Nedlac Companies Amendment Bill task team: Organised Labour amendments

In this submission, we set out Organised Labour's proposed additions to Government's version of the Companies Amendment Bill ("the Bill"), tabled at Nedlac.[1]

In the Nedlac task team meetings, we shared these proposed amendments with other social partners, providing extensive motivations for these changes to the Companies Act ("the Act"). We do not repeat those motivations here.

Furthermore, we argued that the Bill should not only be limited to those matters currently contained in Government's version of the Bill and why the amendments that Labour has raised cannot wait for a review that will take place between three and five years from now. We do not repeat those motivations here.

1. Remuneration report

The Bill attempts to strengthen the remuneration report provisions. However, the proposed amendments are not adequate.

Given the extraordinary level of corporate governance failures South Africa has seen recently, very little accountability for obscenely paid executives and huge, unsustainable pay discrepancies between the highest and lowest paid, this Bill presents an opportunity to make changes that will allow shareholders to reign in executive pay and obtain more information on what the lowest paid workers are earning.

Below we propose additional amendments to the Act for inclusion in the Bill.

1.1 Report details

We support the inclusion in the Act of a requirement to prepare a three part directors' remuneration report for each financial year, consisting of a background statement; an overview of the main provisions of the company's policy on remuneration; and an implementation report. This amendment reflects the requirements of the King IV Report on Corporate Governance for South Africa ("King IV").

However, Section 30A of the Bill only prescribes that the remuneration report should consist of three parts, without giving guidance as to what those parts should consist of. This will not bring the desired improvements in the remuneration reports and could just lead to confusion and obfuscation.

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[1] There tends to be more emphasis on the regulation of publicly traded companies, as opposed to private companies. The underlying assumption is problematic as it suggests that increased corporate governance regulation is an imperative only where it potentially affects a larger number of shareholders, as opposed to promoting better corporate governance for its own sake and in recognition of the general public interest. In our submission and the proposed amendments therein, we do not limit the application of any of our amendments to public companies only.

King IV not only recommends the parts of the remuneration report (which the Bill incorporates) but it also proposes what should be in these parts[2]. The Bill should be amended to also include these proposals. We therefore propose amending Section 30A by inserting the sections directly from the King Code (additions to the Bill have been underlined):

> 30A (1) The directors of a public company or state-owned company must prepare a directors' remuneration report for each financial year of the company.
> (2) The directors' remuneration report must, in the prescribed manner, consist of the following parts:
>
> (a) The background statement, which must provide context for remuneration considerations and decisions, with reference to:
> - i. internal and external factors that influenced remuneration;
> - ii. the most recent results of voting on the remuneration policy and the implementation report and the measures taken in response thereto;
> - iii. key areas of focus and key decisions taken by the remuneration committee during the reporting period, including any substantial changes to the remuneration policy;
> - iv. whether remuneration consultants have been used, and whether the remuneration committee is satisfied that they were independent and objective;
> - v. the views of the remuneration committee on whether the remuneration policy achieved its stated objectives; and
> - vi. future areas of focus.
>
> (b) An overview of the main provisions of the company's policy on remuneration, which must address the objectives of the policy and the manner in which the policy seeks to accomplish these. The overview must include:
> - i. the remuneration elements and design principles informing the remuneration arrangements for executive management and, at a high level, for other employees;
> - ii. details of any obligations in executive employment contracts which could give rise to payments on termination of employment or office;
> - iii. a description of the framework and performance measures used to assess the achievement of strategic objectives and positive outcomes, including the relative weighting of each performance measure and the period of time over which it is measured;
> - iv. an illustration of the potential consequences on the total remuneration for executive management, on a single, total figure basis, of applying the remuneration policy under minimum, on-target and maximum performance outcomes;
> - v. an explanation of how the policy addresses fair and responsible remuneration for executive management in the context of overall employee remuneration;
> - vi. the use and justification of remuneration benchmarks;
> - vii. the basis for the setting of fees for non-executive directors;
> - viii. a reference to an electronic link to the full remuneration policy for public access;
>
> (c) An implementation report containing details of remuneration and benefits received by each director or prescribed officer, which must show:
> - i. the remuneration of each member of executive management, which must include in separate tables:
>   - a. a single, total figure of remuneration, received and receivable for the reporting period, and all the remuneration elements that it comprises, each disclosed at fair value;

[2] King IV, Principle 14 Recommended Practice 32

b. the details of all awards made under variable remuneration incentive schemes in the current and prior years that have not yet vested, including the number of awards; the values at date of grant; their award, vesting and expiry dates (where applicable); and the fair value at the end of the reporting period; and
c. The cash value of all awards made under variable remuneration incentive schemes that were settled during the reporting period.

ii. An account of the performance measures used and the relative weighting of each, as a result of which awards under variable remuneration incentive schemes have been made, including: the targets set for the performance measures and the corresponding value of the award opportunity; and for each performance measure, how the organisation and executive managers, individually, performed against the set targets.
iii. Separate disclosure of, and reasons for, any payments made on termination of employment or office.
iv. A statement regarding compliance with, and any deviations from, the remuneration policy

1.2 Pay ratios

We propose that the remuneration report should include disclosure of companies' pay ratios.

