South Africa moves to a global model of corporate governance but with important national variations

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South Africa's path toward sustainable economic development requires a sound legal structure for governance of its businesses – a structure that complements and supports the continuing development of a diverse, equitable political system and respects South Africa's distinct social needs. With the Companies Act of 2008, South Africa has established a model of corporate regulation that can substantially improve its business climate while supporting essential broader economic and social aims. In this chapter, we compare the new Companies Act governance provisions to those in comparable statutes in the United States, the United Kingdom, and Germany. We also compare Companies Act rules to securities market listing standards, codes applicable to publicly traded companies, and other statements of corporate governance 'best practices', including those set out in the King Reports. The comparative analysis addresses protection of stakeholder rights; board duties, governance, and independence; appointment and removal of directors; director and management compensation; board supervision of management; and shareholder rights. Our analysis confirms that, in line with tested standards in other major economies and current international trends in corporate governance, the Companies Act sets out a modern, enabling model of regulation. In providing for flexibility and simplicity of company formation, transparency of governance, and effective exercise of shareholder rights, the Act creates a secure environment for entrepreneurship and investment. At the same time, it establishes standards of corporate responsibility distinctly appropriate to South Africa.

I NEW COMPANIES ACT GOVERNANCE MODEL

The South African Companies Act 71 of 2008 (the Companies Act or the new Act)[1] is one of a number of statutes adopted in recent years in industrialised nations which follow an enabling rather than a prescriptive

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[1] Companies Act 71 of 2008, *Gazette* No 32121 (Notice No 421). The Companies Bill was adopted by Parliament on 19 November 2008 and was signed by President Motlanthe on 8 April 2009. The Companies Act appeared in the *Government Gazette* on 14 April 2009 and is expected to come into force in 2010.

model. This approach of the new Act, which permits a broad scope of private ordering by those forming a corporation, applies in the area of corporate governance, as it does in the other areas such as capital structure, distributions to investors and the selection and description of the corporation's business purposes.

While the Act thus permits greater organisational flexibility than under current law, it does establish minimum standards for shareholder and other stakeholder participation in corporate affairs and for the qualifications of corporate directors, and it mandates audits of corporate financial statements and directorial oversight of such audits by a board audit committee, in a manner similar to that required by recent legislation in other countries, such as the Sarbanes-Oxley Act, 2002 (Sarbanes-Oxley) in the United States.[2]

Over the past twenty years, corporate governance has seen a surge in interest with regard to corporate responsibilities to society. Often, these interests have not been embedded in statutes but instead have been implemented through guidelines and codes. The Companies Act directly provides a clear framework for the empowerment of stakeholders and includes a directive that companies operate to enhance not only shareholder profits but also societal welfare. To ensure that these purposes are fulfilled, the South African Government is provided greater power in governance decisions than is typically found in most other general corporate statutes.

In this chapter, we compare the governance provisions of the new Companies Act to analogous provisions in comparable company statutes such as in the United States, the United Kingdom, and Germany, as well as to extra-statutory securities market listing standards and codes applicable to publicly traded companies, and various other statements of principle, which require or recommend corporate governance 'best practices'. Such standards, codes and principles have been frequently adopted in recent years, on a global or national market basis, and include the principles set forth in the governance codes issued by South Africa's King Committee on Governance. (The first King code was issued in 1994. *King II* was issued in 2002. *King III* has been issued in draft pending comments).[3] Much of the progress in improving corporate governance

[2] Sarbanes-Oxley Act, 2002, Pub L 107–204, 116 Stat 745 (2002) ('Sarbanes-Oxley'). It should be noted, however, that the audit and audit committee mandates of the Sarbanes-Oxley Act apply only to publicly traded companies, which have securities registered with the United States Securities and Exchange Commission.

[3] King Committee on Governance, *Draft Code of Governance, Principles for South Africa – 2009* [Hereinafter, *King III*], 8. Previous editions of the King Code were issued in 2002 (*King II*) and in 1994. The Johannesburg Stock Exchange (JSE) has required application of *King II* to its listed companies. However, the King Committee has recommended that *King III* apply on a 'comply or explain' basis. Ibid. The Committee noted that some JSE-listed South African

throughout the world has come about through contracted or consensual agreements, or statements of principle, that are not codified by statute but rather rely on enforcement through market forces. This latter category includes securities exchange listing requirements, which may contain mandatory provisions for a listed company, as well as principles and policies of institutional investors and proxy advisory firms.[4]

We also note several other important changes from the 1973 Companies Act[5] (the old Act), including the movement away from criminal penalties and toward shareholder and stakeholder empowerment to enforce rights. The new Act also creates a new role for the Department of Trade and Industry of South Africa (DTI) in resolving disputes, which, hopefully, will foster prompt resolutions of stakeholder concerns and reduce the need to resort to court proceedings.

This discussion focuses on publicly listed corporations, to which most of the new Act's provisions apply. It is important to note, however, that in the application of these provisions, the Companies Act makes important distinctions among public, state-owned, private, personal liability, and non-profit companies.[6] For example, private non-profit companies are exempt from some governance related provisions, including those related to company secretaries and audit committees.[7] Exceptions to the application of the new Act with regard to certain types of company are noted where they apply.

II STAKEHOLDER RIGHTS AND PUBLIC POLICY CONSIDERATIONS

(1) *Spectrum of viewpoints for corporate social responsibility*

The conventional view of the modern corporation posits that the corporation operates primarily to advance the interests of its shareholders.

companies have successfully chosen not to follow *King II* but rather to explain their practices that are at variance with that code. Ibid. The King Committee is still receiving comments on *King III*. The final version of this code is expected to be published in 2010, after the Companies Act comes into force.

[4] The JSE, for example, applies some governance related mandates through its listing standards, for example related to shareholder voting rights, forbidding the chief executive officer also to serve as chairman, and requiring director independence from management and controlling shareholders. See JSE Listing Requirements, 3.84*(c)*, *(f)*(iii). Available at http://www.jse.co.za/lr_listing_requirements.jsp. The New York Stock Exchange also has mandatory governance-related requirements for listed companies. See New York Stock Exchange Listed Company Manual § 303A. Available at http://www.nyse.com/Frameset.html?nyseref=http%3A//www.nyse.com/regulation/nyse/1101074746736.html&displayPage=/lcm/lcm_subsection.html.

[5] The Companies Act 61 of 1973 (the 1973 Act or the old Act).

[6] Companies Act ss 8, 9, 10.

[7] Section 10(2)*(c)*.

Milton Friedman, one of the most influential economic scholars of the 20th century, once commented that:

> there is but one and only one social responsibility of business – to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game.[8]

Some scholars and practitioners, however, believe that the corporation should operate to benefit a wider range of constituents. For example in 1994 John Elkington, a pioneer in the corporate responsibility movement, coined the phrase 'triple bottom line', referring to the corporate goal of achieving a balanced and integrated economic, social, and environmental performance.

Elkington's triple bottom line reflects an increasing trend among corporate governance codes and guidelines to focus the attention of those governing the enterprise beyond just the economic interests of the shareholders. *King II*, in particular, focuses heavily on the importance of the triple bottom line and the wider responsibilities of good corporate governance. *King II* notes that:

> [t]here is a move from the single to the triple bottom line, which embraces the economic, environmental and social aspects of a company's activities.[9]

Whereas the traditional view would insist that increasing shareholder wealth is the sole prerogative of a company, *King II* emphasises that shareholders 'change from time to time while as the owner, the company remains constant. Consequently, directors, in exercising their fiduciary duties, must act in the interest of the company as a separate person.'[10] As a result, *King II* concluded that a 'well-managed company will be aware of, and respond to, social issues, placing a high priority on ethical standards.'[11] *King III* continues to build upon the foundation of concern for a broad range of stakeholder interests laid out in *King II*. *King III* explains that a 'stakeholder-inclusive corporate governance approach recognises that a company has many stakeholders that can affect the company in the achievement of its strategy and long-term sustained growth.'[12] *King III* therefore directs companies to 'proactively manage the relationships with its stakeholders'[13] and 'strive to achieve the correct balance between its various stakeholder groupings, in order to advance the interests of the

[8] Milton Friedman *The Social Responsibility of Business is to Increase its Profits*, The New York Times Magazine (13 September, 1970).

