SHAREHOLDERS SHAFTED

Changes to the Companies Act seem to favour established business and executives, not minority shareholders, in the latest parliamentary overhaul

Ann Crotty

After listening to days of parliamentary portfolio committee hearings it would be difficult not to assume that the proposed amendments to the Companies Act (2008) had been entirely about executive pay.

Apart from a brief nod to the disclosure of beneficial interests, the recent hearings at the parliamentary portfolio committee on trade, industry & competition dealt almost entirely with the likely impact of just two proposed amendments, both related to remuneration.

The first would require the disclosure of the gap between the highest- and the lowest-paid employees, and the second would oblige members of the remuneration committee to step down from the committee if 50% or more shareholders voted against the implementation of its remuneration policy.

There was such an outcry about the second proposal that within two business days trade, industry & competition minister Ebrahim Patel headed back to parliament to tell the committee he had decided to scrap it and instead run with a slightly tweaked proposal suggested by the JSE.

Patel told the committee that after listening to the objections to the proposal that remuneration committee members step down in the event of a negative vote, the drafters had taken a closer look at the JSE's submission to the portfolio committee. They decided that it was the way to go.

And so, in terms of the revised proposed amendment, remuneration committee members will have to step down from that committee only after two consecutive reports have not passed the 50% threshold.

But almost as remarkable as all the fuss about creating consequences for flawed remuneration policies was the lack of fuss about the proposal to gouge out a section of the act that has protected minority shareholder interests from the opportunism of corporate executives and their advisers.

As Patel told the committee: "What was striking about the public comments was that the members of the public and organisations that chose to make written or oral submissions have very limited or no opposition to most aspects [of the proposed amendments], with much of the debate concentrated around matters of remuneration."

Proposals that apparently found wide support in the submissions included those relating to section 48. More specifically, the proposal, which has been on the cards since the release of the first Companies Amendment Bill in 2021, to rewrite section 48(8)(b) fundamentally.

As it now stands, that subsection requires that if a company is planning a transaction or series of transactions that entails the repurchase of more than 5% of the company's shares, sections 114 and 115 are triggered and, in turn, section 164. This means an independent expert has to be appointed, a special resolution must be passed and shareholders are entitled to exercise appraisal rights.

These rights and obligations are designed to provide a safeguard for minority shareholders. As Adam Pike of Pike Law says, they acknowledge the opportunity provided by buybacks for self-dealing by directors. "The appraisal remedy assumes the function of a bulwark against directors' self-interested decision-making and ensures that dissident shareholders' interests are accounted for."

Buybacks are no small matter. The JSE does not have the same stringent reporting requirements regarding them as exist in the US or

Ebrahim Patel: Presented a tweaked proposal

Freddy Mavunda

the UK, but it is estimated that JSE-listed companies spend hundreds of billions of rand each year buying back their shares.

As Pike reminds us, before the 1999 amendment to the 1973 Companies Act, a company was prohibited from buying its own shares because of the inherent dangers this posed.

The prohibition was designed to protect a company's creditors from a reduction in its capital and "to protect the company's shareholders by preventing the company from trafficking in its own shares and thereby preventing a board of directors from favouring one group of shareholders over another", said Pike in an earlier submission to the department.

Without access to the appraisal rights to ensure minority shareholders can demand "fair value" for their shares, insiders can easily hoover up large blocks of the company's shares even at a heavily discounted market price. Or they can use a spiked share price to repurchase the shares of an insider.

Purists might argue that the market price is always the "fair value", without considering the possibility that an unscrupulous insider, with access to the company's resources, could influence that price in the short term. And that, while the market price might reflect the marginal value of a share in the short term, it may not be a fair reflection of the company's NAV.

Pike's stance is in line with those of most academics. Juta's publication "Commentary on the Companies Act of 2008" describes the situation as follows: "Repurchase places the directors in a position of severe conflict of interest, and invites abuse of powers. If the directors hold shares, they are for that reason alone interested in the transaction. They may be tempted to repurchase at a premium or a discount, or to obtain or consolidate their control."

Inevitably Pike, who has acted for several minority shareholders in appraisal battles against boards and their corporate and legal advisers, has incurred the wrath of the establishment, which accuses him of creating uncertainty for their deals. They also accuse his clients of being opportunistic.

