.1.3 Shareholder and stakeholder relational role

Another role of the board is to manage the relationship between the company and its shareholders. To meet this responsibility, the board must keep the shareholders informed so that they can make informed assessments of the company's short-, medium- and long-term performance.[16] This is reinforced by the requirement in the Companies Act that boards must provide comprehensive reports at the annual general meeting (AGM).[17]

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12 Dallas op cit note 3. It must be noted that, in the South African context, directors owe duties to the company and not to the shareholders.

13 See chapter 2 (para 2.2.1).

14 See, for example, the report of the Public Protector entitled *Derailed: A report on an investigation into allegations of maladministration relating to financial mismanagement, tender irregularities and appointment irregularities against the Passenger Rail Agency of South Africa (PRASA)* available at https://www.gov.za/documents/derailes-report-investigation-allegations-maladministration-relating-financial (accessed 19 February 2020).

15 Section 50(1)*(b)* of the PFMA specifically calls on SOCs' boards to observe these values when managing the affairs of SOCs.

16 Principle 5 of King IV.

17 Section 61(7) and (8) of the Companies Act.

Implicit in the board's relational role is the responsibility to act as an intermediary between the shareholder and executive management. In this role, the board acts as a conduit between the policy maker (the shareholder) and the ultimate policy implementor (executive management), which implements policy under the direction and on behalf of the board.

In the context of SOCs, the intermediary role is governed by a 'shareholder's compact' recording the key performance areas of the SOC, which are broadly stated in a statement of 'strategic intent' that communicates the SOC's strategic objectives.[18] As opined in chapter 3, despite the conclusion of a shareholder's compact annually, many shareholder-representatives engage with SOCs' boards and management in an unstructured fashion, thus negating the value of the compact as a structured strategic relationship-governing instrument. In turn, this compromises the board's ability to effectively manage its relationship with the shareholder and creates room for shareholder interference.

It is noteworthy that the board's responsibility to manage relations extends to other stakeholders, such as employees (and their unions) and customers. In practice, the management of these relations is difficult for the board because of the shareholder's direct engagement with these stakeholders. It is not uncommon for shareholder-representatives (ministers) to negotiate and engage directly with trade unions regarding labour and other issues at SOCs. This practice of undermining the intermediary role of boards disempowers them, resulting in 'lame duck' boards that cannot govern effectively.

According to the OECD, both the explicit and implicit roles of the board should be clearly defined and founded in legislation.[19] In addition to defining the roles in legislation, it is deemed ideal to broadly define these roles in the ownership policy, which should also prescribe structured communication between the

18 See Treasury Regulation 29.2.

19 OECD (2013) op cit note 10 at 22.

board, the shareholder, and stakeholders.[20] In the case of South Africa, there is no clear ownership policy.

Lastly, it is considered good practice to inform SOCs' boards of their strategic objectives in clear terms and through proper instruments to ensure their maximum autonomy.[21] The practice of concluding annual shareholder's compacts by shareholder representatives and SOCs in South Africa appears to embrace this recommendation. However, the delayed conclusion of the compacts and the lack of strict compliance with their terms undermine their overall efficacy.

In sum, the lack of clearly defined and readily discernible roles and responsibilities of SOCs' boards in both ownership policy and legislation leaves room for unstructured engagement and the imposition of demands not previously contained in shareholder's compacts, which may be incongruent with the strategic objectives of the SOCs.

5.2 POSSIBILITY AND DESIRABILITY OF BOARD PRIMACY AND INSULATION IN SOCs

The theoretical underpinnings of the notion of board primacy and insulation were explored extensively in chapter 2. It was noted that there is a view that board primacy and insulation are less likely where there is a dominant shareholder.[22] The question that then arose was whether board primacy would be possible and effective in SOCs. A further question was whether it is even desirable for SOCs' boards to enjoy sovereignty in SOCs' affairs given that SOCs are tasked with achieving national developmental goals.

The latter question is perhaps informed by s 195(1) and (2) of the Constitution, which requires public institutions and entities such as SOCs to be governed by democratic principles and values such as accountability and

20 Ibid.
21 Ibid 26.
22 See chapter 2 (para 2.2.5).

transparency.[23] It may also be that SOCs are funded by taxes towards the achievement of national strategic objectives; therefore, they cannot be left solely to unelected directors who have no public mandate. As observed in chapter 2, these issues have not received proper attention in legal and governance discourse.

Section 66(1) of the Companies Act that vests the power to direct the business and affairs of the company is alterable since it has a caveat that the MOI can alter the position. According to *Henochsberg*, it is legally possible to limit or even remove the management powers and duties of the board, but without affecting their position as directors on the board.[24] It is submitted that in SOCs, 'judicious intervention' for purposes of protecting the public interest in specified circumstances can be introduced in the MOI, the PFMA and the shareholder's compact without necessarily usurping the directors' power to direct the day-to-day operational affairs of the SOC. It is proposed that public interest should be the only consideration that may limit board primacy in directing the affairs of SOCs. This may be called 'quasi-board primacy'.

The specific circumstances where the board's power to direct may be limited include crisis situations that are likely to jeopardise the public interest, such as a global financial crisis, electricity load-shedding, water unavailability, and the possible liquidation of a SOC. It must however be noted that crisis situations are not cast in stone. In determining which crisis warrants the shareholder's 'judicious intervention' or what was called 'high-level supervision' in *Minister of Defence and Military Veterans v Motau and Others*,[25] regard must be had to the principles of subsidiarity and transparency.

Regarding subsidiarity, what constitutes a crisis situation in a particular SOC may not necessarily be a crisis viewed from the context of another SOC; therefore, a determination must be made on whether the crisis threatens

23 Constitution of South Africa, 1996.
24 P Delport (ed) *Henochsberg on the Companies Act 71 of 2008* 1 (2015) at 250(2).
25 2014 (5) SA 69 (CC) para 46.

public interest and the extent to which it does.[26] This is what Rycroft calls a 'common sense view of the circumstances' for the determination of public interest.[27] Making these decisions requires demonstrable transparency by both the board and the shareholder-representative.

Support for public interest considerations in the governance of SOCs was also confirmed in *SOS Support Public Broadcasting Coalition v SABC*, where the court emphasised that the public interest should be considered by Parliament when the latter is performing an oversight function on behalf of the public.[28] It is argued, however, that public interest considerations must permeate the management, governance and oversight over SOCs. Waiting for Parliament to make a decision on public interest implications of SOCs' operations may be impractical given that business decisions are usually time-sensitive.

It is contended that this sort of public interest 'intervention' is different from 'interference'. In the case of intervention, the shareholder will meaningfully engage the board as the 'directing mind' on possible solutions to the crises – in a deferential manner – and then balance proposed board solutions with the overall public interest. For example, if the board recommends voluntary liquidation or a business rescue practitioner recommends liquidation, the shareholder might secure a bailout to avert such liquidation and thus preserve jobs, which would, it is submitted, be in the public interest.[29]

To further illustrate the difference between public interest intervention and political interference, let us consider the following two scenarios. In the first

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26 For principles governing the process of defining public interest, see Jean-François Méthot 'How to define public interest?' A paper presented at the Ethics Practitioners Association of Canada Roundtable, Saint Paul University (2003) available at https://ustpaul.ca/upload-files/EthicsCenter/activities-How_to_Define_Public_Interest.pdf (accessed 28 April 2020).

27 Alan Rycroft 'In the public interest' (1989) 106 *South African Law Journal* 172–183 at 179.

28 *SOS v SABC* para 126.

29 See, for example, s 66(3)*(d)* of the PFMA, which allows a shareholder-representative to seek a loan or guarantee for the SOC.

scenario, a former director of Eskom decried political interference in the affairs of Eskom in the following statement:

> So, if you're going to be given an instruction to say keep lights on at all costs because we are nearing elections, it's actually problematic. I wish we could actually be given the latitude as this board to do what we're supposed to do.[30]

This is a classic example of objectionable interference for narrow party-political interests (principal costs). Such interference is neither in the best interests of the SOC, as a separate entity, nor in the public interest.

In the second scenario, the shareholder-representative instructed Eskom not to retrench 16 000 employees as retrenchment would have a devastating impact on the economy. The shareholder is reported to have said:

> We all have to make difficult decisions and one of the difficult decisions is whether we fire 16 000 people or not and a government that is responsible ... will not fire 16 000 people.[31]

The shareholder's position was followed by securing the biggest bail-out Eskom has ever received (R59 billion).[32] Recently, the shareholder has been exploring further means of recapitalising Eskom to return it to sustainability.[33] It is submitted that, unlike in the first scenario, the second scenario falls squarely within the public interest as the shareholder is seeking to avert hasty retrenchments that would exacerbate the current unprecedented unemployment rate and ruin the economy.[34]

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30 Gaye Davis 'Political interference halting us from saving Eskom' available at https://ewn.co.za/2019/10/30/eskom-board-political-interference-halting-us-from-saving-it (accessed 20 February 2020).

31 ILO 'Board member warned to "be careful" after claim of "political interference" at Eskom' available at https://www.iol.co.za/news/politics/board-member-warned-to-be-careful-after-claim-of-political-interference-at-eskom-36297926 (accessed 20 February 2020).

32 Special Appropriation Act 25 of 2019.

33 Bonga Dlulane 'PIC open to finding solutions for the "Eskom problem"' available at https://ewn.co.za/2020/02/13/pensions-pic-open-to-finding-solutions-for-the-eskom-problem (accessed 1 March 2020).

34 It may be argued that endless bailouts are also not in the public interest; however, it may also be argued that mass retrenchments are not in the public interest. Perhaps this requires a balance to be struck on an ongoing basis. See Richard Jolly

To sum up, interference in operations should be prohibited. Yet, in instances of crisis and other situations that are likely to imperil the public interest, a happy medium between board primacy and public interest intervention (quasi-primacy) must be found, bearing in mind that deference to the board should be the starting point. In other words, the shareholder's intervention to secure the public interest should happen only where the board's prescribed solution does not adequately protect the public interest.

To be sure, the intervention procedures and manner of intervention must be clearly spelt out in the MOI, the shareholder's compact or some other legislation, as permitted by s 66(1) of the Companies Act. In this way, SOCs' boards will be insulated from unwarranted shareholder (political) interference. As argued next, for public interest intervention to happen smoothly, it will be useful to redefine SOCs formally and explicitly as companies *sui generis*, that is, public interest companies.

5.3 REDEFINING SOCs AS 'PUBLIC INTEREST COMPANIES'

The notion of public interest in SOCs was contextualised earlier, where it was argued that the true nature of SOCs and the purpose for which they exist is to discharge a dual public mandate of delivering public goods and contributing to the national fiscus. Therefore, SOCs are 'public interest companies' that must be 'governed in the public interest'.[35] The idea of public interest governance was expanded upon and it was argued that this idea must be enabled and underpinned by a regulatory design that puts public interest at the centre of regulation, that is, 'regulation in the public interest'.[36]

To take the above argument to its logical conclusion, SOCs, being creatures of statute, must be explicitly defined as public interest companies, and this in turn will have a bearing on directors' duties. Therefore, this part of the chapter is concerned with situating public interest within the applicable

'Government-owned corporations: Public ownership, accountability and the courts' (2000) 24 *Australian Institute of Administrative Law Forum* 17–33 at 22.

35 See chapter 2 (para 2.4.3).

36 See chapter 3 (para 3.1.4).

legislation (the Companies Act and the PFMA) by redefining directors' duties and considering their enforcement. Naturally, directors have recognised defences against a breach of duties, such as the business judgement rule. Therefore, the applicability of these defences will also be explored in the context of refined directors' duties.

The idea of redefining SOCs is not self-serving. According to Wymeersch, a distinction ought to be drawn between a company founded to serve the public interest and one serving pure economic interests in a competitive and private business setting.[37] The distinction allows a company serving the public interest to be regulated, governed and judged appropriately. At present, the Companies Act defines SOCs as enterprises registered in terms of the Act and that are either listed as such in the PFMA or are owned by a municipality as contemplated in the Municipal Systems Act.[38] For its part, the PFMA defines a SOC as a 'national public entity', which is a national government business entity in the form of either a company, a fund or a corporation.[39]

Interestingly, the Handbook for the appointment of persons to boards of state and state-controlled institutions categorises certain institutions as 'public interest institutions'.[40] These institutions are said to perform functions serving the public and government has an interest in promoting these institutions. They are primarily sector-regulating institutions, such as those licensing or regulating professions, or sports and recreation federations. They are member-based and may receive subsidies from the government. Importantly, these institutions are not subject to the PFMA and do not include SOCs. As has been argued throughout this thesis, SOCs also have a public

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37 Eddy Wymeersch 'Implementation of the corporate governance codes' in Klaus Hopt, Eddy Wymeersch, Hideki Kanda and Harald Baum *Corporate Governance in Context: Corporations, States, and Markets in Europe, Japan, and the US* (2005) 408.

38 Section 1 of the Companies Act.

39 Section 1 of the PFMA.

40 Department of Public Administration 'Handbook for the appointment of persons to boards of state and state-controlled institutions' (2009) (referred to as 'Handbook on Appointments') chapter 1 at 4. This Handbook does not flow from any statute. It is merely a stand-alone guidance document.

interest mandate and therefore limiting public interest institutions to sector-regulating institutions is overly restrictive.

Going back to the Companies Act, s 8(2)*(a)* categorises a SOC as a 'profit company' while s 1 defines a profit company as a 'company *incorporated for the purpose of financial gain* for its shareholders.'[41] But, clearly, not all SOCs exist exclusively to serve an economic interest. For instance, Eskom and PRASA, to mention two, do not exist for the sole purpose of generating income; instead, they exist to serve as economic enablers and meet various public needs, such as energy and rail transport. Therefore, the characterisation of SOCs as profit companies in the Companies Act is in fact a mischaracterisation. Perhaps the only purpose of this characterisation is to structure SOCs in the mould of profit companies, so that they can be expected to adopt the operational efficiencies that typify profit companies.

It is proposed that s 8(2)*(a)* of the Companies Act should be amended to define a SOC not as a profit company but as a 'public interest company' in order to capture its public interest nature. Section 1 of the Act (definitions) should also be amended to include a new definition of what a public interest company means. The new formulation could be as follows:

> 'public interest company' means a 'state-owned company incorporated for the purposes of financial and/or non-financial gain for its shareholders'.

Following from this, the definition of a 'state-owned company' in s 1 should also be revisited to read as follows:

> 'state-owned company' means an enterprise that is registered in terms of this Act as a [public interest][42] company, and either –
>
> *(a)* is listed as a public entity in Schedule 2 or 3 of the Public Finance Management Act, 1999 (Act No. 1 of 1999); or

41 Emphasis added.

42 Proposed changes to existing legislation are indicated in square brackets.

(b) is owned by a municipality, as contemplated in the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000), and is otherwise similar to an enterprise referred to in paragraph *(a)*.

The proposed definitional changes and the re-categorisation of SOCs place public interest at the core of their existence and should, with the necessary alterations, be reflected in other legislation applicable to SOCs, such as the PFMA. This approach is not unheard of. In Delaware, the law allows businesses to structure themselves as 'public benefit corporations' with public interest as their stated objective.[43]

Elsewhere in the world, there appears to be 'a sea of change' with regard to the change of the 'corporate purpose'. In 2019, the British Academy issued the 'Principles for Purposeful Business' and the US Business Roundtable published a 'Statement on the Purpose of a Corporation'. In 2020, the World Economic Forum released 'The Davos Manifesto 2020'. All these statements view the purpose of the corporation in a new light. They proclaim that corporations should no longer be viewed as narrow profit machines; rather, they should constitutionally serve interests beyond those of their shareholders.[44] Again, this 'sea of change' supports the claim that SOCs must be seen as definitionally and constitutively pursuing both public and economic interests.

The proposed restatement of the corporate purpose of SOCs requires all stakeholders, including shareholder-representatives, boards, management and oversight bodies, to discharge their duties and roles in relation to SOCs in a manner that prioritises the public interest. Their actions in respect of SOCs should also be judged against the public interest standard. It follows

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43 See Rodgin Cohen 'It's good for shareholders when boards consider public interest' available at https://www.ft.com/content/40e06550-ee72-11e9-a55a-30afa498db1b (accessed 23 February 2020).

44 John Wilcox 'Corporate purpose and culture' *Harvard Law School Forum* available at https://corpgov.law.harvard.edu/2020/02/21/corporate-purpose-and-culture/ (accessed 21 February 2020).

that the duties of SOCs' directors must also reflect the proposed public interest character and definition.

5.3.1 Directors' duty to act in the best interests of the company and in the public interest

As previously noted, SOCs are governed by their founding legislation, the PFMA, the Companies Act and common law. As far as directors' duties are concerned, s 50 of the PFMA resembles, to a large extent, the fiduciary duties in s 76 of the Companies Act. Section 51 of the PFMA provides more details about the general duties of the board in managing the SOC than does s 66(1) of the Companies Act.[45]

For its part, the Companies Act ushered in a schema of directors' duties that reside in both the Act and at common law.[46] There is consensus that, despite the elaboration of these duties in the Act, 'recourse may [still] be had to the common law which, save for the express legislative exclusions, remains the structure of company law upon which the superstructure of the Act rests.'[47] The immediate advantages of this partial codification are that the courts have the latitude to develop the duties on an ongoing basis and even create new duties.[48] In the case of SOCs, it is submitted that it would not be appropriate

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45 For an overview of the interaction of these sections, see Riekie Wandrag 'Governance of state-owned companies' in A Loubser and DP Mahony *Company Secretarial Practice* (2018) 29-1–29-22.

46 This thesis does not intend to provide an elaborate exposition of directors' duties, save for the duty to act in the best interests of the company, the duty to apply an independent mind to the interests of the company, and the duty not to fetter discretion. For a comprehensive commentary on the entire subject of directors' duties, see J Yeats (ed) *Commentary on the Companies Act of 2008* (2018) 2-1276–2-1286; *Henochsberg* op cit note 24 at 290(4); FHI Cassim 'The duties and the liability of directors' in FHI Cassim et al *Contemporary Company Law* 2 ed (2012) 523–594; Tshepo Mongalo 'Directors' standards of conduct under the South African Companies Act and the possible influence of Delaware law' (2016) 2 *Journal of Corporate and Commercial Law and Practice* 1–16; Irene-Marie Esser and Michele Havenga 'Directors and other officers' in A Loubser and DP Mahony *Company Secretarial Practice* (2017) 8-19–8-33; and the many authorities cited in these works.

47 *Mthimunye-Bakoro v Petroleum Oil and Gas Corporation of South Africa (SOC) Limited and Another* 2015 (6) SA 338 (WCC) para 61.

48 If the Act had completely codified the duties, the opposite would be case. Courts would be bound to interpret the statutory duties without venturing into creating new duties

for courts to judicially engineer a new duty proposed below, because it has wide public policy implications. Therefore, legislation must be amended to explicitly provide for the proposed duty.

The extant law, both in statutes and at common law, compels directors to always place the interests of the company front and centre. For instance, s 76(3)*(b)* of the Companies Act unequivocally provides that directors must exercise the powers and perform the functions of director 'in the *best interests of the company*'.[49] The question that arises is whether the interests of the company are always compatible with the public interest, which, as argued throughout this thesis, is the *raison d'être* for SOCs. To answer this question, it is important to first understand what is meant by 'best interests of the company'.

According to various authorities, the fiduciary duty to act in the interests of the company means acting in a manner that places the interests of the company, *as a separate entity*,[50] above those of shareholders and other stakeholders.[51] This exclusivity of focus is informed by the realisation that there may be an asymmetry of interests of the company and those of shareholders. For instance, a shareholder concerned with short-term gains

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lest they be accused of 'judicial engineering'. On the undesirability of judicial engineering, see *Sepheri v Scanlan* 2008 (1) SA 322 (C) 331. A more elaborate examination of the pros and cons of partial codification of directors' duties can be found in Lindi Coetzee and Jan-Louis van Tonder 'Advantages and disadvantages of partial codification of directors' duties in the South African Companies Act 71 of 2008' (2016) 41 *Journal for Juridical Science* 1–13. See also Lindi Coetzee 'Directors' fiduciary duties and the common law: The courts fitting the pieces together – *Mthimunye-Bakoro v Petroleum Oil and Gas Corporation of South Africa (SOC) Limited* (12476/2015) [2015] ZAWCHC 113; 2015 (6) SA 338 (WCC) (4 August 2015)' (2016) 37 *Obiter* 401.

49 Emphasis added.

50 Section 19 of the Companies Act.

51 Directors owe a fiduciary duty to the company and this means acting in the best interests of the company itself. See *Percival v Wright* [1902] 2 Ch 421; *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168; *Howard v Herrigel NO* 1991 (2) SA 660 (A); *S v De Jager and Another* 1965 (2) SA 616 (A); and *Phillips v Fieldstone Africa (Pty) Ltd* 2004 (3) SA 465 (SCA). According to *Phillips*, the extent of this duty is informed by the surrounding circumstances (para 27). See also Lindi Coetzee and Jan-Louis van Tonder 'The fiduciary relationship between a company and its directors' (2014) 35 *Obiter* 285–315. The authors unpack the content of a fiduciary relationship from a comparative perspective and hold the view that the duty is owed only to the company.

may see no value in the company engaging in the maintenance of assets or research and development. For this reason, directors must always place the interests of the company, as a separate entity, first.

Similarly, in the context of SOCs, what is in the 'best interests of the SOC', as a separate entity and distinct from its shareholder-representative (by virtue of its corporatisation), may not necessarily be in the public interest. To illustrate: on the one hand, it may be in the interests of Eskom to increase electricity tariffs by a huge margin in order to escape from its current financial quagmire. On the other hand, it is certainly not in the interests of the public to increase tariffs to unaffordable levels. Further still, it will not be in the public interest if Eskom succumbs to debilitating debt. So, in such circumstances, where must the directors' loyalty lie?

It is submitted that this requires a delicate balancing act. The directors' loyalty must lie with the SOC to the extent that the best interests of the SOC, as a separate juristic entity, are compatible with the broader public interest.[52] However, as the law stands, directors' loyalty must lie *only* with the SOC. To bring the public interest into the picture, as argued already, the fiduciary duties of SOCs' directors must, therefore, be refined to allow directors to act in the best interests of the SOC *and* in the public interest. However, where there is a conflict between these interests, the directors must give precedence to the public interest.

This refinement can be achieved through the amendment of s 76(3)*(b)* of the Companies Act as follows:[53]

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52 The notion of loyalty is central to the fiduciary duty. Concepts such as honesty, good faith, utmost trust, reliance, and confidence all culminate in loyalty. JS McLennan 'Directors' fiduciary duties and the 2008 Companies Bill' (2009) 1 *Journal of South African Law* 184–190 at 185. See also Coetzee and Van Tonder, ibid at 287.

53 The proposed amendments are placed in square brackets. It must be noted that the amended s 76(3) will be applicable only to SOCs or it can be included in a separate SOC Act. The need for a separate SOC Act will be canvassed in chapter 7.