[9] *King II* s 17.

[10] Op cit s 17.3.

[11] Op cit s 18.7.

[12] *King III* s 8.1.1.

[13] Op cit s 8.2.

company.'[14] Guidelines and codes of corporate governance such as the King Codes influence the governance practices of many companies and often form the basis for 'comply or explain' listing standards of securities exchanges as with the Johannesburg Stock Exchange (JSE) and *King II*.

Part of the debate as to stakeholder rights is not simply what rights various stakeholders should have, but also how such interests should be advanced. In the United States, there are virtually no statutory rights for stakeholders other than shareholders in the governance process.[15] Some states do provide for discretionary consideration of the interests of various stakeholders other than shareholders, but give such stakeholders no rights of direct participation in corporate governance. For example, in Pennsylvania, directors, in exercising their fiduciary duties, may consider:

> [t]he effects of any action upon any or all groups affected by such action, including shareholders, employees, suppliers, customers and creditors of the corporation, and upon communities in which offices or other establishments of the corporation are located.[16]

In Connecticut, a director of a corporation:

> shall consider, in determining what he reasonably believes to be in the best interests of the corporation, (1) the long-term as well as the short-term interests of the corporation, (2) the interests of the shareholders, long-term as well as short-term, including the possibility that those interests may be best served by the continued independence of the corporation, (3) the interests of the corporation's employees, customers, creditors and suppliers, and (4) community and societal considerations including those of any community in which any office or other facility of the corporation is located.[17]

Furthermore, in Connecticut:

> a director may also in his discretion consider any other factors he reasonably considers appropriate in determining what he reasonably believes to be in the best interests of the corporation.[18]

Canadian case law has established that:

> [i]n considering what is in the best interests of the corporation, directors may look to the interests of, inter alia, shareholders, employees, creditors, consum-

[14] Op cit s 8.4.

[15] It should be noted, however, that some governance decisions may be constrained by minimum wage laws, fraudulent conveyance statutes, environmental laws, Occupational Safety and Health Administration regulations, and other rules and regulations that limit the conduct of a company.

[16] Pennsylvania Business Corporation Law, 15 Pa Cons Stat § 1715 (2008).

[17] Connecticut Business Corporation Act, Conn Gen Stat § 33–756*(d)* (2009).

[18] Connecticut Business Corporation Act, Conn Gen Stat § 33–756*(d)* (2009).

> ers, governments and the environment to inform their decisions. Courts should give appropriate deference to the business judgment of directors who take into account these ancillary interests, as reflected by the business judgment rule.[19]

In the United Kingdom, the Companies Act 2006 (UK Companies Act) requires a director to act in the manner that will most likely promote the success of the company as a whole, and in doing so the director must consider, among other things:

> the interest of the company's employees, the need to foster the company's business relationships with suppliers, customers and others, the impact of the company's operations on the community and the environment, the desirability of the company maintaining a reputation for high standards of business conduct, and the need to act fairly as between members of the company.[20]

What is not mandatory is how much weight is to be given to these factors and commentary to the UK Companies Act makes it clear that the primary consideration must be the interests of the shareholders and there is no provision of a remedy if such considerations are thought not to have been appropriately taken into account.[21] Thus, in both the United States and the United Kingdom, rules requiring consideration of non-shareholder stakeholders' interests are precatory rather than mandatory, in that such stakeholders are given no direct rights of participation in corporate decisions.

As explained by the DTI, in developing the new Companies Act, South Africa was guided by a legislative framework that:

> reflects the recognition that the company is a social as well as an economic institution, and accordingly that the company's pursuit of economic objectives should be constrained by social and environmental imperatives.[22]

The DTI noted, however, that the 'advancement of certain stakeholder interests may best be effected through separate legislation' that could have greater impact on foreign companies as well.[23] DTI ultimately concluded that the:

> recognition of the public interest in new company law can be best effected

[19] *BCE Inc v 1976 Debentureholders* 2008 SCC 69 (Can).

[20] UK Companies Act 2006 s 172. Available at http://www.opsi.gov.uk/acts/acts2006/pdf/ukpga_20060046_en.pdf.

[21] Association of General Counsel and Company Secretaries of the FTSE 100, *Companies Act (2006) – Directors' Duties*, February 7, 2007.

[22] The Department of Trade and Industry of South Africa *South African Company Law for the 21st Century – Guidelines for Corporate Law Reform* (May 2004) 27.

[23] Ibid.

> through mechanisms that are facilitative . . . [but] what is clear is that there is a need to promote and facilitate a greater emphasis on corporate citizenship.[24]

Thus, the new Companies Act provides for much broader stakeholder protections than would be found in similar statutes in the United States or the United Kingdom. The Companies Act focuses on more than simply increasing the wealth of shareholders by also including a directive to:

> promote compliance with the Bill of Rights; . . . reaffirm the concept of the company as a means of achieving economic and social benefits; [and] . . . [e]nhance the economic welfare of South Africa as a partner within the global economy.[25]

(2) *Enfranchising employee stakeholders*

To a US observer, one of the most unusual aspects of the Companies Act as compared to the corporate laws of other jurisdictions is the amount of power, including that of direct participation, it bestows on employee groups. In comparison, the corporate laws of the United States and the United Kingdom provide no direct power or authority to employees or trade unions to participate directly in governance of the enterprise. Some jurisdictions, such as Germany, enfranchise employee stakeholders through a two-tier board system in which employee groups can elect members to the supervisory board, but give these groups little direct power.[26] In contrast, under the Companies Act, shareholders, directors, officers or trade unions representing employees of the company may initiate proceedings to restrain the company from doing anything inconsistent with the new Act.[27] Under the Companies Act, employees, through a trade representative, are also provided the opportunity to have a director declared delinquent[28] and are given the authority to make a derivative action demand to recover for losses to the corporation directly on the board, a power held only by shareholders of a company in most jurisdictions.[29]

In addition to the broadened power given to employees under the Companies Act, employees are also provided with more expansive access to information than is typically provided to non-shareholder stakeholders. The South African Companies Act requires that trade unions be given access to company financial statements for the purpose of initiating a business rescue

[24] Op cit 28.
[25] Companies Act s 7.
[26] Sections 1 *et seq* German One Third Codetermination Act, Sections 1 *et seq* German Codetermination Act and Sections 1 *et seq* German Coal, Iron and Steel Codetermination Act.
[27] Companies Act s 20(4).
[28] Section 162(2).
[29] Section 165(2)*(c)*.

process.[30] Additionally, like shareholders, trade unions must be notified if the board provides financial assistance to any director.[31]

(3) *Government involvement in the corporate governance process*

Another aspect of the Companies Act that is quite different from other jurisdictions is the number of opportunities provided by the Companies Act for access to the courts. In the United States, the role of the judiciary in corporate governance is generally limited to the adjudication of disputes between the corporation and other parties (including shareholders) based upon settled statutory or common law; there is, in general, no direct court involvement with directorial or other corporate governance decisions except in cases where it is alleged that directors have breached their fiduciary duties of loyalty or care in conducting or overseeing the company's business.[32] Absent such a breach, courts will not second-guess directors' business judgments.[33]

In contrast, the Companies Act provides courts with the power to override a corporate decision based solely on the judge's own judgment. For example, if a dispute arises among the directors regarding whether a director has been negligent or is otherwise disqualified from being a director, even if the board, through a majority vote, determines that the director in question is qualified, a court can, upon request from a director who voted with the minority, review the board's decision and, in its discretion, override such decision.[34] Similarly, the courts are also vested with discretion to exempt a director from disqualification.[35]

Besides the powers given to the courts, the Companies Act is very different from other jurisdictions in the sheer number of venues it offers aggrieved parties. Parties may seek to address an alleged contravention of the Companies Act by *(a)* attempting to resolve the dispute with the company through alternative dispute resolution,[36] *(b)* applying to the Companies Tribunal for adjudication,[37] *(c)* filing a complaint with the

[30] 'Trade unions must, through the Commission and under conditions as determined by the Commission, be given access to company financial statements for purposes of initiating a business rescue process': Companies Act s 31(3).

