THE CORPORATE GOVERNANCE REVIEW

TENTH EDITION

Editor
Willem J L Calkoen

THE LAWREVIEWS

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PREFACE

I am proud to present this new edition of *The Corporate Governance Review* to you.

In this 10th edition, we can see that corporate governance is becoming a more vital and all-encompassing topic with each year that passes. We all realise that the modern corporation is one of the most ingenious concepts ever devised. Our lives are dominated by corporations. We eat and breathe through them, we travel with them, we are entertained by them, most of us work for them. Most corporations aim to add value to society, and they very often do. There is increasing emphasis on this. Some, however, are exploiting, polluting, poisoning and impoverishing us. A lot depends on the commitment, direction and aims of a corporation's founders, shareholders, boards and management, and employees. Do they show commitment to all stakeholders and to long-term shareholders, or mainly to short-term shareholders? There are many variations on the structure of corporations and boards within each country and between countries. All will agree that much depends on the personalities and commitment of the persons of influence in the corporation.

We see that everyone wants to be involved in better corporate governance: parliaments, governments, the European Commission, the US Securities and Exchange Commission (SEC), the Organisation for Economic Co-operation and Development (OECD), the UN's Ruggie reports, the media, supervising national banks, more and more shareholder activists, proxy advisory firms, the Business Roundtable and all stakeholders. The business world is getting more complex and overregulated, and there are more black swans, while good strategies can quite quickly become outdated. Most directors are working very diligently. Nevertheless, there have been failures in some sectors and trust must be regained. How can directors do all their increasingly complex work and communicate with all the parties mentioned above?

What should executive directors know? What should non-executive directors know? What systems should they set up for better enterprise risk management? How can chairs create a balance against imperial CEOs? Can lead or senior directors create sufficient balance? Should most non-executive directors understand the business? How much time should they spend on their function? How independent must they be? Is diversity actively being pursued? Is the remuneration policy defendable? What are the stewardship responsibilities of shareholders? What are the pros and cons of shareholder rights plans and takeover defences?

Governments, the European Commission and the SEC are all pressing for more formal inflexible legislative acts, especially in the area of remuneration. Acts set minimum standards, while codes of best practice set aspirational standards. We see a large influence on norms by codes and influential investor groups.

More international investors, the Business Roundtable, voting advisory associations and shareholder activists want to be involved in dialogue with boards about strategy, succession and income. Indeed, far-sighted boards have 'selected engagements' with stewardship

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shareholders to create trust. What more can they do to show all stakeholders that they are improving their enterprises other than through setting a better tone from the top? Should they put big signs on their buildings emphasising integrity, stewardship and respect?

Interest in corporate governance has been increasing since 1992, when shareholder activists forced out the CEO at General Motors and the first corporate governance code – the Cadbury Code – was written. The OECD produced a model code, and many countries produced national versions along the lines of the Cadbury comply or explain model. This has generally led to more transparency, accountability, fairness and responsibility. However, there have been instances where CEOs have gradually amassed too much power, or companies have not developed new strategies and have incurred bad results – and sometimes even failure. More are failing since the global financial crisis than before, hence the increased outside interest in legislation, further supervision and new corporate governance codes for boards, and stewardship codes for shareholders and shareholder activists. The European Commission is developing regulation for this area as well. Recently, we see that governments want to involve themselves in defending national companies against takeovers by foreign enterprises. We also see a strong movement of green investors, which often is well appreciated by directors. There is a move to corporate citizenship. The Business Roundtable with about 180 signatories has confirmed to embrace stakeholder corporate governance.

This all implies that executive and non-executive directors should work harder and more as a team on long-term policy, strategy, entrepreneurship and investment in R&D. More money is lost through lax or poor directorship than through mistakes. On the other hand, corporate risk management with new risks entering such a digitalised world and cybercrime is an essential part of directors' responsibilities, as is the tone from the top. How can directors do their important work well without being petrified of attacks from shareholders, regulations and the press?

Each country has its own measures; however, the chapters of this book also show a convergence. Understanding differences leads to harmony. The concept underlying the book is that of a one-volume text containing a series of reasonably short, but sufficiently detailed, jurisdictional overviews that permit convenient comparisons, where a quick first look at key issues would be helpful to general counsel and their clients.

My aim as editor has been to achieve a high quality of content so that *The Corporate Governance Review* will be seen as an essential reference work in our field. To meet the all-important content quality objective, it was a condition *sine qua non* to attract as contributors colleagues who are among the recognised leaders in the field of corporate governance law from each jurisdiction.

I thank all the contributors who helped with this project. I hope that this book will give the reader food for thought; you always learn about your own law and best practice by reading about the laws and practices of others. Further editions of this work will obviously benefit from the thoughts and suggestions of our readers. We will be extremely grateful to receive comments and proposals on how we might improve the next edition.

Willem J L Calkoen
NautaDutilh
Rotterdam
March 2020

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Chapter 20

SOUTH AFRICA

Ezra Davids, Ryan Kitcat and Lauren Midgley[1]

I OVERVIEW OF GOVERNANCE REGIME

Listed companies in South Africa operate within a robust and flexible governance framework comprising statutes, regulations, common law, and both international and South African codes of best practice.[2]

The Companies Act 71 of 2008 is the primary source of company law in South Africa. Each public company is constituted in accordance with the Companies Act and its constitutional document, the memorandum of incorporation (MOI), which establishes the company's capacity, legal powers and governance.[3]

Public companies whose securities are listed on the Johannesburg Stock Exchange (JSE),[4] South Africa's main securities exchange, must adhere to various requirements imposed on them by the Listings Requirements of the JSE (Listings Requirements). Given the high levels of public interest in such companies, the Companies Act and the Listings Requirements together impose a demanding accountability and transparency regime.

