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The Protection of Employees as Stakeholders Against Malfeasant Directors in South Africa and Comparable Jurisdictions

By

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- Best interests of the company
- Corporate failures
- Corporate Governance
- Director Malfeasance
- Employees
- Employee welfare/wellbeing
- Shareholder-primacy
- Stakeholders
- Stakeholder-oriented provisions

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Chapter 1

Introduction

1.1 Background

Corporate failures have been prevalent within the last two decades. The most prominent scandal occurred in 2001, which saw Enron's[1] share price take a freefall to its all-time low, thus inevitably leading to its bankruptcy.[2] The Enron collapse had far-reaching effects which saw 4000 employees lose their jobs, medical insurance and billions of dollars in retirement and pension funds and creditors were unable to recoup the full amount on their claim.[3]

The Enron collapse can be paralleled to South Africa's (SA) most recent corporate scandal, Steinhoff. In a nutshell, the accounting skulduggery that led to the Enron demise was to some extent, adopted at Steinhoff.[4] This led to the implosion of its

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[1] Enron managed the world's largest portfolio of natural gas risk management contracts and pioneered innovative trading products and was ranked 7th on the Fortune 500 list. See Enron Corporation: A Case Study by T Ghosh available at https://www.academia.edu/28328128/Enron_Corporation_A_Case_Study, (accessed on 29 July 2019).

[2] M Rantanen '*Reasons of Systemic Collapse in Enron*', page 171 available at https://sal.aalto.fi/publications/pdf-files/rran07.pdf (accessed on 29 July).

[3] *An Overview of The Enron Collapse*: Hearing before the committee on Commerce, Science, and Transportation. United States Senate, First Session (2001), pages 6-11, available at https://www.govinfo.gov/content/pkg/CHRG-107shrg82282/pdf/CHRG-107shrg82282.pdf, accessed at 15h28 on 5 July 2019. Also see Rantanen '*Reasons of Systemic Collapse in Enron*',

[4] Enron's appeal to investors was based on artificially inflated profits and questionable accounting practices that saw Enron conceal substantial financial losses at Enron by using off balance sheet

shares that wiped out hundreds of thousands of pension savings and investments.[5] The Steinhoff scandal has thrown the spotlight on the unenviable position which employees (and other stakeholders) find themselves in and on whether or not directors consider the impact of their decisions on employees.

The common denominator between the abovementioned corporate failures and other prominent failures like WorldCom[6], is failed leadership at board-level, particularly the malfeasance by board directors.[7] Empirical evidence has shown that failure at board-level ultimately results in the ruin of a company, and for large companies, the effects can be catastrophic for the company's stakeholders, especially for employees.[8]

The same way Einstein believed "God does not play dice with the universe"[9], it is submitted that company directors should not play dice with employees' welfare. The Companies Act, 71 of 2008 (hereafter, the new Companies Act) that came into effect on 1 May 2011, has brought a paradigm shift in corporate law. This shift encompasses the significant impact on directors' duties and liability in SA. The provisions of directors' duties in the new Companies Act are said to have set the bar for directors at a "higher" standard than the common law dispensation.[10]

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entities. Same is alleged to have occurred at Steinhoff, see 'Overview of Forensic Investigation on Steinhoff International Holdings NV', summary on PwC report (hereafter Steinhoff report), pages 2-4 available at www.steinhoffinternational.com/downloads/2019/overview-of-forensic-investigation.pdf. (accessed on 5 July 2019)

[5] See Styan "*Steinhoff: Inside SA's biggest corporate crash*", prologue, July 2018

[6] See J Ashraf '*The Accounting fraud at WorldCom: The causes, the characteristics, the consequences, and the lessons learned*' at pages 25-26 WorldCom, like Enron, effected *inter alia*, accounting fraud designed to deceive the public through misrepresentation of financial statements, available at http://etd.fcla.edu/CF/CFH0003811/Ashraf_Javiriyah_201105_BSBA.pdf (accessed on 5 July 2019)

[7] MJ Jones "*Alphabetical List of Most Important Accounting Scandals Across 12 Countries and Beyond since 1980*" available at https://onlinelibrary.wiley.com/doi/abs/10.1002/9781119208907.app2 (accessed on 5 July2019)

[8] R Watts *et al* "*Corporate Scandals: Causes, Impacts and Implications*", at 958 and 961.

[9] A famous quote he intimated to sum up his views on Max Born's published article on Quantum Mechanics.

[10] F Cassim *et al* 'Contemporary Company Law' at page 507 (2nd Edition).

Given that the 20th - 21st centuries have been marred by corporate failures, these should, to some extent, provide context within which corporate law reform ought to be effected. In addition, the constitutional paradigm shift that occurred in SA also ought to be factored in the policy formulation. It is due to these corporate scandals that some jurisdictions, *inter alia*, the United Kingdom (UK) endeavoured to provide employees with protection against director misconduct by way of an extension of the directors' duties to expressly require directors to consider the consequences of their decisions on employees.[11] The Enron collapse led to the United States of America (US) promulgating the Sarbanes-Oxley Act (SOX) as a counter-measure for corporate malfeasance.[12] Upon a thorough read through the SOX, one can easily gather that SOX augmented the independence and financial literacy of company boards, ensures the protection of whistle-blowers and holds directors personally liable for accounting fraud, among other malfeasant conduct.[13] This mini-dissertation does not seek to recommend the promulgation of an equivalent Act that would make it costly for companies to do business in SA, thus warding off investment. However, the research endeavours to answer a question of public interest, namely whether employees as stakeholders are protected from director malfeasance.

1.2 Research Question

Pursuant to the above background, the fundamental question to be asked and answered in this research is:

[11] Section 172 of the UK Companies Act, 2006.

[12] K Vasileiou "*The Sarbanes-Oxley Act and Accounting Quality: A Comprehensive Examination*" International Journal of Economics and Finance, Vol 3 (2011) at 50. Available at https://www.researchgate.net/publication/266467922_The_Sarbanes-Oxley_Act_and_Accounting_Quality_A_Comprehensive_Examination/link/55353f260cf218056e929326/download, accessed on 5 July 2019.

[13] Sarbanes-Oxley, Act of 2002. For a brief overview, see Sarbanes-Oxley Act summary at https://www.thebalance.com/sarbanes-oxley-act-of-2002-3306254.

Given SA's corporate law reform towards a framework that is stakeholder-inclusive, why are employees as stakeholders still vulnerable against director malfeasance?

To ultimately answer the research question, it is imperative to answer the following sub-questions:

- What is a 'Stakeholder', and what strides have been taken to protect employees as stakeholders?
- Assessment of the protection of employees as stakeholders within the framework of SA corporate governance, specifically with reference to directors' fiduciary duties. Are there provisions in the new Companies Act and ancillary corporate law provisions that are stakeholder-oriented and provide sufficient protection to employees?
- What is SA's position in relation to comparable jurisdictions (UK)? And what can we learn from the UK for our next reform phase? Lastly, how Germany's employee representation model can be imported in SA in relation to the Social and Ethics Committee.

This research is essential in that it aims to show that corporate responsibility regarding stakeholder protection can pressure directors to consider the interests of employees in a more conspicuous way; can alleviate, if not deter director malfeasance; and it will result in sustainability and higher financial returns for the company. It also aims to inform stakeholders, especially employees, on whether or not they are adequately shielded from director malfeasance, and lastly, to make recommendations for future corporate law reform.

1.3 Purpose of Research

The purpose of this research is to investigate whether employees as stakeholders in SA are protected against director malfeasance and to give an overview on why they should be protected. Lastly, to recommend legislative amendments where current provisions seem inadequate to protect employees.

1.4 Exposition

A myriad of legal scholars advocate the opposition of extending directors' duties towards stakeholders. Therefore, this research will not be free from critique by other learned colleagues. Some arguments opposing the extension of directors' duties to cover employees can be summed up as follows:

I. SA's corporate governance already allows for directors to consider the interests of stakeholders;
II. Extending directors' duties will make it too onerous for directors to discharge their duties as envisaged in the Act as they will be overly cautious in making decisions, and because interests may clash, thus creating a dilemma for directors on whose interests to act on;[14] and
III. There are already sufficient measures available to protect employees i.e. contracts and labour laws.[15]

The three arguments advanced above will be addressed and refuted in passing below. Further, it will be submitted that protecting employees' interests is necessary, and where there is a dichotomy between interests the directors are to act in the best interests of the company as a separate legal entity, thus ultimately ensuring the company's sustainability to everyone's benefit.

[14] A Keay '*The Director's Duty to Take into Account the Interests of Company Creditors: When is it Triggered?* (2001) 25' MelbULawRw 11, at 8.
[15] A Keay '*Directors' Duties to Creditors: Contractarian Concerns Relating to Efficiency and Over-Protection of Creditors',* The Modern Law Review Vol. 66, (2003), No. 5, pages 687-693.

1.5 Limitations

The focus of this research is on the protection of employees against malfeasant directors. This will be examined with reference to the partly codified directors' duties.[16] The research will be confined to employees interests for the following reasons: **(i)** Employees' economic welfare is dependent on the survival of the company (their retirement savings and pension funds may also be lost if invested in the company, like in Enron); **(ii)** Companies are dependent on the skills and expertise of employees in order to gain better financial returns. Lastly, addressing 'stakeholder interests' in its broader sense has a myriad of extensive issues which fall beyond the requirements of an LLM thesis.

It should be noted that fiduciary duties expand beyond directors. It also includes other functionaries.[17] However, this research will only be limited to the board of directors as the company's survival or lack thereof depends on their decision-making. Therefore, any duty that non-director functionaries may have to consider the interests of stakeholders fall beyond the contours of this research.

Lastly, it is important to note that this dissertation will not discuss employee protection re employment protection or distributional issues such as wages and better working conditions etc. This dissertation will only be confined to the protection of the well-being of employees which may be compromised as a result of corporate fraud. It is acknowledged that the protection that will be discussed does cover the issues such as wages, however, these will not be canvassed in this dissertation. Although including economic analysis to augment the arguments proffered below would add value to this dissertation, it is unfortunate that it would be going beyond the contours of this

[16] P Delport *et a*l "*Henochsberg on the Companies Act 71 of 2008*", at 292(2). Directors duties find partial regulation in the new Act (see ss 75 and 76). However, the common law is still applicable unless expressly excluded in the new Act or in conflict with the new Act. This is to provide flexibility to the extent where certain codified duties' content is not defined in the Act. This will be left to the Common law.

[17] In *Canadian Aero Service Ltd v O'Malley* (1973) 40 DLR 371 (SCC) it was enunciated that other company officials (i.e. senior officials) owe a duty of loyalty and good faith to the company.

dissertation. This includes canvassing the many issues and concepts that arise from corporate governance. It should be noted that this dissertation may be a prelude to an extensive LLD thesis that will cover extensive issues and concepts that could not be canvassed in this dissertation.

1.6 Methodology

This research entails a legal analysis of local company law principles that will be pertinent in answering the research question. Essentially, this mini-dissertation is a desktop research underpinned by local and international primary and secondary sources.

The above will be followed by a comparative analysis in order to determine whether other jurisdictions have an answer to the research question, this will also assist in pinpointing a *lacuna* in South African company law. The jurisdictions to be analysed in this research is the United Kingdom (UK) and Germany (in passing), following its two-tiered board structure that encompasses a supervisory board that may be comprised of employees/employee representative. The UK is the key comparator in this research because SA company law has its genesis from and is partly based on English Company Law. Other jurisdictions (that are also based on English Company Law) may be mentioned in passing. The selected jurisdictions will serve as a guide for the recommendations that will be enclosed in this research. An overarching view of the UK's (and other jurisdictions) position may be informative in formulating the recommendations in this research paper.

No quantitative analysis is done in this research paper as no questionnaires have been administered. The focus is on the analysis of the abovementioned company law principles and their protection (or lack thereof) of employees with reference to malfeasant directors

1.7 Chapter Outline

Chapter 1: Introduction

This chapter entails an introductory chapter which delineates the background to the research subject matter, research problem, research question(s), purpose of the research, research methodology, limitations of the research and the chapter outline.

Chapter 2: Trajectory of Employee Protection as Stakeholders in SA Corporate law

The point of departure in this chapter is to define "stakeholders". This will be followed by a general discussion on the history of SA's corporate governance in affording employees protection in SA against director malfeasance and how the constitutional paradigm shift and the Kings have brought about change.

Chapter 3: The Protection of Employees as Stakeholders Within the Framework of SA Corporate Governance.

This chapter aims to analyse the provisions of the 2008 Act and ancillary company law provisions in order to investigate whether or not the protection of employees against director malfeasance can be inferred from the provisions. To that effect, the 2008 Act, King IV and the JSE listing requirements along with other rules/codes within the corporate governance framework will be reviewed.