[31] 'If the board provides financial assistance to a director or officer is must provide written notice to all shareholders and to any trade union representing its employees': see s 45(5).

[32] See, eg *Stone ex rel AmSouth Bancorporation v Ritter* 911 A.2d 362 (Del 2006). There are other very limited examples of court involvement, including the ability to summarily order a shareholder meeting if the company does not hold one after 13 months, but this involvement by the court is typically triggered by a corporation's non-compliance with other statutory requirements.

[33] Ibid.

[34] Companies Act s 71.

[35] Section 69(11).

[36] Sections 166–167.

[37] Section 156*(b)*.

Takeover Regulation Panel with respect to a change of control matter[38] or with the Companies and Intellectual Property Commission for any other matter,[39] or *(d)* applying to a court.[40] Thus, the Companies Act provides several venues for enforcement of its provisions beyond seeking relief from a court.[41]

Also different from corporate statutes in other jurisdictions is the new Act's grant of powers over corporate internal affairs to the Minister of Trade and Industry, particularly the power to prescribe that a company or category of companies has a social and ethics committee if the Minister determines that such is beneficial to the public interest.[42] In determining the appropriateness of a social and ethics committee, the Minister is to consider the public interest in a company's annual turnover, the size and nature of its workforce, and the nature and extent of its activities.[43]

III BOARD COMPOSITION AND STRUCTURE

The Companies Act's provisions for board composition and structure reflect the movement toward a more modern, enabling corporate governance model. The Act allows private ordering of the board's structure and functioning, but consistent with modern governance models, the Companies Act provides specifically for auditing functions and board authority to delegate board functions to committees.

(1) *Companies Act*

The new Companies Act appears to permit broad freedom in organising the structure of company management. No particular top-level structure is prescribed, but the Act's provisions appear to be organised around a unitary board concept. It does require a minimum of three directors for state-owned and public companies.[44] Though the new Act does not directly contemplate a board with separate executive and non-executive structures, it expressly permits *ex officio* members who hold 'some other office, title, designation or similar status' with the company.[45]

The new Act requires an audit committee and a substantial audit function for the board for state-owned and public companies. And it

[38] Section 168*(a)*.
[39] Section 168*(b)*.
[40] Section 156*(c)*.
[41] For a more detailed discussion on the enforcement provisions in the Companies A, see D Farisani 'The Potency of Co-ordination of Enforcement Functions by the New and Revamped Regulatory Authorities Under the New Companies Bill' in this publication.
[42] Section 72(4).
[43] Section 72(4).
[44] Section 66(1). However, the Act requires only a single director for a non-public or a personal liability company.
[45] Companies Act s 66(4).

expressly permits 'any number' of additional committees and delegation to them of 'any authority of the board'.[46] As noted above, the new Act also provides that the Minister of Trade and Industry may require a social and ethics committee or other committees.[47] A committee may include non-director members, although those members may not vote on matters the committee decides.[48] The Companies Act represents a significant development of policy on board structure relative to current law. The 1973 Act is silent on committees and possible board structures. It does, however, set out extensive requirements for the appointment and function of an auditor.[49]

(2) *US models*

The Companies Act is largely consistent with state corporations laws in the United States, ie it favours a unitary board and makes possible liberal delegation of board functions to committees. US law, however, provides more detailed prescriptions with regard to committee roles, and may be more limiting. For example, the Delaware General Corporation Law (DGCL) expressly prohibits a committee from approving or recommending any action to shareholders, except the election or removal of a director or amending the by-laws,[50] and the Model Business Corporation Act (MBCA) forbids delegation to a committee of certain actions, including independent approval of distributions (ie without a pre-approved formula), filling a board vacancy, or amending by-laws.[51] The Companies Act, by contrast, contains no such limitations on delegation to committees of the board, nor does it mandate independence of committee members from managers; indeed, as noted above, it expressly permits company managers to serve on committees *ex officio*.

Sarbanes-Oxley imposes separate requirements related to audit committees and the audit function. Section 301 of Sarbanes-Oxley requires a public company whose securities are listed on a US exchange to have an audit committee.[52] This committee must oversee the work of an independent auditor.[53] Sarbanes-Oxley sets out strict requirements that audit committee members be independent of management. It also requires that a public listed company disclose whether an 'audit committee financial expert' (as defined in a regulation adopted by the Securities and Exchange

[46] Section 72(1).
[47] Companies Act s 72(4).
[48] Section 72(2)*(a)*.
[49] The 1973 Act ss 269–83.
[50] Delaware General Corporation Law, Del Code Ann tit 8, § 141*(c)*(2) (2008) ('DGCL').
[51] Model Business Corporation Act, Model Bus Corp Act § 8.25 (2002) ('MBCA').
[52] Sarbanes-Oxley § 301.
[53] Sarbanes-Oxley § 301.

Commission) serves on its audit committee.[54] NYSE rules, applicable to companies listing with the exchange, require formation of committees addressing nominations, corporate governance, and compensation, all of which must be composed entirely of directors independent of management, and require documentation of their duties.[55]

(3) *UK and Germany*

The UK Companies Act does not provide directly for the organisation of the board, but the UK Companies Act does set forth a non-mandatory model Articles of Incorporation which suggests certain organisational details.[56] Moreover, the 2006 United Kingdom Financial Services Authority *Combined Code on Corporate Governance* (*Combined Code*) recommends the inclusion of, and a balance between, executive and non-executive directors on the board.[57] However, a unitary board structure is standard in the United Kingdom, and there is no legal distinction between the duties of executive and non-executive board members.[58] The *Combined Code*, which applies to listed companies in the United Kingdom, specifies the creation and duties of compensation, audit, and nomination committees, with related independence provisions.[59]

The lack of provision for a two-tiered board distinguishes the Companies Act from German and other major European models. For example, Germany, in certain cases, may require employee representation on the supervisory board of a stock company, and, under 'codetermination' principles, employees may have the right directly to elect some supervisory board members.[60] In a German stock corporation or another German company subject to the 'codetermination' principles, the company's management board is appointed by its supervisory board. However,

[54] Sarbanes-Oxley §407; SEC Release Nos 33–8177 and 34–47235 (January 23, 2003). Available at http://www.sec.gov/rules/final/33–8177.htm.

[55] NYSE Listed Company Manual s 303A.04.

[56] UK Companies Act 1985, Companies (Tables A to F) Regulations 1985 as amended by SI 2007/2541 and SI 2007/2826. Available at http://www.companieshouse.gov.uk/companiesAct/implementations/TableAPublicOct2007.pdf. Parts of the Companies Act 1985 will remain in effect until official implementation of the Companies Act 2006. Some parts of the latter Act have already been brought into force.

[57] The 2006 United Kingdom Financial Services Authority *Combined Code on Corporate Governance* (*Combined Code*) A3. Available at *http://www.fsa.gov.uk/pubs/ukla/lr_comcode2003.pdf*. The *Combined Code*, as does *King III*, applies on an 'adopt or explain' basis. *Combined Code*, Preamble (para 4).

