

Legal Perspective on an Annual Board

"Statement of Significant Audiences and Materiality" - South African Perspective

This note was prepared in response to a request of Professor Robert Eccles, Professor of Management Practices at the Harvard Business School, to assist Professor Eccles in his "Statement Campaign".

This note reflects the law and any proposals for new legislation or policy as at 2 December 2015.

Setting the legal landscape

1. Briefly explain the broader legal landscape regarding the obligations that a company has to its stakeholders or with regard to its impact on stakeholders, and in particular whether its primary duty is or is not to shareholders over all other stakeholders.

1.1 The governance framework of South African companies is set by the common law, the Companies Act 71 of 2008 (Companies Act), the King Code on Corporate Governance, the Johannesburg Stock Exchange's Listings Requirements (Listings Requirements) and other applicable laws and regulations.

1.2 Most companies in South Africa are constituted as profit companies which are defined in the Companies Act as companies incorporated for the purpose of financial gain for its shareholders. The primary consideration of directors is to act in the best interest of the shareholders as a group.

1.3 However, the Companies Act introduced provisions which require companies to consider the interests of other stakeholders. In particular, the Companies Act provides that it must be interpreted and applied in a manner that give effect to its stated purpose, which includes:

1.3.1 to promote compliance with the Bill of Rights as set out in the Constitution;

1.3.2 to promote the development of the South African economy;

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- 1.3.3 to promote innovation and investment in South African markets;
- 1.3.4 to reaffirm the concepts of the company as a means to achieving economic and social benefits; and
- 1.3.5 to encourage the efficient and responsible management of companies.
- 1.4 Other provisions of the Companies Act in relation to the appointment of a social and ethics committee will be considered in question 7.
- 1.5 In addition, the King Report on Corporate Governance for South Africa and the King Code on Corporate Governance (together, King III) emphasise the stakeholder-inclusive approach of corporate governance, implying that boards of companies should consider the interests of all stakeholders and not just those of the shareholders when deciding on the best interests of the company. King III sets out a number of corporate governance principles and best practice recommendations. King III applies to all South African companies. However, compliance with King III is voluntary on an "apply or explain" basis. This means that companies are required to consider the recommended principles and practices of King III and explain in their annual reports how the principles and recommendations were applied, or if not applied, the reasons.

Regulatory Framework

2. To what legal tradition does the jurisdiction belong, i.e. civil/common law, mixed?

The South African legal system is a mixed system, based on the principles of Roman-Dutch civil law, English common law and indigenous law.

3. Are corporate/securities laws regulated federally/nationally, provincially or both?

South African corporate and securities laws are regulated nationally through legislation enacted by the national legislature.

4. Who are the government corporate/securities regulators and what are their respective powers (in summary only)?

The main government corporate/securities regulators are:

- 4.1 The Companies and Intellectual Property Commission (**CIPC**) is responsible for registering corporate entities, maintaining information on juristic persons, ensuring compliance with and enforcing the Companies Act and raising public awareness of company laws.
- 4.2 The Companies Tribunal serves as a forum for voluntary alternative dispute resolution in relation to matters arising under the Companies Act and carries out reviews of certain administrative decisions made by CIPC.
- 4.3 The Takeover Regulations Panel (**TRP**) is responsible for regulating transactions that constitute affected transactions and offers (takeovers) and providing an orderly framework within which these transactions must be conducted.
- 4.4 The Johannesburg Stock Exchange (**JSE**) acts as a frontline regulator and self-regulatory authority, setting listings requirements and enforcing trading rules.
- 4.5 The Financial Services Board (**FSB**) is an independent umbrella body established to oversee the South African non-banking financial services industry and administer and enforce financial services legislation.
- 4.6 The Banking Supervision Department of the South African Reserve Bank (**SARB**) is responsible for banking supervision and regulations.
- 4.7 The South African Revenue Service (**SARS**) is responsible for administering the South African tax system and customs service.
- 4.8 The Financial Reporting Standard Council (**FRSC**) is responsible for considering relevant information relating to the reliability of and compliance with financial reporting standards and adapting international reporting standards for distinctive local circumstances.
- 4.9 The Financial Intelligence Centre (**FIC**) regulates money laundering and other unlawful activities and facilitates the administration and enforcement of anti-money laundering laws.

5. **Does the jurisdiction have a stock exchange?**

Yes, the JSE.

Incorporation and listing**6. Do the concepts of "limited liability" and "separate legal personality" exist?**

6.1 The concepts of separate legal personality and limited liability are key legal concepts in South African law. Each company is a legal entity with separate legal personality and rights, privileges, duties and liabilities distinct from those of other companies in the same group and its directors and shareholders.

6.2 In exceptional circumstances, the courts will "pierce" the corporate veil and attribute liability to directors or shareholders who misuse or abuse the principle of separate legal personality.

7. Did incorporation or listing historically, or does it today, require any recognition by the company or its directors of a duty to society, an obligation to take account of the company's social or environmental impacts, or to respect its stakeholders?

7.1 Under South African law, there is no legal requirement on incorporation for companies or directors to recognise a duty to society, or an obligation to take account of the company's social or environmental impacts, or to respect its stakeholders.