Chapter 4: Comparative Study

In this chapter, company law principles of the UK and Germany will be analysed in order to determine the extent it will serve as a benchmark for SA's reform. The UK's analysis will be regarding its directors' fiduciary duties provision, and Germany's brief analysis will be regarding its two-tiered board system that caters for the representation of employees at board level. Shortcomings of said principles will also be outlined in

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order to enable the researcher to recommend a pragmatic reform that is best suited for SA's company law, specifically section 76(3)(b) of the new Act and the Social and Ethics Committee in being a suited platform to enhance employees' voice in the company.

Chapter 5: Recommendations and Concluding Remarks

This chapter contains the recommendations regarding effective protection of stakeholders in a way that finds expression in the new Act namely, directorial duty to employees.

1.8 Literature Review

Recall this mini dissertation focuses on the literature review of company law principles limited to directors and stakeholder-centred provisions. Therefore, this mini dissertation will be laser-focused on literature relevant to the position the researcher will try to establish. These include the Companies Act (1973 and 2008), King IV, JSE Listing Requirements, Journal Articles, contemporary company law textbooks and online articles. The UK companies act will also be used as a comparator to inform and serve as a persuasive force underpinning the recommendations that will be set out in this research. Furthermore, owing to the fact that we are living in a digital age, some internet sources will be used as a plethora of information is disseminated online.

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Chapter 2

Trajectory of Employee Protection as Stakeholders in SA Corporate law

2.1 Defining "Stakeholders"

In modern economies, employees play a crucial role in the success of companies and therefore are essential stakeholders deserving of protection from director misconduct. In terms of the King IV "stakeholders" are:

"*Those groups or individuals that can reasonably be expected to be significantly affected by an organisation's business activities, outputs or outcomes, or whose actions can reasonably be expected to significantly affect the ability of the organisation to create value overtime".*[18]

Despite the ubiquitous usage of the term among scholars from various disciplines, only a few provide a clear understanding regarding what a stakeholder is. A myriad of definitions have been examined without the term ever gaining definite consensus, hence the lack of a conclusive definition. A different definition with added elements from the one outlined above is used below to show inconclusiveness of the term. According to *Black's Dictionary*, a "stakeholder" is:

"***2**. Someone who has an interest or concern in a business or enterprise, though not necessarily as an owner. **3**. A person who has an interest or concern (not necessarily financial) in the success or failure of an organisation, system, plan, or strategy, or who is affected by a course of action*".[19]

Looking at the definitions above, one can easily conclude that there is a diverse list of stakeholders depending on the nature of the company or circumstances. For example, a gold mine will have a slightly distinct list of stakeholders to that of a company that

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[18] King IV, see glossary. Emphasis added.
[19] *Black's Law Dictionary*, 10th Ed at page 1624.

operates in the market for provision of online classifieds platform like Takealot. Furthermore, when examining the elements of the above definitions holistically, the essential elements of the definitions can be characterised into three categories namely, **(i)** "interest in"; **(ii)** "affect the company/affected by the company": and **(iii)** a combination of one and two.

In view of the definitions and the three elements illuminated above, it is submitted that a stakeholder, in a nutshell is a person/group of people which a company cannot survive without. In his book, Julian Richer laments that he would describe employees as <u>enablers</u>.[20] He is of the view that in a retail environment, "*employees are those people who facilitate the supply chain, and without whom, no retailer can exist*". This assertion is supported because employees are sources of value creation that contribute to the profitability of companies. It is opined that value creation is among the essential foundations of capitalism. Pre-20th century company law was founded on capitalism.[21] It therefore made provision for legal structures that were germane for the operations of a capitalist system. These structures, at common law, were founded on English law.[22] Companies' objectives were ultimately to maximise profits for its shareholders.[23] The implication of this is that the company's interests are equated with those of the collective shareholders.[24] The Companies Act 61 of 1973 (old Companies Act) was heavily influenced by English law, which was inherently shareholder-centric.[25] This submission is due to the fact that the old Companies Act did not recognise the protection of non-corporate constituents, however it can be concluded that it did consider employees' financial interests because it made provision for

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[20] J Richer "*The Ethical Capitalist: How to Make Business Work Better for Society*" (2018), at 80.
[21] T Hadden "*Company Law and Capitalism*" 2nd ed, at 3.
[22] Ibid.
[23] Ibid.
[24] *Hutton v West Cork Railway* 23 ChD (1883) 654 at 673. Also see T Mongalo "*Corporate Law and Corporate Governance: A Global Picture of Business Undertakings in South Africa*" (2003) at 208.
[25] T Wiese "*Corporate Governance in South Africa: With International Comparisons*" (2014) at 17. Also see *Fisheries Development Corporation of SA Ltd v Jorgensen* 1980 (4) SA 156 (W) where the court held that the principles of SA's company law are the same as those of English law.

employee share schemes.[26] Notwithstanding the company's metaphysical state, the company's effects could be felt in communities.[27] This is because companies do not operate in isolation from societies, and because they employ people from said societies. As sources of value creation for the company, it is equally essential to protect employees. SA's corporate governance is morphing into a system that caters for multiple stakeholders because of SA's constitutional dispensation and the ubiquitous realisation of the need for stringent corporate governance systems that will alleviate malfeasance that served as precursors for corporate failures.

2.1.2 Corporate Governance

Comprehensive corporate governance predicated on transparency hardly existed before and during the apartheid era. Prof De Vos laments that "*apartheid was not (simply) a form of racial separation and oppression ''but a means of creating a dispossessed and radical closely controlled labour force for white-owned enterprises".*[28] In summation, companies existed purely for the maximisation of profits and wealth for its shareholders, the elite few. Before corporate governance can be defined and its approaches outlined, the origins of corporate governance ought to be outlined as a starting point.

Corporate governance has its genesis from the agency problem that was caused by the separation of ownership and control of a company.[29] This is because owners of companies (shareholders aka principals) no longer had management control of the company because that responsibility for controlling the company shifted to directors (aka agents). The quandary that arises from the above situation is that directors, as managers of the company could abuse their control powers to the detriment of the

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[26] Section 144A of the old Companies Act.
[27] Cilliers and Benade "*Company Law*" 4th ed at 4.
[28] P de Vos '*A bridge too far? History as context in the interpretation of the South African Constitution'* (2001) 17 South African Journal of Human Rights 1 at 14.
[29] G J Rossouw "*Corporate Governance in South Africa*" Journal of Business Ethics (2002) Vol 37 (3) at 289.

shareholders.[30] Corporate governance therefore was birthed to regulate directors' conduct by ensuring that directors, as agents of shareholders, manage the company for the interests of shareholders.[31] Directors are therefore accountable to shareholders. It is submitted that this position is not consistent with the modern-day definition of corporate governance. Corporate governance has no definitive definition, however in summation, corporate governance is concerned with who controls the company, in whose interests is the firm governed[32], and the various ways control is exercised.[33] The ubiquity of corporate failures such as Enron shaped corporate regimes of countries that consequently culminated in two approaches to corporate governance: **(i)** Rules-based approach (aka legislative approach); and the **(ii)** Principles approach to corporate governance. The rules approach codifies principles into law with the commensurate sanctions for contravening the law in order to ensure shareholder protection, and enhance confidence in the market and in companies.[34] An example of this is the US' SOX. The principles approach is the antithesis of the rules-based approach. The principles approach is predicated on the fact that companies must either comply with a principle or explain why it has not done so.[35] The principles approach is adopted in SA which used the King Reports as an element of its hybrid model of corporate governance which incorporates shareholder and stakeholder interests, and blending these interests with the principle of Ubuntu.

Upon an extensive perusal of SA's corporate regulatory framework, one can note that the trajectory of SA's corporate governance system has been bolstered towards morphing into a hybrid system that caters for multiple company stakeholders. One can

[30] Ibid.
[31] Ibid.
[32] Question regarding in whose interests is the company governed is usually assessed under what is termed the "Theories of Corporate Governance" which are briefly outlined in the next chapter of this mini-dissertation.
[33] H Gospel "*Finance, Corporate Governance and the Management of Labour*" British Journal of Industrial Relations 41 (2003) at 560.
[34] R Naidoo "*Corporate Governance: An Essential Guide for South African Companies*" (2018) at 32.
[35] Ibid.

easily conclude that this is a consequence of SA's constitutional dispensation and the ubiquitous realisation that corporate malfeasance ultimately leaves stakeholders worse-off, especially employees. The push to develop principles that protect a broader spectrum of stakeholders can be segmented into four reform phases that diverged from the Anglo-American Eurocentric approach. The King Reports provided an invigorating move away from the prescriptive approach of rules-based regimes to ensure a flexible business environment suited for SA.

King I[36], which came into being at the birth of SA's constitutional dispensation was the first gear shift that propelled SA from the traditional shareholder-centric model of corporate governance to one that recognises stakeholder interests.[37] King I advocated for an integrated approach that encouraged directors to consider the interests of stakeholders when executing their duties.[38] King I was predicated on voluntary principles that resulted in self-regulation by companies. Company boards had the discretion to apply principles relevant to it, and to explain any departures from the principles.[39]

The second shift came in the form of the King II[40] which was introduced in 2002. King II incorporated the same principles of stakeholder recognition, with an additional sustainability-centred approach.[41] Lastly, King II moved away from the single bottom line predicated on measuring a company's success by its economic impact to a triple bottom line that served as a metric for measuring the company's success by looking at its economic, environment and social impact.[42] The King II was predicated on voluntary compliance, and introduced the 'comply or explain' approach in SA.[43] In

[36] King I Code on Corporate Governance for South Africa, 1994.
[37] King I principle 5.3.
[38] King I principle 6.
[39] Ibid.
[40] King II Code on Corporate Governance for South Africa, 2002.
[41] King II principle 1.4.
[42] King II principle 1.5.
[43] Op cit note 40.

terms of the 'comply or explain' approach, directors had to comply with corporate governance prescripts and decisions to not comply would need to be explained in, *inter alia*, annual reports.[44]

The development of corporate governance regimes in the US and the UK following corporate scandals prompted SA to a third shift in order to align its corporate governance regime with international best practices. The corollary of the third shift was the King III[45], which was congruent with the DTI's objective (in its *Guideline for Corporate Reform*, hereafter referred to as the 'the Policy Document') to create a regulatory framework that promotes *inter alia*, employment, good governance and growth.[46] It placed significance on ethical leadership, sustainability of companies and encouraged companies to be socially responsible corporate citizens.[47] The King III adopted an 'apply or explain' approach. It was based on the philosophy that a company must apply governance prescripts (as opposed to 'comply' which depicts an element of rigidity) or explain non-application of recommended principles where directors opted to apply other practices in the best interests of the company.[48] Lastly, the King III was underpinned by governance that was aligned with constitutional underpinnings and the objectives of the new Companies Act.[49] Some of its principles were imported into the new Companies Act.[50] This was carried on along with the fourth shift to the King IV which brought about a definition of corporate governance aligned with the constitution and the objectives of the new Companies Act.[51] King IV slightly deviated from the King III's philosophical underpinnings by, *inter alia*, recommending an 'apply and explain' approach which is "outcome based".[52] This encourages

[44] Op cit note 34, at 33.
[45] King III Code on Corporate Governance for South Africa, 2009.
[46] South African Company Law for the 21st Century: Guidelines for Corporate Law Reform, background.
[47] King III, principle 1.1.
[48] King III Code on Corporate Governance for South Africa, page 7.
[49] Ibid.
[50] Ibid.
[51] King IV Code on Corporate Governance for South Africa, 2016 at page 25.
[52] Op cit note 51, at 7.

companies to view corporate governance not as a mindless compliance, but a process underwent mindfully, with cognisance of the best interests of the company.[53] Most importantly, it places emphasis on stakeholder inclusivity.[54] SA's hybrid regime deviates from the prescriptive approach of corporate governance regimes such as those espoused by the SOX because, *inter alia*, compliance costs in complying with rigid rules are high.[55]

2.2 Concluding remarks

The trajectory outlined above indicates SA's shift from the prevailing paradigm that is centred on shareholder primacy to a broadened scope of company law that proffers the recognition of stakeholder interests in the management of companies. Noting the prevailing corporate failures as a result of director malfeasance, one is moved to submit that the stakeholder inclusive nature of SA's corporate law framework may be nothing more than a smoke screen that conceals the entrenchment of the common law position that tilts heavily towards the exclusive Anglo-American model.

[53] Ibid.
[54] The King IV will be expanded upon in chapter 3.
[55] Op Cit note 35, at 33.

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Chapter 3

Protection of employees as stakeholders within the framework of South African Corporate Governance

3. Introduction

It is common knowledge that companies are artificial persons, and being viewed as "persons" companies coexist in a corporate society with other constituents such as customers, employees and creditors among others. For purposes of this mini dissertation, the definition of "society" enclosed in the king IV will be used. Society in this context means "the broader society or community as part as part of the triple context in which the organisation operates, and the social and relationship capital that the organisation uses and affects. Society includes the organisation's internal and external stakeholders, which in turn form part of the broader society as a whole".[56] To coexist in harmony in this corporate ecosystem, inhabitants ought to demonstrate responsible corporate citizenship.