[58] *Combined Code* B1.

[59] Ibid A.4.1, A.4.2.

[60] If a stock company has 500 or more employees, one-third of its supervisory board must be elected by employees. If the company has 2000 or more employees, one-half of the supervisory board must be chosen by employees. Sections 1 et seq German One Third Codetermination Act, Sections 1 *et seq* German Codetermination Act and Sections 1 *et seq* German Coal, Iron and Steel Codetermination Act.

European Union companies may now choose the 'European Company' form (Societas Europaea or SE), which provides for a unitary board.[61]

(4) *Governance guidelines and codes*

Echoing the Companies Act, *King III* finds a unitary board structure best suited to South African companies.[62] It also recommends an effective audit oversight function for the board.[63] King recommends the use of well-structured committees with clear mandates – the report envisions standing committees for nominations, compensation, audit, and risk, all features absent from the new Act.[64]

Other leading guidelines and codes also do not tend to favour a multi-tier board over a unitary board. However, as with the Companies Act, the use of committees is recognised and encouraged, especially as a way to address to potential conflicts of interest, and in supervising the audit function. For example, the United Nations Conference on Trade and Development (UNCTAD) *Guidance on Good Practices in Corporate Governance Disclosure* emphasises the use of committee charters and full disclosure of board and committee activities.[65] The Organisation for Economic Co-Operation and Development ('OECD') 2004 code, *OECD Principles of Corporate Governance*, addresses employee access to some governance functions through, for example, board representation.[66]

IV NOMINATION AND APPOINTMENT OF DIRECTORS

The Companies Act provisions for selecting directors also move toward increasing private ordering. Mirroring modern US and UK practice, the new Act gives a company the freedom to organise a board with staggered terms, and to establish a variety of process and decisional rules. However, it provides less detailed requirements and normative guidance than US or UK models.

(1) *Companies Act*

The Companies Act enables broad private ordering of terms and classification of boards. Creating space for a tailored election process, the Act's

[61] The EU Council Regulation on the Statute for a European Company establishing the form was adopted in October 2001. See The Government Commission on the German Corporate Governance Code, *German Corporate Governance Code* (2008) 1. Available at http://www.corporate-governance-code.de/eng/kodex/index.html. It is this observer's understanding that at least so far the SE is not being widely used.

[62] *King III* 1.17.

[63] Op cit 1.10, 5.1, ch. 3.

[64] Op cit 1.24, 1.26.

[65] See United Nations Conference on Trade and Development, *Guidance on Good Practices in Corporate Governance Disclosure* (2006) [Hereinafter, *UNCTAD Guidance*] 15, 16.

[66] See Organisation for Economic Co-Operation and Development, *OECD Principles of Corporate Governance* (2004) [hereinafter *OECD Principles*], 21, 47.

default rule allows directors to serve for an indefinite term.[67] It allows directors to be elected by a series of single votes, each on a single candidate, for each vacancy.[68] The default rule is for an individual to be elected, by a majority of eligible votes, in a single election for each seat.[69] However, the memorandum may provide for a different arrangement. Also, the new Act allows a director to be appointed or removed by 'any person who is named in, or determined in terms of' the memorandum of incorporation.[70] But (for a non-state-owned profit company) at least half of a company's directors and alternate directors must be elected by shareholders.[71] Adding some normative guidance, *King III* recommends a structure that is in some respects similar to a staggered rotation of non-executive directors, with one-third standing for election each year.[72]

(2) *US models*

The Companies Act is similar in approach to the US model for the nomination and election of directors, although the latter offers greater detail on procedures. For example, as with the Companies Act, while Delaware also does not fix a term for directors, it expressly provides for elections at every annual meeting.[73] Delaware also permits staggered boards with as many as three separate classes of directors, each having terms of up to three years.[74] Delaware also allows corporations to provide for separate elections by different classes of stock, each voting on specified board seats, which can have different terms.[75] In an area of distinction, Delaware and most US states establish election by plurality (of shares present in person or by proxy) as a default rule.[76] As noted above, the Companies Act's default arrangement is election by a majority of votes exercised.[77]

[67] Companies Act s 68(1).
[68] Section 68(1).
[69] Companies Act s 68(2). The rule for an ordinary resolution is 50 per cent of votes cast, see s 5(7). The old Act appears to provide for a single vote for an individual for each seat, but it also expressly permits, upon a shareholders' resolution passed with no votes against the resolution, election of two or more directors in a single vote, old Act s 210.
[70] Companies Act s 66(4).
[71] Section 66(4)*(b)*.
[72] *King III* 1.17(76). A staggered board structure, once common, is now found in a declining percentage of American public companies. It is still permitted in most states (with the notable exception of California). About 45 per cent of the S&P 500 had a classified board in 2006, *2007 ISS Background Report: Classified Boards of Directors* 4.
[73] DGCL § 141.
[74] DGCL § 141*(d)*.
[75] DGCL § 141*(d)*.
[76] See DGCL § 216.
[77] Companies Act s 68(2).

(3) *UK and Germany*

Although its prescriptions are less detailed than the US model, in its model Articles of Incorporation the UK Companies Act suggests certain practices that allow broad private ordering of the elections process. It provides that the shareholders may elect directors by ordinary resolution. The board may also appoint directors between annual general meetings, but an appointed director must stand for reelection at the next general annual meeting.[78] The *Combined Code* also suggests a nine-year limit on board service.[79] But, as with the Companies Act, the Combined Code also makes room for staggered boards, permitting a director to serve for a term of up to three years.[80] Slate voting is allowed (if that procedure is approved, at the same meeting, by unanimous resolution).[81] In Germany, in certain cases, a separate supervisory board and management board are mandatory, and the supervisory board, which appoints the management board, may partially be constituted through the votes of employees.[82]

V QUALIFICATION AND INDEPENDENCE OF DIRECTORS

The Companies Act is remarkable for its extensive regime of director qualification and disqualification. By its extensive mandatory provisions, it polices by rule the kind of potential conflicts often dealt with in other countries by disclosure obligations, independent director actions, listing standards, and shareholders' judgment. With regard to independence, the new Act does not include provisions seen in other jurisdictions with regard to board independence from management, such as express separation of the chief executive officer and board chair or a requirement for a minimum percentage of non-management directors.

(1) *Companies Act*

The Companies Act prescribes a detailed set of statutory disqualifications for a director. A director is barred and disqualified if she or he is subject to a court order for delinquency of directorial duties, which a court must enter if a director is found to have, *inter alia*, 'grossly abused' her or his position, taken improper advantage of a corporate opportunity, committed 'gross negligence, willful misconduct or breach of trust', violated a relevant law or compliance notice, or has been 'twice convicted of any

[78] UK Companies Act 1985, Companies (Tables A to F) Regulations, 1985 as amended by SI 2007/2541 and SI 2007/2826 at regs 78, 79.
[79] *Combined Code* A7.2.
[80] *Combined Code* A7.1.
[81] *Combined Code* s 160.
[82] Sections 1 *et seq* German One Third Codetermination Act, Sections 1 *et seq* German Codetermination Act and Sections 1 *et seq* German Coal, Iron and Steel Codetermination Act.

offence'.[83] A director is also disqualified if she or he is an 'unrehabilitated insolvent', removed from an office of trust due to dishonesty, or convicted and imprisoned (or given an extraordinary fine) for theft, fraud, forgery, or similar offence.[84] The new Act permits the memorandum of incorporation to impose additional grounds for disqualification or minimum qualifications.[85] It also allows conflicts that arise after appointment to be cured by notice and shareholder affirmation.[86]

These qualification provisions are apparently based on similar provisions in the old Act. Under the old Act an 'unrehabilitated insolvent' or a person convicted of theft, fraud, forgery or a like offence is barred.[87] Under existing law, a company is permitted to set out further bases for disqualification.[88] And the 1973 Act also sets out detailed judicial powers to bar directors.[89] The Companies Act, however, does remove certain anachronistic formal requirements such as the requirement that directors own qualifying shares, which is a requirement enforceable by criminal penalty under the old Act.[90] As in other jurisdictions, some independence provisions are provided as requirements for exchange-listed companies (in South Africa, via *King II* and the listing standards of the JSE).