7.2 However, companies listed on the JSE and state-owned companies are required by the regulations to the Companies Act (the Regulations) to establish a social and ethics committee. Any other type of company whose "public interest score" is above that prescribed by the Regulations must also appoint a social and ethics committee. The "public interest score" of a company must be calculated at the end of each financial year. It takes into consideration a company's annual turnover, workforce size and the nature and extent of the activities of the company. If a company scores more than 500 points in two of the last years, it must establish a social and ethics committee. Companies can apply for an exemption to appoint a committee if (i) it is not reasonably necessary in the public interest to require the company to have a social and ethics committee, having regard to the nature and extent of the activities of the company; or (ii) the company is required in terms of other legislation to have, and does have, some form of formal mechanism within its structure that

substantially performs the functions that would otherwise be performed by the social and ethics committee.

- 7.3 The social and ethics committee's function is to monitor the company's activities with regard to (among others) matters relating to (i) social and economic development, (ii) good corporate citizenship, and (iii) the environment, health and public safety.
- 7.4 With regard to matters relating to social and economic development, the social and ethics committee must have regard to applicable legislation and prevailing codes of good practice, including the company's standing in respect of goals and purposes of the ten principles set out in the United Nations Global Compact Principles, the OECD Guidelines, the South African Employment Equity Act and the South African Broad-based Black Economic Empowerment Act.
- 7.5 The Regulations provide that good corporate citizenship includes matters such as (i) the company's promotion of equality, prevention of unfair discrimination, and reduction of corruption; (ii) the company's contribution to development of the communities in which its activities are predominantly conducted or within which its products or services are predominantly marketed; and (iii) the company's record of sponsorship, donations and charitable giving.
- 7.6 The committee must also consider the company's impact on the environment, health and public safety, including the impact of the company's products and services. Finally the committee must consider the company's standing in terms of the International Labour Organisation's protocol on decent work and working conditions, the company's employment relationships and the company's contributions towards the development of its employees.
- 7.7 The matters mentioned in the Regulations are not exhaustive and the company's board may add any other matter to the committee's mandate that it feels should be considered.
- 7.8 The social and ethics committee is required to draw matters within its mandate to the attention of the board and to report to shareholders at the annual general meeting.

- 7.9 In addition, applicants to listing on the JSE must include in their pre-listing statement (i) a narrative statement of how it has applied the principles set out in King III and (ii) a statement addressing the extent of the company's application of the principles of the King Code and the reasons for each and every instance of non-application. It is a principle of King III that the board should provide effective leadership based on an ethical foundation. King III recommends that ethical leaders should (i) direct the strategy and operations to build a sustainable business; (ii) consider the short and long-term impacts of the strategy on the economy, society and the environment; (iii) do business ethically; (iv) not compromise the natural environment; and (v) take account of the company's impact on internal and external stakeholders.
- 7.10 Practically, in certain instances such as mining, a broad societal or environmental duty may be inferred as a result of the legislative framework adopted in respect of the industry in question. In mining, for example, companies are required to make financial provision for rehabilitation on the cessation of mining activities.
8. **Do any stock exchanges have a responsible investment index and is participation voluntary? (See eg FTSE4Good, Dow Jones Sustainability Index, the Johannesburg Stock Exchange's Socially Responsible Investment Index).**

In October, the JSE launched the FTSE/JSE Responsible Investment Index Series, in collaboration with FTSE Russell, the global index provider. The new index series replaces the JSE's Socially Responsible Index created in 2004 to promote good corporate citizenship and sustainable development. The FTSE/JSE RI index series will be reviewed twice a year (as opposed to the annual review under the SRI index) in June and in December, using the last trading day in May and November, respectively. As was the case for the SRI index, the review process only considers publically available information. (websites, annual reports etc). Further details are available on the JSE website here: <https://www.jse.co.za/services/market-data/indices/ftse-jse-africa-index-series/responsible-investment-index>

Directors' duties**9. To whom are directors' duties generally owed?**

Directors' duties are generally owed to the company itself (ie, to the body of shareholders as a whole) and not to individual shareholders or groups of shareholders or shareholders who appointed directors or other members of the company's group, such as holding companies or subsidiaries.

10. What are the duties owed by directors - please state briefly. Please indicate if there are any express or implied duties to avoid damage to the company's reputation.

10.1 Directors' duties can be categorised as (i) fiduciary duties and (ii) a duty to act with care and skill. The Companies Act partially codifies directors' duties at common law, in that it provides in detail for standards of conduct required of directors, specifying liabilities for breach of duties. However, directors' common law duties continue to apply to the extent that they are not amended by or in conflict with the Companies Act.

10.2 Fiduciary duties include:

10.2.1 to act in good faith in the interest of the company;

10.2.2 not to exceed the director's own or the company's powers;

10.2.3 to act for a proper purpose;

10.2.4 to exercise independent and unfettered discretion;

10.2.5 to disclose any interest in company transactions;

10.2.6 to account for secret and incidental profits;

10.2.7 not to take corporate opportunities;

10.2.8 not to compete with the company; and

10.2.9 not to misuse confidential information.