It does not require ingenuity to deduce that companies are one of the most, if not the most powerful institutions in societies. This was echoed in the DTI's Policy Document where then Minister Mandisi Mpahlwa of the Department of Trade and Industry (DTI) opined the following:

"Corporations, in various forms, are central to a country's economy and its prosperity – for wealth creation and social renewal."[57]

With that being said, companies' activities impact on a myriad of stakeholder interests and government's policy objectives. Therefore, the requisite checks and balances are essential in ensuring that companies conduct their activities with employees' interests at heart, and that they act responsibly towards the society at large. This can be done

[56] King IV, glossary at page 17.
[57] Policy Document Foreword by then Minister of the DTI.

through corporate governance which is concerned with who controls companies, and in whose interests is the company governed.[58]

3.1 Constitutional framework in corporate law

In SA's constitutional era, a plethora of corporate law rules have been adopted. For want of a better phrase, one could say a 'hybrid system' has been adopted in which corporate governance principles of, *inter alia*, fairness, responsibility and transparency ought to be observed. These principles will be discussed below. Before delving deeper in this section, it is briefly highlighted that these principles' life force is derived from the Constitution of the Republic of South Africa, 1996 (hereafter referred to as the Constitution) because no legislation that is inconsistent with it will be valid. The Constitution will be observed as a starting point in the investigation of employee protection within SA's corporate governance.

In chapter 1, the Constitution expresses that -

"1. The Republic of South Africa is one, sovereign, democratic state founded on the following values:

- *(a) Human dignity, the achievement of equality and the <u>advancement of human rights</u> and freedoms".*[59]

In the same section, the Constitution further expresses that it is the supreme law of the Republic[60], and that law or conduct inconsistent with it is invalid, and obligations imposed by it must be fulfilled.[61] Section 3(2) provides that all citizens are equally entitled to the rights of citizenship and that they are equally subject to the corresponding duties and responsibilities of citizenship. Considering that juristic

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[58] H Gospel *et al* "*Finance, Corporate Governance and the Management of Labour*" British Journal of Industrial Relations 41 (2003) at 560.
[59] Section 1(a) of the Constitution.
[60] Section 1(c) of the Constitution.
[61] Section 2 of the Constitution.

persons are practically citizens, it is submitted that companies as citizens have an obligation to observe the prescripts of the Constitution.

Chapter 2 of the Constitution, specifically sections 7 and 8 are the apex points of this introduction. Firstly, section 7 describes the Bill of Rights as a cornerstone for democracy in SA which enshrines the rights of all people in the Republic and affirms the democratic values of human dignity, equality, and freedom. Section 8 speaks to the application of the Bill of Rights. Section 8(1) provides that the Bill of Rights applies to all law, and all organs of the state which comprise of the legislative body, executive body and the judiciary. Meaning all arms of government must work together in enforcing laws that are consistent with the Bill of Rights. In this context, it would mean promulgating and passing corporate law rules that are consistent with the Bill of Rights. Sub-section 2 of the abovementioned section provides that the provision of the Bill of Rights binds a natural or juristic person if, and to the extent, it is applicable, considering the nature of the right and the nature of the duty imposed by the right. The Constitution expressly provides for the direct application of rights and obligations to companies, as juristic persons. This would not have a come at a better time than the present, considering that the private sector is dubbed the largest job creator in SA.[62] This justifies the enhanced obligations that companies ought to have re protecting employee welfare and conducting their activities in line with the prescripts of the Bill of Rights.

3.1.1 Purpose section of the Companies Act 71 of 2008

Section 7 of the new Companies Act attempts to reinforce the duty for companies to ensure that their activities are in line with the objects of the Constitution. It basically attempts to balance the imposition of the abovementioned obligations and companies'

[62] See Financial mail article available at https://www.businesslive.co.za/fm/special-reports/2019-02-21-jobs-private-sector-the-key-to-job-creation/ accessed on 7 July 2019.

ultimate objective, profit maximisation.[63] The objectives of the new Companies Act encompass stakeholder-oriented provisions. This can be seen as a form of employee protection. The veracity of truth or lack thereof of this statement will be explored below. Section 7(a) expresses the promotion of company law within a constitutional framework.[64] Section 7(b)(iii) provides that the purposes are to promote the development of the SA economy by encouraging transparency and high standards of corporate governance as appropriate, given the significant role of enterprises within the social and economic life of the nation. Another stakeholder-oriented provision in section 7 expresses that the purpose of the Act is to reaffirm the concept of the company as a means to achieving economic and social benefits.[65] Sections 7(i) and (k) make provision for the responsible management of companies and the provision for the efficient rescue of financially distressed companies in a manner that balances the rights and interests of all relevant stakeholders, including employees. This will be canvassed below. Section 7 read with the abovementioned Constitutional provisions implies that employees' rights ought to be considered during decision-making processes in the company. This view is also expressed by Katzew where she held that:

"…Section 7 bolstered by the overarching directive of the Bill of Rights, demands that human rights concerns are placed at the centre of policy making within the company and should be embedded in the holistic functioning of the company"[66]

The disjunctive occurring in section 7, sub-section (k) in particular, is that it makes mention of 'stakeholders', and yet there is no definition of the concept of a

[63] J Katzew '*Crossing the divide between the business of corporation and the imperatives of human rights – the impact of section 7 of the Companies Act 71 of 2008*', SALJ vol 128 (2011) at 686.
[64] Section 7(a) provides that the purposes of the Companies Act is to promote compliance with the Bill of Rights as provided for in the Constitution, in the application of Company law".
[65] Section 7(d).
[66] Op cit note 27, at 686-687.

'stakeholder'. Delport is of the view that the ordinary meaning of the concept of a 'stakeholder' would include the meaning enclosed in the King IV report.[67]

Since companies are juristic persons whose activities cannot be attributed to it as it does not possess any cognitive abilities, that honour fortunately lies with its board of directors. Section 66(1) of the new Companies Act provides that –

"*The business and affairs of a company must be managed by or under the direction of its board, which has the authority to exercise all of the powers and perform any of the functions of the company, except to the extent that this Act or the company's Memorandum of Incorporation provides otherwise*"

The company's board of directors are entrusted and empowered to manage the affairs of the company. Therefore, the company's activities can be attributed to the directors' decision-making. A director, in this instance, stands in a fiduciary relationship with the company.[68] This fiduciary relationship creates an obligation on the directors to act in good faith towards the company, and to exercise power as directors for the benefit of the company.[69] This was the common law position which is mirrored in the partly codified directors' duties encompassed in section 76 of the new Companies Act which provides that directors must, *inter alia*, not use their position/acquire information as directors to gain a personal advantage for themselves unless it is for the company[70] and must not knowingly cause harm to the company or its subsidiary.[71] In addition to this, directors of companies must act in good faith when discharging their duties, with due regard to exercising care, skill and diligence in the best interests of the company.[72] The rationale of directors' fiduciary duties is to protect companies against

[67] Op cit note 16, at 53.
[68] A person is in a fiduciary relationship when he/she controls the business affairs/assets of another, and has the power to act on behalf of another person. See R W Hamilton "*The Law of Corporations*" 5th Ed (1996)at 444.
[69] Cillers & Benade 'Company Law' 4ed, at 327.
[70] Section 76(2)(a)(i).
[71] Section 76(2)(a)(ii).
[72] Section 76(3)(a), (b) and (c).

unscrupulous directors who may pursue self-interests at the expense of companies. Section 66 read together with section 76, without question implies that in being the company's proverbial controlling mind– directors in their management of the company, must develop and implement strategies that are directed at creating profitability and long-term sustainability of the company. It is therefore opined that since the activities of companies have far-reaching effects that consequently hurt employees in the aftermath, it would be prudent for directors to consider the effects of their decision on employees. The pertinent question however, is does section 76(3)(b)'s "best interests of the company" cover employees?

3.2 Director's duty to act in the best interests of the company

During the SA company law overhaul in the early 2000s, one of the issues debated were to whose interests should directors manage the company.[73] Succinctly put, there are generally three schools of thought regarding whose interests holds primacy when directors discharge their duties towards the company. These are referred to as the theories of corporate governance. The first being the Shareholder Value approach, which posits that directors must manage companies for the interests of shareholders and that the consideration of the interests of other stakeholders should only be to the extent that it would be in the interests of shareholders to do so.[74] The second is the Enlightened-Shareholder Value approach (ESV) which posits that the directors' prime mandate is to maximise value for shareholders by promoting the success of the company, and allows directors to consider stakeholder interests if these will be subordinate to profit maximisation.[75] The third school of thought is the Stakeholder Value approach (Pluralist approach), which views shareholders as one of many constituencies whose interests ought to be recognised.[76] Meaning employees'

[73] T Wiese "*Corporate Governance in South Africa: With International Comparisons*" (2014), at 16.
[74] P M Vasudev et al "*Corporate Governance after the Financial Crisis*" (2012), at 25-26.
[75] F Cassim et al "*Contemporary Company Law*" (2011) at 471.
[76] Ibid.

interests would have to be considered as an end, rather than a means.[77] This approach was enshrined in King III and is predicated on balancing shareholders' interests with those of stakeholders like employees. In the King IV, this is recognised as the 'Stakeholder-inclusive approach' in which the board of directors takes account of the legitimate interests, reasonable needs and expectations of all material stakeholders in the execution of its duties in the best interests of the company over time.[78]

SA common law position is that a director has to act *bona fide* and in the best interests of the company.[79] This is the fundamental duty which qualifies the exercise of power which directors have. A similar approach was adopted in *Da Silva*[80] where the court held that "*it is a well-established rule of company law that directors have a fiduciary duty to exercise their powers in good faith and in the best interests of the company*".[81]

The duty to act bona fide and in the best interest of the company has since been entrenched in the new Companies Act. Section 76(3)(b) of the new Act states that –

(3)…a director of a company when acting in that capacity, must exercise the powers and perform the functions of director –

(a) in good faith…;

(b) <u>in the best interests of the company</u>.

3.2.1 Concept of the 'best interests of the company'

Looking at the wording of section 76(3)(b), it is submitted that it implies that the literal meaning of the provision is that directors of a company owe their fiduciary duty to the company and the company alone. This argument would be augmented by the reliance

[77] Ibid.
[78] King IV, page 25 par 4.
[79] *Cohen v Segal* 1970 (3) 702 (W).
[80] *Da Silva v CH Chemicals (Pty) Ltd* 2008 (6) SA 620 (SCA).
[81] Op cit 31 par 18.

on the *Stilfontein*[82] judgment where the court held that the resignation of directors *en masse* would not be in the best interests of the company. The reasonable conclusion to draw is that by 'company', it is meant the entity itself, distinct from its members. Sustaining this proposition however is not without difficulty as the new Companies Act does not define "company" for purposes of section 76(3)(b).[83] As a result, it follows that the common law meaning attributed to the word "company" is applicable to section 76(3)(b). At common law the word "company" refers not to the legal entity itself, but rather the interests of the collective body of present and future shareholders.[84] The court in *Greenhalgh*[85] held that the phrase 'company as a whole' does not mean the commercial entity distinct from the incorporators. This approach was followed in *Ngurli*[86] where the court stated that the phrase "company as a whole" does not mean the company as a commercial entity distinct from the incorporators. Therefore, "company as a whole" means the shareholders or incorporators as a general body.[87] The underlying principle from the above is that the duty to act in the best interests of the company means the best interests of the shareholders, and consequently makes shareholders the sole beneficiaries of directors' duties.

3.2.2 Employees formal/legal recognition under section 76(3)(b)

The implication of the common law principle is that directors owe their fiduciary duties to the collective body of shareholders. They do not however, as a general rule, owe their fiduciary duties the employees of the company.[88]

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[82] *Minister of Water Affairs and Forestry v Stilfontein Gold Mining Co Ltd* 2006 (5) SA 333 (W) at par 16.
[83] The word "company" is defined in section 1 of the new Companies Act as a 'juristic person incorporated in terms of this Act'. This definition is of no assistance in the context of section 76(3)(b).
[84] Op cit 10, at page 515.
[85] *Greenhalg v Arderne Cinemas* Ltd (1950) 2 All ER 1120 at 1126E.
[86] *Ngurli Ltd v McCann* (1953) 90 CLR 425.
[87] *Brady v Brady* (1998) BCLC 20 (CA).
[88] *Hutton v West Cork Railway Co* (1883) 23 ChD 654 (CA) 673.