Insofar as 'good practice' standards are concerned, the King IV Code on Corporate Governance (King Code), which is recognised as one of the world's leading corporate governance codes,[5] sets out principles and recommended practices that an organisation should apply in order to substantiate a claim that it is practising good governance, reflected in four outcomes: ethical culture, good performance, effective control and legitimacy.[6] Certain

1 Ezra Davids is a partner, Ryan Kitcat is a senior associate, and Lauren Midgley is an associate at Bowmans.

2 The Companies Act recognises two types of company: a profit company and a non-profit company. A profit company may be a private company (whose securities may not be offered to the public), state-owned company, personal liability company, or public company. This chapter focuses on public companies whose securities are listed on the Johannesburg Stock Exchange.

3 An object of the Companies Act is to create a facilitative and enabling corporate law regime. As such, companies are subject to certain 'unalterable' provisions of the Companies Act that prescribe core company law rules applicable to a company, with the remaining provisions being 'alterable' default provisions that apply to a company only to the extent that the MOI does not vary them. There is, therefore, a lot of flexibility in incorporating a company in South Africa.

4 The JSE is operated by JSE Limited.

5 See, for example, American Bar Association – BLT, 20 July 2017, Michael Judin, Leigh Roberts, Ramani Naidoo, 'Corporate Governance…Innovative Thinking In South Africa's Latest Code', available at: www.americanbar.org/groups/business_law/publications/blt/2017/07/01_judin/.

6 The King IV Code on Corporate Governance forms part of the King IV Report on Corporate Governance™ for South Africa, 2016, issued by the Institute of Directors in Southern Africa NPC (IoDSA).

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recommended practices in the King Code are incorporated into the Listings Requirements, making it mandatory for JSE-listed companies to comply with them, with the balance of the King Code's recommendations to be implemented on an 'apply and explain' basis.

The philosophies underpinning the principles and recommendations in the King Code reflect and recognise three paradigm shifts that appear to be taking place globally: (1) from financial capitalism towards more inclusive capitalism, which takes account of all sources of capital – financial, manufactured, intellectual, human, social, relationship and natural – involved in the value-creation process; (2) from short-term capital markets towards long-term, sustainable, capital markets;[7] and (3) from silo reporting towards integrated reporting, based on integrated thinking, which takes into account the connectivity and interdependencies between a range of exogenous factors (e.g., the economy, society and environment) and endogenous factors that affect a company's ability to create value over time.[8]

II CORPORATE LEADERSHIP

i Board structure and practices

The business and affairs of a company must be managed by or under the direction of the board, which has the authority to exercise all of the powers and perform all of the functions of the company, except to the extent that the Companies Act or the company's MOI provides otherwise.[9] While shareholders still retain ultimate authority in respect of specific reserved matters[10] (including the right to reconstitute the board), the Companies Act vests the board with original statutory authority – without any delegation from shareholders – regarding the conduct of the company's business and affairs. Such power may only be exercised collectively by way of majority vote; in the absence of a specific delegation from the board, individual directors do not have the power to bind the company.

The traditional structure of a South African board is unitary, with no separation between executives and non-executives. The King Code contains various recommendations on board composition, including that the board comprise a majority of non-executives, most of whom should be independent. The Listings Requirements require that independence be determined holistically on a 'substance over form' basis, which takes into consideration various interests, positions and relationships listed in the Companies Act and the King Code that might reasonably call the integrity or objectivity of the director into question.

Typically, the board delegates the responsibilities of day-to-day operational management to an executive team, whose members are subject to board oversight and are appointed and dismissed at the behest of the board. The board may appoint any number of committees and may delegate to such committees any of its authority; however, the directors retain ultimate responsibility for the committees' decisions and actions.

Available at: www.iodsa.co.za/page/KingIVReport. The IoDSA owns all copyright and titles in the 'King IV Report on Corporate Governance for South Africa, 2016'. King IV™, King IV Report™ and King IV Code™ are trademarks of the IoDSA.

7 The King Code recognises that companies (and other organisations) are an integral part of society: they both contribute to and are dependent on society, and are affected by and have an effect (both positive and negative) on the societies in which they operate.

8 The King IV Report at 4-5 ('Foreword').

9 Section 66 of the Companies Act.

10 See Section V.i.

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The Companies Act requires public companies to constitute an audit committee.[11] Public, state-owned and certain significant private companies (i.e., those that have attained a certain 'public interest score' derived from factors such as annual turnover, workforce size, and nature and extent of activities) are required to appoint a social and ethics (S&E) committee.[12] Under the Listings Requirements, 'King compliant' audit, remuneration and S&E committees are mandatory. Risk and nomination committees are only encouraged, although JSE-listed companies constitute such committees in practice.

JSE-listed companies must appoint a chairperson (or a lead independent director, in the event that the chair is not an independent non-executive) to lead the board, as well as a CEO to lead management. As independence is considered essential to the proper fulfilment of the chair's role, the Listings Requirements insist that these positions be held by separate individuals. However, in certain limited instances, a dispensation may be granted by the JSE allowing an executive chair to be appointed on a temporary basis.

Non-executive directors have no automatic right to remuneration. Rather, the Companies Act provides that the company may pay its directors for their service in such capacity only in accordance with a special resolution approved by the shareholders within the previous two years. As such, the Companies Act places the decision of whether to remunerate individual directors squarely in shareholders' hands, with a view to curtail excessive compensation and encourage good corporate governance.

ii Directors

Appointment, nomination, removal and term of office

In the case of a profit company other than a state-owned company, at least 50 per cent of the directors (and alternate directors) must be elected by shareholders. For the remainder, the MOI may include a right in favour of a person named in, or determined in terms of, the MOI to appoint a director; certain persons who hold office are also recognised as *ex officio* directors.