- 10.3 Directors must conduct the affairs of the company with due care and skill. This depends on the nature of the business and the degree of skill that could reasonably be expected of a person performing the particular function of a specific director in the context of that director's knowledge, skill and experience.
- 10.4 In addition, the directors must not carry on the business of the company recklessly, with gross negligence, with intent to defraud any person or for any fraudulent purpose.¹
- 10.5 The rules and recommendations on corporate governance contained in King III reinforce the requirements of the Companies Act regarding directors' duties and amplify the Companies Act by giving guidance on best practice for directors and the executive management of a company.²
- 10.6 One of the principles of King III is that the board should appreciate that stakeholder perceptions affect a company's reputation. It states that the board should be the ultimate custodian of the corporate reputation and shareholder relationships and that the company's reputation and its linkage with stakeholder relationships should be a regular board agenda. The board should take account of and respond to, the legitimate interests and expectations of stakeholders in relation to its decision-making.³
- 10.7 The statutory duties relating to directors' conduct under the Companies Act, particularly the duty not to use the position of a director to knowingly cause harm to the company or a wholly-owned subsidiary of the company, also impose an implicit duty on the director to avoid damage to the company's reputation.
11. **More generally, are directors required or permitted to consider the company's impacts on non-shareholders, including impacts on the individuals and communities affected by the company's operations? Is the answer the same where the impacts occur outside the jurisdiction? Can or must directors consider such**

¹ Section 22(1) of the Companies Act.

² See Principle 2.14 and Principle 8.3 of King III.

³ See Principle 8.1 of King III.

impacts by subsidiaries, suppliers and other business partners, whether occurring inside or outside the jurisdiction?

- 11.1 As mentioned in question 7, the Companies Act requires certain companies to appoint a social and ethics committee to monitor the social activities of the company and to report to the company and its shareholders. See question 7 for further details on the functions of the committee.
- 11.2 In addition to the enhanced accountability requirements imposed by the Companies Act on certain companies, King III provides that directors should build sustainable businesses by having regard to the company's economic, social and environmental impact on the community in which it operates⁴. The directors should also consider both the short-term and long-term impact of their personal and institutional decisions on the economy, society, future generations and the environment⁵.
- 11.3 King III further states that a board should ensure that the company is and is seen to be a responsible corporate citizen⁶ and must take responsibility for building and sustaining an ethical corporate culture.⁷ The responsibilities of the board need to go beyond the interests of its shareholders and must take into account the interests of the society and affected environment.
- 11.4 In the case of group companies, directors owe their duties to the company on which they serve as directors and not to the group.
- 11.5 In addition, the African Peer Review Mechanism (the APRM⁸) is a mutually agreed instrument to which the Member States of the African Union voluntarily agree as a self-monitoring mechanism. South Africa acceded to the APRM in 2003. The mandate of the APRM is to encourage conformity in regard to political, economic and corporate governance values, codes and standards⁹. The APRM defines

⁴ King III, Principle 1.1

⁵ King III, Principle 1.1

⁶ King III, Principle 1.2

⁷ King III, Principle 1.3

⁸ The APRM was initiated in 2002 and established in 2003 by the African Union in the framework of the implementation of the New Partnership for Africa's Development (NEPAD).

⁹ <http://aprm-au.org/mission>

corporate governance as being "*concerned with the ethical principles, values and practices that facilitate holding the balance between economic and social goals and between individual and communal goals*".

- 11.6 One of the objectives of the APRM with regard to corporate governance is to ensure that corporations act as good corporate citizens with regard to human rights, social responsibility and environmental sustainability. This means that a company's purpose is not only to create benefits for its shareholders but also to create benefits for the society as a whole and that it should consider the interests of the society of which it forms part.
12. **If directors are required or permitted to consider impacts on non-shareholders to what extent do they have discretion in determining how to balance different factors including such impacts? What additional liabilities, if any, do the board or individual directors assume in exercising such discretion?**
- 12.1 The law requires that directors have a general duty to act in good faith and in the interests of the company, and directors would need to comply with this duty when considering impacts on non-shareholders.
- 12.2 It is a principle of King III that a company should strive to reach a balance between the various stakeholder interests in the company, with the primary aim of serving the best interests of the company¹⁰. Board decisions on how to balance the interests of stakeholders should be guided by the aim of ultimately advancing the best interest of the company. King III states that this does not mean that a company should and could always treat all stakeholders equally. Some may be more significant to the company than others in particular circumstances.
- 12.3 The Companies Act provides that a director in exercising his duties will have satisfied his statutory obligations vis-à-vis the company if he acted with reasonable diligence and his decision has a rational basis (business judgment rule). Therefore should a decision comply with the business judgment rule, a director is unlikely to incur liability.

¹⁰ King III, Principle 8.3

13. What are the legal consequences for failing to fulfil any of the duties described above; and who may take action to initiate them? What defences are available? Can these issues give rise to other causes of action or regulatory routes whereby a stakeholder can exert pressure on a company with regard to its actions?

- 13.1 A director is liable in accordance with the common law for any loss, damages or costs sustained by the company as a consequence of breach by the director of its fiduciary duties.
- 13.2 A director may also be held liable in accordance with the principles of common law relating to delict for any loss, damages or costs sustained by the company as a result of any breach by the director of its duty to act with care and skill.
- 13.3 In addition, in terms of section 77(3) of the Companies Act, a director is liable for any loss, damages or costs sustained by the company as a direct or indirect consequence of the director's actions listed in section 77(3). These include, among other things, having (i) acquiesced in the conduct of the company's business fraudulently or recklessly with gross negligence contrary to section 22(1); (ii) been a party to an act or omission by the company despite knowing that the act or omission was calculated to defraud a creditor, employee or shareholder of the company, or for another fraudulent purpose; and (iii) knowingly signed, consented to or authorised the publication of materially false or misleading annual financial statements or a prospectus or written statement.
- 13.4 If a director is found by the courts to have been party to fraudulent activities¹¹ or guilty of making untrue or misleading statements in financial statements and public offerings¹², such a director will be guilty of an offence and subject to a fine and/or imprisonment not exceeding 10 years¹³.
- 13.5 The general common law position that only the company (and in limited instances shareholders) could initiate and enforce actions has been altered by the Companies Act which makes it possible for shareholders, creditors and other parties to initiate

¹¹ Section 77(3)(c) read with section 214(1)(c) and 216(a) of the Companies Act.

