



THE COMPANIES ACT, NO 71 OF 2008 ALERT

SOCIAL AND ETHICS COMMITTEE

The enactment of s72(4) and s(5) of the Companies Act, No 71 of 2008 (Act), read with Regulation 43, marks the most significant shift in the history of corporate accountability and reporting in South Africa.

Previously regulated by voluntary standards and norms, the Act requires that companies falling within specific categories appoint a Social and Ethics Committee (Committee) to report on company performance in respect of non-financial aspects involving social, economic and environmental governance. Another departure, comparatively, is the incorporation of the UN Global Compact and OECD requirements, which are voluntary standards in other jurisdictions, into local corporate law.

Faced with a legislated committee structure with equal standing to that of the Audit Committee, companies are grappling with the interpretation of the provisions of the Act, the structuring of the committee within an already existing board structure and the reconciliation of the mandate of the Committee with other best practice standards such as the King III Code on corporate governance.

This publication addresses some of the commonly asked questions in relation to the Committee:

- **With reference to the terms of reference or charter of the Committee, can more powers be delegated to the Committee over and above what is contained in the Act?**

A company's Memorandum of Incorporation (MoI) can provide for the imposition of a higher standard or onerous requirement than would otherwise apply in terms of s15(2)(iii).

Notwithstanding that the Committee has monitoring and reporting powers in terms of the Act and the board may, in its discretion, grant to the Committee decision making powers on any of the aspects falling under its mandate.

- **What considerations would the Tribunal take into account when assessing an application for exemption?**

The non-existence or otherwise of a public interest with regards to that company, calculated as provided in s72(4) (a), alternatively the provisions of s72(5)(a) or (b), which require that a company demonstrates that it has some form of a formal mechanism within its existing structures that substantially deals with matters falling under the Committee's mandated areas, are the primary grounds for application of an exemption. Objective evidence may have to be provided in the form of terms of reference to support such application.

- **What should the frequency of the meetings of the Committee be?**

The Act does not prescribe a number of meetings per se. The meetings of the Committee should fall within that Company's annual board cycle depending on the agenda to be covered by the Committee.

- **Who must be the chairperson of the Committee?**

The regulated composition of the Committee has at least three directors who may hold full time position with the company and one director who is a non-executive. While not explicitly provided for in the Act and Regulation 43(3), the implication is that the director who is not a full time director should chair the Committee.

- **Who should appoint the Committee members?**

The power to appoint members of the Committee vests with the board in terms of s72(1) unless otherwise provided in the company's MoI. However, in terms of s84(6)(a) and (b), where the board or the company fails to appoint a Committee, then the Commission may issue a notice to the company to "show cause" leading to the Commission convening a general meeting of shareholders to appoint the Committee. The pro-rata costs of which may be borne by each director who knowingly permitted the company to fail to appoint the committee.

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- **How can one convince the board of directors of the company, who comprise mainly of accountants, that the Committee is not just a checklist type of committee, but rather the conscience of the company?**

The ambit of the areas over which the Committee is to exercise oversight covers legislated matters with which the Company must comply, for example, employment equity, BEE and health and safety. Companies are not only required to comply but report to shareholders on their performance in these areas. Other aspects covered by the Committee entail non-regulated matters. These matters may go to the heart of a company's reputation which, if there are breaches, may result in erosion of the value of the company. The matters involving the impact of the activities of the company on communities will require qualitative assessment of impacts. This, together with the potential to be questioned at an AGM over such activities should encourage companies to develop qualitative benchmarks and procedure to enable reasonable reporting.

- **Would the best approach to setting up the Committee be a "piecemeal" approach, or a "silver bullet" approach?**

Whether to set up the Committee of a company in a piecemeal fashion or a "silver bullet" manner is dependent on when the company is required to have a Committee. If the company is a state owned company, a listed public company or a company within a public interest score of 500 points or more in any two of the previous five years, a silver bullet approach to the set of the Committee is required as these companies must appoint a Committee by 1 May 2012.