The common law principle is still applicable to this day in the new Companies Act regime because of the lack of expansion of the beneficiaries of directors' duties. Therefore, interests of employees other than the collective body of shareholders have received no express legal recognition under the new Companies Act, save for provisions re, *inter alia*, Social & Ethics committee which will be discussed below. Directors' fiduciary duties are therefore centred on shareholder primacy, which ultimately requires directors to make decisions that are directed at advancing shareholders' financial interests – any decision that deviates from that objective (i.e. considering other stakeholders' interests) will be viewed as a breach of that duty, and would consequently render directors liable. The common law concept of what the 'best interests of the company' entails not only excludes the interests of employees as stakeholders, it also leaves no room of an implied protection of their interests. It is submitted that this common law principle is an anomaly and is antiquated to the extent that SA's post-apartheid era requires the observation of constitutional prescripts, even in corporate decision-making.

3.2.3 Common law concept of 'best interests of the company' being an anomaly

The common law concept of what entails the 'best interest of the company' is problematic for the following reasons: **(i)** It is not consistent with the principle of separate legal personality; **(ii)** it is not consistent with the Bill of Rights and section 7 of the new Companies Act; and **(iii)** the fact that shareholder-primacy is retained under section 76 still leaves employees vulnerable to gross director malfeasance and a reckless disregard for their interests.

Recall that companies play a crucial role in modern economies. It therefore should be mandatory for directors to exercise socially conscious decisions in a scope broader than profit maximisation for shareholders. This would, to some extent, require directors to have a social focus with company funds. It is acknowledged that company funds do not belong to directors. Courts have noted this point and also held that charitable donations must be *bona fide* and reasonably incidental to the business of the company and for its benefit.[89] This mini-dissertation does not seek to advocate for charitable donations to employees. It is to advocate for employee protection against director malfeasance that led to prominent corporate failures. The same way company funds do not belong to directors, it is submitted that they also do not belong to shareholders. This submission is predicated on the separate legal personality principle enunciated in *Salomon*. [90] The court expressed the following:

"*The company is at law a different person altogether from the subscribers to the memorandum; and, though it may be that after incorporation the business is precisely the same as it was before, and the same persons are managers, and the same hands receive the profits, the company is not in law the agent of the subscribers or a trustee for them*"[91].

This approach was echoed in SA's leading case re separate personality, the case of *Dadoo*[92] where the court held that the conception of the existence of a company as separate entity distinct from its shareholders is a matter of substance, and not merely artificial.[93] At the core of company law is the concept of a company as a separate legal person. All persons have the capacity to acquire legal rights and legal duties.[94] It is already established that companies as juristic persons, have rights and obligations. Although a company as a legal person cannot perform functions that are emblematic to humans i.e. voting and getting married, it does possess its own legal personality to acquire rights and commensurate obligations that are distinct from those of its shareholders and directors. This is echoed in section 19(1)(b) of the new companies Act which states that from the date and time that the incorporation of a company is registered, as stated in its registration certificate, the company has all the legal powers and capacity of an individual, except to the extent that it is incapable of exercising such

[89] *Evans v Brunner Mond & Company Ltd* (1921) ChD 359.
[90] *Salomon v Salomon & Co Ltd* [1897] AC 22 All ER.
[91] Ibid, 51.
[92] *Dadoo Ltd v Krugersdorp Municipal Council* (1920) AD 530.
[93] Op cit 45 at 550.
[94] Section 8(2) and (4) of the Constitution.

power/capacity or the company's constitution states otherwise. The ancillary consequences of separate legal personality are, *inter alia*, **(a)** the company's debts are the company's debts and not of its members' (shareholders); **(b)** the profits of the company belong to the company and not its shareholders; **(c)** assets of the company are its exclusive property and shareholders of the company have no proprietary rights in the property; **(d)** and the fact that a shareholder holds all the shares in a company enabling him to control the company does not mean the company is an agent of the shareholder.[95]

Therefore, it is submitted with respect that the common law principle that equates the "company" to the collective body of shareholders of the company contradicts the very essence of separate legal personality. The derivative action enshrined in section 165 of the new Companies Act proves that, and will be discussed below. Put briefly, it is a section that makes provision for the procedure in which shareholders, directors and registered trade unions can bring legal proceedings on behalf of the company against directors that breached their fiduciary duties towards the company. The fact that an action is brought on behalf of the company implies the very point expressed above, that a company is separate from its members. The King IV also espouses this stance and expresses that directors owe their duties to the company alone as the company is a separate legal entity from the moment it is registered.[96]

A company is distinct from its shareholders and therefore should be treated as such – as the primary beneficiary of directors' duties, with its shareholders and requisite stakeholders such as employees being the secondary beneficiaries. It is finally submitted that directors' duties should be towards the company, consequently resulting in the shareholders and employees deriving a benefit from the success of the company. The common law principle of what "company" means should therefore be

[95] Cilliers & Benade '*Corporate Law*' (1987), at page 7-8.
[96] King IV, at page 26.

augmented to make provision for the company as a separate persona, for the benefit of its shareholders and employees.

3.2.4 Inconsistency between the Common law concept of 'best interests of the company' with the Bill of Rights and section 7 of the new Companies Act

Section 76(3)(b) of the new Companies Act was derived from the common law, which was largely influenced by English law. Courts have been applying directors' fiduciary duties years before the old Companies was enacted.[97] The Constitution came into effect in 1996 and the part codification of directors' fiduciary duties came into effect 15 years later, in May 2011 when the new Companies Act was enacted. Considering that the Constitution predates section 76(3)(b), it is unfathomable how the common law concept of the 'best interest of the company' would not be fine-tuned to align with the Bill of Rights and the purpose section of the new Companies Act. It is acknowledged that the DTI endeavoured to formulate a policy that would breathe life into new company law regime aimed to remedy past imbalances and be aligned with SA's constitutional context.

The corollary of the DTI's attempts was the purpose mechanism enshrined in section 7. As seen above, section 7 incorporates the Bill of Rights into company law and requires observance of the Bill of Rights, the consideration of stakeholder interests and the managing of a company for an economic and social benefit. The common law principle retains the shareholder primacy at the exclusion of non-shareholder constituencies. This view is sustained by the definition of a 'profit company' found in section 1 which states that a profit company is a company incorporated for the purpose of financial gain for its shareholders. Section 76(3)(b) read with section 1 clearly solidifies an obligation to maximise financial value for shareholders, leaving no room to imply that employees are also beneficiaries of directors' duties. Section 7 however,

[97] *Inter alia*, *Percival v Wright* [1902] 2 Ch 421; *Robinson v Randfontein Estates Gold Mining Co* 1921.

is drafted in line with a broader purpose than maximising profit for shareholders.[98] It is submitted that section 7 allows for a liberal interpretation of the duty to act in the company's best interests because it brings the Act's application within the scope of the Bill of Rights. Particularly, section 7(d) that makes it mandatory for companies to be managed in a manner that promotes economic and social benefits.

Section 5 expresses that the Act must be interpreted and applied in a manner that gives effect to the purposes outlined in section 7.[99] The plain reading of sections 5, 7 and 76(3)(b), creates the impression that directors' duties have been extended to provide for the protection of employees as stakeholders. At face value it gives the impression of a *quasi*-duty on directors to consider stakeholder interests. Prof. Delport however cautions against this inference by lamenting that:

"*It is doubtful that section 7(d) establishes a new sui generis duty on directors. It rather seems against the background of the policy paper and the traditional interpretation that section 7(d) should also be interpreted to mean that directors must pay attention to the interests of stakeholders, but that it does not provide stakeholders with direct rights*"[100]

Granted if this were the intention of the legislature there would be no doubt about this position. There would be an express duty obligating directors to consider employees' interests as company stakeholders. It is appreciated that the inclusion of section 7 does propel the consideration of stakeholder interest, however, the disjunctive between section 7 and section 76(3)(b) still creates uncertainty as to the position of the protection of employees as stakeholders of the company. The legislature therefore overlooked to harmonise the duty to act in the best interests of the company with section 7. In conclusion, the common law concept is predicated on an antiquated principle that justified a bias towards maximising shareholder wealth at the exclusion of non-shareholder constituencies. The concept of the 'best interests of the company' should be read liberally to include employees, thus furthering the prescripts of the Bill

[98] Esser and Delport "*Protection of Stakeholders: Part 1*" at 107.
[99] Section 5 (1) of the Companies Act.
[100] Op cit note 16, at 53.

of Rights and section 7. If this is left unremedied, directors will continue to act with impunity as they will be of the view that their only concern is the company (its shareholders). In the long run, it will enable a reckless disregard for employees' interests and foster a culture of corporate sociopathy.

3.2.5 Common law concept of the 'best interests of the company' disregards employees' interests

The absence of express provisions to protect employees may be misconstrued as leeway to overlook employees' interests when managing a company. This exclusion has the potential to bring about a violation of employee rights. In summation, the common law concept embodies the Darwinian philosophy re survival of the fittest which advances that greed and competition motivate human nature. This epitomises profit-maximisation and enhances the utilisation of questionable methods in pursuit of profit maximisation, and ultimately directors enriching themselves. Once the comeuppance of malfeasance occurs, it is employees who are left worse off.

Granted at times company directors will have to secure legit commercial interests at the expense of employee rights. For example, in the Constitutional Court case of *Hoffman*[101] Mr Hoffman having gone through an arduous employment selection process that required a medical examination, tested positive for HIV and was consequently deemed not fit for the job of a cabin attendant. The decision by *SAA* to exclude Mr Hoffman infringed on his right to dignity[102] , as well as his right to not be subjected to unfair discrimination.[103] The arguments advanced by *SAA* were, *inter alia*, that Mr Hoffman's life expectancy was shortened and therefore it would not make commercial sense to invest in someone who would not be a good long-term

[101] *Hoffman v South African Airways* 2001 (1) SA 1 (CC).
[102] Section 10 of the Constitution.
[103] Section 9(3) of the Constitution.

investment to *SAA*.[104] The court had to balance the right of a potential employee with SAA's best interests. In an exemplary rebuttal, the court held that:

"*Legitimate commercial requirements are, of course, an important consideration in determining whether to employ an individual. However, we must guard against allowing stereotyping and prejudice to creep in under the guise of commercial interests. The greater interests of society require the recognition of inherent dignity of every human being and the elimination of all forms of discrimination. Our Constitution protects the weak, the marginalised, the socially outcast, and the victims of prejudice and stereotyping. It is only when these groups are protected that we can be secured that our own rights are protected*"[105]

Similarly, the Competition Tribunal of SA (Tribunal) has taken great strides in considering public interests, particularly those involving employment. In *Metropolitan Holdings*[106], the then proposed merger presented a potential net amount of 1000 job losses. The rationale for the proposed merger was, *inter alia*, to reduce costs for the merging parties.[107] The Tribunal held the following:

"*Whilst the extract quoted (board document) refers to savings on capital adequacy ratios and <u>not redundancies</u>, it is evidence of what the drivers of this transaction were; <u>persuading a shareholder constituency of an increased rate of return by savings not driven by growth</u> through more aggressive pricing in the form lower premiums to consumers…*"[108]

This resulted in the Tribunal concluding that there is no rational connection between the efficiencies claimed and the contemplated job losses.[109] Employees' wellbeing would be disregarded but for this protection by the Tribunal had it not demonstrated that private interests of shareholders could be outweighed when there is a public interest need to prevent large scale job losses. Employees' interests were protected at the expense of profit maximisation. In view of the above, it is submitted that an express protection of employees and the requisite guide on balancing interests of

[104] Supra note 95, par 7.
[105] Supra note 71, at par 24.
[106] *Metropolitan Holdings Ltd and Momentum Group Ltd* 41/LM/Jul10.
[107] Op cit note 57, at par 5.
[108] Ibid, at par 97.
[109] The merger was conditionally approved subject to a moratorium on retrenchments.

shareholders and employees is needed in order to reflect the mutual interdependence of companies and employees in SA's modern economy.

If the two judgments above are viewed within the context of directors' duties to act in the company's best interests, they unequivocally set the tone that employees' interests should outweigh shareholders' interests where there is an unwarranted disregard for employees' interests. It is therefore submitted that the concept of the 'company's best interest' must align with the abovementioned disciplines in ensuring employees' interests are not disregarded. Interpreting the 'best interests of the company' under the lens of an inclusive approach would harmonise section 76(3)(b) with section 7, and thereby ensuring employees are not disregarded in the management of companies. Section 76(3)(b) should not operate in isolation without being viewed through the lens of section 7.[110] Having established a lack of express protection of employees' interests, we now turn to the broader framework to investigate whether employees' interests find protection under the recent company law regime.

3.6 Broader framework where an inference on employee protection can be drawn

The term "interests" is broad enough to not merely cover employee rights in relation to the company, it also includes equitable considerations i.e. financial interests. Congruity with section 7 is an essential prerequisite because the purpose section lays out the foundation upon which the new Companies Act regulates corporate conduct that falls within its purview. Considering the ostensible stakeholder-inclusive nature of the new Companies Act, stakeholder-oriented provisions that align with section 7 will be considered below to determine employee protection. It is essential to note that the stakeholder-oriented provisions enumerated in the new Companies Act will not all be

[110] C Samaradiwakera-Wijesundara '*Business and Human Rights: To what extent has the Constitution Transformed the Obligations of Businesses*' at 10. Available at https://www.researchgate.net/publication/316039004_Business_and_human_rights_to_what_extent_has_the_Constitution_transformed_the_obligations_of_business accessed on 17 August 2019.

discussed. The focus will be on a select few that may be deemed to proffer some protection for employees.