This is a remarkably strange accusation from a profession whose primary purpose is to look for just such opportunities. Certainly, some of his activist clients do look for opportunities when they see the terms of announced buybacks, but such opportunities exist only when company insiders are abusing their position to make inappropriately priced offers that benefit the insiders. The prospect of such an activist pouncing on an abusive buyback offer has helped to ensure better pricing, to the benefit of all shareholders.

And, it seems, it's not only academics that back Pike. So do the courts. On two occasions Pike's battle to use the appraisal rights provided for in section 48(8)(b) to secure a "fair value" has ended up before them.

Both times the court has ruled in favour of the minority shareholder and against the directors. In one such battle, in early 2021, judge Leonie Windell of the Joburg high court reminded corporate South Africa that the appraisal remedy "is aimed at maintaining the equilibrium between minority shareholders and controlling shareholders". An appeal of this decision to the Supreme Court of Appeal was given short shrift.

You'd think this decisive stance by the courts would secure section 48(8)(b)'s position in our corporate law. But no.

The Specialist Committee on Company Law (SCCL), which drafts the amendments, decided the crucial section granting appraisal rights should be excised from the act.

It is probably no coincidence that the SCCL is now dominated by established business interests, with influential academics playing almost no role.

No explanation has been given for the removal of the safeguards provided by section 48(8)(b) other than an earlier reference that "one of the prime categories of policy objectives sought to be addressed in the proposed amendments is the ease of doing business and conversely the reduction of unnecessary burdens".

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Michael Katz: Eliminating uncertainty

Jeremy Glyn

Michael Katz, chair of the SCCL and of law firm ENSafrica, previously told the FM that the section had been a major source of dispute in the profession and had given rise to uncertainty. "By eliminating that section we eliminated the uncertainty."

Pike says this is a strange position to take, "given that the section was absent from the original version of the 2008 act. Section 48(8)(b) was introduced at the behest of the SCCL in the 2011 amendment act, shortly before the new Companies Act came into force."

All in all, given the watering down of the proposal relating to the remuneration implementation vote and the determination to remove discipline-enhancing "uncertainty" from share buyback activity, it's difficult not to believe that established business has been the major winner in the latest overhaul of the Companies Act.

What remains to be seen is how the second controversial remuneration-related proposed amendment is finally drafted. That's the one relating to disclosure of the gap between the remuneration of the highest- and the lowest-paid employees.

Business is pushing hard for disclosure of the gap between the top-paid executives and the median, rather than the lowest paid. In addition, it wants only the guaranteed remuneration figure to be used. That is, it wants to exclude annual bonuses and long-term incentives, which generally make up at least 60% of the remuneration value of a CEO. **x**

HOW THE LAW PROTECTS THE ESKOM BOARD

Though the PFMA takes precedence in the governance of state-owned companies, Eskom directors could still be called to account for their failures under the Companies Act. The odds of that happening, though, are small

What it means: A new board at Eskom will make little difference to the utility because the government that appointed the previous boards has also appointed the new one

Piet Delport

For those excited about a clean-up of the Eskom board, hoping it might bring about even the tiniest improvement to the parastatal's grim existence, there is bad news: the sad reality is that the board makes not a jot of difference.

To assume that it could is to assume the board of a state-owned company (SOC) operates with the same authority as any other corporate board. It doesn't. The differences are fundamental and render the existence of SOC boards almost pointless.

It is trite law that the board of directors bears the ultimate responsibility for a company and its management. Irrespective of statutory provisions that have been in place since about 1844, the common law states clearly that the minimum categories of duties of company directors are twofold. They must act *bona fide* and in the interest of the company, and they must act with due care, skill and diligence.

This is not so difficult to understand – but in application it's a bit more complex. If the directors do not comply with those duties, they are – independently and/or collectively – responsible to the company for loss and damage to it.

We listen, more or less, to endless explanations about Eskom's inability to provide power to SA and the economy. One of the apparent reasons for this lack of generation capacity – apart from boilers being dropped by the Chinese manufacturers or new control rod mechanisms at Koeberg that don't work – is the lack of maintenance at power stations. This, we are told, has been the case for decades.

So where was the Eskom board all this time?

The basic duty of a board is to ensure long-term sustainability for the company. This is a fundamental principle of corporate law and is even an anchor principle in the King 4 report on corporate governance. If you sit on the board, the duties apply – and the reason there are many people on a board is so they can exercise their combined wisdom in carrying out these duties. Critically, the directors are also required to exercise independent discretion.