On the other hand, companies that do not fall within the prescribed categories on the effective date of the Act, may take a piecemeal approach (which may be informed by its growth strategy) to setting up the Committee bearing in mind that a company must constitute a Committee within one year after:

- Its date of incorporation in the case of a state owned company
- The date it first became a listed public company
- The date it first meets the public interest score criteria

- **In the case where the holding company of a subsidiary has a similar committee to the Committee, who would submit the application for exemption to the Tribunal, the holding company or the subsidiary?**

A subsidiary of a holding company must have its own Committee unless the holding company of the subsidiary has a Committee, and that holding company's Committee will perform the function of the Committee for such subsidiary, or the subsidiary has been exempted by the Tribunal. Accordingly, the subsidiary would be the applicant in an application for exemption submitted to the Tribunal.

The holdings company must be a company registered in terms of the Act, a domesticated company as defined. If the holding company is registered in another jurisdiction, then the local subsidiary would have to establish a Committee in terms of local law.

- **How can the company be compelled in terms of the Act to comply with its stakeholder or community engagement obligations?**

Section 156 of the Act dealing with "alternative procedures for addressing complaints or securing rights" and s157 of the Act dealing with "extended standing to apply for remedies", could be used to compel a company to comply with its "its stakeholder and/or community engagement obligations" as they both contemplate some form of "class action".

Section 156 provides that a person:

- directly contemplated in the particular provision of the Act;
- acting on behalf of a person contemplated above, who cannot act in their own name;
- acting as a member of, or in the interest of, a group or class of affected persons, or an association acting in the interest of its members; or
- acting in the public interest, with leave of the court,

may seek to address an alleged contravention of the Act, or to enforce any provision of, or right in terms of the Act, a company's MoI or rules, or a transaction or agreement contemplated in the Act, the company's MoI or rule.

The redress or enforcement may take the form of:

- attempting to resolve any dispute with or within a company through alternative dispute resolution contemplated in the Act;
- applying to the Companies Tribunal for adjudication in respect of any matter for which such an application is permitted in terms of the Act;
- applying for appropriate relief to the division of the High Court that has jurisdiction over the matter; or
- filing a complaint contemplated in the Act.

Section 157 provides that an application can be made to, or a matter can be brought before, a court, the Companies Tribunal or the Commission, the right to make the application or bring the matter may be exercised by the persons listed above, namely a person:

- directly contemplated in the particular provision of the Act;
- acting on behalf of a person contemplated above, who cannot act in their own name;

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- acting as a member of, or in the interest of, a group or class of affected persons, or an association acting in the interest of its members; or
- acting in the public interest, with leave of the court.

■ **The role between the Committee and management and the board needs to be distinguished. Is it correct to say that the Committee is concerned with governance whereas the board of directors is concerned with action?**

The board is responsible for overall governance of the company and may, in order to give effect to its governance obligations, appoint any number of committees of directors and delegate to any committee any authority of the board in terms of s72(1)(a) and (b). The board of directors does not abdicate its governance responsibility, but rather delegates the committee structures to perform this function. The board may elect to grant the Committee greater powers than provided in the Act and Regulations. The information over which the Committee is to exercise oversight vests with management as part of the day to day operations of the Company. The ultimate direction, best practice standards and score cards with which each Company will conform will be determined by the board unless the board mandates the Committee otherwise.

■ **How can the company be compelled in terms of the Act to comply with its obligation to establish a Committee?**

In terms of s72(10), read with s84(6) and s(7) of the Act, if the board of a company fails to make an appointment of a Committee (where it is required to have one):

- the Companies and Intellectual Property Commission may issue a notice to that company to show cause why the Commission should not proceed to convene a shareholders' meeting for the purpose of making that appointment; and
- if the company fails to respond to a notice contemplated above or, in responding, fails to satisfy the Commission that the board will make the appointment within an acceptable period, the Commission may:
 - give notice to the holders of the company's securities of a general meeting, and convene such a meeting, to make that appointment; and
 - assess a pro rata share of the cost of convening the meeting to each director of the company who knowingly permitted the company to fail to make the appointment of a Committee.