3.6.1 Company law provisions in which employee protection can be inferred

Section 20(4) provides that one or more shareholders, directors or prescribed officers of a company, or a trade union representing employees of the company, may apply to the High Court for an appropriate order to restrain the company from doing anything inconsistent with this Act. This section can be read together with section 157(1)(a)-(d) which makes provision for "extended" standing to apply for remedies. Section 157(1)(a)-(d) provides that when an application can be made to or a matter be brought before a court, the Companies Tribunal, Takeover Regulation Panel or the CIPC, that right to make an application may be exercised by a person acting, *inter alia*, as a member of, or in the interest of a group or class of affected persons or acting in the public interest with leave of the court. What one would glean from section 20(4) read with section 157 is that interested stakeholders of the company have been granted a right to institute legal proceedings to restrain directors from contravening the new Companies Act. This however does not protect employees because when directors are brought to book for contravening the Act while discharging fiduciary duties, the director's conduct will be assessed against section 76(3)(b), which does not encompass the rights of employees.[111] Therefore, it is concluded that section 20(4) read with section 157(1) creates the right to institute actions when wrongful acts are committed against the company. Further, Samaradiwakera advances the idea of section 20(9) being a mechanism used to hold directors liable.[112] In summation, section 20(9) states that if on application by an interested person or in any proceedings in which a company is involved, a court finds that the incorporation of a company has

[111] L Muswaka "*A Critical Analysis of the Protection of Stakeholders' Interests under the South African Companies Act: (Part 1)*" MJSS vol 5 no: 3 (2014) at 62.
[112] Op cit 81, at 11.

resulted in an unconscionable abuse of the juristic personality, the court will disregard the fictitious veil and hold controllers of the company personally liable. This is referred to as "veil piercing" or "lifting the corporate veil".[113] She is of the view that section 20(9) should be interpreted as a mechanism designed to enable stakeholders to hold directors liable in their personal capacities for failing to observe stakeholders' interests in discharging their fiduciary duties.[114] One is compelled to disagree with this view because this mechanism is used as a last resort against conduct that defiles a company's separate personality. Disregarding the separate personality of large companies due to director misconduct will most likely not succeed. The remedy is more suitable for smaller companies where the shareholders and directors are the same people.

The new Companies Act has been implanted with the Social and Ethics Committee which is dubbed as an innovative provision in the new regime. It is argued that the introduction of the Social and Ethics Committee under section 72 epitomises managing the company for an economic and social benefit. The rationale for this mechanism is to promote Corporate Social Responsibility (CSR)[115] and to ensure that directors consider stakeholder's interests when making decisions.[116] Therefore, directors have a key role in the determination of the values and ethical position of the company.[117] The Social and Ethics Committee in the new Companies Act that serves as a platform for companies to observe human rights. Prof. Botha opines that a new concept of the "company" should be acknowledged.[118] One that is based on embracing

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[113] R C Beuthin "*Basic Company Law*" (1984), at 11-12.; Gower et al "*Principles of Modern Company Law*" 8th Ed (2008), at 200-205.
[114] Note 81, at 12.
[115] Mostly defined along the lines of "*a concept whereby companies integrate social and environment concerns in their business operations and in their interaction with their stakeholders on a voluntary basis*". See D Crowther "*A Handbook of Corporate Governance and Social Responsibility*" (2010) at page 21.
[116] Botha M.M "*Evaluating the Social and Ethics Committee: Is Labour the Missing Link?*" Part 1 (2016) 79 THRHR at 591.
[117] T Mongalo et al "*Companies and Other Business Structures in South Africa*" 2nd ed (2011) at 110
[118] Op cit note 86, at 591.

the interests of non-shareholder constituencies. In furthering this argument, he holds that the inclusion of stakeholders and the consideration of their interests are essential for achieving sustainability.[119] This stance finds endorsement in this instance, mainly because employees contribute largely to the success of the company. To supplement Botha's argument, the provisions regulating the Social and Ethics Committee places a duty on companies to promote the realisation of human rights.[120] It is therefore submitted that directors should observe employees' rights in their decision-making when managing companies.

The legislature's valiant efforts to incorporate the protection of employees' rights through the Social and Ethics Committee are however inadequate. This is because it does not make provision for employees to sit on the Social and Ethics Committee in order to have a voice on issues that affect their welfare and the society at large. Prof. Botha laments the following:

"…*the social and ethics committee could be made more effective as its functions and scope could be expanded. It appears at least on face value when the functions of the social and ethics committee are taken into account with regard to social and sustainability issues that it could have been* <u>*valuable*</u> *(own emphasis) to include employees as relevant stakeholders when these matters are addressed*"[121]

It is submitted that although employees find some form of protection of rights through the Social and Ethics Committee, that protection appears sparse because employees are not provided with an ancillary opportunity to be on the committee, thus adding value in the consideration of issues that affect them. It is submitted that it would be more beneficial to SA corporate governance, in relation to accountability, to make provision for employees to be on the Social and Ethics Committee. An importation of

[119] Ibid.
[120] Companies Regulation 43.
[121] Op cit note 86, at 584-585.

the German model in relation to the Social and Ethics Committee would be a game changer in relation to enhancing the voice of employees within the company.[122]

Many companies' prized assets are its employees, and as such companies may take measures to retain skilled employees who add substantial value to the company. This is usually done through large bonuses, high salaries, and share incentive schemes. Employee share schemes find expression in section 97 of the new Act. This is a commendable attempt by the legislature to provide for a mechanism that enhances employee participation in the company through share schemes and one that ensures that they share in the success of the company. The flaw however is that it is not mandatory for companies to provide share schemes to employees. Section 97 therefore does not protect employees' financial interests, it merely serves to advance them, subject to the company's discretion. There is nothing in the new Companies Act (nor in other corporate law provisions) that indicates that share schemes provide employees with benefits that extend beyond having an equity interest in the company, meaning employees cannot have a vote on decisions that may affect their financial welfare. Lastly, employee share schemes are risky because it denies employees diversification, and once a company fails, the value of employees' investments in the company may be extinguished.[123] This is more likely to have a serious impact on employees' welfare.

Recall that the new Companies Act makes provision for the efficient rescue of financially distressed companies in a manner that balances rights and interests of all relevant stakeholders.[124] The business rescue (BR) section make provision for the following: **(i)** that employees must be treated as post-commencement finance which means that employees ought to be paid salaries due to them before BR proceedings

[122] This is expanded upon in chapter 4.
[123] This was demonstrated in the Enron corporate failure when the share price imploded and saw the company going under.
[124] Section 7(k) of the new Companies Act.

commence, and that salaries must form part of the company's BR expenses[125]; **(ii)** makes provision for the rights of employees during BR proceedings in that they have a right to be consulted during the development of the BR plan and must be afforded time to review and make submissions on the BR plan.[126] It is clear that the BR provisions afford employees with far reaching rights as opposed to the sections that have been canvassed above. Notwithstanding the considerable benefits granted under the BR provisions, employees have no rights to vote on the BR plan, except to the extent that employees are preferred unsecured creditors in respect of unpaid salaries that were due before the BR proceedings commenced.[127] It is submitted that this is of minute significance because creditors' and shareholders' rights to vote to develop the BR plan will outweigh employees' interests by far.

BR's ultimate objective is to avoid liquidation proceedings because liquidation will inevitably result in job losses.[128] Upon successful avoidance of liquidation, the company will endure and the possible peril towards employees' welfare will have waned.[129] Although the importance of BR proceedings is acknowledged as a mechanism used to prevent job losses and protect employees' welfare, its flaw is truncating worker participation in the formulation of the BR plan. This did not go without criticism from the legal fraternity as scholars like Prof. Botha opines that it would be meaningful if the new Companies Act granted employees sufficient participation rights in relation to the approval of the BR plan.[130] Prof. Botha's intimation finds support on this aspect because the BR plan's success/failure has an impact on employees'

[125] Section 135.
[126] Section 144(3)(d)-(g).
[127] Op cit note 16 at 504.
[128] See *BP South Africa (Pty) Ltd v Intertrans Oil SA (Pty) Ltd and Others* 2017 (4) SA 592 par 77, where the court preferred business rescue over liquidation because the latter would result in job losses.
[129] In *New Holdco/Edgars Consolidated Stores Ltd LM270Mar19*, the counterfactual was that but for the merger, *Edcon* would undergo liquidation proceedings and that it would result in approximately 40000 job losses. The merger would facilitate the turnaround of the company and save jobs in the process (par 91-12).
[130] M.M Botha "*Evaluating the Social and Ethics Committee: Is Labour the Missing Link?*" THRHR (2017) Vol 80 at 584.

welfare. Considering the passing of the BR plan will have a bearing on employees, they too ought to have a right to vote on the BR plan.

The relevant stakeholder-oriented provision that will be canvassed below is section 165(2) which confers a right on certain persons, *inter alia*, trade unions (representing employees) to institute legal proceedings on behalf of the company where the company has been prejudiced by director malfeasance and where the company is unable to institute legal proceedings on its own. Recall that in previous sections of this chapter it was intimated that companies as juristic persons have rights. It is therefore logical to conclude that a company can be party to litigation proceedings when its rights are encroached (and vice versa).[131] Since directors are the "controlling mind" of the company as per section 66(1), the power to institute legal proceedings is therefore vested in the board of directors. However, where the wrongdoers are the directors who control the company, they may deter the institution of legal proceedings in order to protect themselves.[132] The derivative action remedies this potential abuse by conferring on other constituents (i.e. trade unions) a right to institute legal proceedings on behalf of the company.[133] In other words, trade unions "derive" a right to institute legal proceedings by serving a demand on the company to commence legal proceedings to protect the interests of the company. Section 165(2)(d) goes on to say that the court may grant leave to the party if the court is satisfied that it is necessary/expedient to commence proceedings to protect the legal rights of that person. The fact that employees may bring an action to hold directors into account may easily cause some to believe that this serves as a protective mechanism towards employees' rights. The derivative action should not be obfuscated for a mechanism that was promulgated to protect employees, it is meant to be an essential tool

[131] At common law this is known as the "proper plaintiff rule" which states that when a wrong is done to a company, only it can institute legal proceedings against the wrongdoers. This principle was enunciated in *Foss v Harbotle* (1843) 2 Hare 461.
[132] F Cassim "*The Statutory Derivative Action Under The Companies Act of 2008: The Role of Good Faith*" SALJ (2013) Vol 130, at 499
[133] Section 165 (2) of the Companies Act.

necessary to police directors, to ensure good governance and to ensure the company's rights are enforced when its fiduciaries fail to do so.[134] It is opined however, that through the derivative action mechanism, employees may find an indirect protection because an infringement on the company's rights may indirectly affect the employees', and as such enforcing the company's right may consequently indirectly protect employees' interests.

Lastly, section 218(2) is another statutory provision that finds relevance in the analysis of stakeholder-oriented provisions. In summation, this section states that any person who contravenes any provision of the new Companies Act will be liable to any other person for any loss or damage suffered by that person as a result of the contravention. This section creates a *sui generis* liability that avails a remedy to any person (including employees) to hold any person (directors) who causes them damage as a result of contravening the Act.[135] Although directors owe a duty to the company, this section may allow employees to sue directors. However, in *Rabinowitz*[136] it appears as though the court implied that liability in terms of this section would apply if directors are found guilty of contravening the Act. It is therefore submitted that directors may escape liability if they are found to not have breached their fiduciary duties under the business judgment rule.[137] It is further believed that proving liability would be too onerous for employees for the following reasons: **(i)** they would have to prove that but for the directors' malfeasance, they would not have suffered harm; **(ii)** and they would have to have access to internal board documents. Although section 26 affords the right to have access to information[138], it is submitted that this would not remedy information asymmetries because the documents could be easily disposed or withheld. Lastly, even if employees succeed under this section, the damage suffered by them would be

[134] Op cit note 132, at 501.
[135] *Chemfit Fine Chemicals (Pty) Ltd v Maake* (2017) JDR 1473 (LP) PAR 30.
[136] *Rabinowitz v Van Graan and Others* 2013 (5) SA 315 (GSJ) par 17.
[137] A mechanism designed to shield directors from personal liability for losses incurred by the company during the course of discharging their duties (**briefly discussed below**).
[138] Section 26 of the new Companies Act makes provision for access to company records.

irreparable. For example, in Enron employees lost millions worth of investments and pension monies. Paralleled to SA where director malfeasance may result in a similar corporate catastrophe, employees succeeding under this section would be inconsequential because directors will do not have that kind of capital outlay to pay the aggrieved employees. It would be akin to squeezing blood out of a stone, basically impossible to recoup losses suffered from director malfeasance. In conclusion, this section does not do enough to protect employees, and it being too onerous begs the question whether the juice would be worth the squeeze if employees were to sue malfeasant directors under this section. Considering the above, the answer is no.