Under the Companies Act, directors are appointed for an indefinite term, unless the MOI provides to the contrary. However, owing to the growing awareness surrounding the link between director tenure and independence, the King Code recommends that arrangements for periodic, staggered rotation be put in place. These arrangements should strike a balance between retention of valuable knowledge and experience on the one hand, with the need to infuse fresh ideas and perspectives into board decision-making on the other. As such, companies often provide in their MOIs for staggered retirement by rotation, whereby certain classes of directors (usually non-executives) retire at each annual general meeting (AGM), and then stand for re-election by shareholders. To prevent this process from becoming a mere formality, some companies have adopted policies limiting the duration for which non-executives may hold office. For JSE-listed companies, the annual retirement of at least one-third of non-executive directors is mandatory.[13] The board will recommend whether each of such directors is eligible to stand for re-election, taking into account past performance and contributions made.

11 See Section III.

12 See Section IV.

13 In a new company, all directors must retire at the first AGM.

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Shareholders have the right to remove a director for any reason by way of an ordinary resolution (which requires a simple majority threshold) adopted at a shareholders' meeting by those entitled to exercise voting rights in such director's election. To mitigate against the risk of director entrenchment, the Companies Act states that this shareholder right prevails despite anything to the contrary contained in a company's MOI or rules, or in any other agreement.[14]

The board is also empowered to remove a director by way of resolution, but only on prescribed grounds pertaining to such director's fitness to hold office, namely where the director has: (1) become ineligible or disqualified in terms of the Companies Act (e.g., where the director is labouring under a legal disability, or has been convicted of a dishonesty-related offence); (2) become meaningfully incapacitated; or (3) been neglectful or derelict in the performance of his or her functions as a director.[15]

Directors' duties

The fiduciary duties of directors, as well as the duty of care and skill, have been partially codified in the Companies Act. However, the common law principles are preserved, informing the interpretation of, and filling gaps in, the statutory provisions.

All directors, be they executive or non-executive, owe the same fiduciary duties individually and directly to the company. A 'director' (which encompasses alternate directors, prescribed officers and members of board committees) must exercise his or her powers and functions in good faith and for a proper purpose, and in the best interests of the company.[16] At common law, the duty to act in good faith and in the best interests of the company is the paramount and overarching fiduciary duty from which all others flow. These duties are to: (1) act within designated powers; (2) maintain and exercise unfettered discretion and independent judgement; and (3) avoid conflicts of interest.

The Companies Act has incorporated, and in some ways expanded upon, this latter integral common-law fiduciary duty. It prescribes that directors must: (1) not use their company position, or any information obtained while acting in such capacity, to gain a personal advantage or knowingly cause harm to the company or a subsidiary thereof;[17] and (2) fully disclose any material personal financial interest that they may have in respect of any matter to be considered at a board meeting, and if present at the meeting, recuse themselves so as not to take part in the deliberation of the matter.[18]

While our courts draw no distinction between executive and non-executive directors when applying fiduciary duties, the duty of care and skill provides a court with scope to weigh the director's specific role and function within the company. Section 76 of the Companies

14 Moreover, while the MOI may ordinarily set a higher percentage of voting rights to approve a resolution, the simple majority threshold cannot be varied in the case of a resolution effecting the removal of a director.

15 Regardless of circumstances, before any vote is cast on his or her removal, a director is afforded certain procedural rights under the Companies Act (and in accordance with common law rules of natural justice). These include the right to receive reasonable notice of the resolution, and a reasonable opportunity to make representations in his or her defence at the meeting.

16 Section 76 of the Companies Act.

17 Section 76 of the Companies Act.

18 Section 75 of the Companies Act.

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Act requires that a director should at all times act with the degree of care, skill and diligence that may reasonably be expected of a person: (1) carrying out the same functions; and (2) with the general knowledge, skill and experience of that director.

In order to promote innovation and encourage calculated risk-taking by entrepreneurs, the Companies Act has adopted a US-style 'business judgment rule', which guards against court interference in directors' honest errors of judgment. In essence, the rule provides that a director is deemed to have satisfied his or her duties if such director made an informed, unconflicted decision that he or she genuinely and rationally believed was in the best interests of the company.

Liability

Directors, prescribed officers and board committee members may be held jointly and severally liable for any loss, damages or costs sustained by the company as a consequence of having breached any of their duties, or for having breached the Companies Act or the company's MOI.

Section 77 lists specific instances where a director may incur liability, including where a director knowingly: (1) acted without authority on behalf of the company; (2) acquiesced in the reckless trading of the company's business; (3) conducted an act calculated to defraud stakeholders; or (4) was party to false or misleading communications to the market.

In limited instances, directors may also be subject to criminal penalties, particularly in instances involving fraud or dishonesty.

Requirements and diversity

Directors are not legally required to possess any special qualifications, skills, business acumen or experience in the company's business to hold office. That said, the duty of care and skill is such that directors cannot avoid liability by remaining culpably ignorant of company affairs or blindly deferring to other board members or experts.

The King Code recommends that the board should comprise the appropriate balance of knowledge, skill, experience, diversity and independence for it to discharge its governance role and responsibilities objectively and effectively. In light of these recommendations, as informed by global trends, board diversity is becoming an ever-greater priority for South African companies; particularly in light of our unique history and the prevalent role that Broad-Based Black Economic Empowerment (B-BBEE) plays in our corporate environment.[19] The traditional understanding of 'diversity' is also evolving in South Africa: the Listings Requirements have long required the adoption of policies that promote racial and gender diversity at board level, but a recent amendment[20] expands upon these diversity attributes to include culture, age, experience and skillset, in line with the King Code.

19 See Section IV.

20 Effective from December 2019.

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III DISCLOSURE

The purposes of the Companies Act include encouraging transparency and high standards of corporate governance as appropriate, given the significant role of enterprises within the social and economic life of the nation.[21] Under the Companies Act, all companies must report to shareholders annually on the state of the company. Public companies are required to hold an AGM at which certain minimum business must be conducted, including director elections and appointing an auditor. Public companies must also have their annual financial statements (AFS) audited.