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

(a) ….

(b) in the best interests of the [state-owned] company [, and in the public interest. Where there is a conflict between the two interests, the public interest shall take precedence]; and

(c) ….

The refinement of the PFMA is also necessary, particularly because it trumps the Companies Act in the event of inconsistencies.[54] Thus, it is central to the regulation of SOCs. Section 50(1) of the PFMA provides for the fiduciary duties of accounting authorities (boards). It should be amended to read as follows:

50. (1) The accounting authority for a public entity must–

(a) act with fidelity, honesty, integrity and in the best interests of the public entity [and in the public interest] in managing the financial affairs of the public entity;

(b) ….

(c) ….

(d) seek, within the sphere of influence of that accounting authority, to prevent any prejudice to the financial [and other public] interests of the state.

It appears that s 50(1) already imposes a public interest duty on SOCs' boards, albeit limited only to 'financial interests of the state'. The amendment proposed above broadens the public interest duty to cover all other matters that fall within the definition of the public interest. For instance, employment within SOCs and security of supply of public services for SOCs like Eskom would fall within the broader public interest. In *Organisation Undoing Tax*

54 Section 3(3) of the PFMA.

Abuse and Another v Myeni and Others (*OUTA case*), Justice Tolmay stated *obiter* that:

> Whoever serves on the Board of an SOE should ultimately be a servant of the people and whoever is appointed as such, has a sacred duty to society and should ensure that state resources are not squandered, or the economy placed at risk.[55]

The learned judge's remarks aptly capture the public interest character of SOCs and the consequent duty of SOCs' directors to act both in the interest of the SOC and in the interest of society and the economy.

It may be argued that the directors of SOCs may not be able to readily determine what constitutes public interest because the concept of public interest is definitionally complex. However, as argued in chapter 2, courts have interpreted public interest on numerous occasions and many statutes refer to the concept of public interest, therefore it is not an alien concept. According to Finn J in the Australian case of *Hughes Aircraft Systems International v Airservices Australia*, public interest in the case of state companies is to be determined from what is express or implied in the founding Act of such a company.[56]

In addition to the founding statutes, it is submitted that what constitutes public interest for a particular SOCs may be found in the shareholder's compacts, industrial policy applicable to the particular SOC, and the national strategic objectives contained in the National Development Plan (2030). Collectively, these instruments and case law will provide ample guidance to directors on what constitutes public interest in a particular context. If directors are still unsure of what constitutes public interest in a particular context, they can consult with the shareholder-representative, or the shareholder may in fact intervene if he or she is of the opinion that the board's interpretation of public interest is unsatisfactory.

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55 (15996/2017) [2020] ZAGPPHC 169 (27 May 2020) at para 276 (delinquency judgment).

56 (1997) 146 ALR 1.

This view is consistent with what transpired in the United Kingdom a while ago. It has been noted that the early nationalisation statutes of British SOEs obliged boards 'to consider ministerial advice on how to interpret the concept of "public interest", although that provision was rarely used (notably because the advice had to be in writing and defended in detail)'.[57] It is proposed that, similarly, in South Africa, a shareholder-representative should interpret and defend public interest for the SOC board in writing. This allows for transparency. It also allows the board and other stakeholders to test the rationality of the shareholder-representative's decision regarding matters in the public interest.[58]

A further argument against the expansion of directors' duties to include public interest considerations may be that s 7*(d)* of the Companies Act already 'reaffirm[s] the concept of the company as a means of achieving economic and *social benefits*.'[59] Therefore, the latter covers the interests of the public. In response to this view, it is submitted that social interests, as contained in s 7*(d)*, are usually 'voluntary'. The practice in public and private companies is often to pursue social benefits through voluntary corporate social responsibility programmes. Social benefits in s 7*(d)* would, therefore, not convincingly cater for the public interest in various contexts.

In any event, s 7*(d)* is couched in aspirational language ('reaffirms') which does not identify public interest as the paramount objective of SOCs. In line with this view, it has been submitted that it is unlikely that s 7*(d)* establishes a new *sui generis* duty for directors to prioritise the non-commercial interests of stakeholders. Rather, the section should be interpreted only to mean that directors must heed the interests of stakeholders, without affording such stakeholders any direct rights.[60]

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57 Maria Vagliasindi 'Governance arrangements for state-owned enterprises' World Bank Policy Research Working Paper 4542 (2008) at 7. Available at SSRN: https://ssrn.com/abstract=1102837 (accessed 2 May 2020).

58 On the rationality of executive decisions see *Democratic Alliance v President of South Africa and Others* 2013 (1) SA 248 (CC).

59 Emphasis added.

60 *Henochsberg* op cit note 24 at 250(2).

Furthermore, it has been argued that the law would have explicitly incorporated a new enforceable duty in s 76, had it been the intention of the lawmaker to create a new duty, rather than relegating it to the 'purpose' section of the Act.[61] For these reasons, s 76(3)*(b)*, or its equivalent (in a separate SOC Act), must be expanded to explicitly impose a new duty to act in the public interest, to avoid any unambiguity or the half-hearted pursuit of the public interest.[62]

For what it is worth, s 7*(d)* envisages the attainment of two types of interests (economic and social), yet they may at times be at odds. Therefore, to some extent, this section reinforces the argument made here that the attainment of what are sometimes incongruent interests is not novel. The only difference is that, unlike in public and private companies, where economic interests trump aspirational social interests, in the case of SOCs, the public interest will be prioritised, but only when there is incompatibility with narrow economic interests.

The argument made here is not that SOCs must not pursue profits; instead, they must pursue profits to the extent that they do not decimate the broader public interest (such as the delivery of public goods to the greater majority). This view finds support from Schwarcz, who argues that:

> [M]anagers [and boards] would not only have a private corporate governance duty to investors but also a *public corporate governance duty to society* (public governance duty) not to engage in excessive risk-taking that could harm the public.[63]

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61 Ibid.

62 For a similar view, see Robert Branston, Keith Cowling and Roger Sugden 'Corporate governance and the public interest' (2006) 20 *International Review of Applied Economics* 189–212. The authors make a general submission that serving the public interest can be achieved by, among other things, changing the law to make directors owe duties to all key stakeholders.

63 Steven Schwarcz 'Keynote reflections: The public governance duty' (2015) 50 *Georgia Law Review* 2–16 at 5–6. Emphasis added.

To buttress his point, Schwarcz notes that Iceland has passed legislation that requires managers of systemically important companies to operate businesses in the interests of both shareholders *and the economy*.[64]

For directors of SOCs to discharge their duties, as proposed above, they must act independently and not fetter their discretion. This is provided for in s 66(1), which vests exclusive power and authority to direct the business and affairs of the company in the board. In this regard, even shareholders have no say in the day-to-day business and affairs of SOCs.[65] They can get involved only in limited circumstances where the public interest is threatened.

Directors taking instructions from anyone, including shareholders, amounts to fettering their discretion and lacking independent judgment.[66] Where this happens, directors fail the test of acting honestly and in the best interests of the company and the public interest. In *Democratic Alliance v South African Broadcasting Corporation*, the court observed that the board was pressurised by the shareholder to hastily appoint an unqualified executive manager even though such appointment was not on the agenda of the board meeting.[67] This

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64 Schwarcz ibid, citing the Act on Financial Undertakings (Act No 161/2002) (Iceland). Emphasis added.

65 *Hacker v Hartmann and Others* (1415/2017) [2019] ZAECPEHC 22 (10 April 2019) para 45; *Pretorius and Another v PB Meat (Pty) Ltd* (1057/2013) [2013] ZAWCHC 89 (14 June 2013) para 25, quoting *Henochsberg* op cit note 24; *Navigator Property Investments (Pty) Ltd v Silver Lakes Crossing Shopping Centre (Pty) Ltd and Others* [2014] 3 All SA 591 (WCC) para 31. In the UK, in *Automatic Self-cleansing Filter Syndicate Company Limited v Cuninghame* [1906] 2 Ch 34 (CA) para 45, the court emphasised that shareholders cannot compel directors to act in a particular manner, thus interfering with their duty to direct the affairs of the company. See further Rehana Cassim 'The power to remove company directors from office: Historical and philosophical roots' (2019) 25 *Fundamina* 37–69. See also Carias Chokuda *The Protection of Shareholders' Rights versus Flexibility in the Management of Companies: A Critical Analysis of the Implications of Corporate Law Reform on Corporate Governance in South Africa with Specific Reference to Protection of Shareholders* (PhD thesis, University of Cape Town, 2014) 21–39.

66 The duty of directors to act independently and not fetter their discretion was affirmed in *Mthimunye-Bakoro* op cit note 47 at para 340 and *Fisheries Development Corporation of SA Ltd v Jorgensen; Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd* 1980 (4) SA 156 (W) 163.

67 [2015] ZAWCHC 182; 2016 (3) SA 468 (WCC) para 8. For a more comprehensive discussion of this case and the governance woes at the SABC, see Victoria Bronstein and Judith Katzew 'Safeguarding the South African public broadcaster: Governance, civil society and the SABC' (2018) 10 *Journal of Media Law* 244–272.

case is a classic example of a SOC's directors surrendering to shareholder pressure and fettering their discretion. This was not a matter of public interest that warranted shareholder intervention and therefore the directors ought to have resisted the minister's interference.

5.3.2 Enforceability of the duty to act in the public interest

To act in the best interests of a SOC, a director must subjectively believe that his or her actions are in pursuit of the public interest; however, such a belief must have a rational basis, thus introducing some level of objectivity into the test. In *Shuttleworth v Cox Brothers and Co*, the court held that the test for determining whether a director acted in the best interests of the company is whether a reasonable man would have considered the actions of the director to be in the best interests of the company.[68] A similar test must be applied to determine whether a SOC's directors acted in the best interests of the SOC *and* in the public interest.

The question that arises is: who will determine whether a SOC's directors have acted in the public interest or not? In short, how will the duty to act in the public interest be enforced? Normatively, the company is the proper plaintiff in any action where wrongs are committed against it and the directors or management must represent it – this is the *Foss v Harbottle* rule.[69] However, it may happen that a SOC, as the proper plaintiff, improperly rejects or fails to take action to protect the public interest in its dealings. Since the SOC acts through directors, it may be that the directors have failed to govern in the public interest and therefore refuse to take action against themselves.

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68 [1972] 2 KB 9 at 23. See also *Gething v Kilner* [1972] 1 WLR 337 at 342. See further Cassim op cit note 46 at 524. See also *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd and Others* 2014 (5) SA 179 (WCC) para 74, where the court held that, in terms of s 76(4), the duty to act in the best interests of the company (s 73(3)*(b)*) is not objective in nature. Rather, it is subjective and a director must have a rational basis for believing that he or she acted in the best interest of the company. For a discussion of this case, see Natania Locke and Irene-Marie Esser 'Corporate law (including stock exchanges)' (2014) *Annual Survey of South African Law* 216–291 at 265–270.

69 *Foss v Harbottle* (1843) 67 ER 189 at 203–204.

It may also happen that the shareholder-representative fails or refuses to act to protect the public interest because the actions of the SOC are done at his or her instance, meaning that the remedy of derivative action would be unavailable. It is submitted that, given the importance of SOCs to society, if the directors or shareholder-representatives abdicate on matters that require the protection of the public interest, other means of protecting the public interest must be found.

A. Expansion of standing under s 165(2) of the Companies Act

A cursory reading of s 165(2)*(d)* may suggest that a member of the public can institute derivative action to enforce the public interest, but careful scrutiny of this section shows that it is available only to a person whose legal right has been infringed. Therefore, a member of the public will not be able to allege breach of public interest because directors of SOCs do not currently owe a duty to act in the public interest and a member of the public is not an interested party under s 165(2). However, if the proposed amendments to ss 66(1) and 76(3) are implemented, that is, SOCs are redefined as public interest companies and directors' fiduciary duties are expanded to incorporate the duty to act in the best interests of the SOC and in the public interest, then a member of the public would have an actionable interest to specifically protect the public interest.[70] This will require the amendment of s 165(2) to specifically include a member of the public in the list of those who have the right to serve a demand on the SOC to commence or continue legal proceedings, or take related steps, to protect the legal interests of the SOC, including the public interest.

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70 The link between derivative action and the public interest is that derivative action provides for the enforcement of duties, thus helping regulatory authorities if they are unable to prosecute due to competing demands or limited resources. See Stephen Bottomley 'Shareholder derivative actions and public interest suits: Two versions of the same story' (1992) 15 *University of New South Wales Law Journal* 127–148 at 143.

B. Public interest action under s 157(1)(d) of the Companies Act

Historically, public interest action has not been part of South African law.[71] The law of standing has always demanded that a litigant must have a direct interest in the relief sought.[72] For instance, South African courts have consistently rejected the *actio popularis*, which is an action instituted solely for the benefit and in the interest of the public. In *Dalrymple v Colonial Treasurer*, Justice Wessels held that 'the person who sues must have an interest in the subject-matter of the suit, and that interest must be a direct interest.'[73] In another case, Justice Wessels went further, stating that the plaintiff must show that 'he has a direct interest in the matter and *not merely the interest which all citizens have.*'[74]

Public interest actions have been rejected primarily because such actions would supposedly inundate and inconvenience the courts.[75] This position was effectively changed by s 38*(d)* of the Constitution, which allows any person 'acting in the public interest', sometimes referred to as an 'ideological plaintiff',[76] to protect rights contained in the Bill of Rights. Section 38*(d)* was therefore a resounding rejection of the floodgates argument advanced in the *Dalrymple* case. In *Wildlife Society of Southern Africa v Minister of Environmental Affairs and Tourism of the RSA*, the court rejected the view that public interest actions would unnecessarily 'open the floodgates to a torrent of frivolous or vexatious litigation against the State by cranks or busybodies'.

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71 See South African Law Reform Commission *The Recognition of Class Actions and Public Interest Actions in South African Law* (1998) Project 88, at 21, available at https://www.justice.gov.za/salrc/reports/r_prj88_classact_1998aug.pdf (accessed 1 May 2020).

72 See, generally, Cheryl Loots 'Locus standi to claim relief in the public interest in matters involving the enforcement of legislation' (1987) 104 *South African Law Journal* 131–148. The author challenged the legal position that people who sought relief in the public interest lacked *locus standi*.

73 1910 TS 372 at 390.

74 *Roodepoort-Maraisburg Town Council v Eastern Properties (Prop) Ltd* 1933 AD 87 at 101.

75 *Dalrymple v Colonial Treasurer* op cit note 73 at 392 (emphasis added).

76 On the idea of an ideological plaintiff, see Louis Jaffe 'The citizen as litigant in public actions: The non-Hohfeldian or ideological plaintiff' (1968) 116 *University of Pennsylvania Law Review* 1033–1047 at 1036. He characterises the plaintiff in such actions as one who has a right, privilege or power to intervene on ideological grounds, such as the public interest.

The court held 'that it may sometimes be necessary to open the floodgates in order to irrigate the arid ground below them.'[77]

The South African Law Commission recommended the promulgation of a law that would specifically provide for public interest and class action suits in non-constitutional matters.[78] The Commission defined 'public interest action' as follows:

> an action instituted by a representative in the interest of the public generally, or in the interest of a section of the public, but not necessarily in that representative's own interest. Judgment of the court in respect of a public interest action shall not be binding (res judicata) on the persons in whose interest the action is brought.[79]

Although a general law governing public interest and class action cases has not been passed as recommended by the Law Reform Commission, the Companies Act took the bold step of providing for 'expanded standing to apply for remedies'.[80] In terms of s 157(1)*(d)* of the Act, a person acting in the public interest may bring an application for a remedy, with the leave of the court.

This section was recently considered in *Organisation Undoing Tax Abuse NPC and Another v Myeni and Another* (*OUTA* case).[81] The court was called upon to decide whether the applicant had standing to institute an action declaring the former director of SAA a delinquent director. The applicant based its *locus standi* on two factors. First, its primary objectives are aligned with the public interest, for instance, the protection and advancement of the Constitution, as well as the proper management of all major public entities. Second, SAA is a major public entity and a recipient of a state loan guarantee of R19.1 billion;

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77 *Wildlife Society of Southern Africa and Others v Minister of Environmental Affairs and Tourism of the Republic of South Africa and Others* [1996] 3 All SA 462 (Tk) 473.

78 For guidelines on how to extend public interest actions to non-constitutional matters, see CF Swanepoel 'The public-interest action in South Africa: The transformative injunction of the South African Constitution' (2016) 4 *Journal for Juridical Science* 29–46.

79 Law Reform Commission Report op cit note 71 at 24.

80 See s 157.

81 (15996/2017) [2019] ZAGPPHC 957 (12 December 2019) (special plea judgment).

therefore, the public has an interest in the proper management of SAA's affairs.[82]

In determining whether the applicant was genuinely acting in the public interest, the court in the *OUTA* case considered *Recycling and Economic Development Initiative of South Africa v Minister of Environmental Affairs* (*REDISA* case),[83] in which the court held that the proper approach was to follow and adapt the criteria set out in *Ferreira v Levin.*[84] In the context of the case, the Supreme Court of Appeal (SCA) in the *REDISA* case held that the following factors must be considered in determining whether a party is genuinely pursuing the public interest:

> (i) the nature of the allegations advanced as to why the public interest is implicated; (ii) the relevant provisions of the 2008 Act, which provide the context of the allegations; (iii) the provisions of the 2008 Act for addressing such allegations; (iv) whether there [are] other reasonable and effective ways in which the challenge may be brought; and (v) the range of persons or groups who may be directly or indirectly affected by any order of the court and the opportunity that those persons or groups have had to present evidence and argument to the court.[85]

The court in the *OUTA* case applied the above criteria and held that it was 'in the interests of justice that the public interest is both advanced and protected due to the nature of SAA as a state-owned company'.[86] The court went further to hold that s 157(1)*(d)* grants standing to a person who alleges contravention of the Companies Act or who applies for the enforcement of any provision or right in terms of the Act, except for derivative action as envisaged in s 165. It was important for the court to highlight this exception because s 157(3) explicitly provides that no person may institute derivative action on behalf of another, provided the person on whose behalf the derivative action is instituted is one contemplated in s 165(2). That said, the court was satisfied that *in casu* the applicant's case was an application to declare a director

82 Ibid paras 2 and 3.
83 2019 (3) SA 251 (SCA) para 134.
84 1996 (1) SA 984 (CC) para 234.
85 2019 (3) SA 251 (SCA) para 134.
86 *OUTA* op cit note 81 at para 34.

delinquent under s 162 (and not derivative action under s 165); therefore, the applicant was entitled to bring the action in the public interest.

The *OUTA* case demonstrates the utility of a public interest action in enforcing sound corporate governance in SOCs. Directors who fail to uphold their duties can no longer escape liability simply because either the board or shareholder-representatives, or both, have abdicated. Civil society organisations, with no direct relationship with a SOC, can now institute actions to protect and promote corporate governance in SOCs.

C. The USA qui tam litigation as a possible solution

It has been suggested that one way of facilitating the monitoring and enforcement of a 'public governance duty' in the USA is to incentivise members of the public to take action against directors who do not act in the public interest; for example, if they commit fraud. This, so the proposal goes, can be done through *qui tam* litigation, where a member of the public enforces a public interest duty on behalf of the state and retains a share of the damages recovered from the guilty party.[87] A similar remedy to enforce the duty to act in the public interest can be adopted in South Africa.

To avoid its possible abuse and to protect directors of SOCs from frivolous litigation, safeguards similar to those in s 165 of the Companies Act can be introduced.[88] It may, however, be argued that the *qui tam* remedy could dissuade directors from serving on the boards of SOCs because they will be exposed to claims for damages. To address this argument, it is submitted that directors are already exposed to claims for damages if they fail to discharge their duties and they have defences in that regard. In the case of the *qui tam* remedy, it will not be an automatic remedy, meaning that a member of the public will have to apply for leave of court to institute the action and will have

87 See Steven Schwarcz 'Misalignment: Corporate risk-taking and public duty' (2016) 92 *Notre Dame Law Review* 1–50 at 38.

88 For an elaborate study of the derivative action remedy, including safeguards built into s 165, see Maleka Femida Cassim *The New Derivative Action under the Companies Act: Guidelines for Judicial Discretion* (2016).

to demonstrate a *prima facie* case, thus ensuring that directors are not exposed to frivolous and vexatious claims. To counter-balance the burden of defending *qui tam* actions on SOCs' directors, s 78 can be invoked. This section provides for directors' indemnification and insurance.[89]

The remedies discussed above are potent mechanisms that can be deployed in advancing the public interest and upholding sound corporate governance in SOCs. With the exception of the *qui tam* remedy, the other remedies are already part of the law. All that is required is to expand the list of parties with *locus standi* under s 165 and apply s 157(1)*(d),* which has been successfully done in the *OUTA* case.

5.3.3 Defences against breach of the duty to act in the public interest

In running the business and affairs of the company, a director must act with a certain degree of care, skill and diligence that, in the circumstances, may reasonably be expected from a person of his or her knowledge and experience in relation to the same company.[90] Where the director acts with the necessary care, skill and diligence but it turns out that his or her actions were in hindsight not in the best interests of the company, the director will be protected from personal liability by the business judgment rule.[91]

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89 See generally, Mildred Bekink 'Indemnification and aspects of directors' and officers' liability insurance in terms of section 78 of the Companies Act of 71 of 2008' (2011) 23 *South African Mercantile Law Journal* 88–105.

90 Section 76(3)*(c)* of the Companies Act. See also *In re City Equitable Fire Insurance Co Ltd* [1925] 1 Ch 407 (CA) 427–429. See further *Fisheries Development Corporation of SA Ltd v Jorgensen* 1980 (4) SA 156 (W) 165–166, which is considered the *locus classicus* on the duty of care and skill by Richard Stevens 'The legal nature of the duty of care and skill: Contract or delict?' (2017) 20 *Potchefstroom Electronic Law Journal* 1–29.

91 For a comprehensive discussion of the business judgment rule, see Linda Muswaka 'Shielding directors against liability imputations: The business judgment rule and good corporate governance' (2013) 2 *Speculum Juris* 25–40; Natasha Bouwman 'An appraisal of the modification of the director's duty of care and skill' (2009) 21 *SA Mercantile Law Journal* 509–534; Derek Botha and Richard Jooste 'A critique of the recommendations in the King Report regarding a director's duty of care and skill' (1997) 114 *South African Law Journal* 65–76; Michele Havenga 'The business judgment rule – Should we follow the Australian example?' (2000) 12 *SA Mercantile Law Journal* 25–37; E Jones 'Directors' duties: Negligence and the business judgment rule' (2007) 19 *SA Mercantile Law Journal* 326–336; Jan-Louis van Tonder 'An analysis of the directors' decision-making function through the lens of the business-judgment rule' (2016) 37 *Obiter* 562–

In terms of this rule, directors should not be held personally liable if their decisions were informed, made in good faith, and without any conflict of interest.[92] To benefit from the business judgment rule, sometimes referred to as a 'safe haven', a director must have had a rational basis for believing that his or her decisions were in the best interests of the company and in the public interest (in the case of SOCs). Where the director had such a rational basis and in fact believed that his or her actions were in the interests of the SOC and the public interest, then the courts and shareholders will not in hindsight adjudge the director to have breached his or her duties. In *Levin v Felt and Tweeds Ltd*, the court cautioned against holding directors liable for business decisions taken in good faith:

> In the absence of any allegations that the directors acted mala fide this amounts to asking the court to usurp the functions of the directors and to consider what is in the best interest for the company from a business point of view … this is not the function of a court of law … the court is not concerned with the commercial wisdom of the scheme.[93]

It is submitted that the business judgment rule will sufficiently protect directors of SOCs against the breach of the proposed duty to act in the public interest, provided the usual conditions are met.