(2) *US models*

In the area of director qualifications, the Act departs distinctly from modern US practice. Neither the MBCA nor the DGCL requires specific qualifications for directors, although both permit the incorporation document or by-laws to prescribe qualifications for serving as director. Statutory share ownership and residency requirements were long ago abandoned. And the DGCL does not set out statutory terms of disqualification or ineligibility. In the United States companies may, and many do, allow the chief executive officer, the senior corporate manager, to also serve as board chairman. Regarding independence, Delaware law primarily treats the subject as an aspect of a director's duties, which is addressed primarily as a matter of disclosure. The MBCA does not define independence, but does apply standards of disinterestedness for certain actions where a director's interests might affect her vote, for example in shareholder demand proceedings, and corporate opportunity issues.[91]

[83] Companies Act s 69(5).
[84] Section 69(8).
[85] Section 69(5).
[86] Section 75(3).
[87] Companies Act, 1973 s 218(1).
[88] Section 218(3).
[89] Section 219.
[90] Section 211(1) and (6).
[91] MBCA §1.43.

As noted above, for publicly traded companies, a web of additional rules and guidelines on independence supplement state corporate laws. Sarbanes-Oxley creates specific independence requirements related to the audit function and the audit committee.[92] And NYSE listing standards require a board to have a majority of independent directors. The NYSE standards set 'bright line' minimum tests to be used in determining director 'independence', such as family relationship to company executives, a provision of substantial services by a director or his family member to the company, or other transactions between the corporation and the director or a member of her immediate family.[93] However, beyond these 'bright line' independence tests, final director independence determinations are left to the board, which must consider all factors related to an actual or potential conflict of interest.[94] NASDAQ rules also set out standards of independence and identify certain relationships and transactions that impair independence.[95] US securities laws allow the government to seek to bar a corporate director or officer from further service to public corporations. The Securities Exchange Act, 1934 provides that courts can issue such orders, on application of the Securities and Exchange Commission, in cases where the director or officer has engaged in fraudulent activity contrary to the federal securities laws.[96]

(3) *UK and Germany*

The Companies Act also does not go as far in its prescriptions as UK law and practice. The *Combined Code* sets out requirements for director independence similar to those found in stock exchange listing standards in the United States, for example, no close family relationship to a senior employee, no business relationship with the company.[97] And the *Combined Code* provides that the same person is prohibited from serving as both chief executive officer and board chairman or for a CEO to later become chairman, and requires the chairman to be independent, as determined by the board.[98] It also recommends appointing a senior non-executive director to allow shareholders to bypass non-independent directors and management.[99] German law is generally more detailed than the Act. Regarding disqualifications it bars from the management board

[92] See Sarbanes-Oxley, § 301, 407.
[93] NYSE Listed Company Manual s 303A.02.
[94] Ibid.
[95] NASDAQ Marketplace Rules, 4200*(a)*(15) (2004). Available at http://www.nasdaq.com/about/marketplacerules.pdf.
[96] See Securities Exchange Act 1934, § 21*(d)*(2) (15 USC 78u*(d)*(2)).
[97] *Combined Code* A3.1.
[98] *Combined Code* A3.2, A3.1.
[99] *Combined Code* A3.3. ('The senior independent director should be available to shareholders if they have concerns which contact through the normal channels of chairman, chief executive or finance director has failed to resolve or for which such contact is inappropriate.')

of a stock corporation persons convicted of insolvency-related offences or who are for other reasons prohibited from practising a profession.[100]

(4) *Governance guidelines and codes*

King III adds some detail to the Act's provisions on independence. It recommends that the board include a 'balance of executive and non-executive directors, with a majority of non-executive directors', and a minimum of two executive directors, including the CEO and the chief financial executive.[101] It recommends that the board be led by an independent non-executive chairman who is not also the CEO,[102] and that a current or former company CEO should not become the board chairman.[103] It also recommends a board representing diverse qualifications, taking into account a broad array of social and relevant professional factors.[104] Other codes deal with qualifications as a matter of disclosure to shareholders in an election process.[105]

VI OVERSIGHT OF DIRECTOR AND MANAGEMENT COMPENSATION

The Companies Act provisions on director compensation modernise the current law by emphasising disclosure and shareholder approval instead of specific prohibitions. The Act provides for shareholder approval of director compensation, including compensation of the chief executive officer and any other members of management who serve as directors. It does not, however, ensure that compensation for directors and executives is handled by an independent committee or that incentive-based compensation schemes are policed by the shareholders.

(1) *Companies Act*

Under the Companies Act, a director's pay, unless otherwise provided in the memorandum, must be approved by a shareholders' special resolution 'within the previous two years'.[106] But there is no specific provision for a compensation committee or other restriction on director compensation.[107] The Act does not separately discuss management compensation, and these provisions therefore appear to apply only to managers who are also on the board. However, as discussed above, a company is encouraged

[100] Sections 283 to 283d German Criminal Code, s 76 para 3 sentences 3, 4 German Stock Corporation Act and s 6 para. 2 sentences 3, 4 German Limited Liability Companies Act.
[101] *King III* 1.17(73).
[102] Op cit 1.17(77).
[103] Op cit 1.18(88).
[104] Op cit 1.17(71).
[105] See *UNCTAD Guidance* 18.
[106] Companies Act s 66(9).
[107] Companies Act s 66(8) and (9).

to delegate some governance functions to committees. South African company boards certainly may appoint a remuneration committee composed of non-management directors, as *King III* recommends. The 1973 Act does not directly address structures for addressing director compensation. However, it specifically forbids certain compensation arrangements, for example, any payment or benefit upon removal due to retirement or a change of control, unless approved by a special resolution.[108]

(2) *US models*

The DGCL expressly permits the board to fix directors' compensation.[109] In practice, many companies delegate compensation decisions to a committee of outside directors.[110] The MBCA similarly puts directors' compensation in their own hands, unless the articles or by-laws provide otherwise.[111] Stock exchange listings standards require shareholder approval of stock-based compensation of US public company managers.

(3) *UK and Germany*

Under the *Combined Code* remuneration is determined by a compensation committee, which is encouraged to follow a set of recommendations in drafting performance-related compensation schemes, including the recommendation that long-term incentive schemes meet shareholder approval.[112] The board can delegate determination of executive director compensation to a committee or reserve the task to itself.[113]

The United Kingdom, many European countries, and Australia require a retrospective, nonbinding shareholder vote approving or disapproving the board's prior decision on remuneration of officers and directors to be taken at each annual general meeting. There is a movement to impose similar requirements in the United States, which have, in fact, already been imposed as to senior management compensation of the 500 or so companies that have received federal capital investments, including many banks, under recent US legislation.[114]

In a German stock company, supervisory board compensation can be stipulated in the company's articles or approved by the shareholders at a general meeting. There is no distinction among supervisory board members with regard to permitted remuneration. However, in practice, the

[108] Companies Act, 1973 s 227.
[109] DGCL § 141*(h)*.
[110] Drexler, *Delaware Corporation Law and Practice*,§ 15.09[2], Matthew Bender and Company Inc (2008).
[111] MBCA § 8.11.
[112] *Combined Code* B1.1, Schedule A.
[113] *Combined Code* B2.2.
[114] See American Recovery and Reinvestment Act, Pub L 111–5, s 7001, Stat (2009).

chairman and vice-chairman of the supervisory board, as well as members of certain committees, sometimes receive higher compensation than other supervisory board members.[115] Management board members' employment contracts stipulate their compensation. The supervisory board negotiates these contracts, and may amend or terminate them by resolution. It often delegates this function to a supervisory board committee.