The Bill should be amended to compel all companies, both public and private, to publish the ratio between the top 5% and bottom 5% earners in the remuneration report. All elements of remuneration should be taken into account – not just cash payments and not just salaries.

This proposal is fully in line with King IV, which states that "the remuneration of executive management should be fair and responsible in the context of overall employee remuneration. It should be disclosed how this has been addressed. This acknowledges the need to address the gap between the remuneration of executives and those at the lower end of the pay scale"[3].

While disclosure of executive remuneration is important, in the absence of how directors' pay compares to that of the lowest-paid workers in a company, it is not possible to assess whether or not directors' remuneration is "fair and responsible", as per King IV.

There may be challenges raised by companies over requiring pay ratio disclosure. However, these can be overcome.

One argument could be that the calculation of the ratio is an expensive and time-consuming process. However, many companies have to do this already or have the systems to do so without difficulty, and the equity-enhancing benefits for society of this measure have the potential to outweigh any additional cost to companies in collecting the data.

Another concern is that companies are able to manipulate the pay ratio reported by outsourcing the lowest-paid jobs or turning low-paid workers into contractors or part-

[3] King IV, Highlights of the King IV Code, page 31

time workers. This could be overcome by mandating the inclusion of such workers in pay ratio calculations.

It may be necessary to set out the mechanics of how the publication of the pay ratios will work in regulations.

1.3 Pay for lowest paid

The remuneration report should also include what companies pay their lowest paid workers. The current Section 30A of the Bill should be changed to compel companies to do so.

Information about the lowest paid workers would provide valuable insights into inequality in South Africa, by showing the extent to which the profits made by companies are founded on unfair and/or irresponsible remuneration of the lowest paid workers. It would enable shareholders and stakeholders to determine whether the remuneration of these workers is sustainable and whether these workers receive a living wage, which allows them to maintain a satisfactory standard of living.

This amendment to the Act will also reveal whether companies comply with minimum wage legislation and whether their policies on remuneration is fair. This should give shareholders additional information on companies' risks and compliance.

2. Shareholders' vote on report on directors' remuneration

The Companies Act should be amended to make the shareholders' vote on the remuneration report binding. The current advisory (or non-binding) vote serves no purpose. This is evident with several companies in recent years, where large proportions of shareholders have voted against the remuneration report year after year but nothing changes. Often, the boards just commit to discuss the matter with the shareholders who voted against the report but this does not lead to anything of consequence.

If the vote is not binding, there should be some sort of mechanism for escalation. For instance, in Australia, if more than 25% of the shareholders vote against the remuneration report three years in a row, the directors all have to resign and, in the United Kingdom, successive votes that fail mean the composition of the remuneration committee changes.

3. Social and ethics committee

Some amendments are proposed in the Bill to the Social and Ethics Committee section of the Act. However, not all of these are clear and neither are they sufficient.

3.1 Vote on the report

In section 72 of the Bill, it is proposed that a Social and Ethics Committee report must be presented to shareholders at a shareholders meeting. We support this but it is not clear whether there will be a vote on the report and, if so, whether this vote will be advisory or binding. This should be clarified.

We would support the report being put to a vote at AGMs, specifically a binding vote. As per our proposal above on the remuneration report vote, we would recommend that there are consequences should shareholders vote against it, in line with those examples provided above. Changes should be made to the Bill to reflect this.

3.2 External assurance

The Bill, in section 72, proposes that the report by the Social and Ethics Committee must be externally assured. We support this and cannot agree to a situation where internal persons assure it. It will dilute the importance and credibility of the report and will diminish the seriousness with which these reports are treated by companies.

3.3 Worker & union inclusion

Labour proposes that the Social and Ethics Committee also includes worker or trade union representatives. The Bill should be amended to provide for this.

This is in line with recent changes to the competition legislation which elevates worker empowerment and ownership and with government statements about a stronger social compact and greater partnership between Business and Labour.