3.6.2 King IV and the JSE Listings Requirements

Recall that SA has developed a hybrid system of corporate governance, thus not only statutes impact on the conduct of directors. There are various layers of regulatory measures in the form of "soft laws" that serve as voluntary principles and good practice codes that guide directors in exercising the requisite standard of care when discharging their duties in the management of companies. Relevant for a perfunctory discussion under this section is the King IV and the JSE Listing Requirements.

One of the foundations of the King IV, in addition to ethical leadership, is stakeholder inclusivity.[139] This makes it good practice for directors to consider the legitimate interests and expectations of stakeholders when executing their duties in the best interests of the company. It is submitted further that the King IV emphasises the need for directors to perform in the best interest of the company and to predicate corporate governance on ethical leadership with their responsibilities extending not only to shareholders, but stakeholders as well.[140] King IV also aligns with the Companies Act's objective in that it encourages directors to effect social transformation by addressing social ills such unemployment and inequality.[141] In addition to the stakeholder inclusive

[139] King IV Code, principle 5
[140] King IV Code, principle 1
[141] King IV Code, principle 3.

approach, the King IV alternatively encourages the cognisance of the six capitals model[142] to have regard to stakeholders' interests because each forms of capital encompasses one or more stakeholders with an interest in it.[143] These can be balanced to create value for the company i.e. skills development for employees may decrease the financial capital of the company, but will increase efficiency of the human capital of the company. This trade-off will benefit the company in the long-term. Lastly, probably to avoid another atrocious incident like the one that occurred in Marikana, King IV encourages companies to resolve disputes effectively and expeditiously to avoid prolonged strikes.[144]

Although not binding legislation, the legal force of the King IV should not be underestimated. This is because non-compliance may attract legal liability for directors. The submission is made following a precedent set by the court in *Stilfontein* when it judged directors' conduct against the principles of the King III and found against directors for non-compliance with the principles enclosed therein. This is evident that SA's economic and social climate has propelled courts to consider various factors in determining whether directors executed their duties with the requisite standard of care. The *Stilfontein* case serves as an indication that "soft laws" such as King IV have a significant influence on what may be considered as good practice. Once widely accepted as orthodox principles of good practice, "soft laws" such as King IV may be regarded as custom which will consequently compel courts to incorporate voluntary codes into common law jurisprudence that will utilise the King IV as a yardstick against which directors' conduct will be judged.[145] Therefore, failure by directors to comply with the King IV may see courts adopting the precedent

[142] Defined in the King IV glossary as "*Stocks of value which all organisations depend for their success as inputs to their business model, and which are increased, decreased or transformed through the organisation's business activities or outputs.*". These include financial, manufactured, intellectual, human, social and relationship, and natural capital.
[143] Ibid.
[144] King IV Code, Principle 16.
[145] King IV's Legal Status, at 35.

established in *Stilfontein*. Lastly, JSE Listing Requirements impose an obligation on listed companies to observe good practices as set out in the King IV and compels companies to apply and explain compliance with the King IV principles in their annual reports.[146] These compliance reports include information on the achievement of priority elements such as the company's Broad-Based Black Economic Empowerment (B-BBEE) status, socio-economic development and skills development.[147] Failure by a listed company to comply with the King IV principles when it is in the public interest to do so may result in the suspension of the listing of that company's securities on the JSE.[148] Considering these supposed stringent mechanisms, the question still remains, why is SA still plagued by corporate fraud?

3.7 Employee Protection Against Malfeasant Directors

The DTI, through the policy document, attempted to take the lead through policy formulation that would culminate in the adoption of a corporate governance that embodies African values of inclusivity. It is submitted that 76(3)(b) however resists the change and remains rooted in the Anglo-American regime that ultimately caters for shareholders. As assessed above, the *lacuna* in section 76(3)(b) in its quintessence, is that it does not offer protection of employees against director malfeasance. The stakeholder-oriented provisions that were subsequently assessed above offer minute or no protection against director malfeasance. Prof. Botha opines that SA's corporate governance regime no longer focuses on shareholder wealth creation.[149] He extends this by laying out the King IV's recommendation that the board of directors, in their decision-making processes should consider the interests of stakeholders

[146] JSE Listing Requirements section 3.84 dealing with corporate governance requirements for listed companies.
[147] Ibid.
[148] Listings Requirement section 1.6(b) states that "*The JSE may, subject to the suspension provisions of the FMA, and if the applicant issuer has failed to comply with the Listings Requirements and it is in the public interest to do so, suspend the listing of securities of an applicant issuer and impose such conditions as it may, in the circumstances, deem appropriate for the lifting of such suspension.*"
[149] M.M Botha "*Responsibilities of Companies Towards Employees*" PER/PELJ (2015) Vol (18)2, at 3

(employees).[150] Prof. Botha's statement is partly supported because the inclusive philosophy of corporate governance is largely found in soft laws with less legal bearing. As can be seen above, the King IV embodies recommendations of good practices, and compliance is not mandatory. The JSE Listing Requirements compels listed companies to apply and explain their compliance with the principles in their annual reports. The conundrum however is that the outcomes-based approach of the King IV offers some leeway to companies to not consider stakeholder interests, and they may explain it away by stating that different practices had to be observed in the best interests of the company. Alternatively, good practice principles re the interests of employees may be applied and explained in the reports, however, employees appear not to be intrinsically involved in the process.[151] This means that employees do not inform/they minimally inform the contents of said reports. Employees are still vulnerable because they have been neglected within company law, and are primarily forced to rely on labour laws because protection of their interests has not been sufficiently integrated into company law.[152] This protection in labour law includes, *inter alia*, the right to be consulted in relation to any impending retrenchments[153], and unfair dismissals.[154] It is submitted that the above provisions (and the Labour Relations Act 66 of 1995,in its entirety) fall short of protecting employees in instances of director malfeasance. It will be taken a step further below by laying out the type of director malfeasance labour laws does not shield employees against.

By "director malfeasance", it is meant the corporate fraud that empirical evidence has shown to result in corporate failures of companies. The "creative accounting" methods said to have been effected by executives in Enron and Steinhoff. A more plausible example is the collapse of the Maxwell Group. The Maxwell Group incurred a 4-5

[150] Ibid.
[151] D Lingenfelder *et al* "*Stakeholder inclusiveness in sustainability reporting by mining companies listed on the Johannesburg Stock Exchange*" African Journal of Business Ethics (2011) Vol 5 (1) at 1.
[152] Op cit note 149, at 54
[153] Section 189 and 189A of the Labour Relations Act.
[154] Sections 185-188 of the Labour Relations Act.

billion dollars debt due to an acquiring spree of several publications worldwide.[155] In addition to this, it was found that Robert Maxwell had looted approximately 500 million pounds from the pension funds of his group of companies as he controlled the trust company that managed these pension funds.[156] It was further found that he used these funds to acquire shares in listed companies of his group in an attempt to increase the share price because the shares of his companies were used as collateral for his debt.[157] The corollary of this corporate failure was that employees received only a portion of what their pension funds could have been but for the looting of their pension funds.[158] It is acknowledged that directors of failed companies like Enron and the Maxwell Group were not acting in the interests of shareholders when "accounting irregularities" were being effected to conceal poor performance or boost ostensible economic performance. Their conduct may easily be attributed to capitalist greed, and that they acted out of self-interest when they defied their fiduciary duties to shareholders, and consequently effecting irreversible harm to all stakeholders. However, it cannot be refuted that shareholder primacy models, which is rooted in section 76(3)(b), enables such as malfeasance due to limited oversight. Further, it cannot also be refuted that shareholders partly benefited from surging share prices as a result of "creative accounting" that boosted share prices.[159] Although both shareholders, and employees end up suffering harm, employees suffer the most harm. This is because shareholders' homes and pension funds will not be affected by the effects of a corporate failure, employees on the other hand will be affected due to lack of/or limited diversification.[160] The common denominator in the world's most prominent

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155 T Wiese "*Corporate Governance in South Africa: With International Comparisons*" 2nd ed (2016), at 4-5. See presentation of Maxwell Collapse at https://www.slideshare.net/AlimehsanDipon/maxwell-collapse.
156 Ibid.
157 Ibid.
158 Ibid.
159 J Armour et al "*After Enron: Improving Corporate Law and Modernising Securities Regulation in Europe and the US*" (2006), AT 7.
160 Gower "*Principles of Modern Company Law*" 8th ed, at 193.

corporate failures is that employees suffer the most. Labour laws therefore cannot shield employees against such malfeasance, let alone minimise the effects of such conduct on them. Corporate failures effected by malfeasance should be the catalyst for company law reform that makes provision for the protection of employees. Therefore, it is submitted that to fully align directors' duties with SA's inclusive philosophy, section 76(3)(b) must have an express inclusion mandating directors to consider employees' interests when discharging their duties in the best interests of the company.

There are opposing views against the extension of directors' duties to include employees. They may be, *inter alia*, **(i)** employees are afforded enough protection by labour laws; **(ii)** SA's corporate regime is already sufficiently permissive to allow directors a wider discretion to take into account the interests of employees;[161] and **(iii)** having an extended group of corporate constituents to be accountable to may result in the abuse of the extended discretion by directors when deciding what interests to take into account.[162] The first opposing view was refuted above when it was argued that the labour laws cannot protect employees against director malfeasance. No further argument to that effect can logically maintain that labour laws protect employees against corporate fraud.

Apparent wider discretion to consider the interests of employees

There is no recent clear case law in SA which holds that only shareholder interests are to be the primary concern of directors. Directors are able to, but not legally mandated to consider the interests of employees. This is because SA's governance regime, specifically section 7(d) of the new Companies Act, the King IV, is already sufficiently permissive to allow directors a wider discretion to consider employees' interests. However, as canvassed above, the flaw is that the maintained common law

[161] S Marshall "*Stakeholders and Directors' Duties: Laws, Theory and Evidence*" UNSW Law Journal Vol 35(1) (2012) at 292.
[162] M Roe "*The Shareholder Wealth Maximization Norm and Industrial Organization*" (2001) 149 University of Pennsylvania Law Review 2063, at 2065.

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position in section 76(3)(b) holds that such consideration should be done with a view to benefit shareholders. The shareholder-primacy is retained, and it is submitted that this pressures directors to focus on short-term profit maximisation as opposed to long-term employee value creation which strengthens corporate governance in businesses.[163] It is submitted that the new Companies Act must clearly permit directors to take into account the interests of employees. Express protection will give employees confidence that directors will consider their interests when making decisions in the best interests of the company

Abuse of extended discretion

It is logical to conclude that the extension of directors' duties towards an extended body of constituencies widens their discretion in considering what is in the best interests of the company. To that effect, directors would have to balance the interests of shareholders and employees.[164] Under this argument, it is advanced that directors could use a balancing exercise as an opportunity to advance their own self-interest at the expense of shareholders, and other company stakeholders.[165] With directors having greater discretion in deciding what interests to take into account, it may be thought that shareholders will have difficulties in monitoring the performance of directors, and that directors might resist claims of breach of duty on the basis that their actions were rooted in the consideration of the interests of employees.[166] It should be noted that the duty to act in good faith is the precursor of the duty to act in the best interests of the company.[167] To that effect, directors must act *bona fide* in what they consider is in the best interests of the company.[168] Therefore, directors have a duty

[163] Op cit note 159, at 13.
[164] In *Re Phoenix Contracts Ltd* (2010) EWHC 2375 (Ch) at 103, while the court did not take a stance on the balancing of interests by the director, it did not critique the director for balancing the interests of shareholders and employees.
[165] Op cit note 167.
[166] Ibid.
[167] Section 76(3)(a) of the Companies Act.
[168] *Re Smith & Fawcett Ltd* (1943) Ch 304, at 306.

act in what he/she honestly, and in good faith, believes is in the best interests of the company. Granted the conundrum of abusing a wide discretion may be a possibility considering that "honesty" is a subjective element and courts are reluctant to scrutinise directors' decisions that directors allege they arrived at honestly.[169] This view was also expressed in *Hogg*[170] where it was stated that courts should not overstep by overly reviewing decisions of directors they honestly arrived at. In light of this, directors may abuse the wide discretion by relying on the difficulty of determining directors' state of mind. However, the subjective element is not unencumbered.