¹² Section 77(3)(d) read with 214(1)(a), (d) and 216(a) of the Companies Act.

¹³ Sections 214(1)(c) and 216(a) of the Companies Act.

proceedings against directors in the event of a breach of their duties and against the company (and other persons) in some instances for loss and damage suffered.

13.6 In terms of the Companies Act, the following persons may take action against a director who failed to comply with his duties:

13.6.1 a shareholder has a claim for damages against any person (including the directors) who intentionally, fraudulently or due to gross negligence causes the company to do anything inconsistent with the Companies Act or a limitation, restriction or qualification of the constitutional documents of the company on the purposes or activities of the company, or on the authority of the directors;¹⁴

13.6.2 any person who suffers any loss or damage as a result of the contravention of a provision of the Companies Act.¹⁵

13.7 The Companies Act further extends the pool of possible claimants against directors by providing that a claim can be instituted by:

13.7.1 the person directly contemplated in the relevant provision of the Companies Act;

13.7.2 a person acting on behalf of the person directly contemplated;

13.7.3 a person acting as a member of or in the interests of a group or class of affected persons, or an association on behalf of its members;

13.7.4 a person acting in the public interest, with the leave of the court.¹⁶

13.8 A director who breaches his duties could face removal by an ordinary shareholders resolution¹⁷ or a company, shareholder, director, company secretary or prescribed officer of a company, a registered trade union that represents employees of the company or another representative of the employees of a company may apply to

¹⁴ Section 20(6) of the Companies Act

¹⁵ Section 218(2) of the Companies Act

¹⁶ Section 157 of the Companies Act

¹⁷ Section 71(1) of the Companies Act.

court for an order declaring a director delinquent or placing such director on probation.¹⁸

- 13.9 In cases of a breach of the duty to act in the best interests of the company and the duty of care, skill and diligence), a director may raise the "business judgement rule" as a defence.¹⁹ The business judgement rule exonerates a director from a breach of his duties if that director: (i) has taken reasonably diligent steps to become informed about the matter; and (ii) either (a) had no material personal financial interest in the subject matter of the decision or had no reasonable basis for knowing that any related person had a personal financial interest; or (b) the director has disclosed the personal financial interest and otherwise complied with the relevant disclosure requirements of section 75 of the Companies Act; and (iii) the director made or supported a decision and had a rational basis for believing and did believe that the decision was in the best interests of the company. The decision itself is not required to be one which a reasonably prudent director would have taken; all that is required is a rational basis for believing that the decision was in the best interests of the company.
- 13.10 Importantly, however, the business judgement rule will not apply in respect of a breach of a director's duty to act in good faith or for a proper purpose²⁰.
- 13.11 A director may also mitigate and/or avoid liability arising in terms of the Companies Act if he has acted honestly²¹ and reasonably or, in the circumstances, the court believes it is fair to limit or negate his liability²².

Can these issues give rise to other causes of action or regulatory routes whereby a stakeholder can exert pressure on a company with regard to its actions?

¹⁸ Section 162(2)(a) of the Companies Act.

¹⁹ Section 76(4) of the Companies Act.

²⁰ Section 76(3)(a) of the Companies Act.

²¹ Wilful misconduct or wilful breach of trust will not constitute "honesty", *Ex parte Lebowa Development Corporation Limited* 1989 (3) SA 71 (T).

²² Section 77(9) of the Companies Act.

13.12 Health and safety

13.12.1 Under the Occupational Health and Safety Act of 1993 ("OHSA"), every employer (to whom the Act applies) must provide and maintain, as far as reasonably practicable, a working environment that is safe and without risk to his employees. The OHSA places ultimate responsibility, to ensure compliance by an employer with the obligations under the OHSA on the chief executive officer²³.

13.12.2 Although the OHSA does not generally place health and safety obligations/duties on directors of a company, the duties imposed on directors under the Companies Act and King III would also include health and safety obligations. However, the CEO may be held personally liable under the OHSA and any other directors to whom duties may have been assigned in terms of the OHSA may also be held personally liable.

13.12.3 The failure by an employer or any person employed by an employer to comply with the OHSA is an offence which may result in criminal charges being levelled against the employer or responsible person. If the employer is charged criminally, the CEO or any of the directors may be named in the charges in a representative capacity and be required to appear in court on behalf of the employer. Any person (including directors) may be prosecuted for alleged breaches of the OHSA. Further if an employer's act or omission led to injuries or to the death of employee further charges may be brought against the employer including that of culpable homicide. If found guilty, a person may be imprisoned (the maximum period is currently two years) and/or fined (the maximum fine is currently R 100 000 although we have experience of the State seeking increased fines).