The conceptual, definitional, interpretative and other gaps identified above seem to have negatively impacted how directors direct SOCs, hence the systemic weak governance that has plagued the majority of SOCs. Could this be exacerbated by the calibre of directors of SOCs and the manner of their appointment and removal? These questions are addressed next.

5.4 COMPOSITION, APPOINTMENT AND REMOVAL OF SOCs' BOARDS

It goes without saying that it matters who serves on the board of directors, because those who serve on boards are expected to possess certain skills and experience to enable them to effectively govern the company. The key question

580; Stephen Kennedy-Good and Lindi Coetzee 'The business judgment rule (part 1)' (2006) 27 *Obiter* 62–74.

92 See s 76(4) and (5) for a full statutory exposition of the business judgment rule.

93 *Levin v Felt and Tweeds Ltd* 1951 (2) SA 401 (A) 414–415.

is whether SOCs' boards are fit for purpose. Does the board's composition, structure, appointment, and removal have a bearing on its ability to govern effectively?

5.4.1 Composition

Neither the Companies Act nor the PFMA prescribe qualifications for directors. Instead, the Companies Act provides for grounds that either disqualify or render one ineligible to be director.[94] Additionally, the Companies Act provides for directors to be declared delinquent or to be placed on probation.[95] The law is limited with regard to the qualifications of directors because it focuses on 'exclusionary variables' that effectively set the bar rather low, regard being had to the importance of directors in the life of corporations and by extension the health of the economy.[96] It can be argued that even the exclusionary variables are not entirely clear. For instance, a recently appointed judge was also appointed to chair the board of PRASA thus raising questions of her eligibility to serve on the board..[97]

The Handbook on Appointments seems to address the weaknesses in the law. It emphasises merit that is relevant to the needs of the SOC, representativity and probity, among other qualifications.[98] Surprisingly, these lofty criteria

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94 Section 69(7) and (8). It is possible that the MOI may provide clearer criteria. For a further survey of the legal framework for the appointment of SOCs' boards, see Riekie Wandrag 'The legal framework of SOEs' boards: Appointment and dismissal of board members and executives of Eskom, PRASA and the SABC' (2018) available at https://dullahomarinstitute.org.za/ (accessed 1 March 2020). See also Jaap de Visser and Samantha Waterhouse 'SOE boards and democracy' (2020) available at https://dullahomarinstitute.org.za/ (accessed 1 March 2020).

95 Section 165(5).

96 De Visser and Waterhouse op cit note 94 at 18.

97 See ENSafrica legal opinion, 'Advice on the constitution of the interim board and the appointment of the chairperson' (28 February 2018) available at https://unitebehind.org.za/wp-content/uploads/ensafrica-opinion-for-the-interim-board-of-prasa-28_02_2018-1.pdf (accessed 20 March 2020).

98 See chapter 5 of the Handbook on Appointments read with Principle 7 of King IV. See also Lukas Muntingh 'Appointing directors to the boards of state-owned enterprises: A proposed framework to assess suitability' (2020) 24, available at https://dullahomarinstitute.org.za/ (accessed 1 March 2020). The author submits that the criteria for appointment should take the 'inherent requirements of the duties to be undertaken'. It may be added that the nature, business and mandate of SOCs should

have not always been applied: after the adoption of the Handbook in 2008, directors with questionable skills and probity were appointed to various SOCs' boards, arguably along patronage lines. For instance, some were found to have falsified qualifications, while others were implicated in tender rigging.[99]

The Public Protector has also observed that some SOCs' boards were 'improperly appointed and not in line with the spirit of the King III report on good Corporate Governance.'[100] She further observed that the competencies of the appointed directors were questionable, and that some directors had serious conflicts of interest.

Evidently, there is a problem of non-compliance with the tenets of good corporate governance and the Handbook on Appointments. Furthermore, the Handbook itself has a limitation because it does not require due diligence before the appointment of candidates. In *Democratic Alliance v President of the Republic of South Africa* the court underscored the importance of due diligence when making high-profile appointments.[101]

Given the enormity and complexity of the mandate of SOCs and their strategic importance in advancing the national development goals, it is submitted that the law, rather than non-binding instruments, should provide clear and strict criteria on board composition, including qualifications. This will ensure the appointment of competent boards and will curb governance woes, which are

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also be considered. See further Dallas op cit note 3 at 799, who makes the point that having global perspectives on boards is important for the success of businesses. In South Africa, unlike in Singapore (see chapter 6), there is a lack of appetite for foreign directors (and executives) to represent global perspectives, even for SOCs operating in a global market, like SAA.

99 It has been reported that the former board chairperson of the SABC, Ellen Tshabalala; former executive director of the SABC, Hlaudi Motsoeneng; former SAA board chairperson, Dudu Myeni; and former CEO and executive director of SAA, Nico Bezuidenhout all misrepresented their qualifications. See 'High profile cases of fake qualifications in 2014' available at http://www.sabcnews.com/sabcnews/high-profile-cases-of-fake-qualifications-in-2014/ (accessed 23 February 2020).

100 See Public Protector 'State of Capture Report' No 6 of 2016/17 at 19, available at http://www.pprotect.org/ (accessed 10 August 2019).

101 2012 (1) SA 417 (SCA) para 17. On the importance of this case in the appointment of directors of SOCs, see Muntingh op cit note 98 at 7.

arguably partly attributable to the poor calibre of directors. Consistent with this assertion, Chief Justice Mogoeng is reported to have candidly said:

> It is the president who appoints people who head state-owned companies or enterprises. If you appoint a rotten apple at any level, you don't even have to split hairs to understand what is going to happen to that entity.[102]

The Chief Justice's strong views lend support to the view that who serves on the boards of SOCs does matter, from a corporate governance perspective.

On the question of stricter criteria on composition, it is suggested that the legal standard of 'fit and proper' should be introduced. In this regard, guidance can be found in s 9(1)*(b)* of the National Prosecuting Authority Act (NPA Act),[103] read with s 179 of the Constitution. The NPA Act provides that:

> Any person to be appointed as National Director … must be a *fit and proper person*, with due regard to his or her *experience, conscientiousness and integrity* ….[104]

This section was examined by the Constitutional Court in *Democratic Alliance v President of the Republic of South Africa and Others*, where the court held that the appointment of the then National Director of Public Prosecutions (NDPP) was irrational, because a commission of inquiry had previously found him to be dishonest, thereby impugning his credibility, honesty, integrity and conscientiousness.[105] Consequently, he did not meet the standard of fit and proper.

The proposed fit and proper standard would ensure that candidates are thoroughly vetted to determine their credibility and integrity before they are appointed to serve on SOCs' boards, thus ensuring the professionalisation and legitimacy of boards. According to Licht:

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102 See IODSA 'SOE boards: It matters who gets appointed and how they get appointed' (2019) available at https://www.iodsa.co.za/news/459327/SOE-boards-It-matters-who-gets-appointed-and-how-they-get-appointed.htm (accessed 23 February 2020).

103 Act 32 of 1998.

104 Emphasis added.

105 2013 (1) SA 248 (CC).

> Composition regulation harnesses board members' personal attributes — specifically, their values — to facilitate the attainment of … goals. Instead of telling board members what to do, the state may fare better by regulating who they are.[106]

This approach can only augur well for corporate governance, as it will ensure that boards are composed of upright directors with the necessary competencies to direct SOCs. Logically, directors who, at any time, lose their fitness to hold office should be immediately disqualified.[107] For instance, directors found to have falsified their qualifications or who have committed infractions involving trust should be disqualified from serving on any SOC's board.

5.4.2 Appointment and removal ('captured boards' and 'bureaucratic creep')

The previous discussion focused on the calibre of directors appointed to the boards of SOCs. This part is concerned with the authority that appoints and removes boards (both executive and non-executive directors) and the process of their appointment and removal. It also discusses how these aspects impact corporate governance.

Chapter 2 noted that the PFMA vests 'ownership control' (shareholder functions) in the 'executive authority' (shareholder).[108] Among the functions of the shareholder is the appointment and removal of all, or the majority of, the directors, including the CEO. In practice, the appointment process and practice vary from one SOC to another. In some cases, the shareholder-representative makes a direct appointment of the CEO, while in others the nomination task is delegated to the board, with the shareholder-

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106 Amir Licht 'State intervention in corporate governance: National interest and board composition' (2012) 13 *Theoretical Inquiries in Law* 597–622 at 567.

107 This is consistent with s 69(4) of the Companies Act. Alternatively, depending on the severity of the director's infractions, they may be placed on probation or be declared delinquent as it was done with the former board chairperson of SAA in See *Organisation Undoing Tax Abuse and Another v Myeni and Others* (15996/2017) [2020] ZAGPPHC 169 (27 May 2020) (delinquency judgment).

108 See s 63(2), read with the definition of 'ownership control' and 'executive authority' in s 2 of the PFMA.

representative making a recommendation of the preferred candidate to Cabinet for approval.[109]

The practice of the shareholder appointing executive directors goes against the prescripts of good corporate governance, because it removes the conventional authority of the board to make such appointments. The court took a similar view in *SOS Support Public Broadcasting Coalition and Others v SABC*. It held that the appointment and removal of executive directors was to be done solely by the board, without any involvement of the shareholder.[110]

Surprisingly, the Municipal Systems Act 32 of 2000, which governs municipal-owned companies, does not vest the power to appoint executives in the shareholder, as is the case with the PFMA. It unambiguously vests the power in the board and provides that executives shall be fully accountable to the board.[111] Why this approach is not adopted in the PFMA in respect of major SOCs is unclear.

The implications of the direct appointment and removal of executive directors is that this complicates relations within the board and renders the board weak. For example, in the case of PRASA, when relations between the board and the seconded CEO became strained, the shareholder sided with the seconded bureaucrat.[112] Another challenge concerning board appointments is the phenomenon of cadre deployment and the endemic practice of interlocking and revolving directorships by political cadres in various SOCs.[113] The former Minister of Public Enterprises gave disquieting testimony

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109 It is clear that there is confusing inconsistency. See Public Service Commission 'Presentation to the Portfolio Committee on Arts and Culture: Appointment of Senior Officials of Public Entities' (2018) (on file).

110 *SOS v SABC* para 146.

111 Section 93J(1) and (2).

112 See *Molefe and Others v Minister of Transport and Others* para 21.

113 Affidavit of Barbara Hogan (testimony of 12 to 14 November 2019) at the Commission of Inquiry into State Capture, available at https://sastatecapture.org.za/site/documents (accessed 20 November 2019).

at the Zondo Commission[114] on cadre deployment in SOCs. She indicated that politicians as far up the political hierarchy as the President had preferred candidates as executive directors of SOCs and imposed executives who were not recommended by the boards, some of whom were seconded bureaucrats. The imposition of executives who are not recommended by the board has the effect of vetoing the board recommendations.[115]

Directors deployed or imposed on SOCs' boards by shareholder-representatives (politicians) are likely to be beholden to the politics and interests of those who deployed them. At best, the deployed cadres may be deemed non-independent.[116] At worst, they may be deemed puppet directors who take instructions from their political principals.[117] Therefore, they can be reasonably considered to be 'captured' and 'lame duck' directors whose autonomy and authority to govern is significantly diminished.[118]

To curb unwarranted shareholder influence and insulate SOCs from political interests, Norway has opted to completely ban the inclusion of politicians and

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114 See 'Judicial commission of inquiry into allegations of state capture, corruption and fraud in the public sector including organs of state' Proclamation 3 of 2018 (also known as the Zondo Commission).

115 See, for example, clause 13.5.3 of the amended SABC MOI read with clause 8.2 of the SABC Charter, which give the SABC shareholder an unrestricted veto. See also clause 14(4) of the Eskom MOI, which vests the power to approve the board-recommended CFO in the shareholder. This approach can be abused to the detriment of the expeditious appointment of executives and the smooth running of SOCs. On the dangers of an unrestricted veto, see *Dawood and Another v Minister of Home Affairs and Others* 2000 (3) SA 936 (CC). For a critique of the shareholder's power to appoint (and remove) executive directors, see Applicant's Heads of Argument in *SOS v SABC* (on file). An example of a proper (restricted) veto is s 174 of the Constitution, which allows the President to veto the JSC only once on the appointment of judges.

116 See King IV General Guidance Note on Composition of Board, which states that substance over form should be a factor that determines whether a director is independent or not. Thus, the independence of politically deployed directors is questionable.

117 The PRC Report correctly notes that the appointment of government officials to boards compromises or erodes board independence because such officials are loyal to the shareholder-minister instead of the entity. See the Report of the Presidential Review Committee (PRC) of state-owned entities (SOEs) (2012) 17, available at https://www.gov.za/documents/report-presidential-review-committee-prc-state-owned-entities-soes (accessed 27 May 2020).

118 On puppet directors and the consequences of being a puppet director, see *S v Shaban* 1965 (4) SA 646 (W) 652–653.

civil servants on SOCs' boards. Brazil has banned the inclusion of regulators, union leaders and politicians.[119] Given the ubiquitous political interference in South Africa, it is suggested that these examples should be followed. Others may argue that this approach robs the shareholder of the chance to protect state interests in SOCs. This argument, however, lacks merit, since the boards of SOCs are appointed by the shareholder who also concludes annual compacts with the board. Therefore, policy imperatives can be addressed by appointing the right directors who will be sensitive to government policy and by explicitly detailing these policy imperatives in shareholder's compacts.

A further challenge confronting SOCs is the abuse of shareholders' unfettered power to remove directors in terms of s 71(1) of the Companies Act, read with s 1 of the PFMA.[120] This unfettered power has led to an unhealthy turnover of boards and executive managers. As observed elsewhere, the implications of this on the effective governance of SOCs are dire because 'at any given time, the board and executive management lack the stability, continuity and institutional memory to resolve the complex governance issues confronting the organisation.'[121]

5.5 OTHER SHAREHOLDER CONTROL MEASURES

Control in this context means the 'capacity to influence the board of directors and possibly dominate it.'[122] As noted above, this can be achieved through the appointment of the board of directors, which then decides on the strategic direction of the company and monitors the affairs of the company. It can also be achieved by removing directors who are insensitive to shareholder interests. Both these means of control have been abused, resulting in a

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119 Curtis Milhaupt and Mariana Pargendler 'Governance challenges of listed state-owned enterprises around the world: National experiences and a framework for reform' (2017) 50 *Cornell International Law Journal* 473–542 at 537.

120 See definition of 'ownership control' in s 1 of the PFMA.

121 Tebello Thabane and Elizabeth Snyman-Van Deventer 'Pathological corporate governance deficiencies in South Africa's state-owned companies: A critical reflection' (2018) 21 *Potchefstroom Electronic Law Journal* 1–32 at 16.

122 Adolf Berle '"Control" in corporate law' (1958) 58 *Columbia Law Review* 1212–1225 at 1212.

negative impact on the board's overall capacity to direct both in the interests of the SOC and in the public interest.

Beyond these means of shareholder control, there are other means of control peculiar to SOCs: control through the power of the purse and control by oversight mechanisms. They are briefly discussed in turn and their impact on the board's ability to govern is highlighted.

5.5.1 The power of the purse

Undeniably, most strategic SOCs are perennially underperforming. Lately, many have recorded staggering losses.[123] As a result, they have been downgraded by credit rating agencies, not only because they are debt-ridden and their ability to repay loans is doubtful, but also because of abysmal governance practices.[124] Consequently, SOCs are unable to borrow from the market to sustain their operations, let alone expand their offerings. This drives them to the shareholder for either more capital injection or sovereign guarantees, against which they can secure loans in the open market. This arrangement has created a dependency that has given the shareholder inordinate influence and control over the operations of SOCs. It has also led to micromanagement of SOCs by shareholder-representatives such as the National Treasury against the prescripts of good corporate governance.

5.5.2 Control by oversight and ad hoc mechanisms

Parliament and its subcommittees exercise oversight over SOCs. Chapter 9 institutions also provide some level of oversight, although this is triggered by

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123 Carol Paton 'Eskom announces record R20.7bn loss' (2019) available at https://www.businesslive.co.za/bd/national/2019-07-30-eskom-announces-record-r207bn-loss/ (accessed 1 March 2020).

124 See Vernon Wessels 'Eskom's credit rating cut deeper into junk' (2019) available at https://www.fin24.com/Economy/South-Africa/eskoms-credit-rating-cut-deeper-into-junk-20191001 (accessed 1 March 2020). See also Olga Constantatos and Tarryn Sankar 'SOE governance unmasked: A learning journey' (2018) available at https://www.futuregrowth.co.za/media/2373/futuregrowth_soe-governance-unmasked_electronic.pdf (accessed 1 March 2020). The authors explore the causes of governance challenges at SOCs from a lender's perspective.

complaints. These institutions exert indirect control over SOCs and add another layer of accountability. Admittedly, s 195(1) and (2) of the Constitution requires accountability and transparency in public institutions. However, oversight by too many stakeholders is problematic because their expectations sometimes contradict shareholder expectations, which makes governance difficult for boards.

Lately, government has added further layers of control, ostensibly to augment the performance of SOCs. For instance, a SOE Coordinating Council was created pursuant to the recommendations of the Presidential Review Committee (PRC) on SOEs.[125] Further still, so-called 'war-rooms' have been created at various SOCs to address performance and governance challenges.[126] Strangely, the terms of reference, mandate, decision-making authority, and duration of these ad hoc control arrangements are unclear.

These control arrangements appear to exert excessive control over SOCs, leaving little or no room for boards to direct the business and affairs of SOCs. This raises a pertinent question of where the decision-making authority of and accountability for SOCs ultimately lie, considering the current legal and regulatory framework.[127] In other words, these control arrangements are not envisaged by the law (the SOCs' founding legislation, the Companies Act, and the PFMA).

Like the impact of unfettered control over the composition, appointment, and removal of boards, these other control measures negatively impact corporate governance in SOCs. They are legally suspect, undefined, and uncoordinated, and they usurp the board's powers, rendering the board's autonomy and authority to govern SOCs almost nugatory. The *status quo* can be remedied by observing the statutory division of corporate power between SOCs' boards

125 Report of the Presidential Review Committee (PRC) of state-owned entities (SOEs) available at https://www.gov.za/documents/report-presidential-review-committee-prc-state-owned-entities-soes (accessed 1 March 2020).

126 For instance, there have been war-rooms at Eskom and PRASA.

127 Constantatos and Sankar op cit note 124 at 13.

and shareholder-representatives, with necessary modifications to accommodate public interest considerations.

5.6 REITERATING THE NEED FOR THE SEPARATION OF OWNERSHIP AND CONTROL

Effective governance depends on the predictable and legally defined division of corporate power between the two organs of the corporation.[128] The advent of s 66(1) of the Companies Act significantly shifted the power between these two organs away from shareholders onto the board, although this is subject to the provisions of the law and the contents of the MOI. The King IV Code reinforces this power shift by recommending that the board should have 'effective control' of the affairs of the corporation.[129] This shift is consistent with the view that 'control is generally intended to remain with management [the board], but to be legitimated by the appearance of shareholder democracy' regarding voting on matters of a constitutional nature that require the legitimation or approval of the shareholder.[130]

The wisdom behind separation of ownership and control is that vesting control in the board allows for effective and timely decision-making by professionals who possess the necessary skills, experience and acumen to make complex business decisions.[131] Nowhere does this wisdom need to be implemented more than in SOCs. The former CEO of SAA decried the confusion regarding the division of power, noting that the lines of accountability between the CEO, the board and the shareholder on operational matters were blurred and this

128 MM Katz 'Governance under the Companies Act 71 of 2008: Flexibility is the key word' (2010) *Acta Juridica* 248–262 at 258.

129 See King IV Glossary of Terms read with Principle 15.

130 Lynne Dallas 'The relational board: Three theories of corporate boards of directors' (1997) 22 *Journal of Corporation Law* 1–26 at 13.

131 Stephen Marks 'The separation of ownership and control' in Boudewijn Bouckaer and Gerrit de Geest (eds) *Encyclopedia of Law and Economics* (2000) 692–742 at 694–696. See also OECD *Ownership and Governance of State-owned Enterprises: A Compendium of National Practices* (2018).

negatively impacted trust and working relations.[132] Surely, corporate governance cannot be effective in such circumstances.

5.7 CONCLUSION

This chapter sought to examine the ability of SOCs' boards to truly govern the business and affairs of SOCs as provided for in law and governance codes. It also aimed to probe the nature, extent, and impact of shareholder control measures on the boards' ability to govern SOCs effectively.

What is clear is that the true purpose of SOCs is not adequately reflected in the legislation. In fact, the legislation mischaracterises SOCs as profit companies. This mischaracterisation has an effect on how boards govern SOCs because their duties and responsibilities flow from the nature and conceptualisation of the entities they govern. To consider SOCs as merely profit companies means that the primary role and responsibility of the board is to generate profit. Yet, this is not the overarching purpose of SOCs; theirs is often a dual purpose. Therefore, this chapter has strongly argued that the true purpose of SOCs is to serve the public interest and that this must be reflected in their legal definition. Furthermore, directors' duties must be reconsidered to reflect the public interest nature of SOCs.

Several amendments to provisions of the Companies Act, the PFMA and other regulatory instruments have been proposed. However, as will be argued in chapter 7, overarching legislation is required to harmonise the law governing SOCs. Making amendments to existing law will not only be inelegant but will also perpetuate the contradictory nature of the current legal and regulatory framework. Therefore, the amendments proposed in this chapter should form part of the completely new statute. Chapter 7 will examine a single statute approach, its reach and its interplay with existing legislation governing SOCs, after lessons are drawn from Singapore in the next chapter.

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[132] Lameez Omarje 'SAA CEO Vuyani Jarana resigns' available at https://www.fin24.com/Economy/saa-ceo-vuyani-jarana-resigns-20190602 (accessed 21 February 2020).