The directors' decisions on balancing interests should be guided by the objective of furthering the best interests of the company. This requires a reasonableness metric which is objective. Therefore, the absence of a reasonable ground to indicate that directors acted in the best interests of the company may be a basis for finding lack of good faith by a director.[171] In summation, the best interests of the company are not assessed by courts, however, the yardstick used is whether a reasonable person would regard the decisions of directors to be in the best interests of the company.[172] The objective metric therefore, alleviates the scope of abuse of a wider discretion. For example, in *Neptune*[173] the court found that it was not reasonable and not in the company's best interests for a sole director to arrange that the company make gratuitous payments to himself on the termination of his contract with the company. It was held that the director acted out of his own self-interests. Lastly, an express inclusion of a provision that will make directors also accountable to employees will increase the checks and balance of directors' conduct, and thus further alleviate abuse of director discretion. Granted directors may have difficulties balancing the interests. Specifically, the issue could be what weight should they attach to the interests of employees as opposed to those of the shareholders. This may also make directors

[169] *Da Silva v CH Chemicals (Pty) Ltd* 2008 (6) SCA par, 627B.
[170] Hogg v Cramphom Ltd (1967) Ch 254 at 268.
[171] *Gelhing v Klner* (1972) 1 WLR 337, at 342.
[172] *Teck Corp Ltd v Miller* (1972) 33 DLR (3d) 288 (BCSC).
[173] *Neptune (Vehicle Washing Equipment) Ltd v Fitzgerald (No.2)* (1995) 1 BCLC 352.

more risk averse.[174] As expressed above, the board's decision on how to balance the interests of the company's constituencies should be predicated on advancing the best interests of the company. To that effect, it is submitted that an additional explicit requirement to consider employees' interests is unlikely to result in directors being more risk averse. This is because directors, under the business judgment rule enshrined in section 76(4), are protected from personal liability for losses incurred by the company due to exercising their judgment as to the best decision that they deem is in the best interests of the company.[175] The decision largely has to be predicated on rationality.[176] Lastly, considering that employees are stakeholders of the company, it should be noted that stakeholder movements were initiated in the early 1980s when corporate directors sought legislative protection for considering the interests of employees other than those of shareholders when deciding on a response to takeover offers.[177] In view of SA's economic and social climate, it is submitted that directors will be pressured by civil rights movements and unions, among others, to consider the interests of employees. The economic and social climate may be used as legitimate factors for rationality in relation to shielding directors, in relation to the business judgment rule, from considering the interests of employees. In addition to this, a further

[174] Chaver & Fried "*Manager's Fiduciary Duty Upon the Firm's Insolvency: Accounting for Performance Creditors*" (2002) 55 *Vanderbilt Law Review* 1813 1823.

[175] Section 76(4) of the Companies Act, 2008 states that a director would be considered to have acted or performed his/her powers and functions in the best of the interests, and have complied with section 76(3) if: (i) the director has taken reasonably diligent steps to become informed about the matter; (ii) either— the director had no material personal financial interest in the subject matter of the decision, and had no reasonable basis to know that any related person had a personal financial interest in the matter; or the director complied with the requirements of section 75 with respect to any interest contemplated in subparagraph (aa); and (iii) the director made a decision, or supported the decision of a committee or the board, with regard to that matter, and the director had a rational basis for believing, and did believe, that the decision was in the best interests of the company.

[176] Section 76(4)(iii).

[177] M. J Loewenstein "*Stakeholder Protection in Germany and Japan*" Tulane Law Review Vol 76, at 1673.

protection would be legislatively empowering directors to consider the interests of employees when effecting their decision-making authority.

3.8 Concluding remarks

As can be seen from the above, shareholder primacy is retained in the new company law regime and stakeholder protection does not find legal expression. It is submitted that this will hamper the company's sustainability and jeapardise employee welfare. A species that is not sustainable goes extinct eventually. Maintaining that company directors should maximise profits regardless of the social impact of the company's activities on public interests fosters a culture of corporate sociopathy, predatory capitalism[178] in its essence. The corollary of this form of capitalism is, *inter alia*, increased corporate failures arising from greed, high wealth inequality, high unemployment, increased poverty rates and decreasing social provisions.[179]

It is a serious company law oddity, in a post-apartheid dispensation, to hold the position that employee interests do not form part of the interests of the company. SA's constitutional era has made it difficult for company directors to ignore public interest issues, as can be seen from the *Stilfontein* case and some competition law matters. The repercussions of neglecting these do not come without consequences. It should be a growing trend that directors should be cognisant of the fact that companies' continued success also relies on the company's ability to address interests of its key stakeholders such as employees. Although companies' objective is to maximise profit and wealth for shareholders, they are also economic agents that have a far-reaching

[178] C J Polychroniou describes it as "Contemporary capitalism is characterized by a political economy which revolves around finance capital, is based on a savage form of free market fundamentalism, and thrives on a wave of globalizing processes and global financial networks that have produced global economic oligarchies with the capacity to influence the shaping of policymaking across nations".
[179] C.J Polychroniou "*Predatory Capitalism and the System's Denial in the Face of Truth*", accessed at https://thruthout.org/articles/predatory-capitalism-and-the-systems-denial-in-the-face-of-truth/ on 6 September 2019.

impact on a broad range of stakeholders and should therefore also consider employees' interests.

Whatever the theoretical genesis of the common law approach of what a "company" entails, SA company law needs to align with SA's unique social, political and economic context. It is submitted that this includes observing the best interests of SA's citizens and prescripts of the Constitution. It is therefore further submitted that SA company law should mandate company directors to observe the impact of their conduct and decisions on employees. This approach was echoed in the Policy Document where it was proposed that "*a company should have as its objective the conduct of business activities with a view to enhancing the economic success of the corporation, taking into account, as appropriate, the legitimate interests of other stakeholder constituencies.*"[180] The DTI was of the view that stakeholder interests should be observed as well. However, this approach was never entrenched in section 76(3)(b) of the new Companies Act. A further proposition in the Policy Document was that the new company law regime should not only be consistent with principles of equity and fairness, but also with other laws such as the Competition Act, 89 of 1998 as Amended.[181] It is submitted that this also includes foreign law that may be relevant for SA's economic and social context. In the subsequent chapter an assessment of whether foreign law can be imported into SA will be conducted.

On the other hand, competition authorities have made great strides in observing principles of equity and fairness. This should be considered for future corporate law reform.

In conclusion, it is submitted that the question of what entails the "best interests of the company" should be assessed within SA's prevailing social and economic context. This would encompass the change required for company directors to consider the

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[180] Policy Document at page 25.
[181] Ibid at 14.

impact of their decisions on a broader scope beyond profit maximisation. More specifically, the long-term effects of their decisions on the well-being of employees.

Chapter 4

UK's Position in Considering Employees' Interests and German Codetermination Model in Affording Employees a Voice in the Company

4. Introduction

The inquiry in this chapter is concerned with the extent to which SA and UK's current corporate governance frameworks, in relation to directors' duties, allows for the consideration of the interests of employees. Recall that at common law, both in SA and the UK directors were obligated to act in the best interests of the company, which meant the collective shareholders.[182] Both countries have taken strides to shift from a shareholder-centric approach of governance to one that recognises companies as vehicles that ought to benefit stakeholders as well. The approaches from the respective jurisdictions will be contrasted in order to indicate which best protects employees. Lastly, the contrasting will also serve as an assessment that will assist in filtering parts of the UK law that will not serve SA.

The second part of this chapter will briefly canvass how the German model of corporate governance can be imported into SA law in order to give employees a voice in the company, specifically with regards to the Social and Ethics Committee.

4.1 Brief recap on SA's position

Section 76(3)(b) requires directors to act in the best interest of the company when managing the affairs of the company. The "best interest of the company" are equated with the interests of the collective shareholders. Owing to SA's hybrid system including, *inter alia*, King Codes that are centred on stakeholder-inclusivity, and the objectives of the new Companies Act, the philosophy of SA's corporate law regime is stakeholder inclusive in nature. The disconnect however, between this philosophy and

[182] *Hutton v West Cork Railway Company* (1883) LR 23 ChD 654, 637.

section 76(3)(b) and other shareholder-centric provisions raise some uncertainty regarding the protection of employees' interests, especially against director malfeasance. The inconsistencies point towards the retainment of the traditional approach of corporate governance centred on the regulating directors' duties for the ultimate benefit of shareholder. Therefore, the shareholder-centric model is maintained in SA despite the new Companies Act's stakeholder-inclusive philosophy.

4.2 UK position

On the other end of the spectrum, the UK Companies Act, through section 172, fosters a change in the way companies operate. This submission is based on the fact that when one reads section 172 one logically deduces that there appears to be a compromise between the shareholder-primacy approach and the stakeholder approach. Section 172 states that:

"172 ***Duty to promote the success of the company***

(1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to—

(a) the likely consequences of any decision in the long term,

(b) the interests of the company's employees,

(c) the need to foster the company's business relationships with suppliers, customers and others,

(d) the impact of the company's operations on the community and the environment,

(e) the desirability of the company maintaining a reputation for high standards of business conduct, and

(f) the need to act fairly as between members of the company."

This section embodies the concept of the ESV.[183] Section 172 is a consequence of Tony Blair's vision of enhancing stakeholder protection. Blair's government was of the

[183] P M Vasudev et al "*Corporate Governance after The Financial Crisis*" (2012), at page 69.

view that the shareholders would benefit greatly if stakeholders' interests were considered during the management of companies.[184]

In summation, section 172 requires directors to discharge their duties in what they consider would promote the success of the company for the benefit of its shareholders as a whole. In doing so, directors must have regard to the long-term consequences of their decisions on employees' interests, among other factors from the list encompassed in sub-sections (a)-(f). The phrase "among other matters" in sub-section (1) indicates that the directors are not confined to observing only those factors listed in sub-sections (a)-(f). In other words, directors are required to regard the interests of stakeholders merely when it is in the interests of shareholders. At face value, the formulation adopted in section 172 creates the impression that the UK moved from its common law position to embracing a new stakeholder-inclusive approach. One feels compelled to partly agree with Prof. Delport's assertion that section 172 is probably, in modern company law, the clearest recognition of the importance of interests of stakeholders such as employees.[185] The assertion does not find full support because there are jurisdictions like Singapore that make express provision for the consideration of employees' interests in relation to directors' duties.[186] During the UK's company law reform, Blair's government considered the interests of *inter alia*, employees, customers and suppliers when contemplating what was in the <u>best interests of the shareholders</u> (own emphasis).[187] The formulation of section 172 reaffirms the traditional position of regulating directors' duties for the benefit of shareholders. The

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184 O M Mudawi "*Does the Concept of Enlightened Shareholder Value Succeed in Bridging the Gap between the Shareholders and Stakeholders Value Theories*" Business and Economics Research (2018) Vol 8 No. 2 at 57.

185 P Delport et al "The protection of stakeholders: the South African social and ethics committee and the United Kingdom's enlightened shareholder value approach: Part 2" De Jure (2017), at 237.

186 Section 159(a) of the Singapore Companies Act (Cap 50, 2006 Rev Ed) expressly states that directors of a company, in exercising their powers, are entitled to have regard to the interests of the company's employees generally, as well as the interests of its members. Employees however lack the corresponding remedy which would enable them to bring an action against errant directors who failed to regard their interests.

187 Department of Trade and Industry '*Modernising Company Law'*, 2002 CM5553-I (White Paper).

wording clearly indicates that shareholders' interests take primacy, and it leaves no room for a different interpretation other than the fact that the common law is merely being restated with the inclusion of stakeholder considerations that have no, if not minute effect in diluting shareholder primacy.[188] It can also be argued that section 172 essentially weakens employees' interests given that directors were previously expressly required to have regard to the interests of employees when discharging their duties.[189]

Looking at the above, one feels compelled to agree with Tate's view regarding the apparent paradox resulting from section 172, being the advocacy and promulgation of a stakeholder-inclusive concept which ultimately elevated shareholders' interests above those of stakeholders.[190] In addition, cases that have dealt with section 172 concluded that the section merely codifies existing law.[191] It is therefore submitted that the ostensible endorsement of the traditional shareholder-primacy model hampers the fortification of stakeholders' interests in the UK. In conclusion, section 172 creates a corporate ecosystem utopia seeped in the illusion of stakeholder protection. On the contrary, stakeholder protection ought to be regarded as means that promote the

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188 This view is in line with the views of various legal commentators: See Gower "*Principles of Modern Company Law*" 8th Ed, at 508 where it is opined that the statutory formulation of section 172 was somewhat of a "*modernised version of shareholder primacy*"; A Keay " *Tackling the Issue of the Corporate of the Corporate Objective: An Analysis of the United Kingdom's Enlightened Shareholder Value Approach*" (2007) Sydney Law Review 577, at 579 where he holds that the ESV bears a slight distinction from the shareholder value approach.

189 Section 309 of the United Kingdom Companies Act 1985 which stated that the interests of the company's employees were among matters that had to be regarded by directors in the performance of their functions. Gower *op cit* note 167 at 603 opines that the implications of section 309 was to dilute directors' accountability to shareholders instead of extending their accountability to employees. This assertion does not find support because the employees' interests were relevant in so far as they coincided with the company's, for the benefit of its shareholders. This was enunciated in *Hall Parke v Daily News*.