13.13 Environmental responsibility and liability

13.13.1 Environmental legislation in South Africa provides strict liability for contraventions across a wide range of environmental legislation. Liability can

²³ Section 16(1) of the OHSA. Under section 1, the Chief Executive Officer (CEO) is defined as the person who is responsible for the overall management and control of the business.

extend to companies, holding companies, contractors lenders and directors. Provision is made for fines of up to R10 000 000 (approximately USD1000 000) and up to 10 years imprisonment. Courts are also able to enquire into any costs the State may incur in rehabilitating the environment and any monetary advantage gained by the offender. The court may order the award of compensation, damages or a fine equal to such amounts.

13.13.2 In terms of the National Environmental Management Act of 1998 ("NEMA"), directors can be held liable for environmental offences committed by the company during the period of his or her appointment and if he or she failed "*to take all reasonable steps that were necessary under the circumstances to prevent the commission of the offence*". This applies only to specific offences under which are set out in Schedule 3 of NEMA. Typically a director would seek to avoid responsibility by claiming that reasonable steps were taken to prevent the commission of the offence, or that it could not reasonably have been expected to be aware of the situation requiring steps to be taken.

13.13.3 Enforcement action is usually taken after complaints have been lodged and an inspection carried out by the Environmental Management Inspectors, either at a provincial level or from the national Department of Environmental Affairs or the Department of Water and Sanitation. This is commenced through an administrative process by first issuing a notice outlining the alleged offences and granting an opportunity to make representations as to why a final directive should not be issued and criminal proceedings instituted.

13.14 **Anti-competitive behaviour**

13.14.1 The Competition Act of 1998 ("Competition Act") prescribes criminal sanctions against directors who participate in cartel conduct. These criminal sanctions include jail sentences of up to 10 years, or fines of R500 000 or both, for directors and managers who are responsible for, or knowingly acquiesce in cartel conduct as regulated by Competition Act, including the fixing of prices and trading conditions; market division; or collusive tendering.

13.14.2 The recent Constitutional Court decision in *Mukaddam v Pioneer Foods (Pty) Ltd and Others*²⁴ which involved a much-publicised bread cartel, has opened the way for damages claims to be brought by a class action against firms or cartel participants (which include directors) that have been found guilty of anti-competitive conduct. Although the actual damages claim has yet to be heard by the courts, it is anticipated that such a claim will set a landmark precedent for civil actions for damages suffered as a result of anti-competitive practices.

14. **Are there any other directors' duties which are relevant to the interests of stakeholders?**

See our responses in paragraph 10 above.

15. **For all of the above, if these exist in your jurisdiction, does the law provide guidance about the role of supervisory boards in cases of two tier board structures? What obligations are owed by senior management who are not board directors? Is this determined by law if no specific contractual provision applies?**

15.1 There is no two tier or supervisory board structure in the South African legal system. The obligations of senior management are set out in their employment contracts.

15.2 The Companies Act does, however, place specific obligations on "prescribed officers". A prescribed officer is a person who is not a director but who, irrespective of his title or function, exercises general executive control over, or who regularly participates to a material degree in the exercise of general executive control over, the whole or a significant portion of the business and activities of the company.²⁵ Prescribed officers are required to comply with the standards of conduct of directors and are subject to the same liabilities set out in the Companies Act as directors.

²⁴ *Mukaddam v Pioneer Foods (Pty) Ltd and Others* [2013] ZACC 23 (27 June 2013).

²⁵ Regulation 38 of the Companies Regulations 2011 provides as follows: despite not being a director of a particular company, a person is a "prescribed officer" of the company for all purposes of the Act if that person (a) exercises general executive control over and management of the whole, or a significant portion, of the business and activities of the company, or (b) regularly participates to a material degree in the exercise of general executive control over and management of the whole, or a significant portion, of the business and activities of the company.

Reporting

16. **Are companies required or permitted to disclose the impacts of their operations (including stakeholder impacts) on non-shareholders, as well as any action taken or intended to address those impacts? Is this required as part of financial reporting obligations or pursuant to a separate reporting regime? Please specify for each reporting route whether it is mandatory or voluntary.**
- 16.1 South Africa was one of the first countries in the world where integrated reporting by listed companies was recommended. Its earlier requirement for sustainability reporting was formalised by the second King Code on Corporate Governance (King II, introduced in 2002), which stated that "every company should report at least annually on the nature and extent of its social, transformation, ethical, safety, health and environmental management policies and practice". King II was updated in 2010 with the introduction of King III which emphasised the importance of integrated reporting. King III recommends that organisations should adopt integrated reporting instead of their annual financial and sustainability report, focusing on substance over form. King III provides that the integrated report should have sufficient information to record how the company has both positively and negatively impacted on the economic life of the community in which it operated during the year under review and how the board believes that it can improve the positive aspects and reduce the negative aspects in the year ahead.²⁶
- 16.2 However, the principles of King III in relation to integrated reporting are not mandatory principles and can therefore be applied on an "apply or explain basis". So while it is not compulsory for listed companies to prepare an integrated report if they do not do so, they will have to publicly explain why. However, in practice, many South African companies, JSE top 100 companies, many smaller listed companies, and some of the larger state-owned companies voluntarily prepare integrated reports.
- 16.3 Companies other than listed companies are required to prepare traditional annual financial statements (AFS). The AFS of public companies must be audited. As for

²⁶ King III, Recommended practice 9.2.4

other companies, the AFS may either be voluntarily audited or independently reviewed.