CHAPTER 6

OWNERSHIP AND CONTROL OF GOVERNMENT-LINKED COMPANIES IN SINGAPORE: 'THE TEMASEK WAY'

6. INTRODUCTION

This chapter examines the extent to which Singapore's state-owned companies (domestically known as government-linked companies (GLCs)) under the parentage and tutelage of Temasek – a state investment holding company – uphold high corporate governance standards to ensure the nation's economic prosperity.[1] The chapter identifies the salient features of the Temasek 'model' and determines how they impact on the overall governance of both Temasek and its subsidiary GLCs. Essentially, like the rest of this thesis, this chapter examines both the ownership and control aspects of the Temasek model and reflects on the model's impact on corporate governance as well as its replicability in other settings, like South Africa. In reflecting on the replicability of the model, some comparisons with the South African environment are inevitably drawn.

As briefly observed in chapter 1, the choice of Singapore and Temasek as a potential model of ownership and control for SOCs is informed by three main reasons: first, Temasek and its subsidiaries (GLCs) are considered an 'unusual breed' of SOCs that are run efficiently and profitably and are highly competitive, domestically and globally.[2] Second, they are world-renowned for

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1 GLCs are subsidiaries or associated companies in which Temasek holds at least 20 per cent of voting shares. They are also called 'Temasek-linked companies'. See Lay-Hong Tan and Jiangyu Wang 'Modelling an effective corporate governance system for China's listed state-owned enterprises: Issues and challenges in a transitional economy' (2007) 7 *Journal of Corporate Law Studies* 143–183 at 173. See also Isabel Sim *Does State Capitalism Work in Singapore? A Study on Ownership, Performance and Corporate Governance of Singapore's Government-linked Companies* (PhD thesis, University of Western Australia, 2011) 66.

2 Carlos Ramirez and Ling Hui Tan 'Singapore Inc. versus the private sector: Are government-linked companies different?' International Monetary Fund Staff Papers WP/03/156 (2003). Due to the success of the Singapore model, other countries are borrowing from it. See Lin Li-Wen and Curtis Milhaupt 'We are the (national)

upholding exceptional corporate governance standards which make them the 'gold standard' for the governance of SOCs.[3] Lastly, Singapore has a common-law legal system and, like South Africa, its corporate law and corporate governance principles have their genesis in UK law and the Cadbury Report respectively. For these reasons, the Temasek model is worthy of examination and possible emulation.

The next section of this chapter explores the socio-economic, political, and cultural context within which Temasek and its subsidiary GLCs exist and operate. This is followed by an examination of the enabling legal and regulatory environment. Thereafter, the focus shifts to the ownership and control arrangement and how it shapes the corporate governance practices of Temasek and its subsidiaries. Finally, the chapter explores the promise and pitfalls of the model, recognising that the replicability of any model must take into consideration the peculiar context that gave rise to, and sustains, such a model.[4]

6.1 'SINGAPORE INC.': A SOCIO-ECONOMIC, POLITICAL, AND CULTURAL CONTEXT

Singapore is a small city-state that became a British crown colony in 1945. In 1963 it became part of the Federation of Malaysia, after the withdrawal of the British. However, the Malaysian Federation soon crumbled, forcing Singapore to become an independent state in 1965.[5] Singapore was a precarious state with no natural resources, rendering its viability as an

champions: Understanding the mechanisms of state capitalism in China' (2013) 65 *Stanford Law Review* 697–759.

3 Curtis Milhaupt and Mariana Pargendler 'Governance challenges of listed state-owned enterprises around the world: National experiences and a framework for reform' (2017) 50 *Cornell International Law Journal* 473–542 at 521.

4 In this regard, see the views of Tan Cheng-Han, Dan Puchniak and Umakanth Varottil 'State-owned enterprises in Singapore: Historical insights into a potential model for reform' (2015) 28 *Columbia Journal of Asian Law* 61–97. The authors explore the extent to which the Singapore model can be transplanted to other jurisdictions. See para 6.5 below. See further the theories of path dependence and gradual hybridisation discussed in chapter 2 (para 2.1).

5 Richard Vietor and Emily Thompson 'Singapore Inc.' Harvard Business School Case 703-040, February 2003 (revised February 2008) 2 available at https://hbr.org/ (accessed 29 October 2018).

independent state almost improbable.[6] This grim reality shaped the political and economic outlook of the ruling People's Action Party (PAP), which has ruled the country since independence. To survive and succeed as an independent state, Singapore's neophyte government had to embark on an ambitious growth path. To this end, the country's first prime minister modelled Singapore on his own values of discipline, strong work ethic, ethnic tolerance, and excellence in education.[7]

On the political front, a governance model characterised as 'soft authoritarianism'[8] in nature and one that operates a system of 'authoritarian constitutionalism'[9] imbued with 'authoritarian pragmatism'[10] was adopted to realise the dream of a prosperous Singapore. In this system, there is no genuine political pluralism and 'reasonably free and fair elections with a moderate degree of repressive control of expression and limits on personal freedom' are observed, essentially rendering the country an 'illiberal democracy'.[11] Although labelled a soft authoritarian state and an illiberal

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6 Lee Kuan Yew *From Third World to First: The Singapore Story 1965–2000* (2002) 3 and 19. The former prime minister and leader of PAP remarks that his party 'inherited the island without its hinterland, a heart without a body' meaning without natural resources, and that the city-state faced 'tremendous odds with an improbable chance of survival.' See Cheng-Han et al op cit note 4 at 75.

7 Kuan Yew ibid.

8 Hussin Mutalib 'Illiberal democracy and the future of opposition in Singapore' (2000) 21 *Third World Quality* 313–342 at 318. A 'soft authoritarian' system is one where some democratic norms are permitted, and opposition is tolerated to the extent that it does not threaten the ruling PAP's hegemony.

9 Singapore is neither a liberal democracy nor a fully authoritarian state. Rather, it is considered to be a constitutionally authoritarian state that allows human rights in moderation. See Mark Tushnet 'Authoritarian constitutionalism' (2015) 100 *Cornell Law Review* 391–461.

10 Kenneth Tan 'The ideology of pragmatism: Neo-liberal globalisation and political authoritarianism in Singapore' (2012) 42 *Journal of Contemporary Asia* 67–92 at 89. The author argues that Singapore is largely driven by pragmatism underpinned by a strong link between economic growth and an authoritarian, meritocratic and technocratic system of governance. See also Richard Carney 'Dominant party authoritarian regime with a strongly dominant ruling party: Singapore' in Richard Carney (ed) *Authoritarian Capitalism: Sovereign Wealth Funds and State-Owned Enterprises in East Asia and Beyond* 214–257.

11 On the lack of political pluralism, see Garry Rodan 'Singapore in 2005: "vibrant and cosmopolitan" without political pluralism' (2006) 46 *Asian Survey* 180–186. On 'illiberal democracy', see Mutalib op cit note 8.

democracy, Singapore has consistently been remarkably transparent and is one of the least corrupt countries in the world.[12]

Notably, when Singapore gained independence, it was faced with enervating levels of unemployment, poverty, high public expenditure, a budget deficit, and no natural resources. To overcome these challenges, the independence government adopted a programme of social reform that would be attained through aggressive industrialisation, explicitly led by the state through GLCs.[13] Yet, industrialisation through state entrepreneurship was not necessarily grounded in ideology. Rather, it was adopted because of a realisation that 'control over key domestic markets and institutions was the most effective way to … meet the main planning objectives of [the country] … and promot[e] economic growth.'[14] Indeed, it was a pragmatic response to an existential threat 'brought about by the reality of an independent Singapore without a hinterland' and near-insurmountable social challenges at independence.[15]

Over time, GLCs have not only served to deliver on the original mandate of economic growth but have also helped the ruling PAP to gain political legitimacy, as a delivering party of the people.[16] It is therefore plausible to suggest that there is both economic and political logic behind state ownership in Singapore.

On the economic front, Singapore identifies as a developmental state that fully embraces pro-business policies, free trade, high corporate governance

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12 Singapore ranks fourth on the corruption perceptions index, which surveys 180 countries. See Transparency International Corruption Perceptions Index (2019), available at https://www.transparency.org/en/cpi/2019 (accessed 10 October 2020).

13 Cheng-Han et al op cit note 4 at 80–81 observe that Singapore established many GLCs using British assets that were bequeathed to it.

14 Cheng-Han et al op cit note 4 at 79.

15 Cheng-Han et al op cit note 4 at 83–84. See also Anthony Shome 'Singapore's state-guided entrepreneurship: A model for transitional economies?' (2009) 11 *New Zealand Journal of Asian Studies* 318–336 at 319–322; and Tan op cit note 10.

16 Cheng-Han et al op cit note 4 at 69.

standards, a strict monetary policy, and a culture of high savings.[17] This outlook has resulted in the country becoming one of the leading developed economies and a reputable international financial centre. Indeed, many economic indicators confirm this fact. For instance, with respect to the Gross Domestic Product (GDP) per capita, Singapore surpasses all but one of the Group of Seven (G7) countries.[18] Singapore's Gini coefficient, which is a measure of income inequality, shows a healthy economy with relatively low levels of inequality. Singapore also has the second highest number of millionaires per capita in the world.[19] Its economic miracle is enabled by, among others, a strong culture of respect for economic freedom and a sterling corporate governance culture. In this latter regard, Singapore ranks highest on corporate governance in Asia.[20]

The state's control of the economy through GLCs accounts for over one-third of the stock market, rendering it the single largest shareholder on the Singapore Stock Exchange (SGX).[21] GLCs deliver greater market returns and are highly valuable, attracting a premium of 20 per cent compared to non-

17 Alan Chong 'Singapore's political economy, 1997–2007: Strategizing economic assurance for globalization' (2007) 47 *Asian Survey* 952–976. The author comments on the Singaporean developmental state and how it has stayed relevant in a globalising world.

18 For a comparison of GDPs see https://www.imf.org/en/Countries (accessed 29 October 2019).

19 Andrew Henderson 'Top 5 countries with the most millionaires per capita' available at http://nomadcapitalist.com/2013/03/31/top-5-countries-by-millionaires-per-capita/ (accessed 29 October 2018). It must be noted, however, that others view the dominance of the state in the economy as a form of 'crowding out the private sector'. See Ho Khai Leong 'Corporate governance reform and the management of GLCs: Pressures, problems and paradoxes' in Ho Khai Leong (ed) *Reforming Corporate Governance in Southeast Asia: Economics, Politics and Regulations* (2005) 282.

20 Singapore ranks number 1 out of 11 Asian economies. See 'Tracking corporate governance in Asia' available at https://www.eastspring.com/lu/perspectives/tracking-corporate-governance-in-asia (accessed 20 October 2018).

21 Cheng-Han et al op cit note 4 at 67; Isabel Sim, Steen Thomson and Gerard Yeong 'The state as shareholder: The case of Singapore' available at https://bschool.nus.edu.sg/Portals/0/docs/FinalReport_SOE_1July2014.pdf (accessed 20 October 2018). The authors note that GLCs account for 37 per cent of Singapore's stock market.

GLCs.[22] Furthermore, they are run efficiently with relatively low expenses and lean operating structures. Importantly, Singapore's 'state capitalism', led by GLCs, debunks the so-called 'Washington consensus', which is a neo-liberal economic view that the state is an inefficient owner and that true economic prosperity can be driven only by private business with a hands-off state.[23]

Culturally, the government and PAP have entrenched an ethos of service and meritocracy in both the private and public sectors. This is underpinned by a Confucian culture that relies on the strength and value of the family in maintaining an orderly society. Confucian values and ethics also include higher obligations to society, leading to a productive people, and entrench an excellent work ethic.[24] In turn, these cultural values are said to create a disciplined and prosperous society.

Undeniably, the story of Singapore's economic success, which is unmatched by many advanced economies, is both astonishing and remarkable. It is an economic miracle underpinned by a culture of efficiency, meritocracy, and a strong work ethic that permeates the fabric of society. For this reason, the

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22 Ramirez and Hui Tan op cit note 2. See further a study of 30 GLCs from 1964 to 1998 that found that they were as profitable and efficient as non-GLCs: Fang Feng, Qian Sun and Wilson Tong 'Do government-linked companies underperform?' (2004) 28 *Journal of Banking and Finance* 2461–2492.

23 Dan Puchniak 'Multiple faces of shareholder power in Asia: Complexity revealed' in Jennifer Hill and Thomas Randall (eds) *Research Handbook on Shareholder Power* (2015) 511–534. The author examines the complexity of shareholder power in Asia and asserts that the Asian 'miracle economies' are led by active shareholders, some of which are states, and that their role is determined by the political and institutional environment, and the societal and business culture in each jurisdiction. On the Washington consensus, which is supposedly 'prudent macroeconomic policies, outward orientation, and free-market capitalism' see generally John Williamson 'What Washington means by policy reform' in John Williamson (ed) *Latin American Adjustment: How Much has Happened?* (1990) 1.

24 Eugene Kheng-Boon Tan 'Law and values in governance: The Singapore way' (2000) 30 *Hong Kong Law Journa*l 91–119; and Christopher Koh Theng Jer 'Corporate governance: Finding an appropriate model for Singapore' (1999) 20 *Singapore Law Review* 51–102 at 61.

country is often called 'Singapore Inc.' signifying the corporate ethos that underpins its overall governance and success.[25]

Against this context, it is now appropriate to examine the legal and regulatory landscape that birthed and guides the operations of Temasek and its subsidiary GLCs, which are at the centre of the country's economic prosperity.

6.2 THE LEGAL AND REGULATORY FRAMEWORK APPLICABLE TO TEMASEK AND GLCs

The influential 'World Bank Ease of Doing Business Report' ranks Singapore as the number 2 country out of 190 countries.[26] A high ease of doing business ranking signifies an efficient legal and regulatory environment that is conducive to starting and operating a business. A closer examination of this environment as it relates to the governance of Temasek and GLCs follows.

Both Temasek and GLCs are incorporated under the Singapore Companies Act.[27] The Act provides for various ways of classifying companies in Singapore, with the most common classifications being whether the liability of members is limited and whether a company is 'private' or 'public'.[28] Interestingly, Temasek and other GLCs are incorporated as 'exempt *private* companies'.[29] In terms of the Act, a private company that is wholly owned by the state may be declared an exempted company if the national interest so requires.[30] Important characteristics of this breed of companies are that transferability of their shares is restricted, membership may not exceed 20, and no corporation may hold a direct or indirect beneficial interest in any of their shares. Furthermore, they are exempted from filing financial statements with

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25 For the salient features of Singapore Inc., see Linda Low 'Rethinking Singapore Inc. and GLCs' (2002) *Southeast Asian Affairs* 282–302 at 283–289.

26 The World Bank 'Doing Business 2020: Reforming to Create Jobs', available at http://www.doingbusiness.org/en/doingbusiness (accessed 6 May 2020).

27 Companies Act 42 of 1967 (Chapter 50, revised edition 2006), hereafter referred to as the Companies Act.

28 Luh Luh Lan *Essentials of Corporate Law and Governance in Singapore* (2018) 27.

29 Chapter 50, paragraph (b) of the definition of 'exempt private company' in section 4(1). See also Tan Lay Hong *The Annotated Singapore Companies Act* (2017) 4.10–4.12 at 17.

30 Tan Cheng-Han (ed) *Walter Woon on Company Law* (2005) 15.

their annual statements. They may not provide loans to directors or companies related to directors.[31]

The above characteristics seem ideal for state ownership. It makes sense that these corporations' shares are not easily transferable, and that their directors may not make loans to themselves in ways that could increase agency costs to the detriment of the state. The issue of not filing financial statements is, however, questionable in that it can potentially compromise transparency. Although exempted by law on this issue, Temasek has been releasing its financial statements since 2004, ostensibly for the sake of transparency.[32]

It is worth noting that Singapore's GLCs do not enjoy any special treatment under the Companies Act simply because they are state-owned. By contrast, South African SOCs can be wholly, partially or conditionally exempt from the application of the Companies Act.[33] It may be argued that the position in Singapore augurs well for corporate governance because the Companies Act is the only statute that comprehensively regulates the governance of companies by regulating the powers and duties of the board (control) and the role and rights of shareholders (ownership). Thus, there is little or no room for overregulation, inconsistency, and overlaps between and among various statutes in Singapore, as is the case in South Africa.

Another interesting fact is that GLCs are subject to the same competition rules as other companies under the Singapore Competition Act.[34] Although the Act provides for 'public interest' or 'minister-led' exemptions, they have not been invoked in favour of GLCs.[35] As proof of the fact that competition rules are indeed fully applicable to GLCs, the Competition Commission of Singapore (CCS) fined SSTIC (a state-owned ticketing company) for abuse of

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31 Sections 4 and 163 of the Companies Act. For a list of wholly state-owned companies incorporated as exempt private companies, see Companies (Exempt Private Companies) (Consolidation) Notification N8 G.N. No. S 252/2002 (revised edition 2004).

32 Temasek Review (2014) available at https://www.temasek.com.sg/en/our-financials/library/temasek-review (accessed 10 May 2019).

33 Section 9 of the Companies Act.

34 Competition Act 46 of 2004.

35 Sections 34, 35, 47 and 48 of the Competition Act.

market dominance.[36] This is the only reported case where a GLC was fined for anti-competitive behaviour, and illustrates the fact that 'government liability under the Act is not illusory'.[37]

Other than complying with binding legal rules, GLCs also comply with the corporate governance codes. At the behest of the Ministry of Finance and the Monetary Authority of Singapore (MAS), the first code of corporate governance was drafted by a private-sector-led committee (the Committee on Corporate Governance) and its recommendations were accepted by MAS in 2001.[38] The Code was then revised in 2005, 2012 and 2018. This Code, like many across the world, is broadly modelled on the UK Cadbury Report. It is a voluntary code with an underlying philosophy of 'comply-or-explain'.[39]

It is important to note that although the Code is drafted and updated by a private-sector-led committee, it must be ratified by MAS before it becomes effective. Over the years, MAS has actively driven corporate governance beyond just issuing a code.[40] Importantly, in 2007, MAS took over from the SGX the primary role of regulating corporate governance in listed companies, thus signalling a shift away from pure self-regulation (through the SGX) to government-backed regulation. Arguably, this demonstrates the seriousness with which the government views regulation and compliance with corporate governance standards in Singapore.[41]

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36 See Kala Anandarajah 'Competition law' (2012) 13 *Singapore Academy of Law Annual Review* 153–179 at 166–167.

37 Deborah Healey 'Application of competition laws to government in Asia: The Singapore story' Asian Law Institute Working Paper Series No. 025 (2011) 21.

38 The Monetary Authority of Singapore (MAS) is a statutory body governed by the Monetary Authority of Singapore Act (CAP 186, 1999 Revised Edition). One of its duties is to facilitate compliance with the law on securities regulation by issuing guidelines, circulars, and notices. See Luh Luh Lan op cit note 28 at 7.

39 In this regard see the 2018 Code (Introduction, para 7). However, viewed in the context of the stock exchange listing requirements, the code is mandatory for all listed companies because the listing requirements so declare. Any company that fails to comply loses its listing.

40 See Kala Anandarajah *Corporate Governance: Practical Issues* (2010) 7–12. The author provides a useful account of the key milestones in the evolution of corporate governance in Singapore.

41 Kala Anandarajah 'Corporate governance reforms in Singapore: Economic realities, political institutions, and regulatory frameworks' in Khai Leong op cit note 19 at 225–

It is submitted that Singapore is probably ranked number 1 in Asia on corporate governance because the regulatory space is led by a statutory authority (MAS). This statutory regulator has the legal responsibility and authority to enforce compliance, thus ensuring a responsive regulatory system. Significantly, MAS operates in a harmonious fashion with other (self)-regulators like the stock exchange.[42] By contrast, regulatory oversight in South Africa is dispersed, uncoordinated, and led by self-regulation bodies that lack any legislative authority to provide oversight and enforce compliance.

Beyond the corporate governance code, listed Singapore companies must comply with the SGX Listing Requirements, which in many respects complement the Code.[43] Many GLCs are listed and are therefore obliged to comply with the Listing Requirements. The SGX acts as an additional regulator of listed companies and is by law required to cooperate with MAS in the latter's fulfilment of regulatory functions, particularly ensuring that listed companies comply with rules and regulations.[44] This confirms that there is indeed legislated harmony and complementarity between regulators, which is lamentably absent in South Africa.

Evidently, Singapore operates a unitary legal and regulatory system applicable to all companies, regardless of whether they are state-owned or not. This is different to the South African environment which is dual in nature, and where SOCs are subject to the ordinary laws and regulations applicable to all public companies (the Companies Act, the King Code and the JSE Listing Requirements) and to other laws and regulations applicable only to

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254. See also Yvonne Lee 'The corporate rule of law: Governing Singapore's securities regulators' (2007) 3 *Corporate Governance Law Review* 225–254. The author notes that regulatory bodies function in a coordinated and complementary fashion.

42 The regulatory bodies are seen as responsive in that where rules are difficult to implement or have undesired consequences, they are swiftly modified or completely removed. See Anandarajah op cit note 41 at 267.

43 Rule 710 of the Singapore Exchange Listing Manual provides that all listed companies shall detail how they have implemented the principles of the Corporate Governance Code in line with the comply-or-explain approach.

44 Luh Luh Lan op cit note 28 at 7.

state entities (the PFMA, PAJA, founding legislation, and the Protocol on Corporate Governance in the Public Sector). As argued in chapter 3, this duality creates onerous overregulation, puzzling overlaps, duplication, and disjointedness, all of which impact negatively on compliance with corporate governance standards.[45]

A unitary system, as followed in Singapore, avoids the challenges presented by a dual system. Additionally, and perhaps most importantly, a unitary system ensures certainty, predictability, consistency, and compliance. Furthermore, the system guarantees competitive neutrality as GLCs are forced to play by the same rules as other listed companies. This in turn forces them to follow sound corporate governance practices. That said, a unitary system is probably ideal for an environment where SOCs are run on a purely commercial basis, as in Singapore, where they are not burdened with a social or public mandate, as in South Africa. Whether South Africa also needs to adopt a unitary system or should retain a dual system with modifications to address some of its apparent weaknesses will be addressed in the next chapter.

6.3 THE OWNERSHIP OF TEMASEK AND GLCs: A STATE HOLDING COMPANY MODEL

As seen in chapter 4, state ownership can take one of three forms. It can either be decentralised between various ministries (also known as the sector model), or it can be dual, where the ownership function is performed by two ministries. Alternatively, it can be completely centralised within a single state holding company or government agency. In Singapore, state ownership is primarily centralised in a state holding company (Temasek), which discharges all the shareholder functions over its subsidiaries. What follows is a deeper examination of the ownership model of Temasek and its relationship with its shareholder to determine the extent to which the ownership arrangement enables sound corporate governance within the public sector.

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45 See chapter 3 (para 3.6).