190 R Tate "*Section 172 CA 2006: the ticket to stakeholder value or simply tokenism?*" at 3 available at https://www.abdn.ac.uk/law/documents/Section172CA2006-thetickettostakeholdervalueorsimplytokenism.pdf .

191 *Re Southern Fresh Food Ltd* [2008] EWHC 2810; *Re West Coast Capital (LIOS) Ltd* [2008] (SOH 72).

success of the company for the shareholders' benefits. In view of the above, the directors' duty engraved in section 172 retains the shareholder primacy model, although it obliges directors to consider the long-term effects of their decisions on employees, among other stakeholder-oriented factors.

4.3 Comparison[192]

Comparison elements	**SA**	**UK**
1. Model	➢ It is not clear which model SA follows, but philosophy of the new Act (incl. corporate governance principles) is stakeholder inclusive. Section 76(3)(b) retains shareholder value approach. It is therefore uncertain. ➢ Mongalo however, opines that upon close examination of the new Act's provisions, it reveals that SA has adopted an Actionable Enlightened Shareholder Value approach (AESV).[193] This is because there is a framework for the empowerment of stakeholders which includes the commensurate remedies available to stakeholders.	➢ Section 172 codified the ESV approach.

[192] Comparison points are partly based on Delport & Esser's comparative analysis.
[193] T H Mongalo "*Corporate Actions and the Empowerment of Non-Shareholder Constituencies*" LLD Thesis at 63-64.

2.	Consideration of stakeholder interests & balancing shareholder interests to stakeholders’	➢ Section 76(3)(b) does not encompass a consideration of stakeholders’ interests. However, objectives of the new Act indicate a stakeholder inclusive philosophy and therefore directors have a discretion to consider stakeholders’ interests provided the consideration is in the best interests of the company. ➢ Stakeholder interests may be considered. However, shareholder primacy takes preference.	➢ Directors may regard stakeholders’ interests (at directors’ discretion). ➢ Section 172 does not provide guidance on how to reconcile stakeholder and shareholders’ interests if they conflict. Shareholder primacy however takes preference.
3.	Mechanisms available to stakeholders to hold directors into account for harm suffered due to breach of fiduciary duties	➢ Stakeholders do not have direct rights to enforce directors’ duties. However, stakeholders (i.e. trade unions representing employees) may bring a derivative action on behalf of the company in terms of s165 if company directors’ conduct harm the company (subject to court’s discretion). ➢ Stakeholders may sue errant directors if breach of fiduciary duties/contravention of the new Act by directors caused them to suffer damage.	➢ Stakeholders have a right in terms of section 172, but no commensurate remedy to enforce that right. Only shareholders can bring a derivative action claim.

In light of the above, employees as stakeholders have received legislative attention from the UK in an attempt to bridge the gap between profit maximisation for shareholders and the recognition of stakeholders’ interests. SA has also attempted to bridge that gap, although with a distinct *modus operandi*, through its DTI policy that intended to create a regulatory framework that promotes economic and social interests. The culmination of the policy was the new Companies Act’s objective, especially section 7(d) that states that companies must be managed for an economic and social benefit. Although distinct attempts have been made by both jurisdictions, both have yielded the same lack of success in fortifying employee protection within their respective corporate governance frameworks.

4.4 Comparative Analysis and Recommendation

It has been established that section 172 and section 76|(3)(b) are not without fault. Although both have had lack of success in the protection of employees, it is submitted that the UK approach is the better model of the two. This is because it seems to have taken better strides than SA's approach to filling, to some extent, the gaps between the shareholders and stakeholders value theories. In the UK, a director may be more inclined to consider the effects of a decision on employees than a director in SA. It is therefore a better option to adopt in SA because it provides an expanded framework that considers employees' interests as a means to promote the success of the company.[194] Further, section 76(3)(b) is too rigid in its application and limits accountability to shareholders, and thus leaves employees at the mercy of directors with no direct rights to enforce against them. It is submitted that this enhances the kind of directorial malfeasance that led to corporate scandals such as Steinhoff. An express inclusion of employees' interests in section 172 may pressure directors to consider their interests in a more conspicuous manner.[195] It is submitted that SA is in need of such a provision, albeit one that applies to SA's social and economic context.

The importation of such an approach in SA would be a game changer because not only will it align with the inclusive approach of the new Companies Act, it will ensure normative measures which will encourage inclusive decision-making which will deter malfeasance.

194 S Kiarie "*At crossroads: Shareholder Value, Stakeholder Value and Enlightened Shareholder Value: which road should the United Kingdom take?*" International Company and Commercial Law Review, 17 (11), 329-343.

195 A Keay "*Moving Towards Stakeholderism? Constituency Statutes, Enlightened Shareholder Value and more: Much Ado About Little?*" 22 EBLR 11, at 40.

4.4 German Codetermination Model

From a SA perspective, the German model is distinct in that it, *inter alia*, provides extensive protection for the employees of the company by giving them a stronger voice within the company through a role in the company's corporate governance.[196] SA is inverse.

This German system traces back to the late 1800s when the government had oversight of German companies while management took care of the daily running of the companies.[197] This system of codetermination culminated in the destruction of individual entrepreneurialism, and consequently, the Codetermination Act of 1976 which makes it an obligation to have employee representation on the supervisory *Aufsichtstrat* board.[198] Despite minor reform of the German corporate governance system over the years, the constant has always been its maintenance of the two-tiered board system, consisting of the management board and supervisory board.[199] Two-tiered board systems consist of a management board that oversees the company and provides general direction of the company, while a supervisory board must, *inter alia*, approve of major business decisions. The German Codetermination Act of 1976, with its subsequent reforms, require all listed companies, and all other businesses employing over a certain number of employees, to have a two-tier board that includes employee representatives on the supervisory board.[200] The supervisory board convenes intermittently to, inter alia, evaluate the performance of, hire and fire directors.[201] The Law for the Strengthening of Control and Transparency (KonTrag) of 1998 shifted power to the supervisory board which limited the powers of the

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[196] Op Cit note 182, at 1675.
[197] Ibid.
[198] Ibid. Also see K J Hopt et al "*Corporate Governance in Context: Corporations, States, and Markets in Europe, Japan and the US*" (2005); T Hadden "*Company Law and Capitalism*" at447.
[199] Financial Dictionary https://financial-dictionary.thefreedictionary.com/two-tier+board, accessed on 28 November 2019.
[200] German Corporate Governance Code s 90.
[201] Op cit note 182, at 1677.

management board, and ultimately, the management augmented the cooperation of the two boards to closely coordinate to the benefit of the company.[202] As a result, employee representation on the supervisory board provide a counterbalance to the directors' decisions and shareholders in the appointment of said directors. This also enables the monitoring of the strategic business decisions by management.[203] The German has taken great strides legislatively to protect and consider the interests of employees. The Codetermination-model however, may be seen to be flawed due to the difficulty it presents in distinguishing between the functions of the managerial and supervisory board.[204] Considering SA's ubiquitous politicising of unions, a two-tiered system would not be ideal. This is why it is submitted that the German Codetermination model should be imported into SA insofar as the Social and Ethics Committee is concerned. Putting employees on the Social and Ethics Committee will not only give employees a voice in the governance stratospheres of the company, but will also ensure that employees serve as a proxy for the protection of the interests of their societies at large.

4.5 Concluding Remarks

SA should not follow section 172 to the letter because the wording of section 172 is vague[205] and the consequence of its formulation is that the protection afforded to employees is unclear.[206] Lastly, because SA's formulation should be congruent with SA's social and economic context. This will be canvassed in the recommendations chapter below.

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[202] The Law for the Strengthening of Control and Transparency (KonTrag) of 1998.

[203] G Jackson *et al* "*Corporate Governance and Employees in Germany: Changing Linkages, Complementaries, and Tensions*" at 8

[204] J J Du Plessis "*The German Two-Tier Board and the German Corporate Governance Code*" , at 1139 found at https://www.researchgate.net/publication/284058831_The_German_two-tier_board_and_the_German_corporate_governance_code accessed on 3 December 2019.

[205] A Keay "*Section 172(1) of the Companies Act 2006: An interpretation and assessment*" 2007 The Company Lawyer 106, at 109.

[206] Op cit note at 237.

SA should also make provision for employee representation on the Social and Ethics Committee which it is submitted will better enable directors to observe and respond to the concerns of employees. Also, this will value add in the preparation of the company's annual reports because they will also be informed by employees, who can also serve as a proxy for other company stakeholders at large.

Chapter 5

Conclusion and Recommendations

Traditionally, corporate governance was predicated on maximising wealth for shareholders. Shareholders intended to invest a "dollar" in companies and receive two in return. To protect that investment, directors were obligated to manage companies for the benefit of shareholders. But how much does a dollar really cost? The model has continuously proven that it comes at the expense of employees who are left worse off once companies collapse from failed governance resulting from director malfeasance. The role of a company as a corporate citizen must be afforded the requisite framework to enable it to be socially responsible. Companies as causes of most social ills, are also solutions to those social ills. The 'best interests of the company' maintains an antiquated system that has proven to exclude employees. Some call it a working system. It is submitted that the shareholder-primacy model rooted in section 76(3)(b) is like a car. Of course it has wonderful features like moving investors from deficits to liquidities, but it can potentially be lethal, especially to employees. One decision that may result in corporate failure can paralyse employees. Additional safety measures to the system to alleviate risks of corporate failure accidents will have an inconsequential effect on the system, in fact it will better accountability checks and balances. Germany is proof that it is possible. Of course SA ought to adopt a system best suited for its business environment.

Therefore, SA's economic and social context should inform the corporate law reform that will usher SA's deviation from the antiquated shareholder primacy model which must yield to the context of modern life.[207] Although the new Companies Act grants employees' rights to some extent, these are not enough to protect employees from director malfeasance. The recent Steinhoff corporate failure among other recent failures is testament to this. It is submitted that an express inclusion of the

[207] *Teck Corp Ltd v Millar* (1972) 33 DLR (3d) 288 (BCSC) 313-14.

consideration of employees' interests will be sufficient to alleviate malfeasance at board level as this will dissuade directors to manage companies arbitrarily. This will require an amendment of section 76(3)(b) in order to align it with the objectives of the new Companies, thus embedding African values that bring it in line with the prescripts of the Bill of Rights. It is therefore recommended that section 76(3)(b) would be meaningful if it read along the lines of:

A director of a company must –

(3) Subject to subsections (4) and (5), a director of a company when acting in that capacity, must exercise the powers and perform the functions of a director –

(a) in good faith…

(b) in the best interest of the company as a separate entity, for the benefit of its shareholders, <u>employees</u> and other stakeholders who are affected by the company's activities.

In effecting these changes, the legislature must also provide a guide on how these interests will be reconciled. As things stand, directors would have to balance these interests in what would be in the best interests of the company. Decisions made in good faith may allow directors to escape liability in terms of the business judgment rule when they are being held liable for overlooking one group's interests over the other's. In order to determine what is in the best interests of the company, courts will have to adopt a merit-based approach.

Further, amending section 76(3)(b) would require an alteration of the definition of a "profit company" in section 1 to the following:

"*Profit company means a company incorporated for the purposes of financial gain for its shareholders and enhancing economic and social welfare for its employees*".

Granted some may opine that shareholders deserve primacy because they are a vulnerable group as opposed to employees who are protected by labour laws and employment contracts. It is submitted that this argument does not appreciate the inadequacy of these measures in protecting employees against conduct that saw big companies fail. How would the Labour Relations Act protect employees from market to market accounting that is alleged to be the cause of Steinhoff's demise?

The same way shareholders have invested in companies, so did employees in terms of human capital. The fact that employees contribute to the profitability of companies warrants an express protection in relation to directors' duties. With regards to affording employees with a voice in the management of companies, it is submitted that the legislature can follow the German model that grants employees a say at board level.[208] However, in SA it would serve their interests better if they were to have a seat on the Social and Ethics committee. Further, the Social Ethics committee needs to be revisited because its functions is not to protect stakeholders, but to highlight stakeholder interests to the board. Having employees sit on the Social and Ethics committee, in addition to finding legal recognition in terms of section 76(3)(b) will enhance employee protection and alleviate director misconduct.

The part importation of the UK's section 172 into SA, and the German model of employee participation would be a giant leap towards engraving provisions that align with section 7 and constitutional prescripts, and ultimately doing away with the current section 76(3)(b) that entrenches shareholder primacy. This will be good for companies from a sustainability point of view. The best way to maximise shareholder value, ironically, is not to solely prioritise shareholder interests. Usually, customs and systems recreate themselves to fit the status quo. However, employees cannot solely rely on the changed perceptions re the consideration of their interests in the running of companies, this has to be supplemented by an express inclusion in section 76(3)(b) which will consequently be in line with the Constitution and the ubiquitous egalitarian values rooted in our Africanism.

[208] G Wirth et al "*Corporate Law in Germany*" 2nd Ed (2010), at 27.

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