16.4 In addition, the formation of the Integrated Reporting Committee (IRC) in South Africa in May 2010 has done much to promote awareness and develop integrated reporting in South Africa. In March 2014, the IRC endorsed the international framework released by the International Integrated Reporting Council (IIRC) in December 2013, as guidance on good practice on how to prepare an integrated report. However, South African companies are not obliged to comply with the framework and this guidance.

17. Please describe any mandatory reporting requirement, major voluntary initiative or trend towards voluntary reporting with regard to transparency (for example, payments to government or state-owned entities, reports on government orders to undertake surveillance or interception, reports on tax payments etc).

17.1 There are a number of South African statutes and regulations that promote financial integrity and aim to combat corruption, anti-bribery and fraud by corporates, including:

17.1.1 the Prevention of Organised Crime Act of 1998, criminalising money laundering;

17.1.2 the Protection of Constitutional Democracy Against Terrorism and Related Activities Act of 2004, criminalising terror financing; and

17.1.3 the Financial Intelligence Centre Act of 2001 (FICA). FICA prescribes a list of accountable institutions and (as part of the Know Your Client (KYC) principle) requires them to identify the clients with whom they have business relationships and conduct due diligence with respect to them.

17.2 In addition, companies may voluntarily comply with John Ruggie's "Guiding Principles", however this is driven internally, contractually or when submitting tenders in certain instances.

17.3 The Companies Act also imposes certain common accountability and transparency requirements on all companies. For example, public companies and certain other

companies are required to appoint a company secretary, an auditor and have an audit committee.

- 17.4 In addition, the Companies Act incorporates anti-corruption measures by requiring the establishment of social and ethics committees for certain companies, as seen in question 7. Social and ethics committees are required to perform a wide range of activities, including monitoring the company's anti-corruption activities.
- 17.5 In addition, section 75 of the Companies Act requires in certain circumstances that directors must disclose their personal financial interests to the board and shareholders. This disclosure may provide early warning in relation to the Prevention of Organised Crime Act of 1998.
- 17.6 In terms of FICA²⁷ a person who carries on a business or is in charge of, or manages, a business or who is employed by a business and who knows or ought reasonably to have known or suspected that:
- 17.6.1 the business has received or is about to receive the proceeds of unlawful activities or property which is connected to an offence relating to the financing of terrorist and related activities;
 - 17.6.2 a transaction or series of transactions to which the business is a party:
 - 17.6.2.1 facilitated or is likely to facilitate the transfer of the proceeds of unlawful activities or property which is connected to an offence relating to the financing of terrorist and related activities;
 - 17.6.2.2 has no apparent business or lawful purpose;
 - 17.6.2.3 is conducted for the purpose of avoiding giving rise to a reporting duty under this Act;
 - 17.6.2.4 may be relevant to the investigation of an evasion or attempted evasion of a duty to pay any tax, duty or levy imposed by legislation administered by the Commissioner for the South African Revenue Service; or

²⁷ Section 29(1) of FICA

- 17.6.2.5 relates to an offence relating to the financing of terrorist and related activities; or
- 17.6.3 the business has been used or is about to be used in any way for money laundering purposes or to facilitate the commission of an offence relating to the financing of terrorist and related activities,
- 17.7 must, within the prescribed period after the knowledge was acquired or the suspicion arose, report to the FIC the grounds for the knowledge or suspicion and the prescribed particulars concerning the transaction or series of transactions.
- 17.8 "Money laundering" or "money laundering activity" is defined in FICA as:
"an activity which has or is likely to have the effect of concealing or disguising the nature, source, location, disposition or movement of the proceeds of unlawful activities or any interest which anyone has in such proceeds, and includes any activity which constitutes an offence in terms of section 64 of [FICA] or section 4, 5 or 6 of Prevention of Organised Crime Act, 1998 (**POCA**)."
- 17.9 "*Proceeds of unlawful activities*", as used in section 29, has the meaning ascribed to it in POCA, namely, any property or any service, advantage, benefit or reward which was derived, received or retained, directly or indirectly, in the Republic or elsewhere, at any time before or after the commencement of POCA, in connection with or as a result of any unlawful activity carried on by any person, and includes any property representing property so derived.
- 17.10 "*Unlawful activity*" means any conduct which constitutes a crime or which contravenes any law whether such conduct occurred before or after the commencement of POCA and whether such conduct occurred in the Republic or elsewhere; and "*property*" means money or any other movable, immovable, corporeal or incorporeal thing and includes any rights, privileges, claims and securities and any interest therein and all proceeds thereof.

18. Do legal reporting obligations extend to such impacts outside the jurisdiction; to the impacts of subsidiaries, suppliers and other business partners, whether occurring inside or outside the jurisdiction?

Reporting obligations generally relate to the activities or group of companies and may extend to impacts outside the jurisdiction and to impacts of subsidiaries. However they do not currently extend to the supply chain.

19. Who must verify these reports; who can access reports; and what are the legal or regulatory consequences of failing to report or misrepresentation? Is there a regulator tasked with investigating complaints of misreporting?

19.1 This answer does not cover the sanctions for failing to report on or misrepresentation in relation to, financial information contained in annual reports of companies.

19.2 The Companies Act subjects the financial statements of companies to an audit or an independent review depending on the type of companies.

19.3 for the Companies Act requires the annual financial statements of public companies, state-owned companies and certain private companies to be audited. Other companies must have the annual financial statements independently reviewed.