6.3.1 The nature of Temasek as a constitutional steward

Temasek holdings was established to kickstart Singapore's industrialisation in 1974. It is a creature of the Constitution of Singapore, listed under the fifth schedule.[46] Temasek is also incorporated under the Companies Act as an exempt private company. Its primary mandate is to own and commercially manage Singapore's investments and assets.[47] Its initial capitalisation in 1974 consisted of a portfolio of 35 companies that were state-owned. At the time, the net portfolio value was S$354 million and in 2019 it was a staggering S$313 billion.[48]

Temasek is exclusively owned by the state through the Minister of Finance, who discharges shareholder functions in a representative capacity.[49] The company was established due to the realisation that the government needed to focus on its core functions of policymaking and regulation, while a commercial entity would own and manage state investments and assets on a commercial basis. The government had realised that:

> One of the tragic illusions that many countries of the Third World entertain is the notion that politicians and civil servants can successfully perform entrepreneurial functions. It is curious that, in the face of overwhelming evidence to the contrary, the belief persists.[50]

The idea of separating the role of policymaking from regulation and shareholding is now embraced as the gold standard of state ownership.[51] The

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46 See Article 22C read with Part II of the Fifth Schedule of the Constitution of Singapore (1965, as amended).

47 Temasek is also considered to be a Sovereign Wealth Fund (SWF). See Paul Rose 'Sovereigns as shareholders' (2008) 87 *North Carolina Law Review* 83–149 at 85; and Gerard Lyons 'State capitalism: The rise of sovereign wealth funds' (2008) 14 *Law and Business Review of the Americas* 1–62. The author notes that Temasek is one of the largest seven SWFs known as 'The Super Seven'.

48 Temasek Review (2019) available at https://www.temasek.com.sg/en/our-financials/library/temasek-review (accessed 10 May 2019).

49 See ss 2 and 3 of the Minister of Finance Act of 1959 (2014 edition).

50 Deputy Prime Minister, Dr Goh Keng Swee, made this observation in 1972, quoted in Isabel Sim et al 'The state as shareholder: The case of Singapore' at 15, available at https://bschool.nus.edu.sg/Portals/0/docs/FinalReport_SOE_1July2014.pdf (accessed 20 October 2018).

51 OECD *OECD Guidelines on Corporate Governance of State-Owned Enterprises* (2015). 'The exercise of ownership rights should be centralised in a single ownership function,

understanding that conflated roles compromise corporate governance and performance is in fact what led to the creation of Temasek as an interposition between politicians and state entrepreneurial endeavours.

Temasek is considered a 'behemoth, comparable with some of the world's largest conglomerates.'[52] It commands an impressive globalised portfolio with a smorgasbord of business interests held by its subsidiary GLCs. These include banking and finance, shipping and ports, telecommunications and media, power and utilities, and aviation and transportation.

Notably, Temasek subscribes to mixed ownership, including foreign ownership of its subsidiary GLCs. In this mixed ownership arrangement, particularly where it does not hold the majority shareholding, it prefers to hold a 'golden share', especially in the more strategic GLCs.[53] Unlike many of its subsidiary GLCs, Temasek itself is not listed on the Singapore Stock Exchange, presumably to shield it from the unpredictability and turbulence that sometimes affects the capital markets.

The philosophy and outlook of Temasek is three-pronged: It identifies as an 'active investor' that delivers sustainable value over the long term. It is also a 'forward-looking institution' – a generational investor – that invests in people and good corporate governance and is primarily interested in long-term rather than short-term returns. Finally, it strives to be a company with a corporate conscience, a 'trusted steward' of the people that seeks to advance communities across generations.[54] This guiding philosophy is realised through the pursuit of an unmistakeably commercial agenda in a resolutely independent fashion. These two factors and their impact on the overall governance of Temasek are discussed in turn.

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or, if this is not possible, carried out by a co-ordinating body.' See also World Bank Group *Corporate Governance of State-owned Enterprises: A Toolkit* (2014) chapter 3.

52 Khai Leong op cit note 19 at 276.

53 Healey op cit note 37 at 8–11. The golden shares are meant to secure Singapore's national strategic objectives.

54 Temasek Review (2013) and Temasek Review (2018) available at https://www.temasek.com.sg/en/our-financials/library/temasek-review (accessed 10 May 2019).

6.3.2 Commercial orientation and independence

As indicated already, Singapore's economic policy has always been that of state-entrepreneurship facilitated and led by Temasek and its subsidiary GLCs. Effectively, these corporations are instruments of state capitalism. They constitute what others aptly call the 'commercial arm' of the state.[55] At the heart of any capitalist project is the goal of shareholder wealth maximisation. This is also the objective of Temasek and its subsidiaries, namely, to help Singapore meet its developmental aspirations by being value-oriented and declaring dividends that are used for development, including welfare. It follows that any GLC within the Temasek stable that fails to advance the mission of shareholder (state) wealth maximisation will be offloaded. In contrast, in South Africa, there is a puzzling aversion to divesting from perennially failing SOCs even if they are non-strategic. A good example is the reluctance to sell SAA despite being financially unviable for over a decade.

In the true spirit of capitalism, GLCs are subject to market discipline, and commercial viability informs Temasek's continued investment in them. In this regard both Temasek and its GLCs enjoy carte blanche in their commercial decisions, but they are accountable to the shareholder (the state) for those decisions. To illustrate this point, Temasek once made a politically controversial investment in neighbouring Thailand; the government's attitude was that the company was at liberty to invest in whichever venture it deemed commercially viable and that the government had no say in such commercial decisions.[56] As contended in chapters 4 and 5, the situation in South Africa is different. Shareholder-representatives of many SOCs constantly interfere in commercial decisions in ways that weaken boards and compromise governance.

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55 Christopher Chen 'Solving the puzzle of corporate governance of state-owned enterprises: The path of the Temasek model in Singapore and lessons for China' (2016) 36 *Northwestern Journal of International Law and Business* 303–370 at 313.

56 Lee op cit note 41.

It is worth noting that it is constitutionally impermissible for Temasek to draw on past reserves unless the transaction is approved by the State President, who is constitutionally empowered to provide fiscal oversight over past reserves.[57] The restriction on drawing on past reserves compels Temasek and, by extension, its subsidiary GLCs, to be commercially viable and sustainable. By necessary implication, this also means that 'soft budget constraints' (bailouts) in the form of government guarantees, endless loans and capital injections would be difficult to obtain. In contrast, soft budget constraints are the norm rather than the exception in South Africa. As argued in chapter 3, where soft budget constraints are impermissible, the corporation is forced to survive on the strength of its balance sheet and for that reason it is incentivised to observe sound corporate governance and be commercially viable.[58]

Despite not receiving preferential treatment and soft budget constraints from the state, Temasek and its GLCs outperform or at least equal the profitability and efficiency of non-GLCs. They have, therefore, truly 'don[ned] the golden straitjacket of market discipline', which demands corporate efficiency and profitability for continued survival.[59] Interestingly, yet unsurprisingly, they loath the label of 'SOE' because of the negative connotations of poor corporate governance, weak performance and political meddling that the term often attracts in many jurisdictions. Instead, they prefer to be seen as companies like any other, but with links to the state, hence the term 'government-linked companies'.[60] This may seem trivial at first, however, properly considered, it is a deliberate and significant mindset that positions Temasek and its GLCs as purely commercial vehicles concerned only with securing dividends for their shareholder. It also shows their dislike for political interference.

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57 Yvonne Lee 'Under lock and key: The evolving role of the elected president as a fiscal guardian' (2007) 290 *Singapore Journal of Legal Studies* 290–322.

58 See chapter 3 (para 3.1.4).

59 Shome op cit note 15 at 327.

60 Linda Low 'Rethinking Singapore Inc. and GLCS' (2002) *Southeast Asian Affairs* 282–302.

To boost efficiency, the Temasek portfolio is organised into groups of companies that serve as 'national champions'. For example, companies in the aviation industry are grouped together under the banner of the Singapore Airlines Group, which owns several subsidiaries in low cost airlines, engineering, and travel. The clear advantages of this approach are that the entire group extracts synergies in shared services, such as engineering, cargo, data systems and algorithms, and the group has one healthy balance sheet. Since the ownership arrangement is in a group, this also means that subsidiaries are shielded from politicians as they are owned by the Singapore Airlines Group, which is in turn owned by Temasek.

In South Africa, the opposite is true. SOCs in the aviation industry, such as SAA, SA Air Link, Mango and ACSA, are all independent companies with their own boards and surprisingly different shareholder ministers, who impose different political and economic agendas. The shareholders' proximity to corporate operations also leads to political interference and myriad agency and principal costs, which impact negatively on governance.[61]

Additionally, since these otherwise related companies are dispersed, their resources are not shared, despite them all being in the aviation business. This then results in costly inefficiencies. For instance, when one company faces financial difficulties, as is currently the case with SAA and SA Air Link, it independently approaches government for a bailout whereas it could leverage the group balance sheet if all the aviation companies were under one holding company. Clearly, the ownership arrangement in South Africa is irrationally dispersed into small companies that have different shareholder-representatives, resulting in confused governance and poor performance.

6.3.3 Government ownership of Temasek: An active but not activist shareholder?

Temasek is exclusively state-owned. In many jurisdictions, this type of exclusive ownership typically attracts shareholder interference. However, in

61 See chapter 4 (para 4.2).

the case of Temasek, the state is surprisingly distant although not apathetic. As a shareholder, the government receives regular updates on the performance of GLCs and holds Temasek accountable for any underperformance.[62] The shareholder also allows Temasek the authority and autonomy necessary for the discharge of its constitutional mandate. The distance maintained by the state occurs in the context of a country where shareholders are generally not activist.[63]

The interposition of Temasek between the government and the GLCs was not aimed only at addressing the agency predicament; it was also aimed at insulating GLCs from political influence and strengthening their commercial orientation.[64] Reflecting on the separation of roles, the former CEO of Temasek once remarked that:

> As a monitoring arm of the Ministry of Finance, we were responsible for tracking the performance of the various investments and companies, and for reviewing and appointing directors and chairmen to the boards of various companies to represent the government's interest as a shareholder. This … clearly separated the incidental role of government as an owner and shareholder, from its over-arching responsibility as policymaker and market regulator. A mandate was thus tacitly given for government-owned companies to operate purely as commercial enterprises, and for Temasek to deliver value as an investment holding company.[65]

The chairman of the Temasek board echoed the CEO when he observed that 'this move [of establishing Temasek] clearly separated authority and responsibility between policymaking and enterprise ownership. It is a distinction that still serves us well today, 44 years later.'[66]

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62 Shome op cit note 15 at 326.

63 Luh Luh Lan and Umakanth Varottil 'Shareholder empowerment in controlled companies: The case of Singapore' in Jennifer Hill and Thomas Randall (eds) *Research Handbook on Shareholder Power* (2015) 581.

64 Milhaupt and Pargendler op cit note 3 at 519 and Puchniak op cit note 23 at 529.

65 Ho Ching 'Temasek Holdings: Building sustainable value' *Institute of Policy Studies*, published in *Straits Times*, 13 February 2004, quoted in Khai Leong op cit note 19 at 277–278.

66 Temasek Review (2018) op cit note 54 at 10.

In sum, the government actively engages Temasek on its overall performance but in so doing does not overstep its shareholder boundaries. It appreciates the very rationale that informed the creation of Temasek as an interposition between government and business activities to shield it from political interference, as well as the wisdom of not conflating various roles. All this is possible because of a particular mindset that politicians and bureaucrats have maintained since the creation of Temasek in 1974.

6.3.4 The powers and rights of Temasek's shareholder

The shareholder of Temasek operates within a constitutional framework. Since Temasek is a creation of the Constitution, the powers regarding the appointment and removal of its board of directors and CEO are spelt out in the Constitution. Such appointment or removal can happen only if the President concurs with it.[67] However, where the President unreasonably withholds concurrence, the Constitution allows for a 'constitutional bypass' in that Parliament may overrule the decision by passing a resolution supported by no less than two-thirds of the members of Parliament. Such an action will then be constitutionally attributed to the President.[68] The high threshold of a two-thirds majority required to pass the resolution ensures that the decision receives overwhelming support. Where the ruling party seeks to appoint along patronage lines rather than merit, the resolution would presumably not be easy to pass because it would not enjoy the support of the opposition. Similarly, where the removal is in pursuance of narrow political interests, the resolution would also be difficult to pass because of the high percentage of votes required.

Another constitutional power over Temasek and its GLCs is the power given to the President to exercise his discretion to refuse the approval of any budget or transaction that has the effect of drawing on past government reserves.[69] As argued earlier, this compels Temasek and its GLCs to maintain healthy

67 Constitution of Singapore (1999 Reprint) s 22(C)(1A).
68 Constitution of Singapore (1999 Reprint) s 22(C)(1B).
69 Constitution of Singapore (1999 Reprint) s 22(C)(1B) and Lee op cit note 57.

balance sheets, which are generally characteristic of sound corporate governance practices. The fiscal oversight by the President also makes 'soft budget constraints' difficult to obtain, thus forcing Temasek and its subsidiaries to practise sound corporate governance and work towards strong performance.

It may be argued that the powers and rights of government in the Constitution are aimed at ensuring that the boards and management of Temasek and GLCs pursue public interest.[70] Therefore, similar constitutional guarantees would make sense in an environment such as South Africa, where SOCs are perennially underperforming and are constantly receiving government bailouts. Furthermore, they would make sense because board appointments are mostly informed by patronage, while removals are sometimes informed by political expediency rather than public interest. However, it could also be argued that such constitutional guarantees would be inflexible, particularly where the exigencies of business demand amendments. This is because constitutions are typically difficult to amend, compared to ordinary legislation. How South Africa should approach the question of the composition of SOCs' boards, including the issues of the appointment and removal of directors, will be explored in the next chapter, where a model of ownership and control is proposed.

6.4 THE CONTROL OF TEMASEK AND GLCs: A CORPORATE GOVERNANCE PERSPECTIVE

Singapore's corporate governance framework, like many across the world, comprises a blend of mandatory rules, contained mostly in the Companies Act, the Securities and Futures Act, and the Listing Rules of the SGX, as well as best practice recommendations contained in the Code of Corporate Governance issued by MAS.[71] This framework applies to all public companies and GLCs in equal measure.

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70 Chen op cit note 55 at 321.

71 Annabelle Yip and Joy Tan 'Chapter 21: Singapore' in Willem Calkoen (ed) *The Corporate Governance Review* (2013) 290–303 at 290.

Temasek as a holding company has achieved high corporate governance scores, which in turn set the governance tone for its subsidiary GLCs. However, others have questioned its influence on the overall governance of its portfolio GLCs, asking whether it 'really impose[s] good corporate governance standards on its domestic portfolio[.] Or is Temasek's good image merely public relations puffery?'[72] An answer to these questions requires a deeper examination of the relationship between Temasek (as a shareholder) and its subsidiaries. It is important to assess Temasek's role in the appointment and removal of its subsidiaries' boards, their structure and composition, their independence and authority, as well as directors' duties, to establish the true nature of the relationship and how it affects the governance of subsidiaries. These aspects are the building blocks of a sound corporate governance system, particularly for SOCs.

6.4.1 Structure, composition and duties of boards

Singapore operates a system of single-tier boards whose responsibility is to oversee and supervise the management of the company. The memorandum and articles of association of companies spell out the roles of the chair and board in fulfilling their responsibilities. Additionally, the Companies Act, amplified by the Code of Corporate Governance, describes the roles and competencies of the chair and the entire board. The Act also provides for a mandatory audit committee for listed companies and determines its composition, while the Code provides for additional committees.[73]

In terms of board composition, the Companies Act provides that only natural persons who are at least 18 years old and of full capacity may act as directors.[74] Unsurprisingly, directors' duties in Singapore are similar to those in other common-law jurisdictions. They are provided for partly at common law and partly in the Companies Act. As fiduciaries, directors owe the duties

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72 Chen op cit note 55 at 306.

73 Studies have shown that the boards of Temasek and GLCs are composed of predominantly non-executive directors, and the roles of the Chairman and the CEO are separated. See Sim et al op cit note 50 at 27.

74 Section 145(2) of the Companies Act.

of honesty, good faith, care, and skill to the company and always must act bona fide and in the best interests of the company.[75]

A unique feature of the Temasek board is that it has fortified itself with international expertise by creating advisory panels.[76] For instance, in 2004, it created the Temasek International Panel, which is largely composed of prominent international business people and political figures, including the former Australian Prime Minister and former CEO of Exxon Mobile. The primary role of the international panel is to offer global business perspectives to the board.[77] Additionally, Temasek has created a Temasek Advisory Panel composed of prominent entrepreneurs who serve on the boards of internationally reputable companies. Their primary role is to advise the board and senior management on workable global strategies for Temasek.[78]

Remarkably, Temasek does not only fortify itself with international expertise at the board level; it also encourages and allows the boards of its various subsidiary GLCs to recruit foreign CEOs, where there is no local talent, in order to render the GLCs more global and responsive to global business demands and competition.[79] In contrast, this practice of hiring foreign executives for SOCs is unknown in South Africa.

So, in terms of the board structure, composition and duties as stipulated in the law, the Singapore system seems to be on all fours with that of South Africa. Yet, the quality of corporate governance and the overall performance of Temasek and its GLCs is far superior to that of South African SOCs. Could the difference be attributed to the implementation of rules and codes or to who serves on boards (and advisory panels) and how they are appointed and removed? Could this in turn have a bearing on the boards' independence from political direction and the necessary authority to direct the companies? In

75 Yip and Tan op cit 295.

76 These advisory panels are created pursuant to s 157C of the Companies Act.

77 Chen op cit note 55 at 323.

78 Ibid.

79 This has been criticised by some government backbenchers. See Khai Leong op cit note 19 at 288.

short, the question is: If the content of company law and corporate governance standards in Singapore is generally comparable to that in South Africa, what makes the Singapore model flourish and the South African model flounder? These vexed questions are addressed next.

6.4.2 Adherence to corporate law and governance practices

As previously observed, Singapore operates a unitary system where all companies regardless of ownership are subjected to a single system of corporate law and governance. This system is overseen by a statutory regulatory body, leaving self-regulation to play a complementary as opposed to a primary role in corporate regulatory affairs. Temasek also leads by example on corporate governance and performance, thus setting a governance tone for the rest of the GLCs.[80] Confucian values of discipline and ethics improve adherence to corporate rules and governance practices. Collectively, these offer a plausible explanation why Temasek and its GLCs have a culture of adherence to rules and codes and why they rank high on various corporate governance indices in Asia and beyond.

6.4.3 Appointment and removal of directors

The composition of the boards of GLCs is regulated by the Companies Act, which does not prescriptively provide for any specific number of board members. Neither the Companies Act nor any other statute requires the state to be represented on the boards of GLCs. Even the shareholder of GLCs – Temasek – does not control the directors of the boards of its subsidiary GLCs.[81] This is important as it limits political interaction with state companies and thus ensures some level of board independence in GLCs. Within Temasek, however, the law requires that two board members out of a board of nine members be government representatives, namely, the Permanent Secretary of the Ministry of Trade and Industry and the Permanent

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80 Although Temasek leads on the corporate governance front, its board diversity is questionable. Only one woman sits on a 13-member board. See Temasek Board Composition available at https://www.temasek.com.sg/en/who-we-are/our-leadership.html (accessed 12 June 2020).

81 Chen op cit note 55 at 339.

Secretary of the Ministry of Finance.[82] In addition to these bureaucrats, the practice is to appoint retired ministers and leading industrialists who exude charisma, integrity, and authority.[83] These practices are ostensibly aimed at securing the government's policy objectives.

6.4.4 Autonomy and authority of boards

One of the important hallmarks of an effective board is autonomy from management and shareholders so as to enable the board to effectively monitor the former and to protect the interests of the latter.[84] The other hallmark is being clothed with the requisite authority to make decisions for the company. For the board to enjoy both autonomy and authority, the shareholder(s) must not encroach on what is otherwise board territory. It is important to note that the shareholders' role in governance can be either 'offensive' or 'defensive'.[85] An offensive governance posture is typified by a shareholder who directly engages management not only on governance issues but even on business matters, such as advising on business strategy. A defensive governance posture is one where the shareholder's role is limited to voting, approval of fundamental transactions, and other traditional shareholder functions as stipulated by the law and recommended governance practices.

In many jurisdictions, including South Africa, shareholder-representatives in SOCs adopt an offensive and unhealthy governance posture, interfering in what is traditionally the terrain of either the board or management.[86] The converse is the case in Singapore. Both the Ministry of Finance as the sole shareholder of Temasek and Temasek as a shareholder in its GLCs adopt a defensive governance approach. According to one commentator, the top listed

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82 Shome op cit note 15 at 324.

83 Tan and Wang op cit note 1 at 174.

84 See Daniele Marchesani 'The concept of autonomy and the independent director of public corporations' (2005) 2 *Berkeley Business Law Journal* 315–353 at 335. See also chapter 5 (para 5.3).

85 On the notion of the 'offensive' and 'defensive' governance approaches, see Paul Rose 'Sovereign investing and corporate governance: Evidence and policy' (2013) 18 *Fordham Journal of Corporate and Finance Law* 913–962.

86 See chapter 4 (para 4.3).

GLCs in which Temasek is a shareholder have greater board independence than other top listed companies in Singapore. This is partly attributable to the fact that Temasek is a distant shareholder in its GLCs, just as the state, through the Ministry of Finance, is a distant shareholder in Temasek.[87] Another commentator agrees with this observation and notes that:

> Temasek's role is one of strategy and oversight, and distances itself from the operational management of the GLCs. Temasek's 'voluntary abstinence from direct involvement in the operational management of state-owned enterprise[s] is a unique and admirable ownership stance'.[88]

In one empirical study that surveyed the state of corporate governance in GLCs, it was found that GLCs have a higher proportion of independent directors and most have an independent chairman, compared to non-GLCs. Furthermore, the boards of GLCs also appeared to be more independent from the major shareholder than the boards of non-GLCs.[89] However, the level of independence of GLCs' boards has been questioned because of the tendency to appoint retired bureaucrats and apparatchiks.[90]

At a pragmatic level, though, the independence of GLCs has been demonstrated. For instance, as observed earlier, the government declined to interfere with the investment decisions of its companies even when they were deemed politically controversial and possibly detrimental to the state's diplomatic relations with its neighbour. Rather, the government emphasised that it had no role in the business or operational decision-making of GLCs.[91]

The picture presented above leads to the conclusion that the boards of GLCs enjoy the necessary autonomy and authority to make decisions unimpeded by the political considerations that are usually brought to bear by the political

87 Chen op cit note 55.
88 Shome op cit note 15 at 326.
89 Sim et al op cit note 50.
90 Ibid 27.
91 See the discussion on commercial orientation in para 6.3.2 above.

class in other jurisdictions. Indeed, this appears to be one factor that makes the Singapore model attractive.

6.4.5 The effect of listing and co-ownership on corporate governance

As the shareholder-representative of the government in GLCs, Temasek prefers most of its subsidiaries to be publicly listed. This is intended to subject them to the rigours of market competition and discipline, which require companies to be efficient and profitable to remain afloat.[92] Over and above listing in Singapore and beyond, GLCs invest in multinational companies (MNCs) that are listed on various stock exchanges around the world. These foreign investments require GLCs and Temasek to comply with various foreign laws and listing requirements in order to maintain their listing on those stock exchanges.