The AFS, presented at the first shareholders' meeting after being approved by the board, must contain certain prescribed information. In addition to an auditor's report (if relevant), a detailed directors' report on the business and financial condition of the company is required, such that shareholders are able to appreciate the state of the company affairs. Further, audited AFS must include a host of particulars regarding the emoluments received by directors and prescribed officers – on an individual basis, and not as an aggregate amount – including all fees, bonuses, options, pension contributions and any non-financial benefits.

Director remuneration has become a contentious issue in recent years. Responding to growing calls for transparency on this subject, the King Code includes a recommendation (which has been incorporated into the Listings Requirements) that companies should produce and disclose, in respect of a reporting period, a remuneration policy and a report on the implementation of that policy.[22] This report must be tabled annually for a separate non-binding advisory vote by shareholders at the AGM. If 25 per cent or more of voting rights are exercised against any part of this remuneration policy, the board must engage with shareholders in good faith to understand shareholder dissatisfaction and the reasons for dissenting votes. The board is required to appropriately address reasonable and legitimate concerns raised in the evaluation of performance. Although the advisory vote given to shareholders is non-binding, this vote coupled with increased disclosure encourages the board to engage with shareholders, promotes transparency and provides shareholders with a platform to express their dissatisfaction.

The audit committee plays a vital role in ensuring that adequate accounting records are maintained and that company reporting is comprehensive and reliable. As such, the Companies Act mandates that all public companies must elect an audit committee at the AGM. In contrast to regular board committees, which are appointed by and derive their authority directly from the board, audit committees hold a special status as a statutory committee, appointed by (and by inference, accountable to) shareholders. These committees must comply with the composition requirements (e.g., at least three independent, financially literate members), and must carry out prescribed duties (e.g., nominating and confirming the independence of the company auditor), contained in the Companies Act.

21 Section 7 of the Companies Act.

22 The King Code recommends further detailed disclosures regarding: (1) each board committee; (2) the CEO; (3) risk management and governance; (4) stakeholder arrangements; and (5) inspections by environmental regulators, and any related findings of non-compliance or criminal sanctions.

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The Listings Requirements contain various continuing disclosure obligations and General Principles[23] regarding disclosure by listed entities to their securities holders and the general public, including to ensure that: (1) full, equal and timeous public disclosure is made regarding activities that are price sensitive; (2) full information is given regarding substantial changes in business operations and matters affecting the MOI; (3) the highest standards of care are adhered to when disseminating information into the market; and (4) the Listings Requirements promote investor confidence in disclosure standards and corporate governance. Accordingly, JSE-listed entities are subject to stringent financial reporting and disclosure requirements in key areas, including: (1) year-end and interim financial results and trading statements; (2) price sensitive information; (3) profit forecasts; (4) directors' dealings; and (5) significant corporate actions.

Insofar as the application of the King Code is concerned, good corporate governance outcomes may be achieved through the King Code's 'apply and explain' application and disclosure regime. That is, a company should: (1) mindfully consider and apply the recommended practices that underpin the King Code principles proportionally in line with the company's size, resources, and the extent and complexity of its activities; and (2) provide a narrative account of that application, with reference to the recommended practices.[24] This 'apply and explain' approach is intended to generate an account that allows stakeholders, including shareholders, to evaluate and independently assess the extent to which the company and its group is applying the principles and recommendations in the King Code. This account should be contained in an integrated report prepared by the company,[25] which the King Code defines as a 'concise communication about how an organisation's strategy, governance, performance and prospects, in the context of its external environment, lead to the creation of value in the short, medium and long term'.[26]

The King Code describes 'materiality' in relation to the inclusion of information (financial or other) in an integrated report as referring to matters that 'could substantively affect the organisation's ability to create value over the short, medium and long term'.[27]

IV CORPORATE RESPONSIBILITY

Corporate citizenship

The purposes of the Companies Act include encouraging the efficient and responsible management of companies.[28] Directors are obliged when making decisions to act in the best interests of the company. Reflecting the growing awareness of the integral societal role

23 The General Principles are set out in the introduction to the Listings Requirements, and may be applied by the JSE in circumstances not otherwise covered by the Listings Requirements. The JSE has discretion to modify the application of any requirement in the main body of the Listings Requirements where the strict application thereof would conflict with the General Principles.

24 Earlier iterations of the King Code imposed a binary 'apply or explain' regime.

25 In practice, JSE-listed companies tend to take into account the King Code, Global Reporting Initiative (GRI) standards, and/or International Integrated Reporting Council (IIRC) guidance in preparing annual integrated reports.

26 King IV Report at 13 ('Glossary of Terms').

27 Definition of 'materiality' taken from the IIRC, The International <IR> Framework (13 December 2013), at 5, available at: https://integratedreporting.org/wp-content/uploads/2013/12/13-12-08-THE-INTERNATIONAL-IR-FRAMEWORK-2-1.pdf.

28 Section 7 of the Companies Act.

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companies occupy, the Companies Act essentially promotes the 'enlightened shareholder value' approach: boards are permitted to take broader stakeholder interests into account, while remaining cognisant of their principal duty of maximising shareholder value.