While Labour would prefer that workers are represented on the boards of companies, this step – appointing workers on these committees – will help to ensure some sort of co-determination.[4]

When the Companies Act was crafted in 2007 and 2008 at Nedlac and Parliament, Labour (as a transitional measure from the existing board structure) had already proposed that the Social and Ethics Committee should include trade unions.

The worker and trade union representatives should be elected / appointed by the workers and their union, not by the board, management or owners.

4. Share buybacks

While the Bill proposes some changes to when shares can be bought back and the circumstances under which this can happen, including when shareholder approval is required, we believe it is not sufficient, taking into account the myriad of problems with share buybacks.

Share buybacks, which have only been allowed in South Africa since 1999, occur when the issuing company pays shareholders to purchase their shares and re-absorbs that portion of its ownership that was previously distributed among public investors.

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[4] In 2007 and 2008, when the Companies Act was discussed in Nedlac and at Parliament, we proposed the inclusion of co-determination models (adopted in jurisdictions in the European Union and Germany particularly) applicable to board structures allowing for trade union participation.

The Bill, in Clause 12, proposes that a share buyback must be approved by a special resolution of shareholders if shares are to be bought back from a director, a prescribed officer or a person related to a director or a prescribed officer. A special shareholder resolution will also be required if the buyback entails an acquisition other than an equal offer made to all shareholders or transactions effected in the ordinary course on a stock exchange. It is believed that these changes will bring about additional protection to shareholders, as 75% of shareholders will need to vote in favour of the deal for it to go ahead.

4.1 Prohibition of share buybacks

Labour proposes that companies are prohibited from buying back their own shares, taking into account the significant negative economic consequences thereof and the lack of regulation by the stock exchange or government of this area.

There is also a big gap in our knowledge of share buybacks. For instance, there is no comprehensive database on share repurchases by listed companies, as they are only required to announce share buybacks on SENS when the buyback comprises more than 3% of issued share capital. It is estimated that, as a result, only about 50% of the repurchasing activity on the JSE are in SENS announcements.

For companies, share buybacks are advantageous from a tax perspective, because a share buyback transaction can be structured so as to fall within the income tax definition of a dividend, which is exempt from normal income tax.

Share buybacks also allow those selling shares (to the corporate whose shares they are) to avoid paying capital gains taxes.[5]

This tax avoidance has resulted in SARS become increasingly concerned that these practices are resulting in a loss of tax revenue.

Around the world there is concern at the increasing tendency to use cash to carry out share buybacks rather than to invest in development spending or reinvest funds into companies.

Further, companies attempt to boost their own share price through share buybacks. In the United States in 2005, funds spent on buybacks exceeded dividends and this has continued to widen since then.[6]

Buying back shares and boosting the share price allow directors to make huge amounts of money in short periods of time but this can have implications for the long-term sustainability of a business. In the United States, economists believe that whatever the stated reasons for buybacks, the most powerful one is that executive remuneration is now heavily exposed to share price performance, and for the most part, buybacks are good for share price performance.

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[5] Werksmans Tax Team, "2017/2018 Budget Proposals-Tax Overview", *Werksmans.com.* February 2017 https://www.werksmans.com/wp-content/uploads/2017/02/070053-WERKSMANS-budget-speech-2017-updated.pdf

[6] Amy Dittmar, 'Corporate Cash Policy and How to Manage It with Stock Repurchases', *Journal of Applied Corporate Finance* 20, no. 3 (Summer 2008): 22–34

Share buybacks are of little use to the economy as they represent funds that could otherwise have been invested and can drive inequality.

Each of these reasons above are sufficient in itself to prohibit share buybacks.

4.2 Reporting of buybacks

Should the Department decide not to amend the Act to prohibit share buybacks now, we would propose that the regulation of share buybacks be strengthened more than mooted in the Bill.

In order to allow government, shareholders and stakeholders to better understand the extent to which share buybacks are being undertaken by JSE-listed companies, the first step is to require them to disclose all repurchases on SENS within 24 hours (as is required in the United Kingdom).

It is proposed the following amendments be inserted in Clause 12 of the Bill:

> If a company purchases any of its own securities under a general authority from shareholders to do so, an announcement must be made as soon as possible and, in any event, by not later than 08h30 on the day following which the repurchase of shares occurred
>
> Such announcement should contain all of the information currently required to be disclosed by paragraph 11.27 of the JSE Listing Requirements when a company has cumulatively repurchased 3% of the relevant class of securities

4.3 Offer to all shareholders

Should the Department decide not to amend the Act to prohibit share buybacks now, we would propose that the Act then be amended so that companies should not be permitted to buy back shares unless they make the same offer to all shareholders pro rata.