A company could also be subject to a "compliance notice" (a new enforcement mechanism introduced by the Act) issued by the Commission in terms of s171 of the Act. If a person to whom a compliance notice has been issued fails to comply with the notice, the Commission may either:

- apply to a court for the imposition of an administrative fine; or
- refer the matter to the National Prosecuting Authority for prosecution as an offence (it is an offence to fail to comply with compliance notices).

There are other, more indirect ways in which a company may be compelled to comply with its obligation to establish a Committee. Section 218(2) of the Act states that "[a]ny person who contravenes any provision of this Act is liable to any other person for any loss or damage suffered by that person as a result of that contravention." This provision could find application in the following context: The purpose of the Committee is to effectively monitor and to keep the board informed with regard to the company's compliance with certain legislation. If the board fails to appoint a Committee, it may find itself being less aware of any non-compliance and, if such lack of awareness ultimately results in a breach by the company of such legislation resulting in damages or loss to third parties, such third parties may have recourse against the company in terms of the Act (if they would not already have recourse under other legislation or common law).

Section 157 of the Act, may be another avenue that could be used to compel a company to comply with "its stakeholder and/or community engagement obligations." Section 157 provides for a potential "class action" suit pursuant to contraventions of the Act. When, in terms of the Act, an application can be made to or a matter can be brought before a court, the Companies Tribunal or the Commission, the right to make the application or bring the matter may be exercised by a person:

- directly contemplated in the particular provision of the Act
- acting on behalf of a person contemplated in above, who cannot act in their own name;
- acting as a member of, or in the interest of, a group or class of affected persons, or an association acting in the interest of its members; or
- acting in the public interest, with leave of the court.

The directors may also be in breach of their fiduciary duties to the company as it is in the best interests of the company that it complies with applicable laws, including laws obliging a company to have a Committee. If such breach of fiduciary duties results in loss or damage to the company, directors would be liable in terms of s77 of the Act, dealing with directors' liability. Further, the action by the company against the board could be enforced by shareholders, any director or prescribed officer, registered trade unions or any other person with leave of court, in terms of the derivative action under s165 of the Act.

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■ **How should companies reconcile the requirements of the Committee with the JSE rules and King III?**

The legislated areas which are the subject matter of the Committee fall within the ambit of information required for the compilation of the integrated report as well as the combined assurance tasks recommended by King III. Rule 8.63 of the JSE requires that companies disclose their compliance or otherwise with King III. Further, King III recommends that companies form Audit, Remuneration, Risk and Nominations Committees and the JSE Rule 3.84(d) require that Companies establish these committees.

King III places a strong reliance on the role of the Audit Committee to approve the combined assurance model and external assurance providers as well as the integrated report.

In order to comply with the Act, companies may be required to "carve out" those functions that overlap with statutory requirements and provide for coordination in the functions of the various committees. The Act's provisions are peremptory while recommendations in King III can be "applied and/or explained". Both the Audit Committee and the Committee have equal standing in terms of the Companies Act.

Section 72(8)(e) grants the the Committee a right to be heard at any general meeting of shareholders on any part of the business that affects its functions. In terms of Regulation 43(5)(c) it is assigned the function of reporting to Shareholders at the company's AGM through one of its members.

Our service offering with regards to the Committee includes the following:

- Drafting client appropriate Terms of Reference that coordinate the legislated functions with those of other Board Committees.
- Developing and sensitising the Board and the Committee of its role and functions in terms of the Act and the context of Sustainability and integrated Reporting through structured training.
- Assisting the Committee in developing the right Agenda and Work Plan to fulfil its functions.
 - Assisting with applications for Exemptions.
 - Advising on AGM reports and requirements.

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