It is trite that listing requirements impose binding requirements beyond corporate laws. Although the requirements are not legally binding per se, they tend to be indirectly binding in that listing is conditional on compliance. The net effect of the GLCs' exposure to multiple listing requirements is that they and their parent, Temasek, are forced to uphold high corporate governance standards imposed by various quarters.

Temasek is not the sole shareholder of all its subsidiary GLCs. It mostly holds controlling stakes in GLCs that are considered strategic. This means that GLCs are co-owned by Temasek and other shareholders, some of which are foreign. These other shareholders require efficiency and profitability and tend to demand high corporate governance standards from GLCs in order to realise their returns on investment. Therefore, the effect of this co-ownership and multiple listing is to significantly improve corporate governance in Singapore GLCs and this is what sets them apart from SOCs in South Africa, where both co-ownership and listing are the exception rather than the norm.

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92 Sim et al op cit note 50 at 27. The authors note that a staggering 73 per cent of GLCs are listed.

6.4.6 The overall corporate governance outlook

Having examined the various aspects of corporate governance above, it is now possible to provide an overall picture of the state of corporate governance in Temasek and its GLCs, highlighting a catalogue of attributes that set them apart as 'good' companies in a corporate governance continuum of 'the good, the bad, and the ugly'.[93] These attributes include the following:

- Temasek and its subsidiary GLCs operate in a unitary legal and regulatory environment enforced by a statutory regulator in a coordinated and complementary fashion with self-regulatory bodies, thus ensuring responsive regulation.
- The companies are governed by fit and proper directors who are charismatic and highly skilled. The boards also enjoy both domestic and international advisory services provided by international panels and advisory teams.
- The boards have a culture of compliance with corporate rules and governance practices. They comprise the right mix of executive directors and non-executive directors, separate the CEO and chairman roles, and maintain adequate board committees.
- The appointment and removal of Temasek directors is constitutionally entrenched while political deployment in GLCs is discouraged, thus ensuring limited political interaction and interference.
- The shareholder of Temasek and Temasek in respect of its subsidiary GLCs prefer a 'defensive' governance posture, thus giving the boards and management the necessary autonomy and authority to govern.
- The shareholder of Temasek and Temasek in respect of its subsidiary GLCs also prefer a pure commercial orientation and to that end encourage co-ownership and listing on stock exchanges, which in turn

93 See generally Chew Heng Ching *Casebook on Corporate Governance: The Good, the Bad and the Ugly* (2009).

forces the companies to observe high corporate governance standards so as to be competitive and remain listed on various stock exchanges.

- Temasek and its subsidiary GLCs have sound audit and accountability structures and measures in place, which enable them to govern risk well. The boards also communicate effectively with their respective shareholders, compared to non-GLCs. In addition, they have more accountable CEOs and executive directors (some of whom are foreigners) due to effective remuneration disclosure mechanisms, when compared to non-GLCs.[94]

The corporate governance and performance outlook of Temasek and its GLCs explored above is undoubtedly positive. Accordingly, all the major credit rating agencies rate Temasek and its GLCs at 'AAA' which is the highest possible rating, indicative of not only their creditworthiness but also the quality of their corporate governance.[95]

At this stage, the question that needs to be answered is whether the Temasek model is replicable, given that it is a product of Singapore's idiosyncratic factors, such as history, culture, and political orientation, to name a few.[96] In the next section, this question is answered and in the process the promise and pitfalls of the Temasek model are reflected upon. This is done with the South African SOC landscape in mind.

6.5 THE PROMISE AND PITFALLS OF 'THE TEMASEK WAY'

Before examining the pros and cons of the Temasek model, it is important to note that its indisputable success dislodges two common fallacies that have gained traction over time. First, the success of the model proves that privatisation is no panacea for all states. Indeed, the Temasek model proves

94 Grant Kirkpatrick 'Managing state assets to achieve developmental goals: The case of Singapore and other countries in the region' available at https://www.oecd.org/daf/ca/Workshop_SOEsDevelopmentProcess_Singapore.pdf (accessed 10 March 2019) 13.

95 Temasek Review (2018) op cit note 54 at 31; Chen op cit note 55 at 311–312, and chapter 3 (para 3.4.3).

96 Cheng-Han et al op cit note 4 have reflected on these questions.

that state ownership can still lead to overwhelmingly successful economies, contrary to the neo-liberal economic world view, which advocates free-market fundamentalism led exclusively by private ownership. Second, the model deals a huge blow to the view that state ownership is synonymous with poor corporate governance and weak performance. Therefore, in this respect alone, the Temasek way of ownership and control is full of promise, particularly for the developing world that is yearning for a counter-hegemonic economic model.

Turning to the question of whether the model is replicable, it has been suggested that although the model is unique, this does not necessarily mean that it cannot be replicated. Rather, for it to be successfully copied, certain conditions must be present. In this regard, it has been cautioned that there are certain factors that gave birth to and sustain the Temasek model, and these are to some degree peculiar to Singapore. Therefore, any attempt to replicate or adapt the model must be mindful of these factors.[97]

The first factor to consider is that the model was developed because of a need for survival, not only of the state but of the ruling party as well. Thus, there is both political and economic logic behind the model. Put differently, the future of the ruling party and the state itself are intertwined with the future of 'Singapore Inc.' to such an extent that if the Temasek model fails, the ruling party will likely lose power and the viability of the state will be at risk. This logic does not seem to apply in South Africa. Despite the extremely poor performance of all the strategic SOCs over a sustained period of time, the ruling ANC continues to receive an electoral mandate every five years to continue running the country.

Second, the Temasek model is underpinned by a corruption-free environment where there are high standards of accountability and integrity.[98] This

97 Ibid.

98 See Tan Cheng-Han 'The Beijing consensus and possible lessons from the "Singapore model"' in Weiteng Chen (ed) *The Beijing Consensus? How China has Changed Western Ideas of Law and Economic Development* (2017) 69–93.

environment is propelled by Confucian values that emphasise ethics and order in society. By all accounts, the South African corporate and public sectors are mired in corruption, with the public sector being the epicentre of massive corruption, as is currently being revealed by the commission on state capture.[99]

Third, the Temasek model is sustained by a culture of meritocracy, efficiency, and an exceptional work ethic in the workforce, so that where skills are unavailable locally, international talent is brought in to lead GLCs and serve on boards. In the South African setting, meritocracy is substituted with political patronage (cadre deployment) and nepotism, so that SOCs are not always led by the most talented individuals. Reversing this culture of patronage may prove challenging in reforming the sector.

Fourth, the unitary legal and regulatory space that gave birth to and sustains the Temasek model is responsive, thus ensuring compliance with both rules and best corporate governance practices. As demonstrated in chapter 3, the legal and regulatory framework in South Africa is the complete opposite. It is dual in nature, uncoordinated and unresponsive, leading to poor compliance and weak performance.

Fifth, the Temasek model is quintessentially commercial, with a strong emphasis placed on shareholder value creation, as opposed to the multiple objectives or mandates that characterise SOCs in South Africa. In pursuing shareholder value, the model allows flexibility by means of co-ownership, competition, listing on various stock exchanges, and investment (or divestment) where commercial interests so dictate. These, as already noted above, have the effect of strengthening corporate governance and improving credit ratings. In South Africa, particularly within the ruling ANC, the notions

99 See for instance, the terms of reference of the Zondo Commission in Proclamation 3 of 2018.

of co-ownership and divestment are considered almost taboo, although some are beginning to question this position.

Sixth, Singapore is a reputable international financial centre with a corporate governance culture that permeates both the public and private sector and is shaped by domestic and foreign investors.

Last, and perhaps most importantly, the Temasek model is underpinned by sheer political will to respect the separate role of the government as a shareholder from the regulatory roles played by various regulators and the control role played by various GLC boards. As Cheng-Han observes:

> While the Temasek model is intended to provide a separation between the government and GLCs so as to enhance their ability to be managed on a commercial basis without undue government interference, and to ensure that there are checks and balances within Temasek and each GLC, there is nothing to stop the Singapore government from interfering if it wishes to do so. However, there exists a strong convention built up over many years against such interference.[100]

The political will to adhere to the separation of roles and non-interference in SOC affairs is almost non-existent in South Africa. Increasingly, the government, through its shareholder-representatives, seeks more proximity to SOCs.

As seen above, the Temasek model is particularly appealing. However, it is not a perfect model, as will be argued next. There are at least three factors or attributes of the model that are problematic from the South African point of view.

First, the model operates in a one-party state where the ruling party exhibits some authoritarian tendencies, labelled by some as a 'soft authoritarian'

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100 Cheng-Han op cit note 98 at 89. See also Hyungon Kim and Kee Hoon Chung 'Can state-owned holding (SOH) companies improve SOE performance in Asia? Evidence from Singapore, Malaysia and China' (2018) 11 *Journal of Asian Public Policy* 206–225. The authors argue that the institutional framework that provides for a state-holding company model is important, but equally important is the 'government's willingness to enforce it and restrain itself from intervention'.

arrangement or a 'restrained democracy'.[101] Ironically, the authoritarian nature of the regime coupled with the small size of the country facilitates policy implementation and strong compliance with laws and regulations.[102] Incidentally, citizens are content with the *status quo* because the state and its GLCs secure their welfare. The situation is different in South Africa, which is a constitutional democracy with all the trappings of constitutionalism. The state is often challenged by the media, civil society and trade unions, and the courts are free to hold any laws, regulations and conduct of politicians unconstitutional. Therefore, the state cannot be allowed to implement any policy in an authoritarian fashion, even if such a policy is good for the running of SOCs and the country.

The second attribute of the Temasek model that is not positive, at least from the South African perspective, is the fact that the GLCs are predominantly run by retired bureaucrats and political apparatchiks. The proximity of politicians to SOCs is already a huge problem in South Africa, because politicians and politically connected directors and executives are the architects of what is colloquially referred to as the 'capture' of SOCs. For this reason, any adaptation of the Temasek model should not include this aspect.

The last attribute, which appears positive at first blush but may be problematic upon deeper scrutiny, particularly in the South African context, is the pure commercial orientation of Singapore GLCs. South Africa is still grappling with the effects of colonialism and apartheid, which rendered the majority of its citizens poor. For this reason, the state has a constitutional duty to alleviate the plight of its citizens.[103] This means that South African

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101 Singapore scores 52/100 in the Freedom House 'Freedom in the World' 2018 index, which makes it a partly free country. Available at https://freedomhouse.org/report/freedom-world-2018-table-country-scores (accessed 10 June 2019). On the notion of a 'restrained democracy', see Cheng-Han op cit note 98 at 93.

102 Cheng-Han op cit note 98 at 82.

103 This was the case in *Mazibuko and Others v City of Johannesburg and Other*s 2010 (4) SA 1 (CC), where the Johannesburg Water (Pty) Ltd, a company wholly owned by the City of Johannesburg was found to have breached s 27 of the Constitution (the right of

SOCs may not always be motivated by profit maximisation. There may be instances where they are uncompetitive or render services below market prices in order to meet the state's obligations to poor citizens.

6.6 CONCLUSION

This chapter had four objectives. First, it sought to understand the socio-economic, political, and cultural context that has shaped and continues to sustain Singapore's Temasek and its GLCs. Second, the chapter analysed the prevailing legal and regulatory regime. Third, and in the light of the first two objectives, the chapter examined both the ownership and control aspects of the Temasek model. Lastly, the chapter examined the pros and cons of the Temasek model, from a South African perspective. This chapter clarifies that the Singapore model proves that the neo-liberal economic prism that envisages economic prosperity only in circumstances of deregulation and state non-interventionism in the economy is not entirely correct.

This chapter has also demonstrated that the state-holding company model – the Temasek way – is a resounding success in Singapore and that the government's benevolence, which manifests in its political will not to interfere in corporate affairs, stands out as a salient feature. Yet, the model is not fool proof because politicians and bureaucrats can interfere if they so wish. However, there is a longstanding convention against interference, because of the particular mindset that abhors political meddling in corporate affairs. It has been suggested that this mindset and the culture of meritocracy may prove difficult to instil among South African politicians and bureaucrats, because a culture of interference and patronage is embedded.

Be that as it may, the Temasek model's exceptionalism does not mean that it is inherently unadaptable. For instance, nothing prevents the South African state from adopting a 'defensive' governance approach; adopting a zero tolerance approach to corruption; reforming and aligning the legal and

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access to sufficient water) by introducing pre-paid water meters, which it had done because it was struggling to recover payments from citizens.

regulatory framework to be responsive rather than reactive to the market and governance needs of SOCs; introducing co-ownership, listing and competition within the SOC environment; and appointing fit and proper boards clothed with the necessary authority to govern. There exists a 'gradual hybridisation' of laws and best practices across jurisdictions, where they borrow from each other. It is therefore possible for South Africa to adapt that which is feasible for its particular context. The next chapter will attempt this borrowing exercise, taking into account the socio-economic, political, cultural, and legal idiosyncrasies of South Africa.

CHAPTER 7

TOWARDS A MINIMALIST AND STRUCTURED ARCHITECTURE OF OWNERSHIP AND CONTROL OF STATE-OWNED COMPANIES

7. INTRODUCTION

Thus far, this thesis has exposed the inherent limitations of the current architecture of ownership and control of SOCs and has reflected on the extent to which they impact governance. This thesis has also made several proposals to respond to these limitations. Central to the proposals is the idea of centring public interest in the governance of SOCs, truncating shareholder control powers, and asserting board primacy, given that the board is the locus of governance.

This chapter develops and synthesises the proposals made throughout this thesis to arrive at a minimalist, structured and responsive architecture of ownership and control that will improve the governance of SOCs. In crafting this new ownership and control architecture, this chapter reflects on the government's proposed policy responses and other proposals made in the legal and governance discourse regarding the governance of SOCs.[1] It also adapts certain elements of the Temasek model as well as best practice from the OECD and elsewhere.

7.1 INHERENT LIMITATIONS OF THE CURRENT OWNERSHIP AND CONTROL MODEL

The current architecture is characterised by four major deficiencies. First, it is neither underpinned by a well-defined theoretical framework nor is it informed by a clear and consistent economic and political logic. Second, the legal and regulatory framework governing SOCs is plural, complex,

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[1] Key policy proposals are contained in the Presidential Review Committee on state-owned entities Report (2013) (PRC Report) available at https://www.gov.za/sites/default/files/gcis_document/201409/presreview.pdf (accessed 1 March 2020). See also OECD *Corporate Governance of State-Owned Enterprises in Southern Africa* (2014).

fragmented, and uncertain. Third, the motivations for state ownership are contradictory, and the ownership model appears irrational, leading to shareholder proximity to the locus of governance. Lastly, shareholder control powers are excessive and often abused, resulting in weak boards that lack the autonomy and authority to effectively direct the business and affairs of SOCs. Collectively, these inherent limitations of the architecture adversely impact the governance of SOCs. Responses to these deficiencies are discussed and consolidated in the paragraphs that follow.

7.2 A NEW THEORETICAL APPROACH

A public interest approach to the governance of SOCs as an anchoring theoretical paradigm has been proposed in this thesis.[2] This is in line with the view that theory does matter, since it shapes policies and pragmatic implementation models. The absence of a clear theoretical framework is largely responsible for the confused state of the model of ownership and control in South Africa. Earlier chapters exposed aspects and instances of this confusion and its overall impact on the governance of SOCs. For instance, all stakeholders of SOCs, including shareholder-representatives, oversight bodies, boards and management, and employees' unions are uncertain about where their loyalty lies with respect to the mandate and operations of SOCs. This is because there is no clear theoretical base and logic (either political or economic) informing the policies, laws, and regulations that in turn define stakeholders' respective roles and duties.

How then does a public interest approach to the governance of SOCs contribute to a structured architecture of ownership and control? First, it proposes a new way of thinking, namely, a re-conceptualisation of SOCs as public interest corporations. Second, it advocates a governance regime that centralises public interest as an organising idea, which then informs directors' duties and introduces a new duty to act in the public interest. Third, it informs

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[2] This approach is not without its detractors. For instance, public interest as a concept has been criticised for being nebulous and thus definitionally complex. See the discussion in chapter 2 (para 2.4.6).

the truncation of excessive shareholder control rights that have proven to negatively affect governance. Thus, the public interest approach brings order and determinability to the governance of SOCs and their entire architecture of ownership and control.

7.3 RE-CONCEPTUALISATION AND RE-CATEGORISATION OF SOCs

It was contended in the previous chapters that SOCs are, properly considered, public interest companies. To develop this point further, it is necessary to understand the different categories of these public interest companies in order to design an appropriate ownership and control framework within which governance takes place.

It is submitted that there are essentially three broad categories of SOCs.[3] The first is the category of SOCs with a strong commercial orientation. These SOCs serve a public purpose but in so doing are expected to declare dividends and contribute to the national fiscus. For example, SAA serves a public mandate of integrating the South African economy into the regional and global economy by providing passenger and cargo flights. Transnet is the custodian of ports, railways, and pipelines; its objective is to ensure a globally competitive freight system. Broadband Infrastructure Company provides long-distance national and international internet connectivity to the private sector, projects of national importance, and previously underserviced areas. These entities are undoubtedly economic enablers but must also declare dividends for the state, to the greatest extent possible.[4]

The second category of SOCs consists of those whose mandate inherently involves the delivery of public goods. Some SOCs in this category provide

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3 The mandate of these three categories of SOCs must always be balanced because they all serve the public interest. See Hans Christiansen 'Balancing commercial and non-commercial priorities of state-owned enterprises' (2013) OECD Corporate Governance Working Papers, No. 6, available at http://dx.doi.org/10.1787/5k4dkhztkp9r-en (accessed 10 May 2020).

4 These entities are found in Schedule 2 of the PFMA and are classified as major public entities.

constitutionally sanctioned rights and services that cannot be easily limited.[5] Generally, these SOCs can be categorised as public goods or 'social service rendering' SOCs.[6] Typically, they render the following essential services: electricity, water infrastructure, and broadcasting services that inform and educate the public, to mention a few. Although primarily concerned with the delivery of public goods, these SOCs are expected to deliver efficiently and sustainably without requiring government bailouts.

Entities categorised here as commercially orientated SOCs and public goods SOCs are currently grouped together under Schedule 2 of the PFMA and are defined as 'profit companies' under the Companies Act. However, a cursory look at some entities in Schedule 2 of the PFMA reveals that they are not profit-orientated. For instance, the SABC, the South African Post Office (SAPO), and the Trans-Caledon Tunnel Authority (TCTA) are not profit companies despite having some income-generating units to fund their core mandate.

The third category of state-owned entities comprises regulatory bodies whose main mandate is the regulation of different sectors by acting as watchdogs, developing and enforcing regulations, providing licences, and performing other related functions. These entities are effectively extensions of state departments. They are semi-autonomous and operate with a commercial ethos, yet they are not structured like companies and are not established for profit-making.[7]

The common aspect of the three categories is that they all promote the public interest in one way or another. It is therefore important to re-conceptualise

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5 See, for instance, *Mazibuko and Others v City of Johannesburg and Others* 2010 (4) SA 1 (CC), where the court held that the installation of water meters was to be done in a way that does not infringe citizens' right to water.

6 This categorisation follows the one adopted in s 4(2)*(a)*(ii) of the Namibian Public Enterprises Governance Act 2 of 2006.

7 Koen Verhoest 'Agencification processes and agency governance: Organizational innovation at a global scale?' in Pekka Valkama, Stephen Bailey and Ari-Veikko Anttiroiko (eds) *Organizational Innovation in Public Services: Forms and Governance* (2013) 49–71.

all SOCs as public interest entities and re-categorise them as commercially orientated, public goods orientated (or service rendering), and regulatory. This categorisation is important because it informs the ownership and control framework of different categories, and the framework in turn informs how the different categories are governed.[8] Later it will be argued that the ownership and control of commercially oriented SOCs should not be the same as that of public goods delivering entities.

7.4 COORDINATED AND COMPLEMENTARY LEGAL AND REGULATORY FRAMEWORK

The governance of SOCs resides in both private and public law: the Companies Act and the PFMA, coupled with the Treasury Regulations and founding statutes, respectively. Furthermore, SOCs follow self-regulatory governance codes: the King Code and the Protocol on Corporate Governance in the Public Sector (the Protocol). The greatest challenge with this arrangement is that company law (and the King Code) seek to primarily achieve separation of ownership and control, while the PFMA pays lip service to separation. In fact, the PFMA arguably promotes the convergence of ownership and control.[9] This tension results in legal and regulatory complexity, fragmentation, conflict, and uncertainty.

To address these challenges, overarching legislation and a single corporate governance code are proposed. It must be noted, however, that the approach of this thesis is generally normative, therefore the content of the proposed instruments is not provided in any specific detail. Rather, broad strokes are drawn, and suggestions are made regarding the relationship with existing laws and codes. Importantly, the thesis reflects on the potential of the proposed legislation and code to improve the governance of SOCs.

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8 See Curtis Milhaupt and Mariana Pargendler 'Governance challenges of listed state-owned enterprises around the world: National experiences and a framework for reform' (2017) 50 *Cornell International Law Journal* 473–542 at 535.

9 See chapter 3 (para 3.3.1).

7.4.1 Justification for overarching legislation for SOCs

The OECD's best practice recommends that SOCs be governed by the Companies Act in each country because they are usually more comprehensive on governance principles compared to other laws.[10] Bronstein and Katzew compellingly rebut this view, arguing that 'there is a lack of "fit" between company law principles geared to commercial success and the regulatory approach necessary for a legitimate public broadcaster.'[11] In addition to this rebuttal, it is submitted that the Companies Act is unsuited to regulating SOCs because they are, properly considered, not profit companies but public interest companies with complex mandates. Because of this realisation that SOCs are a different breed of companies, the Companies Act permits departure (partly, wholly or conditionally) from its provisions to accommodate their uniqueness – the so-called modified application of the Act to SOCs.[12] As indicated previously, many provisions of the Companies Act are not applicable to SOCs thus indicating that the Act is in fact not a proper fit for SOCs.

The PFMA is also not a correct fit for SOCs. Its real purpose, as captured in its Preamble, is mainly to regulate financial management to ensure that state revenue, expenditure, assets and liabilities are managed efficiently and effectively.[13] Importantly, the PFMA regulates government departments, constitutional institutions and public entities of all types. Surely, these institutions are markedly different, particularly SOCs. Unlike other state institutions, SOCs are mainly corporatised and are managed according to corporate law rules and frameworks. Because of their distinctly corporate nature, they do not seem to neatly align with the other state institutions governed by the PFMA.

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10 OECD *OECD Guidelines on Corporate Governance of State-Owned Enterprises* (2015) 26.

11 Victoria Bronstein and Judith Katzew 'Safeguarding the South African public broadcaster: Governance, civil society and the SABC' (2018) 10 *Journal of Media Law* 244–272 at 263. The authors' criticism focuses on non-commercial entities, but it is submitted that their criticism is equally applicable to commercially oriented SOCs because they are not outright profit companies.