The King Code adopts an approach to corporate citizenship based on the view that an organisation has rights, obligations and responsibilities in the society in which it operates. That is, a company is 'licensed to operate by its internal and external stakeholders, and by society in the broad sense'.[29] In recognition of the interdependent relationship between a company, its stakeholders and the company's ability to create value, the King Code recommends a stakeholder-inclusive approach 'in which the [board] takes into account the legitimate and reasonable needs, interests and expectations of all material stakeholders in the execution of its duties in the best interests of the [company] over time'.[30] Consequently, directors must grapple with finding the right balance between these approaches when making decisions in the best interests of the company.[31]

S&E committee

The Companies Act requires public companies to appoint an S&E committee, which is meant to guide the organisation in fulfilling its role as responsible corporate citizen. The S&E committee's functions include:

a monitoring the company's activities, having regard to any relevant legislation, other legal requirements or prevailing codes of best practice, including the King Code, with regard to matters relating to:
- social and economic development;
- good corporate citizenship, including issues of discrimination, corruption, and development of local communities;
- the environment, health and public safety, including the impact of the company's activities and of its products or services;
- consumer and employee relationships;

b reporting on matters within its mandate to the board as occasion requires; and

c reporting to shareholders on matters within its mandate at the company's AGM.[32]

Risk management

The board is ultimately responsible for the company's overall approach to risk, as expressed in a board-approved risk policy. The King Code embraces the modern approach to risk governance, which requires boards to appreciate not only the downside of risk, but also the upside, as materialised in potential opportunities and rewards. In this regard, the board should approve both the company's risk appetite, and the limit of the potential loss the company can tolerate. The board must ensure that systematic, formal risk assessments are performed annually to identify, quantify, evaluate and prioritise risk. The annual report should incorporate a risk management statement that includes details of key risks relevant

29 King IV Report at 25 ('Corporate citizenship').

30 King IV Report at 17 ('Glossary of Terms').

31 Our courts have been known to take corporate governance practices recommended by the King Code into account when rendering judgment against errant directors: see, for example, *South African Broadcasting Corporation Ltd and Another v Mpofu* [2009] 4 All SA 169 (GSJ) and *Minister of Water Affairs and Forestry v Stilfontein Gold Mining Co Ltd* 2006 (5) SA 333 (W).

32 Regulation 43 of the Companies Regulations, 2011.

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to the company and the steps taken to mitigate these risks. The board should allocate the oversight of risk governance to a dedicated committee, which should comprise executive and non-executive directors (with the latter forming the majority).

Broad-Based Black Economic Empowerment

As a measure to redress the legacy of apartheid, the legislature adopted the Broad-Based Black Economic Empowerment Act 53 of 2003 (B-BBEE Act) to increase levels of economic participation by previously disadvantaged race groups. Other than in certain state licensing, permitting and authorisation processes, there is no 'hard law' requiring any private entity to meet specific B-BBEE targets. However, various Codes of Good Practice under the B-BBEE Act must be taken into account by government entities when dealing with the private sector (e.g., selling state-owned assets and entering into public-private partnerships). As such, a low B-BBEE rating may constrain an entity's ability to compete for business from the government, organs of state and even private sector customers (who, in turn, may be required to adhere to certain B-BBEE requirements – for instance, by ensuring that their own procurement is sourced from suitably empowered suppliers).

Whistle-blowing

Under the Protected Disclosures Act 26 of 2000 (PDA), employees who make certain disclosures of unlawful or irregular conduct by employers or fellow employees are protected against victimisation or any 'occupational detriment' (such as dismissal, demotion or harassment). Section 159 of the Companies Act, which is intended to complement the PDA, provides safeguards to company stakeholders, including shareholders, directors and employees, who make good faith disclosures of specific wrongful or unlawful acts of a company, director or prescribed officers. Such whistle-blowers are immune from civil, criminal or administrative liability and have qualified privilege in relation to the disclosure.

V SHAREHOLDERS

i Shareholder rights and powers

Shareholders are entitled to attend, speak and vote at a meeting, either themselves or via proxy. This allows shareholders to ask difficult questions of directors, express their views or lobby support from other shareholders for a particular agenda (e.g., a 'vote no' campaign).

Shareholders have the ability to requisition a shareholders' meeting by delivering signed demands to the company, specifying the purpose for which the meeting is proposed. If the company receives, in aggregate, demands from holders of at least 10 per cent of the voting rights entitled to be exercised in relation to the matter proposed, it must call a meeting unless the company or another shareholder successfully applies to court to set aside the demand on the grounds that it seeks only to reconsider a matter that has already been decided by shareholders, or is frivolous or vexatious.

Any two shareholders of a company may propose that a resolution concerning any matter in respect of which they are each entitled to exercise voting rights (e.g., the removal of a director) be submitted to shareholders for consideration at the next shareholders' meeting, at a meeting demanded by shareholders or by written vote.

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Although the board is imbued with wide-ranging statutory powers to manage company affairs,[33] the board must defer to shareholders on certain prescribed matters requiring their approval, either by way of an ordinary resolution or special resolution (requiring a 75 per cent approval threshold). Key examples of matters requiring ordinary resolutions are the appointment and removal of directors under the Companies Act, and the entering into of a Category 1 transaction (being principally substantial acquisitions and disposals) under the Listings Requirements. Special resolutions are required for matters concerning fundamental company affairs, such as amending the MOI or entering into a fundamental transaction (e.g., statutory mergers, schemes of arrangement, and disposals of all or a greater part of a company's assets or undertaking).[34] The Listings Requirements provide an overlay of special resolution matters (e.g., the carrying out of a general repurchase of securities).

The Companies Act contains a range of remedies and protective mechanisms for shareholders. The statutory derivative action contained in Section 165 enables a shareholder (among other stakeholders) to demand that the company bring or continue proceedings, or take related steps, to protect the legal interests of the company.[35] A company may apply to court to set aside the demand only on the grounds that it is frivolous, vexatious or without merit.

In extreme cases, a shareholder may apply to court for an order necessary to protect any right of the shareholder, or rectify any harm done to the shareholder by: (1) the company due to an act or omission that contravened the Companies Act, the MOI or the shareholder's rights; or (2) any director of the company, to the extent that he or she is or may be liable for a breach of fiduciary duties. Similarly, a shareholder may apply to court for appropriate relief if: (1) any act or omission of the company has had a result; (2) the business of the company is being carried on in a manner; or (3) the powers of a director, prescribed officer or related person are being exercised in a manner that is oppressive or unfairly prejudicial, or unfairly disregards the interests of that shareholder. Having considered the application, the court may make any interim or final order it considers fit, including an order restraining the conduct complained of, ordering a compensation payment, or varying or setting aside an agreement or transaction.