(4) *Governance guidelines and codes*

King III substantially extends Companies Act compensation oversight measures, albeit on a 'comply or explain' basis. *King III* specifies a remuneration committee, and makes extensive prescriptions for the manner of approving compensation, recommended limits on forms of compensation, and documentation of remuneration committee work.[116] *King III* encourages performance-based pay schemes, but adds extensive prescriptions for monitoring equity-based compensation for non-executive directors and disclosure of directors' remuneration.[117]

UNCTAD's *Guidance on Good Practices in Corporate Governance Disclosure* recommends that the mechanism for compensation be clear and fully disclosed, and that evaluation criteria value long-term performance. UNCTAD notes that some national codes require compensation to be put to a shareholder vote at each annual meeting.[118] The *OECD Principles of Corporate Governance* recommends that shareholders be given an opportunity to give their views on executive and board compensation, and that equity compensation be put to a shareholder vote.[119]

VII REMOVAL OF DIRECTORS

The Companies Act appears to permit easier removal of directors than its predecessor, and may offer less protection for incumbency than US models. The Act's approach, mandating that a director can be removed by resolution adopted by a majority of shareholder votes cast, is comparable to the UK practice. The Act differs from European systems where removal of a management board director may be reserved to the supervisory board or employee approval may be required to remove employee-appointed directors.

(1) *Companies Act*

The Companies Act, as a mandatory rule, allows shareholders to remove a director by ordinary resolution (by 50 per cent plus one vote of the votes

[115] See s 113 para 1 German Stock Corporation Act.
[116] *King III*, 1.26, 1.27, 1.28.
[117] *King III*, 45–47.
[118] *UNCTAD Guidance* 21.
[119] *OECD Principles* 18, 34.

cast)[120] adopted at a shareholders meeting, as compared to the old Act, which required a special resolution procedure.[121] And if 'a shareholder or director' alleges that a director has become disqualified by statute, is incapacitated, or 'has neglected, or been derelict in the performance' of her or his functions, the board may remove the director by majority vote of the other directors.[122] The Companies Act also allows a single shareholder or director to initiate the board removal process.[123]

(2) *US models*

The DGCL, in contrast, appears to prescribe higher bars for removing a director. Delaware law allows a director to be removed without cause by a majority of voting shareholders.[124] However, where a corporation has a staggered board, a director may be removed only for cause.[125] And where cumulative voting is permitted, a director may not be removed without cause if the votes cast against the removal would be enough to elect the director at an election of the entire board, or for the class of directions of which she or he is a part.[126] The MBCA permits shareholders to remove a director with or without cause, unless the articles of incorporation limit such removal to cause. As with the DGCL, the MBCA prescribes that a director's removal under a cumulative voting regime require that votes cast for removal exceed the number of votes needed to elect a director.[127]

(3) *UK and Germany*

As with the South African Companies Act, the UK Companies Act requires a company to allow shareholders to call an extraordinary meeting and to remove a director by ordinary resolution at the meeting, subject to the director's right to notice and an opportunity to make his case.[128] It is difficult to compare the Act to two-tier European models, where rights of removal of directors vary across tiers, and may require negotiation with employee representatives to effect removal of an employee-designated member of a supervisory board.[129] Nonetheless, on balance, it appears that

[120] Companies Act s 65(7) and (8).
[121] Companies Act, 1973 s 220(1).
[122] This provision does not apply to a company with less than three directors, ie a non-public company, s 71(8)*(a)*. These decisions are subject to judicial review. Under 69(8)*(a)*,*(b)*, directors are barred for being, *inter alia*, found delinquent by a court, an unrehabilitated insolvent, convicted of certain crimes of theft, fraud, or deceit. Companies Act 69(8).
[123] Companies Act s 71(3).
[124] DGCL § 141*(k)*.
[125] DGCL § 141*(k)*(1).
[126] DGCL § 141*(k)*(2).
[127] MBCA § 8.08.
[128] Companies Act s 168.
[129] Sections 1 *et seq* German One Third Codetermination Act, Sections 1 *et seq* German Codetermination Act and Sections 1 *et seq* German Coal, Iron and Steel Codetermination Act.

the complexities of the German system tend to encumber shareholders' ability to remove directors.

VIII BOARD POWERS AND SUPERVISION OF MANAGEMENT

The Companies Act clarifies provisions in the old Act on company powers and board process, and generally brings South Africa into line with leading global models. The board's powers are not limited by *ultra vires* restrictions. With regard to supervision of management, the Companies Act does not directly address the roles and duties of other officers. However, mirroring UK practice, and at variance with US models, the Act focuses on the role of the company secretary, who is assigned specific governance-related as well as ministerial duties.

(1) *Companies Act*

The Companies Act expressly eliminates the use of *ultra vires* as a basis for voiding company action or for a legal challenge to company action, notwithstanding any limitation in the company's memorandum.[130] In terms of process, a director so authorised by the board may call a meeting at any time, and that director must do so if 25 per cent of the directors (where a company has 12 or more board members), or (for a smaller board) any two directors, request a meeting.[131] The memorandum may raise or lower these bars. Unless the memorandum of incorporation provides otherwise, board resolutions are approved by a majority of votes cast on a matter, providing that a majority of the directors are present. It thus appears that a resolution can be approved by single vote, in the case where all but one director abstains from voting.[132]

The Act does not discuss the duties, roles, and powers of officers generally, except with regard to the company secretary.[133] Beyond ordinary ministerial duties, the secretary is tasked with advising directors on their duties and powers, and relevant laws relating thereto, and informing the board of any memorandum or companies law violations.[134] Falling under the chapter headed 'Enhanced Accountability and Transparency', this provision appears aimed at placing ownership of important governance responsibilities with a particular officer. The Act also allows

[130] Companies Act s 20(1), see s 19(1). However, shareholders may approve any otherwise legal action even though inconsistent with limits set out in the memorandum by special resolution. Companies Act s 20(2).

[131] Companies Act s 73(1) and (2).

[132] Companies Act s 73(5)*(b)* and *(d)*. The chair may cast a tie-breaking vote, if he did not vote initially. See s 73(5)*(e)*.

[133] Companies Act s 86.