12 Section 9 of the Companies Act. A similar realisation exists in respect of NPCs. See s 10.

13 See the Preamble to the PFMA.

It is therefore submitted that the 'legal and regulatory dualism' that locates SOCs within the ambit of both the Companies Act and the PFMA leads to contradictions, duplication, incoherence, and fragmentation, which is untenable. Consequently, overarching and dedicated legislation for SOCs appears to be the elegant and tenable solution that can harmonise the legal regulation of SOCs.[14]

Government is alive to the need for a harmonised legal framework,[15] yet its response has been paradoxically fragmented. For instance, the National Treasury aims to develop a Public Finance Management Amendment Bill (PFM Bill) that will govern both the financial and governance aspects of SOCs, since the PFMA currently focuses predominately on the financial aspects of state institutions. The DPE is also contemplating a Government Shareholder Management Bill (GSM Bill) to reinforce the PFMA by clarifying the formation and classification of SOCs, directors' duties, roles of the shareholder, and the appointment of directors and management.[16] Ironically, the main thrust of these proposals is to expand shareholders' powers and influence, which has already proven to be inimical to good corporate governance.[17].

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14 This is consistent with the recommendation of the Presidential Review Committee on state-owned entities Report (2013) (PRC Report) available at https://www.gov.za/sites/default/files/gcis_document/201409/presreview.pdf (accessed 1 March 2020).74, which notes that a single statute for SOCs would follow best practice, namely, the Australian Government-owned Corporations Act, 1993 (GOC Act); New Zealand's State-owned Enterprises Act, 1986; and Namibia's State-owned Enterprises Governance Act (SOEG Act), 2006.

15 The PRC Report op cit note 14 recommended a single law for SOCs, but the PFM Amendment Bill and GSM Bills are pursued after the release of PRC Report. See, for instance, Sabinet 'Shareholder Management Bill under construction' available at https://legal.sabinet.co.za/articles/shareholder-management-bill-under-construction/ (accessed 18 March 2020).

16 For a further discussion of the proposed PFM Amendment Bill and the GSM Bill, see the PRC Report op cit note 14 at 73.

17 See Alicestine October 'Government at odds with civil society over new SOE law' available at https://www.dailymaverick.co.za/article/2019-07-08-government-at-odds-with-civil-society-over-new-soe-law/ (accessed 8 September 2020).

7.4.2 Key features of the overarching legislation

The overarching legislation proposed in this thesis must not reinvent the wheel; rather, it must harmonise the law. It must also incorporate proposals in the discourse and take account of court decisions and the proposals of the PRC Report. Importantly, public interest considerations must permeate the proposed law. Additionally, the law must state its reach and interplay with the existing legal and regulatory framework. Below is a catalogue of the key features of the proposed Act, including its specific purposes.

The Act must provide for the following issues, among others:[18]

- Overarching strategic intent of the state's ownership of SOCs,
- Mandates and definition of SOCs as public interest companies,
- Incorporation, registration (and deregistration),
- Organisation and management of SOCs,
- Categories of SOCs and modified application where necessary,
- Capitalisation, including criteria and procedures for acquiring state aid,
- Composition, appointment, and removal of directors,
- Duties and responsibilities of directors (including the duty to act in the public interest and the responsibility to appoint executive managers),
- Definition, circumstances, and overall regulation of shareholders' public interest intervention,
- Regulation of the relationships between SOCs and stakeholders inter se,
- Efficient rescue of financially distressed SOCs,
- Effective protection of minority shareholders,
- Criteria and conditions for stock exchange listing and delisting,
- Regulation of financial management to ensure that all revenue, expenditure, assets, and liabilities of SOCs are managed efficiently and effectively,
- Performance plans, corporate plans, and shareholder compacts,

[18] The Act will address aspects of ownership, control, governance, and financial management.

- Reporting,
- Pre-eminence of the Act in the event of conflict with other laws,
- Repeal of other specific SOC laws, such as founding statutes.

The Act must also state its purpose clearly, as is the case with the Companies Act. For instance, it must have the following purposes:[19]

- Promoting compliance with the Bill of Rights, as provided for in the Constitution (since SOCs are public interest companies),
- Promoting the development of the South African economy in line with the national development objectives contained in the National Development Plan 2030 and other similar plans,
- Encouraging transparency and high standards of corporate governance as appropriate, given the public interest character of SOCs and the social and economic life of the nation,
- Creating optimum conditions for the aggregation of capital for productive purposes, and for the investment of that capital in SOCs that will act as economic enablers in the economy,
- Balancing the rights and obligations of shareholders and directors, taking into account shareholders' public interest intervention,
- Encouraging the efficient and responsible management of SOCs,
- Providing for the efficient rescue and recovery of financially distressed SOCs in a manner that balances the rights and interests of all relevant stakeholders,
- Providing a predictable and effective environment for the efficient regulation and governance of SOCs.

In sum, the proposed legislation should categorise SOCs as public interest companies, clearly define the roles and duties of all stakeholders, and significantly remedy the problem of conflicting and overlapping laws, duplication, and uncertainty. With these attributes, the legislation will

19 This is an adaption of s 7 of the Companies Act.

provide an enabling and robust framework for the effective governance of SOCs.

7.4.3 A combined governance code for SOCs

SOCs must comply with the King Code, the Protocol, and the Handbook for the Appointment of Persons to Boards of State and State-controlled Institutions (the Handbook).[20] This multiplicity of governance codes creates a compliance and reporting burden, as explained in chapter 2.[21] It is also contended that these governance instruments are not a correct fit for SOCs for the following reasons: The King Code is primarily designed for profit companies although the latest instalment seeks to focus on SOCs as a special category through a sector supplement for SOCs. However, at its core, the supplement categorises SOCs as profit companies.[22] Similarly, the Protocol is modelled on and amplifies the King Code, and therefore suffers the same conceptual flaw regarding SOCs.

To address these issues and take into account the peculiar character of SOCs, it is suggested that a single combined code of corporate governance be developed. Like the overarching legislation proposed earlier, the single governance code must be public interest-centred. It must also consider the role of SOCs in the developmental state; this role is to be service delivery champions and economic enablers. The code must also promote transformative corporate citizenship, transparency, accountability, ethical leadership, and sustainability.[23]

To avoid compliance fatigue, the code must be the only soft instrument applicable to SOCs. A similar approach is followed in Malta where 'Principles

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20 See the discussion of 'soft regulation' in chapter 3 (para 3.4).

21 See chapter 2 (pages 61 and 72).

22 See the King IV Report on Corporate Governance for South Africa (2016), Part 6: Sector Supplement for State-owned Entities.

23 This is consistent with Recommendation 2 in the PRC Report op cit note 14.

of Good Corporate Governance for Public Interest Companies' have been adopted to guide SOCs specifically.[24]

7.5 FROM IRRATIONAL TO FOCUSED STATE OWNERSHIP

As discussed previously, state ownership can be decentralised, dual, centralised, or follow a twin-track model. This thesis contended that the South African ownership model is irrational because it defies any categorisation, and SOCs are moved from one shareholder ministry to another without any rational explanation. The ownership of SOCs, particularly those that can be considered 'related' given their mandates, is also dispersed and fragmented, leading to inefficiencies and lost synergies.[25] This thesis also contended that the key feature of this irrational ownership model is that shareholder-representatives enjoy extensive powers with a deleterious effect on board primacy and governance.

To remedy this situation, it is proposed that a sound ownership model with certain hallmarks be adopted. This model must be designed to achieve state ownership objectives and must ideally fit the current taxonomy of tested ownership models. Where it departs from these models, it must do so rationally. Importantly, the South African model must address the perennial challenge of state ownership that gives rise to shareholder (political) interference. This can be achieved by fortifying board primacy. Finally, the model must promote the 'autonomisation' and 'professionalisation' of the state shareholder function.[26] Ideally, these and other aspects must first be broadly articulated in a clear ownership policy and guidelines.

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24 'Principles of Good Corporate Governance for Public Interest Companies' (2005) available at https://www.mfsa.mt/wp-content/uploads/2019/07/Corp-Gov-Principles-public-interest.doc-1-Nov05.pdf (accessed 10 March 2020).

25 In terms of s 2(1)*(c)*(iii) of the Companies Act, a company is related to another if they are both controlled by one person.

26 On the meaning of autonomisation and professionalisation of state functions, see Sandra van Thiel 'Quangos in Dutch government' in Christopher Pollitt and Colin Talbot (eds) *Unbundled Government: A Critical Analysis of the Global Trend to Agencies, Quangos and Contractualisation* (2004) 167.

7.5.1 State ownership policy and guidelines

A comprehensive ownership policy should address the following crucial points: the motivations for state ownership; the clarification of SOCs that are strategic for the achievement of state ownership objectives; how and when the state should own such SOCs; and when, how and why the state must divest from such SOCs. South Africa has no single coherent ownership policy that addresses these issues. To some extent, state ownership motivations are scattered in various laws and regulations such as the PFMA, founding statutes and Treasury regulations. This makes it difficult to discern with certainty what informs state ownership.

The state has oscillated from rejection of privatisation to partial acceptance and back to total rejection.[27] At one point, it was envisaged that Eskom, Transnet, Telkom, and Denel would be privatised. At another time the state attempted partial privatisation or mixed ownership by selling minority stakes in SAA and ACSA, but these were bought back, only to be resold at a later stage, in the case of ACSA.[28] It appears that the state undertook partial privatisation 'with no clearly defined "frames" or "waves"'.[29] The confusion continues to this day. For instance, it is unclear whether certain SOCs, like SAA, are strategic, when (if at all) to divest, and the extent of divestment.

Critically, the confusion on state ownership is not limited to whether SOCs are strategic or not and whether to continue investing or to divest. The confusion extends to the conceptualisation of SOCs, their mandates and role in the developmental state, and the roles and responsibilities of different stakeholders in their management and governance. Clearly, the confusion is pervasive.

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27 Stephen Greenberg *The State, Privatisation and the Public Sector in South Africa* (2006) 11.

28 John Kane-Berman 'Privatisation or bust' (2016) available at https://irr.org.za/ (accessed 10 March 2020).

29 Jerome Afeikhena and Moses Rangata *The Tortuous Road to Privatisation and Restructuring of State Assets in South Africa: Lessons from African Privatisation Experience* (2003) 19.

7.5.2 Twin-track ownership model

Among the different types of ownership models, this thesis proposes the twin-track model, given the idiosyncratic challenges of South Africa. With the twin-track model, two broad SOCs' portfolios (twin tracks) are typically divided into commercial and non-commercial tracks, with two distinct shareholders for each track. The shareholders for the two tracks can either be a central agency or a state holding company. It is proposed that South Africa's commercially orientated SOCs should be owned by a state holding company similar to Singapore's Temasek.[30] All other non-commercial state entities should be owned by a 'state entities governance council'.

The proposed twin-track model is necessitated by the distinct nature and mandates of these two categories of entities. The terminology adopted in this model also denotes the nature of the entities within each track. The first track comprises state-owned companies (SOCs) that are structured like any other public company. The second track comprises state-owned entities (SOEs) that are also structured like companies, but lack outright commercial orientation, hence the deliberate choice of the term 'entity' as opposed to 'enterprise' or 'company'.[31]

Since these two categories of state entities are different, their ownership and control cannot be identical. Consequently, those who discharge control functions over the two tracks should have varying degrees of influence, depending on the nature of the entities. Furthermore, the boards of the two entities overseeing the two tracks should have differing degrees of primacy. The ownership of the two tracks is explored further below.

A. State holding company: Commercially orientated SOCs

Commercially orientated SOCs are established and restructured in the mould of public or private corporations and are principally expected to carry out

30 See chapter 6 (para 6.3).

31 This is a deliberate departure from the interchangeable use of the terms throughtout this thesis. See chapter 1 (para 1.4.3).

business in pursuit of commercial objectives.[32] Some of them operate in competitive environments, like SAA, and a few are listed, such as Telkom. Thus, the ownership and control of this category of SOCs should generally resemble that of public or private companies. This means that the shareholder should not have unreasonably extensive control powers that dilute board primacy.

To achieve this, it is submitted that a state holding company should be established to operate as an 'autonomous operative arm of government shareholding'.[33] The objective of autonomous operation is to eliminate or curb political interference while also improving efficiency and corporate governance. The example of Singapore's Temasek indicates that a state holding company model has several advantages that can address the many challenges facing South African SOCs, which are highlighted throughout this thesis.

The first advantage is that a holding company will professionalise the state shareholding function. Rather than having ministers as shareholder-representatives, the holding company, comprising a highly skilled board and executive managers, will professionally discharge shareholder functions for the state. This will obviate the problem of shareholder-representatives who lack business acumen overseeing large and complex SOCs.

The second advantage of professionalising the shareholder function through a state holding company is that it will address the high turnover of shareholder-representatives occasioned by Cabinet reshuffles and the appointment of new ministers following a general election. Oftentimes, the turnover of shareholder-representatives brings policy oscillation that destabilises SOCs and complicates the boards' governance role. For example, in the Department of Communications, the policy on set-top boxes has

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32 Richard Jolly 'Government-owned corporations: Public ownership, accountability and the courts' (2000) 24 *Australian Institute of Administrative Law Forum* 17–33.

33 See Jon Pierre 'Central agencies in Sweden: A report from Utopia' in Christopher Pollitt and Colin Talbot (eds) *Unbundled Government: A Critical Analysis of the Global Trend to Agencies, Quangos and Contractualisation* (2004) 203.

fluctuated constantly, with a negative impact on the ability of various SABC boards to govern the public broadcaster effectively.[34]

The third advantage of a holding company will be to shield all other SOCs (subsidiaries) from government interference. The holding company will essentially break the direct link between government as a shareholder and the various SOCs. Therefore, the primary challenge of political interference will be addressed.

The fourth advantage is that a holding company will run its subsidiaries without being affected by narrow political interests, given its composition. As a result, the holding company will provide clear objectives and targets to its subsidiaries, leaving room for the boards and executives of the subsidiaries to exercise primacy towards the achievement of such objectives. In turn, the holding company will be accountable to its shareholder for the performance of its subsidiaries, as is the case with Temasek.

The fifth advantage is that a holding company will have the latitude to structure its subsidiaries in a manner that will best benefit it and by extension the government as its shareholder. This latitude will allow the holding company to adopt any measures that enhance corporate governance, such as listing a subsidiary SOC on the stock exchange and seeking an equity partner or partners.

The sixth advantage is that a holding company will free government to concentrate on policy formulation and regulation while the holding company focuses on managing all other SOCs for the state. The separation of roles further helps to avoid interference because it limits the proximity between government and subsidiary SOCs.

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[34] The court observed in *Electronic Media Network Limited and Others v e.tv (Pty) Limited and Others* 2017 (9) BCLR 1108 (CC) para 16 that 'Minister Muthambi pursued a policy 'direction' that is significantly dissimilar to that of Minister Carrim'. This must have complicated the board's governance function.

To ensure the success of a state holding company model in South Africa, certain safeguards must be put in place. The first safeguard is that its nature and mandate should be clearly defined in law to avoid any room for the intrusion of political interests. In this regard the holding company should be defined as a public interest company with commercial orientation in an overarching statute regulating SOCs. The second safeguard is that its relationship with its shareholder and the role of the shareholder should also be clearly defined in law. The third safeguard should be to secure the board's primacy in directing the business and affairs of the holding company, the appointment of its own CEO, and the appointment of all boards of its subsidiary SOCs. To ensure that the holding company's board enjoys primacy, it must be appointed (and removed) using rigorous criteria and procedures. In this regard, an appointment and removal process similar to that of the SABC board is recommended.[35]

In terms of the Broadcasting Act, the board of the SABC is appointed by the President following a recommendation of the National Assembly; this recommendation is preceded by a transparent nomination process involving public participation.[36] The removal of directors or the entire board is also conducted by the President following an enquiry by and the recommendation of a committee of the National Assembly, and adopted by a resolution of the entire National Assembly.[37] It is submitted that this process is, theoretically, likely to deter cadre deployment and ensure that directors are appointed on merit, since the majority of Parliament must agree on the appropriate candidates. In practice, however, the majority party in parliament may abuse its majority and appoint directors along political lines.

Regarding the composition of the board of the holding company, it is recommended that politicians be completely excluded. Instead, the board

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35 For a detailed exposition of the appointment and removal process in SOCs, see Riekie Wandrag 'The legal framework of SOEs' boards: Appointment and dismissal of board members and executives of Eskom, PRASA and the SABC' (2018) available at https://dullahomarinstitute.org.za/ (accessed 1 March 2020).

36 Section 13 of the Broadcasting Act 4 of 1999 (as amended).

37 Section 15A of the Broadcasting Act 4 of 1999 (as amended).

should comprise leading industrialists who exude integrity, authority, charisma, business acumen and relevant experience, as is the case with the board of Temasek.[38] To represent government (shareholder) interests and ensure that government policy trickles down to the operations of the company (and its subsidiaries), Directors-General of the Departments of Finance and Trade, who are public administration professionals, should be included in an *ex officio* capacity.[39]

The PRC Report recommends the formation of two central SOE authorities – one for commercial entities and another for Development Finance Institutions (DFIs). This recommendation appears untenable because it does not address the main problem of political proximity to SOCs and the resulting erosion of board primacy. As former minister Barbara Hogan lamented, politicians as high up the political hierarchy as the President tend to impose their political and sometimes nefarious interests on SOCs. So, central authorities of a political nature may not address the problem of political interference.

The PRC Report also recommends the creation of an SOE Council of Ministers, whose functions will include oversight over the implementation of the overarching SOC Act, strategic joint planning, and collaboration between SOCs and government.[40] It appears that this recommendation was implemented in 2016 by the creation of a Presidential SOE Coordinating Council.[41] However, the council was not created by law and its oversight role and mandate remain unclear. It is submitted that, notwithstanding the uncertain legal standing of the Coordinating Council, it would be an

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38 This is consistent with the recommendation made in OECD *Ethics and Business Integrity in Southern Africa: Handbook for Governments as Owners and State-owned Enterprises* (2016).

39 This is the case with the Temasek Board. See chapter 6 (para 6.4.3).

40 It is envisioned that the council will comprise the Department of Public Enterprises (DPE), National Treasury, the Department of Trade and Industry (DTI), the Economic Development Department (EDD), the National Planning Ministry and other relevant government stakeholders. See Recommendation 2 in the PRC Report op cit note 14.

41 The Presidency 'Presidential SOE Coordinating Council arises from Presidential SOE Review Committee and is not a new or sinister creation' (25 August 2016) available at http://www.thepresidency.gov.za (accessed 3 April 2020).

appropriate entity to be a shareholder of the state holding company proposed in this thesis. The composition of the Coordinating Council – the inclusion of different ministries – and the fact that it is headed by the President renders it suitable for providing shareholder direction to the proposed state holding company. This is because of the gravitas of the office of the President and the inclusion of ministers to represent an array of government interests. However, to curb what could otherwise be excessive shareholder influence over the holding company by the Coordinating Council and to protect the autonomy of the holding company's board, it is proposed that the board be appointed (and removed) exclusively by Parliament, as proposed above.

It is contended that a state holding company with the attributes proposed here will be an appropriate, depoliticised, professional and autonomous operative arm of government shareholding that will address the major issues that have an adverse effect on how SOCs are governed in South Africa.

B. Public Entities Governance Council: Non-commercial SOEs

Non-commercial state-owned entities (SOEs) are established primarily to render essential socio-economic services. The fact that these entities render public goods that are in some instances constitutionally mandated means that the government, as a shareholder, must ensure that services are rendered in ways that are consistent with constitutional imperatives, namely, transparency, accountability and efficiency within a human rights paradigm.[42] Unlike commercially orientated SOCs, these service-rendering SOEs may attract a higher degree of public interest; therefore, the shareholder

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42 See s 195 of the Constitution, 1996. See also the Municipal Systems Act 20 of 2000 which provides for universal access to essential services that are affordable. See further Nico Steytler 'Socio-economic rights and the process of privatising basic municipal services' (2004) 8 *Law, Democracy and Development* 157–180; and Danwood Chirwa 'Water privatisation and socio-economic rights in South Africa' (2004) 8 *Law, Democracy and Development* 181–206. See also s 7*(a)* of the Companies Act that requires promotion of human rights in the application of company law and s 7*(b)*(iii) which encourages transparency and high standards of corporate governance and the significant role of companies in the social and economic life of the nation.

may need to intervene judiciously from time to time to protect the public interest.

A structure that can best achieve this is a Public Entities Governance Council (PEGC), modelled on the National Economic Development and Labour Council (NEDLAC). NEDLAC is a tripartite body comprising members who represent organised business, organised labour (including organised community and development interests), and members who represent the state.[43] Given the mandate and nature of non-commercial SOEs, it is submitted that the proposed tripartite configuration will enable the PEGC to professionally and effectively oversee SOEs since it will comprise members with business acumen, a good understanding of community interests, and an understanding of government policy and objectives.

To ensure the independence of the PEGC, it is proposed that its members be appointed by Parliament following nominations by their respective sectors.[44] This tripartite configuration will also address the problem of political interference in the affairs of SOEs because the different sectors represented in the PEGC will serve to check each other, in such a way that narrow political interests will not be accommodated. Instead, the PEGC, as the shareholder of all non-commercial SOEs, will be guided by public interest in discharging its oversight and ownership role.

The PRC Report recommends a decentralised ownership model for statutory and non-commercial entities, which means that these entities should remain within line function ministries.[45] This recommendation fails to consider the damage that shareholder-representatives and political interests have inflicted on the governance of SOCs. The recommendation misses the point made by Milhaupt and Pargendler that:

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43 National Economic Development and Labour Council Act 35 of 1994 (NEDLAC Act). NEDLAC is a body through which government, organised business, labour, and community organisations seek consensus on the negotiation of economic, labour and development issues and related challenges facing the country.

44 A similar process is adopted for the appointment of members of NEDLAC, but they are appointed by the Minister as opposed to Parliament. See s 3 of the NEDLAC Act.

45 Recommendation 2 in the PRC Report op cit note 14.

> The principal objective of any governance framework for SOEs is to insulate the management of the enterprise from political interference that distorts its public mission and commercial orientation and makes public (including both investor and citizen) understanding and oversight of the firm more difficult.[46]

The recommendation also fails to address the multiplicity of roles that shareholder ministries have under the decentralised model and how this compromises their discharge of shareholder functions, which in turn deleteriously affects the governance of the entities by their respective boards.

It is contended that a centralised professional shareholder entity (the PEGC), answerable to the Presidential SOE Coordinating Council but appointed (and removed) by Parliament, will be able to address the challenges confronting SOEs. This appears to be a more convincing solution when compared to the current decentralised and somewhat irrational model.

7.5.3 Mixed ownership and 'golden shares'

The state is mostly a single shareholder of SOCs, with the exception of Telkom and ACSA.[47] This form of concentrated ownership has a dark side that usually dilutes board primacy in a rather toxic manner.[48] This fact has been illustrated with various examples in the previous chapters.