Shareholders also have the right to bring a claim for damages against any other person who intentionally, fraudulently or due to gross negligence causes the company to do anything inconsistent with the Companies Act.

Dissenting minority shareholders may, in certain prescribed circumstances (e.g., fundamental transactions), force the company to purchase its shares in cash at a price reflecting fair value.[36] This is a 'no fault' appraisal right that enables a shareholder to sell all of its shares and exit the company. It applies if the shareholder notified the company of its

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33 See Section II.i.

34 In certain instances, the Companies Act and the Listings Requirements impose more stringent requirements for the passing of a special resolution. For instance, resolutions proposing fundamental transactions require shareholder approval be obtained at a quorate meeting of 75 per cent of disinterested shareholders present and voting (i.e., excluding voting rights of the acquirer and related or concert parties). Similarly, in respect of JSE-listed companies undertaking related party transactions, the votes of related parties and their associates will not be taken into account in the approval of any resolution in connection with the related party transaction.

35 A trade union or employee representative may also bring a statutory derivative action to protect the company's legal interests.

36 Section 164 of the Companies Act provides for appraisal rights.

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objection to the resolution to approve the action or transaction, and the shareholder voted against the resolution (which was nonetheless approved) and complied with various exacting procedural requirements.

If 15 per cent or more of shareholders vote against a resolution proposed for implementing a fundamental transaction, any dissenting shareholder may require the company, at its expense, to obtain court approval before implementing the resolution.[37] A single dissenting shareholder may also apply to court, at its expense, to have a resolution set aside. A court may only set aside the resolution if it is satisfied that there is manifest unfairness to shareholders or a material procedural irregularity.

Where an offer for a target company has been accepted by at least 90 per cent of the target company's disinterested shareholders, the Companies Act allows a buyer to initiate a minority 'squeeze out', by compulsorily purchasing the remaining shares held by non-accepting shareholders. However, Section 124 provides a measure of protection to minority shareholders in such instances, by not only empowering them to compel the buyer to take up their shares, but also allowing them to apply to court for an order prohibiting the 'squeeze-out' or imposing conditions thereon (usually on the basis that the offer is unfair).

ii Shareholders' duties and responsibilities

Shareholders, be they controlling or otherwise, owe no fiduciary or statutory duties to the company or other shareholders. Based on the principle of separate legal personality, shareholders are not liable for the company's acts or omissions. Only under exceptional circumstances may a court attribute personal liability to a shareholder who has abused the principle of corporate personality under the common law, or rely on the statutory mechanism in the Companies Act to 'pierce the corporate veil' where an 'unconscionable abuse' of a company's separate juristic personality has transpired.

The Companies Act contains disclosure obligations impacting on-market or off-market stake-building by shareholders. Persons who acquire or dispose of a beneficial interest in securities, such that they hold or no longer hold 5 per cent or any further multiple of 5 per cent of the voting rights attaching to a particular class of securities, must notify the issuer within three business days thereof.[38] This applies irrespective of whether the acquisition or disposal was made directly, indirectly, individually or in concert with any other person, and options and other interests in securities must be taken into account.

Institutional investors, such as pension funds, mutual funds, and insurers, may be required to engage in stewardship activities by virtue of obligations to responsibly manage their investments in JSE-listed companies – particularly insofar as sustainability and environmental, social and governance (ESG) factors are concerned. For example, pension funds in South Africa are obliged, before making an investment in and while invested in an asset, to consider any factor that may materially affect the sustainable long-term performance of the asset, including those of an ESG character.[39] A recent guidance note issued on such requirement by the Financial Sector Conduct Authority (FSCA) – the body responsible for enforcing the market conduct rules of financial institutions under the Financial Markets Act 19 of 2012 (FMA) – contemplates 'active ownership' by pension funds, being the prudent fulfilment of responsibilities relating to the ownership of, or an interest in, an asset. These

37 Section 115 of the Companies Act.

38 The issuer then has 48 hours to disclose the acquisition/disposal to the market and shareholders.

39 Regulation 28 of the Pension Funds Act 24 of 1956.

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responsibilities include guidelines to be applied for the identification of sustainability concerns in that asset, and mechanisms of intervention and engagement with the responsible persons in respect of the asset when concerns have been identified.[40]

iii Shareholder activism

Shareholder activism has gradually been on the rise in South Africa. This trend can be attributed to numerous factors, including South Africa's regulatory and corporate governance framework, which creates an enabling environment for shareholder activism or activist-like interventions.[41] In addition to the array of shareholder rights and protections under the Companies Act,[42] each iteration of the King Report has included ever-increasing recommendations regarding greater shareholder participation, thereby entrenching the position that shareholders have an active role to play in policing good governance.

Historically, most shareholder campaigns in South Africa have focused on executive compensation and board composition. On remuneration, following the introduction of 'say-on-pay' rules, certain JSE-listed companies have had to reconsider their remuneration policies following significant shareholder opposition to such policies or implementation reports. On board composition, campaigns have forced companies to take steps to change the make-up of their boards or pushed for the resignation of the CEO. The most notable example of this was in 2014, involving PPC, a cement manufacturer, where activists sought to remove the entire board.[43] In the M&A context, the influence of shareholder activism is also gradually increasing. Shareholders have intervened to block or force certain M&A activity. Recent examples of the former include shareholder opposition to a proposed takeover of PPC,[44] and Prudential's opposition to an attempted takeover of poultry producer Sovereign Foods by Country Bird Holdings.[45] An example of the latter is Grand Parade Investment's disposal of its interests in certain franchises.[46]

JSE-listed companies that are involved in or fund carbon-intensive industries are experiencing increased shareholder activism in respect of sustainability and ESG issues, from both institutional investors and NGOs (such as Just Share, the Raith Foundation and the

40 FSCA Guidance Notice 1 of 2019 (June 2019): Sustainability of investments and assets in the context of a retirement fund's investment policy statement.