[134] Section 88.

the Minister of Trade and Industry to prescribe or designate a particular function 'to constitute a prescribed office' in a company.[135]

(2) *US model*

Delaware also does not permit corporate actions to be voided as *ultra vires*. But the DGCL does allow a shareholder to use this basis to seek to enjoin a transfer of corporate property, or to challenge an unauthorised act on behalf of the company.[136] Delaware company board resolutions pass by a majority vote of directors present, so long as there is a quorum, but the certificate of incorporation may require a larger majority.[137] The DGCL expressly permits different classes of directors elected by different classes of shareholders to have different voting powers on the board.[138] The DGCL requires the appointment of officers, with duties to be specified in the by-laws or by the board. It requires one of the officers effectively to serve as secretary, but specifies only ministerial and no expressly governance-related duties for that office.[139]

With regard to voting and quorum, the MBCA is consistent with the DGCL.[140] Similar to Delaware law, the MBCA identifies the role of officers and the board's ability to appoint them, but does not specify their individual functions, except to require that one of them record board meetings and maintains corporate records, ie a company secretary.[141]

(3) *UK and Germany*

The UK Companies Act also bars any challenge to the validity of a company action on the basis of a lack of capacity or a restriction in the company's constitution.[142] But, as with Delaware law, it allows shareholders to restrain directors' actions that exceed their powers.[143] Regarding board process, the UK Company Act's model articles of incorporation prescribe that, subject to other provisions of the company's articles, 'the directors may regulate their proceedings as they think fit'.[144] It prescribes that resolutions may be approved by majority vote with a quorum of at least two directors, unless otherwise decided by the directors.[145] A single

[135] Section 66(10).
[136] DGCL § 124.
[137] DGCL § 141*(b)* (Quorum for a board must be at least one-third of the total number of directors.)
[138] DGCL § 141*(d)*.
[139] DGCL § 142.
[140] MBCA § 8.24.
[141] MBCA § 8.40.
[142] UK Companies Act s 39.
[143] UK Companies Act s 40(4).
[144] UK Companies Act 1985, Companies (Tables A to F) Regulations 1985 as amended by SI 2007/2541 and SI 2007/2826, reg 88.
[145] Ibid.

director may call a board meeting.[146] Like the South African Companies Act, the UK Companies Act requires appointment of a secretary for a public company, and specifies some aspects of the secretary's role, but leaves definition of other officers' roles to the board.[147] The *Combined Code* adds further detail to the secretary's duties, appointment and removal.[148]

The Companies Act departs from major European models in this area. The two-tier board structure employed in Germany, for example, introduces procedural and management oversight rules unique to companies with that structure. In Germany, a stock corporation's management board is responsible for day-to-day management of the company, and it is supervised by the supervisory board.[149] The management board must report to the supervisory board on business strategy, company profitability, and other management matters.[150] Though the management board may delegate certain actions, the management board must act collectively, and the company's articles or procedural rules may not empower a board member to decide a matter against the will of a majority of the board.[151]

(4) *Governance guidelines and codes*

Like the Companies Act, *King III* emphasises the role of the company secretary, specifying his qualifications and duties, which encompass ethics and good governance.[152] Codes in other jurisdictions forgo this level of detail and do not discuss the duties and oversight of officers. They generally emphasise disclosure and the deployment of committees, for example governance, remuneration, and audit committees, to oversee management.[153]

IX SHAREHOLDER RIGHTS AND INTERVENTIONS IN FIRM SUPERVISION

Corporate governance is a balance in which shareholders limit their right to manage the company in exchange for limited liability and the greater

[146] Ibid.

[147] Companies Act ss 271, 272. The Companies Act also sets out certain qualifications for a public company secretary, see s 273. A private company is not required to have a secretary, see s 270.

[148] *Combined Code* A5 paras 2.7, 2.13–14 at 41.

[149] Sections 76 para 1, 90 para 1 German Stock Corporation Act. The supervisory board is formally excluded from company management functions and its supervision is primarily retrospective. See s 111 para 1, 4 German Stock Corporation Act. However, in practice, the supervisory board may address such functions by investigating issues brought to it by the management board and engaging the management board on business planning and other management matters.

[150] Section 90 para 1 German Stock Corporation Act.

[151] Section 77 para 1 German Stock Corporation Act.

[152] *King III* 1.22.

[153] See *OECD Principles* 49, 62; *UNCTAD Guidance* 8.

efficiency of centralised management, while the directors provide for and oversee management of the company and owe ongoing duties and, potentially, liabilities to the company and the shareholders. Different countries allocate this balance in a variety of ways. Whereas the old Act gave few explicit rights to shareholders, the Companies Act is more robust in providing shareholder protections. In this respect, the Companies Act resembles other corporate governance models found around the world. However, as we have noted, there are some South African variations; for example, the Companies Act provides greater power and more forceful means of intervention to shareholders than would be found in the United States or United Kingdom.

(1) *Shareholder meetings*

This section compares the key provisions of the Companies Act with other corporate governance models. As perhaps the primary tool for shareholder interaction with the company, broad protections for shareholder meetings are a staple of good corporate governance. Whereas the old Act provided little support and guidance for such meetings, the new Companies Act modernises and clearly delineates the provisions for shareholder participation at general meetings. The Companies Act also allows shareholder participation beyond the annual meeting, which is one of the areas in which the old Act provided little support.

(a) Annual meeting

The Companies Act, as with most general corporate statutes, requires an annual meeting of the shareholders.[154] The Act is unusual, however, in the broad power it conveys to the shareholders at such meetings. Most striking is the requirement that the business to be transacted at the meeting must include 'any matters raised by shareholders, with or without advance notice to the company'.[155] In comparison, the DGCL, which governs many publicly traded companies in the United States, requires only that 'any other proper business may be transacted at the general meeting'.[156] In practice, the limitation to 'proper' business substantially narrows the power of shareholders to control the agenda at annual meetings. Pursuant to Delaware case law, shareholders may not direct the ordinary business of the company[157] and may adopt advance notice by-laws which require that agenda items be noticed prior to the

[154] Companies Act s 61.
[155] Section 61(8)*(d)*.
[156] Del Code Ann tit 8 § 211*(b)*.
[157] *CA, Inc v AFSCME Employees Pension Plan*, 953 A.2d 227 (Del 2008). See also Risk Metrics Group, *2009 Governance Background Report: Advance Notice Requirements* (April 1, 2009).

meeting.[158] In contrast, the Companies Act appears to permit even a single shareholder to request that an item be considered at the annual meeting without providing any advance notice to allow the management or the board of directors to prepare an organised response to such matter.

(b) *Special meetings*

The right to call special meetings is currently a subject of great debate among shareholder activists in the United States. Some constituencies view the right of shareholders to call a special meeting as a key component of proper shareholder oversight. The crux of the debate currently revolves around not only whether shareholders should be able to call a special (extraordinary) meeting without board action but also what minimum percentage of shares must be held by shareholders to allow them to compel such a meeting.[159]

(i) *Companies Act*

The Companies Act grants shareholders representing at least 10 per cent of the voting rights in a company the right to call a special meeting.[160] The memorandum of incorporation may specify a *lower* threshold, but may not increase the threshold.[161] The Act does, however, allow the company or a shareholder to apply to a court:

> for an order setting aside a demand for meeting on the grounds that the demand is frivolous, calls for a meeting for no other purpose than to reconsider a matter that has already been decided, or is otherwise vexatious.[162]

This provision strikes a non-South African observer as unusual for two reasons: first, it empowers the company's management or shareholder to apply for a court order that can override the meeting call made by other shareholders; secondly, it appears to grant wide discretion to the courts to apply their own judgment in deciding whether an otherwise duly called meeting in fact goes forward.

(ii) *US model*

The DGCL provides that special meetings of the stockholders may be called by the board of directors or by such person or persons as may be

[158] See, eg *Stroud v Grace,* 606 A2d 75, 95 (Del 1992). See also Md Code Ann, Corps & Ass'ns § 2–504*(f)* (LexisNexis 2009).
[159] Risk Metrics Group *2009 Governance Background Report: Special Meetings & Written Consent* (March 15, 2009).
[160] Companies Act s 61(3)*(b)*.
[161] Section 61(4).
[162] Section 61(5).

authorised by the certificate of incorporation or the by-laws.[163] There is no right to call a special meeting in Delaware unless a company chooses to include such a right in its governing documents. As noted above, in recent years shareholder activists and good governance advocates have ever more emphatically urged that publicly traded companies amend their charter documents to authorise shareholders to call special meetings. Many companies have complied with these requests and allow shareholders holding 25 per cent or a higher threshold of outstanding shares to call special (extraordinary) meetings. Activists and good governance advocates have increasingly demanded lower thresholds, with recent requests asking for thresholds in the 10 per cent range.[164] Notwithstanding these developments, it is still very rare for shareholders to call special meetings.