So, while Eskom CEO André de Ruyter, COO Jan Oberholzer and a lot of other people were running out of fingers to plug the holes in the dykes, what was the board up to? Did the directors carry out their fiduciary duties and duties of care, skill and diligence? If so, how could the situation have come to this?

And if it's accepted that the Eskom directors *did* carry out their duties and the entity is still failing, is it safe to say that no-one on the boards of the many private sector companies that have been plagued by "corporate scandals" should be held liable?

The dilemma with the Eskom board lies in a fundamental flaw that's built into the legal structure of parastatals.

The concept of the SOC was, unfortunately, imported by the 2008 Companies Act. But it wasn't thought through properly. The very name "state-owned company" is actually a misrepresentation, as the Companies Act defines it as an "enterprise" registered in terms of the Companies Act and listed as a public entity in terms of the schedules to the Public Finance Management Act (PFMA).

What this means is that "ownership" – whatever that may mean in company law – is not the test of what constitutes an SOC. Instead, that falls to the provisions of the PFMA.

Consider that Telkom is not 100% "owned" by the state, but is still an SOC. (Of course, one cannot "own" a company – one merely "owns" the shares and can thereby exert some control.)

The involvement of the PFMA in Eskom's life is an additional, and substantial, complication from a governance perspective. The PFMA is the "ultimate" act if there is a conflict with the Companies Act.

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In the context of the SOC, the "state" means the department of public enterprises and it is the public enterprises minister who exercises all the shareholding rights. A full 100% of the shares in Eskom (and in SAA) are owned by the state, which makes the regulation more problematic, because there is no accountability whatsoever to outside shareholders – not even AGM disclosure.

If the state owns a minority in an SOC, it has little control in company law. But the PFMA in any case gives ultimate authority in respect of a lot of powers to the minister, which means "control" is actually irrelevant.

If the state owns all the shares, it has total control over the SOC in terms of the Companies Act. This means the minister has unfettered control over the appointment and dismissal of the board. This has consequences for the exercise of "independent discretion". It also makes a lot of the governance provisions, such as shareholder meetings, a farce. In addition, the minister has ultimate control in terms of the PFMA, especially when it comes to loans to the SOC.

The directors on the board are therefore, in effect, puppets of the minister. This does not, however, exonerate them from their duties to the company or their accountability for lack of proper governance under the Companies Act.

This governance reality needs to be considered in the context of the reconstitution of the Eskom board due to a lack of "skills and management capacity".

The new board has been reasonably well received and commentators seem to assume public enterprises minister Pravin Gordhan has appointed directors with the necessary skills and capacity. But is this a realistic assumption given that all of the old boards, which successively failed Eskom, were also appointed by the minister?

Recall that the PFMA is the ultimate act if there is a conflict with the Companies Act. So, if the board of Eskom doesn't carry out its duties of care and skill (or fiduciary duties), what will happen? And will the directors be held accountable?

The reality is that absolutely nothing will happen – because the duties are to the company, which means it is the directors who must then institute action on behalf of the company against themselves. This will certainly not be the case in the real world.

If the board doesn't act, action can also be instituted on behalf of the company in terms of section 165 of the Companies Act by the shareholder (the minister). But, again, this is unlikely to happen because it was the minister who appointed the directors in the first place.

In addition, section 165 provides for a registered trade union to do so – but that's unlikely too, given that wage increases are determined by the board.

Finally, a third party may get leave from the court to institute action, as in the case of the Organisation Undoing Tax Abuse vs former SAA board chair Dudu Myeni. But this requires determination and involves jumping through numerous hoops, as the Myeni case indicated.

This is also why the SAA business rescue keeps dragging on for months (years, even) and may, according to Gordhan, only be finalised by the end of 2022. It's because the ultimate powers and authority to manage the company don't lie with the board.

In corporate business rescue, these powers are transferred to, and exercised by or under the authority of, the business rescue practitioners. However, for an SOC in business rescue this transfer isn't possible because, under the PFMA, the ultimate powers lie with the minister. That makes any attempted business rescue a farce, because the minister makes the ultimate decision.

The business rescue practitioners raking in millions are, like the Eskom board, "toothless". The ultimate "master" was (and still is) the minister.

So why do we keep shouting about Eskom's board? It's a waste of time. After all, those that came before were in breach of their duties and responsible for the demise of the utility – but weren't held accountable for a single cent. **x**

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