19.4 It is mandatory for public companies and state-owned companies to appoint an auditor. Auditors must express an opinion and report on the annual financial statements of the company.

19.5 In addition, the Companies Act requires public companies, state-owned companies and certain private companies to appoint an audit committee. The audit committee nominates external auditors, reports to the shareholders annually and makes submission to the board.

19.6 King III provides principles and recommendations in relation to the review of the integrated report. King III recommends that the board should ensure the integrity of the company's integrated reports and should delegate to the audited committee to

evaluate sustainability disclosures.²⁸ King III elaborates on the functions of the audit committee. It provides that the committee should oversee integrated reporting and ensure that it conveys adequate information about the social, economic and environmental impact of the company on which it operates.²⁹ It should review the integrated report to ensure that information it contains is reliable and does not contradict the financial aspects of the report. If necessary, the audit committee should recommend the appointment of an external assurance provider on material sustainability issues.

- 19.7 Generally, integrated reports are made available to shareholders, but may be accessible to other interested parties. A person who holds or has a beneficial interest in any securities issued by a company has the right to inspect and copy the information contained in the company's records but not certain information, including but not limited to, accounting records and minutes of directors' meetings. The Promotion of Access to Information Act of 2000 regulates the right of access to information held by companies, among other persons. It aims to give effect to the rights of access to information subject to justifiable limitations protecting privacy, commercial confidentiality and effective corporate governance.
- 19.8 As mentioned in question 16, only financial reporting is mandatory for South African companies. Integrated reporting is voluntary only and applicable on a "apply or explain" basis. Therefore, there is no sanction for not preparing an integrated report. However, companies will need to publicly explain why they have not prepared such a report. There is also no formal regulatory monitoring of the quality of the integrated report if one is prepared in accordance with the recommended practices of King III.
- 19.9 The Companies Act provides that a director of a company is liable to the company for any loss, damages or costs sustained by the company as a result of the director having signed, consented to or authorised the publication of any financial statements which were false, misleading or untrue.

²⁸ King III, Principle 9.1 and 9.1.2

²⁹ King III, Principle 3.4

20. **What is the external assurance regime for reporting on a company's impacts on stakeholders? Please specify any mandatory requirements and also where reporting is voluntary what the current market practice is as regards third party assurance. Please summarise any regulatory guidance on reporting that relates to impacts on non-shareholder stake-holders.**

There is no mandatory external assurance regime for reporting in relation to stakeholders.

Stakeholder engagement

21. **Are there any restrictions on circulating shareholder proposals which deal with impacts on non-shareholders, including stakeholder impacts?**

No

22. **Are institutional investors, including pension funds, required or permitted to consider such impacts in their investment decisions. What is the legal duty that pension funds owe with regard to investment decisions in this regard?**

22.1 Pension funds are obliged to consider a number of "soft issues" when they make investment decisions.

22.2 The Regulations promulgated under the Pension Funds Act, 1957 imposes a number of restrictions and limitations on pension funds and the types of investment decisions that they may make.³⁰

22.3 In particular these Regulations provide that, before making an investment in and while invested in an asset, a pension fund and its board, must consider any factor which may materially affect the sustainable long term performance of the asset including, but not limited to, those of an environmental, social and governance character.³¹

³⁰ Regulation 28

³¹ Regulation 28 (2)(c)(ix)

- 22.4 Although pension funds are not obliged to take into consideration the specific ethical beliefs of their beneficiaries or other non-commercial considerations, the constitutional documents of a particular pension fund may, however, provide for this.
- 22.5 The Code for Responsible Investing in South Africa ("CRISA"), which came into effect in February 2012, provides guidance on how institutional investors should execute investment analyses and investment activities and exercise rights to promote sound governance. Its principles are aligned with those of the UN's Principles for Responsible Investing. The application of CRISA is voluntary. Institutional investors are however expected to adopt the principles and practice recommended in CRISA on an "apply or explain" basis. Disclosures are required at least once a year.
- 22.6 CRISA requires that institutional shareholders disclose publicly the following policies:
- 22.6.1 a policy on incorporation of sustainability considerations, including, impact on the environment, societal and governance (ESG), into investment analyses and investment activities with reference to the matters as set out under Principle 1 thereof;
- 22.6.2 a policy in regard to ownership responsibilities, including voting as set out under Principle 2 thereof;
- 22.6.3 a policy on the identification, prevention and management of conflicts of interest as set out under Principle 4 thereof.
- 22.7 CRISA applies not only to institutional investors but also to asset managers (defined as service providers in CRISA). The issues contemplated within CRISA and the adoption of its principles are evolving. As noted, the application of CRISA is voluntary. However, pension funds have been remarkably quiet in relation to driving ESG changes in relation to their underlying investments. This is probably as a result of the relative inexperience and/or absence of skills by pension fund trustees in this regard. It may be expected (especially as pension fund trustees acquire greater insight and expertise in relation to ESG investment), institutional shareholders (at least where such an institutional investor is a pension fund) may become more vocal

in driving the issues contemplated in CRISA. As such, arguably, the issues contemplated within CRISA may evolve from the voluntary nature thereof to becoming regulated. This may also be due to the fact that the compact between pension funds and their beneficiaries will become increasingly transparent in the future.

How does the legal duty of the fund align with term and contractual performance criteria of fund managers - does this facilitate or deter consideration of such impacts?