We therefore propose the following amendment to section 48(2) of the Act:

> "Subject to subsection (3) <u>and subject to the condition that all shareholders shall be made the same offer pro rata …"</u>

5. Business rescue

It has been acknowledged by Government that business rescue could be improved to better save companies and jobs. We agree and believe that in the current jobs crisis, we address this forthwith. We propose several amendments.

Section 7 of the Act provide for the rescue and recovery of financially distressed companies, in a manner that attempts to balance the rights and interests of all relevant stakeholders. However, Labour believes that the act does not provide a balance between the interests of workers and creditors.

5.1 General business rescue amendments

We therefore propose amendments. The Act must be amended in the following respects:

- Workers' wages right before and during business rescue must be given preference over the practitioners' remuneration and all other creditors, whether secured or unsecured
- The business rescue plan must guarantee payment of salaries during business rescue
- Employees must be allowed to exercise their remuneration claims during business rescue. This should be an exception to the moratorium on legal proceedings against the company
- Business rescue should be a maximum of six months after the initial three month period and, if it has to be extended after this, then it should be applied for in court

5.2 Additional or joint practitioner

The business rescue process is an alternative mechanism to liquidating a financially distressed business. Labour's experience gained in liquidation processes is a useful illustration of what is missing with business rescue.

In the past, liquidators generally did not enjoy a good reputation and in the experience of trade unions were biased to larger creditors and banks. Over time, after realising that workers' interests were being consistently undermined, it had become necessary for trade unions to make their own nominations of liquidators who then operate alongside those appointed by other creditors.

Our experience with business rescue is similar to our initial experience with liquidators. Often business rescue practitioners are not independent and invariably arrive at the conclusion that the business may only be saved if retrenchments are effected. This mindset tends to prevail even where the financial problems arise from senior level corruption or mismanagement or where retrenchment employees are replaced by outsourced contracts.

On this basis we do not believe that the provisions in the Act applicable to the appointment of the business rescue practitioners adequately protects workers interests. Accordingly we call for the inclusion of a provision in the Bill that trade unions be allowed to either appoint an additional practitioner to represent work interests or alternatively that a joint practitioner be appointed in consultation with trade unions.

6. Strengthening of minority shareholder rights

The following proposal is intended to support minorities' rights, which we believe have been diminished in the Act.

All companies should be required to present their audited financial statements to the AGM for shareholder approval. The first part is a requirement only for public companies at present. We propose amending

- Section 61(7):

"A public company and a private company (unless the shareholders unanimously decide otherwise) must convene an annual general meeting of its shareholders…"

- Section 30(3)(d):

"… be presented to the first shareholders' meeting after the statements have been approved by the board, for approval by majority vote of the shareholders, and in the event that this approval is not given, all the directors shall retire and elections for the vacant directorships shall take place"

7. Shareholder resolutions

Recent developments has shown that the Act should be amended to allow for a statutory procedure by which shareholders may introduce resolutions at an AGM, even if the board resists.

We propose the following amendment to section 65(3):

> "Any two shareholders of a company -
> (a) may propose a resolution concerning any matter, in respect of which they are each entitled to exercise voting rights, which shall include without limitation the conduct of the company's business and the policies of the company;…"

8. Transparency

While current legislation allows for workers and their unions to view certain company records and the Companies Act has improved the right of access to company records, several unnecessary hurdles and blockages are used to restrict this access.

We believe amendments should be made to the law to ensure greater access to certain essential documents. The persons who have the right to inspect company records should be expanded as well as those records that can be accessed.

Labour believes essential documents should be available for scrutiny by workers and unions (not only to shareholders, defined as having a beneficial interest). This includes

- Accounting and financial records
- minutes of all directors' and board meetings, as well as board committees, and resolutions of directors and boards
- share register
- beneficial ownership

In light of the above, we propose that section 26(1) of the Act be amended to include workers, in addition to persons who have beneficial interests.

Section 31(1) provides for the rights of holders of securities to access copies of the annual financial statements. We believe this section should be amended for trade unions to have the right to access financial information on behalf of workers. If this is not made an unfettered right, we propose that access should apply when a company fails to comply with employment-related contractual or statutory obligations.

To facilitate access the documents listed above, as well as the share register and beneficial ownership, should be available at no cost and should be published on companies' websites and, where this is not possible, on the CIPC's website.

While section 33 provides for access to documents, companies restrict access by placing hurdles in the way, including the cost and location of documents and the way it can be copied. While section 31 prohibits companies from doing this, it still happens. The way to address this problem is to make the documents available on the internet.