41 Other factors include: (1) the influence of shareholder activism in other jurisdictions, mainly the US and Europe; (2) a widely held market with an internationalised shareholder base; and (3) a greater tendency towards active engagement by institutional and other investors, as facilitated by more efficient media platforms and other technological advancements that aid communication.

42 See Section V.i.

43 During 2014, a group of shareholders requisitioned a special shareholders' meeting to consider the removal of the entire board of PPC and to replace it with the nominees of the requisitioning shareholders. These measures successfully forced the board to engage with the requisitioning shareholders' concerns.

44 In 2018, PPC was the subject of a merger attempt by a consortium comprising its smaller rival AfriSam and a Canadian investment house, Fairfax Financial Holdings. This failed as a result of shareholder resistance to a perceived undervaluation of PPC. Following failure of the proposed transaction, activist shareholders pressed for the removal of the chairperson and reconstitution of the PPC board.

45 Chris Wood 'Shareholder activism (2): Sovereign Foods: Defending against a hostile takeover', August 2018, available at: https://prudential.co.za/insights/articlesreleases/ shareholder-activism-2 -sovereign-foods-defending-against-a-hostile-takeover.

46 In February 2019, Grand Parade Investments (GPI) announced that it was exiting its interests in the Dunkin' Donuts and Baskin-Robbins franchises. A consortium of disgruntled minority shareholders had long pushed for GPI to exit these chains, given their track record of underperformance.

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Centre for Environmental Rights). Recent instances of this activism have sought to compel companies to: (1) report on and disclose information on their assessment of greenhouse gas emissions attributable to their activities or portfolio; (2) develop policies on the funding of carbon-emitting operations; and (3) develop and disclose plans to protect shareholder value in the face of climate-related 'transition risks'.

With regard to short-selling, while the regulatory framework recognises the important role that short-sellers can play in holding management accountable and ensuring that markets operate efficiently, it does not permit market abuse, which is prohibited under the FMA.[47] In November 2018, following campaigns conducted by short-sellers that had a disruptive effect on the markets,[48] the FSCA published a 'Discussion Paper on the Implementation of a Short Sale Reporting and Disclosure Framework'.[49] Discussions on the proposed framework are ongoing.[50]

Insofar as debates around 'short-termism' versus the creation of long-term shareholder value are concerned, the King Code encourages boards to avoid prioritising narrow, short-term objectives at the expense of the company's prospects for growth and profitability over the long term.

Takeover defences

Takeovers and 'affected transactions' (e.g., statutory mergers, schemes of arrangement and disposals of all or a greater part of a company's assets or undertaking) are regulated under Chapter V of the Companies Act and the Takeover Regulations promulgated under that Act. In the context of such transactions, the Takeover Regulation Panel (TRP) is mandated to ensure the integrity of the marketplace and fairness to securities holders, and to prevent actions by offeree companies designed to impede, frustrate or defeat an offer or the making of fair and informed decisions by securities holders.[51]

The Companies Act contains a 'catch-all' rule that restricts 'frustrating action' in the context of an offer.[52] If the board of a regulated company has received a bona fide offer (or believes one may be imminent), it may not, without the approval of each of the TRP and the holders of the relevant securities,[53] take any action in relation to the affairs of the company that could effectively result in: (1) a bona fide offer being frustrated; or (2) the relevant securities holders being denied an opportunity to decide on the merits. Examples of 'frustrating action'

47 Under the FMA, market abuse offences include: (1) prohibited trading practices (e.g., knowingly engaging in practices which create an artificial price or false appearance of demand for a security); and (2) false, misleading or deceptive statements (e.g., publishing any statement, promise or forecast in respect of a listed company which the person knows is materially false, misleading or deceptive).

48 See, in particular, the National Treasury's media statement, 'National Treasury's view on Viceroy's Capitec Report', dated 1 February 2019, available at: www.treasury.gov.za/comm_media/press/2018/2018020201%20Media%20statement%20Viceroys%20Capitec%20Report.pdf.

49 The discussion paper is available at: https://www.fsca.co.za/Regulatory%20Frameworks/Documents%20for%20Consultation/Discussion%20paper%20on%20the%20implementation%20of%20a%20Short%20Sale%20Reporting%20and%20Disclosure%20framework%20-%2019%20November%202018.pdf.

50 R Jooste 'Rules to manage short-selling still being 'discussed'' *Daily Maverick* 16 August 2019, available at: www.dailymaverick.co.za/article/2019-08-16-rules-to-manage-short-selling-still-being-discussed/.

51 The TRP has the power to initiate or receive complaints, conduct investigations and issue compliance notices.

52 Section 126 of the Companies Act.

53 Unless such action was taken in terms of a pre-existing obligation/agreement.

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under the Companies Act include: (1) issuing or granting options in respect of unissued securities; (2) disposing or acquiring a material asset; (3) making an abnormal distribution; and (4) entering into contracts outside the ordinary course of business.

The rule against 'frustrating action' therefore makes it difficult for a board to ward off a hostile bidder by adopting takeover defences common in the US, such as a shareholder rights plan (poison pill). However, there are various steps that the board could legitimately take, which would have the effect of creating hurdles in the implementation of the hostile bid, without necessarily constituting 'frustrating action' – for instance, mobilising opposition by key stakeholders with respect to the takeover.