22.8 Pension funds and their boards may appoint investment managers to administer fund assets and make investment decisions on their behalf. The fund and its board, however, remain ultimately responsible for compliance with Regulation 28 and contracts with fund managers will typically require fund managers to provide a specific undertaking that they will comply with Regulation 28.

23. Can non-shareholders address companies' annual general meetings?

23.1 Non-shareholders do not have the right to participate at a company meeting. However, certain non-shareholders may be invited to attend and address shareholders meetings.

What is the minimum shareholding required for a shareholder to raise a question at a company's AGM?

23.2 The Companies Act provides that any matter may be raised by the shareholders at the AGM with or without advance notice to the company³² (in this regard, only public companies are required to hold AGMs).

Other issues of corporate governance

24. **Are there any other laws, policies, codes or guidelines or standards applied in the context of particular contractual relationships (for example project finance) or through adherence to particular sustainability principles (for example the UN Global Compact, the OECD Guidelines for Multinational Enterprises ("OECD Guidelines") etc), related to corporate governance that might encourage companies to consider**

³² Section 61(8) of the Companies Act

in a structured way their impacts upon and the interests of their wider stakeholders including through a stakeholder engagement process?

25. Also see our response to question 11.

25.1 As mentioned elsewhere in this note, South Africa has laws and guidelines in place in order to encourage companies to engage with stakeholders. This requires a company to embrace engagement with its shareholders, employees, unions, suppliers, communities and consumers. In terms of the doctrine of enlightened shareholder value, directors are entitled to take into account the interests of all stakeholders of the company subject to the best interest of the company.

25.2 In addition, South African companies should also take into account the ten principles of the United Nations Global Compact as recommended in King III. This policy initiative provides for businesses to align their operations with the ten principles in the areas of human rights, labour, environment and anti-corruption.

25.3 Multinationals should also take into account the OECD Guidelines which provide voluntary principles and standards for responsible business conduct consistent with applicable laws.³³ They encourage co-operation between companies and stakeholders in order to create jobs, wealth and sustainable businesses.

25.4 The African concept of "Ubuntu" enlightens good corporate governance practices in South Africa. It can provide guidance to directors in their dealings among themselves as well as in their relationships with all stakeholders of a company. South African courts have in the past recognised the values incorporated in Ubuntu in informing corporate decisions made by directors. Ubuntu is a culture that places emphasis on the principles of communality, consultation, respect and fairness.

26. Are there any laws requiring representation of particular stakeholder constituencies (ie employees, representatives of affected communities) on company boards?

No.

³³ OECD Guidelines for Multinational Enterprises

27. Are there any laws requiring gender, racial/ethnic, religious or other stakeholder constituencies (ie employees, representatives of affected communities) on company boards?

27.1 South Africa has in place laws and standards that promote racial representation on company boards.

27.2 the Broad-based Black Economic Empowerment Act 53 of 2003 (B-BBEE Act) aims to redress inequalities imposed by the previous government in order to achieve economic transformation and enhance meaningful participation of black people (defined in the B-BBEE Act) in the economy.

27.3 Entities are generally measured in terms of the generic B-BBEE scorecard, against five criteria, namely: ownership, management control, skills development, enterprise and supplier development, and socio-economic development. This entails that a company, in order to maximise its B-BBEE rating, must have black people in executive management and strategic and operational control of the company. The company must also invest in training black employees and assist in developing black businesses.

27.4 The B-BBEE Act does not impose criminal sanctions or make it unlawful to trade as a result of non-adherence to B-BBEE (as opposed to a misrepresentation of B-BBEE status, such as fronting). Rather, the B-BBEE Act contemplates that government and public entities, as well as entities doing business with government and public entities will take account of B-BBEE as a factor in determining which entities they trade with, or to which entities they issue licences or concessions. Private sector clients are also increasingly cognisant of B-BBEE in order to boost their own B-BBEE ratings. B-BBEE is therefore an important factor to be taken into account by any entity conducting business in South Africa.

27.5 King III also highlights and encourages diversity (including race and gender diversity) among the board. In terms of the King III, every board should consider whether its size, diversity and demographics make it effective. Diversity applies,

among other things, to nationality, age, race and gender.³⁴ Social transformation and redress from apartheid are considered important and should be integrated within the broader transition to sustainability. It is further considered that integrating sustainability and social transformation in a strategic and coherent manner will give rise to greater opportunities, efficiencies, and benefits, for both the company and society.³⁵

- 28. In your jurisdiction is there any legal route whereby a parent company can incur liability with regard to the impacts that one of its subsidiaries has had on stakeholder groups? Are there any serious proposals to impose such responsibility?**

See the response to Question 13 for a discussion of these issues.

- 29. Are you aware of any incoming law proposals that are relevant to the issues raised in this questionnaire? If so please describe, providing an indication of the anticipated date of legislation will come into force or be adopted.**

The King III is in the process of being updated. The timeline for finalisation of the revision is not yet confirmed but it is expected that the revision will be completed during 2016.³⁶

WEBBER WENTZEL**December 2015**

³⁴ King III, Principle 2.18.

³⁵ King III, Principle 9.

³⁶ "King Committee sets wheels in motion for King IV". <http://www.hrfuture.net/news/king-committee-sets-wheels-in-motion-for-king-iv.php?Itemid=812>; "Revision of King III report to help smaller entities" <http://www.bdlive.co.za/companies/2014/06/02/revision-of-king-iii-report-to-help-smaller-entities>