The MBCA provides for shareholders to call special meetings and sets the default threshold at 10 per cent of the outstanding voting shares.[165] The MBCA allows companies to specify any lower threshold, but it also allows for companies to increase the threshold to as high as 25 per cent. Thus, with regard to special meetings, the Companies Act is not dissimilar in concept from the MBCA, except that the Companies Act does not permit a threshold above 10 per cent.

(iii) *UK model*

In the United Kingdom, special meetings are referred to as Extraordinary General Meetings (EGMs). The power to call an EGM continues in force as set out in the Companies Act of 1985.[166] Under recent changes, an EGM can be called by shareholders holding 5 per cent of the company's outstanding voting shares.[167] Also of interest, in the United Kingdom, under certain circumstances, courts and auditors have the power to call an EGM.[168]

(2) *Shareholder resolutions*

Shareholder resolutions have become an increasingly significant corporate governance practice, particularly for public companies in the United States, where many types of such resolutions may be placed in the formal notice and proxy disclosure statement for the annual meeting, at the expense of the company, on behalf of holders of a small amount of

[163] DGCL § 211(s) (2009).
[164] Risk Metrics Group *2009 Governance Background Report: Special Meetings & Written Consent* (March 15, 2009).
[165] MBCA § 7.02*(a)*(2).
[166] UK Companies Act 1985 s 368(3).
[167] Section 368(3).
[168] Sections 371, 392A. For example, courts can call an EGM if it would otherwise be impracticable to call one and auditors can call an EGM in connection with their resignation.

stock.[169] Shareholder resolutions can also provide a good starting point for negotiations and discussion between shareholder groups and corporate leaders. If abused, however, resolutions can drain corporate resources and leave the corporation vulnerable to special interests.

The Companies Act provides a particularly broad scope of power to shareholders to create resolutions and allows any two shareholders of a company to propose a resolution 'concerning any matter of which they are each entitled to exercise voting rights'.[170] The scope of a permitted resolution is narrowed only in that it requires that the resolution be 'expressed with sufficient clarity and specificity' and

> accompanied by sufficient information or explanatory material to enable a shareholder who is entitled to vote on the resolution to determine whether to participate in the meeting and to seek to influence the outcome of the vote on the resolution.[171]

Thus, any two shareholders may propose a resolution on anything to which they are entitled to vote as long as the resolution is clear and properly explained.

The Companies Act allows a shareholder or director to challenge the form of a resolution by filing a judicial proceeding. According to the Companies Act, this challenge is limited to whether the proposal is clear and properly explained.[172] If the proposal is found by the court not to be sufficiently clear and specific or properly explained, the proposal may be modified to meet those requirements.[173]

In comparison, the United States addresses shareholder proposals for publicly traded companies at the national level by SEC rule.[174] The Rule is limited with regard to which shareholder proposals a company is required to include in its notice of meeting and proxy statement sent to shareholders in advance of the annual meeting. To submit a proposal under SEC rule 14a–8, a shareholder need own only $2000 in value or 1 per cent of a company's stock, whichever is less, have held that stock for a period of one year prior to submitting the proposal, and state that she will continue to hold such shares through the annual meeting. The proposal is limited to 500 words or less. In addition, there are numerous limitations

[169] SEC Rule 14a–8; 17 C.FR § 240.14a–8.
[170] Companies Act s 65(3).
[171] Section 65(4). These are the sub-s (4) requirements.
[172] Section 65(5). 'At any time before the start of the meeting at which a resolution will be considered, a shareholder or director who believes that the form of the resolution does not satisfy the requirements of subsection (4) may seek leave to apply to a four for an order . . . restraining the company from putting the proposed resolution to a vote until the requirements of subsection (4) are satisfied.'
[173] Section 65(5).
[174] SEC Rule 14a–8.

and exceptions that permit companies to exclude proposals such as that the proposal, if adopted, could be contrary to the law of the incorporating state, deals with the ordinary business (which is the province of directors and managers, not shareholders) or has been substantially implemented.[175] Companies may request confirmation from the SEC that the proposal is excludable on any of these grounds. Thus the SEC rule defers to state law on the subject-matter of resolutions that may be presented, but the SEC administers the process. This dual federal/state regime in the United States is not followed in other nations and was not followed in South Africa, where there is no difference between the rights of shareholders of publicly traded as opposed to private companies to present resolutions.[176] In the United States, through its by-laws or articles of incorporation, a corporation can impose reasonable advance notice requirements for shareholder proposals and director nominations.[177]

(3) *Demands and right to derivative actions*

Although derivative actions may not be an ideal form of corporate governance, they are nonetheless an important right, typically provided to the shareholders, to vindicate the rights of a corporation. As such, derivative actions may represent the ultimate control of corporate governance. The Companies Act replaces South African common law with regard to derivative actions.

As a comparative analysis to other corporate governance models, the Companies Act is unusual in the constituencies to which it grants the power to bring a derivative action. Derivative actions have traditionally been a right solely entrusted to shareholders. For example, in the United States, the power to bring a demand for a derivative action is limited to the company's shareholders at the time of the alleged injury (the so-called 'contemporaneous ownership rule') and the plaintiffs must continue to be shareholders throughout their pursuit of the claim.[178]

In comparison, the Companies Act significantly expands the power to bring derivative actions. It defines four categories of persons who may serve a demand on the company to commence a derivative action. Those persons are:

(i) a shareholder or a person entitled to be registered as a shareholder;
(ii) a director or prescribed officer;
(iii) a registered trade union that represents employees of the company or another representative of employees of the company; or

[175] SEC Rule 14a–8.
[176] *CA, Inc v. AFSCME Employees Pension Plan*, 953 A2d 227 (Del 2008).
[177] See, eg *Stroud v Grace* 606 A2d 75, 95 (Del 1992). See also Risk Metrics Group, *2009 Governance Background Report: Advance Notice Requirements* (April 1, 2009).
[178] See, eg *Feldman v Cutaia*, 951 A2d 727 (Del 2008).

(iv) any person granted leave of the court to do so if the court is satisfied that it is necessary and expedient to do so to protect a legal right of that person.[179]

These categories, especially categories iii and iv, are an unusual grant of corporate governance power to stakeholders other than shareholders. It will be interesting to see if and how they are employed in practice. As discussed in s II(2), the Companies Act provides rights for direct participation in corporate governance to trade unions and company employees not found in the US and UK models. The right of such groups to bring derivative actions is consistent with the Act's expansive view of the role of stakeholders and societal interests whose claims extend beyond share ownership and economic benefit to the corporate enterprise.

X CONCLUSION

The point of the comparisons made in this chapter between the approach to corporate governance in the Companies Act and approaches used in other modern global models is not to suggest that one model is right or another wrong. What is 'wrong' in Delaware or England may be entirely appropriate for South Africa, just as what works well in South Africa may not work as well in the culture of Germany or Australia. There is and should be room for national variations in the thrust and content of corporate governance prescriptions. In South Africa, it seems clear to this observer, as a direct result of the relatively recent establishment of a just and diverse political system and related changes to the nation's social and economic structures, that the concerns of the Companies Act for promotion of broader economic and social benefits than corporate profitability, and for worker and other stakeholder representation, are understandable and appropriate. South Africa has an important role to play in the global economy, as both the pre-eminent economy of Africa and a democratic country with tremendous human and natural resources. With these considerations in mind, the flexibility and simplicity of company formation, and the consequent encouragement of entrepreneurship and capital investment, represented by the Companies Act's adoption of a predominately enabling model, departing from many of the prescriptions of the old Act, should provide South Africa with a solid basis in the law governing its business enterprises which will permit it to continue its critical participation as a leader in the global economy of the 21st century.

[179] Companies Act s 165(2).