Contact with shareholders

Contact with shareholders is an important feature of corporate governance in South Africa. Shareholders regularly pursue one-on-one or collaborative engagement with listed companies on a range of issues. Good practice codes such as the United Nations-supported Principles for Responsible Investment (UN-PRI) and Code for Responsible Investment in South Africa promote 'active ownership', responsible stewardship, and collaborative engagement by institutional investors, particularly in respect of ESG issues.

The FMA includes rules prohibiting insider trading and market abuse. Shareholders must adhere to these provisions when engaging with management or pursuing stewardship activities, whether engaging with management one-on-one or collaboratively with other shareholders. A shareholder may become an 'insider' by becoming privy to 'inside information'[54] for the purposes of the FMA, at which point insider trading rules would apply to it.[55]

Collaborating shareholders should take into account 'acting in concert' rules under the Companies Act and Takeover Regulations.[56] As a general principle, provided the collaboration is not for the purpose of proposing or entering into an 'affected transaction' or offer, the collaboration would not amount to acting in concert. As such, there is considerable scope for shareholders to come up with collaborative engagement plans to conduct stewardship and other activities. We expect a significant amount of contact with shareholders in relation to ESG and sustainability issues going forward.[57]

The King Code promotes proactive shareholder engagement through a number of its recommendations. Among other things, the King Code recommends that the board

54 The FMA defines 'inside information' as 'specific or precise information, which has not been made public and which – (1) is obtained or learned as an insider; and (2) if it were made public, would be likely to have a material effect on the price or value of any security listed on a regulated market'.

55 There are three broad categories of insider trading offences under the FMA: (1) dealing offences (e.g., when an insider, who knows he or she has inside information relating to listed securities, deals in those securities to benefit him- or herself or another person); (2) disclosure offences (e.g., when an insider knowingly discloses inside information); and (3) influencing offences (e.g., when an insider knowingly encourages another person to deal in listed securities likely to be affected by inside information).

56 The Companies Act regards concert party conduct as any action pursuant to an agreement between or among two or more persons, in terms of which any of them cooperate for the purpose of entering into or proposing an affected transaction or offer.

57 In 2010, UN-PRI published guidance on this particular issue, following engagements between the PRI South Africa Network Engagement Working Group and the TRP. Available at: https://cdn.ymaws.com/www.iodsa.co.za/resource/collection/58CA7BC8-8C67-4CF7-A644-0EDB06165C8B/2013.05.14_PRI_Collaborative_Engagement_Guidance.pdf.

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encourage shareholders to attend the AGM, at which all directors should be available to respond to shareholders' queries. In line with the 'stakeholder inclusive' approach, the King Code recommends the adoption of comprehensive policies on stakeholder relationship management, and that engagement take place through media platforms designed to facilitate access by a broad range of stakeholders, such as websites, advertising and press releases.

VI OUTLOOK

The proliferation of high-profile corporate governance failures in South Africa – notably the 2017 saga involving alleged accounting irregularities at Steinhoff – has intensified public interest in, and regulatory scrutiny of, corporate governance. Listed companies that simply pay lip-service to corporate governance, viewing compliance as a 'tick box' approach unconnected to the long-term viability of their businesses, will undoubtedly experience increased levels of activism and calls from shareholders for ever-greater levels of accountability and transparency from the companies in which they are invested.

We expect sustainability and ESG issues to feature high on the corporate governance agenda in the coming years, for boards and shareholders (particularly institutional investors) alike.[58]

58 See, for example, UN-PRI and UNEP FI, Final Report: Fiduciary Duty in the 21st Century, available at: www.unpri.org/download?ac=1378. See also www.unpri.org/fiduciary-duty/fiduciary-duty-in- the-21st-century/244.article. See also M Isa 'Ignore sustainable investment at your own peril' *FinWeek* 6 November 2019, available at: www.fin24.com/Finweek/Investment/ignore-sustainable-investment- at-your-own-peril-20191105.

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Appendix 1

ABOUT THE AUTHORS

EZRA DAVIDS

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Ezra Davids is chairman of corporate/M&A at Bowmans, specialising in M&A, capital markets and securities law.

Ezra is the most recent chairman of the Faculty Advisory Board of the Law School of the University of Cape Town. He is a member of the board of trustees of the Legal Resources Trust (a non-profit human rights organisation using the law as an instrument of justice); a director of Freedom Under Law (a non-profit organisation dedicated to the promotion of the rule of law in Southern Africa); and a patron of the Student Sponsorship Programme (a non-profit organisation that enables academically talented, low-income students to excel in South Africa's best high schools). He is also the former chairman of the Recent Developments in M&A Subcommittee of the Corporate and M&A Committee of the International Bar Association and is a regular contributor to international M&A and equity capital markets publications.

Ezra was the first practising African lawyer to be featured on the cover of *The American Lawyer*.

RYAN KITCAT

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Ryan Kitcat is a senior associate in the corporate department at Bowmans, and a member of the M&A practice area.

Ryan specialises in public and private M&A and general corporate and commercial law. He has advised JSE-listed and multinational clients on a variety of national and cross-border mandates. He has worked in particular in the energy and natural resources, education, mining, hospitality and private security sectors. His expertise extends to B-BBEE transactions, corporate reorganisations, corporate governance, shareholder activism and takeovers.

In 2018, Ryan spent six months on a StrongerTogether secondment to the London office of Freshfields Bruckhaus Deringer.

Ryan holds BA and LLB degrees from the University of Cape Town and an LLM from the University of Florida, USA.

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Lauren specialises in general corporate and commercial matters and in M&A. She has advised private and public companies on various domestic and cross-border transactions, and has expertise in due diligence, corporate governance, takeover law and corporate restructurings.

Lauren holds a BA degree (with distinction) and an LLB degree (*magna cum laude*) from the University of Cape Town. She also holds an LLM from Harvard Law School, USA. Lauren has passed the New York Bar Examination and will be admitted to practice law in the State of New York.

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