To address the toxicity of concentrated state ownership, many have advocated mixed ownership (partial privatisation).[49] However, caution must be sounded that the current legal and regulatory framework governing SOCs is not designed to accommodate private equity partners. For instance, the PFMA

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46 Curtis Milhaupt and Mariana Pargendler 'Governance challenges of listed state-owned enterprises around the world: National experiences and a framework for reform' (2017) 50 *Cornell International Law Journal* 473–542 at 535.

47 The government holds only 39.8 per cent of Telkom shares and 74.6 per cent of ACSA shares.

48 Martin Gelter 'The dark side of shareholder influence: Managerial autonomy and stakeholder orientation in comparative corporate governance' (2009) 50 *Harvard International Law Journal* 129–194. See also Lynn Stout 'Toxic side effects of shareholder primacy' (2013) 161 *University of Pennsylvania Law Review* 2003–2023.

49 OECD *OECD Guidelines on Corporate Governance of State-Owned Enterprises* (2015) available at http://dx.doi.org/10.1787/9789264244160-en (accessed 10 March 2020). It is noteworthy that mixed ownership may not be ideal for SOCs with a pronounced public mandate orientation, such as delivery of public goods (eg water and energy).

vests shareholder powers in the executive authority (the cabinet minister) who appoints and removes boards and executive managers.[50] It must be remembered that minority shareholder protection, such as relief from oppressive or prejudicial conduct, dissenting shareholder appraisal rights, and the derivative action, are not built into the PFMA.[51] Instead, these protective mechanisms are contained in the Companies Act, whose provisions may not be applicable where modified application has been activated by the government shareholder.[52] In essence, the law is designed in such a manner that non-government shareholders have little room to exercise shareholder powers. Going forward, the proposed overarching SOC legislation must explicitly cater for mixed ownership and provide the necessary protection for minority or non-government shareholders.

Mixed ownership has clear advantages for SOCs, not only from a financial perspective but also from a corporate governance perspective. By their nature, equity partners are driven by returns on investment, which require efficiency and robust governance. They usually bring a wealth of experience in the reorganisation of companies, management experience, and industry expertise. They also bring board directors with governance expertise and business insights to improve performance and overall corporate governance. Left unchecked, however, private equity partners may prioritise profit over everything else, hence the need for state participation to ensure that profits are balanced with public interest.

Another way of securing the public interest is for the state to semi-privatise and hold a golden share, particularly in strategic SOCs that have a clear public interest mandate. A golden share is a special share that allows the government to retain some control over a privatised entity. This share gives its holder veto rights against certain decisions, such as liquidation and the large disposal of assets. The share may also be used to control the

50 Section 1 of the PFMA.

51 These remedies are found in ss 163 to 165 of the Companies Act.

52 Section 9 of the Companies Act.

appointment of directors and block foreign ownership of the company.[53] The essence of this type of share is to safeguard the public interest. The state held golden shares in Telkom when it was partially privatised, until they lapsed in 2011.[54]

In sum, non-government shareholders provide effective checks and balances between the management and the board, on the one hand, and the board and shareholders, on the other. This has the effect of improving board autonomy and authority, operational efficiency, and directorial accountability.[55] For instance, performance and corporate governance at Telkom and ACSA is sound compared to SOCs where the state is the sole shareholder. Both companies have consistently declared dividends for the state. In Singapore, GLCs are mostly co-owned by Temasek and other strategic investors, and this approach has yielded both performance and governance dividends.

7.6 TOWARDS IMPROVED INTERNAL GOVERNANCE

To recall, the key challenges confronting the internal governance of boards generally include poor practices regarding the composition, appointment, and removal of directors. These poor practices result in 'captured', 'lame duck' and 'disempowered' directors who lack the autonomy and authority to direct the business and affairs of SOCs. Internal governance is also compromised by shareholder usurpation of boards' powers, for instance interference in the appointment of executive managers and unwarranted involvement in operational decisions.

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53 For the nature of the share, see generally Christine O'Grady Putek 'Limited but not lost: A comment on the ECJ's golden share decisions' (2004) 72 *Fordham Law Review* 2219–2286 and Alice Pezard 'The golden share of privatized companies' (1995) *Brooklyn Journal of International Law* 85–96.

54 See Ann Crotty 'JSE chief stands firm against keeping Telkom golden share' (2011) available at https://www.iol.co.za/business-report/economy/jse-chief-stands-firm-against-keeping-telkom-golden-share-1034573 (accessed 20 May 2020).

55 Jiangyu Wang and Tan Cheng Han 'Mixed ownership reform and corporate governance in China's state-owned enterprises' (2020) 53 *Vanderbilt Journal of Transnational Law* 1055–1107. The authors discuss the background, policy, regulatory frameworks, and rationale of mixed ownership.

The proposed legislation governing SOCs can address these challenges by clearly entrenching the following safeguards to cement internal governance. First, the law must ensure the professionalisation of boards by articulating clear criteria on the qualifications, appointment, and removal of directors. This will eliminate, among others, unqualified political cadres and captured, lame duck and disempowered boards. Second, board primacy in governance matters should be jealously guarded in law and only curtailed (quasi-primacy) in limited and defined cases of public interest.

It is submitted that the PRC recommendation that confines the role of the board in the appointment of the CEO to the nomination of three 'appointable' candidates, one of whom must be appointed by the Minister with Cabinet concurrence, is untenable for several reasons.[56] At a theoretical level, this recommended process interferes with the board's authority to direct the affairs of the SOCs, including appointing key executives.

At a practical level and as demonstrated previously, this process complicates the relationship between the board and the CEO appointed by the shareholder. It also gives the shareholder an unrestricted veto over nomination, in that the appointment will not be made if the preferred candidate is not nominated by the board or where the three 'appointable' candidates are not acceptable to the shareholder and cabinet.[57] The involvement of the shareholder and Cabinet also creates room for political interests to creep in. Furthermore, the three-stage appointment process prolongs the appointment, yet the appointment of a CEO is always time-sensitive. For these reasons, the PRC recommendation is untenable. The board as the sole organ vested with the power to direct the business and affairs of the SOC must exclusively appoint a CEO and other key executives. There is no rational basis for departure from this position.

Incidentally, the King IV SOC sector supplement makes a disturbing concession that the shareholder should appoint the CEO but that the process

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56 Recommendation 3(b) in the PRC Report op cit note 14.

57 See chapter 5 (para 5.5).

should be robust and transparent. It goes on to suggest that the CEO appointed by the shareholder should be accountable to the board and that the board should have the power to remove the CEO.[58] This is untenable in that the power to appoint incorporates the power to remove in law.[59] It is curious that the sector supplement recommends that the board should be the focal point of governance yet the board has no power to appoint the key executive who will execute its strategy.

The third way of fortifying internal governance is for the law to clearly define directors' duties (including the duty to act in the public interest), which will ensure that corporate governance custodianship truly resides with the board. This custodianship must also be secured by pruning otherwise excessive shareholder control powers. Collectively, these efforts, if legislated, have the potential to drastically improve the internal governance of SOCs.

7.7 CORPORATE GOVERNANCE ENHANCING MEASURES

Incorporators of companies have the latitude to choose whether to incorporate a private or public company. They also choose whether to list on the stock exchange. Furthermore, they choose the market within which to operate – ideally one with less regulation and competition. Similarly, the state has the latitude to list SOCs and expose them to competition.

7.7.1 Considered stock exchange listing

The advantages of listing, at least from a corporate governance and performance perspective, are that it subjects companies to enhanced governance standards. Although the JSE Listing Requirements do not have legal force, they are mandatory for listed companies.[60] Interestingly, the Listing Requirements compel companies that choose to list to submit their

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58 See King IV sector supplement for SOEs, chapter 3: Governing structures and delegation.

59 *Masetlha v President of the Republic of South Africa and Another* 2008 (1) SA 566 (CC) para 166.

60 This fact is acknowledged by s 5(5) of the Companies Act which provides that in the case of inconsistency between the provisions of the Act and the Listing Requirements, the Act will prevail.

MOIs for approval, and any amendments to the MOI after listing must also be approved by the JSE. Where the MOI contradicts the Listing Requirements, listing is not approved.[61] In terms of the requirements, listing companies must comply with the Companies Act and apply all the King IV principles.[62] Specifically, listed companies, including SOCs, must apply all practices such as the appointment of a company secretary, an audit committee, a social and ethics committee, and a remuneration committee.[63] The net effect of this regulation is enhanced transparency and improved governance.

Notwithstanding the governance benefits of listing, at least in theory, some SOCs may be ill-suited to the cutthroat listing environment, where companies are exposed to the perils of the market such as volatility and the tumbling of share prices due to external factors. Additionally, it may be imprudent to list strategic SOCs that enjoy a natural monopoly, such as Eskom, because they are both service providers and economic enablers, and their collapse will almost certainly lead to economic hardships for the country. Alternatively, their acquisition by private interests in the open market may lead to high electricity charges because private investors are primarily motivated by profit.

7.7.2 Competitive neutrality

The Competition Act binds the state and all its institutions.[64] However, some SOCs have escaped the reach of the Competition Act on public interest grounds. Those that have not escaped the tentacles of the Act are forced to operate efficiently in order to compete in the marketplace. For them, survival requires operational efficiency, which in turn requires sound corporate governance. In this regard, competition is healthy for SOCs as it enhances corporate governance, albeit indirectly.

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61 See schedule 2 of the JSE Listing Requirements (2019).

62 See chapter 3 (para 3.4).

63 Michalsons 'The JSE Listing Requirements and King III and IV' available at https://www.michalsons.com/blog/jse-listing-requirements-king-iii-iv/11545 (accessed 10 March 2020). Recommendation 19 of the PRC Report op cit note 14 also encourages government to consider developing and adopting a policy shift towards a greater mix of debt finance and equity finance while preserving government control.

64 Section 81 of the Competition Act 89 of 1998.

Incidentally, anti-competitive SOCs have been operationally inefficient and their governance has been far below par. A case in point is SAA, which has on numerous occasions been found to have contravened the Competition Act.[65] This proves the strong link between competition, performance and corporate governance.

South Africa's SOCs, particularly the commercially orientated ones, must be subjected to competitive neutrality, which essentially implies that they should not be advantaged solely because they are state-owned.[66] In practical terms, this means that they should not readily receive state aid or 'soft budget constraints' as this incentivises poor governance and crowds out competitors, which is unhealthy for the economy.

7.8 CONCLUSION

Having recounted the inherent deficiencies of the current model of ownership and control of SOCs, this chapter has recommended a new approach. This can be achieved by delayering the legal and regulatory regime through the adoption of a single overarching statute that is centred on the public interest. Instead of expecting SOCs to apply multiple soft regulatory codes, a single combined code of corporate governance should be adopted to lessen the compliance burden and provide regulatory certainty. To enhance governance, competition rules must be observed and listing on the stock exchange may be pursued, where appropriate.

A twin-track ownership model appears to be best suited to addressing the governance challenges occasioned by grouping significantly different categories of state-owned entities under one ownership regime. With regard to control arrangements, it appears that several measures aimed at curtailing shareholder control powers, while at the same time protecting board primacy

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65 See, for example, *Competition Commission and South African Airways (Pty) Ltd* (final) (18/CR/Mar01) [2005] ZACT 50 (28 July 2005). See also the cases discussed in chapter 3 (para 3.5.3).

66 See chapter 3 (para 3.3.3). See also OECD *State-Owned Enterprises as Global Competitors: A Challenge or an Opportunity?* (2016).

and insulating SOCs' boards from political interference, can improve the overall governance of SOCs. It is submitted that this represents a minimalist, structured and responsive architecture of ownership and control that is public interest-centred and has the potential to address the current governance woes in SOCs.

CHAPTER 8

CONCLUSION

8. GENERAL

This thesis has examined how SOCs are owned and controlled in South Africa. It has reflected on the impact of the ownership model and the various control arrangements on corporate governance. This exercise started by providing theoretical clarity regarding the nature of and rationale for SOCs. This was followed by a detailed examination of the design and impact of the legal and regulatory regime on the governance of SOCs. The thesis also examined different aspects of state ownership, paying particular attention to the role and powers of shareholder-representatives within the ownership model, and how these impact corporate governance. The role of the board of directors as the focal point and the custodian of corporate governance was also examined, with an emphasis on directors' powers and duties as well as their relationship with other stakeholders, particularly the shareholder-representatives. The aim was to examine the extent to which boards of directors truly govern the business and affairs of SOCs. The overarching question addressed in this thesis is whether the ownership and control architecture of South Africa's SOCs is conceptually flawed and whether that impedes effective corporate governance. In response to the question, several propositions were made throughout the thesis and are summarised next.

8.1 THESIS PROPOSITIONS

South African SOCs have endured chronic governance deficiencies and poor performance over the years, which has led to persistent calls for their privatisation. Renewed calls have been made in the wake of the state capture phenomenon, and more specifically the capture of SOCs, which has outraged the South African public. This thesis has not joined the call for the wholesale privatisation of SOCs. Instead, it has conceded that SOCs have experienced 'pathological corporate governance deficiencies' and that they are prone to

inefficiency and capture due to their proximity to political interests, among other factors. However, this does not warrant their abandonment; instead, the solution to the maladies lies in a paradigm shift regarding their ownership and control, which will in turn improve corporate governance and efficiency. This view is premised on the fact that South Africa is a unique developmental state with a long and troubled history of inequality that requires deliberate state ownership to reverse decades of inequality, and to stimulate and transform the economy.

The ownership and control of SOCs lacks a clearly defined economic and political logic. The nature of SOCs and the purpose they serve remains unclear due to the lack of an explicit ownership policy. The legal and regulatory framework governing SOCs is unhelpful in many ways; it fails to distribute power between the two corporate organs in a workable way. Instead, it vests excessive control powers in the shareholder-representatives, which has the effect of weakening boards and adversely impacting corporate governance. The framework is plural, complex, fragmented, and contradictory. When different pieces of legislation and various corporate governance codes do not cohere and do not define the powers and duties of different organs with precision and complementarity, there are bound to be compliance challenges, accountability and governance deficits, as well as vulnerability to capture for nefarious interests. The ownership model within which the organs discharge their duties is also problematic because it has attributes of all the established models of ownership, but without any rational basis. In simple terms, it is a perplexing model.

To address the aforementioned shortcomings, a paradigm shift on ownership and control is required, which must be based on a clear theoretical foundation in order to transcend mere description of the problem and enter the realm of critical engagement. In this regard, it has been argued that the various corporate governance theories and approaches are not entirely applicable to SOCs because SOCs are a peculiar breed of companies. The governance theories and approaches are applicable primarily to profit companies. Yet,

properly considered, South African SOCs are *sui generis* companies because, unlike other companies, they do not exist for the sole purpose of profit maximisation. Rather, they exist to serve the public interest. Notably, SOCs have an indeterminate shareholder (the public) represented by shareholder-ministers. SOCs also have an intricate mandate that is both commercial and non-commercial and they are enjoined to discharge their mandates in line with constitutional values such as transparency and accountability within a human rights paradigm.

It is important to note that SOCs also have a complex stakeholder mix that includes oversight bodies like Parliament, the Chapter Nine institutions, and trade unions, which all influence SOCs in different ways. Unlike other types of companies that experience agency costs from a limited set of agents, SOCs experience 'infinite agency costs' from a multiplicity of agents. They also experience 'principal costs' from various players that discharge different roles that fall within the broad category of the principal's roles. For instance, the National Treasury, sector ministries (as shareholder-representatives), and Parliament all have objectives that must be met by SOCs, which sometimes conflict. All these examples confirm that SOCs are indeed corporations *sui generis*.

Since SOCs are *sui generis*, their entire ownership and control architecture must be different. The architecture must prioritise the public interest as the 'overarching theme and objective' of SOCs. In practical terms, this requires SOCs to be explicitly defined as public interest companies and for directors' duties to incorporate a duty to act in the public interest. This duty essentially requires directors to owe their loyalty to both the company and the public interest. However, in instances where the narrow interests of a SOC, as a separate legal entity, do not align with the broader public interest, directors must prioritise the public interest.

It has been argued that the duty to act in the public interest may be enforced by members of the public through an expanded derivative action that recognises them as interested parties with the right to enforce the duty and

thereby promote corporate governance in SOCs. Another avenue for achieving these objectives is to mount public interest actions under s 157*(d)* of the Companies Act, as was recently done in the *OUTA* case. The duty to act in the public interest may also be enforced by instituting action similar to the US *qui tam* action. In this action a member of the public enforces a public interest duty on behalf of the state and retains a share of the damages recovered from a guilty director. To lessen the burden of these remedies on directors, the usual hurdles for a party seeking derivative action will apply, and directors can have advance expenses to defend litigation. Additionally, SOCs can purchase insurance on behalf of directors in terms of the provisions of the Companies Act.

The idea of a public interest approach is not limited to directors; it applies equally to shareholder-representatives. The roles and responsibilities of shareholders are linked to the legal and regulatory framework as well as the ownership model. Currently, the law vests extensive *de jure* control powers in shareholder-representatives, such as the power to govern financial and operating policies, the appointment and removal of CEOs, and the initiation and approval of major corporate decisions. In practice, shareholder-representatives often impose certain decisions on SOCs that fall outside 'ownership control', thus acting *ultra vires* their *de jure* control powers. The effect of all this is a skewed division of power in favour of shareholder-representatives and a convergence of ownership and control that leaves the boards of SOCs weak and unable to govern effectively.

It must be noted that the proximity of the shareholder-representatives to the locus of governance is not, in and of itself, antithetical to corporate governance, provided shareholder-representatives get involved to advance and protect the public interest, that is, 'public interest intervention'. Public interest 'intervention' is distinguishable from 'interference'. In the case of intervention, the shareholder-representative meaningfully engages the board as the 'directing mind' on matters that are likely to either advance or imperil the public interest – in a deferential manner – and then balances proposed board solutions with the overall public interest. For example, if the board of a

SOC recommends huge tariff hikes for utilities, mass retrenchments or liquidation, the shareholder-representative may intervene in the public interest to veto the board decision. To guard against abuse of this type of intervention, the law must articulate, perhaps in a non-exhaustive manner, what constitutes public interest and the procedure by which shareholder-representatives may intervene. Guidelines on what constitutes public interest in the context of the Companies Act have already been laid out by the Supreme Court of Appeal in *Recycling and Economic Development Initiative of South Africa v Minister of Environmental Affairs.*[1] It is important that the shareholder-representatives should intervene in writing and be ready to defend their intervention should it be challenged on judicial review. This approach will weed out political and unstructured intervention that does not advance or protect the public interest and sound corporate governance.

It may be argued that public interest intervention interferes with board primacy. However, such intervention is justifiable because SOCs are by nature public interest companies and as such they cannot be left to absolute control by their boards. There must be quasi-board primacy that allows shareholder-representatives to intervene to protect the public interest within narrowly defined circumstances and using clear procedures. This is because ordinary shareholder protection remedies such as derivative action, removal of directors and others may not be agile enough for shareholder-representatives to speedily advance or protect the public interest.

Central to the overhaul of the current model of ownership and control is a tailored, de-layered, and responsive legal and regulatory framework centred on the idea of public interest. This can be achieved by adopting overarching legislation and a single governance code. Importantly, the statute will curtail shareholder control powers, while protecting board primacy and insulating boards from political interference. A single governance code will prescribe SOC-specific governance principles and practices, which will address the problem of overregulation and improve compliance. Idiosyncratic dynamics –

[1] 2019 (3) SA 251 (SCA).

such as entrenched political interference in SOCs' affairs, rampant corruption, and compromised boards – call for a twin-track ownership model that professionalises the ownership function while placing SOCs at arm's length vis-à-vis politicians.

8.2 CONTEMPORARY RELEVANCE AND CONTRIBUTION

This thesis provides a direct response to the unfolding national crisis of poorly governed and underperforming SOCs. It provides a scholarly contribution to the corporate governance discourse by advancing a conceptually sound and coherent answer to the calamity of failing SOCs. The thesis is therefore a timely contribution that is likely to serve as a resource for the impending reform of the sector. It will be useful to policymakers, legislators, lawyers, regulators, bureaucrats, scholars and students of corporate governance and corporate law as it introduces new ways of viewing the nature, role, ownership, and control of SOCs in a holistic and structured manner.

The theoretical underpinnings of SOCs, from a legal perspective, have until now not been examined in a critical way. The discourse generally conceptualises SOCs as profit companies and the exiting theory is premised on this conceptualisation. This thesis differs from the current academic writings on corporate governance in SOCs as well as legislation as it does not adhere to the conceptualisation of SOCs as profit companies. Furthermore, it does not adopt any one of the three approaches of corporate law and governance scholarship, namely, the shareholder value approach, the enlightened shareholder approach, and the stakeholder approach. Instead, it draws on these approaches to arrive at a unique and SOC-appropriate approach, that is, the public interest approach, which conceptualises SOCs as *sui generis* public interest companies. In bringing the public interest approach into the discourse, this thesis aims to complement the existing literature.

The normative approach that places public interest at the centre of the ownership, control, and governance of SOCs can be applied to other facets of

corporate governance and to other types of companies, such as non-profit companies (NPCs). The public interest approach can also be instrumental, policy-oriented, and forward-looking in that it may serve to inform both policy formulation and law making. If policymakers and lawmakers are to avoid unsuitable policies and legislation going forward, it is essential that they begin to appreciate the true nature of SOCs as public interest companies and design and implement new policies and laws with this approach in mind.

It is worth noting that a public interest approach is neither new nor quixotic. Indeed, the idea of public interest has been simmering in both company law and corporate governance as well as in case law. For instance, the Companies Act recognises the social and economic mandate of enterprises. It requires SOCs and other companies to establish a social and ethics committee whose mandate can be broadly interpreted to be the protection of the public interest by companies with a certain public interest score. It also provides for public interest actions. The courts have held that public interest is the 'overarching theme and objective' of SOCs. Therefore, the key contribution of this thesis is to percolate the idea of public interest, crystallise it, and then systematically deploy it as a definitional and interpretative tool to critique the ownership and control architecture of SOCs and assess its impact on corporate governance. In a nutshell, the thesis uses the public interest approach to reconceptualise SOCs, rethink the legal and regulatory framework, re-evaluate and expand directors' duties, and reassess and reform the ownership model and control arrangements.

8.3 FINAL REMARKS

In closing, the ownership and control architecture of South Africa's state-owned companies is flawed in many ways and its inherent deficiencies have a direct bearing on the quality of corporate governance. This notwithstanding, SOCs fulfil an important role in the socio-economic life of the country. For that reason, it may not be prudent to privatise them wholesale. Instead, the architecture of their ownership and control must be rethought and redesigned in a manner that eliminates the deficiencies and advances corporate

governance and performance. Unlike the current cosmetic efforts, such as the constant changing of boards, the moving of SOCs from one shareholder-ministry to another, and the so-called ad hoc war rooms ostensibly designed to achieve some modicum of short-term stability, this thesis proposes a minimalist and structured architecture of ownership and control that will address the structural issues that cause or contribute to poor governance in SOCs.

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